

Master Budget

What is the master budget?

A master budget is the combination of a series of separate but connected sub-budgets that describe a company's production and financial goals. In order to complete a master budget, company management completes the sub-budgets that make up the master budget. The order that sub-budgets are completed matters, because the outputs of the earlier budgets make up the inputs to the later budgets. By understanding the budgets that make up the master budget, you can bring the budgeting process to your company.

Operating Budgets

In this Operating Budget section, we will discuss the following budgets:

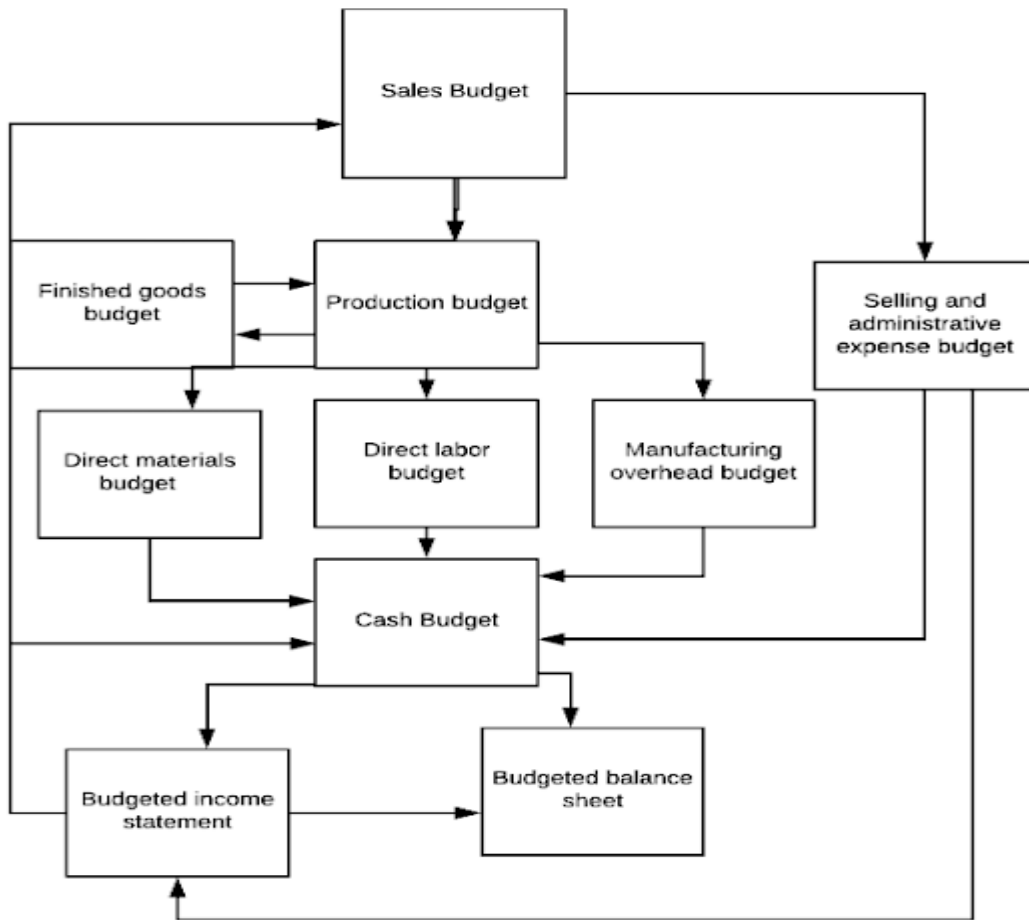
1. Sales Budget
2. Production Budget
3. Cost of Goods Sold Budget
4. Selling and Administrative Expense Budget
5. Income Statement

Financial Budgets

There are three financial budget portion of the master budget as following

1. Cash Budget
2. Budgeted Balance Sheet
3. Capital Expenditure Budget

The chart of master budget;



APPLICATIONS OF MASTER BUDGET

1) IMPORTANT PLANNING TOOL

The master budget is considered one of the most important planning tools for an organization. While planning, top-level management discusses the overall profitability and the asset and liability position of the company. For which, the master budget is being used.

2) MEASURES PERFORMANCE

Master budget measures the performance of the organization as a whole. It helps in departmental control and setting in departmental accountability. It helps in improving the efficiency.

3) INTERDIVISION COORDINATION:

The master budget is used for the interdivisional coordination amongst the divisions of the organization. It helps and ensures that coordination with the other divisions is properly made.

ADVANTAGES OF MASTER BUDGET**MOTIVATION TO STAFF**

The master budget serves as a motivation tool on the basis of which the employees can compare the actual performance with the budgeted performance. The Master Budget helps staff in getting job satisfaction as well as a good contribution to the growth of the business.

SUMMARY OF THE DIVISIONAL BUDGET

Master budget works as a summary budget for the overview of the business owners and the management. The master budget indicates how much the organization is earning and what the expenses are incurred as a whole.

PLANNING IN ADVANCE

The master budget identifies the unusual problems in advance and fixes the same. For instance, one of the company divisions is not performing well and the expenses incurred are exceeding the set budget limit. This results in the lower profitability of the company.

HELPS IN THE ACHIEVEMENT OF GOAL

The organization has short, medium and long-term goals. A master budget helps in achieving the long-term goal of the organization. All the resources of the organization are channelized and controlled for optimization of the profit.

CONTINUOUS IMPROVEMENT

The master budget is a continuous process. Each year the organization prepares the master budget and it works as a tool of analytics. The variances are identified and the worked upon for better results on a continuous basis.

DISADVANTAGES OF MASTER BUDGET**DIFFICULT TO UPDATE**

The master budget is not easy to modify. To add, alter or delete small change requires a lot of steps in the entire budget. It includes lengthy descriptions and charts. Hence, a master budget cannot be easily understood as a layman.

Master budget components:**1- Sales and Production Budgets**

Preparation of the master budget starts with a sales budget. The sales budget guides the rest of the budgeting process because the level of production, and therefore the cash needed for production, is directly dependent on the level of sales forecast. To begin the sales budget, company management usually uses current and prior year sales as a starting point to make an educated guess on the subsequent year's sales figures. Once a projected level of sales dollars is determined, this information is converted into sales units to determine the amount of units needed to satisfy the projected sales. In the production budget, this figure is adjusted by the amount of inventory the company already has on hand to determine the amount of inventory to produce.

1- Inventory and Expense Budgets

The inventory budgets, made up of the direct materials, direct labor and manufacturing overhead budgets, help the company determine how much materials, labor and overhead to expect in order to produce the amount of products that are called for in the production budget. As such, the inventory budget cannot be prepared until the production budget is completed. The sales and administrative expense budget is prepared from the sales budget. This budget helps management determine expected expenses related to sales and administrative personnel and other sales and administrative costs.

2- Cash Budget

The figures obtained from the sales, inventory and expense budgets are combined with the company's beginning-of-the-period cash balance to make the cash budget. This budget can be quite useful to a company, because it helps predict the company's cash balance at the end of each month. This is of paramount importance to seasonal firms, because the company may be solvent on an annual basis, but may not realize that certain months of the year cash shortages are expected. For

some companies, the cash budget represents the end of the budgeting process; however, other companies go on to complete budgeted financial statements.

3- Budgeted Financial Statements

Budgeted financial statements combine prior-period financial statements with the output of the budgeting process to complete projected end-of-year financial statements. This process is important for companies that have loan covenants or are required to uphold certain financial ratios as part of contractual obligations. By completing budgeted financial statements, the company can anticipate running afoul of these requirements and renegotiate the terms of the arrangement or take other actions to stay in compliance.

References

Master budget — AccountingTools. *AccountingTools*. December 2018.

Major Components of a Master Budget. *smallbusiness*. August 2019.

What is Master Budget? | What are its advantages? *Money Matters All Management Articles*. December 2015.

Homework!!

What is the purpose of budgeting? What is the master budget, and what are its major components? How does a top down budgeting process differ from a bottom up approach, and what are the advantages and disadvantages of each?