Financial Planning and Budgeting

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BUDGET DEFINITION

- A budget can be defined as a financial plan which articulates the expected revenue and expenditure of an organization.
- It is generally a list of all planned expenses and revenues. It is a plan for saving and spending for the near future.
- According to Investopedia, a budget is an estimation of revenue and expense over a specified future period of time; it is compiled and re-evaluated on a periodic basis.

THE ESSENCE OF A BUDGET

The essence of a budget generally speaking, is to:

- provide a forecast of revenues and expenditures, and enable the actual financial operation of the business to be measured against the forecast.

REASONS AND BENEFITS OF FINANCIAL PLANNING AND BUDGETING

- Creating a budget for your business helps focus efforts and financial resources to the goals/targets of your business.
- It is to assist policy makers to develop policies that will assist an organization to achieve its main objectives.
- The process is aimed at estimating the total income of an entity to support its expenditure plans and developments.
- It is to give authority to future spending; it is an expenditure authorization means.

REASONS AND BENEFITS OF FINANCIAL PLANNING AND BUDGETING

- It is to provide a mechanism to control the entity's revenue and expenditure. It provides guidelines for authorizing expenditure. It helps you to ensure that your spending is within the budgeted limits.
- It aims at setting standards to enable performance to be monitored and evaluated. It provides a benchmark against which actual performance can be measured.
- It serves as motivating device for both government employees and the departmental managers.
- It serves to bring together the separate sub-systems of an entity to enable them work together towards the achievement of set objectives.

CLASSIFICATION OF BUDGETS

Four principal basis adopted generally by organizations according to Manisha Tanwar are:

- Coverage
- Flexibility
- Nature of activity and
- Time span.

BUDGET CLASSIFICATION(CONTD.)

(A) Coverage

This basis is applicable to large firms that have departments and units. Here budgets are categorized in terms of various activities of the organization. Two types of budget fall under this category.

- **Functional Budgets:** These are budgets prepared to take care of the individual activities of the organization.
- **Master Budget:** Functional budgets prepared by various departments/units based on their individual activities are consolidated to have the master budget. A master budget is a set of interconnected budgets of sales, production cost, purchases, income etc.

BUDGET CLASSIFICATION(CONTD.)

(B) Flexibility

According to this basis, budgets can be grouped into flexible and fixed budget.

- **Flexible or variable budgets**: A flexible budget adjusts the master budget for the actual sales or production volume. For example, your master budget may have assumed that you would produce 5000 units; however, you actually produced 5100 units. The flexible budgets rearrange the master budget to reflect this new number, making all the appropriate adjustments to sale and expenses based on unexpected change in volume.
- **Fixed Budget:** A fixed budget is a budget that is designed to remain constant, regardless of the activity level. It is also referred to as a static budget.

BUDGET CLASSIFICATION(CONTD.)

(C) Nature of Activity

Business activity involves two processes, viz.:

(I) Creation of infrastructure for doing business; and

(II) Actual carrying out of the operations.

Therefore, planning is done for both kinds of activities. Depending on the nature of the activities, budgets can, therefore, be grouped into Capital, Expenditure and Revenue budgets.

Capital Budget

consists of capital receipts and payments.

Capital receipts are loans (long term) raised by the business while capital payments consist of capital expenditure on acquisition of assets like land, building, machinery, equipment etc.

Revenue and Expenditure Budgets

These are operational budgets which are detailed projections of all estimated income and expenses based on forecasted sales revenue during a given period.

BUDGET CLASSIFICATION(CONTD.)

(D) Time Span

According to the periodicity, budgets can be classified as short term, medium term and long term budgets.

(I) Short term budget is normally prepared for a year. It is also called short -range plan. It covers the period of three, six or twelve months depending upon the nature of the business.

(II) Medium term budget is prepared to cover a period above 1year and less than 5 years

(III) Long term budget also called long-range plan is drawn to cover the period above 5 years.

Factors to Consider when Preparing a Budget

- Understand your budget’s purpose
- Use Historical Data
- Use Estimates
- Be Realistic With Your Budget
- Consider Your Common Expenses
- Consider Your Business Specific Expenses
- Understand the importance of Billing Cycles
- Review and Revise

FORECASTING OF SALES REVENUE AND EXPENDITURE

In order to prepare an accurate budget, you first need to develop a revenue forecast for your business. A forecast is an educated prediction for the upcoming year about how much money your business will likely bring in, so that you can estimate what you can afford to spend and what your profit margin will be.

Sales forecasts enable you to manage your business more effectively. Before you begin, there are few questions that may help you clarify your position:

How many customers do you gain each year?

How many customers do you lose each year?

What are the average level of sales you make to each customer?

Are there particular month where you acquire or lose more customers than usual?

Here are some tips to get you started:

- Develop a unit sales projection
- Use past data if you have it
- Be sure to project prices
- Take seasonality into consideration

Working with a Mentor

- Startup entrepreneurs often benefit from working with a mentor or a seasoned business owner within the same industry to help guide the initial revenue forecasting process. A little bit of mentoring can go a long way towards preparing you and your business for the road ahead.
- With their expertise, experience, and data set from their own company’s past revenue, a mentor can offer you great insight into what to expect from your first year’s sales numbers. That data will go a long way helping you in creating a revenue forecast that would be impossible to predict on your own.
- For any company, revenue forecasting is essential in preparing for the ups and downs of the year to come. But for newer businesses, without many years of experience to draw on, the forecasting process can present special challenges.

HOW TO PRPARE A BUDGET

Basic Business Budget Worksheet			
CATEGORY	**BUDGET - 2017**	**ACTUAL – 2017**	**DIFFERENCE (FAVOURABLE & UNFAVOURABLE)**
Sales Revenue	500,000.00	600,000.00	-100,000.00
Other Income	200,000.00	180,000.00	20,000.00
TOTAL INCOME	700,000.00	780,000.00	-80,000.00
EXPENSES			
Advertising	40,000.00	35,000.00	5,000.00
Carriage	10,000.00	15,000.00	-5,000.00
Inventory Purchases	120,000.00	150,000.00	-30,000.00
Salaries & wages	100,000.00	150,000.00	-50,000.00
Printing & Stationery	20,000.00	15,000.00	5,000.00
TOTAL EXPENSES	290,000.00	365,000.00	-75,000.00
TOTAL INCOME MINUS TOTAL EXPENSES (Budget Surplus)	410,000.00	415,000.00	-5,000.00

HOW TO PREPARE SHORT, MEDIUM AND LONG TERM PLANS

Strategic Planning Characteristics

Strategic plans are majorly long term plans ranging from 10 to 20years and can be broken down into short term, medium term and long term framework.

- Short-term usually involves processes that show results within a year.
- Medium-term involves processes that show the results above one year to four years.
- Long-term plans include the overall goals of the company set for five years and above in the future.

Planning in this way helps you complete short-term tasks while keeping longer-term goals in mind.

(A) Short-Term Planning

- Short-term planning looks at the characteristics of the company in the present and develops strategies for improving them. Examples are the skills of the employees and their attitudes. The condition of production equipment or product quality problems is also short-term concerns.
- To address these issues, you put in place short-term solutions to address problems. Employee training courses, equipment servicing and quality fixes are short-term solutions. These solutions set the stage for addressing problems more comprehensively in the longer term.

(B) Medium-Term Planning

- Medium-term planning applies more permanent solutions to short-term problems. If training courses for employees solved problems in the short term, companies schedule training programs for the medium term. If there are quality issues, the medium-term response is to revise and strengthen the company's quality control program.
- Where a short-term response to equipment failure is to repair the machine, a medium-term solution is to arrange for a service contract. Medium-term planning implements policies and procedures to ensure that short-term problems don't recur.

(C) Long-Term Planning

- In the long term, companies want to solve problems permanently and to reach their overall targets. Long-term planning reacts to the competitive situation of the company in its social, economic and political environment and develops strategies for adapting and influencing its position to achieve long-term goals. It examines major capital expenditures such as purchasing equipment and facilities, and implements policies and procedures that shape the company's profile to match top management's ideas.
- When short-term and medium-term planning is successful, long-term planning builds on those achievements to preserve accomplishments and ensure continued progress.

THANK YOU