

PREPARING A PURCHASES BUDGET

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This lesson will show you how to prepare a purchases budget, both in units and in dollars.

Given:

Beginning account balances:

Raw Materials \$ 42,000

Budgeted Sales: Qtr 1 = 40,000 units

 Qtr 2 = 50,000 units

It takes 2 units of raw material to make 1 finished unit.
Raw Material costs \$5 per unit.

Work-In-Process [WIP] is budgeted to have no beginning balance and no ending balance.

Assume the company wants to produce 42,000 units during Qtr 1.

WIP [in units] would then look like:

```
      Qtr 1
      #
      WIP
-----
      |
      | 42,000
      |
      |
```

But, it takes 2 # of RM to make 1 # of FG, so:

```
      Qtr 1
      #
      WIP
-----
      |
      | 42,000
      |
      |
DM = 2 * 42,000 | 42,000
      |
      |
```

So, 84,000 # of DM are needed to produce the 42,000 # of FG.

The beginning balance for Raw Mat is \$42,000. Remember this is dollars. If we convert the beginning balance to units, we would divide the \$42,000 by the \$5 per unit RM cost and get 8,400 units.

So, the RM account [in units] would look like:

Qtr 1	
#	
RM	
8,400	
	84,000 units issued to WIP

GIVEN: This company wants to have an ending inventory for RM that is equal to 10% of its next Qtr's RM requisition requirements.

This means we must compute the RM requisition requirements for Qtr 2.

 The Qtr 2 FG account in units would be:

Qtr 2	
#	
FG	
10,000	
	50,000
6,000	

Remember, the company wants a FG ending inventory amount equal to 20% of next Qtr sales.

So, EI = 20% * 30,000#, which equals 6,000 units. And the account looks like:

Qtr 2	
#	
FG	
10,000	
	50,000
6,000	

We can then calculate Qtr 2 production to be 46,000 units.

Qtr 2 FG now looks like:

Qtr 2	
#	
FG	
10,000	
46,000	50,000
6,000	

Qtr 2 WIP would be:

Qtr 2	
#	
WIP	
DM = 2 * 46,000	46,000

So, the 2*46,000 units of RM are needed for production in Qtr 2. In other words, 92,000 RM units are needed in Qtr 2.

Now, back to the discussion of Qtr 1 RM Ending Balance!

Qtr 1	
#	
RM	
8,400	
	84,000 units issued to WIP

GIVEN: This company wants to have an ending inventory for RM that is equal to 10% of its next Qtr's RM requisition requirements.

Since the next Qtr [i.e., Qtr 2] material requirements for production are 92,000, and we want the RM ending to be 10% of this, the Ending RM would be 9,200 units.

And the RM account in units would be:

Qtr 1	
#	
RM	
8,400	
	84,000 units issued to WIP
9,200	

We can now calculate how much RM to purchase for Qtr 1 in a way similar to how we calculated production for Qtr 1, i.e.,

What came out of the acct + ending balance must = what is in the acct.

$$84,000 + 9,200 = 93,200 \text{ units must be in the acct.}$$

Since the acct already has 8,400 units [the beginning balance], it needs 84,800 more units; and these have to be purchased.

So, Purchases for Qtr 1 are 84,800 units.

To calculate Purchases in dollars, we need to multiply the units by the unit price of \$5.

$$\text{So, Purchases in dollars} = 84,800 * \$5 = \$424,000.$$

And that's how to prepare a Purchases Budget in units and dollars.