Developing goals and preparing various budgets

The implementation of a company's strategic plan often begins by determining management's basic expectations for future economic, competitive and technological conditions and their impact on the expected goals, both in the long and short term. Many companies are currently carrying out a situational analysis which involves examining their strengths and weaknesses and the external opportunities and threats they may face from competitors. This common analysis is often labeled as SWOT. After conducting the situation analysis, the organization identifies potential strategies that can enable it to achieve its goals. Finally, the company will develop, initiate and monitor both long-term and short-term plans. An important step in the start of the company's strategic plan is the creation of a budget. A good budget system will help a company achieve its strategic goals by allowing management to plan and control major categories of activity, such as revenue, expenses and funding opportunities. As described in Accounting as a tool for managers, planning involves developing future goals, while monitoring involves monitoring the planning goals that have been put in place. There are many benefits to budgeting, including: Communication Budgeting is a formal way to communicate a company's plans to its internal stakeholders, such as managers, department managers, and others who have an interest in - or responsible for - monitoring the company's performance. Budgeting requires managers to plan both revenue and expenses. Planning Preparing a budget requires managers to consider and evaluate the prerequisites used to prepare the budget. Long-term financial goals. Short-term financial targets. The company's position on the market. How each department supports the strategic plan. Preparing a budget requires departments to work together to determine sales goals that can be realized. Calculate the production or other requirements necessary to meet sales goals. Solve bottlenecks predicted by the budget. Allocate resources so that they can be used efficiently to meet sales and production goals. Compare budgeted or flexible budgets with actual results. Evaluation Compared to actual results, budgets are early reports and they predict: Cash flows for different production levels. When loans may be required or when loans can be reduced. Budgets show which areas, departments, units, etc. are profitable or meet their relevant goals. Similarly, they also show which components are unprofitable or do not reach their expected goals. Budgets set defined benchmarks that can be used to evaluate company and management performance, including travel and bonuses, as well as negative Such as. To understand the benefits of budgeting, consider Big Bad Bikes, a company that manufactures Mountain bikes. The company will start producing and selling trainers this year. Trainers are stands that allow a rider to ride their bike indoors similar to the way bikes are used in spinning classes. Big Bad Bikes has a 5-year plan and has always been successful in managing its budget. Managers participate in the development of the budget and are aware that all expenses must be related to the company's strategic plan. They know that it is much easier to manage their departments when the budget is designed to support the strategic plan. The plan for Big Bad Bikes is to introduce themselves to the trainer market with a sale price of $70 for the first two quarters of the year and then raise the price to $75 per unit. The marketing department estimates that sales will be 1,000 units for the first two quarters, 1,500 for the third quarter and 2,500 per quarter through the second year. Management will work with each department to communicate goals and build a budget based on the sales plan. The resulting budget can be evaluated by all departments involved. All companies – large and small – have limits on how much money or resources they can receive and disburse. How these resources are used to achieve their goals and goals should be planned. The quantitative plan that estimates when and how much cash or other resources are received and when and how the money or other resources should be spent is the budget. As you've learned, some of the benefits of budgeting include improved communication, planning, coordination, and evaluation. All budgets are quantitative plans for the future and will be drawn up on the basis of the needs of the organisation to which the budget is being set up. Depending on the complexity, some budgets can take months or even years to develop. The most common period covered by a budget is one year, although the time period can range from strategic, long-term budgets to highly detailed, short-term budgets. In general, the closer the company is to the start of the budget period, the more detailed the budget becomes. Management begins with a vision for the future. The long-term vision sets the direction of the company. The vision evolves into objectives and strategies built into the budget and directly or indirectly reflected in the master budget. The main budget has two main categories: the financial budget and the operating budget. In the financial budget there are plans for the use of assets and liabilities and results in an expected balance sheet. The operating budget helps plan future revenues and expenses and results in an expected profit and loss statement. The operating budget has several subsidiary budgets, all of which begin with expected sales. Management, for example, estimates that the number of people who are in work is The estimated sales are then broken down into quarters, months, and weeks and prepare the sales budget. The sales budget is the foundation other operating budgets. Management uses the number of units from the sales budget and the company's inventory policy to determine how many units to produce. This information in units and in dollars becomes the production budget. The production budget is then divided into budgets for materials, labor, and fixed costs, which use the standard quantity and the standard price for raw materials to be purchased, the standard direct labour rate and the standard direct work hours to be scheduled, and the standard costs for all other direct and indirect operating costs. Companies use the historical quantities of material per unit and the hours of direct labor per unit to calculate a standard used to estimate the amount of materials and working hours required for the expected production level. Current costs are used to develop standard costs for the price of materials, the direct labor rate, as well as an estimate of fixed costs. The budget development process results in different budgets for different purposes, for example, in the budget development process. To save time and eliminate unnecessary iterations, management often starts with the current year's budget and adjusts it to meet future needs. There are different strategies companies use to adjust budget amounts and planning for the future. For example, budgets can (Figure) show the general difference between the top-down approach and the bottom-up approach. The top-down approach typically begins with senior management. Information about targets, assumptions and expected revenue and expenses is transferred from the chief executive to middle managers, which further discloses the information downwards. Each department will then have to determine how it can allocate its expenses efficiently while still meeting the company's goals. The advantage of this approach is that it is related to the strategic plan and the company's objectives. Another advantage of reducing the permitted costs is that the final expected costs are reduced by examining the process (fact-checking and collecting information). In the top-down approach, management should pay attention to an efficient allocation of resources to ensure that expenditure is not padded to create budgetary slack. The downside of this approach to budgeting is that the budget is prepared by individuals who are not familiar with specific operations and expenses to understand each department nuances. The bottom-up approach (sometimes also called a self-imposed or participative budget) begins at the lowest level of the business. Once the senior management has announced the expected department goals, the departments then plan and predict their sales and estimate how much resources are needed to achieve these goals. This information is disseminated supervisor, who then transfers it to the senior management levels. The benefits of this approach are that managers feel that their work is valued and that savvy individuals develop the budget with realistic numbers. Therefore, the budget is more likely to be reached. The downside is that leaders may not fully understand or misunderstand the strategic plan. Other approaches in addition to top-down and bottom-up approaches are a combination approach and zero-based budgeting method. The combination approach sets guidelines and goals at the top, while managers work to develop a budget within the targeted parameters. Zero-based budgeting begins with zero dollars and then adds only revenue and budget expenses that can be supported or justified. (Figure) illustrates the difference between traditional budget preparation and zero-based budgeting in a bottom-up budget scenario. The advantage of zero-based budgeting is that unnecessary spending is eliminated because managers cannot justify them. The downside is that each expense must be justified, including obvious ones, so it takes a lot of time to complete. A compromise tactic is to use a zero-based budgeting approach to certain expenses, such as raises that can be easily justified and linked to the company's goals. Comparison of traditional budgeting process and zero-based budgeting process. In a bottom-up budget environment, the budget process begins with lower level or operational management. Under a traditional budgeting, last year's budget would be the starting point for the creation of the current budget. Under a zero-based budgeting method, all budget numbers are recently derived each year or budget cycle. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license) Budgets are often developed so that they can adjust for changes in volume or activity and help management make decisions. Changes and challenges can affect the budget and affect a company's plans. A flexible budget adjusts the price of items produced to different production levels and is more useful than a static budget that remains at one amount regardless of production level. A flexible budget is created at the end of the fiscal year, while the static budget is created before the fiscal year begins. In addition, (Figure) shows a comparison of a static budget and a flexible budget for Bingo's Bags, a company that produces purses and backpacks. The flexible budget calculates the budgeted costs with the actual sales, while budgeted costs in the static budget are calculated with budgeted sales. The flexible budget allows management to see how they expect the budget to look based on actual sales and budgeted costs. Flexible budgets are addressed in more detail in Prepare Flexible Budgets. flexible flexible and a static budget. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license) To deal with changes that occur in the future, businesses can also use a rolling budget that is constantly updated. While the company's goals can be multi-year, the rolling budget is adjusted monthly and a new month is added as each month passes. Rolling budgets allow management to respond to changes in estimates or actual events, but it also removes management from other tasks because it requires continuous updating. (Figure) shows an example of how a rolling quarterly budget would work. Note that when a month rolls off (is completed), another month is added to the budget, so that four quarters of the year are always presented. Rolling budget. In a quarterly operating budget, the budget always projects forward for four months or a quarter. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license) Because budgets are used to evaluate a manager's and company's performance, managers are responsible for specific expenses within their own budget. Each manager's performance is evaluated on the basis of how well he or she manages the income and expenses under his or her control. Each person exercising control over expenditure should have a budget setting limits on those expenditure. Most organizations create a main budget — whether your organization is large or small, public or private, or a merchandising, production, or service company. A main budget is a budget comprising two areas, operational and financial, each of which has its own sub-budgets. The operating budget spans several areas to help plan and manage day-to-day operations. The financial budget shows the expectations for cash flows and outflows, including cash payments for planned operations, asset purchases or sales, payment or financing of loans, and changes in equity. Each of the subbudgets consists of separate but interconnected budgets, and the number and type of separate budgets vary depending on the type and size of the organization. For example, the sales budget predicts a 10%- The direct materials budget uses information from the sales budget to calculate the number of units needed for production. This information is used in other budgets, such as <a0></a0> or <a1></a1>. You review some specific examples of budgeting for direct materials in Prepare Operating Budgets. (Figure) shows how operating and financial budgets are related within a main budget. Operating budgets, budgets, and the ratio of budgets. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license) An operating budget The budget for sales, production, direct material budget, direct labour budget and fixed budget. These budgets serve to help with planning and monitoring the organization's day-to-day activities by informing management about how many units to produce, how much material to order, how many hours of work to plan, and how many fixed costs are expected to be incurred. Each part of the operating budget leads to the overall preparation of the budgeted profit and loss account. For example, Big Bad Bikes estimates that it will sell 1,000 trainers for $70 each in the first quarter and prepares a sales budget to show sales by quarter. Management understands that it needs to have on hand the 1,000 trainers that it estimates will be sold. It also understands that additional inventory must be available if there are additional sales and to prepare for sales in the second quarter. This information is used to develop a production budget. Each trainer requires 3.2 pounds of material, which usually costs $1.25 per pound. Knowing how many units to produce and how much inventory should be in stock is used to develop a direct material budget. The direct materials budget tells managers when and how much raw materials to order. The same applies to direct labour, as management knows how many units will be manufactured and how many hours of direct labour is needed. The necessary hours of direct labor and the estimated labor rate are used to develop the direct labor budget. While the materials and labor are determined from the production budget, only the variable costs can be determined from the production budget. Existing information on fixed production costs is combined with variable production costs to determine the budget for indirect production costs. The information from the sales budget is used to determine the sales and administration budget. Finally, sales, direct materials, direct labour, fixed production budget and sales and administrative budgets are used to develop a pro forma profit and loss statement. A financial budget consists of the cash budget, the budgeted balance and the budget for capital expenditure. Like the individual budgets that make up the operating budgets, the financial budgets serve to help plan and monitor the organization's funding needs. Management plans its capital asset needs and states them in the capital expenditure budget. Management addresses its debt collection and payment policy to determine when it will receive cash from sales and when it will have to pay material, labour and overheads. The capital expenditure budget and the estimated payment and collection of cash allow management to a cash budget and decide when it will need funding or have additional funds to repay loans. These budgets budgets together will be part of the budgeted balance. (Figure) shows how these budgets are related. Retaining a Cash Balance DaQuan recently began working as a senior accountant at The Food Coffee Company. He learned that he would be responsible for monitoring cash because there is a bank loan requirement that a minimum balance of $10,000 be maintained with the bank at all times. DaQuan asked to see the cash budget so he could predict when the balance was most likely to go below $10,000. How can DaQuan determine potential cash balance issues by looking at the budget? Solution Budgeting helps to plan for the times when cash is a shortfall and bills have to be paid. Proper budgeting shows when and for how long a lack of cash can exist. DaQuan can see the months when cash payments exceed cash income and when the company is at risk of having a cash balance below the minimum requirement of $10,000. Knowing the influx and outflow of cash will help him plan and manage the shortage through a line of credit, delay in purchases, delay in hiring, or delay in payment of non-essential items. Key concepts and summaries A good budget system helps management achieve their goals through planning and control of cash flows through revenue and financing and outflows through payment and expenses. There are various budgeting strategies, including bottom-up, top-down and zero-based budgeting. A static budget is created at one activity level, while a flexible budget allows variable expenditure to be adjusted for different activity levels. A main budget includes subcategories of operating and financial budgets. A main budget shall be drawn up at the estimated level of activity. (Figure) Which of the following is not part of the budgeting? planning of bottlenecks that provide performance evaluations that prevent net operating losses (figure)Which of the following is an operating budget? cash budget budget budget capital budget budget (Figure)Which of the following is a funding budget? cash budget production budget direct materials procurement budget tax budget (Figure)Which approach is most likely to result in employee buy-in to budget? top-down approach bottom-up approach overall participation approach basing the budget on the previous year (Figure)What approach does management require to justify all its spending? bottom-up approach zero-based budgeting master budgeting capital allocation budgeting (Figure)Which of the following is the case in a bottom-up budgeting approach? All expenditure shall be justified. Supervisors tell departments their budget amounts and departments are free to work within those amounts. Departments budget their needs, but they deem it appropriate. their needs and relate them to the overall objectives. (Figure) The most common budget is prepared for a _____ (Figure) What is a budget and and are the different types of budgets? A budget is a written financial plan for a specific period, which is typically a year. There are several different types of budgets, including main budget, operating budget, financial budget, flexible budget and operating budget. (Figure) What is the difference between budgeting and long-range planning? (Figure) What are the advantages and disadvantages of the bottom-up budget approach? This approach begins at the lowest level of management. These managers know the information involved in their departments. This allows for more accurate budget estimates when management understands how their department contributes to the company's goals. The disadvantages include that this type of budgeting takes time, leading to more labor costs, and when management does not fully understand how it contributes to the company's goals, the budget can support the department and not the company. (Figure) Why can a rolling budget require more leadership participation than an annual budget? (Figure) Why is a clear understanding of management's goals and goals necessary for effective budgets? (Figure) It's proper budgeting procedure to begin with estimated revenue, but why could some nonprofit entities start planning their spending instead of their revenue? budget quantitative plan estimates when and how much cash or other resources will be received and how the cash or other resources will be used financial budget category of budgeting, describing estimates for cash flows and outflows through planned operations and changes capital investments of assets, liabilities and equities overall budget that include operating and financial budgets operating budget category of budgeting , managers plan and manage production , order materials, plan direct labour, and monitor the current budget budget for fixed expenses, which is continuously updated by adding an additional budget period at the end of the current budget period zero-based budgeting budget, beginning with zero dollars and then only including revenue and expenditure in the budget that can be supported or justified by eligible ones;