

Budgets – Your guide to a perfect(?) one

Budgets are important. Done well they help people and organisations plan their future, monitor their progress towards it, and achieve their goals. Hence creating a good budget for your organisation is a key skill and tool in your creating the future you want and hopefully sustainable success. We are not sure that a perfect budget is possible, however this article looks at some of the basics and tips for creating a great budget.

Being presented with a large multi-page spreadsheet of numbers in considerable detail can be a daunting prospect for anyone, even those whose daily job it is to be familiar with numbers. For people whose job is not dealing with such numbers on a daily basis the impact is generally much more pronounced; commonly an instant glazing of the eyes and feelings of being totally overwhelmed.

As accountants we are often asked to provide comment or guidance on budgets and budgeting. Commonly the expectation is that as financial professionals we will have some almost magical powers to make a difficult task easy, and instantly spot any mistakes, weaknesses and omissions...and generally the ability to turn a sow's ear into a silk purse. Well, we hate to burst the perception bubble but that is simply not the case for most. Instead, most good accountants just work through some basics to help them critique, identify possible issues, and hopefully assist in providing improvement suggestions, if these are needed.

A definition

To start at the beginning, it is important that we all understand what a budget actually is. We define a budget simply as "our best estimate of income and spending over a specified future period of time." Most commonly this period of time is 12 months, but it can be shorter or longer. While usually dominated by revenue and expenses the spending also often includes capital expenditure intentions.

Possibly the two most important words in that definition are "best" and "estimate". Unless you are lucky enough to have found the mythical crystal ball (and if you have; may we please borrow it!), your budget will always be an estimate. It's about the future and we are not there yet.

The word "best" comes into play in that to improve our chances of success we want to base our estimate of the future on the best available information that we have. The more we know our numbers, our organisation's activities, wider plans, and market conditions, the better we can accurately predict future revenue and expenditure.

Some key steps to budget building

1. Know your numbers

The more you understand your existing income and expenditure, wider market impacts and changes, and future changes, the more likely you are to be able to create an accurate budget. Seeking advice from others and comparing budgets of other organisations can also be a useful technique. The more knowledge and research generally the better the estimate.

2. Align with your goals

Your organisation should be clear on your big picture aims and objectives. Are you growing, shrinking, changing focus, developing a new area(s) of operation, gaining or losing funding? All these factors will impact your budget. Your budget is just one part of your overall strategy and planning for your organisation. It should follow and help you achieve your bigger picture aims. The dots need to be joined up.

3. Identify income and expenses

Where does your income come from and what do you need to spend on? This is where you create your list of detail items, or budget lines. Last year's actual results can be a great place to start but you then need to amend for future plans and knowledge of changes.

4. Identify variable and fixed income and expenditure items

Understanding relationships within your revenue and expenditure is very important to accurate budgeting. For example, if you plan to employ more people then there will generally be a host of flow on expenses caused by that such as office accommodation, training, equipment needs, HR admin etc. Likewise, increased revenue targets generally require more investment in sales and marketing support to generate the revenue etc. Some items will be fixed costs no matter what and it is important to understand the nature and quantum of these. For example, you are generally locked into your office lease costs no matter whether you are generating any income or not.

5. Separating essentials from desirables

Setting any budget will be an exercise in compromise. We are yet to find an organisation that is able to achieve and fund everything it desires to do. Hence an important part of most budget setting will be identifying what has to be done vs what you would like to do, and then ranking these in order of priority/achievability etc.

6. Get some critical review

Creating a comprehensive budget requires a lot of detailed work. A fresh set of eyes is always helpful to question and query...and at times point out the screamingly obvious.

Note: As the saying goes: "cash is king". Indeed the timing of cashflows may differ significantly from when an entity recognises income and expenditure on an accrual basis. Cashflow budgets play a critical role in ensuring the entity manages peaks and troughs in cashflows so it can pay its debts when due, The above guidance relates equally to a cashflow budget rather than an income and expenditure budget.

Tips, Tricks, Techniques & Observations

1. It's about balance

Good budgeting is ultimately about balancing your expenses with your income. If they don't balance, then longer term you will have a big problem! Debt, if you have access to it and can afford to fund it, can be a short term solution but ultimately unless your revenue at least matches, or ideally exceeds, your expenses then you are planning for problems.

2. There is no perfect budget

Sorry but this is called reality. As auditors any estimate of the future that works out absolutely perfectly makes us very suspicious! Life is generally not that neat or kind. So best that you get comfortable now with the reality that even with all your hard work in attempting to create the perfect budget there will be variances.

3. Learn from your past experiences

We've already said that the more knowledge the better the budget. Related to this the more times you do it and the more you can refine your information and processes the better your budgeting is likely to be.

4. Involve and make it easy for others

The process of budgeting is important, not just the resulting budget. If you involve other key people within your organisation your likelihood of accuracy and buy-in is much improved. Additionally, great budgets sometimes collapse because the super-person who used to do it didn't involve or teach others nor note assumptions or instructions on "their" spreadsheet.

5. Be realistic

While everyone wants to achieve lofty aims and a great result there is no sense in being Poly-Anna'ish in your approach. Merely wishing something to be so is not a great strategy in our experience! Better to be realistic and to face any hard compromise decisions that this presents.

6. Don't let it gather dust

Once you have set your budget ensure you actively monitor against it. Timely monitoring lets you keep your hand on the organisation's tiller and make any adjustments necessary to give you the best chance of achieving your aims.



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