Unit 16
Master Budgeting Process III

ILO1. Selling and Administrative Expense Budget
ILO2. Cash Budget
ILO3. ILO3. Budgeted Income statement and Balance Sheet

ILO1. Selling and Administrative Expense Budget

Using the information below it will help us better understand the preparation of the selling and administrative budget. A few noteworthy observations are included.

- It is divided into fixed and variables components
- Variable expenses are $0.50 for each sold unit
- Fixed expenses are $70,000 monthly
- Fixed expense includes $10,000 in depreciation, that is not a cash outflow

The steps to prepare the selling and administrative expense budget are as follows.

- Multiply the variable selling and administrative rate ($0.50) by the units sold.
- Add the fixed selling and administrative expenses ($70,000) to obtain the final total amount.
- Deduct the noncash selling and administrative expenses ($10,000) to obtain the final total cash disbursements.
- The steps are repeated for the additional months to obtain total disbursements for the quarter of $230,000.

	April	May	June	Quarter
Budgeted sales	20,000	50,000	30,000	100,000
Variable S&A rate	0.50	0.50	0.50	0.50
Variable expenses	$ 10,000	$ 25,000	$ 15,000	$ 50,000
Fixed S&A expenses	70,000	70,000	70,000	210,000
Total S&A expenses	80,000	95,000	85,000	260,000
Less: noncash expenses	10,000	10,000	10,000	30,000
Cash S&A expenses	$ 70,000	$ 85,000	$ 75,000	$ 230,000

Fig 16.1 Selling and Administrative Expense Budget

ILO2. Cash Budget

The budget is prepared for each month and can be split into four distinct areas.

- Cash receipts include all cash inflows bar that from financial activities.
- Cash outflows includes all cash payments bar principal and interest payments.
- Cash surplus or shortage area highlights if the organization needs to borrow capital or has the ability to repay loans.
- Financing area shows borrowing influx and disbursements during the period.

To use in conjunction with our table above we will include the additional information below.

- A credit line of $75,000 at 16% is preserved.

- A minimum cash balance of $30,000 is held.
- Capital borrowing take place at the beginning of the month, repayments are made at the end of the month.
- Month of April dividends is $49,000.
- Cash purchases during the quarter include $143,700 for equipment during May, and $48,300 in June.
- An April 1 cash balance of $40,000.

The steps to prepare the budget begin by calculating the total cash available ($210,000). The second step is to determine the total cash disbursements ($228,000). The third step is to obtain the surplus or shortage of cash over payments ($18,000). Next is to determine the amount of financing necessary and the final cash balance. This is more detailed as it includes the $30,000 cash balance minimum; therefore it must borrow $48,000. The ending cash balance of $30,000 equals their minimum requirements. The ending balance of April carries over to become the beginning balance of May. These first four steps are repeated for the month of May which results in a surplus of $40,000 cash over payments. As a condition they must hold a minimum cash balance of $30,000 which means it will not make any loan repayments during the month. The same steps are repeated again for the month of June which produces a surplus of cash available of $130,500. This amount allows the company to repay the $48,000 principal that was borrowed including the interest of $1,920 ($48,000 x 16% x 3/12). The cash balance for the end of the quarter becomes $80,580.

	April	May	June	Quarter
Beginning cash balance	$ 40,000	$ 30,000	$ 40,000	$ 40,000
Add: Cash collections	170,000	410,000	360,000	940,000
Total cash available	$ 210,000	$ 440,000	$ 400,000	$ 980,000
Less: Cash disbursements				
Materials	40,000	72,300	72,700	185,000
Direct labor	13,000	23,000	14,500	50,500
Manufacturing overhead	56,000	76,000	59,000	191,000
Selling and administrative	70,000	85,000	75,000	230,000
Equipment purchase	-	143,700	48,300	192,000
Dividend	49,000	-	-	49,000
Total disbursements	228,000	400,000	269,500	897,500
Excess (deficiency)	(18,000)	40,000	130,500	82,500
Financing:				
Borrowing	48,000	-		48,000
Repayment	-	-	(48,000)	(48,000)
Interest	-	-	(1,920)	(1,920)
Total financing	48,000	-	(49,920)	(1,920)
Ending cash balance	$ 30,000	$ 40,000	$ 80,580	$ 80,580

Fig 16.2 Cash Budget

The budgeted income statement can then be prepared once the cash budget has finished. The main reason this is done, because it allows for the interest expense to be calculated first.

ILO3. Budgeted Income Statement and Balance Sheet

The figures in the budgeted income statement are generated from other budgets. We have included an example below.

Aerial Company Budgeted Income Statement For the Three Months Ended June 30	
Sales (100,000 units @ $10)	$ 1,000,000
Cost of goods sold (100,000 @ $4.99)	499,000
Gross margin	501,000
Selling and administrative expenses	260,000
Operating income	241,000
Interest expense	1,920
Net income	$ 239,080

Fig 16.3 Budgeted Income Statement

For instance, the value for the sales revenue comes from the sales budget, whereas the costs of goods sold is generated from the ending finished goods inventory budget. Previously we saw the selling and administrative expenses budget which provides the expense amount. And finally, the cash budget supplies the interest expense.

The other document that works in conjunction with the budgeted income statement is the budgeted balance sheet. We'll use some additional transactions in our preparation of this.

- Land, $50,000
- Common Stock, $150,000
- Retained Earnings, $248,650 (Beginning of April)
- Equipment, $175,000

We then prepare the following budgeted balance sheet.

Budgeted Balance Sheet June 30	
Assets:	
Cash	$ 80,580
Accounts receivable	90,000
Raw materials inventory	4,600
Finished goods inventory	24,950
Land	50,000
Equipment	367,000
Total assets	$ 617,130
Liabilities and Stockholders' Equity	
Accounts payable	$ 28,400
Common stock	150,000
Retained earnings	438,730
Total liabilities and stockholders' equity	$ 617,130

Fig 16.4 Budgeted Balance Sheet

From our observations, we can see the following.

- $80,580 cash is derived from the ending cash balance taken from cash budget total.
- Junes Sales of $300,000 determines the Accounts Receivable, which is 30% of this amount $90,000.
- The amount for raw materials comes from multiplying the ending inventory by cost per pound. 11,500 x 0.40 = $4,600.
- The finished goods ending inventory budget provides the finished goods inventory balance of $24,950.
- The balance sheet provides for common stock, equipment and land.
- The accounts payable is 50% of Junes purchase allotment. 50% x $56,800, an accounts payable balance of $28,400.
- The final retained earning of $438,730 comes from net income and the beginning balance of retained earnings. $239,080 + $248,650 and then subtracting dividends of $49,000.

	Retained Earnings
Beginning balance	$ 248,650
Net income	239,080
Dividends	(49,000)
Ending balance	$ 438,730

Fig 16.5 Balance of Retained Earnings

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