

Budgeting/Responsibility Centers

As we start this lecture, we should know that managerial accounting covers the planning and control for the organization. Now that we hopefully have a good understanding of the expenses, it is time to PLAN. That means it is budget time!

I'll bet most of you have seen personal financial budgets. You may have tried to produce one and then follow it. Just like an individual's budget, the company also needs to have a plan. The best way to reach profit goals, expense containment and keep management happy is to have a budget. The budget is actually a collection of schedules all bundled into one file called the Master Budget.

When we break the levels of planning into categories, there are three main ones:

- Strategic Planning- This is an overall, long-term vision for the company
- Capital Budget- Where we plan our mid-range goals for expenditures like equipment.
- Operating Budget- Where our short-term or immediate needs are planned.

The very first step that we will take in budget preparation is to produce a sales budget. Why? Well, most all of our associated expenditures and income will be tied to the level of sales that we forecast. So begin here! If we have inventory, then that is the next budget schedule to prepare. The cash budget is one of my favorites! This is where we project the cash inflows and outflows so that we can make appropriate plans! For example, we want to know if we will need \$1,000,000.00 next June for inventory or if we'll only need \$10,000.00! If we know in advance, we can appropriate the funding that is necessary. If we are short of liquidity, we will know in advance to draw on a line of credit or issue stocks/bonds. The budget has three sections: cash receipts, cash disbursements and financing. This is very similar to the statement of cash flows that you learned about in Accounting I.

After this statement is done, we then prepare a pro forma income statement and balance sheet. In this stage, we really see if we need to adjust our entire budget. For example, if the pro forma income statement shows us a loss of \$500,000.00 we would definitely be revising some of our decisions! Budget committees are usually comprised of employees from each department of the organization and report to the CFO. When the budget is ready, the CFO will submit to the Board of Directors for approval. You may find that after all that hard work, the Board is requesting revisions again. It is a work-in-process that sometimes goes on for the entire fiscal year.

Once the budget is approved and implemented, we begin our control function. We will be monitoring the actual income and expenses to compare variances to the budget. Variances must be explained to management on a regular basis. Of course in the real world, there will be variances. We cannot predict every price level or sale level for an

entire year with 100% accuracy. However, if we are proficient in our job we will come pretty darn close! I look at it as a “game”. It’s exciting to see how close you can come to the actual numbers each year.

**** Video Alert****

I found really good videos for you on Youtube. These introduce us to the master budget and the associated schedules:

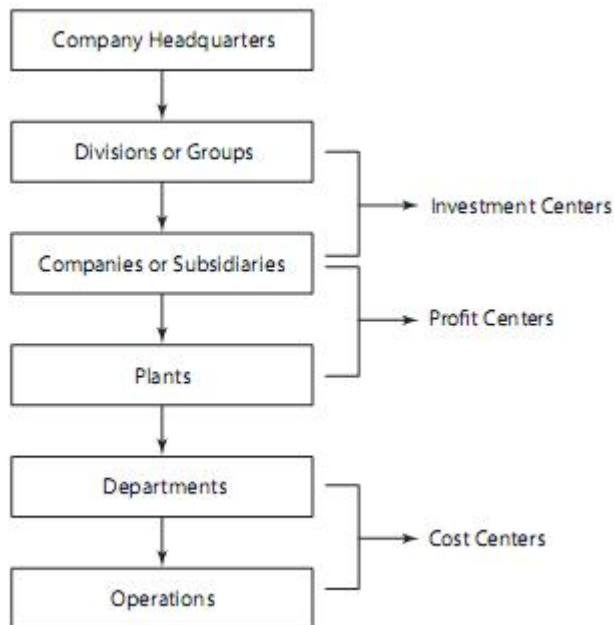
<http://www.youtube.com/watch?v=e83vfYTd34U>

<http://www.youtube.com/watch?v=CMvYWi8EMeE>

Responsibility Centers

An effective way to manage a company is to segregate the departments in to responsibility centers. These are made up of profit centers, cost centers and investment centers. In the profit center, all focus is on profits. See if you can think of some examples of this!

The cost center focusses on costs. And lastly, the investment center handles the excess cash to invest. The investment center is usually run by upper management of the company.



****Web Site Alert****

As I've always mentioned, careers in Accounting are amazing. Here is a web site that details some of the choices you may have:

<http://member.accountingcoach.com/explanations/PDF/AccountingCareers.pdf>



Enjoy your week!

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Reference

Edmonds, T. Olds, P., McNair, F., & Tsay, B. (2012). *Survey of Accounting* (3rd ed.). New York, NY: McGraw-Hill Irwin.
