

# PROFIT PLANNING

Tran Hoang Giang

Phung Thi Thu Huong

Nguyen Thi Bach Diep

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# Basic framework of Budgeting

- **Budget** is a detailed quantitative plan for acquiring and using financial and other resources over a specified forthcoming time period.
- The act of preparing a budget is called **budgeting**.
- The **master budget** is a summary of a company's plans that sets specific targets for sales, production, distribution and financing activities.

# Planning vs Control

## Planning

- Developing objectives
- Preparing various budgets to achieve these objectives.

## Control

- Involves the steps taken by management
- Attempt to ensure the objectives are attained

# Advantages of Budgeting

- Communicate management's plans
- Think about and plan for the future
- Provides a means of allocating resources
- Uncover potential bottlenecks
- Coordinate activities by integrating the plans of its various parts
- Define goal and objectives that can serve as benchmarks

# Responsibility Accounting

Managers should be held responsible for those items - and *only* those items - that the manager can actually control to a significant extent.

- Personalize accounting information
- Manager is not penalized if budgeted goals not achieved

# Choosing budget period

- The annual operating budget may be divided into quarterly or monthly budgets



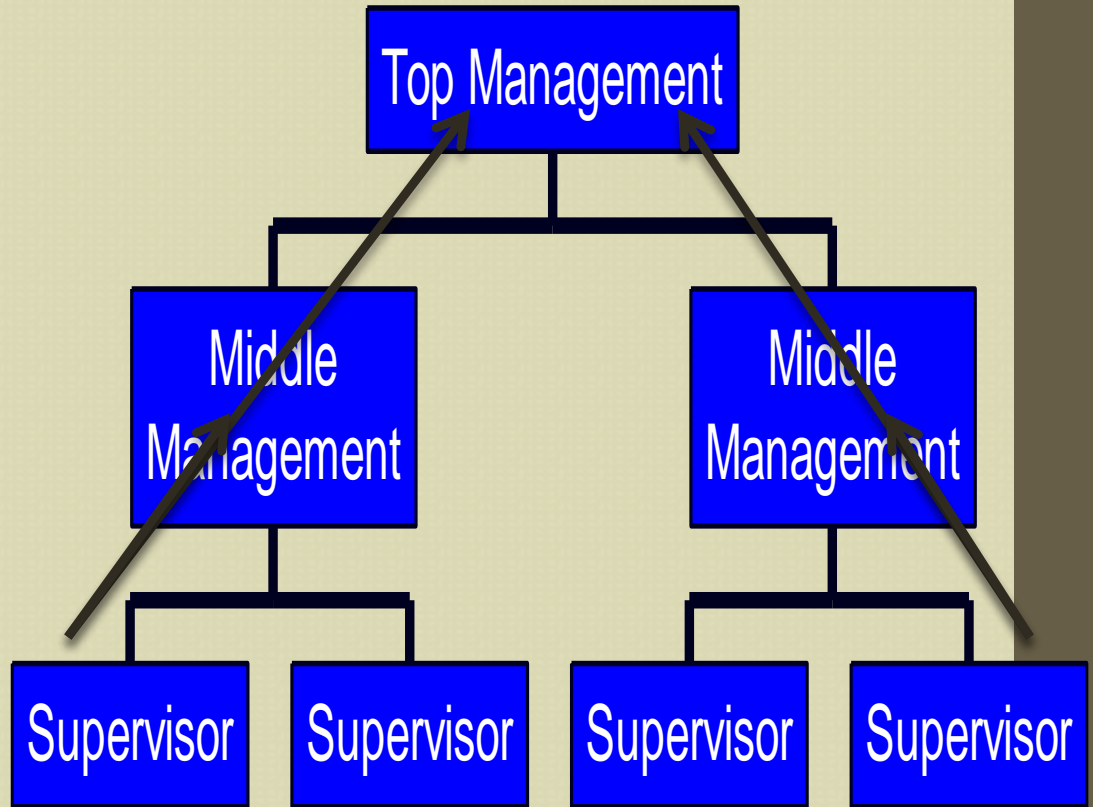
# Continuous/ Perpetual budget

- A 12-month budget that rolls forward one month (or quarter) as the current month (or quarter) is completed.
- Keep managers focused on the future at least one year ahead
- Managers less become too narrowly focused on short-term results



# Self-imposed budget

- Prepared with the full cooperation and participation of managers at all levels
- Targets set by top managers may be unrealistically high or may allow too much slack



# Advantages of Self-imposed budget

- Individuals at all levels of the organization are viewed as members of the team whose judgments are valued by top management.
- Budget estimates prepared by front-line managers are often more accurate than estimates prepared by top managers.
- Motivation is generally higher when individuals participate in setting their own goals than when the goals are imposed from above.
- A manager who is not able to meet a budget imposed from above can claim that it was unrealistic. Self-imposed budgets eliminate this excuse.

# Human factors in budgeting

- Top management must be enthusiastic and committed to the budget process.
- Top management must not use the budget to pressure employees or blame them when something goes wrong.
- Highly achievable budget targets are usually preferred when managers are rewarded based on meeting budget targets.

# Zero-based budgeting

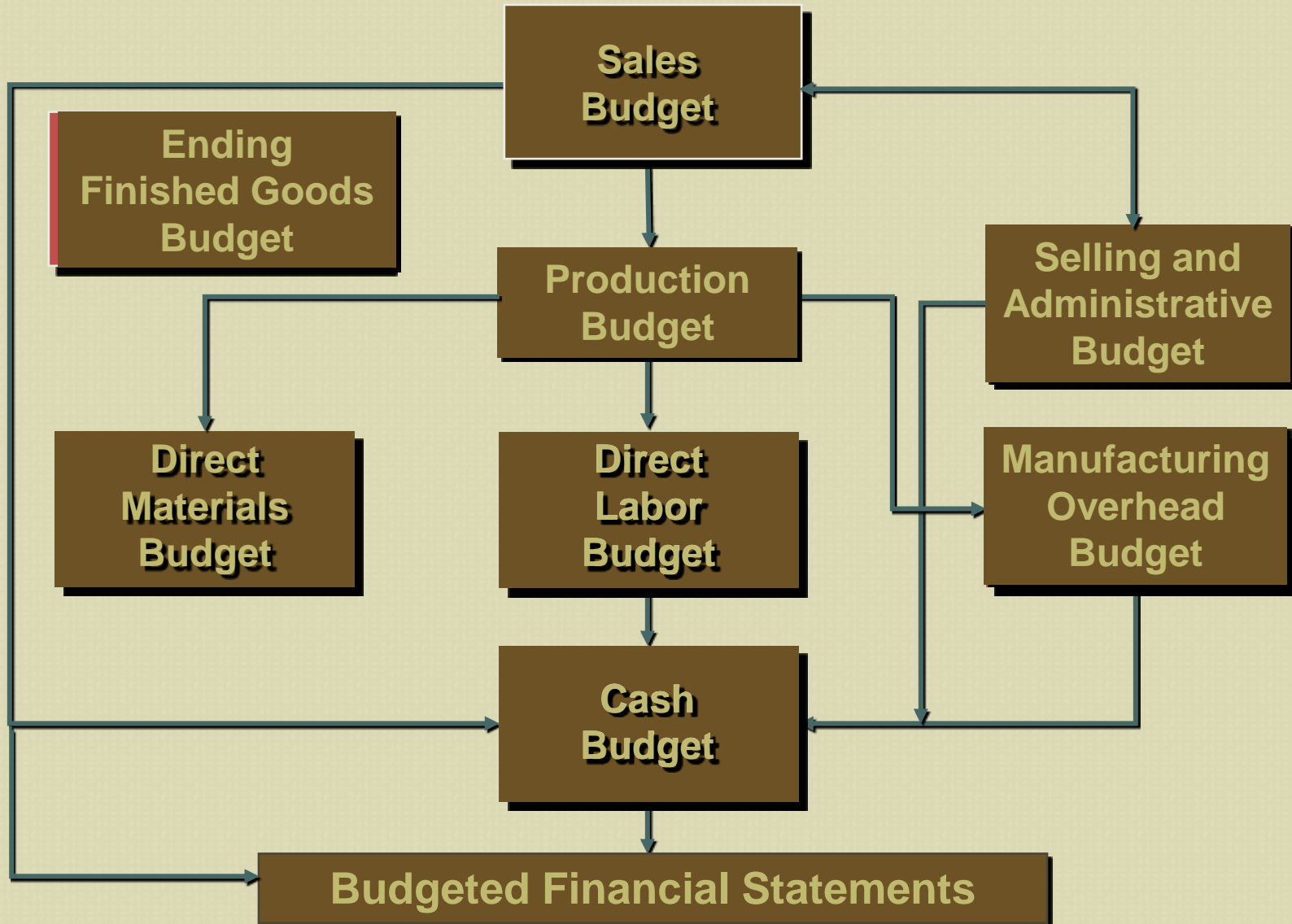
- Managers are required to justify all budgeted expenditures, not just changes in the budget from the previous year.
- Time-consuming & costly to justify on an annual basis

# The Budget Committee

Responsible for:

- Overall policy matters relating to the budget program
- Coordinating the preparation of the budget

# The Master Budget



# The Sales Budget

Budgeted sales in unit x Selling price

HAMPTON FREEZE, INC.					
Sales Budgeted for the year ended Dec 31, 2006					
	Quarter				Year
	1	2	3	4	
Budgeted sales in unit	10,000	30,000	40,000	20,000	100,000
Selling price	<u>\$20</u>	<u>\$20</u>	<u>\$20</u>	<u>\$20</u>	<u>\$20</u>
Total Sales	<u><u>\$200,000</u></u>	<u><u>\$600,000</u></u>	<u><u>\$800,000</u></u>	<u><u>\$400,000</u></u>	<u><u>\$2,000,000</u></u>

# Schedule of expected cash collection

- 70% are collected in the sales quarter
- 30% collected in the next quarter

## Schedule of expected cash collections

Accounts receivable. Beginning balance		90,000				Year
Quarter Sales	1	140,000	60,000			200,000
	2		420,000	180,000		600,000
	3			560,000	240,000	800,000
	4				280,000	280,000
<b>Total Cash Collections</b>		<b><u>230,000</u></b>	<b><u>480,000</u></b>	<b><u>740,000</u></b>	<b><u>520,000</u></b>	<b><u>1,970,000</u></b>



# Production Budget

	Budgeted unit sales
+	Desired ending inventory
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	Total needs
-	Beginning inventory
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	<u>Required production</u>

# Production Budget Example

Desired EI = 20% Next Quarter's Sales

## HAMPTON FREEZE, INC.

### Production Budget for the year ended Dec 31, 2006

	Quarter				Year
	1	2	3	4	
Budgeted sales	10,000	30,000	40,000	20,000	100,000
Add Desired ending inventory of finished goods	<u>6,000</u>	<u>8,000</u>	<u>4,000</u>	<u>3,000</u>	<u>3,000</u>
Total needs	16,000	38,000	44,000	23,000	103,000
Less Beginning inventory of finished goods	<u>2,000</u>	<u>6,000</u>	<u>8,000</u>	<u>4,000</u>	<u>2,000</u>
Required production	<u>14,000</u>	<u>32,000</u>	<u>36,000</u>	<u>19,000</u>	<u>101,000</u>

# Inventory Purchase – Merchandising Company

Budgeted sales

+ Desired ending merchandise inventory

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Total needs

- Beginning merchandise inventory

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Required purchases

# Direct Materials Budget

Raw materials needed to meet production schedule

+ Desired ending inventory of materials

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Total raw materials needs

-- Beginning inventory of raw materials

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Raw materials to be purchased

# Direct material budget example

- 15 pounds of raw materials needed per case
- Cost of raw materials \$0.2/pound
- Desired EI of raw materials= 10% next quarter's production needs

# Hampton Freeze, Inc.

## Direct Materials Budget For the Year Ended December 31, 2009

	Quarter				
	1	2	3	4	
Required production in cases	14,000	32,000	36,000	19,000	101,000
Raw materials needed per case (pounds)	15 <small>10%</small>	15 <small>10%</small>	15 <small>10%</small>	15	15
Production needs (pounds)	210,000	480,000	540,000	285,000	1,515,000
Add desired EI of raw material	<u>48,000</u>	<u>54,000</u>	<u>28,500</u>	<u>22,500</u>	<u>22,500</u>
Total needs	258,000	534,000	568,500	307,500	1,537,500
Less BI of raw materials	<u>21,000</u>	<u>48,000</u>	<u>54,000</u>	<u>28,500</u>	<u>21,000</u>
<b>Raw materials to be purchased</b>	<b>237,000</b>	<b>486,000</b>	<b>514,000</b>	<b>279,000</b>	<b>1,516,500</b>
Cost of raw materials per pound	\$0.20	\$0.20	\$0.20	\$0.20	\$0.20

# Schedule of Expected Cash Disbursements

- 50% of purchases is paid in the sales quarter
- 50% left is paid in the following quarter

Quarter	1	2	3	4	Year
Cost of new materials to be purchased	\$47,400	\$97,200	\$102,900	\$55,800	\$303,300

50%      50%

### Schedule of Expected Cash Disbursement for Materials

Accounts payable, beginning balance	\$25,800				\$25,800
First-quarter purchase	23,700	\$23,700			47,400
Second-quarter purchases		48,600	\$48,600		97,200
Third-quarter purchase			51,450	\$51,450	102,900
Fourth-quarter purchase				<u>27,900</u>	<u>27,900</u>
<b>Total cash disbursement</b>	<b><u>\$49,500</u></b>	<b><u>\$72,300</u></b>	<b><u>\$100,050</u></b>	<b><u>\$79,350</u></b>	<b><u>\$301,200</u></b>



# Direct Labor Budget

Number of units produced

x Number of direct-labor required per unit

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Total direct labor cost

## Hampton Freeze, Inc.

### Direct Labor Budget For the Year Ended December 31, 2003

	Quarter				Year
	1	2	3	4	
Required production in cases	14,000	32,000	36,000	19,000	101,000
Direct labor hours per case	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>
Total direct labor hours needed	5,600	12,800	14,400	7,600	40,400
Direct labor cost per hour	<u>\$15.00</u>	<u>\$15.00</u>	<u>\$15.00</u>	<u>\$15.00</u>	<u>\$15.00</u>
<b>Total direct labor cost*</b>	<b><u>\$84,000</u></b>	<b><u>\$192,000</u></b>	<b><u>\$216,000</u></b>	<b><u>\$114,000</u></b>	<b><u>\$606,000</u></b>

\* Assume that the direct labor work force will be fully adjusted to the total direct labor-hours needed each quarter.