



active business

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Budgeting



## The Active Business Series

### Now is the time to review your budgets



*Budgeting is the backbone of business planning. It helps you keep your business on track and avoid unpleasant surprises while giving you greater control over your business and a more efficient use of resources.*

Budgets are usually drawn up with reference to the previous period's figures combined with future projections. This can be a challenging task when the economic climate is relatively calm but during these turbulent and unpredictable times the task is all the more difficult and requires greater focus – and above all a flexible approach.

There is a very good chance that if your plans and budgets were drawn up some months ago, elements of them will need revising now.

Economic uncertainty does not mean you should abandon attempts to prepare budgets. On the contrary, tight control, and therefore, reliable budgets, are now more important than ever.

What you need is to regularly:

- Review the assumptions your budgets are based on
- Test the accuracy and relevance of the financial data
- Compare actual results with budgeted targets and evaluate any variances
- Determine appropriate corrective action where needed

In uncertain times, all these functions need to be performed with greater frequency.

### Budgeting and forecasting

*Budgeting and forecasting go hand in hand. Your budget is directly related to your business plan and outlines what you want to achieve in a quantified and measurable form. It helps to ensure you have the cash you need to maintain your current operations and the funds to realise your future plans.*

A forecast is a management tool that helps you make realistic estimates of future costs and future revenues, which can then be used as a basis for drawing up budgets. The purpose of this guide is to explain the importance of budgets and the key stages in preparing and implementing them.

### Benefits of structured budgeting

*Most businesses have some kind of budgeting in place – estimating future results and assigning resources accordingly – but in many cases this is an informal and irregular process that lacks discipline and is often overlooked when things get busy or uncertainty takes hold.*

We strongly recommend you develop a structured and systematic budgeting process. This will help you:



**In short, a structured budgeting process helps you focus on keeping your costs down, improving your profits and increasing returns on investment**

- Formulate and implement realistic plans, and monitor their progress with timely, relevant data
- Identify potential problems and take appropriate action in good time
- Improve the decision making process, giving you greater confidence in making key decisions
- Focus on clear targets and objectives and stay on course month by month
- Implement and maintain a programme of continuous improvement
- Improve staff motivation, focus, and accountability
- Improve overall efficiency

## Budgeting is important for all types of business

*Budgeting is important at all stages of a business. Start ups need a realistic budget both as a foundation for their business plan and to support any application for finance, and existing businesses need an ongoing budget process to control cashflow, stay on top of expenditure, and provide sound financial information on which to base key decisions.*

For new businesses budgeting is quite straightforward and usually involves one relatively simple budget. For larger businesses, however, the process can be more complex and often involves splitting the budget into separate areas such as sales, production, distribution, and marketing.

## The budgeting process

*As mentioned before, your budget is drawn up with reference to your business plan, which outlines your overall goals and objectives.*

The actual process will vary in complexity depending on the size and complexity of your organisation, but at a basic level will include the following stages:

1. Begin by specifying your objectives for the budgeting period, usually the year ahead
2. Set realistic sales targets that will enable you to reach these objectives, using your sales forecast as a basis
3. Calculate the direct cost of sales matched month by month to the sales targets
4. Factor in fixed costs and any anticipated capital costs for the budget period
5. Include your own drawings and any tax payments due during the period
6. Agree the budget with all relevant parties
7. Monitor, analyse and adjust the budget on a regular basis



### Useful tips

- Use historical data only as a guide, especially during turbulent economic times when the financial situation is particularly unpredictable.
- Make careful assessments of any factors, both internal and external, that are likely to affect your sales performance, cost of sales etc in the year ahead.
- Be sure to involve relevant people, especially your sales and finance staff, both to source information and to agree targets

## Using budgetary control to monitor and improve performance

*Budgets really start to deliver when they are used to monitor and evaluate performance, whether it is the performance of the business as a whole or of different departments and individuals.*

To evaluate the performance of your business it is best to focus on a few key drivers that have a major impact, known as 'key performance indicators'. For most businesses these will include:

- Sales
- Costs
- Working capital

Monitoring these on a regular basis and measuring the actual numbers against the budgeted numbers will help you identify any trends towards cashflow problems or declining profitability and enable you to take appropriate action.

To monitor departmental and individual performance, a good budgetary control system will:

- Specify agreed targets and who is responsible for them
- Spell out in which circumstances budgets can be departed from, and with whose authority
- Establish procedures for regularly measuring actual performance against targets and evaluating any variances
- Specify who is responsible for determining and implementing any necessary corrective action

## Potential pitfalls

*When not handled skilfully, the budgeting process can lead to some unwanted consequences such as:*

- Wishful thinking leading to unrealistic assumptions and unachievable targets
- An inflexible approach and unwillingness to adapt to circumstances
- Alienation of employees if they feel budgets are being imposed without consultation
- Departmental rivalry over budget allocations
- A culture of spending up to budgets simply to hold on to them for the following year

All of these dangers can be avoided, or at least mitigated, with the right approach.

## How we can help

*We can assist at all the stages of the budgeting process by:*

1. Helping with the initial decisions of which budgets and forecasts to prepare, and what parameters to use
2. Assisting with the preparation of reliable financial information
3. Preparing cashflow and profit and loss forecasts and integrating them into the planning process
4. Assisting in discussions on setting realistic targets
5. Creating 'what if' models to test the viability and resilience of budgets
6. Helping to agree key performance indicators and how they will be measured
7. Comparing actual results with budget targets, investigating possible causes for any variances, and recommending timely remedial actions
8. Sitting in on internal meetings and meetings with third parties where budgets are discussed or evaluated



**At the end of the day budgets are only as good as the data is reliable and the assumptions are realistic – and these are areas where we can lend considerable professional experience. If you would like us to assist in any of these ways or have any questions about the budgeting process, please do not hesitate to call us.**