

Unit F292: Business Functions

Accounting and finance

Chapter 23

Budgets

Questions

- 1** It is important for a business to set a budget:
- to provide a measure of success
 - to provide a method of control, ensuring that expenditure is kept to a sustainable level
 - to provide a sense of direction and a source of motivation
 - to allow delegation/decentralisation to departments
 - to encourage efficiency
- Level 2** understanding/explanation of setting budgets (5–3 marks)
Level 1 knowledge of budgets (2–1 marks)
- 2** Variance is the difference between the predicted/target level of output or sales and what is actually achieved (budget minus actual figure).
- Level 2** understanding/explanation of variance (4–3 marks)
Level 1 knowledge of variance or budgets (2–1 marks)
- 3** Possible problems facing a business when setting a budget are as follows:
- It is important that the budget set is realistic, otherwise it will not act as an incentive for staff and/or will not be achievable.
 - Who sets the budget can be problematic. Those setting the budget need to understand the business environment in which the output or sales are to be achieved.
 - The changing business environment can significantly affect the possibility of the budget being realistic or achievable. For example, all flight sales targets were instantly rendered useless after 9/11. Similarly, the rapid increase in the price of oil, and therefore fuel, greatly affected the ability of businesses to meet their budgets for costs.
 - If a new business is setting budgets, there is no previous experience upon which to base the target budget.
- Level 2** understanding/explanation of the problems of setting budgets (6–4 marks)
Level 1 knowledge of setting budgets, stating problems (3–1 marks)
- 4** variance = budget – actual (1 mark)
- variance = £1,000 – £1,050 = –£50 (1 mark)
- $\frac{50}{1000} \times 100 = 5\%$ (negative) (1 mark)
- Level 1** (3 marks)
- 5** It is important that students comment in the context of the case. For a local café, even £50 could be significant. However, a variance of £50 for a year is only £1 a week. Furthermore, sales were £600 above budget and may have required the use of extra labour at a given peak time (probably as overtime). As profit is a positive variance, this negative wage cost variance is not significant.



Level 3 analysis of variance	(6–5 marks)
Level 2 understanding/explanation of variance	(4–3 marks)
Level 1 knowledge of variance	(2–1 marks)

6 variance = budget – actual	(1 mark)
variance = £100,000 – £105,000 = –£5,000	(1 mark)
As costs are higher than forecast, the variance is negative.	(1 mark)
Level 1	(3 marks)

Case study

1 There are a large number of variables involved in constructing a stadium like Wembley:	
<ul style="list-style-type: none"> ■ Budgeting over a long period of time makes it hard to gauge with any accuracy the level of costs. The business environment can also change significantly over such a time period. For example, the costs of steel may alter, as may the labour costs. Wage levels may alter in line with inflation, but this is also difficult to predict accurately. ■ Delays that add to costs cannot always be easily predicted. Adverse weather conditions, for example, could delay construction. The late delivery of key materials could also delay the construction process. ■ Some aspects of the stadium, such as the arc that takes some of the roof weight, had not been built before and therefore the architects will have had nothing with which to compare them. This will have made setting this part of the budget more difficult. 	
Level 2 understanding/explanation of the problems	(6–4 marks)
Level 1 knowledge of or stated problems	(3–1 marks)
2 variance = budget – actual	(1 mark)
variance = £757m – £900m = –£143m	(2 marks)
$\frac{£143m}{£757m} \times 100 = 18.9\%$	(1 mark)
Level 1	(4 marks)
3 Possible points for discussion are:	
<ul style="list-style-type: none"> ■ As the project spans over a 10-year period, there is bound to be some variance. ■ With such large sums of money involved, any variance will be significant. ■ A negative variance is not acceptable in terms of its consequences for the profitability of the project. ■ A percentage variance of 18.9% is significant. It is likely that the contractors have penalty clauses built into their contracts so that any delays will incur a fine. ■ Many stakeholders of the contractors will not find such a variance acceptable. ■ Shareholders may lose dividends. Managers, who may have been on a bonus for completion within budget, will also miss out. ■ Knowing that similar projects had been delayed and over budget should have suggested to Multiplex that it needed to set its budgets to cope with similar problems. ■ Multiplex could not have envisaged the delays due to subcontractors failing to meet their own budgets and deadlines, and the large numbers of legal and labour disputes that have dogged the project. 	
Level 4 evaluation of acceptability of variance	(14–11 marks)
Level 3 analysis of variance	(10–7 marks)
Level 2 understanding/explanation of variance	(6–4 marks)
Level 1 knowledge of variance	(3–1 marks)