

Unit 14 Master Budgeting Process I

- ILO1. Budgeting Process**
- ILO2. The Sales Budget**
- ILO3. Production Budget**

ILO1. Budgeting Process

To begin the review of the budgeting process we should start with some characteristics. Initially, a budget is a quantitative map, or guideline that can be used for the acquisition and use of financial assets. The process of preparing a budget is referred to as budgeting. And using this budget to control an organization's activities is called budgetary control.

This leads to the intersection of control and planning. Basically, planning involves the development of objectives and the preparation of budgets in aid to achieve those objectives. While, control is made up of the steps by management to ensure success of meeting the objectives. For this crossroad to be effective, a good budgeting system that covers both planning and control must be utilized.

A budget provides more than just stability, and direction, but also serve to communicate strategy and plans throughout an organization, along with the allocation of resources. In also serves the function of identifying any weaknesses, or bottlenecks that could exist. Ultimately, the benefits of a budget, and the budgeting process is as a catalyst for the organization to engage in activities that benefit the company, society etc, but also as means to set benchmarks based on its objectives and measure their performance over time.

A concept that needs to be mentioned relates to the budgeting period. This period varies across industry, with some organizations choosing periods of four quarters, or a twelve month period. For our purposes, we will consider budgets from a one year context, and that has rollover properties, or is perpetual in nature so that managers stay focused on the future. Another important consideration involves the people that it concerns. For example, if managers are not committed, or supportive of the budgeting process it reduces its likelihood of success. Furthermore, directed to managers, they should not use the budget as a tool to punish employees when objectives are not as this would cause drastic depressions in company morale. It is more productive to implement a budget that is realistically achievable than stretching a budget targets. This is especially true when managerial rewards are based on meeting said objectives.

This process now directs us to the master budget. This master budget is actually made up of a number of smaller, interdependent budgets.

- The sales budget illustrates expected sales for the period, in both dollars and units.
- The production budget is prepared after the sales budget. This budget focuses on the number of units that need to be produced in the period to meet the sales requirements, and provide the necessary ending inventory balance. Due to this, the production budget is related to materials, labour, and manufacturing overheads which later influence the preparation of the ending finished goods inventory budget. These two

budgets are then combined with details from the sales budget, and the selling and administrative expense budget to produce the cash budget.

- The cash budget provides the details of how cash resources are acquired, and used over the period.

The process finally concludes with the preparation of a budgeted income statement, and budgeted balance sheet.

ILO2. The Sales Budget

Using our company Aerial, we will use the following data to see the preparation of budgets for the quarter ending June 30th. The budgeted sales for the following five months are as follows;

- April: 20,000 units
- May: 50,000 units
- June: 30,000 units
- July: 25,000 units
- August: 15,000 units
- Unit selling price is \$10 each

	A	B	C	D	E	F	G	H	I
1									
2			April	May	June	Quarter			
3		Budgeted sales in units	20,000	50,000	30,000	100,000			
4		Selling price per unit	\$ 10	\$ 10	\$ 10	\$ 10			
5		Total budgeted sales	\$ 200,000	\$ 500,000	\$ 300,000	\$ 1,000,000			
6									

Fig 14.1 Sales Budget

In this case, the total sales budget for the quarter (\$1,000,000) is found by multiplying the budgeted sales in units for the quarter (100,000) by the selling prices of \$10. We can then make the following assumptions;

- All sales are on account
- 70% collected during the month sold
- 30% collected the month following the sale
- In April, the March 31st accounts receivable balance was at \$30,000, and is to be collected in full during April.

To calculate Aerial's cash collections, we start by including the beginning receivable balance (\$30,000) into the month of April. We see the proceeding results.

	A	B	C	D	E	F	G	H	I
1									
2									
3			April	May	June			Quarter	
4		Accounts Receivable 3/31	\$ 30,000					\$ 30,000	
5		April Sales							
6		70% × \$200,000	140,000					140,000	
7		30% × \$200,000		60,000				60,000	
8		May Sales							
9		70% × \$500,000		350,000				350,000	
10		30% × \$500,000			150,000			150,000	
11		June Sales							
12		70% × \$300,000			210,000			210,000	
13			\$ 170,000	\$ 410,000	\$ 360,000			\$ 940,000	
14		Accounts Receivable 6/30 = 30% × \$300,000 = \$90,000							
15									

Fig 14.2 Cash Collections

Next, we find the April credit sales that will be collected during the quarter. \$140,000 (= \$200,000 × 70%) will be collected in April and \$60,000 (= \$200,000 × 30%) for May. We then calculate the May credit sales to be collected during each month of the quarter. \$350,000 (= \$500,000 × 70%) for May and \$150,000 (= \$500,000 × 30%) will be collected in June. Then we perform the calculations for the June credit sales that will be collected during the month. \$210,000 (= \$300,000 × 70%) will be collected in June. Finally, we find the total for each in the schedule and the total for the quarter (\$940,000).

ILO3. Production Budget

A defining trait of the production budget is that it meets the budgeted sales, and the required ending inventory. To demonstrate this process, we use information from Aerial Co. We start by inserting the budgeted sales data in unit taken from the sales budget. Then we calculate the necessary production in units for the month of April (26,000). Keep in mind from our table below, we include the ending inventory in units for April (10,000) and the required beginning inventory in units for April also (4,000).

	A	B	C	D	E	F	G	H	I
1									
2			April	May	June			Quarter	
3		Budgeted Sales	20,000	50,000	30,000			100,000	
4		Add: Desired ending inventory	10,000						
5		Total needs	30,000						
6		Less Beginning inventory	4,000						
7		Required production	26,000						
8									

Fig 14.3 Production Budget

Next, we find the required production for May (46,000), again considering ending and beginning inventories for May. We repeat the steps to find the production necessary for June (29,000). And finally, we complete the Quarters in the table, paying attention to the carry-over affect of beginning and ending inventory balance.

	A	B	C	D	E	F	G	H	I
1									
2			April		May		June		Quarter
3		Budgeted Sales	20,000		50,000		30,000		100,000
4		Add: Desired ending inventory	10,000		6,000		5,000		5,000
5		Total needs	30,000		56,000		35,000		105,000
6		Less Beginning inventory	4,000		10,000		6,000		4,000
7		Required production	26,000		46,000		29,000		101,000
8									

Fig 14.4 Production Budget (Complete)

This discussion regarding budget is continued in the following unit.



References:

1. Managerial accounting, Ray Garrison-Eric Noreen-Peter Brewer - McGraw-Hill Education, 16 ed., 2018
2. Managerial accounting, John Wild-Ken Shaw - McGraw-Hill Education, 7ed, 2019
3. Management accounting, Will Seal-Carsten Rohde-Ray Garrison-Eric Noreen - McGraw-Hill Education, 6ed. - 2019

