REVIEW FOR EXAM NO. 3, ACCT-2302 (SAC)
(Chapters 20-22)

A. Chapter 20 (Master Budgets and Performance Planning).

1. Budget.
   a. A plan detailing the acquisition and use of financial and other resources in the future, which is expressed in financial terms.

   b. The usual budget period is an annual period, broken down into quarterly and monthly budgets.

2. Master Budget. (Page 773)

   a. Preparation is usually the responsibility of a budget committee.

   b. Set of interrelated budgeted financial statement and supporting schedules that constitutes a plan of action for an entire organization for a specified time period. The major parts of the master budget are:

      (1) Operating Budgets
      (2) Capital Expenditures Budget
      (3) Financial Budgets

   c. Operating Budgets. (Page 775)

      (1) Sales budget (cornerstone of the master budget, **prepared first**) (Page 776)
      (2) Production budget (Page 776)
      (3) Direct Materials Budget (Page 777)
      (4) Direct Labor Budget (Page 778)
      (5) Factory Overhead Budget (Page 779)
      (6) Selling and Administrative Expense Budget (Pages 780)

   d. Capital Expenditures Budget. (Page 781)

      Acquisition and disposal of plant assets over an extended period of years (long-term).

   e. Financial Budgets.

      (1) Cash budget; schedule of budgeted cash receipts and disbursements (Page 781)
      (2) Budgeted Income Statement (Page 785)
      (3) Budgeted Balance Sheet (Page 786)

B. Chapter 21 (Flexible Budgets and Standard Costs).

1. Budget Types.

   a. Fixed (Static) Budget (Page 822)

      (1) Shows the expected results of a responsibility center for only one level of activity.
      (2) A major disadvantage is that a static budget does not adjust for changes in activity levels.

   b. Flexible Budget (Page 823)

      (1) Shows the expected results of a responsibility center for several levels of activity.
      (2) Essentially a series of budgets at the various levels of activity.

2. Purposes of Standards. (Page 825)

   a. Serves as a benchmark or norm for measuring performance.
   b. Preset costs for delivery of a service or product under normal conditions.
   c. Can be used to control operations.

3. Benefits of Standards. (Page 825)

   a. Useful in preparing budgets.
   b. Used to control operations and to evaluate performance.
   c. Help in setting realistic selling prices.

4. Setting Standards. (Page 826)

   a. Types of Standards.

      (1) Ideal (Theoretical) - defined as standards under perfect conditions, no idle time, no materials spoilage, no machine breakdowns, etc.
      (2) Normal or Practical (Currently Attainable) - Those that are tight but attainable (allow for normal downtime, rest periods, mistakes, materials spoilage, etc.).
      (3) Standards are pre-set costs for delivering a product or service under normal conditions.

   b. Three-Step Process.

      (1) Determine price standard.
      (2) Determine quantity standard.
      (3) Determine standard cost of a unit (price std x quantity std)

5. Cost Variance Analysis. (Page 826)

   a. The process of examining the differences between actual and budgeted costs.
   b. Cost variance is the difference between actual price and standard price.
   c. Efficiency variance is the difference between actual quantity and standard quantity.

6. General Model/Formulas for Variance Analysis. (Page 828)

   a. Reference format given as part of chapter lecture.

   b. Elements.

      (1) Actual Quantity x Actual Cost (AQ x AC)
      (2) Actual Quantity x Standard Cost (AQ x SC)
      (3) Standard Quantity x Standard Cost (SQ x SC)

   c. Variances.

      (1) Cost (Price)= (AQ x AC) - (AQ x SC) *or* **AQ(AC-SC)**
      (2) Efficiency (Quantity) = (AQ x SC)-(SQ x SC) *or* **SC(AQ-SQ)**
      (3) Total Variance = Difference between Cost Variance and Efficiency Variance
      (4) Each variance is expressed either as favorable (F) or unfavorable (U).

   d. Analysis.

      (1) Variances are computed for each cost category (material, labor, and overhead).
         (a) Materials (Price and Quantity)
         (b) Labor (Rate and Efficiency)
      (2) Management by Exception - only areas of unusually good or bad performance are examined.

7. Performance Report. (An internal management report that compares actual cost and sales amounts with budgeted amounts, and identifies the differences as either favorable or unfavorable).

C. Chapter 22 (Performance Measurement & Responsibility Accounting).

1. Responsibility Accounting. (Page 865)

   a. Primary Goals:
      (1) Provide information for use in performance measurement (profitability/cost effectiveness).
      (2) Assign costs to managers who are responsible for controlling costs.

   b. Responsibility Centers. (Page 865)

      (1) Cost Center - Accountable for costs (expenses)only.
      (2) Profit Center - Control over revenues and costs.
      (3) Investment Center - Incurs costs, generates revenue and responsible for effective use of center invested assets.

2. Investment Center Evaluation. (Page 873)

   a. Return on Investment (ROI). (Page 873)

      (1) A measure of profitability and efficiency.
      (2) Used to evaluate the performance of investment centers.

      (3) Formula for calculation of ROI:

$$ROI = \frac{\text{Operating Income}}{\text{Average Total Assets}}$$

      (4) To examine the driving factors within ROI, the expanded version is often used.

$$ROI = \frac{\text{Operating Income}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Average Total Assets}}$$

   b. Residual Income (RI). (Page 873)

      (1) A measure of profitability and efficiency, with an added factor of a target return.
      (2) Formula for calculation of RI:

$$RI = \text{Operating income} - \text{Minimum acceptable operating income}$$
$$RI = \text{Operating income} - (\text{Target rate of return} \times \text{Average total assets})$$

3. Transfer Pricing. (Page 876)

   a. The transaction amount of one unit of goods, when the transaction occurs between divisions within the same company or business.

   b. Common Approaches to Transfer Pricing. (Page 877)

      (1) Market-based price
      (2) Cost-based price
      (3) Negotiated price

EXAM NO. 3 REVIEW PROBLEM, ACCT-2302
(Cash Budget)

A. Data:

(1) A company's past experience indicates that 60% of its credit sales are collected in the month of sale, 30% in the next month, and 10% in the second month after the sale.

(2) Cash sales represent 10% of total sales each month.

(3) Budgeted total sales for the first four months of the year:

January.........$50,000
February........ 40,000
March............ 30,000
April............. 60,000

B. Instructions:

Calculate the cash inflows expected for the month of March.

MARCH:
Cash Sales........................($__________ x _____%).................... = $__________

Credit Sales:
January receipts............ ($__________ x _____% x ______%) = $__________

February receipts.......... ($__________ x _____% x ______%) = $__________

March receipts.............. ($__________ x _____% x ______%) = $__________

Total Receipts for March................................ $__________