

Monyetla Project – Accounting Gr 11

Lesson 4: Budgeting notes

CASH BUDGETS

The main aim of any business is to make the maximum profits possible. Thorough planning and control are necessary to realize this goal and thus to survive in the business world which is highly competitive – both nationally and globally.

Budgeting forms an integral part of this planning.

Budgeting involves drawing up a **plan for the activities of the business** for a specific future period of time. Such a plan is:

- expressed in terms of **money**
- based on **forecasts** of amounts coming in (receipts) and going out (payments) during this period

When preparing a cash budget, ask yourself the following two simple questions:

Budgets should be checked and adapted regularly (sometimes once a week) to fulfill its important function as a **planning, coordinating and control tool of receipts and payments**.

Budget periods

- Long-term budget

The long-term budget indicates the direction the business is taking and is usually drawn up for more than one year up to ten years. It includes predictions and planning for the possible expansion of activities, staff provision and acquisition of fixed assets.

- Short-term budget

The short-term budget usually covers a period of one year, but can also be compiled for periods as short as one month. A short-term budget is much more detailed than a long-term budget and focuses on aspects such as expected sales and purchases, payment of short-term obligations and cash flow.

Budgets and internal control

Management must continually receive feedback from the different divisions of the business. A good way of exerting control over different divisions is by comparing budgets and actual figures with one another.

USERS OF BUDGETS

Besides the business using budgets to regulate its financial activity, there are other users who benefit from drawing budgets:

- **The learner at school** has to work out how best to spend her monthly pocket allowances for items such as movie tickets, entertainment, tuck shop, etc.
- **The bread winner** (father or mother) has to work out how much he can afford to pay for the various items such as food, transport, monthly bond, clothing, water and electricity, telephone, medical, etc from one monthly salary.
- **The weekly earner** has to work out how much she can afford to pay for the various items such as food, transport, monthly bond, clothing, water and electricity, telephone, medical, etc from one weekly wage.
- **The church** has to work out how best to use the income from contributions and donations to pay for electricity, repairs and caretaker's wages and other running expenses.
- **The informal trader** has to calculate at what price goods must be sold to make a reasonable profit after she has covered expenses.
- **Educational institutions (schools)** must prepare a budget. The budget takes into account all expected income from school fees, fundraising and the tuck shop and expected expenses incurred in the next academic year.
- **The government** has got national budgets, provincial budgets and local budgets, to promote the smooth running of the economy of the country.

THE PERSONAL BUDGET

When preparing a cash budget, ask yourself the following two simple questions:

1. How much money (cash) will be received over the budget period?
2. How much money (cash) will be paid over the budget period?

So, it is about **MONEY**



Private individuals can draw up a budget showing their income and expenses for the week or month.

Example 1

Suzie Smith tells you that she has R320 in her bank account on 1 January 2012. Complete Suzie's cash budget for January and February 2012 using the information below.

Receipts

1. Suzie receives a monthly allowance of R500
2. Her birthday is on the 2 February and she will receive R800 from her family and friends
3. Suzie walks her neighbours dogs for extra money. In this way she earns R200 per month

Payments

1. Suzie plans to save R300 during January and R600 during February and will deposit this money into her savings account
2. She spends R200 per month at the school's tuck shop
3. Suzie plans to go to the movies once a month. A movie ticket costs R40
4. It is her friend John's birthday on 15 February and Suzie will buy him a CD costing R120
5. She plans to spend R300 on clothing during February

CASH BUDGET OF SUZIE SMITH

	January	February
Cash Receipts		
Monthly allowance	500	500
Birthday gift		800
Money for walking dogs	200	200
Total Receipts	700	1 500
Cash Payments		
Savings	300	600
Tuck shop	200	200
Movies	40	40
Gift for John		120
Clothes		300
Total Payments	540	1 260
Cash surplus	160	240
Bank balance beginning of the month	320	480
Bank balance end of the month	480	720

Suzie starts with R320 in her bank account, but if she sticks to her budget, she will have R720 in her bank account at the end of February

THE FORMAL CASH BUDGET

When a cash budget is drawn up, it only predicts and plans for the **inflow and outflow of cash**. If the cash budget predicts that the business will experience a cash shortfall in a particular month, management can make arrangements with the bank or come up with an alternative plan in advance.

The cash budget indicates:

- the bank balance at the beginning of the month
- a prediction of cash that will flow into the business
- a prediction of cash that will flow out of the business
- the estimated bank balance at the end of the month

CASH BUDGET

		Month
	Cash Receipts	
1.	Cash sales	
2.	Cash from debtors	
	Total Receipts	xx
	Cash Payments	
1.	Cash purchases	
2.	Payments to creditors	
	Total Payments	xx
=	Cash surplus/shortfall	
+/-	Bank balance beginning of the month	
=	Bank balance end of the month	xx

Forecast receipts and payments

Receipts (cash inflow)	Payments (cash outflow)
Cash sales	Cash purchases of goods
Cash from debtors (Debtors collection schedule)	Payments to creditors (Creditors payments schedule)
Proceeds from sale of fixed assets	Purchase of fixed assets
Income from investments, eg interest	Investments, eg Fixed Deposit
Loans received	Loan repayments
Operating income, eg rent income	Operating expenses, eg insurance
	Withdrawal of money

The following will not be included in the budget, since it does not involve cash (non-cash items)
Bad debts
Depreciation
Discount allowed
Discount received
Withdrawal of trading stock/stationery
Profit/Loss on sales of asset

CASH BUDGET OF A TRADING BUSINESS

Many businesses adopt a "cash only" policy. But many business houses offer credit facilities to the buying public. The majority of consumers make use of these facilities. To obviate the risk of credit trading, many businesses encourage their customers to pay by debit cards and credit cards – from the point of view of the business such transactions are treated as cash.

There are also those businesses which grants credit whereby a credit agreement is entered into with the customer. The trader will need to decide on the credit terms to be allowed, eg 30 days, 60 days or 90 days. It is important that the customer is made aware of the credit terms, that if an account becomes overdue he may be charged interest or if he pays before a stipulated day he may be entitles to a cash discount.

CREDIT SALES → DEBTORS COLLECTION SCHEDULE

A careful study of the payments pattern of credit customers is necessary so that future inflows and outflows of cash can be budgeted for. Historical records may reveal that collection from debtors are spread over a few months.

A Debtors Collection Schedule is drawn up to record the expected collections from debtors.

Example 2

Calculate the expected collection from debtors for Sunrise Traders during the months of March, April and May. Credit sales were as follows:

	Actual	Budgeted
January	32 000	
February	33 000	
March		39 000
April		60 000
May		24 000

Debtors usually settle their debts as follows:

50% during the month of sales (the same month)

30% during the month following the month of sales (the next month)

18% during the second month of sales (two months after sale)

2% irrecoverable (bad debts)

Why are the credit sales for January and February actual and those for March, April and May budgeted?

Because we are now at the end of February, so January and February are in the past, and we are going to budget (projected) for March, April and May (collection period – in the future).

Note! Always start with the first month given to you (January) because there is still money for January receivable in the collection period.

Remember! Only credit sales

Memo:

Debtors Collection Schedule of Sunrise Traders

Month	Credit sales	Collection period		
		March	April	May
January	32 000	5 760	-	-
February	33 000	9 900	5 940	-
March	39 000	19 500	11 700	7 020
April	60 000	-	30 000	18 000
May	24 000	-	-	12 000
		35 160 *	47 640 *	37 020 *

* The amount that we are going to take to the Cash Budget – Cash from Debtors

What about the bad debts?

Bad debts is a non-cash item that will not be included in the Cash Budget. Sometimes they will add a column in the Debtors Collection Schedule for Bad debts – Bad debts can only be written off in the month after the last leg, for example the bad debts for the January credit sales can be written off in April, because we are going to receive the money from the Debtors in January, February and March.

Example 3

Given the following information in respect of Mallet Traders, you are required to prepare the Debtors Collection Schedule for the three-month period 1 October 2007 – 31 December 2007

	Actual Sales	Budgeted Sales
July	12 000	
August	16 000	
September	12 000	
October		8 000
November		12 000
December		20 000

Additional information:

1. Cash sales is 25% of total sales.

2. Debtors pay according to the following pattern:

- 60% one month after date of sale (next month) – less 5% discount
- 25% two months after date of sale (after 60 days)
- 12% three months after date of sale (after 90 days)
- 3% never pay and are written off

Calculations:

	Sales	Cash 25%	Credit 75%
July	12 000	3 000	9 000
August	16 000	4 000	12 000
September	12 000	3 000	9 000
October	8 000	2 000	6 000
November	12 000	3 000	9 000
December	20 000	5 000	15 000

What are you going to use in the Debtors Collection Schedule? Only the Credit sales

Memo:

Debtors Collection Schedule of Mallet Traders

Month	Credit sales	Oct	Nov	Dec	Bad debts
July	9 000	1 080	-	-	270
August	12 000	3 000	1 440	-	360
September	9 000	5 130	2 250	1 080	270
October	6 000	-	3 420	1 500	-
November	9 000	-	-	5 130	-
December	15 000	-	-	-	-
		9 210	7 110	7 710	900

CREDIT PURCHASES → CREDITORS PAYMENT SCHEDULE

Stock purchases may be for cash or credit. Cash purchases are simply recorded in the cash budget in the month of the purchase. When preparing a cash budget where credit purchases are involved the following need to be considered:

- the credit terms allowed by suppliers (60/90 days) and any discounts allowed for early settlement of accounts
- the stock replenishment policy of the business regarding the maintenance of a base stock level, thus a minimum amount of stock which will be on hand to be able to meet customers' requirements → stock are kept at constant levels

Example 4

The information given was extracted from the books of Bazuko Traders. Calculate the amounts payable to the creditors for the period 1 January 2008 – 31 March 2008

Information:

	Total Sales	
	Actual	Budgeted
November 2007	24 500	
December 2007	39 000	
January 2008		28 000
February 2008		21 000
March 2008		17 500

Additional information:

1. Cost of sales is equal to 50% of turnover (sales)
2. Cash purchases of trading stock amount to 20% of all purchases
3. Creditors allow the business 60 days credit. These terms will be complied with
4. Trading stock sold each month is replenished in the same month – stock are kept at constant levels

Calculations:

	Sales	Purchases (Cost of sales) $\times 50/100$	Cash 20%	Credit 80%
November	24 500	12 250	2 450	9 800
December	39 000	19 500	3 900	15 600
January	28 000	14 000	2 800	11 200
February	21 000	10 500	2 100	8 400
March	17 500	8 750	1 750	7 000

The Cash Budget → remember the Creditors allow the business 60 days (2 months)!

Memo:

Cash Payments	Jan	Feb	Mar
Payments to creditors	9 800 (Nov)	15 600 (Dec)	11 200 (Jan)

Example 5

Use the information to draw up the Cash Budget of Show Traders for the period 1 June 2007 – 31 July 2007

Information:

1. Actual sales: April R50 000, May 40 000
 Expected sales: June 50 000, July 60 000
2. Credit sales amounted to 50% of total sales
3. Debtors paid their accounts as follows:
 - 30% in the month in which the transaction took place (in 30 days)
 - 60% in the following month (in 60 days)
 - 8% in 90 days
 - 2% irrecoverable after 90 days
4. 60% of purchases are for cash and stock are kept at constant levels, i.e. sold goods replaced in the same month
 Profit on cost price is 25%.
 Creditors are paid after two months (60 days)
5. The rent is received monthly and increases annually by 15% on 1 July. The rent for June was R1 800
6. Bad debts will amount to R1 200 in June, because one of the debtors disappeared
7. The business already has a buyer for one of the vehicles, which cost R30 000 originally. Accumulated depreciation amounts to R17 000. According to the agreement a cheque will be received for the carrying value on 1 July 2007. A new vehicle worth R60 000 will be purchased for cash the same day
8. An advertising campaign is planned for June 2007; R1 000 will be paid for this in June and R500 in July
9. Other operating expenses usually amount to R36 000 p.a. and this is distributed evenly
10. The business is planning to take out a loan of R70 000 during July 2007
11. The owner withdraws R2 000 cash monthly, as well as stationery worth of R600 in June
12. Equipment of R8 000 will be purchased in June 2007. Half of the amount will be paid in June and the other half in August 2007
13. Cash in the bank on 1 June 2007, R14 582

Calculations:

	Sales	Cash 50%	Credit 50%	Purchases x 100/125	Cash 60%	Credit 40%
April	50 000	25 000	25 000	40 000	24 000	16 000
May	40 000	20 000	20 000	32 000	19 200	12 800
June	50 000	25 000	25 000	40 000	24 000	16 000
July	60 000	30 000	30 000	48 000	28 800	19 200

Memo:**DEBTORS COLLECTION SCHEDULE OF SHOW TRADERS**

	Credit Sales	June	July
April	25 000	2 000	-
May	20 000	12 000	1 600
June	25 000	7 500	15 000
July	30 000	-	9 000
		21 500 *	25 600 *

CASH BUDGET OF SHOW TRADERS**Budget period: 1 June – 31 July 2007**

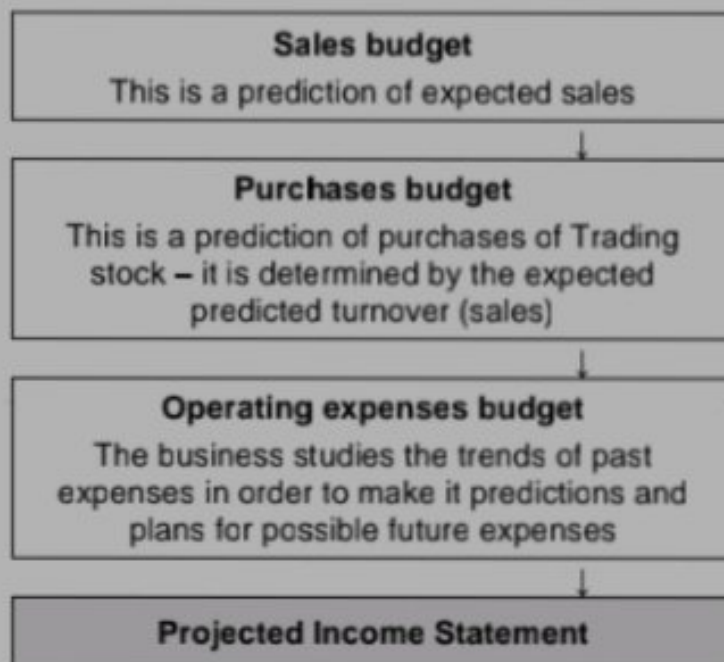
	June	July
Cash Receipts		
Cash sales	25 000	30 000
Cash from debtors *	21 500	25 600
Rent income	1 800	2 070
Loan		70 000
Proceeds from asset disposal		13 000
Total Receipts	48 300	140 670
Cash Payments		
Cash purchases	24 000	28 800
Payments to creditors	16 000	12 800
Vehicle		60 000
Advertising	1 000	500
Operating expenses	3 000	3 000
Equipment	4 000	
Drawings	2 000	2 000
Total Payments	50 000	107 100
Cash surplus/shortfall	(1 700)	33 570
Bank (opening balance)	14 582	12 882
Bank (closing balance)	12 882	46 452

PROJECTED INCOME STATEMENT

The business must prepare an operating budget, which contains the planning and predictions for its future business activities. This is necessary in order to determine whether the business will keep making a profit or, for example, need to cut back on its expenses.

Most businesses have quiet and busy times in the year. For example, a business near the sea that trades in diving and fishing equipment may establish that it needs more stock and additional staff in December, while the opposite may be true during the winter months.

The operating budget consists of a Projected Income Statement which, in turn, contains the sections below.



A Cash Budget looks at future inflows and outflows of cash. The budget indicates the expected bank balances during each month of the budget period.

A Projected Income Statement looks at expected income and expenses during the budget period. This statement shows the expected net profit in the future.

In order to prepare a Projected Income Statement, the following information is required:

- an Income Statement for the past year or month
- expected monthly sales figures or growth rate for the budget period
- percentage gross profit margin on cost of sales or turnover
- expected other income
- expected operating expenses payable
- expected interest payable on loans
- expected non-cash expenses such as depreciation and bad debts

The following will be included in the Projected Income Statement (non-cash items)
Bad debts
Depreciation
Discount allowed
Discount received
Withdrawal of trading stock/stationery
Profit/Loss on sale of asset

When preparing a Projected Income Statement, you must take adjustments into account because this Income Statement looks at expected income and expenses during the budget period.

Example 6

The following information was extracted from the records of Benna Stores for the month ended 30 November 2008.

Required:

Prepare the monthly Income Forecast/Projected Income Statement for the 3 months ended 28 February 2009

INCOME STATEMENT OF BENNA STORES FOR THE MONTH ENDED 30 NOVEMBER 2008

	R
Sales	250 000
Cost of sales	(125 000)
Gross profit	125 000
Operating income	2 500
Rent income	2 500
Gross operating income	127 500
Operating expenses	(116 100)
Salaries	96 000
Depreciation	3 000
Stationery	900
Advertising	7 200
Bad debts	3 000
Insurance	1 200
Sundry expenses	4 800
Operating profit	11 400
Interest income (on fixed deposit)	100
Operating profit before interest expense	11 500
Interest expense	-
Net profit for the month	11 500

Information:

1. Sales forecast:
 - Sales are expected to increase by 60% in December
 - In January a decrease of 20% on December sales is expected
 - Sales in February are expected to amount to R324 000
2. The existing gross profit margin on cost will be maintained during December and January. In February this will be lowered by 20%.
3. Bad debts are calculated at 3% of the expected turnover (credit sales). 40% of the sales during the budget period is on credit.
4. Four temporary workers will be employed for two weeks in December. They will be paid R1 500 each. Permanent employees receive an annual increase of 8% effective from 1 January 2009.
5. Rent increase by 15% per annum on 1 January each year.
6. The interest on the investment will remain constant during the budget period.
7. Depreciation is calculated at 15% p.a. on cost. Additional equipment costing R4 000 would be purchased for cash on 1 February 2009.
8. Other expenses are expected to remain constant.

**PROJECTED INCOME STATEMENT OF BENNA STORES FOR THE THREE MONTHS
ENDING 28 FEBRUARY 2009**

	Dec	Jan	Feb
Sales	400 000	320 000	324 000
Cost of sales	(200 000)	(160 000)	(180 000)
Gross profit	200 000	160 000	144 000
Operating income	2 500	2 875	2 875
Rent income	2 500	2 875	2 875
Gross operating income	202 500	162 875	146 875
Operating expenses	(123 900)	(124 620)	(124 718)
Salaries	102 000	103 680	103 680
Depreciation	3 000	3 000	3 050
Stationery	900	900	900
Advertising	7 200	7 200	7 200
Bad debts	4 800	3 840	3 888
Insurance	1 200	1 200	1 200
Sundry expenses	4 800	4 800	4 800
Operating profit	78 600	38 255	22 157
Interest income (on fixed dep)	100	100	100
Operating profit before interest expense	78 700	38 355	22 257
Interest expense	-	-	-
Net profit for the month	78 700	38 355	22 257