

Exercise walk-through

5.5

Budgets

A-Level Business

What we will cover

- 1 Why finance & cash vs profit
- 2 Sources of finance
- 3 Cash-flow forecasts
- 4 Costs
- 5 Break-even & budgets
- 6 Recap



How costs are classified, and why

a cost

money the business spends to make its product

fixed and variable

fixed do not change with output; variable rise with each unit made

direct costs

traceable to one product – the materials in it, the labour on it

indirect costs

overheads not linked to one product – manager salaries, rent, insurance

average cost

total cost divided by output – the figure that falls with economies of scale

why classify at all

cost information helps managers **set prices, choose what to make, and control spending**

The same cost can be fixed *and* indirect, or variable *and* direct. The two classifications answer different questions and are not alternatives.

Topic 5 – key takeaways

1

Cash vs profit

a profitable firm can still run out of cash

2

Sources

internal vs external; short vs long

3

Break-even

$\text{BEP} = \text{fixed costs} / \text{contribution}$

4

Budgets

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

Exercises 2.1-2.3

2.1 Define the term *budget*.

[2]

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

[2]

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

[2]

Exercises 2.1-2.3

2.1 Define the term *budget*. [2]

2.1

- 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)

2.2 A firm budgeted \$25,000 for materials but spent \$28,000. Calculate the variance and state whether it is favourable or adverse. [2]

2.2

- 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)

2.3 State the difference between an *incremental* and a *zero-based* budget. [2]

2.3

- 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)

Exercises 3.1-3.2

3.1 Explain one benefit to a business of setting budgets.

[3]

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

[8]

Exercises 3.1-3.2

3.1 Explain one benefit to a business of setting budgets. [3]

3.1

- [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
- costs stay under control
- profit is protected (2 developed / 1 limited)

3.2 Analyse two benefits to a business of using **zero-based budgeting**. [8]

3.2

- [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

Exercise 3.3

3.3 'Budgets always improve a business's performance.' Evaluate this view. [12]

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3.3

- [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