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BASIC BUDGET DEVELOPMENT

Budgeting is the process of allocating scarce resources to unlimited demands, a dollars & cents plan of operation for a specific period of time. As a minimum, such a plan should contain information about the types and amounts of proposed expenditures, the purposes for which they are to be made, and the proposed means of financing them.

The adoption of a budget implies that decisions have been made, on the basis of a planning process, as to how the unit is to reach its objectives. The accounting system then provides assistance to the administrators in carrying out the plans and in preparing the statements that permit comparison of operations with the budgets.

GENERAL OVERVIEW OF PROCESS - AREAS TO REVIEW:

1. Purposes of Budgets
2. Considerations in Preparing Budgets
3. Some General Principles of Budgeting
4. Behavioral Implications
5. Basic Budget Terminology
6. Appendix – NACUBO Information

1. Purposes of Budgets

Budget = Guide

- In business, a budget is simply a plan showing how management intends to acquire & use resources and how it intends to control the acquisition & use of resources in a coming time period.

  The budget often has been referred to as a formal quantitative expression of management plans. Yet it is much more than that. It forces all levels of management to think ahead, anticipate results, and take action to remedy possible poor results.

  Need to know expectations, ie % profit desired vs. % profit earned

- Budgets may also be used to motivate individuals, causing them to strive vigorously to achieve stated goals. They may also be used to appraise the performance of individuals.

- Many other benefits result from the preparation and use of budgets:
  - The activities of the business are better coordinated
  - Individual members of the management team become aware of the problems of other members of management
  - Employees may become cost conscious and seek to conserve resources
  - The organization plan of the enterprise may be reviewed more often & changed where needed
  - A breadth of vision, which might not otherwise be developed is fostered

- Another important benefit is that a properly prepared budget will allow management to manage by the exception principle. Management by exception means devoting attention to areas where activities are deviating from their planned levels.

$\boxed{\text{Control}}$
* consider bad food delivery
* consider employee w/sick leave pd & need to get another employee to pay overtime to cover that missing person
* consider fire alarm – lose food, customers (revenue source)

2. Considerations in Preparing Budgets

A budget plan should explicitly spell out management's assumptions relating to such things as:

- the state of the economy over the planning horizon (cost of living)
- plans for adding, deleting, or changing product lines (trends)
- the nature of the industry's competition (on & off campus)
- the effect of existing or possible government regulations (campus card)

If the nature of the assumptions should change during the budget period, an analysis of the effects should be made and reflected upon in the evolution of the company's performance.

In the preparation of a budget, accounting data plays an important role. The details of the budget must be in agreement with the accounts maintained in the company's ledgers. The accounts, in turn, must be designed to facilitate the preparation of the budget and the usual financial statements as well as the numerous reports – cost & financial – that are prepared quarterly, monthly, weekly or even daily to help exercise operational control.

During the budget period repeated comparisons of accounting data and budgeted projections should be made and the differences investigated. But it should be noted that budgeting is not a substitute for management and that a budget is not self-operating. Instead, the budget is designed as merely a tool – but an important one – of managerial control.

12 month periods

Budget periods vary in length, but usually they coincide with the accounting period. Normally, the budget period is broken into months or quarters, and the greater the uncertainty faced, the more likely is this to be the case.

*Cost of living

*Trends (diet – vegan, organic, etc. ⇒ mainstays in industry)

3. Some General Principles of Budgeting

Budgeting involves the coordination of financial and non-financial planning to satisfy the goals and objectives of the organization.

- Top management support
    - All levels of management must be aware of the importance of the budget to the organization
    - Plans must be stated explicitly and over-emphasis on pure mechanics avoided
    - Overall broad objectives of the organization must be decided upon and communicated through the organization

- Participate in goal setting
    - It is generally believed that an employee is more likely to strive to achieve organization goals if the employee participates in the setting of these goals

- Responsibility accounting
    - People should know their own performance goals. Only those costs over which an individual has predominant control should be used in the evaluation of the individual's performance

- Communicate the results
    - People should be informed of their own progress in a timely and meaningful manner. Effective communication implies:
        - Timeliness
        - Reasonable accuracy
        - Understandability
    - Results should be communicated in such a manner that adjustments can be made, if needed

esp w/direct supervisor - will open up communications

- Flexibility
    - As basic assumptions underlying the preparation of the budget are altered during the year, the budget should be restated so that the efficiency of the actual level of operations can be analyzed

Consider investments such as new equipment to save energy bill / water bill / etc. to make up for issues of too low profits.

4. Behavioral Implications

Too often the term budget has very negative connotations to personnel who feel they are subjected to a budget.
Reasons:

- a budget has been imposed by management without giving consideration to the opinions and concerns of the personnel affected
- there might be a lack of understanding about the program, concern about status, expectation of increased pressure

The problems encountered by such imposed budgets have led the accountant and management to participatory budgeting.

Budget participation includes active participation of all levels of management in the setting of operating goals for the forth-coming period. Managers are much more likely to understand, accept and pursue those goals, which they were actively involved in formulating.

Accountants are the compiler or coordinator of the budget, not the preparer. They should be on hand to present and explain significant financial data and their relationships. Accountants have the responsibility for meaningful budget reports.

5. Basic Budget Terminology

Capital versus Current Budgets

Capital budget – a plan of proposed capital outlays and the means of financing them for the current fiscal period (part of the current budget)

* long or short term changes in company that will affect current budget (ex: adding wing to hospital)

Current budget – the annual budget prepared for and effective during the present fiscal year

TYPICAL FORMULA FOR BUDGET DECISION MAKERS IS AS FOLLOWS:

Estimated fund balance, (if you can carry over from previous accounting period) Beginning of budget year	$	X
ADD: Estimated revenues, (where is $ coming from) Budget year	$	Y
Total appropriable resources, budget year	$	X + Y
DEDUCT: Estimated expenditures, (operating expenses: Labor & cost of food, utilities, fees, overhead) Budget year	$	Z
Estimated fund balance, end of year	$	X + Y - Z

Profit or Loss?

Non-profit org → good to be @ Ø balance

6. NACUBO (National Association of College and University Business Officers)

According to NACUBO:

> Auxiliary enterprises are those activities that support the institution but that are financially self-contained and specific enough to be managed as separate budget items. Furthermore, each auxiliary enterprise has a source of income derived from students, and in some cases, the public. Examples of such activities are residence and dining halls, student union retail activities, intercollegiate athletics, and bookstores.

Criteria on how to report revenue

An enterprise as large as higher education is affected by the same economic and political pressures that affect other major activities in this country. Some of the most significant pressures are long term:

1. Personnel costs, especially in an industry as labor intensive as higher education
2. The costs of plant maintenance (bdg maint.)
3. The prices of purchased goods and services
4. The costs of complying with federal regulations and mandated social programs (language, culture, disability)

Consider new apts built $ if those students will eat @ dining hall

Other pressures have been added recently:

1. The cyclical changes in the size of the traditional college-age population
2. Reduced federal aid and state support

In addition, we must work through the budget process as any other company or organization would, involving the coordination of financial and non-financial planning to satisfy the goals and objectives of the organization.

"P n L" statement = Profit $ Loss

Financial Terms

1. **Balance Sheet -** A financial statement that shows the financial position of a business at a particular moment in time – a detailed presentation of the assets, liabilities, and owner's equity.

   Total value of assets = the total liabilities + proprietor's capital

   (proprietor can be interchanged with stockholder)

The balance sheet, which consists of a detailed listing of the various assets, liabilities, and proprietor's capital on a specific date, shows the financial; position and condition of the organization at that moment in time. The balance sheet relies on the preparation of the statement of capital for the determination of the new proprietor's capital balance. The statement of capital in turn relies on the income statement preparation for the determination of the change in capital for the particular period. Because of these relationships, the order of preparation of the financial statements never changes.

2. **Income Statement** – a financial statement that presents revenue and expenses and the net income or loss for a specific period of time.

   Revenue – expenses = net income/(net loss)

The income statement compares the revenue earned for a period of time with the expenses incurred for the same period. If the revenue exceeds the expenses, the excess is known as net income. If total expenses are greater than revenue, the resulting difference is known as a net loss.

3. **Statement of Capital** – a financial statement that shows the change in the value of the ownership in a business over a period of time. The change in capital is due to income or loss and withdrawals by the owner over a period of time.

The capital statement reflects the change that takes place in the proprietor's capital account as a result of business activities of the firm. A change in the investment, the resulting net income or loss, the proprietor's drawing in anticipation of profit – each has an effect on the proprietor's capital account at the end of the specific accounting period.

4. **Variable costs –** those which vary directly with changes in volume

5. **Fixed costs –** those which remain constant over the entire range of output

6. **Break even point** – that level of operation at which revenue and costs are equal during a period so that no element of earnings or loss remains

7. **Profit margin –** that level of operation at which revenues exceed costs during a period

8. **Flexible budget –** a budget showing budgeted amounts for varying levels of output

9. **Capital budget –** are prepared to evaluate particular long term projects such as the addition of equipment or the relocation of a facility

10. **Food cost percentage** – food cost as a percent to sales; monitoring this ratio allows management to identify negative trends in the amount or cost of food that is being used

11. **Labor cost percentage –** labor cost as a percentage to sales; labor costs can be estimated based on the average rate per hour for the most recent payroll; related labor expenses will need to be based on past experience