

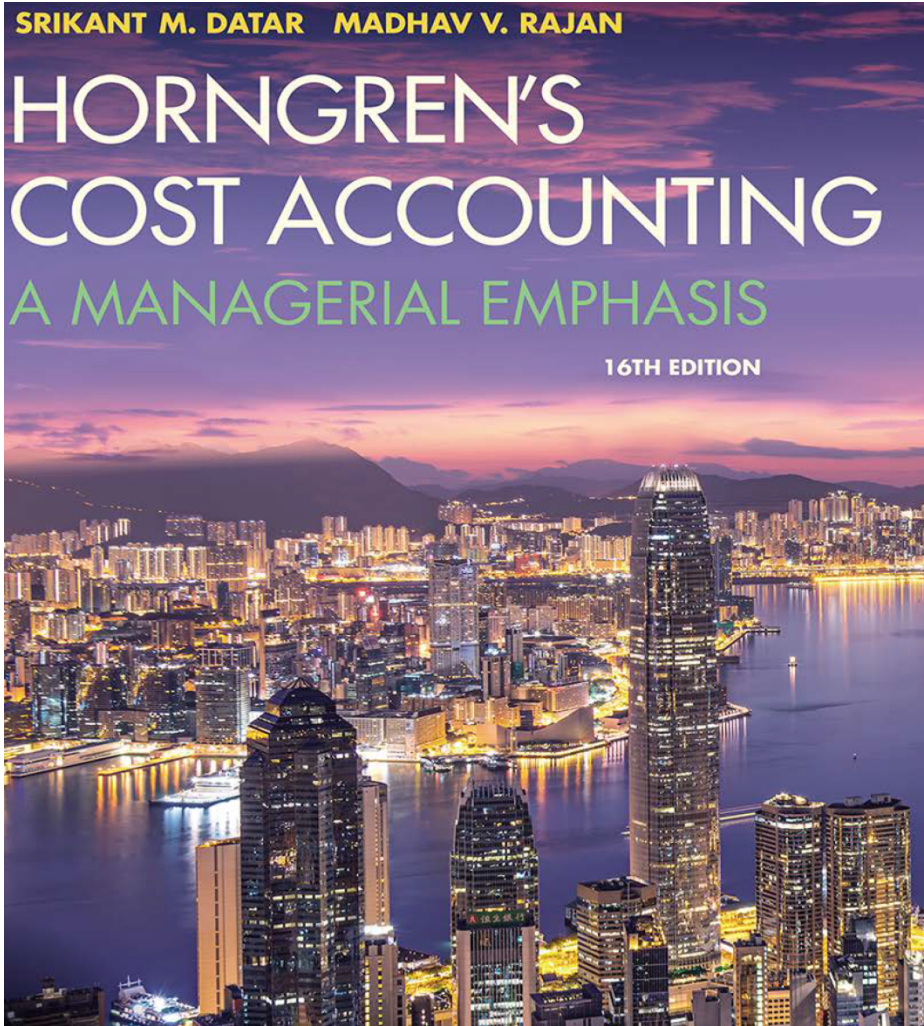
# COST ACCOUNTING

Sixteenth Edition

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## HORNGREN'S COST ACCOUNTING A MANAGERIAL EMPHASIS

16TH EDITION



## Chapter 6 Master Budget and Responsibility Accounting

# Budget Defined

- A budget is the quantitative expression of a proposed plan of action by management for a specified period.
- A budget is an aid to coordinating what needs to be done to implement that plan.

A budget generally includes the plan's both financial and nonfinancial aspects and serves as a road map for the company to follow in an upcoming period.

# Budgets Help Managers....

- Communicate directions and goals to different departments of a company to help them coordinate the actions they must pursue to satisfy customers and succeed in the marketplace.
- Judge performance by measuring financial results against planned objectives, activities, and timelines to learn about potential problems.
- Motivate employees to achieve their goals.

# Strategic Plans and Operating Plans (1 of 2)

Budgeting is most useful when it is integrated with a company's strategy. Strategy specifies how an organization matches its capabilities with the opportunities in the marketplace to accomplish its objectives.

# Strategic Plans and Operating Plans (2 of 2)

**To develop successful strategies, managers must consider questions such as the following:**

1. What are our objectives?
2. How do we create value for our customers while distinguishing ourselves from our competitors?
3. Are the markets for our products local, regional, national, or global?
4. What trends affect our markets?
5. How do the economy, our industry, and our competitors affect us?
6. What organizational and financial structures serve us best?
7. What are risks and opportunities of alternative strategies and what are our contingency plans if our preferred plan fails?

# Budgeting Cycle:

1. Before the start of a fiscal year, managers at all levels take into account past performance, market feedback, and anticipated future changes to initiate plans for the next period.
2. Senior managers give subordinate managers a frame of reference, a set of specific financial or nonfinancial expectations, against which they will compare actual results.
3. Managers and management accountants investigate any deviations from the plan.

# Working Document: Master Budget

The master budget is at the core of the budgeting process. It expresses management's operating and financial plans for a specified period:

- Operating decisions deal with how to best use the limited resources of an organization (the operating budget).
- Financial decisions deal with how to obtain the funds to acquire those resources (the financial budget).

# Advantages of Budgets

Budgets are an integral part of management control systems. As we have discussed at the start of this chapter, when administered thoughtfully by managers, budgets do the following:

1. Promote coordination and communication among subunits within the company
2. Provide a framework for judging performance and facilitating learning
3. Motivate managers and other employees



# Challenges in Administering a Budget

The budgeting process is time-consuming. Estimates suggest that senior managers spend about 10–20% of their time on budgeting and financial planning departments spend as much as 50% of their time on it.

For most organizations, the annual budget process is a months-long exercise that consumes a tremendous amount of resources.

# Time Coverage of Budgets

The timeline for a budget is dependent on the motive for creating the budget.

The most frequently used budget period is 1 year.

Businesses may also use a rolling budget. This budget is always available for a specified future period, by continually adding a month, quarter, or year to the period just ended.

# To Facilitate the Budget Process, use the 5-step Decision-making Process

1. Identify the problem and uncertainties
2. Obtain information
3. Make predictions about the future
4. Make decisions by choosing among alternatives
5. Implement the decision, evaluate performance, and learn

# Operating Budget and Financial Budget

The operating budget begins with the Revenues budget, includes multiple schedules and concludes with the Budgeted Income Statement.

The financial budget is made up of the Capital Expenditure budget, the Cash budget, the Budgeted Balance Sheet, and the Budgeted Statement of Cash Flows.

# Basic Operating Budget Steps

(1 of 2)

1. Prepare the revenues budget (schedule 1; the starting point). Page 206
2. Prepare the production budget (schedule 2; in units). Page 206
3. Prepare the direct materials usage budget and direct materials purchases budget (schedule 3). Pages 207 and 208
4. Prepare the direct manufacturing labor costs budget (schedule 4). Pages 208 and 209

# Basic Operating Budget Steps

(2 of 2)

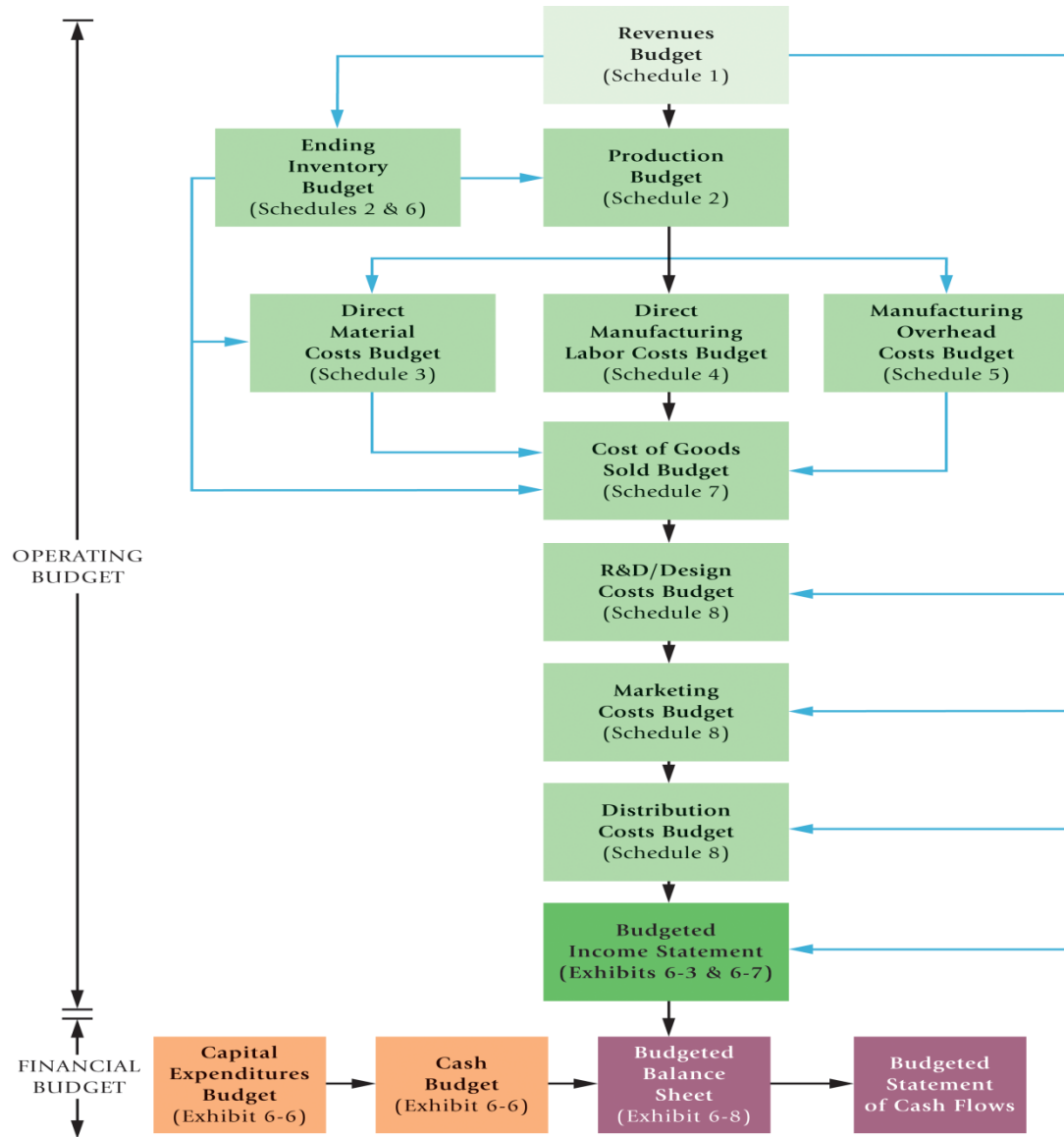
5. Prepare the manufacturing overhead costs budget (schedule 5). Page 209–212
6. Prepare the ending inventories budget (schedule 6A, units; schedule 6B, dollars). Page 212
7. Prepare the cost of goods sold budget (schedule 7). Page 213
8. Prepare the nonmanufacturing costs budget (schedule 8). Pages 213 and 214
9. Prepare the budgeted income statement. Exhibit 6-3, page 214–215

# Basic Financial Budget Steps from Appendix

## Based on the operating budgets:

1. Prepare the capital expenditures budget.
2. Prepare the cash budget.
3. Prepare the budgeted balance sheet.
4. Prepare the budgeted statement of cash flows.

# Overview of the Master Budget





# Financial Planning Models And Sensitivity Analysis

- Financial planning models are mathematical representations of the relationships among operating activities, financing activities and other factors that affect the master budget.
- Sensitivity analysis is a “what-if” technique that examines how a result will change if the original predicted data are not achieved or if an underlying assumption changes.

# Sensitivity Analysis

- Sensitivity analysis is used to assist managers in planning and budgeting.
- Sensitivity analysis is a “what-if” technique that illustrates the impact of changes from the predicted data.
- Two scenarios are being considered for Stylistic Furniture’s (the company from our textbook) budget.

File Edit View Insert Format Tools Data Window Help										
	A	B	C	D	E	F	G	H	I	
1	Key Assumptions									
2		Units Sold		Selling Price		Direct Material Cost		Budgeted Operating Income		
3	What-If Scenario	Casual	Deluxe	Casual	Deluxe	Red Oak	Granite	Dollars	Change from Master Budget	
4	Master budget	50,000	10,000	\$600	\$800	\$7.00	\$10.00	\$4,860,000		
5	Scenario 1	50,000	10,000	582	776	\$7.00	\$10.00	3,794,100	22% decrease	
6	Scenario 2	50,000	10,000	600	800	\$7.35	\$10.50	4,483,800	8% decrease	

# Budgeting and Responsibility

## Accounting (1 of 3)

How each company structures its organization significantly shapes how it coordinates its actions.

Functional organizations develop strong competencies within each function but are generally less focused on particular markets or customers.

Firms that are organized by product line or brand are more focused on particular markets or customers.

# Budgeting and Responsibility Accounting (2 of 3)

Each manager, regardless of level, is in charge of a responsibility center. A responsibility center is a part, segment, or subunit of an organization whose manager is accountable for a specified set of activities.

Responsibility accounting is a system that measures the plans, budgets, actions, and actual results of each responsibility center.

There are four types of responsibility centers.

# Budgeting and Responsibility Accounting (3 of 3)

There are four types of responsibility centers.

Cost—accountable for costs only

Revenue—accountable for revenues only

Profit—accountable for revenues and costs

Investment—accountable for investments, revenues, and costs

# Budgets and Feedback

Budgets, coupled with responsibility accounting, provide feedback to top managers about the performance relative to the budget of different responsibility center managers.

Budgets offer feedback in the form of variances: actual results deviate from budgeted targets.

## **Variances provide managers with:**

Early warning of problems

A basis for performance evaluation

A basis for strategy evaluation

# Responsibility and Controllability (1 of 2)

Controllability is the degree of influence a specific manager has over costs, revenues, or related items for which he or she is responsible.

A controllable cost is any cost primarily subject to the influence of a given responsibility center manager for a given period.

Responsibility accounting helps managers to first focus on whom they should ask to obtain information and not on whom they should blame.

# Responsibility and Controllability (2 of 2)

Responsibility accounting focuses on gaining information and knowledge, not only on control.

The fundamental purpose of responsibility accounting is to enable future improvement.

Performance reports for responsibility centers are sometimes designed to change managers' behavior in the direction top managers desire even if the reports decrease controllability.



# Human Aspects of Budgeting

(1 of 2)

Why did we discuss the master budget and responsibility accounting in the same chapter?

Primarily to emphasize that human factors are crucial in budgeting.

Too often, budgeting is thought of as a mechanical tool because the budgeting techniques themselves are free of emotion.

However, the administration of budgeting requires education, persuasion, and intelligent interpretation.

# Human Aspects of Budgeting

(2 of 2)

Budgetary slack is the practice of underestimating budgeted revenues or overestimating budgeted costs to make budgeted targets easier to achieve.

Stretch targets are challenging but achievable levels of expected performance, intended to create a little discomfort.

Kaizen budgeting explicitly incorporates continuous improvement anticipated during the budget period in the budget numbers.

# Budgeting in Multinational Companies

Multinational companies have operations in many countries. An international presence has benefits—access to new markets and resources—and drawbacks—operating in less-familiar business environments and exposure to currency fluctuations.

Multinational companies earn revenues and incur expenses in many different currencies and must translate their operating performance into a single currency for reporting results to their shareholders each quarter.