

## SUMMARY

- Budgeting is the process of preparing reports which estimate or predict the financial consequences of likely future transactions.
- Budgets assist planning by predicting what is likely to occur in the future and aid decision-making by providing a benchmark or yardstick (a standard) against which actual performance can be measured.
- Budgeted cash and budgeted profit are not necessarily the same.
- Figures can be calculated by preparing Schedules (of receipts from debtors/payments to creditors), or by reconstructing ledger accounts.
- Variance reports compare actual and budgeted figures, highlighting variances so that problems can be identified and corrected.
- A variance is the difference between the budgeted figure and actual figure, and classified as favourable or unfavourable depending on its effect on bank or profit.

## EXERCISES

### Exercise 17.1 Cash budget

On 1 July 2011, Top Hats had \$2700 in its bank account. It has provided the following list of expected transactions for July 2011:

- Cash sales are expected to be \$12 000 . Credit sales are expected to be \$5100, but only \$3000 is expected to be collected in July. All stock is sold at a 50% mark-up.
- Cash purchases of stock will be \$4000.
- Drawings will consist of \$1000 cash and \$300 worth of stock.
- The following expenses will be paid:
  - Advertising \$2 100
  - Wages \$3 600
  - Interest \$ 230
- \$400 wages will be owing at the end of July 2011.
- Yearly rent will be paid on 1 July 2011, costing \$8400.
- The monthly loan repayment of \$1600 will be made on 14 July 2011.
- New shop fittings worth \$3500 will be purchased for cash from Fitts Best.

#### Required

- \* a. Prepare a Budgeted Cash Flow Statement for Top Hats for July 2011.
- b. Suggest two actions the owner may take to plan for the outcome predicted in the Budgeted Cash Flow Statement.

**Exercise 17.2 Cash budget – consecutive periods**

Lockhardt Locks has provided the following information regarding its expected activities for January to March 2011:

- As at 1 January 2011, the business had \$3400 in the bank.
- Sales are made on cash only terms, and are budgeted to be \$26 000 in January, \$27 000 in February, and \$25 000 in March.
- Stock is purchased on credit, with creditors paid the month following purchase. Credit purchases for December 2010 were \$12 000, but are expected to rise to \$13 000 in January, and \$13 500 in February and March.
- The following expenses will be paid each month:
  - Wages \$4 000
  - Advertising \$1 300
  - Interest \$ 150
- Rent for the next 6 months will be paid during January – \$9000.
- In January the business will sell an old vehicle for \$1900 cash, and in February pay cash for a new vehicle, which will cost \$21 000.
- Monthly cash drawings will be \$2000.
- A repayment on the principal of a loan is due on 21 January 2011 – \$1500.
- The owner plans to contribute \$15 000 cash and some office equipment worth \$4200 in March 2011.

**Required**

- \* a. **Prepare** a Budgeted Cash Flow Statement for Lockhardt Locks for January, February and March 2011.
- b. **Suggest** two actions the owner might take to address any problems revealed by your answer to part 'b'.
- c. **Explain** one benefit of preparing a Budgeted Cash Flow Statement for consecutive periods.

**Exercise 17.3 Schedule of receipts from debtors**

Bats 'n' Balls has provided the following budgeted information relating to its credit sales during 2011:

Month	Credit Sales
August (actual)	8 000
September (actual)	9 000
October (budgeted)	10 000
November (budgeted)	11 000
December (budgeted)	12 000

It is expected that 70% of debtors will pay in the month following the sale, while the remaining 30% will pay in the second month.

**Required**

- a. **Suggest** one reason for the trend in sales from August to December 2011.
- b. **Prepare** a Schedule of receipts from debtors for October, November and December 2011.
- c. Referring to the information provided, **explain** one reason why budgeted Net profit and budgeted Net cash flows are likely to be different for December 2011.

**Exercise 17.4 Schedule of receipts from debtors**

Jazzy Jackets has provided the following information to aid in the preparation of its Budgeted Cash Flow Statement for April, May and June 2011:

	Credit Sales	Cash Sales
<b>February</b>	44 000	32 000
<b>March</b>	49 500	35 000
<b>April</b>	38 500	27 000
<b>May</b>	33 000	32 000
<b>June</b>	22 000	26 000

Should be:  
 40 000  
 45 000  
 35 000  
 30 000  
 20 000

It is expected that 50% of debtors will pay in the month of sale, 30% of debtors will pay in the month following the sale, while the remaining 20% will pay in the second month following the sale.

**Required**

- Calculate budgeted Receipts from debtors for April, May and June 2011.
- Prepare an extract of the Budgeted Cash Flow Statement for Jazzy Jackets that shows Operating Cash Inflows for April, May and June 2011.
- Explain how the preparation of a Budgeted Cash Flow Statement can assist planning.

**Exercise 17.5 Schedules and the Budgeted Cash Flow Statement**

On 1 January 2011, Barry's Bags commenced operations. Projected purchases and sales for the first three months are:

	Credit Purchases	Credit Sales	Cash Sales
<b>January</b>	12 000	20 000	30 000
<b>February</b>	13 000	25 000	34 000
<b>March</b>	14 000	28 000	36 000

**Additional information:**

- Barry's Bags allows a 5% discount if debtors pay within the same month that the sale occurred. It is expected that 40% of the sales will be collected within the discount period, 35% by the end of the month after purchase, 20% in the following month, and that 5% will be uncollectable.
- 50% of credit purchases are paid in the month of purchase, with the remainder paid in the following month.
- Monthly expenses include advertising of \$2500, wages of \$1800 and depreciation on equipment of \$1000. There are no prepaid or accrued expenses.
- Cash drawings will be \$3000 per month.

**Required**

- Calculate budgeted Receipts from debtors for January, February and March 2011.
- Calculate budgeted Payments to creditors for January, February and March 2011.
- Prepare an extract of the Budgeted Cash Flow Statement for Barry's Bags that shows the Operating Activities for January, February and March 2011.
- Referring to your answer to part 'c', explain your treatment of Depreciation of equipment.
- Explain how Cash drawings would be reported in the Budgeted Cash Flow Statement.
- Explain how the preparation of a Budgeted Cash Flow Statement can assist decision-making.

**Exercise 17.6 Budgeted reports**

Dan's Detergents will begin trading operations on 1 May 2011, and has provided the following estimates for its first month of operations:

- The owner will make a capital contribution of \$20 000 to commence operations.
- Shelving worth \$6000 will be purchased on credit from Jancke Fittings on 1 May 2011. \$400 will be paid to the creditor before the end of May.
- Cash sales are estimated to be \$15 000
- Credit sales are estimated to be \$12 000. Debtors owing at the end of May is expected to be \$3500.
- All stock will be purchased on credit. Purchases for May are expected to be \$40 000. At the end of May, it is anticipated that \$12 000 will be owed to creditors.
- Cost of sales is expected to be \$18 000, and based on industry averages, stock loss is expected to be \$500.
- Six months' advertising will be paid in advance on 1 May 2010, at a cost of \$1200. There will be no other prepayments or accruals.

The following expenses will be incurred during May:

- Wages \$2 000
- Depreciation of shelving \$ 50
- Rent \$1 000
- On 31 May 2011, a loan for \$35 000 will be received from ZNA Bank. The loan will be used to purchase a van in June. \$500 will be paid off the principal each month, starting on 30 June 2011.
- Cash drawings will be \$1900. Drawings of stock is expected to be \$300.

**Required**

- Prepare a Budgeted Cash Flow Statement for Dan's Detergents for May 2011.
- Prepare a Budgeted Profit and Loss Statement for Dan's Detergents for May 2011.
- Explain two reasons why the budgeted Net increase in cash is much larger than the budgeted Net profit for May 2011.
- Show how the Stock Control account would appear in the General Ledger as at 31 May 2011.
- Prepare a Budgeted Balance Sheet for Dan's Detergents as at 31 May 2011.
- Explain how a Budgeted Balance Sheet can assist planning.

**Exercise 17.7 Budgeted reports**

- \* On 30 June 2011, the Balance Sheet of Jacuzzi Joint showed the following:

**JACUZZI JOINT****Balance Sheet as at 30 June 2011**

<b>Current assets</b>	<b>\$</b>	<b>\$</b>	<b>Current liabilities</b>	<b>\$</b>	<b>\$</b>
Bank	4 000		Creditors Control	9 000	
Stock Control	28 000		Accrued interest expense	300	
Debtors Control	6 880		Sundry creditor – Wilks	750	10 050
Prepaid rent	6 000	44 800			
<b>Non-current assets</b>			<b>Non-current liabilities</b>		
Office equipment	24 000		Loan – APS Finance		30 000
less Acc. Dep.	7 200	16 800	<b>Owner's equity</b>		
			Capital – Jacqui		21 550
<b>Total Assets</b>		<b>61 600</b>	<b>Total Equities</b>		<b>61 600</b>

Should be:  
6 800

The owner has provided the following information to assist in the preparation of budgeted reports for July 2011:

	<b>Credit Purchases</b>	<b>Credit Sales</b>	<b>Cash Sales</b>
<b>June</b>	9 000	17 000	19 000
<b>July</b>	11 000	18 000	22 000

- All stock is marked-up 100%. The owner expects a stock loss of \$300 for July.
- Credit sales are received 60% in the month of the sale and 40% in the month after the sale.
- All purchases are made on credit and paid in the month following purchase to earn a 5% discount.
- Six months' rent was prepaid on 1 May 2011.
- Wages paid during July 2011 will be \$7500, but \$800 wages is expected to be owing at the end of July.
- Depreciation of office equipment for July 2011 will be \$300.
- Electricity expense will be \$200. This amount will be paid in full during July.
- \$450 will be paid in July to cover the interest expense for May, June and July.
- New office equipment will be purchased on 31 July 2010 for \$12 000, with a part payment of \$8000 made in July, and the balance on credit from Phelps Co.
- On 31 July, the owner plans to contribute \$10 000 cash and her own vehicle worth \$23 000. Drawings of cash by the owner will be \$3100.
- The amount owing to Sundry creditor – Wilks will be paid in full.
- The Loan – APS Finance is an interest-only loan due in full in October 2013.

### Required

- a. Calculate budgeted Receipts from debtors for July 2011.
- b. Calculate budgeted Payments to creditors for July 2011.
- \* c. Prepare a Budgeted Cash Flow Statement for Jacuzzi Joint for July 2011.
- \* d. Prepare a Budgeted Profit and Loss Statement for Jacuzzi Joint for July 2011.
- e. Explain two reasons why the Net Operating Cash Flows is budgeted to be greater than the Net profit for July 2011.
- f. Show how the Stock Control account would appear in the General Ledger as at 31 July 2011.
- \* g. Prepare a Budgeted Balance Sheet for Jacuzzi Joint as at 31 July 2011.

### Exercise 17.8 Account reconstruction

Moving Boxes sells cardboard boxes for people who are moving house, and has provided the following information relating to their Debtors Control account:

- Balance as at 1 July 2010 \$ 50 000
- Budgeted balance as at 30 June 2011 \$ 40 000
- Budgeted credit sales for the year ended 30 June 2011 \$100 000
- Budgeted discount expense \$ 4 500

### Required

- a. For each item above, identify the budgeted report in which the item will appear.
- b. Reconstruct the Debtors Control account to determine budgeted receipts from debtors for the year ended 30 June 2011.
- c. Explain the importance of Budgeted sales in the budgeting process.

**Exercise 17.9 Account reconstruction**

Bully Hides sells leather products and has provided the following information relating to their expected transactions for 2011:

- Actual balances as at 1 January 2011:
  - Debtors Control           \$35 000
  - Creditors Control         13 000
- Budgeted balances as at 31 December 2011:
  - Debtors Control         \$45 000
  - Creditors Control        10 500
- From the Budgeted Profit and Loss Statement:
  - Cash sales               \$70 000
  - Credit sales             61 000
  - Sales returns            3 000
  - Discount revenue        1 500
  - Bad debts                4 000
  - Discount expense        2 300
- Other information:
  - Cash purchases         \$30 000
  - Credit purchases        \$45 000

**Required**

- a. **Reconstruct** the Debtors Control account to determine budgeted receipts from debtors for 2011.
- b. **Prepare** an extract from the Budgeted Cash Flow Statement for Bully Hides for 2011, which shows Operating Cash Inflows.
- c. **Reconstruct** the Creditors Control account to determine budgeted payments to creditors for 2011.

**Exercise 17.10 Account reconstruction**

Tony's Tyre Emporium has provided the following information relating to its expected transactions for the year ended 30 June 2011:

- Balances as at 1 July 2010:
  - Stock Control            \$31 000
  - Creditors Control        16 000
- From the Budgeted Profit and Loss Statement:
  - Sales                     \$70 000
  - Sales returns            1 200
  - Stock gain               4 000
  - Discount revenue        2 000
- Expected balances as at 30 June 2011:
  - Stock Control            \$26 000
  - Creditors Control        15 000
- Other information:
  - Cash purchases         \$10 000
  - Drawings                15 000 (Includes \$12 000 cash and \$3000 stock)
- All stock is sold at a 100% mark-up.

**Required**

- a. **Reconstruct** the Stock Control account to determine budgeted credit purchases for the year ended 30 June 2011.
- b. **Reconstruct** the Creditors Control account to determine budgeted payments to creditors for the year ended 30 June 2011.

**Exercise 17.11 Cash variance report**

Simply Stunning sells hair-care products to hairdressers in Melbourne and has provided the following Cash Variance Report for the year ended 30 June 2010:

**SIMPLY STUNNING****Cash Variance Report for the year ended 30 June 2010**

	Budgeted	Actual	Variance	Fav/Unfav
<b>Operating Activities</b>				
Receipts from debtors	110 560	102 410		
Cash Sales	85 000	94 000		
Payments to creditors	(115 000)	(136 000)		
Prepaid rent	(12 000)	(15 000)		
Wages	(30 000)	(26 000)		
Advertising	(2 400)	(900)		
Interest expense	(2 700)	(3 100)		
<b>Net Operating Cash Flows</b>	<b>33 460</b>	<b>15 410</b>		
<b>Investing Activities</b>				
Cash sale of Equipment	5 000	3 000		
Shelving	–	(12 000)		
<b>Net Investing Cash Flows</b>	<b>5 000</b>	<b>(9 000)</b>		
<b>Financing Activities</b>				
Capital Contribution	–	20 000		
Loan	(5 000)	–		
Drawings	(36 000)	(40 000)		
<b>Net Financing Cash Flows</b>	<b>(41 000)</b>	<b>(20 000)</b>		
<b>Net Increase (Decrease) in Cash</b>	<b>(2 540)</b>	<b>(13 590)</b>		
<b>Opening Cash Balance</b>	<b>8 500</b>	<b>8 500</b>	–	–
<b>Closing Cash Balance</b>	<b>5 960</b>	<b>(5 090)</b>		

Sophie had organised an overdraft limit with the bank of \$6 000.

**Required**

- Explain** one benefit of preparing a Cash Variance Report.
- Complete** the Cash Variance Report for Simply Stunning for the year ended 30 June 2010.
- State** whether the variance in Payments to creditors is favourable or unfavourable. **Justify** your answer.
- Suggest** one possible reason for the capital contribution.
- Explain** the effect on the actual Closing Bank Balance of the variance in Investing Activities.
- Identify** two assets that will differ as at 30 June 2010 as a consequence of the variances in the Cash Variance Report. **Justify** each response.

**Exercise 17.12 Cash variance report**

Bright Lights, has provided the following partially complete Cash Variance Report for the year ended 30 June 2010:

**BRIGHT LIGHTS****Cash Variance Report (extract) for the year ended 30 June 2010**

	Budgeted	Actual	Variance	Fav/Unfav
<b>Operating Activities</b>				
Receipts from debtors	100 000	105 000		
Payments to creditors	(45 000)		5 000	F
Interest Expense		(800)	300	U
Prepaid Rent	(12 000)			
<b>Investing Activities</b>				
Cash sale of shelving		5 000	1 000	U
Van	(17 000)	(23 000)		
<b>Financing Activities</b>				
Loan	7 500		2 500	F
Drawings	(25 000)	(15 000)		

*Additional information:*

- The business had a bank overdraft of \$3000 1 July 2011.
- The \$12 000 budgeted for rent failed to take into account \$300 in prepaid rent at 1 July 2009 and prepaid rent of \$500 at 30 June 2010.
- The owner has argued that the Loan variance is unfavourable because it increases the firm's liabilities.

**Required**

- Calculate actual rent paid for the year ending 30 June 2010.
- Complete the Cash Variance Report (extract) for Simply Stunning for the year ended 30 June 2010.
- Explain why the Loan variance is favourable.
- Given that Credit sales decreased, suggest one possible reason for the variance in receipts from debtors.
- Explain one possible effect of Financing Activities on the firm's actual Net profit for the year ended 30 June 2010.

**Exercise 17.13 Profit variance report**

Toot and Twang sells musical instruments from a shop in Melton, and has provided the following Profit Variance Report for 2010:

**TOOT AND TWANG****Profit Variance Report for the year ended 30 June 2010**

	Budgeted	Actual	Variance	Fav/Unfav
<b>Revenue</b>				
Sales	120 000	110 000		
– <b>Cost of Goods Sold</b>				
Cost of Sales	70 000	55 000		

*continued*

		Budgeted	Actual	Variance	Fav/Unfav
	<b>Gross Profit</b>	<b>50 000</b>	<b>55 000</b>		
+ / –	Stock Gain/(Loss)	1 500	(4 200)		
	<b>Adjusted Gross Profit</b>	<b>51 500</b>	<b>50 800</b>		
+	<b>Other revenue</b>				
	Profit on Disposal of Vehicle	1 500	6 500		
		<b>53 000</b>	<b>57 300</b>		
–	<b>Other Expenses</b>				
	Wages	18 000	19 000		
	Rent	12 000	14 000		
	Depreciation of vehicles	2 300	1 600		
	Interest expense	1 400	1 800		
	<b>Net Profit/(Loss)</b>	<b>19 300</b>	<b>20 900</b>		

### Required

- Explain the importance of variance analysis in the budgeting process.
- Complete the Profit Variance Report for Toot and Twang for 2010.
- Explain whether the variance in Cost of sales is favourable or unfavourable.
- Suggest one possible reason for the variance in Depreciation of vehicles.
- Explain why the owner should be concerned about the firm's profit performance in 2010 when compared to the budget.

### Exercise 17.14 Profit variance report

Blades sells kitchen knives and cutting utensils has provided the following Profit Variance Report for the year ended 30 June 2010:

#### BLADES

#### Profit Variance Report for the year ended 30 June 2010

		Budgeted	Actual	Variance	Fav/Unfav
	<b>Revenue</b>				
	Sales	105 000	90 000		
–	Sales returns	8 500		4 500	F
	<b>Net sales</b>	<b>96 500</b>			
–	<b>Cost of Goods Sold</b>				
	Cost of Sales	48 000	54 000		
	Cartage Inwards	3 000	1 000		
	<b>Total Cost of Goods Sold</b>				
	<b>Gross Profit</b>	<b>45 500</b>			
–	Stock Loss	1 800	2 300		
	<b>Adjusted Gross Profit</b>	<b>43 700</b>			
–	<b>Other Expenses</b>				
	Wages	28 000		5 000	U
	Rent	15 000	18 000		
	Depreciation – equipment	1 400	2 200		
	Interest expense		800	300	F
	<b>Net Profit/(Loss)</b>				

The business had an overdraft of \$4000 as at 1 July 2009.

**Required**

- Complete the Profit Variance Report for Blades for the year ended 30 June 2010.
- Suggest two possible reasons for the variance in Sales returns.
- Suggest one possible reason for the variance in interest.
- Explain the implications of the variance in Gross profit.

**Exercise 17.15 Account reconstruction and budgeted reports**

Seth Bayes is the proprietor of Bayes Surfboards that sells surf gear on the Victorian west coast. He has provided the following information to assist in the preparation of budgets for 2011:

**BAYES SURFBOARDS**

**Assets and liabilities as at 31 December 2010**

Assets	\$	Equities	\$
Debtors Control	20 600	Bank	5 000
Stock Control	62 400	Accrued wages	700
Shop fittings	52 000	Creditors Control	41 800
less Acc. depreciation	18 000	Capital – Bayes	69 500
<b>Total Assets</b>	<b>\$117 000</b>	<b>Total Equities</b>	<b>\$117 000</b>

Expected transactions for 2011:

- All stock is sold at a 100% mark-up. Credit sales are expected to be \$300 000 and will include \$20 000 for December 2011. Debtors usually pay in the month following sale to take advantage of a 2% settlement discount.
- Credit purchases are budgeted to be \$140 000, and as at 31 December 2011, \$37 400 is expected to be owing to creditors.
- Other estimates for 2011 include:
 

Occupancy expenses	\$47 000
Office expenses	39 000
Wages expense	35 000
Depreciation expense	3 400
Cash drawings	12 000
Stock loss	2 500
- A new advertising contract will be signed on 30 September 2011, with the payment of \$1800 covering 12 months starting on 1 October 2011. Aside from the advertising, there will be no other prepayments or accruals as at 31 December 2011.
- During December 2011 Seth wants to borrow \$10 000 from AX Bank to finance the purchase of new shop fittings early in 2012. The loan will be repaid in full in December 2012, but interest of \$600 due on 31 December 2011 will not be paid until the next working day on 1 January 2012.
- In November 2011, some old shop fittings will be sold to a local supermarket at a profit of \$300. The shop fittings were originally worth \$4800, but by the sale date will have accumulated depreciation of \$4400.

**Required**

- Calculate budgeted cash proceeds from the disposal of the shop fittings.
- Calculate budgeted Receipts from debtors for 2011.
- Calculate budgeted Payments to creditors for 2011.
- \* Prepare a Budgeted Cash Flow Statement for Bayes Surfboards for 2011.
- Explain one advantage of preparing budgets more than once a year.

- f. **Show** how the Stock Control account would appear in the General Ledger as at 31 December 2011.
- g. **Prepare** an extract of the Budgeted Balance Sheet of Bayes Surfboards as at 31 December 2011 which shows Current assets and Current liabilities.

### Exercise 17.16 Account reconstruction and budgeted reports

Poppy Marcel is the proprietor of Digital Masters, which sells digital cameras. She has provided the following information to prepare her budgets for 2011:

#### DIGITAL MASTERS

##### Trial Balance as at 30 June 2010

Debit	\$	Credit	\$
Prepaid rent expense	1 000	Creditors control	17 100
Debtors Control	16 000	Acc. Dep. – Shop Fittings	21 600
Bank	1 200	Accrued wages	1 300
Stock control	35 000	Capital – Marcel	61 200
Shop Fittings	48 000		
	<b>\$101 200</b>		<b>\$101 200</b>

Anticipated transactions for the year ended 30 June 2011:

- Cash Sales are expected to be \$42 000 and credit sales of \$180 000. Debtors as at 30 June 2011 are expected to be \$30 800.
- All stock is purchased on credit and is sold at a 50% mark-up.
- Other estimates for the year include:
 

Sales returns	\$ 6 000	
Discount expense	3 700	
Purchases of stock	121 000	plus \$12 100 GST
Wage expense incurred	29 000	
Depreciation – shop fittings	5 300	
Cash drawings	23 000	
Stock loss	1 900	
- Poppy is currently renting premises at \$500 per month, payable 12 months in advance. The rent will increase to \$600 per month commencing with the next payment due on 1 September 2010.
- On 1 April 2011, the business will invest \$6000 in a 3-year term deposit. Interest is earned at 8% p.a., payable on 31 March each year.
- Estimated balances as at 30 June 2011 include:
 

Stock Control	\$10 100
Bank overdraft	\$ 2 800

#### Required

- a. **Calculate** budgeted Rent expense for the year ended 30 June 2011.
- b. **Calculate** budgeted Interest revenue for the year ended 30 June 2011.
- \* c. **Prepare** a Budgeted Profit and Loss Statement for Digital Masters for the year ended 30 June 2011.
- d. **Explain** how the preparation of a Budgeted Profit and Loss Statement could assist with planning to achieve an improved Gross profit.
- \* e. **Prepare** an extract of the Budgeted Balance Sheet of Digital Masters as at 30 June 2011 which shows current and non-current assets. (A full Balance Sheet is *not* required.)
- f. **Explain** one benefit of preparing a Budgeted Balance Sheet.