



Unit 3 The Basics of Budgeting

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Recognize different types of organizational financial plans
- ✓ Explain what budgets are and how to prepare them
- ✓ Recognize what computer skills you need to make you a financial whiz
- ✓ Deal with financial situations that impact the people that work for you

Unit 3

The Basics of Budgeting

Defining a Budget

Why are Budgets Important?

A business shouldn't open its doors without having some idea of what to expect, and it shouldn't close its doors without knowing what happened. A business should also plan and prepare for its future. One way to do this is to budget, to plan ahead for future income and expenses.

Budgets provide the baseline against which to measure actual performance. The actual performance of an organization is documented by the accounting system and the reports it generates. Supervisors should compare expected performance against actual performance. With this information, supervisors with budget responsibilities act as physicians to assess the current financial health of their organization. They should look for areas where they have done well and areas that need attention.

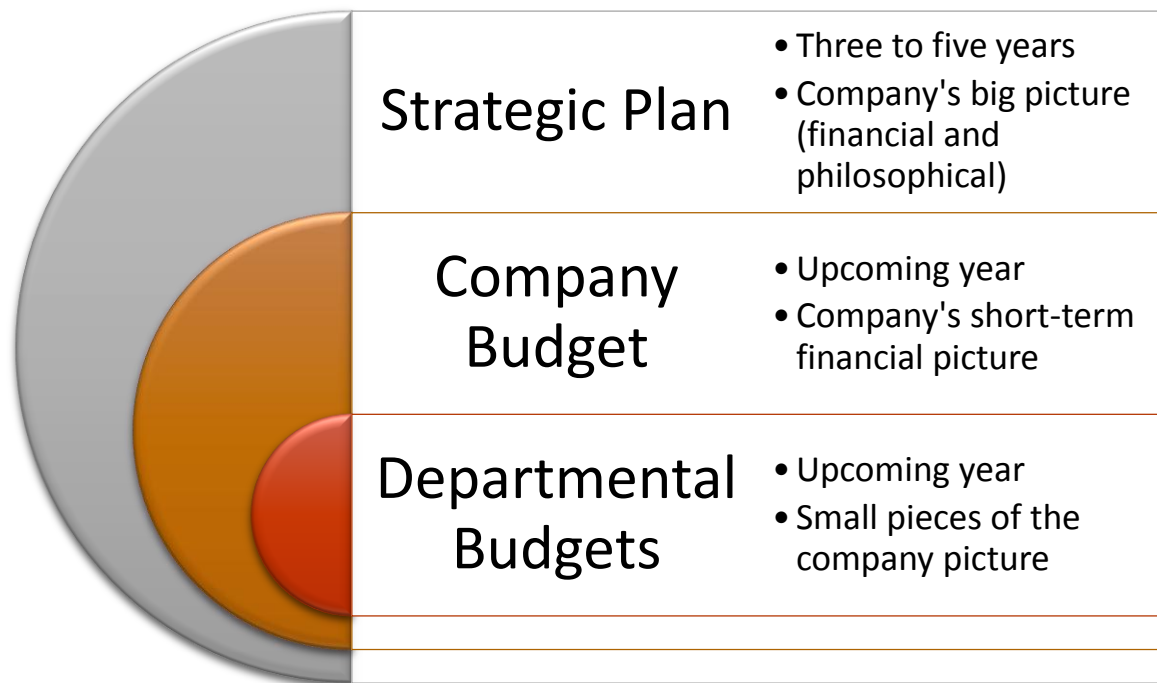
If the latest report from the accounting office says sales are too low compared to budget, the sales manager has to figure out why. If overtime costs are running too high, the production manager has to figure out why. And if there are too many rejects on the shop floor, it may be up to the quality control officer to figure out why.

Why should we bother with budgets in this age of change? Sometimes, you go through all that work and then senior managers make changes that knock your whole budget for a loop. However, even though planning is becoming more and more difficult, we still must plan in order to maintain focus and prevent wasting resources. A budget is an educated guess that reflects your long-term plans. Planning is the key characteristic of budgeting.

What types of budgets have you seen?

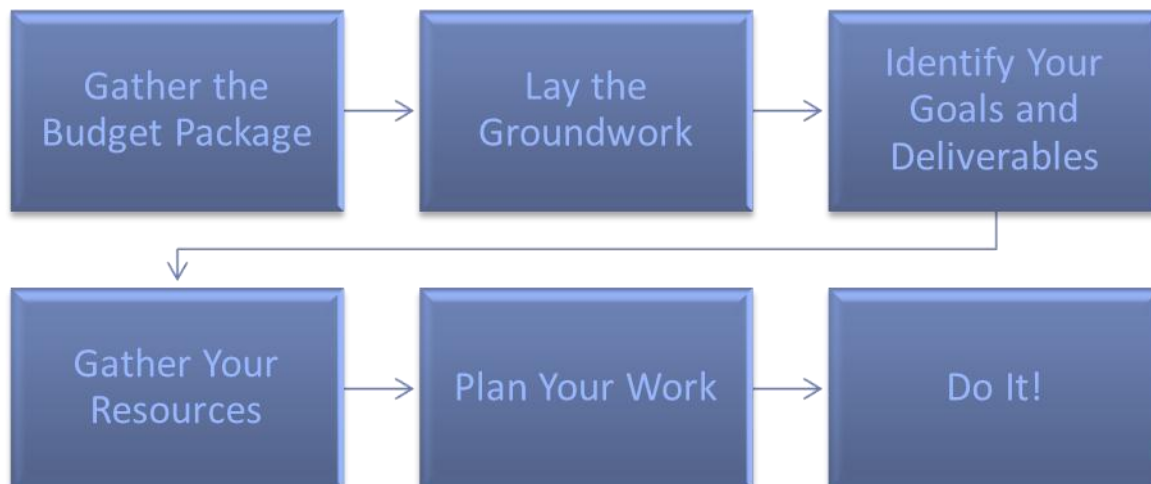
Where Does the Budget Fit In?

Your budget should flow down from your company's plan, like this:



The Budgeting Process

The budgeting process typically has six steps.



Step One: Gather the Budget Package

If you are in charge of preparing a budget, your organization will usually give you a budget package. Typically this contains:

- Company-wide budget and goals
- Description of your department and its goals as laid out in the strategic plan
- Business or performance indicators
- Past financial statements and budgets
- List of accounts and profit and cost centers involved
- Proposed budget, if there is one
- Allocated budget amount, if there is one (Sometimes you are given a pot of money to budget; at other times you need to determine what you need and then fight for it!)
- Templates for completing the budget

If you aren't given this information, then go out and find it!

Step Two: Lay the Groundwork

If you dive into the budget package right now, you won't be able to find your way out! Before you get into things, outline a few key pieces of information.

- How detailed is the budget supposed to be? Should you go down to each line item in pennies, or is general categories in the thousands enough detail?
- How will the budget be monitored?
- Will a review and adjustment take place at any point in the year?
- Is there an allocated budget amount given to you, or will you need to make a case to receive funds?
- What kind of evidence will you need to back up your budget?

Step Three: Identify Your Goals and Deliverables

You should also note what high-level goals your budget must have. Some examples: increase sales by 20%, hire two new staff, or increase production by 5%. Then, make a list of the end deliverable(s): a detailed budget, for example, or a list of new projects and estimated expenses.

Step Four: Gather Your Resources

Next, make sure you have all the information you will need. Make a list of additional sources of information and people who can help you out if you get stuck.

Step Five: Plan Your Work

Now you can create a detailed plan of what needs to be done, when it is due, and how you're going to do it. Make sure you leave enough time to let the budget sit for a few days and then to do a thorough review.

Step Six: Do It!

Now that the groundwork is in place, you can start working through the budget package. (If you don't have a budget package, you should still have enough information about what is expected of you to complete the required documents.) Delegate tasks where appropriate, but make sure you maintain final control over decisions. And, always double-check the numbers (even your own!).

Case Study**Background**

You are the head accountant for the IT department at Too-Cute Teddy Bears Inc. You have been given your budget package for the upcoming fiscal year. It includes the following information:

- The budget has been decreased from \$750,000 last year to \$500,000 this year.
- \$100,000 of the budget must be spent on new software for the accounting department.
- At least 100 employees must be trained. Training is now \$500 per day per person.
- A wage and hiring freeze is still in place from last year.

Task

Create a budget based on the information given above, and the figures in the table below.

Expense Categories	Last Year's Projected Budget	Last Year's Actual Amount	Your Budget	Notes
Training	\$75,000	\$80,000		
Wages	\$150,000	\$150,000		
Software Upgrades	\$150,000	\$200,000		
Hardware Upgrades	\$260,000	\$300,000		Major upgrade done last year; no work should be needed this year
Office Supplies	\$15,000	\$12,000		
Emergency Fund	\$100,000	\$95,000		
Total	\$750,000	\$837,000	\$500,000	

Working Smarter

Computer Survival Skills

In this day and age, most tasks are accomplished electronically, particularly in the financial sector. Very few businesses do their books by hand anymore. Here is a list of computer skills that anyone involved in finance should have.

Internet and E-mail

- Solid overall understanding of Internet browsing and company's e-mail application
- Good understanding of how to efficiently search the Internet
- Repository of appropriate financial and industry journals and resources saved in Internet browser
- E-mail and mail subscriptions to appropriate financial and industry journals set up
- Able to attach files to outgoing e-mail
- Able to open files received in e-mail
- E-mail organizational system has been created and is used
- Help resources have been identified

Word Processing

- Solid overall understanding of the application
- Repository of required templates (provided by company or user-created and company approved) has been created and is kept up to date
- Able to create reports with a table of content, page numbers, index, and table of figures
- Able to insert snapshots of reports from other programs
- Able to link files from other programs to a word processing document
- Able to print and e-mail documents
- Help resources have been identified

Spreadsheet Processing

- Excellent overall understanding of the application
- Repository of required templates (provided by company or user-created and company approved) has been created and is kept up to date
- Good understanding of formulas and functions
- Able to create basic spreadsheets with multiple worksheets
- Able to manipulate data
- Able to create graphs and charts
- Familiar with data manipulation tools, such as lookup equations, goal seek, equation solvers, and scenario management tools
- Able to print and e-mail documents
- Help resources have been identified

In-House Financial System (if applicable)

- Excellent overall understanding of the application
- Repository of required templates (provided by company or user-created and company approved) has been created and is kept up to date
- Excellent understanding of entire document flow, from initial transaction to journal to ledger
- Easily able to perform daily tasks
- Able to identify how data flows in and out of the system
- Able to export data to other applications
- Able to create required reports
- Able to identify where information for other key reports comes from
- Able to print and e-mail documents
- An understanding of how the system is used for tax and auditing purposes is often useful
- Help resources have been identified

Things to Consider When Choosing Accounting Software

With the proliferation of the PC and computerized accounting packages, many companies do their bookkeeping digitally. However, some companies choose to do their bookkeeping by hand. How do you decide what accounting method to use?

Here's a list of things you should consider when you're trying to decide what software package to use, if any.

- Why do we want to upgrade?
- What is the initial investment? (Make sure you include the cost of software and any computer upgrades that will be necessary, as well as time or resources needed to set these components up.)
- What will the cost be later on? (Make sure you consider upgrades or annual fees.)
- Will we need training? How much will that cost in time and money?
- What support options are available?
- Will this software improve my company's productivity? (In the short term, probably not, but in the long term, the benefits should be significant. Otherwise, it's not worth it.)
- Will this software grow with my company?

If you do decide to go digital, treat the purchase like any other. Make sure you:

- Evaluate at least three software packages.
- Get trials and use them (if possible).
- Talk to people who have used this software and dealt with their technical support.
- Get prices from at least three places.

Test your Knowledge

What are some of the most popular accounting packages? What are their advantages and disadvantages?

What are the advantages and disadvantages to manual bookkeeping?

What system does your company use? What are its advantages and disadvantages?

What are the benefits to both small and large businesses?

Will we ever achieve the paperless office?

People and Numbers

An employee asks for a raise that they deserve but that the company can't afford.

An employee asks for a raise that they don't deserve but the company can afford.

Someone has to be laid off.

Someone's pay has to be cut.

An expense report doesn't look correct.

Further Reading:

- ✓ *Weaver, Samuel C., and J. Fred Weston. Finance and Accounting for Nonfinancial Managers. McGraw-Hill, 2001.*
- ✓ *Tracy, John A. How to Read a Financial Report. Wiley, 2009.*