Budgets and Controls

Budgets

• There are three elements in the budget process
  o Planning and budgeting before production
  o Overseeing production and operations during the month
  o Month end actuals → budget analysis; review results

• An operations budget deals with production and costs over coming month
  o Sales forecast
    • Sales department forecasts demand
  o Production/purchases schedule
    • With forecasted demand, this shows how much to make/buy
    • In terms of units, not money
    • Labor, machinery and materials for the units to be needed
  o Manufacturing cost budget
    • Costs of inputs mandated by the production schedule
  o Cost of goods sold and ending inventory
    • Total costs to produce inventory at the budgeted costs
    • Ending inventory needed on hand for next month
  o Operating expenses
    • Shows all other period costs associated with production

• A capital budget deals with asset acquisition (land, machines, buildings)
• A cash budget includes cash collections on sales and receivables less cash disbursements on purchases and payables and operating expense outlays.
• Static budgets assumes a set level of production (good for government)
• Flexible budgets allow for different levels of sales and production
  o A spreadsheet that can change a quantity is helpful

Management Controls

• Cost, profit, service and investment center
  o Cost centers: Allocation of costs depends on responsibility for costs and what center benefits.
  o Profit centers: Produce revenue and incur expenses
  o Service centers: Provide service to other centers (including other service centers); allocate on a step down method
  o Investment centers: Receive capital to expand assets
  o A cost driver comes from the function the cost is related to

• Responsibility: controllable and uncontrollable
  o Management is evaluated based on costs immediate to their decisions (evaluate sales staff by sales volume, manager by overall sales and overhead costs, regional manager by advertising, shipping costs from arrangements negotiated, overall company by marketing strategy

ROI and residual income

• Net Income / Investment is the return on investment (ROI)
• Operating income less (cost of capital % x adjusted average invested capital) gives residual income.