Midterm 2 Review:

Chapter 5 -Job Order Costing

Characteristics of Job Order Environment:

-can be divided into 2 major parts, depending on whether or not their products/services are unique

1) Job Order Accounting System:
   - Firms produce unique products or services
   - EX: tailor making suits, construction company that remodels homes, service station that fixes your car, lawyer who handles your real estate transaction

2) Process Costing Accounting System:
   - Firms producing similar products or services
   - EX: oil producers,

-characteristics of the production process will determine whether it is a job or process

Process Production and Costing:

-firms produce large quantities of similar or homogenous products
   - EX: food, cement, petroleum, and chemical firms
   - One liter of paint is the same as another liter, one bottle of aspirin is the same as another

-cost of one unit or a product is identical to the cost of another

-process firms accumulate production cost by process or by department for a given period of time, output for the process for that period of time is measured

-unit costs are compared by dividing process costs for the given period by the output of the period

Job Order Production and Costing:

-firms operating in job order industries produce a wide variety of services or products that are quite distinct from one another
   - Customized or built to order products fit into this category

-job is one distinct unit or set of units
   - EX: it may be remodeling job for a specific family, or a set of 12 tables for children's reading room

-common job order processes include printing, construction, furniture making, medical/dental services, and automobile repair and beautician services

-key feature is that the cost of one job differs from that of another and must be kept track of separately

-when costs are assigned and accumulated it is called job order costing system

-production cost consists of direct materials, direct labour and overhead

Normal Costing and Overhead Application:

-unit costs are very important because managers need accurate cost information on material, labour and overhead when making decisions

-there are 2 ways to measure the costs associated with production:

1) Actual Costing:

-requires firms to use actual cost of all direct materials, direct labour, and overhead used in production to determine unit cost

-strict actual cost system is rarely used because they cannot provide unit cost information on a timely basis

-main problem of using this system is overhead, overhead items do not have the direct relationship that direct materials and direct labour do
-there are 2 main problems:

- Many overhead costs are not incurred uniformly through the year (EX: repair costs occur when ever a machine breakdown occur, timing can make overhead costs in the month of a machine break down higher than in other months)
- Non-uniform production levels, can mean that low production in one month would give rise to a high unit overhead costs, and high production in another month would give rise to a low unit overhead costs

-you would have to wait at the end of the year to total the actual over head costs, this process takes too long therefore managers must react to day to day conditions in the marketplace in order to maintain a sound competitive position

2) Normal Costing:

-requires firms to assign actual costs of direct materials and direct labour to units produced and too apply overhead to units based on a predetermined estimate
-it is more widely used in practice
-it also solves problems associated with actual costing
-normal cost system determines unit cost by adding direct materials actual direct labour and estimated overhead
-overhead cost can be estimated by approximating the year's actual overhead at the beginning of the year and then using a predetermined rate throughout the year to obtain the needed unit cost information

Normal Costing and Estimated Overhead:

-in normal costing, overhead must be estimated and applied to production, it can be described in 3 steps
1) Calculate the predetermined overhead rate

- Calculated at the beginning of the year by dividing the total estimated annual overhead by the total estimated level of associated activity or cost driver
- Estimated overhead is simply the firms best estimate of the amount of overhead (utilities, indirect labour, depreciation) to be incurred in the coming year, estimate is often based on last year's figures
- Associated activity level depends on which activity is best associated with overhead, activity chosen is the number of direct labour hours or direct labour cost
- This makes sense when much of the overhead cost is associated with direct labour (fringe benefits, worker safety training programs, cost of running the personnel department), number of machine hours could be a good choice for a company with automated production
- Estimated activity level is simply the number of direct labour hours or machine hours expected f
- Predetermined Overhead Rate Formula:
  Overhead Rate = Estimated Annual Overhead/Estimated Annual Activity Level

2) Apply overhead to production throughout the year

- Once you have the overhead rate you can begin to apply overhead to production
- Applied overhead = predetermined overhead rate X actual use of the associated activity for the period

3) Reconcile the difference between the total actual overhead incurred during the year and the total overhead applied to production

- There are 2 types of overhead that must be taken into consideration
  - Actual Overhead: costs are tracked throughout the year in the overhead account

    - Applied Overhead: computed throughout the year and is added to actual direct materials and actual direct labour to get total product costs
- Since the predetermined overhead rate is based on estimated data, applied overhead will rarely equal actual overhead
- Under-applied Overhead: if actual overhead is greater than applied overhead
- Over-applied Overhead: if actual overhead is less than applied overhead
- At the end of the year, costs reported on financial statements must be actual not estimated
- Entire overhead variance is assigned to Cost of Goods Sold
    - Under-applied overhead is ADDED to COFGS
    - Over-applied overhead is SUBTRACTED to COFGS

Plant-wide and Departmental Overhead Rates:
-plant wide overhead is a single overhead rate calculated by using all estimated overhead for a factory divided by the estimated activity level across the entire factory

- Some companies believe that multiple overhead rates give more accurate costing information

-departmental overhead rate is simply estimated overhead for a department divided by the estimated activity level for the that same department

- Step involved in calculating and applying overhead is the same as plant wide

The Conversion Process:
-all organizations convert inputs (material, labour and overhead) into outputs
-product costs are incurred in the production (conversion) area and period costs are incurred in all nonproduction areas
-Degree of Conversion in Firms:
1) Low Degree of Conversion

- Is limited to adding convenience in terms of where and when and in what quantities
- EX: gas stations, travel agencies, hair salons, department stores

2) Moderate Degree of Conversion

- Degree of conversion is small, usually just before delivery such as installing, packaging, washing and labeling
- EX: oil change stores, florists, butcher shops, car washes

3) High Degree of Conversion

- Degree of conversion is high as the input is transformed greatly
- EX: construction companies, manufacturing companies, restaurants

-major distinction of retail firms relative to service and manufacturing firms is that retailers have a much *lower degree of conversion* than the other two types of firms

- Employees of a retail store open shipping containers, hang clothes on racks, and tag merchandise with sales tickets, a labour cost for conversion is incurred, retail stores do not attach the stock workers wages to inverntory such as costs are treated as period costs and are expensed when incurred

-service companies engage in *high degree of conversion*

- Firms of professionals such as accountants, architects, lawyers, engineers, and surveyors convert labour and other resource inputs into completed services (reports, blueprints, legal papers, property, mechanical assessment, survey reports)

Keeping Track of Job Costs with Source Documents:

-accounting for job order production begins by preparing source documents which are used to keep track of the costs of jobs
-in a job order firm where price is based on costs, it is important to keep track of the costs of a job
-the first job is under-costed and under-priced which second job is over-costed and over-priced

Job Order Cost Sheet:

-every time a new job is started, a job order cost sheet is prepared, it is subsidiary to the Work in Process account and is the primary document for accumulating all costs related to a particular job
Ach cost of materials, labour, and overhead added during the month
-work in process consists of all incomplete work, in a job order system this will be all of the unfinished goods, the balance sheet in Work in Process at the end of the month will be the total of all the job order cost sheets for the incomplete jobs

Materials Requisition:

-cost of direct materials is assigned to a job by the use of a course document known as materials requisition form
-form asks for the type, quantity and unit price of the direct materials issued and most important, the number of jobs
-using this form, the cost of accounting department can enter the cost of the direct materials onto the correct job order cost sheet
-the signature transfers responsibility for the materials from the storage area to the person receiving the materials, usually a production supervisor

Time Tickets:

-are used only for direct labourers, since indirect labour is common to all jobs, these costs belong to overhead and are allocated using one or more predetermined overhead rates
-these time tickets are collected and transferred to the cost accounting department, where the information is used to post the cost of direct labour to individual jobs

Source Document for Other Activity:

-company may use an overhead application base rather than direct labour hours therefore, source documents are required
-For EX: machine hours may be used to apply overhead, therefore new document must be developed, a source document that will track the machine hours used by each job can be modeled on job time tickets

Chapter 7 - Activity Based Costing and Management

Limitations of Functional Based Cost Accounting Systems:

-Plant-wide and departmental rates based on direct labour hours, machine hours or other volume based measures have been used for decades to assign overhead costs to products and continue to be used successfully by many organizations
-however, this approach to costing is equivalent to an averaging approach and may produce distorted or inaccurate costs

- Two individuals go out for dinner, one orders steak and lobster ($40) and other orders salad ($10) thus, the total cost of food is $50, if the bill were to split evenly between the two, each individual will pay $25, $25 would be the average cost of the meals NOT actual cost of each meal
- Therefore one meal is overstated by $15 and other is understated by $15

-same way, plant-wide and departmental rates can produce average costs that are either under or overstated product costs
-in order for accurate cost information to be produced, it is important that the firm's cost system accurately reflects the firm's underlying business or economic reality
-unfortunately due to the time commitment and costs required to change cost systems, some firms do not change their systems when their business environment changes, cost distortions result due to the poor matching between the firm's business reality and the cost system's representation of that reality
-need for a more accurate cost has forced many companies to take a serious look at their costing procedures
-at least 2 major factors can impair the ability of unit based plant-wide and departmental rates to assign overhead costs accurately

- Proportion of non-unit related overhead costs to total overhead costs is large
- Degree of product diversity is great

Non-Unit Related Overhead Costs:
-use of either plant-wide rates or departmental rates assumes that a product consumption of overhead resources is related strictly to the units produced
-For **Unit Level Activities,** activities are performed each time a unit is produced
-volume based cost systems label the costs associated with these activities as variable in nature, because they increase or decrease in direct proportions to increase or decrease in the levels of these unit level activities
-all other costs that are not unit based are considered fixed by volume based cost systems
-non unit level activities are activities that are not performed each time a unit of product is produced
-costs associated with non unit level activities are unlikely to vary (increase or decrease) with units products, sometimes these costs vary with some other factors besides units and identifying factors such as is very helpful in predicating and managing these costs
-activity based costing (ABC) refers to the ABC cost hierarchy that categorizes costs either as unit level, batch level, product sustaining or facility sustaining

- Unit Level: varies with output volume (ex. units); traditional variable costs,
  - EX: Cost of indirect materials for labeling each bottle of Victoria's Secret perfume
- Batch Level: varies with the number of batches produced
  - EX: Cost of setting up laser engraving equipment for each batch of Epiolog key chains
- Product Sustaining: varies with the number of product lines
  - EX: Cost of inventory handling and warranty servicing of different brands carried by Best Buy electronics store
- Facility Sustaining: necessary to operate the plant facility but does not vary with units, batches or product lines
  - EX: Cost of General Motors plant managers salary

-non unit level drivers such as setups and engineering orders are needed for accurate cost assignment of non unit level activities
-unit level activity drivers measure the consumption of unit level activities
-activity drivers are factors that measure the consumption of activities by products and other cost objects and can be classified as either unit level or non unit level

Product Diversity:
-presence of significant non-unit overhead costs is a necessary but not sufficient condition for plant-wide and departmental rate failure
-product diversity means that products consume overhead activities in systematically different proportions, this may occur for several reasons

- Differences in product size
- Product complexity
- Set up time
- Size of batches

-regardless of the nature of the product diversity, product cost will be distorted whenever the quantity of unit based overhead that product consumes does not vary in direct proportion to the quantity consumed of non unit based overhead
-proportion of each activity consumed by a product is defined as the consumption ratio

Problems with Cost Distortion:
-main problem with either procedure is the assumption that unit level drivers such as machine hours or direct labour hours drive or cause all overhead costs
- You have two different products that require a whole bunch of different

- Materials
- Labour
- Setups (3 setups compared to 1 etc)

-so if you use plant wide or departmental, the costs will be distorted because the products are very diverse and have different costs and requirements

Solving the Problem of Cost Distortion:
-can be solved by using activity rates
-calculate a rate for each overhead activity and then use those rates to assign overhead costs

Activity Based Costing (ABC):
-in the past, majority of the departments used direct labour hours as the only cost driver for applying cost to products and services, however, direct labour hours are not a good measure of the cause of costs
-labour related costs in an automated system may be only a small percentage of the total costs and often are not related to the causes of most overhead costs
-if many costs are caused by non-volume-based cost drivers, activity based costing (ABC) should be considered
-ABC accumulates overhead costs for each of the organizations activities and then assigns the costs of activities to the products, services, or other cost object that caused those activities

- Production Setup - number of production runs
- Engineering – number of engineering change orders
- Maintenance – number of machine hours
- Power – number of kilowatt hours
- Cleaning – number of square metres to be cleaned

-Activity Based Cost assignment consists of 3 steps:
1) Identify and define activities using interviews and surveys

- Build a list of activities (ex. activity dictionary) this dictionary lists activity attributes which are financial and nonfinancial info. that describes the activities

- Activity Name – consists of an action verb
- Description of the tasks that make up the activity
- Classification as a primary activity – activity consumed by a product or customer or a secondary activity – activity consumed by other primary of secondary activities
- Activity driver – measure of activity output

2) Assign costs to activities

- Determine the cost of resources such as materials, labour and capital, consumed by each activity
  - If resource is exclusive to the activity (materials) use direct tracing
  - If resources is shared by several activities, use drives to trace and measure the consumption of resources by each activity
  - Cost of secondary activities are ultimately assigned to primary activities

3) Assign costs to products

- After cost of primary activities is calculated, assign the cost of these activities to products based on usage of the activity as measured by activity drivers
- Cost assigned to products are calculated as follow:
  - Cost assigned to products = predetermined rate X actual usage of activity

ABC costing has several shortcomings:

-ABC does not conform GAAP, ABC suggests that some non-product costs should be allocated to products, whereas other product costs like factory building depreciation should not be allocated to products

- Companies use ABC for internal reporting but continue to prepare their external financial statements with more traditional systems (job order or process costing)

-ABC requires a significant amount of time, substantial time is needed to properly identify and analyze the activities taking place, trace costs to those activities and determine the cost drivers

-substantial support is needed throughout the firm to overcome a variety of barriers; individual (people need to learn new skills), organizational (people resist change) and environmental (regulatory agencies may not accept ABC data)

ABC Summary:

- ABC is a cost accounting tool that allocates overhead to products and services differently than job order (traditional) systems

- Does not reduce the amount of overhead a company incurs

- It can help identify non-value added activities which reduces overhead
- Produce more effectively and efficiently
- Provides better information on cost, for pricing reasons etc

Cost Drivers:

-organizations engage in various activities that consume resources and cause costs

-every activity has a cost driver, cost driver is a factor that drives or causes coots

-cost drivers may be volume related such as labour or machine costs, or they may reflect frequency of certain events such as # of kilometers driven

-in most cases, more than one cost driver causes costs

- For EX: insurance of a building, the number of employees working in the building, the number of previous claims made etc

-traditionally cost drivers been at the unit level, in which they are referred to as unit-level drivers

-that single unit cost includes direct materials, direct labour, and some traceable overhead

-products or services delivered in batches will have what are known as batch level drivers which includes purchase orders, equipment maintenance, equipment depreciation, and quality control

Value Added Activities and Non Value Added Activities:

-all activities require some resource consumption and resource consumption inevitably drivers costs higher

-higher costs cannot always be passed on to customers because most prices are set by the marketplace

-if prices are fixed, then in order to reduce costs, organizations that want to achieve higher profits have no choice but to reduce or eliminate activities

-*value added activity* increases the value of a product or service to a customer and is one for which the customer if willing to pay, value added activities result in more effective production methods, continuous operating improvements, better operational control, and reduced times for completing the operational cycle

-*non value added activity* increases the time and or cost spent on a product or service, without increasing its worth, it may include warehousing materials or components until needed for production and or hiring employees with the necessary skills to make a product or provide a service

- Try to eliminate non value added activities in ways that do not affect the value or quality of the product or service

-most effective way to determine the value is to ask why the activity is necessary and identify valid business reasons

-the actual time it takes to perform all necessary functions to manufacture a product or provide a service is referred to as "processing or service time" this sort of time adds value

-constructing a value chart for every product or service could indicate where a company is losing time and money through non value added activities, cost of such can be estimated by storage facility depreciation, property taxes, insurance charges, wages for warehouse employees and cost of working capital funds tired up in stored inventory

Assigning Costs to Activities:

- Direct tracing and driver tracing are used to assign resource costs to activities
- Once the activities are identified, we must find out how much it costs to perform each activity
- Direct tracing
  - If the labour is 100% of cost, then direct tracing is used
  - If the cost is split between multiple drivers, then driver tracing is used(and they are called resource drivers)
- Resource drivers are the factors that measure the consumption of resources by activities

Activity Based Customer Costing and Activity Based Supplier Costing:

-since the beginning of the 21st century, the use of ABC has expanded into areas upstream (ex. before the production section of the value chain – research and development, prototyping) and downstream (after production of section of the value chain – marketing, distribution, customer service) from production

- Customers and suppliers also contribute to the costs of products
- Customers can consume costs in many ways
  - Order frequency, delivery, geographical distance, number of sales calls and number of engineering support

- This means that ABC can still have an impact on costs if a firm only produces 1 unit (where direct tracing diminishes the value of the overhead so ABC is not worth it)
- Sometimes you have 1 customer that buys 50% of your production, and 100 that buy the rest. Well the 100 run up costs by extra sales calls, invoices, distribution etc
- Large customer costs less to service than the smaller onces and maybe should be charged less?

-Suppliers can increase costs to the company by

- Costs associated with quality, reliability and late delivery
- The way you calculate suppliers and customer costs is the same for ABC, the activity is "sales calls" and the driver is # of calls

Process Value Analysis:

-is a fundamental to activity based management, it focuses on cost reduction instead of cost assignment and emphasizes the maximization of system wide performance

-process value analysis is concerned with

- Driver analysis
- Activity analysis
- Performance measurement

Driver Analysis: The Search for Root Causes

-every activity has inputs and outputs

-activity inputs are the resources consumed by activity in producing its outputs

-activity output is the result or product of an activity, measures the number of times activity is performed

- Inputs: forklist, driver, fuel and crates
- Output: moved goods and materials

-We want to find the root cause of the cost

- Moving materials: not based on the number of moves, but maybe the cost is because of the layout? Recognizing this and fixing it can reduce costs, which is what process value analysis is all about
- Driver analysis is the effort expended to identify the root causes of the activity cost

Activity Analysis: Identifying and Assessing Value Content

-This is the heart of process value analysis, and includes

- Identifying
- Describing
- Evaluating the activities that an organization performs

- Activity analysis should produce 4 outcomes

- What activities are do
- How many people perform the activities?
- Time and resources required to perform the activities
- Assessment of the value of the activities to the organization, with recommendations on which activities not to include due to NVA

- This step is concerned with cost reduction rather than cost assignment
- Activities can be classified as

- Value added
  - Necessary to remain in business, these are necessary to comply with legal mandates. (these are value added by mandate)

    - Anything else is discretionary, and it is considered to add value if
    - The activity produces a change of state, raw material takes form into a product
- Change of state was not achievable by preceeding activities
    - Activity enables other activities to be performed
- Value added costs are
    - Costs to perform the value added activities with efficiency
- Non value added (NVA)
    - All activities that are not essential to remain in business, or a failure in the 3 defining conditions above
    - Examples: Scheduling, uses time and resources to determine when different products have access to process, how much will be produced and how many setups etc, Moving Waiting, Inspecting, Storing
- Organization can reduce costs in 4 ways
    - Activity elimination
    - Activity selection
    - Activity reduction
- Reduce time and resources required by the activity
    - Activity sharing

Chapter 9 - Budgeting, Production, Cash and Master Budget

Description of Budgeting:
-all business should prepare budgets, all large business do; single-owner business, partnerships, and corporations
-even small business; professional corporations like lawyers, dentists and doctors
-all can benefit from planning and control provided by budgets

Budgeting and Planning and Control:
-planning is looking ahead to see what actions should be taken to realize particular goals
-control is looking backward, determining what actually happened, and comparing it with the previously planned outcomes
-budgets are financial plans for the future and are a key component of planning, they identify objectives and the actions needed to achieve them
-before a budget is prepared, an organization should prepare a strategic plan
-strategic plan identifies strategies for future activities and operations, generally covering at least 5years
-the basis of budget is long and short term goals

Advantages of Budgeting:
-budgetary system gives an organization several advantages
- Forces mangers to plan
    - It encourages managers to develop an overall direction for the organization, foresee problems, and develop future policies
- Provides information that can be used to improve decision making

- EX: a restaurant owner who knows the expected revenue and costs of meat, vegetables, cheese etc. might make menu changes that play up the less expensive items and reduce the use of more expensive ingredients, these better decisions keep customers happy

- Provides a standard for performance evaluation
  - Budgets set standards that can control the use of a company's resources and motivate employees, vital part of budgetary system is control which is achieved by comparing actual results with budgeted results
  - A large difference between actual and planned results is feedback revealing that the system is out of control
- Improves communication and coordination
  - Budgets formally communicate the plans of the organizations to each employee
  - Since budgets for various areas and activities of the organization must all work together to achieve organizational objectives, coordination is promoted
  - Role of communication and coordination becomes more significant as an organization increases in size

The Master Budget:

-is the comprehensive financial plan for the organization as a whole

-master budget is for a one year period, corresponding to the fiscal year of the company, yearly budgets are broken down into quarterly and monthly budgets

-the use of smaller time periods allows managers to compare actual data with budgeted data more frequently so that problems may be noticed and resolved sooner

-some organizations have developed a continuous budgeting philosophy, which is a moving 12 month budget, as a month expires in the budget, an additional month in the future is added so that the company always has a 12 month plan on hand

-most organizations prepare the mater budget for the coming year during the last 4 or 5 months of the current year

- Budget committee:
  - reviews the budget
  - provides policy guidelines and budgetary goals
  - resolves differences the arise as the budget is prepared
  - approves the final budget
  - monitors the actual performance of the organization as the year unfolds

-controller is usually serves as the budget director, person responsible for directing and coordinating the organizations overall budgeting process

Major Components of the Master Budget:

-it can be divided into operating and financial budgets

-operating budgets describes the income generating activities of a firm:
  - sales, production and finished goods inventories
  - outcome of the operating budget is a pro forma or budgeted income statement

-financial budgets detail the inflows and outflows of cash and the overall financial position
  - cash inflow and outflow appears in the cash budget
  - expected financial position at the end of the budget period is shown in a budgeted, pro forma, balance sheet

Preparing the Operating Budget:

-operating budget consists of a budgeted income statement accompanied by the following:

- sales budget
- production budget
- direct materials purchases budget
- direct labour budget
- manufacturing overhead budget
- selling and administrative expenses budget
- ending finished goods inventory budget
- cost of goods sold budget

Sales Budget:
-approved by the budget committee and describes expected sales in units and dollars
- sales budget is the basis for all of the other operating budgets and most of the financial budgets, it is important that it is accurate as possible

-First step in creating a sales budget is to develop the sales forecast which is usually the responsibility of the marketing department
-sales forecast is just the initial estimate, it is often adjusted by the budget committee
-Sales budget = budgeted units to be sold x selling price
- For a multiple product firm, sales budget reflects sales for each product in units and dollars, so don't add them all up, keep them separate)

Production Budget:
-tells how many units must be produced to meet sales needs and to satisfy ending inventory requirements
- If there were no beginning or ending inventories, production = sales needs

-many firms use inventories as a buffer against uncertainties in demand or production, thus need to plan for inventory levels as well as sales
-to compute the units to be produced, both unit sales and units of beginning and ending finished goods inventory are needed:
- Units to be produced= expected unit sales + units in desired ending inventory (EI) – units in beginning inventory (BI)

-beginning inventory for one quarter is always equal to the ending inventory of the previous quarter

Direct Materials Purchases Budget:
-tells the amount and cost of raw materials to be purchased in each time period, it depends on the expected use of materials in production and the raw materials inventory needs of the firm
-company needs to prepare a separate direct materials purchases budget for every type of raw material used
-formula for calculating purchases is:
- Purchases = direct materials needed for production + direct materials in desired ending inventory – direct materials in beginning inventory

-depends on expected use of raw materials and inventory needs of the firm
- Quality in inventory is determined by the firms inventory policy

Direct Labour Budget:
-shows the total direct labour hours and the direct labour cost needed for the number of units in the production budget

-as with direct materials, the budgeted hours of direct labour are determined by the relationship between labour and output
- # of hours X hourly rate

Overhead Budget:
-shows the expected cost of all production costs other than direct materials and direct labour
-many companies use direct labour hours as the driver for overhead, then costs that vary with direct labour hours are polled and called variable overhead
-remaining overhead items are pooled into fixed overhead
-Total Overhead = fixed + variable

Ending Finished Goods Inventory Budget:
-supplies information needed for the balance sheet and also serves as an important input for the preparation of the cost of goods sold budget
-calculate unit cost:

- Direct Materials + Direct Labour + Overhead

Cost of Goods Sold Budget:
-cost of goods sold budget reveals expected cost of the goods sold
-Direct Materials + Direct Labour + Overhead + (Beginning Finished Goods – Ending Finished Goods)

Selling and Administrative Expenses Budget:
-outlines planned expenditures for nonmanufacturing activities
-selling and administrative expenses budget can be broken down into fixed and variable components

Budgeted Income Statement:
-prepares the estimate of operating income
-all information is provided from the 8 budgets above
-operating income is not net income

- Must include interest expenses and taxes that must be subtracted
- Interest expense if taken from the cash budget

Preparing the Financial Budget:
-remaining budget is found in the master budget are the financial budgets
-financial budgets prepared are:

- Cash budget
- Budgeted balance sheet
- Budgeted for capital expenditures

-master budget also contains a plan for acquiring long term assets; assets that have a time horizon that is beyond 1 year of operating period
-cash budgets and balance sheets are the ones we need to know

Cash Budgets:
-by knowing when cash inflows and outflows are likely to occur, a manager can plan to borrow cash when needed and to repay the loans during periods of excess cash
-cash flow is the lifeblood of an organization, it is one of the most important budgets in the master budget

-basic structure of cash budget includes:

- Cash receipts
- Disbursements
- Any excess or deficiency of cash and financing

-cash budget = cash inflows – cash outflows

-cash disbursements

- All planned cash outlays for the period
- All expenses that do not require a cash outlay are ignored (depreciation)
- Handling payments on account, handle timing differences from paying for items on account

-excess cash or deficiency

- Compares the cash available with the cash needed
- Cash needed is the total cash dispursements + the minimum cash balance required by company policy

- Final section is borrowing/repayments

- When you have excess cash, you will repay loans
- When you have deficiency, you will borrow money
- You find the borrowing/repay by
    - Calculating the deficiency/excess
    - Comparing it to minimum cash needed, the difference is the repayment or the borrowing depending on excess or deficiency