

# **BUDGETING BASICS**



**INSTRUCTOR GUIDE**  
**4-HOUR COURSE**

**HRDQ<sup>®</sup>**

**BUDGETING BASICS**

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# Instructional design and learning philosophy

We are committed to providing the best core skills content possible for Instructor-Led Training (ILT). The following principles are applied in the development of programs:

## Sound Instructional Design

All course content is developed using a variety of research techniques. These include:

- Brainstorming sessions with target audience
- Library research
- Online research
- Customer research (focus groups, surveys, etc.)
- Subject Matter Experts (SME)
- Interviews with trainers

Expert instructional designers create imaginative and innovative solutions for your training needs through the development of powerful instructional elements. These include:

- Learning objectives — effective tools for managing, monitoring and evaluating training
- Meaningfulness — connects the topic to the students' past, present and future
- Appropriate organization of essential ideas — helps students focus on what they need to know in order to learn
- Modeling techniques — demonstrate to students how to act and solve problems
- Active application — the cornerstone to learning — helps students immediately apply what they have learned to a real-life situation
- Consistency — creates consistent instructions and design to help students learn and retain new information
- Accelerated learning techniques — create interactive, hands-on involvement to accommodate different learning styles

## Application of Adult Learning Styles

Adults learn best by incorporating their personal experiences with training and by applying what they learn to real-life situations. Our experienced instructional designers incorporate a variety of accelerated learning techniques, role-plays, simulations, discussions and lectures within each course. This ensures that the learning will appeal to all learning styles and will be retained.









## Trainer information

### Excel file

Make sure that you have the Excel file for the Master Budget (Appendix D) or have prepared a handout of this. Note: It is displayed in a PowerPoint slide.

# Course timing

## Module One: Budgeting Basics

Type of Activity	Segment	Time
	Budget facts and basics	45
	Case study	30
	What's the point of budgeting?	5
	Sample of Master budget of a large company	10
	Different approaches to budgeting	5
	Three ways to develop a budget	10
	Flexible vs. static	5
	How does a company benefit from budgeting?	5



Reading



Written Exercise






Facilitate



Group Activity

# Course timing

## Module Two: More Than Numbers

Type of Activity	Segment	Time
	It is not all about the numbers	5
	How to begin	30
	Putting the steps together	30

## Module Three: Negotiating for Results

	Negotiating your budget	10
	Role play	45
	Managing your budget	5



Reading



Written  
Exercise



Facilitate



Group  
Activity

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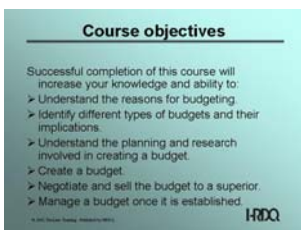
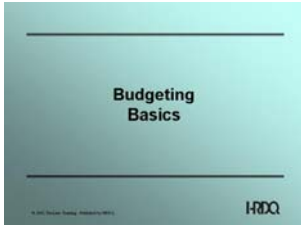
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## Course objectives

Successful completion of this course will increase your knowledge and ability to:

- Understand the reasons for budgeting
- Identify different types of budgets and their implications
- Understand the planning and research involved in creating a budget
- Create a budget
- Negotiate and sell the budget to management
- Manage a budget once it is established



# ModuleOne



## ***BUDGETING BASICS***

## Learning objectives

Successful completion of this module will increase your knowledge and ability to:

- Identify necessary components of a budget
- Understand the steps in the budgeting process
- Calculate a budget
- Analyze the different approaches to budgeting
- Establish the benefits of budgeting

### Learning objectives

Successful completion of this chapter will increase your knowledge and ability to:

- Identify necessary components of a budget.
- Understand the steps in the budgeting process.
- Calculate a budget.
- Analyze the different approaches to budgeting.
- Establish the benefits of budgeting.

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# Budgeting facts and basics

## *What is a budget?*

A quantitative presentation of a plan of action for a company or a division.

An account of how the entity will acquire and use resources over some specified time (one year, one quarter, etc.).

In simple terms, a description of how you get cash and how you spend it.

Consider the following questions:

1. What would you like to get out of this session? Why are you here?

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2. What are your thoughts about the budget process?

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3. When faced with the assignment of designing a budget, how would you approach this process? What are the steps?

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4. How important is budgeting in your company?

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### What is a budget?

#### Cash Inflows

- Cash Receipts
- Cash Sales
- Accounts Receivables
- Other

#### Cash Outflows

- Raw Materials
- Payroll
- Advertising & Sales
- Equipment
- Other

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(Three-part activity — 30 minutes)

1. Start a discussion by asking participants to define what a budget is.
2. Ask participants to answer the questions on this page.
3. **Activity:** After each student answers the questions on this page, ask them to form groups of three or four. Each person in the group will take 30 seconds to introduce themselves. Give each group a piece of chart paper and a thick marker and ask them to write a list of words that come to mind when they hear the term "budgeting." The group members need to appoint a "scribe" for the group who will write down all the answers. Ask the participants to go around the group in a circle with each person stating one feeling. Go around the circle until all of participants run out of descriptions.

After about 10 minutes of this exercise, ask the "scribes" to tape the posters with their group's responses on the walls around the classroom. Once all of the responses are up on the walls, go around the room and have one person from each group read their group's answers.

This could be a great activity full of laughter. Probe for why they said certain things and provide explanations. Be prepared for some negative feelings. Ask participants why they think budgeting elicits negativity, and provide some of your own views on the issue.

# Budgeting facts and basics

## Why do budgets get a bad reputation?

Here are some typical responses:

- It is hard to see their value.
- There is no involvement in the planning or setting of benchmarks (we are just given the numbers).
- Not all budgets are being followed/used after they have been designed—it is hard to see the practical application.
- How can one predict the future?
- We don't like or understand them—it is all math, finance, and accounting and who likes numbers?
- There is a lack of understanding of how important the budgeting process is to the company.

## What's in a budget?

Two main components of a budget:

1. Cash balance
  - Cash Receipts
  - Cash Sales
  - Collections of Accounts Receivables
  - Other income
2. Expected cash expenses
  - Raw materials
  - Payroll
  - Advertising
  - Selling
  - Administrative
  - Plant equipment
  - Other payments

**Why do budgets get a bad rep?**

"Prediction is very difficult, especially if it's about the future."

Nils Bohr, Nobel laureate in Physics

**Why do budgets get a bad rep?**

"Forecasting is the art of saying what will happen, and then explaining why it didn't."

Anonymous (used by Balaji Rajagopalan)

You should see by your class behavior just how comfortable participants are with the budget concept and spreadsheets. If it seems boring and obvious to them, say, "This is what a budget normally looks like" and show [the final budget slide](#)

Use the example of a budget in Appendix D to teach this section. Explain that as managers we are often given the amount of money that we are allowed to spend. Point to the line on the worksheet: Budget Allocated to the Department.

If the participants are unfamiliar with budgeting, explain the above slide in detail. This will be unofficial, and may cause some questions to be raised. First ask the participants to provide examples of different expenses that are not included on the example, but do so for only five minutes. If participants ask detailed questions, say that these issues will be addressed and explained in more detail later on.

## Budgeting facts and basics

### Calculation of a budget

Budgeting is projecting whether with all of the inflows of money throughout a given time period, and the planned expenses, there is money left over or not.

$$\text{Cash Balance less Expected Cash Expenses} = \text{Cash Surplus (or Cash Deficit)}$$

#### *Simple budgets consist of:*

- Sales (all done in cash)
- Cost of Goods Sold (all done in cash and on an as-needed basis)
- Operating Expenses
- Income Tax Expense
- Capital/Interest Expense

#### Calculating a budget

$$\text{Cash Balance} - \text{Cash Expenses} =$$

Cash Surplus (Cash Deficit)

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#### Structure of a simple budget

- Sales
- Cost of Goods Sold
- Operating Expenses
- (Sales/Income) Tax Expense
- Capital/Interest Expense
- = Cash Surplus (Cash Deficit)

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Typically, it is most desirable to spend the amount of money in your budget, i.e., not to overspend and not to under spend. This means we want this equation to equal zero.

Read the example out loud. Ask participants to calculate the budget for Josh by filling in the blanks provided on the following page. (Allow five minutes).

Once the participants have finished, debrief by explaining the associated slides.

## Case study

### Garden Fresh

Several months ago, Josh got sick of working for the flower shop his father owned. When flying to Florida for his yearly spring break escapade, he ran into his old friend from high school who managed a gift shop at the airport. One thing led to another and Josh started selling flower bouquets at his friend's store. The business is going well. Josh sells about 30 of the bouquets each day for \$15.00 each which includes the 9.5 % tax that Josh has to return to the city. He buys fresh cut flowers from a greenhouse in a smaller town 20 miles away, purchases the wrapping paper and the ribbons, and five days a week he arranges and sells flowers at the airport. He spends about \$250.00 to purchase the flowers each day, and the supplies cost him around \$5.00 per day. He had to borrow some money from his sister to be able to purchase a used car for delivery. He promised to pay off the loan by making \$200.00 payments to her each month. It costs \$10.00 to fill up his tank to get to the greenhouse and to the airport from his house, and \$10.00 to park his car each day. Garden Fresh sales are the only source of disposable income for Josh, and his monthly expenses account to \$2,400; therefore, his salary should be at least that amount. What is his monthly cash surplus (deficit)?

# Case study

## Part one

Budget item	Numbers
<b>Sales (Cash Source)</b>	
Cost of Goods Sold:	
Fresh cut flowers	
Wrapping paper & ribbons	
<b>Operating Expenses:</b>	
Gas	
Parking fee	
<b>Sales Tax Expense</b>	
<b>Capital/Interest Expense</b>	
<b>Total Business Expenses</b>	
<b>Money leftover as daily compensation</b>	
Monthly Salary	
Monthly Expenses	
<b>Cash Surplus (Deficit)</b>	

<b>Cash Inflows and Outflows each day:</b>		
<b>Sales (Cash Inflow)</b>	30 bouquets/day at \$15.00/bouquet	\$450.00
<b>Cost of Goods Sold:</b>		
Fresh cut flowers	\$250.00 a day	\$250.00
Wrapping paper & ribbons	\$5.00 per day	\$5.00
<b>Operating Expenses</b>		
Gas	\$10.00 per day	\$10.00
Parking fee	\$10.00 per day	\$10.00
<b>Sales Tax Expense</b>	<b>8.5% of Sales</b>	\$38.25
<b>Capital/Interest Expense</b>	\$200.00 per month or \$10 per day	\$10.00
<b>Total Expenses (Cash Expenses)</b>		\$323.25
Money left over as daily salary		\$126.75
<b>Monthly Budget for Josh:</b>		
Monthly Salary	20 workdays per month	\$2,000.00
Monthly Expenses		\$2,400.00
<b>Cash Surplus (Deficit)</b>		\$135.00

Revenues from the sales of bouquets are the only cash resource for the business and for Josh. He sells 30 bouquets a day for \$15.00 each which generates \$450.00 of cash inflow a day. The cost of goods sold includes the purchase of fresh cut flowers at \$250.00 a day and the wrapping supplies at \$5.00 a day. The Operating Expenses accounted for in the example are: the cost of gas and the parking fee which are \$10.00 each. At the end of each month Josh must write a check to the city and the state to pay for sales tax for the 8.5% of the sales revenue. The price of \$15.00 includes the taxes; therefore, 8.5% has to be subtracted from the revenues. 8.5% times \$450.00 equals \$38.25. Josh also has to repay the loan from his sister which they agreed to be \$200.00 a month. In this example, we assume that Josh works five days a week, or approximately 20 days a month. Then, the expense of the car payment per day is \$200.00 divided by 20 days a month, which is \$10.00 per day. The total cash expenses for each day of sales are \$10+\$10+\$38.25+\$10 = \$323.25. Whatever money is left over from sales is what constitutes Josh's salary.  $450.00 - 323.25 = 126.75$ . Since we have assumed that Josh works 20 days a month, it brings his salary to  $126.75 \times 20 = 2,535$ . Josh's monthly expenses account to \$2,400.00. Therefore, the cash surplus for Josh is \$135.00, which he could choose to spend on advertising.

# Case study

Now explain this slide.

Cash Inflows and Outflows each day:		
	Before	Now
<b>Sales (Cash Inflow)</b>	\$450.00	\$450.00
<b>Cost of Goods Sold:</b>		
Fresh cut flowers	\$250.00	\$250.00
Wrapping paper & ribbons	\$5.00	\$5.00
<b>Operating Expenses:</b>		
Gas	\$10.00	\$10.00
Parking fee	\$10.00	\$10.00
Space Rental	\$0.00	\$50.00
Sales Tax Expense	\$36.25	\$36.25
<b>Capitalized Expense</b>	\$10.00	\$10.00
<b>Total Expenses (Cash Expenses)</b>	\$326.25	\$372.25
Money left over as daily salary	\$123.75	\$77.75
<b>Monthly Budget for Josh:</b>		
Monthly Salary	\$2,400.00	\$1,536.00
Monthly Expenses	\$2,400.00	\$2,400.00
<b>Cash Surplus (Deficit)</b>	\$136.00	-\$865.00

The space rental of \$50 each day is the only change to the Operating Expenses. The money left over as a salary now drops to \$76.00 a day or \$1,536.00 a month (based on 20 days of work a month). As a result of the increased expenses, Josh is faced with a deficit of \$865.00 a month. Josh doesn't want to sacrifice his lifestyle (decrease his personal monthly expenses), so what should he do? Ask the participants to answer the question and to share it with the class. If their answers/ideas are different from the examples provided on the next page, write them down on a flip chart.

## Part two

The store manager noticed how well Garden Fresh was doing and informed Josh that he would have to pay \$50.00 a day to rent space at the gift shop. How does this new situation alter Josh's Living Budget? What should he do?

Budget item	Numbers
<b>Change in Total Business Expenses</b>	
<b>Money leftover as daily compensation</b>	
Monthly salary	
Monthly expenses	
<b>Cash Surplus (Deficit)</b>	

What should Josh do?

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## Case study

### Part three

Classify each item listed below as one of the following:

DE = decreases expenses

IR = increases revenues

IC = increases cash/capital through borrowing

Write your answer in the left-hand column.

Classification	Some "thoughtful" examples
	Start buying from a greenhouse closer to the airport.
	Take the bus.
	Start selling somewhere else where he doesn't have to pay rent.
	Think of a more creative way to sell the bouquets—add a personalized note, or offer to make bouquets instead of having them ready and charge more.
	Get a second job.
	Go back to working for his father.
	Since the margin is pretty good, open up a flower shop at the airport if there is a demand for it.
	Borrow some money or use his credit card.
	Use flowers.com to deliver his supplies.
	Work more than five days a week.
	Rent out or invest in a refrigerator that would hold the flowers longer.

Using the examples the students provided in the previous exercise, ask what each "thoughtful example" can be classified as: decrease in expenses, increase in revenues, or new source of cash. Then read each question and ask for a class-wide response. The answers are: DE, DE, DE, IR, IR, IR, IR, IC, DE, IR, DE

## What's the point of budgeting?

Answer: The point of budgeting is to make sure that we have a cash surplus and not a cash deficit at any given point. In other words ensure that:

**Spending < Earning**

Cash Expenses < Sources of Cash

Helps us see when we are or are about to be in trouble, or preferably how we can STAY OUT of trouble  
 When we see that we may be running into a deficit we can:  
 Decrease Spending (Decrease Expenses)  
 Increase Earnings or find new sources of Cash (through borrowing)

**What's the point?**

- Make sure that
  - Spending < Earning
  - Cash Expenses < Sources of Cash
- Predicts when the above may be the case
- Helps plan preventive actions
  - Decrease Spending (Expenses)
  - Increase Earnings
  - Find new sources of Cash

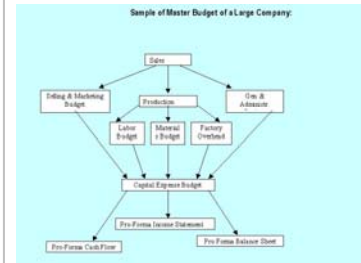
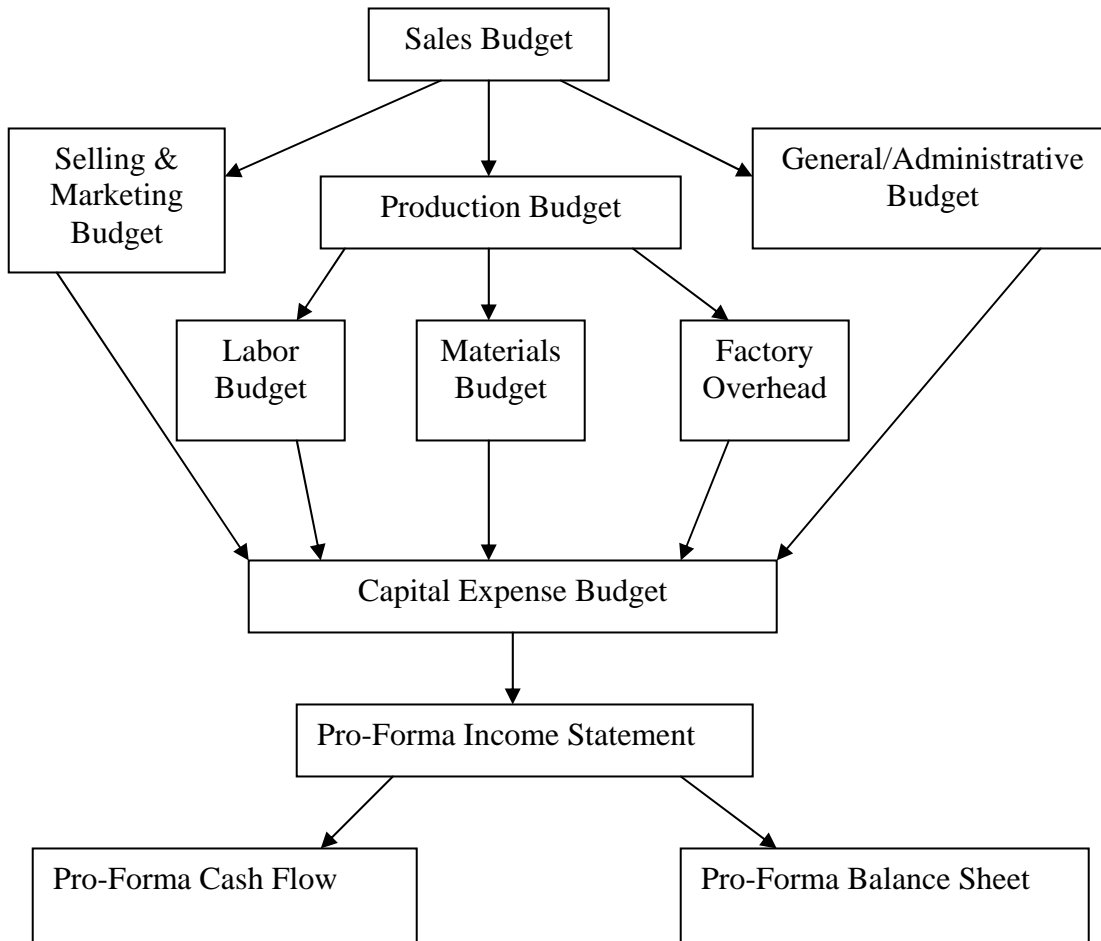
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**Sources of cash**

- Increase Borrowing
  - Assign new stock
  - Equity investments
- Account Receivables
- Account Payables

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# Sample of master budget of a large company



Budgeting in larger corporations is a lot more complicated and includes calculations and projections of various departments and modules in addition to the ones included in this model.

Budgeting in larger corporations starts with a sales/revenue budget which helps determine how much cash resources a company has. From these projections other budgets and needs are being drawn as in the production budget, selling and marketing budget, and general & administrative budget.

Based on the projected sales, the company can justify the production needs, the amount of labor necessary (# of workers and their schedules), the raw materials necessary to produce the final product and the overhead expenses that will result as an outcome of the production needs.

After the departmental budgets are designed, the information is fed to the Capital Expense budget. The finance gurus can then determine the most efficient use of money, and the inflow and outflow of money (loans and investments) for healthy financial operations. Based on all of these projections, the Finance department can draw Pro-Forma Financial Statements, which are projected accounting amounts (usually by month) used to determine the future financial health of the company.

A sales budget is the most important prediction of the master budget. Ask the participants why it may be hard to predict these values? What are some of the internal and external variables that may influence the sales numbers?

Answer: Sales are influenced by:

- 1) EXTERNAL VARIABLES:  
customer tastes,  
economic conditions,  
new competitors
- 2) INTERNAL VARIABLES:  
price, sales effort,  
advertising expenditures

## Sample of master budget of a large company

### *Operating/master budget*

A group of detailed budgets that together constitute the overall operating and financing plans for a specific time period.

### *Sales Budget*

The first step in developing the master budget is forecasting the sales of a company.

Most important budget

Based on expected revenues received from sales of certain amounts of products at a given quantity and value

May be structured according to type of product, customer seasonality, etc.

All other budgets in the master budget are affected/based on the sales budget

Very hard to predict

Function of external and internal variables

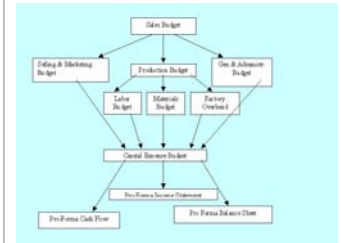
Numerous tentative sales budgets

## Different approaches to budgeting

The process of budgeting for a company can be influenced by one or more of the following factors:

- Company structure
- By division
- By product
- By product line
- By country, etc.
- Organizational culture (control, decision making, authority, communication, etc.)
- Top-down
- Bottom-up
- Status quo
- Amount of flexibility and openness to change
- Flexible
- Rigid
- Time span of budget
- Yearly
- Quarterly
- Monthly
- Company size
- Industry
- Stage of growth
- Goals of the budget

In most service-based companies, budgets are established by division and are a combination of top-down, bottom-up, and status quo. Some flexibility may be allowed for various entries, especially if a company chooses to require long time spans for budgets (annual budgets).



Depending on the company structure, there are different ways in which the budgeting process may take place. Solicit answers to how budgets are structured at participants' workplaces and how this is influenced by the factors on this page. If participants do not provide answers, here are some possibilities:

Size of the company: influences the number of divisions, and controls of the budgeting process.

Type of company: the industry and the marketplace influence the types of entries and the amount of flexibility needed for each entry, as the companies vary according to the volatility & predictability of the environment.

Stage of growth: a start-up has no financial history; on the other hand, an established company in its mature stage has predictable sources of cash and expenses.

Division of the company and the organizational structure: determines the number of budgets and their interdependence.

Organizational control: the amount of flexibility given to the departments to set the budgets (bottom-up).

Goals of the budget: What is the budget used for? Is it a planning tool? Is it just a thing to be filed? Is it a comparison to historical data? Is it a basis for performance reviews?

**Approaches to budgeting**

- Company structure
- Organizational culture
- Company size
- Type of Industry
- Stage of Growth
- Amount of Flexibility
- Time-span of the budget
- Goals of the budget

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Discuss definitions of these three budgets with participants. Allow three minutes for participants to complete the questions. Debrief by asking volunteers to provide answers for the rest of the group.

There is no "best" budget. It all depends on what the purpose of the budget is. Factors such as predictability of the environment, the organization growth stage and its complexity, as well as other factors such as the time allowed for the design of the project, and the project's importance, will greatly influence the type of budgeting used.

Usually, one can use a combination of these types of approaches to various entries within the budget.

Top-down budgets start with a goal in mind – a strategic direction of the company.

Decisions about reasonable production scheduling, pricing, borrowing, investing, and R&D sometimes need to be made before the sales budget can be completed.

Consider using a status quo budget when you have a limited amount of time to design a budget, or when the industry/company is in a mature stage and when very little change occurs.

## Three ways to develop a budget

Top-down	Bottom-up	Status quo
Prepared by top management	Each department manager makes budget requests	Used by both top and department management
Prepared with a strategic direction in mind	Creators are "specialists" in designing workflows and estimating departmental needs and costs of operations	Starting with an existing budget (last year's) and modifying it
Is the best choice to coordinate the competing needs of departments	Setting goals makes department managers more motivated to drive them forward	One does not have to re-invent the wheel

1. Which budget do you think is the best?

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2. Why are sales revenue budgets usually top-down budgets?

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3. What kind of budgets would be best if they were designed from the bottom-up? Why?

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4. When would you consider using a status quo budget? Why?

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## Flexible vs. static

### Static budget — set in stone

This is the most common form used to design a budget that involves planning, setting, or negotiating fixed amounts of cash resources and expenses for a given period.

### Flexible budget — variable approach

A flexible budget projects a range of possible activities. It is used as a tool to control costs and evaluate performance of divisions, product lines, or individuals. It takes into consideration that one variable will have influence over others and the budget should plan and allow for such. The easiest form involves setting three scenarios: the worst case, the best case, and the most probable scenario.

Useful tip: Even if your company only uses static budgets, it is smart to develop your own flexible budget. It will help you see how various variables influence each other. Just developing the best case and the worst case scenarios is a good exercise in contingency planning.

### Goal driven

Budgeting is defined as a plan of action that is stated in quantitative terms. This suggests that it should:

Be based on the Mission/Vision/Business Strategy of the Organization.

Ensure that the short-term objectives are congruent with the long-term objectives of the company.

Establish the long-term goals of the organization (WHAT?), establish the necessary steps to get to them (HOW?), and assign a monetary value to each activity (HOW MUCH?).

WHAT? → HOW? → HOW MUCH?

#### 3 ways to develop a budget

- Top-down
- Bottom-up
- Status quo

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**Flexibility of budgets:**  
It is easy to see that budgeting is not a one-time or a sequential process. Various occurrences or previously unknown facts will influence different budgets at different times, and as a result of that, some or all of the values will change. This is called interdependency of goals. Therefore, this process should be viewed as a flexible and changing view of the organization, rather than a static view.

Designing several tentative sales budgets and using different combinations of various forecasting and budgeting techniques may be very helpful. At least the best and the worst-case scenarios should be portrayed.

Ask participants to provide you with examples when extraordinary events caused their budgets to shift considerably.

#### Flexible vs. static budgets

- **Static Budgets**
  - Most common way of budgeting
- **Flexible Budget**
  - Range of possible projected activities
  - Control costs
  - Evaluate performance
  - Best, worst, and most probable scenarios

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**Goal driven budgeting**

Budget should be based on:

- Mission Statement
- Organizational Vision
- Business Strategy
- Short-term and long-term objectives

WHAT? – HOW? – HOW MUCH?

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This question could start a lively conversation, but some groups may be overly negative. Be aware that some of the following questions may arise:

1. How does this tedious and time-consuming process help the company?

Answer: If the process of budgeting is implemented properly, it helps in planning, communication, and most importantly in forecasting the cash needs.

2. Since the environment is always changing, what is the point of forecasting all of these numbers?

Answer: Contrary to that opinion, a lot of the environment is not changing. One can forecast by looking at past occurrences, similar businesses and getting quotes. It is a lot less stressful to forecast approximate values of revenues and expenses than to play it by ear. It is also required. People and institutions lending money to a company, such as banks, venture capitalists, and shareholders require Pro-Forma financial statements. In today's world, future potential is very important if not more important than the present. So even if you don't see it as a valuable insight others, whom we depend on for survival of our company, do.

**Perfect budget**

A budget has the most possibility for success when it is:

- Bottom-up
- Flexible
- Short-term
- Goal and Performance driven
- Developed by consensus

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# How does a company benefit from budgeting?

In a perfect world budgeting would be...

- Bottom-up
- Flexible
- Very short-term
- Connected to performance
- Goal driven
- Developed by consensus

We all know that for various reasons, all of the above characteristics do not represent current budget designs. If you are starting a budgeting process from scratch, try to include all of the above characteristics (whenever circumstances allow).

Budgets (if properly established and implemented):

- Help in planning (i.e., obtaining a loan on time).
- Influence behavior.
- Help establish a direction for an organization.
- Set accountability and control over spending.
- Serve as a link for the strategic, operational and capital (cash) planning.
- Control costs and make operations more efficient.
- Improve performance, measure progress and eliminate inefficiencies.
- Focus all of the organizational members on results and set performance standards.
- Improve communication and cooperation between stakeholders, divisions and departments of the organization.
- Help in future forecasting and planning.






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