

Managerial Accounting

Exam 3 Concept Review

(** annotates an excerpt directly from the text)

CHAPTER 5: Planning and Forecasting

- ****Strategic planning** is very broad and helps to identify the overall focus of an organization. **Tactical Planning** develops concrete actions that turn strategic plans into reality. One type of tactical planning is the **Budgeting process** (A means of allocating organizational resources among various divisions, projects, or other subsets or an organization)
- ****A Budget** is an operating plan that is expressed primarily in financial terms - that is, in dollars. The budget has its beginnings in the organizations strategic plan.
- **Benefits of budgeting:** Forces managers to plan for the future, facilitates communication between different divisions of the company, serves as a benchmark to evaluate performance.
- In a ****Top Down Budget** environment, executive management creates the budget, and that budget is then pushed down through the rest of the organization. Sometimes called an **imposed** budget because those who implement that budget have no input into it.
- In a ****Bottom Up Budget**, the budgeting process begins at the lowest levels of management and filters up through the organization. At each higher level of management the budget is reviewed and may be altered to satisfy the competing needs of various units within the organizations. As changes are made to the budget, the best practice is for management to communicate the rationale behind those changes to the affected units. This approach is referred to as **participative budgeting** because those employees who will be held accountable for meeting the budget participate in its creation.
- **Types of budgeting:**
 - ****Incremental:** manager begins with the current years budget and adds or subtracts funds for any anticipated changes in operations
 - ****Zero-based budgeting:** budget each year begins at \$0 and each individual budget item must be justified
 - ****Rolling budget:** always includes 12 months of data. As one month ends, it is removed from the budget and the entire budget rolls forward one month. Opposed to **Annual** budgets which compile detailed monthly budgets.
- ****Behavioral effects of budgeting:**
 - **Budgetary Slack:** managers are often tempted to include slack or “padding” in the budget. They may budget lower revenues or higher costs than are expected to incur, to attempt to “beat the budget.”
- **Performance Standards**
 - ****Standards:** expectations called “standards” specify characteristics, rules or guidelines that define a particular level of performance or quality.
 - **Ideal Standard:** Achievable under perfect conditions. (never occurs in manufacturing)
 - **Practical Standard:** Achievable with reasonable effort. Represent a level of performance that can be attained with reasonable effort
- **Product Standards**
 - ****Standard Cost:** when the separate standard for each component of product cost have been determined, a standard cost representing the cost to produce one unit of product can be calculated
 - **Standard Quantity:** the amount (quantity) of input (ex: pounds of DM hours of DL etc.) that should be used to make a unit of output (product).
 - **Standard Price:** the amount (price) that should be paid for a unit of input (ex: pound of DM, hour of DL, etc.)

- **The Master Budget:** is a collection of smaller budgets that lead to pro-forma(budgeted) financial statements.
 - **Operating Budget:** the portion of the master budget that provides a plan for operations during the budget period. (begins with the sales budget)
 - ****The Sales Budget:** Forecasts the number of units expected to be sold, as well as the prices expected to be charged. Drives all other components of the master budget.
 - ****The Selling and Administrative Budget** estimates when and how much selling and administrative expenses will be incurred. Includes expenses required for selling the product and managing the business such as advertising, insurance, accounting, legal services etc.
 - ****Production Budget:** provides a plan for when and how many units will be manufactured. Shows the beginning inventory for the period and the desired ending inventory:
 - **Budgeted sales + Beginning ending inventory - Budgeted beginning inventory = Budgeted production needs**
 - ****The Direct Materials Purchases Budget:** Once the monthly production is budgeted, the amount of direct materials that needs to be purchased can be budgeted. Itemizes the DM that must be purchased to meet budgeted production.
 - **DM Purchases Budget:**
 - Production needs +ending inventory - beginning inventory = **purchases needed.**
 - Enter budgeted production from the production budget
 - Calculate the DM production needs by multiplying the number of units to be produced during the period by the direct materials standard quantity for one unit
 - Calculate the desired budgeted ending inventory of DM
 - Calculate the total DM required for the period by adding the budgeted ending inventory to the DM production needs
 - Calculate the required purchases of direct materials by subtracting the beginning DM balance from the total DM required for the period
 - Calculate the budgeted dollar amount of DM purchases by multiplying the required purchases of DM by the standard price per unit.
 - ****Direct Labor Budget:** calculates the number of direct labor hours required to meet the budgeted level of production using the following steps :
 - Enter budgeted production from the production budget
 - Calculate the number of direct labor hours needed to meet the production schedule by multiplying the number of units to be produced during the period by the standard number of direct labor hours for one unit
 - Calculate the total budgeted direct labor payroll by multiplying the total required direct labor hours by the standard *average* wage rate for the period. If the company pays a wider range of direct labor hours are calculated separately for each pay level.
 - Budgeted Production x standard direct labor hours = total direct labor hours required
 - Total direct labor hours required x standard average wage rate = budgeted direct labor cost.
 - ****Manufacturing overhead budget:** shows the expected overhead costs for the period. All other manufacturing costs (other than direct materials and direct labor) fall into the manufacturing overhead category:
 - Enter budgeted activity base from appropriate budget
 - Calculate the variable overhead costs per period using the variable rate and budgeted activity base
 - Calculate the fixed overhead cost per period assuming that costs are incurred evenly throughout the period

- Calculate the total overhead costs for the period by adding the fixed and variable overhead costs
- Subtract the noncash overhead items from the total overhead cost to determine the cash payment for the overhead
- ****Ending Inventory and COGS Budget:** once all of the detailed manufacturing costs are determined, the budgeted ending inventory and budgeted cost of goods sold (COGS) for the quarter can be calculated:
 - Enter the beginning Raw materials Inventory balance. It will be the same amount as the ending Raw Materials Inventory balance on the previous period's balance sheet
 - Add budgeted purchases from the direct materials purchases budget
 - Subtract the direct materials used in production of new units started during the period.
- ****Cash Budget:** The portion of the master budget that summarizes all budgeted cash receipts and cash disbursements for the period. $\text{Cash available to spend} - \text{cash disbursements} = \text{cash excess or cash need} + \text{short term financing} = \text{ending cash balance}$. The **Cash receipts budget** shows when and how much cash is expected to be collected from the sale of products or services. To prepare apply the established collections pattern to the existing accounts receivable and apply the established collections pattern to budgeted sales.
 - **Cash Collections:** Amount of sales we bring in in each period. Accounts receivable.
 - **Cash disbursements:** made for each of the various expenses identified in the operating budget (DM, DL, OH and S&A expenses). Assumed to be paid in the period in which they are incurred (except DM purchases).
 - ****Cash Payments Budget:** Details when payments for materials purchases will occur. Apply the established disbursements pattern to existing accounts payable, then apply the established disbursements pattern to budgeted materials purchases.
 - ****Financing Needs (Cash excess)(Cash deficit):** once the monthly cash available and cash payments are budgeted, the cash excess or deficit can be calculated.
 - **Cash Available to Spend - Cash Disbursements - Minimum Cash Balance = Cash Excess (or Deficit).** If a shortage of cash exists, short term financing will be needed.
 - **Short term financing:** prepared only if there is a need to secure a new round of short term borrowing or to repay previous short term borrowing.
 - **Ending Cash Balance:** After the cash available, cash disbursements, and financing needs are determined, an ending cash balance can be determined:
 - $\text{Total Cash Available to spend} - \text{total cash disbursements} + \text{short term financing} = \text{Ending Cash Balance}$
- ****Pro-Forma Financial Statements:** the portion of the master budget that predicts the organizations financial position if all components of the master budget are achieved as planned. Prepared based on assumed rather than actual results. Predictions of what will happen in the future.
 - ****Pro-Forma Income Statement:** Shows the results of operations for the entire period.
 - ****Pro-Forma Balance Sheet:** Shows budgeted financial position at the end of the fourth quarter. Begin with the previous quarter's balance sheet and adjust the balances to reflect budgeted operations for the next quarter.