

## *Budgeting*

Budgeting is a complex area of business. Organizations differ in their approach to budgeting based on the industry in which they operate, the size of their organization and the importance of budgeting to their organizational leadership in the decision making process.

If the organization is a service oriented business the budgets will differ from manufacturing businesses. More specifically, manufacturing businesses have additional budgets which do not apply to service oriented businesses. Both types of companies may calculate and use master budgets.

A master budget may contain the following integrated business budgets:

- a) Sales Budget- always the starting point
- b) Purchases Budget (for merchandising companies) OR Production Budgets (for manufacturers)
- c) IF a manufacturer, the next three are Raw Materials; Direct Labor and Manufacturing Overhead Budgets
- d) Cost of Goods Sold Budget
- e) Operating Expense Budget (for some companies)
- f) Budgeted Income Statement
- g) Budgeted Statement of Cash Flows
- h) Budgeted Balance Sheet

The most challenging aspect of the master budget is forecasting sales for the Sales Budget. The organization has little, if any, control over the numerous factors which can influence sales volume. Although there are numerous tools for forecasting including regression analysis, previous experience within the organization regarding sales levels is often the starting place. Last year's figures can be adjusted up or down depending on the state of the economy and the organization as a whole.

If sales are not accurately forecast, the other associated budgets will differ from what they should reflect. This will mean continual monitoring throughout the period so that the most up-to-date numbers are used for the subsequent budgets.

There are numerous other concepts worth introducing which pertain to budgeting:

- Standard vs. actual costs
- Variances
- Usage, Efficiency, Price Variances
- Cost drivers
- Variable Costs
- Fixed Costs
- Flexible Budgets
- Static Budgets
- Activity Based Costing

The organization must use these concepts in a consistent manner. There must be consistency between years since changing the approach or method of budgeting can mislead employees or others and result in a misinterpretation of the budget.

The list above will be examined in later articles by *Accounting and Financial Literacy, Inc.*