

Foundations of Accounting & Finance

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Week - 09

Lecture – 38

Introduction to Budgeting: Preparation of Budgets - Part II

Example

Minden Company is a wholesale distributor of premium European chocolates. The company's balance sheet as of April 30 is given below:

Minden Company Balance Sheet Apr-30	
Assets	
Cash	\$ 9,000
Accounts receivable	54,000
Inventory	30,000
Building and equipment, net of depreciation	2,07,000
Total asset	\$ 3,00,000
Liabilities and Stockholders' Equity	
Accounts payable	\$ 63,000
Notes payable	14,500
Common stock	1,80,000
Retained earning	42,500
Total liabilities and stockholders' equity	\$ 3,00,000

The company is in the process of preparing a budget for May and has assembled the following data:

a. Sales are budgeted at \$200,000 for May. Of these sales, \$60,000 will be for cash; the remainder will be credit sales. One-half of a month's credit sales are collected in the month the sales are made, and the remainder is collected in the following month. All of the April 30 accounts receivable will be collected in May.

b. Purchases of inventory are expected to total \$120,000 during May. These purchases will all be on account. Forty percent of all purchases are paid for in the month of purchase; the remainder are

paid in the following month. All of the April 30 accounts payable to suppliers will be paid during May.

c. The May 31 inventory balance is budgeted at \$40,000.

d. Selling and administrative expenses for May are budgeted at \$72,000, exclusive of depreciation. These expenses will be paid in cash. Depreciation is budgeted at \$2,000 for the month.

e. The note payable on the April 30 balance sheet will be paid during May, with \$100 in interest. (All of the interest relates to May.)

f. New refrigerating equipment costing \$6,500 will be purchased for cash during May.

g. During May, the company will borrow \$20,000 from its bank by giving a new note payable to the bank for that amount. The new note will be due in one year.

Required:

1. Calculate the expected cash collections for May.
2. Calculate the expected cash disbursements for merchandise purchases for May.
3. Prepare a cash budget for May.
4. Prepare a budgeted income statement for May.
5. Prepare a budgeted balance sheet as of May 31.

Solution

1) Schedule of expected cash collections for May

Let us focus for the month of May in this analysis. The same format will be maintained for clarity. Starting with the schedule of cash collections for May:

1. Cash Sales for May: The sales budget for May is 2 lakhs, out of which 60,000 will be in cash.
2. Collection from Credit Sales of May: The total sales for May is 2 lakhs, with 60,000 in cash sales. Therefore, the credit sales amount to 1,40,000. As per the payment terms, half of the credit sales are collected in the month of sale, and the remainder is collected in the following month. So, for May, the collection from credit sales is half of 1,40,000, which is 70,000.
3. Collection of Accounts Receivable: All accounts receivable as of April 30th will be collected in May. The accounts receivable for May amounts to 54,000.

Total Cash Collection for May:

Adding up the cash sales, collection from credit sales, and collection of accounts receivable, the total cash collection for May sums up to 184,000.

Schedule of cash collections for May	
Cash sales for May	60,000
collection from credit sales of May	70,000
collection of accounts receivable	54,000
Total cash collection in May	1,84,000

2) Schedule of expected cash disbursements for merchandise purchases for May

Let us proceed to the next question regarding cash disbursements for the month of May. We'll start by outlining the schedule of cash disbursements for merchandise purchases in May.

1. Purchase of Expected Inventory: In May, the expected inventory purchase is 120,000, all of which will be on account (credit).
2. Payment Terms: According to the terms, 40 percent of all purchases are paid for in the month of purchase, with the remaining amount paid in the following month.
3. Payment for Credit Purchases in May: Calculating the payment for credit purchases in May, we start with the purchase amount for May, which is 120,000. Forty percent of this amount, which is 48,000, is paid in the month of purchase.
4. Payment on Accounts Payable: All accounts payable to suppliers as of April 30th will be paid in May. The accounts payable for May is 63,000, as indicated in the balance sheet.

Total Cash Disbursements for May:

Summing up the payment for credit purchases in May and payment on accounts payable, we arrive at the total cash disbursements for May.

Schedule of cash disbursements for the month of May	
payment for credit purchase in May	48,000
payment for accounts payable	63,000
Total cash disbursement for May	1,11,000

3) Cash budget for May

Let us proceed with preparing a cash budget for the month of May.

1. Opening Cash Balance: The opening cash balance for May is 9,000.
2. Cash Collections: The total cash collections for May is \$184,000 (calculated from the first question).
3. Less Cash Disbursements for Purchases: Subtract the cash disbursements for merchandise purchases worth \$111,000 from the total cash available (calculated from the second question).
4. Less Selling and Administrative Expenditure: The selling and administrative expenditure for May is 72,000, exclusive of depreciation.
5. Less Purchase of Equipment: Deduct the cash paid for the purchase of equipment of \$6,500.
6. Excess Cash Available After Disbursements: Calculate the excess cash available after deducting all disbursements.
7. New borrowings and notes Payable: Pay off the notes payable from April (\$14,500) and account for new borrowings (\$20,000). Subtract the interest on old notes payable (\$100).
8. Net Cash Balance Available: Calculate the final net cash balance available after accounting for all transactions

The net cash balance available at the end of the period is \$3,500, considering borrowings, repayments, and interest payments. This amount represents the total cash available after all cash inflows and outflows for the month of May.

Cash budget for the month of May	
opening cash balance	9,000
cash collection in May	1,84,000
Total cash available	1,93,000
Less cash disbursement for purchase	1,11,000
Less selling and admin exp	72,000
less purchase of equipment	6,500
EXCESS cash available after disbursements	3,500
new borrowings	20,000
Less note payable paid	14,500
less interest on note payable	100
NET CASH BALANCE AVAILABLE	8,900

4) budgeted income statement for May

Let us prepare the budgeted income statement for the month of May.

1. Sales: The total sales for May amount to 200,000.
2. Cost of Goods Sold (COGS): To calculate COGS, we consider the beginning inventory, purchases, and ending inventory. Beginning inventory from the balance sheet is 30,000. Purchases for the month are 120,000, making the total material available 150,000. Deducting the ending inventory of 40,000, we find that the total material consumed is 110,000. This constitutes the COGS.
3. Gross Margin: The gross margin is the difference between sales and COGS amounted to \$90,000.
4. Selling and Administrative Expenditure: The selling and administrative expenditure for May amounts to 72,000.
5. Depreciation: Depreciation expense is 2,000.
6. Net Operating Income: Subtract the total operating expenses (selling and administrative expenditure plus depreciation) from the gross margin to find the net operating income of \$16,000.
7. Interest Expense: Deduct the interest expense of \$100 from the net operating income to calculate the net income.

The net income for May is 15,900, considering the interest expense.

Budgeted income statement for the month of May			
Sales		2,00,000	
COGS			
Opening inventory	30,000		
purchase of material	1,20,000		
total material available	1,50,000		
less ending inventory	40,000		
Total material consumed		1,10,000	
Gross margin		90,000	
selling and admin		72,000	
depreciation		2,000	
net operating income		16,000	
Less interest cost		100	
NET INCOME		15,900	

5) Budgeted balance sheet

Let us prepare the budgeted balance sheet for the month of May.

Assets:

1. Cash: The net available cash balance is 8,900.
2. Accounts Receivable: Total credit sales for May are 140,000, of which 70,000 has been received. Therefore, the accounts receivable is 70,000.
3. Inventory: The ending inventory for May is calculated to be 40,000.
4. Building Equipment (Net of Depreciation): The value of building equipment is 205,000. Additionally, a new refrigerator was purchased, adding 6,500 to the value, resulting in a total of 211,500.

Total Assets: Sum of the above amounted to \$330,400

Liabilities and Stockholders' Equity:

1. Accounts Payable: Purchases for May amount to 120,000. 40% is paid in the month of purchase, so the accounts payable is 72,000.
2. Notes Payable: There is a new borrowing of 20,000, and the previous note payable of 14,500 is paid off.

Stockholders' Equity:

1. Common Stock: The common stock is 180,000.

2. Retained Earnings: The retained earnings consist of the previous balance plus the net income for May, resulting in a total of 58,400.

Total Liabilities and Equity: Sum of liabilities and stockholders' equity amounted to \$330,400

budgeted balance sheet for the month of May	
<i>Assets</i>	
<i>cash</i>	<i>8,900</i>
<i>Accounts receivable</i>	<i>70,000</i>
<i>inventory</i>	<i>40,000</i>
<i>Building equipemnt net of dep</i>	<i>2,11,500</i>
TOTAL ASSETS	3,30,400
<i>Liabilities and stockholders equity</i>	
accounts payable	72,000
notes payable	20,000
common stock	1,80,000
retained earnings	58,400
total liabilities and equity	3,30,400