

# **BUDGET: PROCESS AND PREPARATION**

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# BUDGET: PROCESS AND PREPARATION

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## CONCEPT AND CHARACTERISTICS

Budgets are important tool for short term planning and control in organisations.

A budget (e.g. an operating budget) is normally prepared for one year and contains information about *likely* amounts of revenue and expenses **planned** for that year.

# Major Characteristics

- It reflects the profit potential of the business unit/division/organization
- Stated in monetary terms backed by non monetary amounts ( Units to be produced, no of employees required etc)
- Prepared for a specific time duration (one year or six months, also influenced by nature and seasonality issues)
- Viewed as commitment by management (managers agree to bear responsibility for achieving budgeted objectives)

# Major Characteristics

- Budget draft is reviewed and approved by higher authority (budget committee )
- Budgeted figures for various items revised only under specific conditions
- Periodical comparisons undertaken with actual performance (financial, operational etc.)

# Budgeting vs Strategic Planning

- Strategic planning is the process of deciding on the nature and size of several programs/projects to be undertaken in order to implement an organization's strategies
- The budgeting process focuses on one period (a year) whereas strategic planning focuses on activities which extend over a period of several years
- Strategic planning precedes budgeting process and provides framework within which budgets are developed
- Strategic plans are structured according to product lines or programs; budgets are structured as per the expected operations of various Responsibility centers

## Budgeting vs Forecasting

- A budget is a management (operational) plan with the inherent assumption that managers will undertake actions to make actual events correspond to the *plans (budgets)*; a forecast is only a prediction of what may most probably occur, with no implications that the forecaster will ever attempt to so control or mould the events that the forecasts will be realized.

# Budgeting vs Forecasting

- A forecast normally has the following characteristics which differ from a budget:
- Forecast may or may not be stated in monetary terms
- Forecast can be for any period, even for a day or week
- No responsibility is assumed by forecaster to achieve the forecasted results
- Not usually approved by higher authorities
- Revised frequently upon emerging new set of information
- Variances from forecasts not analyzed



# Purpose and Uses of a Budget

- Fine tune and operationalize the Strategic plans
- Coordinate the activities of various departments (functional areas)/units
- Assign responsibility to managers; authorize them to spend the budgeted amounts; inform them of the performance expected of them
- Obtain a commitment of managers that is used as basis for evaluating performance

# Contents of an Operating Budget

## **Projected Revenues**

- Subject to greatest Uncertainty that differs across companies
- Function of projected unit sales, Backlogs, Production constraints etc
- Also influenced by effective advertising, attitude of sales personnel etc

## **Budgeted Production cost and Cost of Sales**

- A function of Standard Material and Labour Cost
- Also a function of Standard Mix of Products

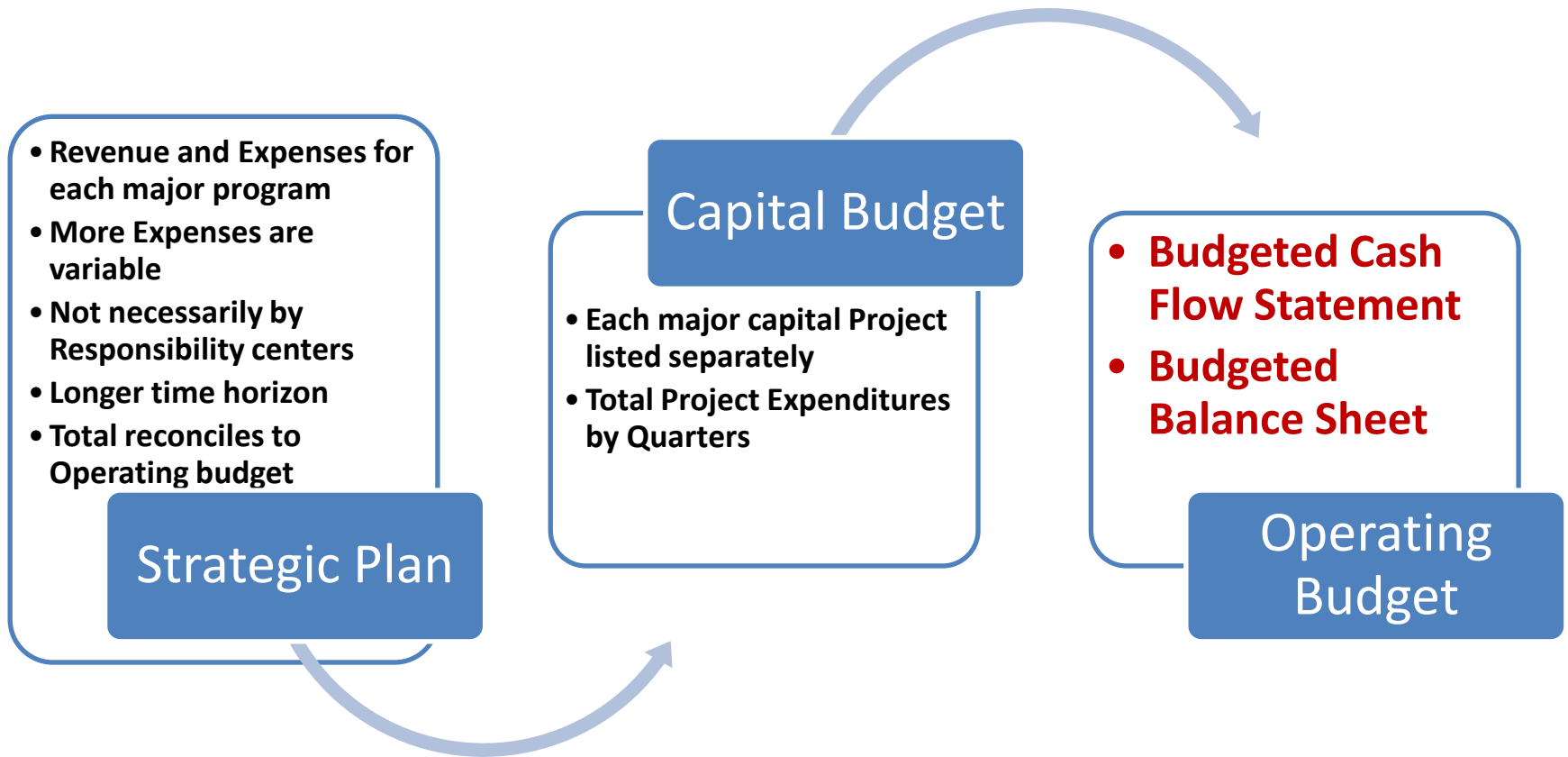
## **Marketing Expenses/ Logistics Expenses**

## **General and administrative Expenses**

## **Research and Development Expenses**

( Expenses may be : **Flexible, Discretionary or Committed**)

# Reconciliation of Operating budget with Strategic Plan and Capital Budget



# Budget Preparation Process

## Functions of Budget Department/Committee

- Coordination among Responsibility centers/Divisions
- Setting Procedures and Preparing Forms
- Developing Guidelines and Assumptions about Economy and Market scenarios
- Inter divisional communication
- Analysis of Proposed Budgets
- Administering Budget revisions
- Analysis of reported performance against budgeted performance
- Interpreting and preparing Summary Reports for senior management

# Budget Preparation Process Continued

- Issuance of Guidelines by Budget Committee
- Setting the Time Line/Time Table
- Initial Budget Proposals
- Updating and Reviews ( Changes in External Forces, Changes in Internal Policies and Practices)
- Negotiation and handling the *Slack (the difference between the budget amount and the best estimate)*
- Revisions and Approval

*Budgeting is a Participatory Process*

*An Ideal Budget is one that is Challenging but Attainable*

# Behavioral Aspects in budgeting

- Top down Vs Bottom up Approaches
- Ensuring Participation in Budgeting Process
- Motivational Impact of Budgeting Process
  - - Greater acceptance of Budget Goals
  - - Effective Information Exchange
- Degree of Budget Target Difficulty and its Implications
- Senior Management Involvement

# Quantitative Techniques Useful for Budgeting

- Simulation
- Scenario Analysis
- Forecasting for Economic and Market variables
- Valuation of Embedded Real Options
- Multivariate Data Analysis