



Budgeting

Chapter: 8



Learning objectives

- ▶ Understand the role of budgets in overall organization plans.
- ▶ Understand the importance of people in the budgeting process.
- ▶ Estimate sales.
- ▶ Develop production and cost budgets.
- ▶ Estimate cash flows.
- ▶ Develop budgeted financial statements.



What is budget?

A **budget** is a plan that helps companies figure out where they will be with respect to finances and inventory after a given period of time.



Why budgeting?



Forces management to plan for the future—to develop an overall direction for the organization, foresee problems, and develop future policies

Helps convey significant information about the resource capabilities of an organization, making better decisions possible

Helps set standards that can control the use of a company's resources and control and motivate employees

Improves the communication of the plans of the organization to each employee



Planning for business success



It's easy to get bogged down in day-to-day problems

Successful businesses invest time to create and manage budgets, prepare and review business plans and regularly monitor finance and performance

Structured planning can make all the difference to the growth of your business

To concentrate resources on improving profits

Reducing costs

Increasing returns on investment



The benefits

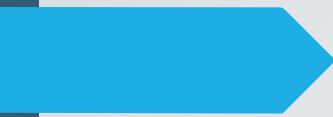


A greater ability to make continuous improvements and anticipate problems

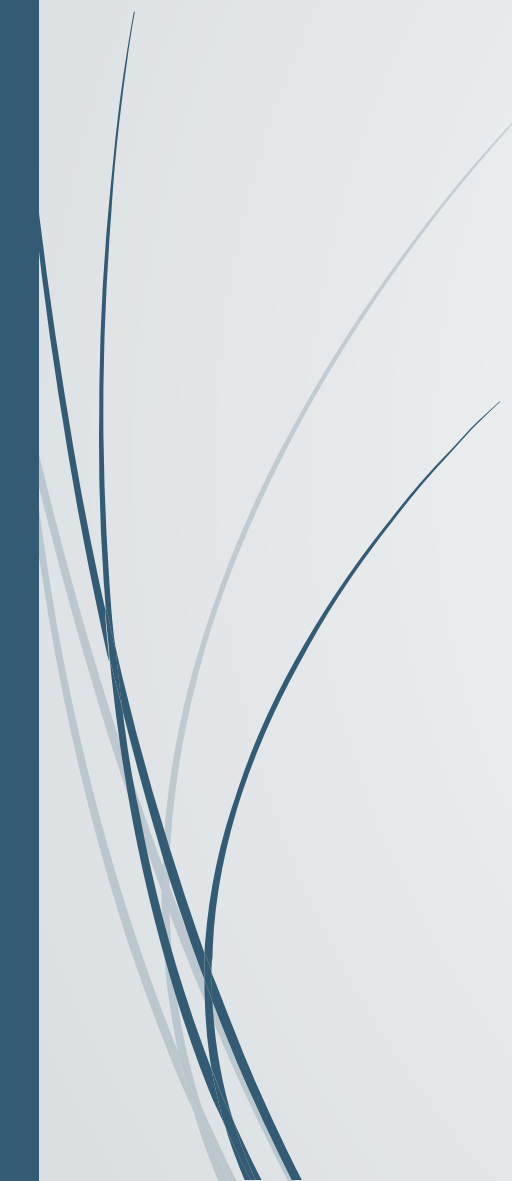
Sound financial information on which to base decisions

Improved clarity and focus

A greater confidence in your decision-making



What to include in your annual plan



An outline of changes that you want to make to your business

Potential changes to your market, customers and competition

Your objectives and goals for the year

Your key performance indicators

Any issues or problems

Any operational changes

Information about your management and people

Your financial performance and forecasts

Details of investment in the business



A typical business planning cycle

1. Review your current performance against last year/current year targets.
2. Work out your opportunities and threats.
3. Analyze your successes and failures during the previous year.
4. Look at your key objectives for the coming year and change or re-establish your longer-term planning.
5. Identify and refine the resource implications of your review and build a budget.
6. Define the new financial year's profit-and-loss and balance-sheet targets.
7. Conclude the plan.
8. Review it regularly - for example, on a monthly basis - by monitoring performance, reviewing progress and achieving objectives.
9. Go back to 1.

Business planning and budgets





Business planning and budgets

A budget is a plan to:

- Monitoring your finances
- Provide you can continue to fund your current commitments
- Allow you to make confident financial decisions and meet your objectives
- Provide you have enough money for your future plans



Benefits of a business budget



Control your money effectively

Distribute appropriate resources to projects

Monitor performance

Meet your objectives

Improve decision-making

Identify problems before they occur - such as the need to raise finance or cash flow difficulties

Plan for the future

Increase staff motivation



Creating a budget



What are the **projected sales** for the budget period? Be realistic - if you overestimate, it will cause you problems in the future.

What are the **direct costs** of sales – i.e. costs of materials, components or subcontractors to make the product or supply the service?

What are the **fixed costs** or overheads?

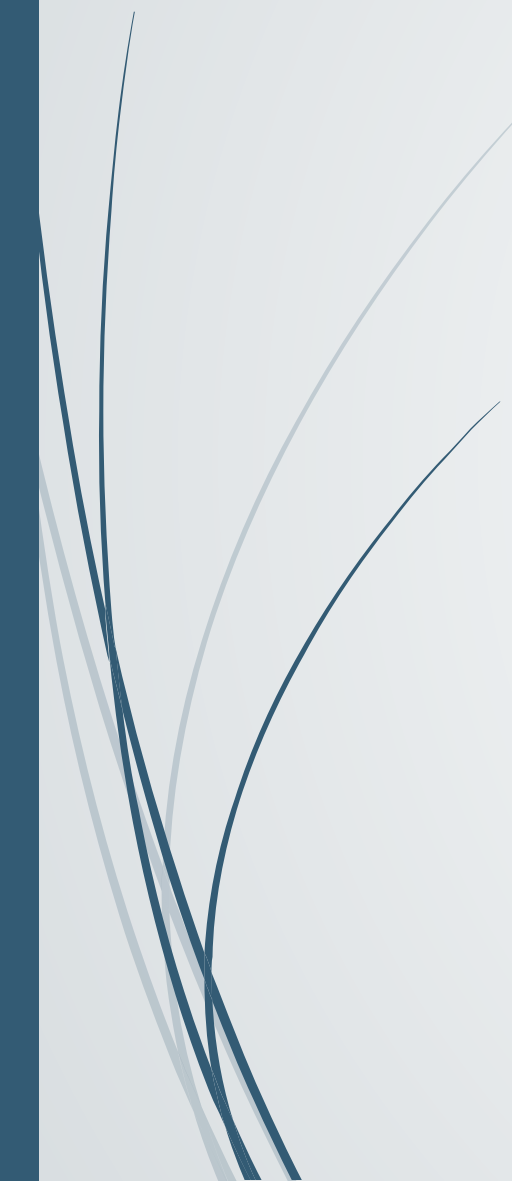


Types of budget expenses

- ▶ Cost of premises, including rent, municipal taxes and service charges
- ▶ Utilities
- ▶ Staff costs
- ▶ Printing, postage and stationery
- ▶ Vehicle expenses
- ▶ Equipment costs
- ▶ Advertising and promotion
- ▶ Travel and subsistence expenses
- ▶ Legal and professional costs, including insurance

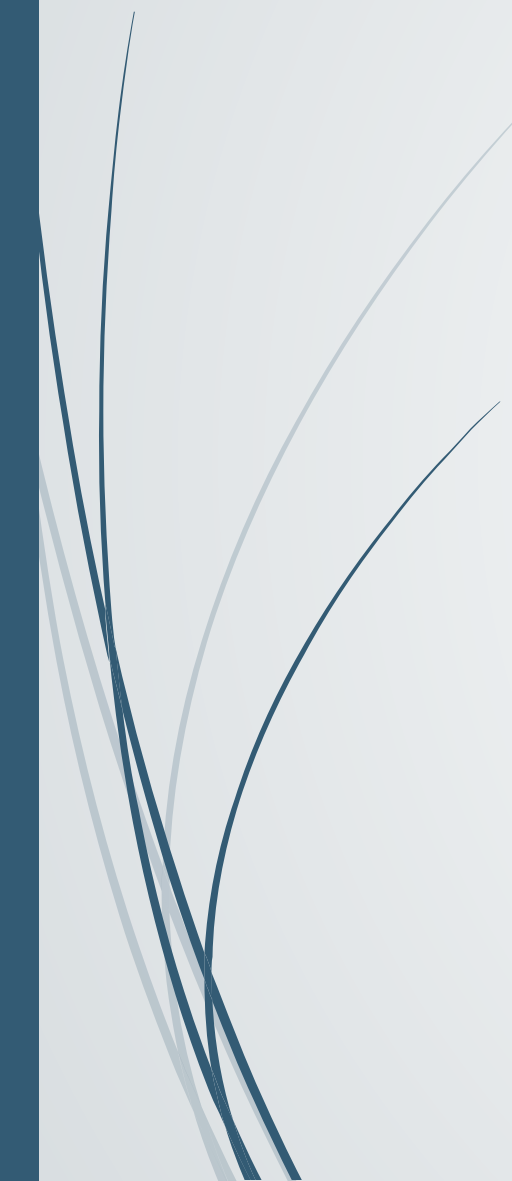


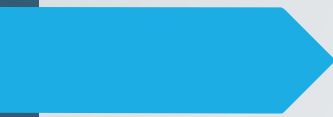
Steps in preparing a budget

- ▶ Update budget assumptions
 - ▶ Available funding
 - ▶ Step costing points
 - ▶ Create budget package
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Steps in preparing a budget

- ▶ Obtain revenue forecast
 - ▶ Obtain department budgets
 - ▶ Validate compensation
 - ▶ Validate bonus plans
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- Obtain capital budget requests
 - Update the budget model
 - Review the budget
 - Issue the budget
 - Load the budget



What your budget include?

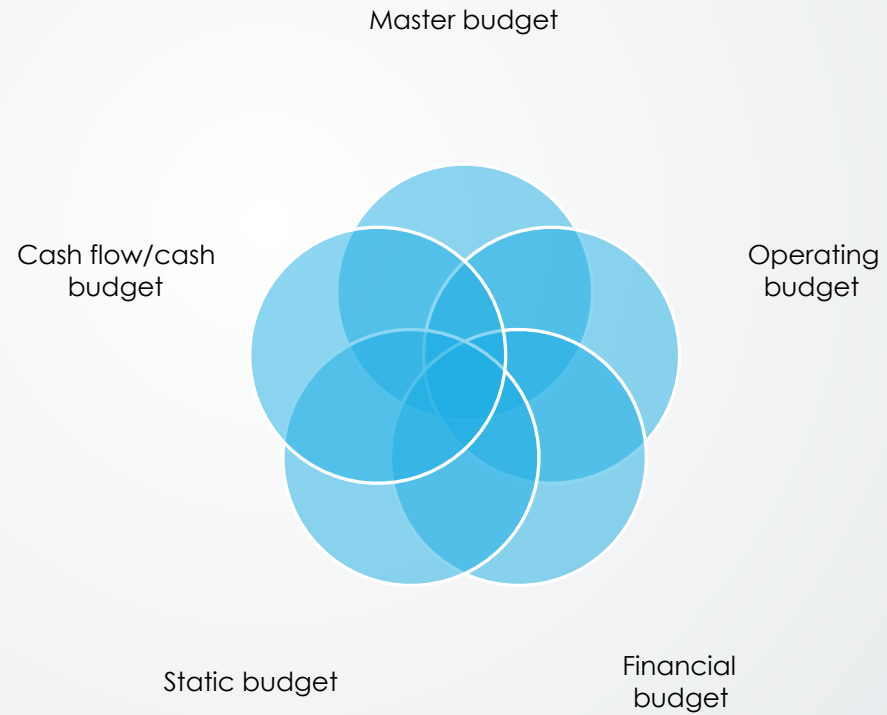
Projected cash flow

Costs

- Fixed costs
- Variable costs
- One-off capital costs

Revenues

Types of budget





Master budget

Definition (businessdictionary.com)

- A budget that summarizes and integrates all the individual budgets within an organization

Advantages

- Estimated profit of the organization
- Information relating to forecast balance sheet is available in the masters budget
- All summary report is prepare in one report



Operating budget

Definition (businessdictionary.com)

- A detailed projection of all estimated income and expenses based on forecasted sales revenue during a given period (usually one year).

Operating budgets contain

- A sales
- Selling expense
- General and administrative budget



Financial budgets



Definition (allbusiness.com)

- Embraces the impacts of the financial decisions of the firm. It is a plan including a budgeted balance sheet, which shows the effects of planned operations and capital investments on assets, liabilities, and equities.

The aim:

- to manage the outflows with the inflows

The financial budget ensures that right types of funds are available whenever they are required



Cash budget



Managing the working capital of the business

It ensures that the inflow of the cash is regular and timely

It is important as it helps the managers to determine the period of cash shortage

Static budget

It's easy to implement and follow

A static budget can offer strong insight into a company's costs

They can help companies control their costs and make smart spending decisions



Budget Example

Sample Monthly Budget			
After tax income	\$ 6,300.00		
			January
Essential fixed expenses	Budgeted amount	Amount left	Spent amount
Mortgage/Rent	\$ 2,000.00	\$ 0.00	\$ 2,000.00
Trash	\$ 25.00	\$ 0.00	\$ 25.00
Cell phone	\$ 60.00	\$ 0.00	\$ 60.00
Cable	\$ 140.00	\$ 0.00	\$ 140.00
Student loan	\$ 500.00	\$ 0.00	\$ 500.00
Life insurance	\$ 50.00	\$ 0.00	\$ 50.00
Subtotal	\$ 2,375.00		\$ 2,375.00
Essential variable expenses			
Groceries	\$ 200.00	\$ 11.27	\$ 208.66
Water, natural gas, electricity	\$ 250.00	\$ 122.83	\$ 127.17
Fuel food and care	\$ 200.00	\$ -89.74	\$ 289.74
Car gas, parking, maintenance and registration	\$ 100.00	\$ 40.10	\$ 140.10
Health and dental care	\$ 500.00	\$ -130.21	\$ 469.79
Home maintenance (homeowners only)	\$ 200.00	\$ 10.00	\$ 210.00
Property tax (homeowners only)	\$ 350.00	\$ 350.00	\$ 0.00
Household items and toiletries	\$ 100.00	\$ 10.10	\$ 110.10
Subtotal	\$ 2,390.00	\$ 278.97	\$ 2,668.97
Nice-to-have expenses			
Restaurants	\$ 100.00	\$ -1.10	\$ 111.10
Concerts and sporting events	\$ 50.00	\$ 50.00	\$ 0.00
Travel	\$ 200.00	\$ 117.95	\$ 297.95
Subscription (books, magazine)	\$ 50.00	\$ 0.00	\$ 50.00
Clothing and shoes	\$ 200.00	\$ 238.75	\$ 438.75
Movies	\$ 40.00	\$ 10.00	\$ 50.00
Internet	\$ 50.00	\$ 0.00	\$ 50.00
Dinner out and gifts	\$ 100.00	\$ 25.00	\$ 125.00
Subtotal	\$ 890.00	\$ 382.25	\$ 1,272.25
Total spending	\$ 5,025.00		\$ 4,941.04
Savings	\$ 675.00		\$ 1,358.96

Expense budget: The math is simple

Operating Expenses	Jan	Feb	Mar	Apr	May
Payroll	\$6,266	\$6,966	\$7,666	\$8,366	\$8,366
Rent	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
Marketing	\$1,000	\$1,000	\$2,000	\$2,000	\$2,000
Leased Equipment	\$150	\$150	\$150	\$150	\$150
Utilities	\$125	\$125	\$125	\$125	\$125
Insurance	\$75	\$75	\$75	\$75	\$75
Benefits	\$1,567	\$1,742	\$1,917	\$2,092	\$2,092
Depreciation	\$1,025	\$1,025	\$1,025	\$1,025	\$1,025
Interest	\$182	\$181	\$180	\$179	\$179
Other	\$0	\$0	\$0	\$0	\$0
Total	\$12,390	\$13,264	\$15,138	\$16,011	\$16,011

Payroll and payroll taxes are operating expenses

	Jan	Feb	Mar	Apr
Owner	\$2,666	\$2,666	\$2,666	\$2,666
Asst. Manager	\$1,950	\$1,950	\$1,950	\$1,950
Asst. Manager	1,650	1,650	1,650	1,650
Other Employees	\$0	\$700	\$1,400	\$2,100
Gross salary	6,266	6,966	7,666	8,366
Benefits %	25%	25%	25%	25%
Benefits	\$1,567	\$1,742	\$1,917	\$2,092
Total	\$7,833	\$8,708	\$9,583	\$10,458



Thanks for attention