Level 5: Unit 9

Management Accounting:
Costing and Budgeting

Lecturer: Matthew Smith-Barrett

Unit Content: (Syllabus)

Level 5: Unit 9

On successful completion of this unit a leaner will:

- Be able to analyse cost information within a business
- Be able to propose methods to reduce costs and enhance value within a business
- Be able to prepare forecasts and budgets for a business
- Be able to monitor performance against budgets within a business

Learning Outcome 3:

Level 5: Unit 9

Upon completion of this Learning Outcome, students should:

- Be able to prepare forecasts and budgets for a business

To realize the above objective the leaner should be able to:

3.1 explain the purpose and nature of the budgeting process

3.2 select appropriate budgeting methods for the organization and its needs

3.3 prepare budgets according to the chosen budgeting method

3.4 prepare a cash budget

Week 9 - Assessment Criteria 3.2:

Level 5: Unit 9

Assessment Criteria 3.2:

Upon completion of this lesson, students will be able to:

Select appropriate budgeting methods for the organization and its needs

Week 9 – Select appropriate budgeting methods for the organization and its needs

Level 5: Unit 9

Management Accounting: Costing and Budgeting

Lecturer: Matthew Smith-Barrett

Recap: Explain the purpose and nature of the budgeting process

L.O. 3:
A.C. 3.1

- What is Budgeting?
- The purpose of budgeting
- Periodic and continuous budgets
- The Benefits of Budgeting
  - Financial Control
  - Goal Setting
  - Financial Awareness
  - Organization of Expenditure and Income
- How Budgets help managers
- Budget Types

Budget Preparation

L.O. 3: A.C. 3.2

There are two broad approaches to setting individual budgets.

The ***top-down approach*** is where the senior management of each budget area originates the budget targets, perhaps discussing them with lower levels of management and, as a result, refining them before the final version is produced.

With the ***bottom-up approach***, the targets are fed upwards from the lowest level. For example, junior sales managers will be asked to set their own sales targets, which then become incorporated into the budgets of higher levels of management until the overall sales budget emerges.

Stages in the Preparation of Budgets

L.O. 3: A.C. 3.2

- The long-term objectives of the organisation, and management policies for meeting these, should be established
- Preparation of the budget is the responsibility of the Cost Accountant or a Budget Committee
- A Budget Officer may be appointed, responsible for all the day-to-day work involved in the preparation of the **subsidiary budgets** and for the preparation of the **Master Budget**

Limiting or Key factors

L.O. 3:
A.C. 3.2

There will always be some aspect of the business that will stop it achieving its objectives to the maximum extent. This is often a limited ability of the business to sell its products.

Sometimes, it is some production shortage (such as labour, materials or plant) that is the **limiting factor**, or, linked to this, a shortage of funds.

Master Budgets

L.O. 3: A.C. 3.2

The master budgets are the budgeted income statement and budgeted statement of financial position (balance sheet), and perhaps a summarised cash budget. All of the information required to prepare these statements should be available from the individual operating budgets that have already been prepared. The budget committee usually undertakes the task of preparing the master budgets.

Cash Budgets

L.O. 3:
A.C. 3.2

- This should show opening cash/bank balance and all expected cash/bank inflows including 'spot cash sales', receipts from debtors, other receipts, dividends and sales of fixed assets
- It should also show expected cash/bank outflows including payments to creditors, purchases of fixed assets and payment of dividends.

Preparing the Cash Budgets

L.O. 3:
A.C. 3.2

Since budgets are documents that are to be used only internally by a business, their style is a question of management choice and will vary from one business to the next. However, as managers, irrespective of the business, are likely to be using budgets for similar purposes, some consistency of approach tends to be found.

Preparing the Cash Budgets

L.O. 3: A.C. 3.2

In most businesses, the cash budget will probably possess the following features:

1. The budget period would be broken down into shorter periods, typically months.
2. The budget would be in columnar form, with one column for each month.
3. Receipts of cash would be identified under various headings and a total for each month's receipts shown.
4. Payments of cash would be identified under various headings and a total for each month's payments shown.
5. The surplus of total cash receipts over payments, or of payments over receipts, for each month would be identified.
6. The running cash balance would be identified. This would be achieved by taking the balance at the end of the previous month and adjusting it for the surplus or deficit of receipts over payments (or payments over receipts) for the current month.

Preparing the Cash Budgets: Exercise

L.O. 3: A.C. 3.2

Vierra Popova Ltd is a wholesale business. The budgeted income statements for each of the next six months are as follows:

	Jan £000	*Feb* £000	*Mar* £000	*Apr* £000	*May* £000	*June* £000
Sales revenue	52	55	55	60	55	53
Cost of goods sold	(30)	(31)	(31)	(35)	(31)	(32)
Salaries and wages	(10)	(10)	(10)	(10)	(10)	(10)
Electricity	(5)	(5)	(4)	(3)	(3)	(3)
Depreciation	(3)	(3)	(3)	(3)	(3)	(3)
Other overheads	(2)	(2)	(2)	(2)	(2)	(2)
Total expenses	(50)	(51)	(50)	(53)	(49)	(50)
Profit for the month	2	4	5	7	6	3

Preparing the Cash Budgets: Solution

L.O. 3: A.C. 3.2

	Jan £000	*Feb* £000	*Mar* £000	*Apr* £000	*May* £000	*June* £000
Receipts						
Trade receivables (Note 1)	60	52	55	55	60	55
Payments						
Trade payables (Note 2)	(30)	(30)	(31)	(26)	(35)	(31)
Salaries and wages	(10)	(10)	(10)	(10)	(10)	(10)
Electricity	–	–	(14)	–	–	(9)
Other overheads	(2)	(2)	(2)	(2)	(2)	(2)
Van purchase	–	–	(11)	–	–	–
Total payments	(42)	(42)	(68)	(38)	(47)	(52)
Cash surplus/(deficit) for the month	18	10	(13)	17	13	3
Opening balance (Note 3)	12	30	40	27	44	57
Closing balance	30	40	27	44	57	60

Preparing Other Budgets

L.O. 3:
A.C. 3.2

Other Budget types include:

1. Debtor's Budget
2. Creditor's Budget
3. Production Costs Budget
4. Raw Materials Budgets
5. Finished Goods Budgets

Sales Budgets

L.O. 3:
A.C. 3.2

- This allows an analysis of expected sales by quantities and revenues (units and £s) from the entire range of products
- Management uses this budget as the basis for other subsidiary budgets ie production, selling cost, capital acquisition, stockholding etc
- This budget helps in early decision making relating to sales policies in different sectors of the market

Conclusion:

L.O. 3: A.C. 3.1

In recent years, a few businesses have abandoned budgeting, although they still recognise the need for forward planning. No one seriously doubts that there must be appropriate systems in place to steer a business towards its objectives. It is claimed, however, that the systems adopted should reflect a broader, more integrated approach to planning. The new systems that have been implemented are often based around a 'leaner' financial planning process that is more closely linked to other measurement and reward systems.

Reference List

L.O. 2: A.C. 2.1

- Methods, C. (2015). *Cost Estimation and Cost Measurement Methods or Techniques*. [online] Transtutors.com. Available at: http://www.transtutors.com/homework-help/accounting/decision-making-cost-measurement-methods/ [Accessed 8 Sep. 2015].
- Available at: http://kfknowledgebank.kaplan.co.uk/KFKB/Wiki Pages/Marginal and absorption costing.aspx#Marginal_x0020_costing [Accessed 8 Sep. 2015].
- Joyce, John. MANAGEMENT ACCOUNTING – PERFORMANCE EVALUATION. 1st ed. CIMA, 2015. Print.
- *O'Sullivan, Arthur; Sheffrin, Steven M. (2003). Economics: Principles in Action. Upper Saddle River, New Jersey 07458: Pearson Prentice Hall. p. 502*
- Cliche, P. (2012). "Budget," in L. Côté and J.-F. Savard (eds.), Encyclopedic Dictionary of Public Administration, http://www.dictionnaire.enap.ca/Dictionnaire/en/home.aspx