Managerial Accounting

Master Budget – 50 points

Prepare a six-month budget for your manager. In addition to the budget, please prepare a brief summary memorandum, explaining the key issues you have identified during the budgeting process, and addressing the major problems or opportunities the company will experience during the 6-month period.

Prepare supporting budget schedules for the first six months of the year 2013, together with an electronic version of the reports and document. These schedules must be printouts directly from Excel or other spreadsheet programs, but make sure each attachment is self-explanatory. Be sure to include all relevant budget schedules, including *pro forma* income statements and a cash budget. Clearly identify if any loans are required, and why. You can download a sample blank budget at the course resource site.

Heron, Inc. is a company that re-sells one product, a particularly comfortable lawn chair. An overseas contractor makes the product exclusively for Heron, so Heron has no manufacturing-related costs. For the first half of 2012 and July 2012, the estimated sales *(in units)* are as follows:

Jan 10,000

Feb 11,000

Mar 12,000

Apr 14,000

May 15,000

Jun 20,000

July 18,000

The forecasted sales *(in dollars)* for November and December 2012 are $125,000 and $140,000 respectively.

Twenty percent of any month’s sales are for cash, and the remaining 80% are on credit. Ten percent of the credit sales are collected in the month of sale, 70% are collected in the following month, and 18% are collected in the second month after the sale. The remaining receivables are deemed uncollectible. Bad debts are written off in the month the debt is deemed uncollectible (e.g. if the sale is made in January and is not collected by the end of March, it is written off in March.)

The firm’s policy regarding inventory is to stock (i.e., have in ending inventory) 50% of the forecasted demand in units (i.e., estimated sales) for the next month.

Monthly sales and administrative expenses consist of the following (if these are cash expenses, they are paid when incurred):

Salaries and wages $6,000

Sales Commissions 8% of sales revenue

Rent $8,000

Other variable cash expenses 5% of sales revenue

Supplies expense $1,000

Other general and administrative overhead, not included above, is expected to be $48,000 per month. Of this amount, $24,000 represents depreciation and other non-cash expenses. Cash expenses for overhead items are paid when incurred.

Per a prior contract, a cash payment of $60,000 for equipment previously purchased is due in January. Another cash payment of $60,000 is due in April. Also, dividends of $40,000 are to be paid in May, as they have been for the previous five years.

Each lawn chair costs Heron $6 per unit. The chair has a sales price of $12/unit.

Half of the inventory purchases are paid for in the month of purchase and the remaining half are paid in the following month (i.e. all of the previous month’s Accounts Payable are paid off by the end of any month.)

Per an existing contract, the cost of each chair is scheduled to increase by 5% on Mar 1, 2013. In addition, because of increasing costs of plastic webbing, the cost is anticipated to increase by an additional 5% on May 1, 2013. To offset these increases, the company plans to raise the sales price to $14.00/unit from May 1, 2013 on. The sales forecast (i.e., estimated sales in units) takes this price increase into account.

Heron uses the first-in, first-out (FIFO) method in accounting for inventories.

The company must maintain a minimum cash balance of $15,000. Borrowing can make up shortfalls. For simplicity, assume that the bank will only lend (and accept repayments) in $1,000 increments. Ignore interest on the loan in your calculations, but minimize the amount borrowed and pay off any loans as soon as possible.

Cash on hand as of December 31, 2012 is expected to be $20,000. In addition, there will be no notes payable as of this date.

Notes & Hints...

If you feel that some critical piece of information is missing, make and highlight an appropriate assumption.

Do not try to derive the loan balances as a result of a formula. Review the cash flow statement (i.e., cash budget) and plug in a suitable number for any loans needed and repayments. Ignore interest expense in your income statement.

It will be helpful to construct a reference row for sales in unit terms.

I recommend constructing the statements for one month and then copying the formulas over to the remaining months. I will look at the copy of your spreadsheet on your electronic copy to see what formulas you have used to develop your model.

Ignore taxes.