PRACTICE QUESTIONS
BUDGETING AND BUDGETARY CONTROL

QUESTION 1

Mavuno Ltd. is a small scale company that specializes in the production of farm tools. The company uses budgets for planning and controlling its activities. Currently the management are preparing budgets for the three months ending 31 March 2006.The projected balance sheet as at 31 December 2005 is shown below:

	Cost Sh.	Depreciation Sh.	Net book value Sh.
Fixed assets	2,000,000	200,000	1,800,000
Current assets			
Inventory		320,000	
Trade debtors		630,000	
Cash and bank balances		8,400	
		958,400	
Current liabilities			
Trade creditors	28,000		
Accrued expenses	20,000		
Proposed dividend	4,000		
Taxes payable	3,500	(55,500)	902,900
			2,702,900
Financed by:			
Ordinary share capital			
100,000 ordinary shares of Sh.10			1,000,000
each.			500,000
Share premium			452,900
Retained profits			
Long term liabilities			750,000
Bank loan			2,702,900

The following information has been extracted from the company's budget schedules:

2005	Sales Sh.	Rent Sh.	Overheads Sh.	Wages Sh.	Materials stocks Sh.
November	500,000	80,000	180,000	40,000	272,000
December	340,000	80,000	180,000	60,000	320,000
2006					
January	400,000	80,000	190,000	60,000	480,000
February	600,000	80,000	200,000	80,000	464,000
March	580,000	80,000	200,000	74,000	464,000
April	580,000	80,000	200,000	70,000	500,000

Additional information:

1. The company sells the farm tools at a markup of 25 %.
2. Purchase of materials stocks is on credit and it is paid for in the month of receipt by the company
3. Employees are paid wages at the end of every week with the earnings of the last week of the month being settled in the following month (Assume one month has 4 weeks).

4. Sales commission is paid on month in arrears at the rate of 1% of sales.
5. Overheads include a monthly depreciation charge of Sh. 25,000.
6. 25% of the sales are on cash basis. The other 75% is receivable two months after the sale.
7. The company will receive a loan of Sh.2, 500,000 in the month of March 2006 from Wakulima Bank.
8. Old equipment will be sold for sh.250, 000 in February 2006 and new equipment will be purchased at Sh.1, 200,000 to replace the old equipment sold. The new equipment will be paid for in month of March 2006.
9. Rent is paid for quarterly in advance in the months of January, April, July and October

Required:
(a) Cash budget for the three months ending 31 March 2006.
(b) Budgeted trading profit and loss account for the three months ending 31 March 2006
(c) Budgeted balance sheet as at 31 March 2006.

QUESTION 2
(a) State the objectives of budgetary planning and control systems
(b) Identify the limitations of using budgeting systems to regulate business activities.
(c) Kuuda Limited manufactures one standard product. Currently, it is operating at a normal level of activity of 70% with an output of 6,300 units, although the sales director believes that a realistic forecast for the next budget period would be at a level of activity of 50%.

	Level of activity		
	60%	**70%**	**80%**
Direct materials	37,800	44,100	50,400
Direct wages	16,200	18,900	21,600
Production overheads	37,600	41,200	44,800
Administration overheads	31,500	31,500	31,500
Selling and distribution overheads	42,300	44,100	45,900
Total cost	165,400	179,800	194,200

Profit is 20% of selling price.

Required:
(i). Prepare a flexible budget based on a 50% level of activity.
(ii). State three problems which may arise from such a change in the level of activity.

QUESTION 3
Ideal Products Limited, manufactures two products A and B. For the financial year ended 30 June 2004, the following information was assembled for preparation of the budget:

Standard data per unit

Direct Materials	**Standard Price per Kg; Sh.**	**Product A Kg**	**Product B Kg**
M1	10	10	4
M2	20	4	6
Direct Labour	Standard rate per hour	Product A Hours	Product B Hours
L1	30	8	10
L2	20	12	5

The following additional information was available:
1) Fixed Production overhead costs were recovered on a direct labour basis.
2) Administration, selling and distribution costs were absorbed at the rate of 20% of production cost.
3) Profit was estimated at the rate of 25% of cost of making and selling the products.

	Product A	**Product B**
	Sh. '000'	**Sh. '000'**
Expected sales for the year	13,494	18,816

4) Finished goods stock valued at standard production cost was as follows:

	Product A	**Product B**
	Sh. '000'	**Sh. '000'**
1 July 2003	1,730	1,176
30 June 2004	1,038	1,568

5) Direct materials stock valued at standard prices was as follows:

	Material M1 Sh. '000'	**Material M2 Sh. '000'**
1 July 2003	640	600
30 June 2004	360	800

6) For the year ended 30 June 2004, 'fixed overheads had been budgeted at Sh.5,760,000 and direct labour hours budgeted at 3,600,00 110urs.
7) It is management's expectations that there will be no opening or closing work-in-progress.

Required:
a) Production budget in units.
b) Direct Material cost budget.
c) Purchases budget.
d) Direct labour cost budget.

QUESTION 4
(a) Define the term "cash budget" and explain two functions of a cash budget.
(b) The Confederation of Trade Unions of Kenya (CTUK) has announced that it will call a general strike for all production workers in textile industry. The strike will commence at the beginning of week 3 of the year beginning 1 January 2004 and is expected to continue at least for four weeks. Agoatex Ltd. a garment manufacturing company will be one of the firms that will be affected by the total interruption of supply of raw materials. The following information is available for Agoatex Ltd. for the year beginning 1 January 2004.

	Week 1	**Week 2**	**Week 3**
	Units	**Units**	**Units**
Budgeted sales	40,000	50,000	40,000
Budgeted production	60,000	40,000	Nil

The budgeted sales will continue to be made during the period of interruption until stock of finished goods is exhausted. Production will stop at the end of the second week. The current stock level of finished goods is 60,000 units. Stocks of work-in-progress (WIP) are not carried.

The product sells at Sh. 600 and the budgeted manufacturing cost is made up as follows:

	Sh.
Direct materials	150
Direct wages	70
Variable overheads	80
Fixed overheads	180
Total	480

The company operates a full absorption costing system and the fixed overhead absorption rate is based upon a budgeted fixed overhead of Sh.9,000,000 per week. Included in the total fixed overheads is Sh.7,000,000 per week for depreciation of equipment. During the period of interruption, direct wages and variable overheads will not be incurred and the cash expended on fixed overheads will be reduced by Sh.1,500,000 per week.

The current stock of raw materials is worth Sh.7,500,000. It is intended that these stock should increase to Sh. 14,000,000 by the end of week 1 and then remain at this level during the period of the strike. All direct materials are paid one week after they have been received. Direct wages are paid one week in arrears. It should be assumed that all relevant overheads are paid for immediately the expense is incurred. All sales are on credit, 70% of the sales value is received in cash from the debtors at the end of the first week after the sales have been made and the balance at the end of the second week.

The current amount outstanding of materials suppliers is Sh.8,000,000 and direct wages accruals amount to Sh.3,200,000. Both of these will be paid in week 1. The current balance owing from debtors is Sh.31,200,000 of which Sh. 24,000,000 will be received during week 1 and the remainder during week 2. The current balance of cash at bank and in hand is Sh.1,000,000.

Required:
A cash budget for weeks 1 to 6 showing the balance of cash at the end of each week together with a suitable analysis of the receipts and payments during each week.

QUESTION 5

a) Name four ways in which a company could finance a cash deficit.

b) On 1 November 2002, Digital Trading Company was in the process of forecasting cash receipts and disbursements for the two months to 31 December 2002. On this latter date, a six month term loan of Shs. 8 million would mature and be payable with the interest at 15% per annum. The trial balance of the company as at 31 October 2002showed, in part, the following:

	Sh '000'	Sh '000'
Cash	800	
Debtors	14,400	
Provision for bad debts		1,260
Stock	7,000	
Creditors		7,350

Sales terms call for a 2 per cent discount, if paid within ten days of the month after purchase with the balance due by the end of the month after purchase. Experience has shown that 70 per cent of the invoices are paid within the discount period, 20 per cent by the end of the month after purchase and 8 per cent the following month while the rest are uncollectible. All sales are on credit.

The unit sales price of the company's product is Sh 20. Actual and projected sales quantities are as follows:

Month	Units	
September 2002	520,000	(actual)
October 2002	1,000,000	(actual)
November 2002	1,200,000	(projected)
December 2002	600,000	(projected)
January 2003	480,000	(projected)

Total estimated sales for year ending 20 June 2003 is Sh 120 million.
All purchases are due for payment within fifteen days. Thus approximately 50 per cent of the purchases in a month are due and payable in the next month. Unit cost is Sh 14.
Target ending stocks at the end of each month are 200,000 units plus 25 per cent of the following month's sales.

Budgeted selling and administrative expenses for the year are Sh 32 million of which Sh 12 million is considered fixed and includes depreciation expenses of Sh 2,400,000. The remainder of selling and administrative expenses varies with sales. Fixed selling and administrative expenses are incurred evenly on a time basis. Both fixed and variable selling and administrative expenses are paid as incurred.

Required:
A statement of budgeted cash receipts, disbursements and balances for each of the months of November and December 2002.

(NB: Show supporting schedules)

QUESTION 6

Lamu Ltd produces a popular brand of biscuits which sells under the brand name "Tamu". The biscuits are sold in packets of 100 grammes at Sh 20 each.
To reduce the distribution costs, the firm is only selling its products through the supermarkets at Sh 12 per packet.

The budgeted standards for the year ended 31 December 2001 are given below:

Annual fixed manufacturing costs	Sh 560,000
Direct materials per packet	Sh 2.50
Direct labour cost per hour	Sh200.00
Variable factory overheads per hour	Sh275.00
Selling costs per unit (variable)	Sh 9.80
Output: Number of packets per hour	100
Number of working hours per week	40

At the end of the year, an analysis of the results revealed the following:

1. The actual selling price was Sh 12.75 per unit.
2. Direct material costs per packet reduced by 5%.
3. The actual production rate was 98 packets per hour, although there was no idle time.
4. All units produced were sold.
5. Actual fixed costs were Sh 480,000.
6. There was no change in the selling and distribution cost per unit.
7. Actual variable overheads amounted to Sh 550,000.

Required:

a) The original (static) budgeted income statement for the year
b) Actual income statement to the year
c) The flexed budgeted income statement for the year

QUESTION 7

a) In the context of budgetary control explain the main functions and importance of a cash budget.
b) You are in charge of making forecasts and preparing budgets.
c) You have been supplied with cost and revenue forecasts and details of payment as follows:

1. Forecast of revenue and costs for the quarter ending 31 March 2001

	January	February	March
	Shs.	**Shs.**	**Shs.**
Direct			
Materials (purchases)	112,000	100,000	135,000
Wages	90,000	80,000	100,000
Overhead			
Production	34,000	32,000	40,000
Administration	22,000	20,000	27,000
Selling and distribution	13,000	11,000	18,000
Sales	360,000	350,000	440,000

2. Forecast of revenue and costs for the quarter ending 30 June 2001

	April	May	June
	Sh.	**Sh.**	**Sh.**
Direct			
Materials (purchases)	90,000	67,000	79,000
Wages	72,000	54,000	63,000
Overhead			
Production	45,000	36,000	40,000
Administration	22,000	25,000	27,000
Selling and distribution	13,000	11,000	16,000
Sales	350,000	360,000	360,000

Cash balance on 1 April 2001 Sh. 90,000

3. Other details

- Period of credit allowed by suppliers averages two months.
- Debenture to the value of Shs.125,000 is being issued in May 2001 and the amount is expected to be received during the month.
- A new machine is being installed at the end of March 2001 at a cost of Sh150,000 and payment is promised in early May 2001.
- Sales commission of 3% is payable within one month of sales.
- A dividend of Sh 100000 is to be paid in June 2001.
- There is a delay of one month in the payment of overheads. There is also a delay in payment of wages averaging a quarter of a month.

- Twenty per cent of the debtors pay cash, receiving a cash discount of 4% and 70% of debtors pay within one month and receive a cash discount of 2 ½%. The other debtors pay within two months.

Required:
A cash budget on a monthly basis from the second quarter of the year 2001.

QUESTION 8
The following information has been assembled by Sancross Products Ltd which manufactures and retails products A and B. The details given below relate to the year commencing 1 July 200:

	Standard	**Product**	
	Price per kg	**A kg**	**g**
Direct material – M1	Sh 4	15	20
M2	Sh 5	14	12
	Standard	**Product**	
	Rate per hour	**A hours**	**B hours**
Direct labour – L1	Sh 8	20	15
L2	Sh 10	22	24

Fixed production overhead is applied on direct labour basis. Administration, selling and distribution expenses are recovered at the rate of 20% of production cost and profit loaded at 25% of standard production cost.

	Product	
	A	**B**
	Sh '000'	**Sh '000'**
Projected sales for the year	12,033	10,053

Finished goods stock position valued at production cost is expected to be as follows:

	Product	
	A	**B**
	Sh '000'	**Sh '000'**
1 July 2000	3,000	2,000
30 June 2001	5,000	4,000

Direct material stocks valued at standard prices are as follows:

	Material	
	M1	**M2**
	Sh '000'	**Sh '000'**
1 July 2000	200	250
30 June 2001	220	270

For the year to 30 June 2001, fixed production overhead has been estimated at Sh 1,800,000 and direct labour at 1,200,000 hours.

No opening or closing work-in-progress is anticipated.

Required:
a) Production budget in units.
b) Direct materials cost budget.
c) Purchases budget in value.
d) Direct labour cost budget.

QUESTION 9

(a) Given below is the budget information for BN Ltd. and the actual results for the period to 30 June 2003.

	Budget	**Actual**
Production/Sales (units)	2,000,000	1,800,000
Direct labour hours	8,000,000	7,560,000
Direct materials (Kg)	5,000,000	4,320,000
Variable overheads (Sh.)	85,000,000	90,000,000
Fixed overheads (Sh.)	80,000,000	76,000,000

The standard selling price of the product is Sh. 240 per unit while the input costs are as follows:

	Sh.
Direct labour per hour	15
Direct material per kg	25

Overheads are absorbed on a direct labour hour basis.

Required:
Prepare in columnar form the budgeted profit and loss account and flexible budget for the level of output achieved for the year ended 30 June 2003.

QUESTION 10

Limu Processing Company Ltd. manufactures a standard product branded "LM". Currently, it is operating on a normal activity level of 70% with an output of 6,300 units.
The sales director believes that a realistic forecast for the next budget period would be at an activity level of 50%.

The following data relates to the forecasted costs of the product for different levels of activity:

	60%	**70%**	**80%**
	Sh.	**Sh.**	**Sh.**
Direct materials	151,200	176,400	201,600
Direct wages	64,800	75,600	86,400
Production overheads	150,400	164,800	179,200
Administration overheads	126,000	126,000	126,000
Selling and distribution overheads	169,200	176,400	183,600
Total cost	**661,900**	**719,200**	**776,800**

Profit is 20% of selling price.

Required:

i) Flexible budget based on 50% level of activity.

ii) State three problems which might arise from such a change in level of activity.

QUESTION 11

i) Summarise four functions of a budget committee.

ii) A budgetary control system could prove successful only when certain conditions and essentials exist".

With reference to the above statement, highlight six conditions and essentials for an effective budgetary system.

QUESTION 12

a) Better Designs Ltd. manufactures a single product using a single grade of labour. Its sales budget and finished goods inventory budget for the third quarter of the year 2018 are as follows:

	Units
Sales	7,000
Opening inventories finished goods	500
Closing inventories finished goods	700

Additional information:

1. The goods are inspected only when production work is completed and it is budgeted that 10% of finished work will be scrapped.
2. Standard direct labour hours per unit is 3.
3. The budgeted productivity ratio for the direct labour is only 80% (which means that labour is working at 80% efficiency).
4. The company employs 18 direct employees who are expected to average 1,440 working hours each for the quarter.

Required:

i) Production budget for the quarter.

ii) Direct labour budget.

iii) Calculate the short-fall in direct labour hours.