Chapter 8 Concepts

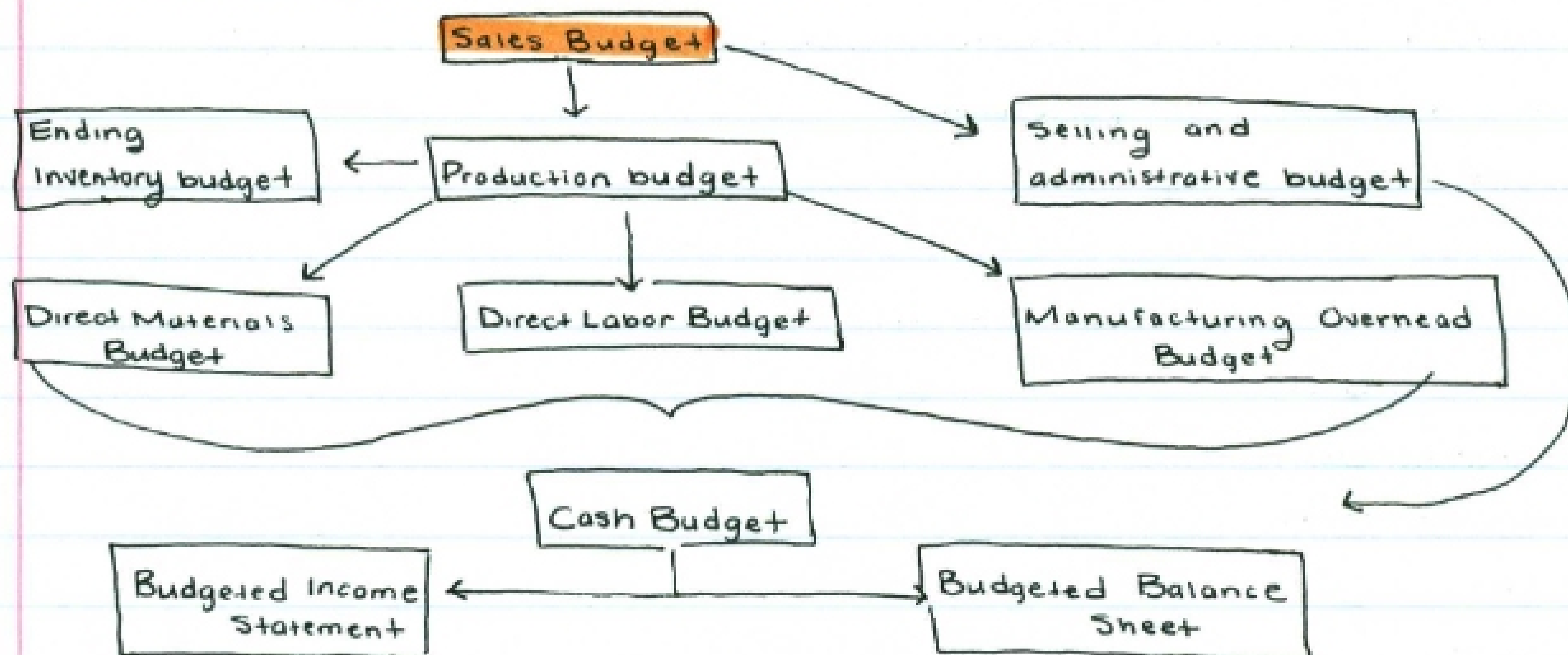
Participative Budgeting (Self-Imposed) System: Bottom-up budget where managers and others in departments are responsible for preparing their budget

Responsibility Accounting: Management must only be held responsible for the cost it controls

Planning and Control: The basics of budget; Planning is creating the budget and control is comparing actual results with the budget and ensuring that the actual activity is within the budget guidelines

The Budget Committee: Members of the organization that insure that the budget is being rationally and reasonably created

The Master Budget (Operational Budget)



Operating Budget: budget that usually covers one year corresponding to a company's fiscal year

Continuous Budget: budget that rolls forward one month as the current month is completed

Zero-based Budget: budget where the baseline is zero and all expenditures must be justified

Techniques for Estimating the Sales Budget:

1) Asking the sales staff what they expect
2) Market research
3) Delphi technique: Group of individuals within the firm that independently predict sales, meet and discuss differences in predictions until convergence occurs
4) Trend Analysis
5) Econometric Models

Benefits of Budgeting:

1. Communicates managements plans to employees
2. Focuses managements attention on the future
3. Allocates resources
4. Uncover potential bottlenecks
5. Improved decision making / Coordinate all departments
6. Benchmark for evaluating performance
7. Improved motivation by employees

How is the budgeted amount of raw materials to be purchased determined?

Production in Units
* Materials / Unit

Production Needs
\+ Desired EI

Total Needed
\- Beg. inventory

= Materials to be purchased

Flexible Budget and Performance Analysis

1. Helps us to better control (for management)
2. Helps in evaluating performance

Chapter 9

Static Planning Budget: Prepared for the planned level of activity. It is static because it is not adjusted even if the level of activity subsequently changes

Flexible budget: Can be adjusted to reflect any level of activity - including the actual level of activity

Actual results can differ from the budget for many reasons:

1. Change in the level of activity
2. Changes in prices
3. Changes in how effectively resources are managed

Changes in the level of activity can have a very big impact on costs

From a manager's perspective, a variance that is due to a change in activity is very different from a variance that is due to changes in prices and changes in how effectively resources are managed. When a budget is directly compared to the actual results, these two kinds of variances are lumped together.

Activity Variance: the difference between a revenue or cost item in the static planning budget and the same item in the flexible budget

↳ Due soley to the difference in the level of activity

Favorable Activity Variance = Variance in cost when actual activity $<$ planned

Unfavorable Activity Variance = Variance in cost when actual activity $>$ planned

Revenue Variance: Difference b/w how much the revenue should have been given the actual level of activity, and the actual revenue for the period

Favorable Revenue Variance = Revenue is greater than expected

Unfavorable Revenue Variance = Revenue is less than expected

Spending Variance: Difference b/w how much a cost should have been, given the actual level of activity, and the actual amount of the cost.

Favorable Spending Variance = Cost is lower than expected

Unfavorable Spending Variance = Cost is higher than expected