UC:-prepare and monitor budget

1. INTRODUCTION TO BUDGETING

- Budgeting is the process of planning the financial operating of a business organization.
- Budgeting are written financial plan of an organization for a specific period of time, expected in monetary value.
- A budget is a plan showing the company’s objectives and how management intends to acquire and use resources to attain those objectives

- The above definitions of budget states that:
- Are estimates of what will happen in the future
- Are expected courses of action that accomplish the desired organizational goal
- Are generally formal quantities expressions of management plans
- Are simply a financial forecast for a future period

- The distinctive features of budgets are:
- It is prepared, generally, a year in advance of the operations
- It is a guide or blueprint for the coming period.
- It is expressed in monetary terms, though initially it is drawn in physical quantities.
- Budgeting in primarily attention is directing because it helps managers to focus on operating or financial problems early enough for effective planning or action.

STAGES OF BUDGET PREPARATION

- There are three main phases to budget preparation:
- Budget preparation:
- Budget adoption:
- Budget execution:
- Generally, once budgets have been prepared and approved by governments, the implementations of the expenditures must be carefully controlled. A system of control use standards, institutions or mechanisms to multiple controls at all levels and phases of budgetary implementation.

1.4.6. BUDGETS VERSUS FORECASTS

- Define budgets as plans expressed in monetary terms. While all plans deal with expectations concerning future events, it may appear that plans are in a sense of forecasts. Actually the two are related, but are different. Paying attention to the differences between budgets and forecasts contributes to an understanding of both. The main difference is inherent in the fact that forecasts attempt to predict future events without implying any attempt to influence their occurrences. In contrast, in developing a budget the implication is clear that we intend to shape events to make them conform to that quantified plan.

- A forecast has the following characteristics:
- It may or may not be stated in monetary terms.
- It can cover any period of time
- The forecaster doesn’t accept responsibility for meeting the forecast results.
- A forecast can be updated as soon as new information indicates a change in conditions.
- Forecasts are not usually approved by higher authority
- Variances from a forecast are not analyzed formally or periodically

1.5. BUDGETARY CONTROL

- Budgetary control *is* the establishment of budgets relating to the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with budgeted results either to secure by individual action the objectives of that policy or to provide a basis for its revision.
- Budgetary control system includes the following steps:
- Clear allocation of duties and responsibilities
- Establishment of budgets or fixation of targets of performance for each department or function of the organization.
- Comparison of actual with budgeted figures, calculation of the variations between two analyses
- Scrutiny of the variations reveals that there has been some change in the basic conditions, in which the budget was prepared, and the change of permanent nature, steps have to be taken to revise the budget.

1.6. OBJECTIVES AND FUNCTIONS OF BUDGETING

- **To guide action**: Budgeting sets a short- term plan for meeting the objectives of the business.
- **To coordinate different activities**; Budgets are the operating decisions.
- **To motive employees**; Budgetary control sets physical and financial targets to be achieved for the next year.
- **To provide basis for performance evaluation**: A continuous comparison is made of actual with budgeted results. It reveals the cause of difference which is then tracked down.
- **To implement management by objectives (MBO) and Management by Exception(MBE).**

1.7. ESSENTIAL ELEMENTS OF SUCCESSFUL BUDGETING

- Support and involvement of top management:
- Built-by responsibility centers:
- Participation by responsible supervisors:
- Clear- cut organizational structure:
- Continuous budget education:
- Timeliness:
- Reasonably attainable targets
- Management by exception (MBE
- Thorough review of budget estimates:
- Proper communication

- Responsibility accounting:
- Flexible:
- Integration with standard costing system:

PURPOSES OF BUDGETING

- Shows management's operating plans for the coming period(s)
- Formalizes management's plans in quantities terms;
- Forces all levels management to think ahead, anticipate results, and take action to remedy possible poor results, and
- May also be used to motivate individuals so that they strive to achieve stated goals

ADVANTAGE OF BUDGETING

- Formulation of Planning
- Expectations as a framework for judging performance
- Coordination and communication
- Human Relation

DISADVANTAGES OF BUDGETING

- can increase paperwork;
- Can be time- consuming;
- Can be inflexible;
- Can meet with resistance;
- Can be slow to work;
- is not a substitute for management itself;
- Can be ineffective and expensive; and
- Can hide inefficiencies

One definition:

Financial document that details an estimate or forecast of revenue and expenses for a specified period of time (usually up to one year) *in the future*

- Revenue – money flowing into the business
- Expenses – money flowing out of the business.

Activity

Correctly identify the following as Revenue or Expense items for the business:

- Food sales
- Advertising
- Stationery
- Rent
- Ticket Sales
- Telephone usage
- Tour sales
- Petrol
- Room sales

- Wages
- Supplies
- Other Sales
- Electricity usage
- Insurance
- Laundry
- Ticket Sales
- Vehicle repairs

Types of budgets

- Smaller business – one budget
- Larger businesses may budget a number of different ways
  - By department
    - Accommodation, Restaurant, Domestic sales
  - By activity
    - Profit centres - Income produced and expenses incurred
    - Cost centres - Expenses incurred only.

Types of budgets

- By individual revenue or expenses
  - Labour, supplies
- Summary budgets
  - Sales budget
  - Advertising budget
  - Cash budget.

The budgeting process

The budgeting process

Where do you begin?

- Almost everything that happens in a business is determined by the level of sales activity
- The first budget to be prepared is the sales budget
  - One or more revenue items are identified and calculated
  - May be a separate budget in a large organisation.

Sources of data

Information is researched and collected

- Internal sources of data:
  - Information gathered from within the organisation or business
  - Advantages
    - Readily available
    - Assistance to interpret the information can come from within the business
    - Cost effective
  - Disadvantages
    - Based on past rather than future activities .

Sources of data

Examples of internal sources of data

- Policies and procedures
- Financial commitments already made for the budgeted period
- Previous periods revenue and expenses
- Marketing plans
- Planned promotions
- Details of planned changes to products sold or services offered.

Sources of data

- External sources of data:
  - Information gathered from outside the organisation or business
  - Is it reliable?
  - Is it relevant to the budgeted period?
  - Disadvantages
    - Time and cost outweigh the benefits
    - Difficult to find.

Sources of data

Examples of external sources of data:

- Commercially available customer research
- Statistics on economic performance
- Direct observation of competitors
- Conversations with suppliers of goods or services to the business

Sources of information

Analysis and review of data:

- Quality in means quality out!
- Time
- Communication with stakeholders
- Changing internal and external issues.

Sources of information

An example:

- Estimating sales
  - Combine internal and external sales data
  - Will price increase or decrease?
  - Will volume of sales change?
  - Is the timing of sales going to change?
  - Calculations.

Budgeting strategies

- Smaller business – less people, less conflicts and opinions to manage

- Larger organisation:
  - Different opinions
  - Competing demands between departments

- Two strategies:
  - Top down approach
  - Bottom up approach.

Budgeting strategies

- Top down approach
  - Direction given from owners and senior managers without consultation
  - Minimal stakeholder input and communication
  - Time and expertise.

Bottom up approach

- Communication and consultation with all stakeholders Open forum for discussing and resolving conflicts Time and The bottom up approach is a much more favored strategy for managing the budget process. At the budget committee level, owners seek the input into budget objectives for the budgeted period.

The budget committee

Most common example of a bottom up approach:

- Budget objectives discussed and set
- Data reviewed and analysed
- Conflicts resolved
- Communication
  - Circulation of information.

The draft budget

Policies and guidelines:

- Enterprise policy
  - Details the budget process
- Budget manual
  - Timelines
  - Templates and forms
  - Notes
  - Checklists

(Continued)

The draft budget

Policies and guidelines:

- Methodology
  - Incremental budgeting
  - Zero based budgeting
  - Rolling budgets
  - Flexible budgets.

1. Incremental Budgeting

One of the first sources of information that is gathered to draft budgets is actual income and expenditure from the previous budget period. Modifying previous actual figures as the basis of your budget preparation for the coming period is called Incremental Budgeting.

2. Zero Based Budgeting

Analysis based on current and future information rather than past performance is used.

3. Rolling Budgets

- As one month finishes another month is added to the budget. Here you update the budget when a period is completed but incorporate recent information for the new budgeted forecast. For example a cash budget for three months for January to March, would become February to April. Rolling budgets are often used by smaller business and are very useful within the hospitality and tourism industry as unexpected events such as natural disasters can significantly affect planned activity.

4.Flexible Budgeting

- Budgets for comparison and control of revenue and expenses provide better information when they are designed for the same level of business activity.

The draft budget

Estimate revenue and expenses:

- Budget objectives set
- Data reviewed for:
  - Validity
  - Reliability
  - Relevance

(Continued)

The draft budget

Estimate revenue and expenses:

- Budgeted sales calculated
  - Overall sales target
  - Previous sales data
  - Price changes
  - Volume changes

(Continued)

EXAMPLE OF PERSONAL SAVING

Ato Belayneh receives 3000 birr from the supermarket he is working in as a salary. He has the following expenditures. 800 birr for food, 430 birr for clothing, 70 birr for car gas expense and 200 birr recreation.

A. calculate personal saving?

Solution income basic salary 3000

Expenses food expense 800

- Cloth expense 430
- Car gas expense 70
- Recreation expense 200
- Total expense 1500
- Personal saving = total income – total expense (3000 – 1500) = **1500**

Additional information

Item	Actual income and Expenditure	Estimated income and expenditure
Income	90%	2100
Clothing	100%	800
Food	85%	400
Gas	50%	200
Recreation	70%	120

B. Calculate the actual income and expenditure.

C. Calculate actual saving and estimated saving.

D. Calculate percentage of actual saving against estimated saving.

Solution

B.

Total actual income = 2100 x 90% = **1890**

Expenditures cloth expense **=** 800 x 100%= 800

Food expense = 400 x 85% = 340

Gas expense = 200 x 50% = 100

Recreation exp = 120 x 70%= 84

Total actual expenditure = **1324**

C. Actual saving = actual income – actual expenditure

= 1890 – 1324 = **566**

Estimated saving = Estimated income – Estimated expenditure

= 2100 – 1520 = **580**

D. percentage of A.S against E.S =A.S/E.S x 100 =566/580 x100= **97.59**

- The following data is given for personal income and expenditure for kaleb demelash from July to Oct 2014. At kaleb wants to the remaining income after expenditures are covered.

Description	July	August	September	October	Total
Clothing's	1,377	-	1,377	-	
Food and other consumption	6,120	6,480	6,120	7,038	
Monthly house rent expense	2,295	2,430	2,295	2,639	
Over time work	300		300	345	
Part time work		1,200			
Salary	15,000	15,000	15,000	17,250	
Transport expense	765	810	765	880	
Tuition fees	1,530	1,620	1,530	1,759	
utilities expense	306	324	306	351	
personal saving					

A. Re arranges the above data and prepare the four month budget for kaleb?

B. Identify a business opportunity that is available in order to establish a business?

C. Identify the advantage of personal saving, investment and related risks on investment?

Description	July	August	September	October	Total
income :					
Salary	15,000	15,000	15,000	17,250	62,250
over time work	300		300	345	945
part time work		1,200			1,200
Total income	15300	16200	15300	17595	64395
Fixed expenses ;					
monthly house rent expense	2,295	2,430	2,295	2,639	9,659
Tuition fee	1,530	1,620	1,530	1,759	6,439
Total fixed expense	**3,825**	**4,050**	**3,825**	**4,398**	**16,098**
variable expense					
clothing's	1,377		1,377		2,754
transport expense	765	810	765	880	3,220
food and other consumption	6,120	6,480	6,120	7,038	25,758
utilities expenses	306	324	306	351	1,287
Total variable expenses	**8,568**	**7,614**	**8,568**	**6,269**	**33,019**

Total fixed and variable expense	**12,39 3**	**11,664**	**12,393**	**12,667**	**49,117**
Personal saving	**2,907**	**4,536**	**2,907**	**4,928**	**15,278**

Task 3.2 business opportunities

- Coffee house
- Barbering
- Beauty salon
- Internet service
- Wood work
- Metal work

Task 3.3 Related risk on investment

1. Political Risk
2. Social Risk
3. Economical Risk
4. Business Risk

- Ato Yared is one of the employees of DDS Company who earns a weekly salary of 525 during 2012. The expenses which are incurred during the month of January are as follows.
- Rent cost 250 birr
- Insurance premium = 150 birr
- Transport expense = 100 birr
- Communication cost =50 birr
- Maintenance cost =60 birr
- Food expenses =140 birr

- Due to addition commitments like saving for condominium houses he wants to increase saving by reducing his cost with the following amount.
- Rent cost 10%
- Food expense 15%
- Transport expense 30%
- Communication cost 50%
- Maintenance cost 15%

A. prepare the annual budget for Yared

B. calculate the percentage change in saving

Item	costs for the month of January 2012	Annual cost of 2012	Budget for the month of the January 2013	Annual budget for the year 2013
income	**2100**	**25,200**	**2100**	**25,200**
Expense				
rent cost	250	3000	225	2,700
insurance premium	150	1,800	150	1,800
Transport expense	100	1,200	70	840
Maintenance	60	720	51	612
Food expense	140	1,680	119	1,428
Total expense	**750**	**9000**	**640**	**7680**
Persona saving	**1350**	**16200**	**1460**	**17520**

B. required percentage change in saving

Parentage change = (1,460 – 1,350)/1,350 x 100 = 8.15%

Ato fentahun earns birr 9,500 basic salary his monthly expense is given as follow

- Closing expense is 12% of his basic salary
- Food expense is 20% of his basic salary
- Rent expense is 30% of his basic salary
- Educational expense is 5% of his basic salary
- Transportation expense is 5% of his basic salary

A. prepare the monthly and annually budget

Ato fentahun wants to open and run a new business with a required capital of birr 80,520. Based on his annual saving he borrowed the remaining amount from bank at 8.5% interest paid semi-annually equal installment within 3 years

B. what are sources of information required for opening and running a business

A. prepare monthly and annually budget

Ato Fentahun

Personal budget

Monthly

Items	Estimated budget
income	
Net salary	9,500
Expenses	
closing expense	1,140
Food Expense	1,900
Rent expense	2,850
Educational expense	475
Transport expense	475
Total expense	6,840
personal saving	2660

- Personal saving = income –Total expense

= 9,500 -6,480 = **Br 2,660**

Items	
income	
Net salary	114,000
Expenses	
closing expense	13,680
Food Expense	22,800
Rent expense	34,200
Educational expense	5,700
Transport expense	5,700
Total expense	82,080
income	31,920

- Annual income = Monthly income x 12Month
- Annual expense = Monthly expense x 12Month
- Personal saving =Annual income–Annual expense

= 114,000 - 82,080 **= 31,920**

Individual assignment I out of (15%)

Mr. 'A’ receives 4000 birr from the supermarket he is working in as a salary. He has the following expenditures. 900 birr for food, 530 birr for clothing, 100 birr for car gas expense and 150 birr recreation.

A. calculate personal saving?

Individual assignment II out of (15%)

- Ato Dawit is one of the employees of DDS Company who earns a weekly salary of 925 during 2020. The expenses which are incurred during the month of January are as follows.
- Rent cost 450 birr
- Insurance premium = 250 birr
- Transport expense = 200 birr
- Communication cost =100 birr
- Maintenance cost =80 birr
- Food expenses =240 birr

- Due to addition commitments like saving for condominium houses he wants to increase saving by reducing his cost with the following amount.
- Rent cost 15%
- Food expense 20%
- Transport expense 30%
- Communication cost 40%
- Maintenance cost 15%

A. prepare the annual budget for Dawit

B. calculate the percentage change in saving

End