



2. Production Budget:

After preparing the sales budget, the production budget is prepared. A production budget is stated in physical units. It specifies the number of units of each product that must be produced to satisfy the sales forecasts and to achieve the desired level of closing finished goods inventory.

Essentially, the production budget is the sales budget adjusted for inventory changes as follows:

Units to produce = Budgeted sales + Desired closing inventory of finished goods – Beginning inventory of finished goods.

A specimen production budget is given in Exhibit 9.4 below:

	<i>Products</i>	
	<i>A</i>	<i>B</i>
Budget sales (units)	70,000	80,000
<i>Add:</i> Desired closing finished goods inventory	20,000	30,000
	<u>90,000</u>	<u>1,10,000</u>
<i>Less:</i> Beginning finished goods inventory	40,000	50,000
Units to be produced	<u>50,000</u>	<u>60,000</u>

Exhibit 9.4 : Production Budget

The production budget, like other budgets, is detailed by months or quarters along with a tentative annual budget. Further, budgets are prepared for every production center for comparison with actual production. The production budget contributes to planning, coordination, and control.



A production budget tends to reveal weaknesses and sources of potential trouble which can then be avoided by timely management action. The production budget is the primary basis for planning raw material requirements, labour needs, capital and cash requirements, and factory costs.

Therefore, the production budget becomes the foundation for factory planning in general. It gives the factory executives something tangible upon which to base operational decisions.



3. Production Cost

Budget:

A production cost budget summarises the materials budget, labour budget, the factory overhead budget, and may be expressed and analysed by departments and/or products.

A production cost budget, also known as a manufacturing budget is made up of three budgets:

- (i) Direct Materials Budget
- (ii) Direct Labour Budget
- (iii) Factory Overhead Budget



(i) Direct Materials Budget:

A direct materials budget indicates the expected amount of direct materials required to produce the budgeted units of finished goods. This budget specifies the cost of direct materials used and the cost of the direct materials purchased. Exhibit 9.5 explains the calculation of the direct materials budget. The usage part of the direct materials budget determines the cost of purchases of direct materials.

The direct materials budget is useful in the following ways:

1. It helps the purchasing department to prepare a schedule to ensure delivery of materials when needed.
2. It helps in fixing minimum and maximum levels of inventories in the stores department.



3. It helps the finance manager to determine the financial requirements to meet production targets.

The materials budget usually deals with direct materials only. Supplies and indirect materials are generally included in the factory overhead budget.

A B C Company			
Direct Materials budget for the year ending December, 2012			
A. Usage Budget			
	<i>Products</i>		<i>Total</i>
	<i>A</i>	<i>B</i>	
Budgeted production in units	50,000	60,000	
Direct materials requirement			
Product A 5 kg per unit	× 5		
Product B 8 kg per unit		× 8	
Direct materials usage (kg)	2,50,000	4,80,000	
Cost per kg	₹1.00	1.50	
Cost of direct materials used	₹2,50,000	7,20,000	₹ 9,70,000
B. Purchase Budget			
<i>Direct Materials (in Kg)</i>	<i>A</i>	<i>B</i>	<i>Total</i>
Direct Materials usage	2,50,000	4,80,000	
Budgeted closing direct materials inventory	+ 50,000	+75,000	
Total requirement	3,00,000	5,55,000	
Beginning direct materials inventory	70,000	1,00,000	
Purchase of direct materials	2,30,000	4,55,000	
Cost per kg.	₹1.00	₹ 1.50	
Cost of purchase	2,30,000	₹ 6,82,000	₹ 9,12,000

Exhibit 9.5 : Direct materials Budget



(ii) Direct Labour Budget:

The labour budget estimates the labour, adequate in number and grades, to enable the production budget to be achieved. It is generally preferable to prepare a separate direct labour budget and to include indirect labour in the factory overhead budget. The labour budget for direct and indirect labour helps the personnel or employment department in determining the number and types of workers needed. If additional workers are not needed, the task of the personnel department is easy. However, when workers are to be recruited, the personnel department has to make plans in advance.



The labour budget prepared must disclose the following information:

(i) The number of each type or grade of worker required in each period to achieve the budgeted output;

(ii) Budgeted cost of such labour in each period;

(iii) Period of training necessary for different types of workers.

Exhibit 9.6 illustrates the preparation of a direct labour budget.

ABC Company
Direct Labour Budget for the year ending December, 2012

	<i>Products</i>		
	<i>A</i>	<i>B</i>	<i>Total</i>
Budgeted production requirements	50,000	60,000	
Direct labour hours per unit	3	2	
Total direct labour hours	1,50,000	1,20,000	2,70,000
Direct labour cost per hour	₹ 5,00	₹ 5,00	₹ 5,00
Total direct labour cost (₹)	7,50,000	6,00,000	13,50,000

Exhibit 9.6 : Direct Labour Budget