Question 15

Explain how budgets can have both positive and negative impacts on personnel within an organisation, giving reasons.

**Positive Impacts**

* Fosters teamwork - when each department works together to put together budgets, they work as a team. In a company that has open communication between levels of staff and departments, the exchange of ideas is encouraged, which leads to more-creative strategies.
* Creates competition - one of the purposes of a budget is to allocate resources. Those resources are limited, and there's only so much money, staff, and time to go around. Departments compete with each other, as well as individuals competing with each other. For example, if the receptionist gets a raise, there might not be enough funds for the factory workers to get raises as well.
* Sets direction - the budget sets the direction for the business by creating goals and objectives and then assigning responsibility to achieve those goals. Employees know what is expected of them for their own particular job and department. The budget preparation encourages employees to become involved and contribute their input.

**Negative Impacts**

* Creates fear - unfortunately, the reaction of some employees is to fear for their jobs when budgeting time rolls around. Employee performance reviews usually take place throughout the year based on the annual date of when the employee was hired. The budget is completed at the same time during the year. If staff cuts have to be made, they're often made during the budgeting process.
* Causes resentment - the budgeting process adds to the workload of some employees, especially those in the accounting department. This additional work could be resented by those employees. Additionally, if the budget is completed on a top-down basis, where the business owner or chief executive officer decides what the expenditure levels will be on a departmental level, the employees may feel they can't achieve the objectives because they had no say in determining those objectives.

Question 16

Why should all senior personnel participate in formulating and submitting budget estimates?

Top management of some organisations imposes rules on subordinates without any discussion. If the budget is imposed from above without consultation this is likely to adversely affect the managers’ motivation and attitude to their superiors. It is likely that a manager of a responsibility centre will have a greater degree of knowledge and understanding of the operation of the centre than any other personnel within the organisation, so this knowledge is important in the formulation of budgets.

**At the executive level, planning decisions about products and services are made that may include product cost leadership or product differentiation strategies.**

**Explain the difference between these two strategies.**

Cost leadership is a strategy to position a business as being price sensitive. It involves a systematic process to eliminate waste and inefficiencies and lower purchasing costs. This will enable the business to sell products more cheaply than its competitors.

The differentiation strategy is about positioning the business so that it is recognised as providing a good or service that is distinct from competing products. The product itself does not need to be unique but some aspect of it should be exclusive or distinct.

**Comment on the results of the Performance Report prepared above.**

The business predicted a profit of $56,500, but the actual profit was $14,600 less at $41,900.

The main factors that contributed to this downturn were:

* lower than expected sales – down $44,000
* this lead to a lower than expected gross profit – down $11,000
* wages were higher than expected - $3,600

To improve their profit performance they should investigate:

* the drop in sales and perhaps consider an advertising campaign to boost sales
* the increase in wages and perhaps consider the staff needs for the business more closely

Question 17

Discuss the interrelationships of the sales budget and the production budget in a manufacturing organisation.

The sales budget estimates your future sales based on the past sales. This information is used to develop your production budget. The production budget is an estimate of how many units you need to manufacture over a specific period.

Question 18

Explain the function of the following budgets:

1. sales budget

A financial plan that estimates a company’s total revenue in a specific time period. It focuses on two things – the number of products sold and the price at which they are sold – to predict how the company will perform.

1. production budget

Details the costs required to keep enough product on hand to meet the inventory requirements of the company. The second factor is sales targets. The production budget forecasts the costs needed to meet sales demand for its products.

1. purchases budget

a budget set for the purchasing function of an organisation under a system of budgetary control, which plans the volumes and cost of the purchases to be made in a budget period.

1. capital expenditure budget

a formal plan that states the amounts and timing of fixed asset purchases by an organisation. This budget is part of the annual budget used by a firm, which is intended to organise activities for the upcoming year.

1. cash budget

A company's estimation of cash inflows and outflows over a specific period of time, which can be weekly, monthly, quarterly, or annually. A company will use a cash budget to determine whether it has sufficient cash to continue operating over the given time frame.

1. operational expenses budget

A detailed projection of what a company expects its expenses will be over a period of time. Companies usually formulate such a budget near the end of the year to show expected activity during the following year.

| **Accounts Receivable Collection Schedule** | | | | | |
| --- | --- | --- | --- | --- | --- |
| **Months** | **Total Sales**  **$** | **Credit Sales**  **(70% of Total)**  **$** | **January**  **$** | **February**  **$** | **March**  **$** |
| **October** | 74 910 | 52 437 | 5 244 |  |  |
| **November** | 104 720 | 73 304 | 21 991 | 7 330 |  |
| **December** | 115 500 | 80 850 | 48 510 | 24 255 | 8 085 |
| **January** | 106 700 | 74 690 |  | 44 814 | 22 407 |
| **February** | 100 100 | 70 070 |  |  | 42 042 |
| **Total** |  |  | **75 745** | **76 399** | **72 534** |

| **Trade Creditors’ Collection Schedule** | | | |
| --- | --- | --- | --- |
| **Actual/Estimated**  **Purchases** | **Total Purchases**  **$** | **October**  **$** | **November**  **$** |
| **September** | 44 000 | \*43 120 |  |
| **October** | 33 000 |  | \*32 340 |
| **Payments For Purchases** |  | **43 120** | **32 340** |
| **Discount Received** |  | **880** | **660** |
| **\* 2% Discount Has Been Deducted** | | | |

| **Rawhide Pty Ltd** | | | |
| --- | --- | --- | --- |
| **Cash Budget for the three months January to March** | | | |
|  | **January**  **$** | **February**  **$** | **March**  **$** |
| Open bank balance 1 January, 2010 | 12 000 | 82 500 | 164 500 |
| **Receipts** |  |  |  |
| Collections from debtors | 260 000 | 232 000 | 186 000 |
| Sale of equipment |  | 3 000 |  |
| **Total cash available** | 272 000 | 317 500 | 350 500 |
| **Payments** |  |  |  |
| Credit Purchases | 130 000 | 120 000 | 90 000 |
| Wages and Salaries | 15 000 | 15 000 | 15 000 |
| Administration Expenses | 3 000 | 3 500 | 3 750 |
| General Expenses | 4 000 | 4 000 | 4 000 |
| Rent |  | 8 000 |  |
| Loan Repayment | 2 000 | 2 000 | 2 000 |
| Interest | 500 | 500 | 500 |
| Capital Expenditure (Purchase of Equipment) |  |  | 15 000 |
| Income Tax | 35 000 |  |  |
| Total budgeted payments | 189 500 | 153 000 | 130 250 |
| **Budgeted cash balance** | 82 500 | 164 500 | 220 250 |

| **Bicton Pty Ltd** | |
| --- | --- |
| **Budgeted Income Statement for the year ended 30 June 2011** | |
|  | **$** |
| Sales | 450 000 |
| Less Cost of Sales | 180 000 |
| **Gross Profit** | **270 000** |
| **Expenses** |  |
| Advertising | 13 500 |
| Rent | 30 000 |
| Electricity | 5 400 |
| Salaries | 132 400 |
| Depreciation | 7 680 |
| Sales Commissions | 13 500 |
| Insurance | 2 275 |
| Bad Debts | 1 200 |
| **Total Expenses** | **205 955** |
| **Budgeted Profit (Before Taxation)** | **64 045** |
| Income Taxation | 19 214 |
| **Budgeted Profit (After Taxation)** | **44 831** |