ACCT 1101 Revision (Lecture 1-3)

Lecture 1:

1. Accounting is the language of business

2. Private Enterprise: (p.7)
    - Service business
    - Merchandising business
    - Manufacturing business

3. Common Business forms: (p.14)
    - Sole proprietorship (like Sweet Temptations)
    - Partnership 9like KPMG)
    - Company/corporation (like JB Hi Fi Ltd)

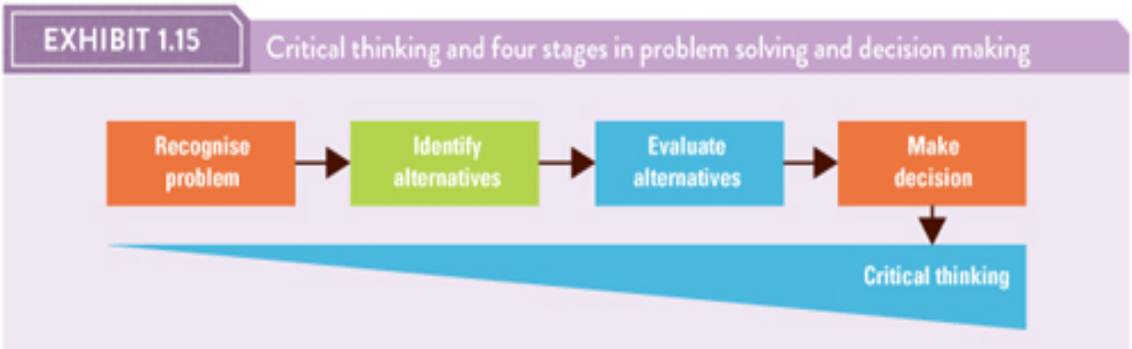
4. Choice of legal business form is an important decision because legal form determines:
    - Business owner's personal obligation for the debts of the business
    - Taxation
    - Legal/regulatory requirements including financial reporting requirements

5. – Users inside the business (managers, supervisors, work groups etc) rely on *management accounting information* to support planning, operating and evaluating activities
   -Users external to the business (like shareholders, potential investors, banker, analysts) rely on *financial accounting information* to decide whether to engage in some activity with the business (like buying some shares)

6. Management accounting information:
    - Budgets
    - Cost analysis
    - Cost reports for products and services
    - Periodic actual financial results for business sub-units
    - One-off reports reports or analysis to support non-routine decision making

7. Financial accounting information:
    - Form and content determined by GAAP
    - Generally Accepted Accounting Principles (GAAP0 are the currently accepted principles, procedures, practices and standards used in Australia for external reporting
    - Periodic reporting (annual, interim)

8. Problem Solving and Decision Making



9. PLANNING (p.18)
   - Planning is the process of thinking about and organizing the activities required to achieve a desired goal
   - Many business (both new and ongoing) prepare a business plan which sets out the business' goals and its current plans for achieving those goals
   - Planning establishes the business' goals and the means of achieving these goals, and is a key requirement for business sustainability
   - Managers use the planning process to identify what resources and employees the business needs and to set standards, or 'benchmarks', against which they can later measure the business' progress towards its goals

   OPERATING (P.18)
   - Operating refers to the set of activities that the business engages in to conduct its business according to its plan
   - Make day-to-day decisions about how best to achieve goals
   - Decide which products to continue to sell and when to add new products or drop old ones
   - Make decisions about how to set product selling prices, whether to advertise and how much to spend on advertising, and whether to buy new equipment or expand facilities

   EVALUATING (P.18)
   - Evaluating is the management activity that measures actual operations and progress against standards or benchmarks
   - It provides feedback for managers to use to correct deviations from these standards or benchmark, and to plan for the business' future operations

10. A business plan typically includes:
    - Description of the business
    - Marketing plan
    - Operating plan
    - Environmental management plan
    - Financial plan
    - Executive Summary

11. A business plan has 3 main purposes:
    - Provides managers with a detailed visualization of the business and fosters communication and critical thinking amongst decision makers
    - Creates a benchmark or standard against which to evaluate actual performance
    - Helps in obtaining finance for the business- often requested by potential lenders and investors

12. Cost analysis
    - Cost analysis, or cost accounting, is the process of determining and evaluating the cost of specific products or activities within a business

13. Projected Financial Performance
    - Net income (Profit)= Revenues – Expenses
    - <u>Revenues</u> include all the cash and credit sales for the period
    - <u>Expenses</u> include all the costs of supplying goods and services and the costs of operating the business for the period

14. Cost-Volume-Profit (CVP) Analysis

- CVP analysis (or break-even analysis) shows how profit will be affected by different sales volume, selling price and costs
- Fixed costs are constant in total for a specific time period and are not affected by differences in volume over that time period
  Variable costs change in total for a specific time period in direct proportion to changes in volume over that time period
  Total costs at any volume are the sum of the fixed costs and the variable costs at that volume
  Relevant range is the range of activity levels over which the particular cost behavior pattern (fixed) remains valid.

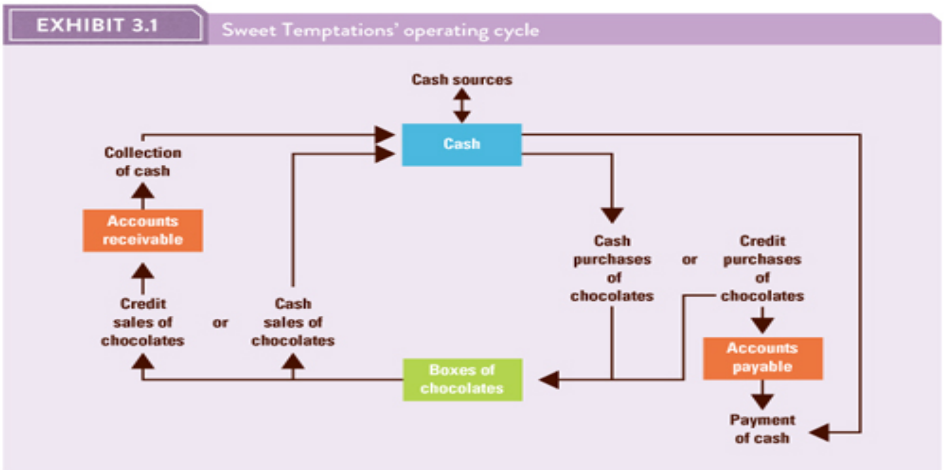
	Fixed costs	Variable costs
Total	Constant	Change
Volume	Change	Change
Unit cost	change	Constant

- The total contribution margin is the difference between total sales revenue ad total variable costs. The contribution margin per unit is the difference between sales revenue per unit and variable costs per unit
  Contribution Margin per unit = Selling Price per unit - Variable Costs per unit
- Total Costs = Total Fixed Costs + Total Variable Costs
- Net Income (profit) = Revenues – Expenses (costs)
- Net Income (profit) = Revenues – Total Variable Costs – Total Fixed Costs
- Net Income (Profit) = Total Contribution Margin – Total Fixed Costs
- Net Income (Profit) = (selling price per unit * sales volume in units) – (variable costs per unit * sales volume in units) – Total Fixed Costs
- Profit = [(selling price per unit – variable costs per unit) * sales volume in units] – Total Fixed Costs
- Profit = (Contribution margin per unit * sales volume in units) – Total Fixed Costs
- Break-even point (in units) is the volume at which total revenues = total costs (and profit = 0)
- BEP (units) = Total Fixed Costs/Contribution Margin per unit
- Contribution margin per unit ration = (Sales price per unit – Variable costs per unit)/Sales price per unit
- After tax target profit = {[target sales volume * (unit selling price – new unit variable costs)] – total fixed costs} * (1-tax rate)

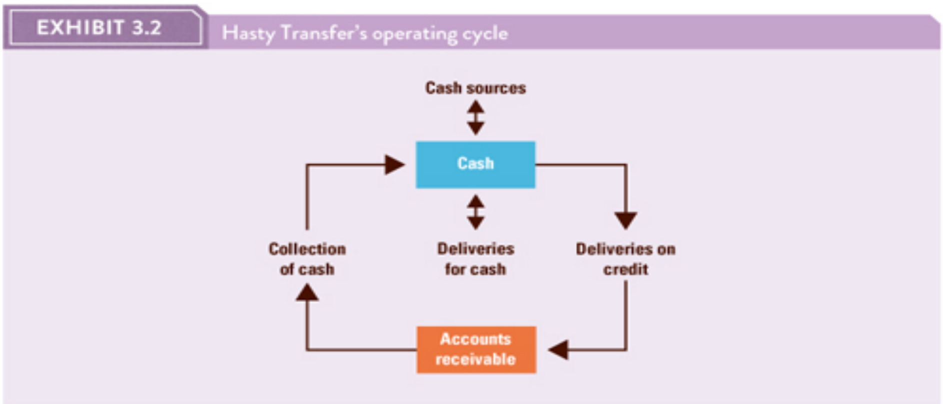
Lecture 2: Budgeting

1. Budgets
   - Budgeting is the process of quantifying managers' plan and showing the impact of these plans on the business' operating activities and financial position.
   - Budgeting is a formal part of the ongoing business planning
   - A budget is a report that gives a financial description of one part of a business' planned activities for the budget period
   - Another budget might show how much cash a business plans to spend during the same year renting business space, employing workers and advertising its products, and also when the business plans to incur these costs
   - Budgeting supports business planning, operating and evaluation processes:
     - Adds discipline- order and detail- to the planning process
       (Budgets add discipline because of their orderliness and detail)
     - Helps to identify and avoid potential problems
     - Quantifies plans – more accuracy and communication about the future
     - Creates benchmarks
       (To save time and effort, the entrepreneur uses a management principle known as management by exception)

2. Operating cycles
   - An operating cycle is the average time it takes a business to use cash to buy or produce goods or services for sale, to sell those goods or services to customers and to collect cash from it customers
   - A retail business (Sweet Temptations): is the average time it takes the business to use cash to buy goods for sale (called inventory), to sell these goods to customers, and to collect cash from its customers.



   - A service business (Hasty Transfer): is the average time it takes the business to use cash to acquire supplies and services to sell the services to customers, and to collect cash from its customers



3. The master budget
   - Master budget refers to the overall structure used to organize the budgeting process
   - The master budget is a set of interrelated reports showing:
     - Goals to be met
     - Activities to be performed in the operating cycle
     - Resources to be used
     - Expected financial results
   - A master budget and supporting CVP analysis are usually included in the financial section of a business plan
   - A master budget for a retail business like Sweet Temptations would usually include the following:
     - Sales budget
     - Purchases budget
     - Selling expenses budget
     - General and admin expenses budget
     - Cash budget (projected cash flow statement)
     - Projected income statement
     - Projected balance sheet

4. Sales budget (p.99)
   - For a retail business, the sales budget shows the number of units of inventory that the business expects to sell each month, the related monthly sales, revenue, and in which months the business expects to collect cash from these sales.

	Jan	Feb	March	Quarter
From December credit sales	17250*	-	-	**17250**
From January cash sales	54000	-	-	**54000**
From January credit sales	-	18000	-	**18000**
From February cash sales	-	56250	-	**56250**
From February credit sales	-	-	18750	**18750**
From March cash sales	-	-	63000	**63000**
From March credit sales	-	-	-	**-**
Total cash collections	**$71250**	**$74250**	**$81750**	**$227250**

5. Purchases budget (p.102)
   - It determines the best approach for purchasing the needed inventory

- The purchases budget shows the purchases (in units) required in each month to make the expected sales (from the sales budget) in that month and to keep inventory at desired levels. It also shows the costs of these purchases and the expected timing and amount of the cash payments for these purchases.

Top Cat Pet Shop Purchases Budget ($) Q1 20XX					
	Jan	**Feb**	**March**	**Quarter**	Quarter = 3 months
Budgeted unit sales (bags)	2400	2500	2800	7700	From slide 14
Add: desired ending inventory	500	560	580	580	20% x next month's sales
Total units required	2900	3060	3380	8280	Sub total
Less: beginning inventory	480	500	560	480	Last month's ending
Budgeted unit purchases (bags)	**2420**	**2560**	**2820**	**7800**	
Purchase price	$18 bag	$18 bag	$18 bag	$18 bag	Slide 14
Cost of purchases	**43560**	**46080**	**50760**	**140400**	purchases x price
Cash payment for purchases	**41940**	**43560**	**46080**	**131580**	Paid for in the next month

6. Selling expenses budget (p.105)
   - The selling expenses budget shows the expenses and related cash payments associated with planned selling activities. Examples of selling expenses include salespeople's salaries and commissions, shop rent and advertising. Each of these expenses directly relates to sales.

Top Cat Pet Shop Selling Expenses Budget ($) Q1 20XX				
	Jan	Feb	March	Quarter
Advertising expense	1500	1500	1500	4500
Sales salary expense	3000	3000	3000	9000
Rent expense	7200	7200	7200	21600
Sub total: Budgeted Fixed Selling Expenses	11700	11700	11700	35100
Variable delivery expense	2400	2500	2800	7700
Total budgeted selling expenses	**14100**	**14200**	**14500**	**42800**
Budgeted cash payments for selling expenses	**14100**	**14200**	**14500**	**42800**

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7. General and administrative expenses budget (p.107)
   - For a retail business, the general and administrative expenses budget shows the expenses and related cash payments associated with expected activities other than selling.

Top Cat Pet Shop General & Admin Expenses Budget ($) Q1 20XX				
	Jan	**Feb**	**March**	**Quarter**
Consultant's fees	500	500	500	1500
Supplies	100	100	100	300
Telephone and utilities	800	800	800	2400
Total budgeted G&A expenses	**1400**	**1400**	**1400**	**4200**
Budgeted cash payments for G&A expenses	**1400**	**1400**	**1400**	**4200**

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8. Cash budget (p.110)

- The cash budget shows the business' expected cash receipts and payments, and how they affect the business' cash balance. The cash budget is very important in cash management.
- The cash budget shows the cash receipts (inflow) and cash payments (outflows) that the business expects as a result of its plans (which is why it sometimes is called a projected cash flow statement).
- A business' cash flow statement reports its actual cash receipts and payments
- A business' investing activities include, for instance, purchases or sales of land, buildings and equipment, or investments in the stocks and bonds of governments or other businesses
- A cash budget can have three sections:
  - Operating cash flow
  - Investing cash flow
  - Financing cash flow

Top Cat Pet Shop Cash Budget ($) Q1 20XX

	Jan	Feb	March	Quarter	
Cash flows from operations:					
Receipts from customers	**71250**	**74250**	**81750**	**227250**	Slide 16
Cash payments for:					
• Purchases	(41940)	(43560)	(46080)	(131580)	Slide 18
• Selling expenses	(14100)	(14200)	(14500)	(42800)	Slide 20
• G&A expenses	(1400)	(1400)	(1400)	(4200)	Slide 22
Total cash payments	**(57440)**	**(59160)**	**(61980)**	**(178580)**	
Net cash inflow(outflow) from operations	**13810**	**15090**	**19770**	**48670**	receipts - payments
Add: Beginning cash balance	10000	23810	38900	10000	Slide 25
Ending cash balance	**23810**	**38900**	**58670**	**58670**	

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9. Projected income statement (p.112)

- A projected income statement summarizes a business' expected revenues and expenses for the budget period, assuming the business follows its plans. Note that the projected income statement is not the same as the cash budget.
- The projected income statement reports on the business' planned operating activities, whereas the cash budget reports on the expected cash receipts and payments related to those activities
- The projected income statement is important because it shows what the business' profit will be if the business follows its plans
- Differences occur because there are timing delays between the recognition of an income statement item and the time at which the related cash flow occurred.
  For example:
  - Sales revenue from credit sales
  - Goods or services purchased on credit

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Top Cat Pet Shop Projected Income Statement ($) Q1 20XX				
	Jan	**Feb**	**March**	**Quarter**
Sales revenue	72000	75000	84000	231000
Cost of pet food sold @$18 bag	(43200)	(45000)	(50400)	(138600)
Delivery expenses @$1 bag	(2400)	(2500)	(2800)	(7700)
Total contribution margin	**26400**	**27500**	**30800**	**84700**
Less:				
Fixed selling expenses	(11700)	(11700)	(11700)	(35100)
Fixed G&A expenses	(1400)	(1400)	(1400)	(4200)
Profit before tax	**13300**	**14400**	**17700**	**45400**

10. Projected balance sheet
    - Usually the Master Budget includes a Projected Balance Sheet, which sets out the expected assets, liability and owners' equity of the business at specific budget dates

11. Comparing budget and actual performance

Top Cat Pet Shop Income Report: Budget vs Actual ($) January 20XX			
	Budgeted	**Actual**	**Variance Favourable/ Unfavourable**
Sales revenue	72000	73500	1500F
Cost of pet food sold @$18 bag	(43200)	(44100)	900U
Delivery expenses @$1 bag	(2400)	(2450)	50U
Total contribution margin	**26400**	**26950**	**550F**
Less:			
Fixed selling expenses	(11700)	(11800)	100U
Fixed G&A expenses	(1400)	(1400)	-
Profit before tax	**13300**	**13750**	**450F**

Lecture 3: Developing a Master Budget

1. Why do I need a master budget?
    - A master budget is the overall structure a business uses to organize its budgeting process
    - Required forward planning and thinking through how the business will achieve its goals
    - A master budget is a set of interrelated reports (budgets) showing the relationship among a business:
        - Goals to be met
        - Activities to be performed in its operating cycle
        - Resources to be used
        - Expected financial results

2. Elements of a master budget
   Your Master Budget for a retail business is likely to contain each of the following budgets
    - Sales budget
    - Purchases budget
    - Selling expenses budget
    - General and administrative budget
    - Cash budget (projected cash flow statement)
    - Projected income statement
    - Projected Balance Sheet

3. Business background information
    - Before developing the master budget, you need to gather information about the business'
        - Operations
        - Goals
        - Objectives
    - Make assumptions about
        - Expected sales
        - Relationships with customers and suppliers
        - Labor
        - Industry and economic influences