



# What is Budgeting?

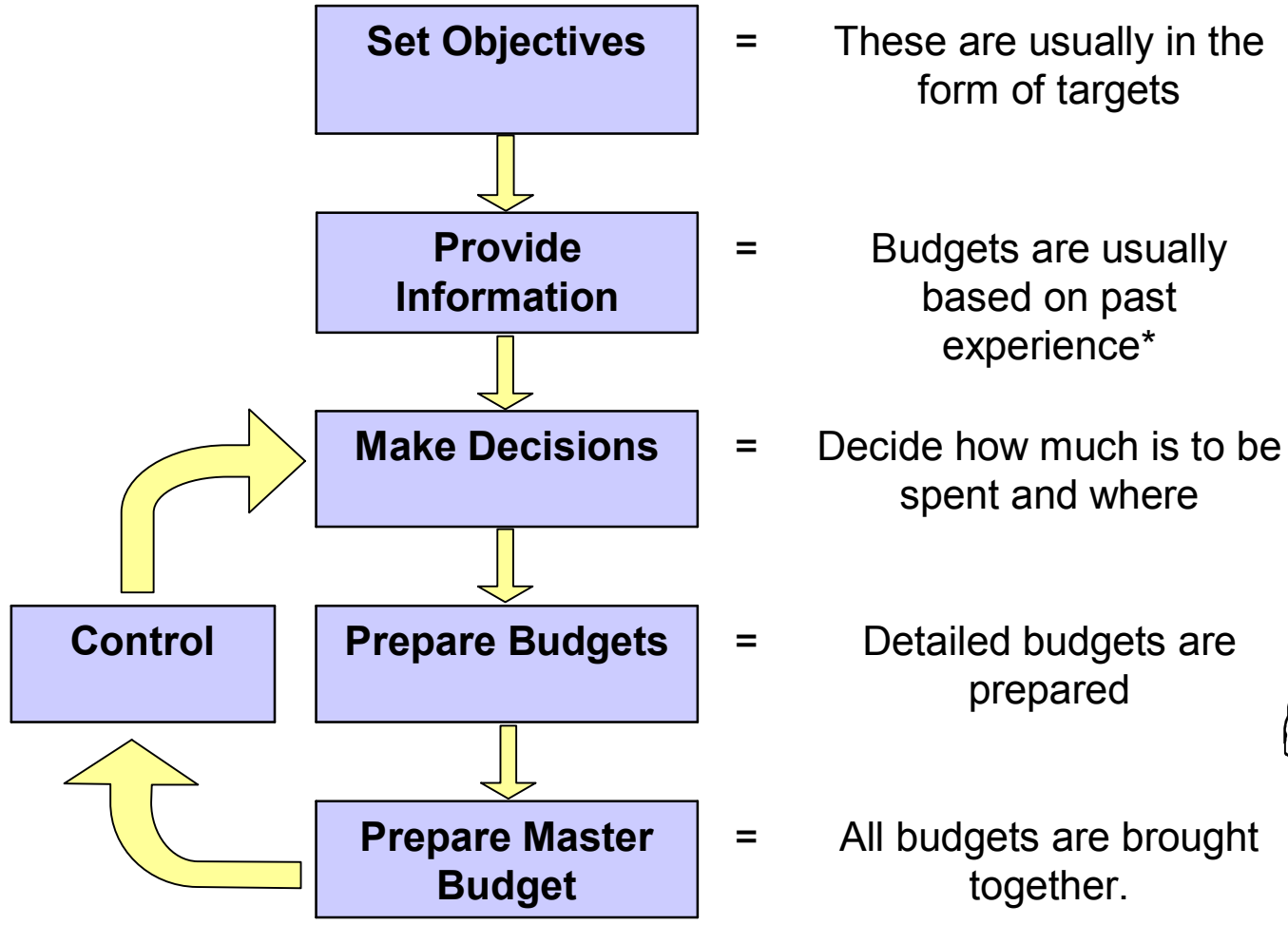
- You will be familiar with “The Budget”
- This is where the Chancellor of the Exchequer outlines his plans for the UK Economy
- He will indicate:
  - the spending plans of the government
  - how and where the government will raise revenue
- This is no different from any other budget drawn up by businesses
- A budget is a statement of the financial position that a business hopes to achieve
- This means that it is a plan, **NOT** a forecast



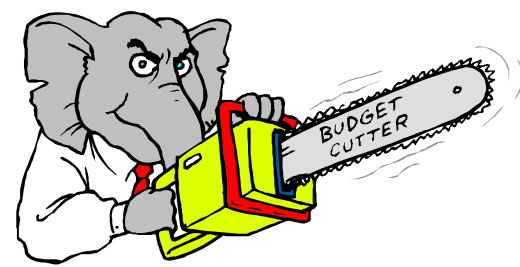


# Setting A Budget

● The following is the usual procedure:



\* NB: Sometimes ZERO-BASED Budgets are used. This means that any historical data is ignored





# Controlling A Budget

- The control section of the process is vital
- It is usually monitored using **VARIANCE ANALYSIS**
- This is a simple method that involves comparing budgeted figures with actual figures
- Clearly for this to be of any value the budget needs to be accurate





# Variance Analysis

- It is calculated using the formula:

$$\text{Variance} = \text{actual level} - \text{planned level}$$

- Care must be taken when interpreting the result:
  - If the answer is **favourable** (actual is better than planned) then it is a **POSITIVE VARIANCE**
  - If the answer is **adverse** (actual is worse than planned) then it is a **NEGATIVE VARIANCE**.
- Managers must look at the reasons for the variance, to avoid future problems
- A favourable variance can sometimes cause as many problems as an adverse one!



# Types of Budget

● A firm will set 2 types of budget

➤ **Capital Budgets:**

- These are concerned with the long-term capital structure of the business, i.e. machinery.



➤ **Operating Budgets:**

- These plan the everyday use of resources. The 3 main ones are:
  - ◆ The profit budget
  - ◆ The cash budget
  - ◆ The budgeted balance sheet





# Why Bother With A Budget?

- Writing a budget requires **targets** to be set
- This target must be realistic, so managers will have to look at what the business is capable of
- This means departments will have to **communicate**
- It concentrates workers minds on what has to be done
- Problems can be identified before it is too late
- By comparing a budget with what actually happened a business can identify weak areas





# Disadvantages of Setting Budgets

- Inaccurate & unrealistic budgets will be ignored
- It can restrict business activity, which may lose the firm business
- If budgets are imposed upon people there is little incentive for them to stick to the targets

