Exercise walk-through

Budgets ▪ 5.5

eXercise

You must be able to

- explain the purpose of a budget and the two main types
- calculate a **variance** and say whether it is favourable or adverse
- analyse and evaluate the use of budgets to control a business

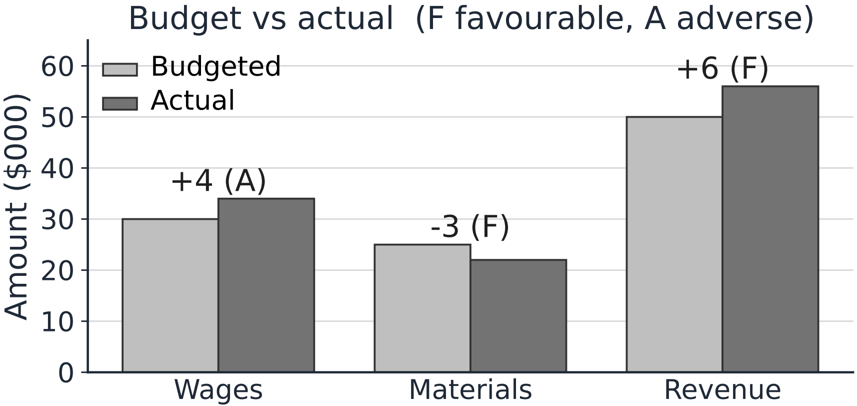
Method — Budgets and variances

$$\text{variance} = \text{actual figure} - \text{budgeted figure}$$

- **Worked (cost):** budgeted wages $30,000, actual $34,000 $\rightarrow$ variance $= \$4{,}000$ $\rightarrow$ costs higher $\rightarrow$ **adverse**.
- **Worked (revenue):** budgeted sales $50,000, actual $56,000 $\rightarrow$ variance $= \$6{,}000$ $\rightarrow$ revenue higher $\rightarrow$ **favourable**.
- **Incremental budget** $=$ last year $\pm$ a little; **zero-based budget** $=$ every cost justified from zero.

Answer shapes: AO1 $+$ AO2 $+$ AO3 (reasoning chain) $+$ AO4 (a supported judgement *in context*).

Method — Budgets and variances



Exam: variance = actual − budget · cost under-spend = F; revenue under-earn = A

Practice 2.1 ▪ 2 marks

Define the term *budget*.

Solution 2.1

Worked steps

a financial plan for the future — a target for income or spending over a set period (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 2 marks

A firm budgeted $25,000 for materials but spent $28,000. Calculate the variance and state whether it is favourable or adverse.

Solution 2.2

Method: Budgets and variances

Worked steps

variance $= \$28{,}000 - \$25{,}000 = \$3{,}000$; **adverse** (costs higher than planned) (2; award 1 for the figure with no favourable/adverse, or correct method with the wrong figure).

Practice 2.3 ▪ 2 marks

State the difference between an *incremental* and a *zero-based* budget.

Solution 2.3

Method: Budgets and variances

Worked steps

an incremental budget starts from last year's figure and changes it by a small amount; a zero-based budget starts from zero and every cost must be justified each year (2 for a clear difference; 1 for a partial idea).

Exam-style 3.1 ▪ 3 marks

Explain one benefit to a business of setting budgets.

Solution 3.1

Method: Budgets and variances

Worked steps

[3] **AO1** 1 — name a benefit (helps planning; controls spending; motivates with targets; measures performance). **AO2** up to 2 — develop it, e.g. a clear spending limit stops a department overspending $\rightarrow$ costs stay under control $\rightarrow$ profit is protected (2 developed / 1 limited).

Exam-style 3.2 ▪ 8 marks

Analyse two benefits to a business of using **zero-based budgeting**.

Solution 3.2

Method: Budgets and variances

Worked steps

[8] For **each** of two benefits: **AO1** 1 + **AO2** 1 + **AO3** up to 2. Example chains — *no wasted spending*: every cost is justified from zero → out-of-date costs are cut → money goes to where it is needed. *Better control*: managers review all spending each year → they understand their costs → tighter cost control and higher profit. Maximum 4 per benefit, 8 total.

Exam-style 3.3 ▪ 12 marks

‘Budgets always improve a business’s performance.’ Evaluate this view.

Solution 3.3

Method: Budgets and variances

Worked steps

[12] **AO1** 2 / **AO2** 2 / **AO3** 2 / **AO4** up to 6. **For:** budgets plan ahead, control costs, set targets and let managers spot variances early. **Against:** they can be guesses, may demotivate if unrealistic, can be inflexible if conditions change, and take time to prepare. Judgement: budgets help only if they are realistic, reviewed and acted on — a poorly set budget can harm performance, so the benefit depends on how well they are made and used.