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<th>Term</th>
<th>Definition</th>
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<td>Bottom Up</td>
<td>Budget prepared by middle managers that is based on an evaluation of the supervisors and middle managers capabilities</td>
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<td>Capital budget</td>
<td>The total costs and maintenance fees planned for the company’s fixed assets</td>
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<td>Cash budget</td>
<td>An estimate of the company’s cash position for a particular period</td>
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<tr>
<td>Expense budget</td>
<td>An estimate of travel, utilities, office supplies, telephones, and many other common expenses for a period</td>
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<td>Forecast</td>
<td>The use of past data to bolster assumptions for future spending and costs</td>
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<td>Labor budget</td>
<td>The total labor cost for a period of time (hours required X rate of pay)</td>
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<td>Operating budget</td>
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<td>Production budget</td>
<td>A forecast that starts with the sales budget and estimates the labor, material, and other required resources to produce the units to sell</td>
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<td>Revenue</td>
<td>Amount of money earned by a company; also gross income</td>
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<td>Sales budget</td>
<td>An estimate of the amount of goods and services to be sold over a period of time</td>
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Module One – Objectives of Budgeting. Why is budgeting so important? Budget management requires two things. The first one: good planning. What do we mean by that? Well by good planning, we mean that budget management requires a manager who can make a reasonable and conservative estimate of income. What we mean is we don’t want somebody that will pad the budget because a padded budget helps no one. And a conservative estimate of the income. We want to be as conservative as we can so we can get a reasonable idea of what needs to be done. Now of course people beginning may not have the knowledge or the ability to do that. But this is the goal that they’re working toward – to be able to make a reasonable and conservative estimate of income.

They also must be able to make an itemized estimate of all expenses. Someone who is new at the budgeting process may not be able to do that. But this is where history, past history, and training come into play. The more that they do the budgeting or are involved in the budget process, the more accurate forecasts and consequently, the better information that the company has as far as making future plans and allocating resources. It also requires good discipline. What we mean by good discipline is they’re able to make continual assessments. They’re able to look at the budget or do some analysis on the budget and say these numbers are out of whack, or we need to make a correction. We need to make a correction as soon as possible, because the faster that a problem is discovered and some corrective action is taken, the better off we are. This also includes the discipline to make month to month adjustments. A review of a budget should not
be put off any longer than a month. So make monthly regularly scheduled adjustments and investigation as far as why the difference, what the difference, what caused it, and what steps do we need to take. This comes from experience. Budgets are nothing more than a plan of action for the manager. Where does he want to allocate the resources? To whom and for what reason? It’s a roadmap for him. There are things that they also help the manager to do. One of them is to plan financial activities. Where is our revenue? What do we need to do to maybe increase revenue or reduce expenses? What are we spending our money on? What are our expenses and what are some steps that we can take to maybe reduce it or bring it more in line? They also help the manager control. The manager looks at the budget and sees he’s over. It prevents over-spending. If he wants to say, for instance, spend $100 on something but his budget only allows $10 in the budget, then it puts a control on over-spending. He sees that when the budget was formulated, that he was allocated $10 and he wants to make a $100 purchase. Maybe he ought to investigate it further. Now this doesn’t mean that he should never spend more than the budget because opportunities may arise that will benefit the company in the future. But it’s a signpost to say hey, let’s stop and maybe investigate this before we plunge in. And finally, it’s a roadmap to evaluate performance. How is the company or the department performing versus budget? And it performs guidelines as to what path or what direction that the spending might take, and maybe where to make corrections, maybe where to increase spending, even. But mostly it’s to reduce spending. What needs to be done? What numbers do
they have to meet for their performance? So three things – plan, control, and evaluate. That’s the big three that the budget helps to do.

[End of recording.]
HOW TO UNDERSTAND AND ADMINISTER A BUDGET
MODULE TWO – APPROACHES TO BUDGETING

In our next module, we’re going to look at different approaches people take to putting their budget together and the different kinds of budget that we have. Let’s begin by taking a look at the types of budgets there are. Many different types of budgets, you hear people refer to “budgets.” And just exactly what kind of budget are they talking about, and what does that mean? First we’re going to look at a working budget. This is an estimate of the cost, revenue, and resources over a specified period. How much are we going to spend over this particular period that this budget covers? This is often referred to as the master budget as well. It’s all the different budgets rolled into one and time slotted as far as this is what we’re going to spend in January, February, March, etc. It gives upper management the idea of the cash outflow and the cash income. You hear people talking of an operating budget. This is a synonym for the working budget. It’s an overall master budget as far as to what the entire company or the entire department is going to be spending. Different people will have accountability for maybe different lines of the budget or different smaller sub-budgets. And this is operating budget and working budget, all of those budgets rolled into one. You’ve also heard of the cash budget. This is important because it estimates the company’s cash position for a particular period. There are – this is different from regular accounting, accrual accounting. In accrual accounting, the revenue and expenses connected with them are realized at the time that the transaction is finalized, whereas in cash accounting, which is what the cash budget is and which most of us use for our bank account, is when we have the money in our
pocket, we may have made the sale two months ago, but we haven’t received the cash yet. So this is a budget that estimates what the company’s cash position will be at a certain period in time. This is important because more companies have gone bankrupt, gone out of business, not because of sales – poor sales, but they’re not receiving the cash in a timely manner to meet their bills, their obligations. So a cash budget alerts management to what’s going on and whether they should be concerned at a particular point in time. Labor budget. This is the total labor cost for a period of time. Generally it’s a matter of hours required times rate of pay. We’re going to schedule a person to work five hours and we pay him $10 an hour, then we’re going to have a labor expense of $50. This is generally tied to the sales budget. This should be the first thing when someone starts to put together a budget. What do they think the sales will be? What are we going to be selling in this particular time period? And it’s generally the product of how many items are we going to sell and what are we going to sell them for? For instance, we’re going to sell 10 widgets and we’re going to sell them at $10 apiece, and we’ll have a sales budget for, say January. We’ll have sales of $100. Now what’s involved in putting that together? Why is labor budget so important? We look at production budget. If we’re going to sell 10 widgets next month, then we’ve got to have 10 widgets produced. And so what does it take to produce 10 widgets? How much are we going to have to pay to get 10 widgets produced? Also, what type of raw materials are required to produce 10 widgets and how much is that going to cost? And is there any overhead cost in that? We should start budgeting in December our production
for sales in January. So that’s just another type of budget. And of course once
again, it’s all rolled up into the master operating budget. Another type of budget
is the expense budget. This is generally our fixed costs – things we will still have
to pay regardless of the amount of production. Whether we produce one widget
or 100 widgets, we’re still going to have to pay rent and we’re still going to have
to pay telephone, utilities, and it generally changes very little from month to
month as far as fixed expenses. But still, it’s something that we have to measure
against sales. It’s an expense of the business that’s required for us to be in
business. And finally our capital budget. This is the total cost and maintenance
fee planned for the company’s fixed assets. We know that we’re going to have to
produce 10 widgets, so we’ve got to have the equipment, the machinery involved
in making those widgets, perhaps. So we’re going to have to decide is there
equipment or machinery that we need to maintain our production budget? What
do we have to spend ahead of time before we start producing these things? It all
is a look into the future and based on best estimates. We’ve looked at several
different sub-budgets here that all roll up into the master operating budget. So
when you hear people talk of budget, it could mean many different things. This is
just an example of some of the type of budgets that people are talking about and
looking at when they talk about budgets. There’s different approaches to
formulating a budget as well. The first one we’re going to look at is called the
top-down approach. Say we have in a company, we have the director level. This
is the big boss, the guy that’s at top, often the CEO or Chief Financial Officer.
He’s working on this level. Then we have the managers – maybe department
heads underneath him. These are the people that are responsible and accountable for different departments. And finally we have these departments – say like if it’s auto production, the paint department or the whatever department. But these people are involved in the production as well. With the top-down approach, the top level decides on what they want to spend, what their goals are, how they want to go about doing things. And then they pass their goals on down to the next level to the managers. Then it’s up to the managers to decide how they’re going to take this budget that’s been handed down to them and how do they want to manage it? So they meet these numbers as far as their departments are concerned. Once they decide that, they pass it down to the heads of these departments. Here are your numbers, and you decide how you’re going to meet these goals and these figures. Obviously it’s called top-down approach because it comes from the top down. Like we said, these budgets are prepared by top management. They set the goals, they see where they want to be at the end of the fiscal period, and it begins with top management. They’re imposed on the lower levels of the organization. Once the top management decides where they want to go and what kind of money they want to spend, then it’s passed down to the next managers who are accountable for their level. They clearly express the expectations of higher management. They pass their desires on down with the numbers and where they want the numbers to be. One problem with this, though, this approach, is it can be unrealistic. The people who are involved in producing the product are not involved in the budget process whatsoever. Oftentimes upper management is unaware of what it takes to
produce the product – what level of labor goes into it. And so oftentimes these budgets can be unrealistic. They often build on last year’s spending. For instance, say they take a look at last year’s spending and take these figures and say well, we want to reduce costs by 10 percent while raising revenue 20 percent. They often don’t look at last year’s spending in any detail. They just take last year’s numbers and add or subtract a percentage. Oftentimes that happens with top down budgeting. Another approach is called bottom-up budgeting. Of course I’m sure you can guess how this is going to go and why it gets that name. The people involved on the lowest level – the department heads say this is what they can do and this is how much it’s going to cost as far as labor, raw materials, and this is what they’re going to produce. And they pass it up to the next level for improvement by someone on the manager level who then review it and revise it, and then pass it up to the top level and it’s all rolled together. And they come up with a bottom-up approach. Bottom-up budgeting, the supervisors and the middle managers prepare the budget. As we said, they look at their capabilities. For instance, if you want us to produce more widgets, we may have to have a new machine this year because the one we’re using now is shot. So something like that’s an example of things involved in the budgeting procedure from the bottom up. When they’re done, they’re forwarded up the chain of command for review and approval. The people on, say the manager level review and see if these costs are within where they want to be and the goals of the company as well. And they may send them back for revision. These types of budgets tend to be more accurate because they involve the people who
are responsible for doing the manufacturing, and the cost involved and the effort as far as what it takes to produce these goods and services. One good thing about it, it involves the lower level employees. So lower level employees have more of a stake in meeting the budget numbers when they’re involved in formulating the budget. And it’s also based on previous spending levels. When we looked at top-down, we often take last year’s spending figures and add a percentage to it. Say we’re going to reduce or increase spending or expenses or revenue. It’s often as well based on previous spending levels. One of the problems with that is that it takes last year’s spending level and does not do any in-depth analysis as far as past performance. So it implies an approved level of spending for at least a portion of last year’s spending. Then you just add 10 percent to it. So it’s often not the best way to go about budgeting, but it’s a very popular use in today’s world. The last approach we’re going to look at is zero-based budgeting. What this amounts to is the manager prepares estimates of expenses for the period. The reason that it’s called zero-based budgeting, it is not based on previous periods, but from scratch. So this tells them no, you’re not going to add 10 percent to expenses or things of that nature, but you’re going to build it from scratch. Start with zero. What costs are involved? What type of money do you have to have to operate your department, assuming no historical or previous costs? And the idea behind this is managers are required to justify expenses. They must go to the manager and say, well this is why we require this amount rather than another amount. And it can oftentimes red-flag out of control expenses or money spent. With that, it minimizes waste. So they’re going to
have to justify all the budget they require for next year’s performance. Now also another problem with this, it often takes more time to gather the information and to make the estimates and do some research as far as putting together a zero-based budget. But this is also a type of budgeting that’s gaining popularity.

[End of recording.]
In our next module we’re going to look at constructing the budget – steps to take in putting together the budget and what to do about them. To begin constructing the budget, the first thing we need to look at is the process should begin two to three months before the start of the fiscal year. This gives us time to review past performance, maybe look at some things that we assume from last year that may be different to look into the future and research some changes – maybe some legal changes, maybe for instance when we’re talking about maybe an increase in payroll taxes, or we’re talking about maybe production as far as when we talked earlier about a machine breaking down, that we’re going to need a new machine. So we need to include that in this year’s capital budget. There are some steps we need to take as far as expenses. Why is our rent cost so high? Or do we need to build a new factory? So you need to give yourself two to three months at the very least to research last year’s budget, how you did, the difference between what was budgeted and what you actually did. And together all this information together – before you start constructing this year’s budget, that’s one of the requirements for good budget and management, is to know what happened previously if that’s at all possible. That’s assuming that you’re not a new company starting right out. You need to have a good understanding of how costs perform and why. Is it a matter of because we increased production, or we had a new labor contract? There are a number of reasons. You need to understand the reason behind the performance of your costs. Also the budget process should include every manager responsible for each line item. What that
means is the manager of the paint shop should be involved in – if he’s going to be held responsible, held to his budget, responsible for the cost and the monies spent during this fiscal year – then he should be involved in putting together the budget for that particular cost unit. More than likely, nobody knows more about that cost unit than the person who manages it from day to day. So don’t exclude a valuable resource as far as performance of cost. Also involved in constructing the budget, both revenue and expenses must be budgeted. We know that – and oftentimes it’s hard to get a cost unit. Different departments, it’s hard to predict what the revenue is going to be for the company because they’re involved in the production of goods and services, and they don’t know the revenue. That’s maybe done at a higher level. But they certainly know the expenses as far as labor, as far as capital, as far as maintenance of machinery, things of that nature. And then the revenue, revenue maybe is predicted on a higher level, higher up the food chain. But they both – revenue and expenses – must be budgeted. Oftentimes the expenses – well all the time – the revenue dictates as far as what the expenses are going to be and maybe variable costs or something of that nature. So keep in mind, particularly for a small company or department that revenue and expenses must be budgeted. The first step in building a budget is the review step. You want to review past fiscal periods’ performance. Like we said before, how did we do? Why did it turn out that way? Are there things that we can do to improve that performance? You also want to review what we budgeted and what the actual spending was. If we were off by 20 percent as far as on our budget, why is that? You want to drill down as far as possible to root
cause analysis to determine why your costs did not perform as what you had expected. You want to review performance to organizational goals and economic realities, too. You want to look and see, by spending this money, how are we working toward what the company stands for and what the organizational goals are? If the company’s goal is to reduce spending by 5 percent, how does that fit in with that goal? And economic realities as well. We want to DO something. But perhaps you want to buy some new equipment, but because of the marketplace, it’s illogical to spend that much money. So in your review process, you want to go over that and see are these numbers realistic as far as what we want to do for our budget for the next year? And how does that fit in to what the company wants to do as well? Our next step in building a budget is to set goals. You review the new goals against strategic and long-range plans. Many companies have 30-year plans, or at least 10-year plans as to what they want to do. They want to capture a percentage of the market, or they want to be the highest quality provider of their goods and services that they sell. How do we go about doing that? And our goals that we’re setting for the next year, how does that fit into these long range goals? Is it realistic? And you want to measure against the progress to organization’s missions. What’s the company’s mission? What are they trying to be? What do they want to do? And how are these numbers and this budget and what we have planned for the next year, how does that fit into the company’s mission? Are we on the right track? Are we headed in the right direction? You want to always keep that in the back of your mind as far as when you’re formulating these budgets. Are we going in the right
direction? Is this something we want to undertake? Is this a project we want to undertake and spend this money on? The next step is to estimate revenue and cost. One thing that can’t be emphasized enough is use caution in forecasting revenue. We talked about that earlier when we first started. Use caution in forecasting revenue. It’s easy to say, you know, this company is going to spend a billion dollars, make a billion dollars in sales next year. But is that realistic? If you’re a big company, maybe. But if you’re a small company just starting out, it may be unrealistic as it could possibly be. You want to be able to justify your estimate on forecasting revenue. One good tip to remember as far as making your estimates and building a budget is to make these assumptions and then write them down for future review. For instance, let’s take the example we used before. We say that we’re going to have sales of a hundred dollars. The reason for that and how we arrived at that figure is we said we were going to sell 10 widgets at $10 apiece. Now when it comes time to review, you want these forecasts and the assumptions you made to be written down somewhere so they can be easily retrieved, then your actual figures measured against them. So you don’t want to come back maybe three months later and say, well I said $100 in sales. But how did I reach that figure? Well, you’ll have those figures available and you’ll be able to compare them against what actually happened. We’ll talk about that analysis here in our next module. You want to be sure to start with the sales forecast. As we said before, we examined before that sales forecasts often drives all your expenses as far as your labor budget or your production budget or your capital budget. You've always got to start with sales forecast and break it
out – itemize it as to how you arrived at what you said sales were going to be. One thing that people often forget is to make sure to account for seasonality. They say that for instance, they’re going to sell $1200 worth of material or goods and services. So they just divide it by 12 and say we’re going to sell $100 every month. That is the wrong way to go. Seasonality is based on the time of year. And you’ll often see this – probably the best example is Christmastime. Sales during October, November and December are far different than the rest of the year – what kind of sales happened in June, July, or August – in certain industries. That’s because of Christmastime. Also another example is back to school. Sales peak for different industries in August and September when school starts rather than in June and July. Or for instance snow shovels. Their sales are different in December, January and February than they are in August and July. So take into account seasonality and look at – usually if you’re an established you can look at historical costs, what you did last year or the last two years. But if you’re new and starting out a new company, you may have to do some research or look at competitors and what their sales are in different seasons. But make sure to take account of seasonality. Make sure to account for any future changes. This takes research and knowledge of what’s going on in the marketplace. It will take some review, maybe current affairs or the political climate or whatever. But make sure to account for future changes. Don’t just take last year’s figure and say well, we did that last year. This is what we’re going to do this year. Be aware of the changes around you and the environment that you operate in. Use the best preliminary information available. By
preliminary information, what I mean is what you know at the time you’re formulating the budget. For instance, and this is an example grim though it might be, but this is an example of maybe you made an estimate as far as your budget before 911, but no one could have foretold what was going to happen on 911. No one saw it coming. So use the best information that you have available when you formulate your budget, and then you may have to go back in the future and take other available information that you have at that time and make adjustments. But use the best preliminary information you have available. You want to estimate the cost to reach goals. If you’ve been handed, especially in the top-down approach, that these are the goals we want to reach for next year, then you’ve got to estimate the cost not to match what you did last year, but the goals that you are tasked to reach in the future. Once again, I can’t emphasize enough, take into account known future changes. What do you know is going to happen? What is coming down the pike? Be as realistic as possible. We touched on this earlier briefly, but a padded budget does not help anybody. As a matter of fact, it could hurt people and throw your company into bankruptcy. So be as realistic as possible. Know that personnel expenses typically account for 60 to 70 percent of total expenses. As far as what you pay the people that work for you, it’s in many industries – and this is just a rule of thumb. Some industries are different. But in most budgets, personnel expenses typically account for 60 to 70 percent of total expenses as far as what you spend for wages, salaries, benefits, vacations, things of that nature. 60 to 70 percent is a good rule of thumb. And the final step is to compare. Compare forecast revenue to forecast
expenses. Does it look like your expenses are going to exceed your revenue? You may need to go back in and review your figures, or go over your assumptions as far as the assumptions that you made. If you’re forecasting negative income for the year, your company may very well be in big trouble. So when you’re budgeting, if you’re using realistic figures and your expenses exceed your revenue, you need to take an in-depth look and go back and review as far as some of the assumptions you made and what you’re planning on. Account for the differences. Know why your expenses are exceeding your revenue. Do some in-depth analysis and some investigation as far as what’s going on and why. That’s part of – that’s how you manage a budget. That’s really the key to managing a budget, is knowing how it performs and what the differences are and why. Investigate and reevaluate. Why are they performing like that? And reevaluate your goals, your costs, everything – the assumptions that have gone into this estimate – and explain why they’re doing it, and change if need be. And then finally, to keep estimates conservative, reduce your revenue forecast by 10 percent and increase expenses by 10 percent. See where that takes you. People are prone to over-estimate both the revenue and minimize the expenses forecast. So as a final check, a final sanity check, reduce revenue by 10 percent and increase expenses by 10 percent and see where that takes you. Some additional steps to take, an established manager may use historical figures for comparison. We touched on this earlier, but it will at least give him a basis as far as reasonableness or a sanity check. If he looks at historical figures and makes his forecasts or estimate based on that, it might be – of course it’s foolhardy to go
and say well, we spent this last year. We’re going to spend this again this year. No, you’ve got to know why you’re going to do that. And it may be that you will spend the same thing as you spent last year. But you’ve got to be able to explain why and what’s going on with that particular line item. A new business, however, without benefit of historical figures, they must rely on research. Oftentimes these figures are available from chambers of commerce or other business organizations, professional organizations. But they need to look at the marketplace, what’s the market doing as far as businesses in this type of business. There are competitors. If they can get access to this information, it’s often very vague, but if they can get access to this information, it will at least give some idea of their cost structure. They need to look into their fixed costs – what’s the rent typically for this type of business? Is there a better deal I can get somewhere else as far as rent, or professional fees, or other fixed costs? And research regarding their sources of income. Who’s going to buy their goods and services? Why are they going to buy it? It’s demographic research as far as who they’re going to sell to and what’s going on with that.

[End of recording.]
In our next module, we’re going to look at variance analysis. When we say variance analysis, what we mean is it’s a fancy term. All it means is it’s the analysis of budgeted and actual data. We budgeted this amount. Our actual costs were this amount. What is the difference, and why? Forecast and actual data is often the product of quantity of units and price per unit. And this has always helped me when I’ve done some variance analysis, is to remember that the reason that we forecast this amount, we said we were going to sell this unit, amount of units, and price per unit. We’re going to sell it at this amount. The thing also, it can often be used as far as your labor budget. We said we were going to use five hours of work at $10 an hour, and we only spent $40. Why? So it’s really not difficult. The hardest part of variance analysis is the root cause analysis as to this is what happened. Why did it happen? But variance analysis is important because it is the key to managing a budget. If you have a good grasp and a good understanding of variances as far as why did costs perform that way, why did revenue perform that way, then you’ve got a stranglehold on reasons behind the budget and what direction you need to take in managing it, and steps maybe you can take to get your budget under control. I’m passionate about this part of managing a budget. It’s so important, and honestly it’s the key to managing a budget. The use of variance data to make adjustments to a future budget or forecast is called a rolling budget. I want to talk about this briefly. If you look at your variance data, once again on a monthly basis if you’re looking at it monthly, which you should be, you see that here are some differences or this will red-flag
something that you didn’t know when you formulated the budget. And now that it’s become available, this information is available to you. Do you need to make an adjustment as far as your future budget, or your future forecast as to what your cost or what your income is going to be? So that’s why variance analysis is important as well. We’re going to go over an example of variance analysis, a very simple example, and I think it will become clear to you. It’s not too complicated. But this is a basic variance analysis. In formulating the budget, managers said that we were going to sell ten units at $1.50 per unit. So we had a total sales forecast of $15. Now when the figures came in, when the month was complete, and the sales were recorded, we had actual units sold of eight and an actual price of $1.25 per unit for actual sales of $10. So our sales forecast was $5 less than what we forecast. Why is that? Well, the conclusion we reached after doing this and breaking it down as far as quantity times price per unit is the firm had less receipts than forecast because they sold two less units – the difference between ten budgeted and eight actually sold. So they sold ten less units, and they had a budget price of $1.50 and an actual price – they actually sold them for $1.25. So at a price of $25 less per unit than forecast. 25-cents less per unit than forecast, excuse me. In compiling next month’s budget, the task the manager is faced with is you must determine if this trend will continue, and should you incorporate it into the forecast? This variance analysis requires some further drilling as far as to the reasons and understanding of why this performed differently. But why did they sell ten less units? Well, maybe there was bad weather, or could be anything. But you need to drill down as far
as you can. Just saying you sold two less units, well your next question is why? And oftentimes a kind of a rule of thumb is you must – not you must, but you should – ask five levels of why. Well, okay. Why did we sell ten less units? Well, because we had some bad weather. We had snow storms or something. Why? And of course, you can go down as far as you want to. But five levels should answer it. Are there outlying factors that maybe you don't have control of, but you need to be aware of? Same way with the budgeted price. Why did we sell it for 25 cents less per unit? Well, we may have had extended sales, or there might have been a problem – once again, the snow storm – and we had to clear some inventory and we sold it at a cheaper price, or a good customer came in and we gave them a volume discount, or whatever. But drill down and find out why. How you take this information, this information here is golden as far as managing a budget. This is the type of information you need because now, you know what happened. Now you've got to determine what steps you have to take to change this performance.

[End of recording.]
HOW TO UNDERSTAND AND ADMINISTER A BUDGET
MODULE FIVE – STEPS TO IMPROVEMENT

Let’s take a look at steps to improvement, maybe some things that are happening and some steps you can take to avoid this. In module five, Steps to Improvement, oftentimes a new manager will ask himself how can I keep from making mistakes? The very simple answer to this is you can’t. If by mistakes you mean that you can’t foretell the future as far as what your costs are going to be or what your revenue is going to be, it’s not a mistake. The key to managing a budget is knowing what to do when your forecast is off. That’s the art of managing. No one has a crystal ball. But the trick in managing a budget is knowing what to do when your actual don’t meet your budgeted amount. It’s not a mistake. You’re not making a mistake. Your budget is a line in the sand, and if you go to either side, the trick is knowing what steps to take to get you closer to that line in the sand. Managing the budget. Here are some tricks to managing the budget, and it will help you to manage the budget better. Learn to be flexible. Realize the different steps that you need to take, and realize that you’re not going to be spot on 100 percent. You’re not going to match budget. If you match budget at all, you’re going to be very, very lucky. Now there’s of course fixed costs that you’ll be able to predict fairly easily. But others, you’ve got to learn to adjust to whether your budget numbers, your actual numbers are over are under your budget numbers, you need to be flexible. You also need to make conservative estimates. When we talked about 10 percent reduction in revenue, or 10 percent increase in expenses, this is what we’re talking about here. You need to make conservative estimates – not some pie in the sky type of estimates, but
something that’s within reason. And have reasonable assumptions to back them up. That’s why when you make assumptions, you should write them down and keep them in a safe place, because you want to be able to pull those out and say well, okay I said $100 and this is why. These are the assumptions I made. That way you will know which assumptions to change as far as if you have to, or explain as to why you arrived at that number, because I guarantee you somebody’s going to come and say, well why this number? And you’ve got to be able to explain yourself. So keep those assumptions well taken care of. You also want to include – now we talked about padding a budget, but budget in a cash emergency fund. By that I mean it’s not padding, but if an emergency should arise, have an idea of where you’re going to get the cash to maybe pay for that. In managing your budget, if this should happen, this how we’re going to handle an emergency. There’s cash included in this particular part of the budget. You must, and this is imperative, you must review your budget every month. There are industries that review their budget every week, depending on the volatility of the industry. But it’s generally, you’ll be fine with reviewing your budget every month. Most budgets are constructed on a monthly basis. But you must review it. You can’t just formulate your budget, put your budget together, and stick it in a drawer and look at it next year when the budget time comes around. You must review it every month. You must be on top of cash flow as well. We said it earlier, we’ll say it again. It can’t be emphasized enough that more businesses went bankrupt and went out of business, were insolvent, because of a poor cash flow – not poor sales, but a poor cash flow. You must
know your cash position at all times. Show restaurant, not rigidity. There will be opportunities that come along that are not budgeted, but they are an excellent opportunity for the company to take advantage of and will pay off in the future. So by showing restaurant, we mean don’t constantly go over your spending limit as far as budget is concerned, but don’t be so rigid that you let an opportunity to make a move, don’t be so rigid that you let it go by because you want to stick to your budget. That is not in the best interest of the organization as well. The trick is to know which ones to be restrained on and which ones to be rigid about.

Steps to take if expense exceeds revenue. First thing, review your budget assumptions. Oftentimes it’s not a problem with over spending, but that your assumptions were incorrect. So the first step you want to take is to review your budget assumptions. Once again, pull out the assumptions that you made in formulating the budget and review them – why you reached this figure, why you came about this figure, and what assumptions you made. You may find that because of new information available that your assumptions were wrong and you just need to change your assumptions and use a rolling forecast to make revisions as far as next month’s budget. So the first step you want to take, rather than go berserk, is to review your budget assumptions. However, you may find that your assumptions are right on, and your expenses still exceed your revenue. Then you will come to the step where you have to freeze spending. It may be a matter of, for instance the easiest example I can think of is you had planned on buying some new equipment, some new machinery, but you’re not in a position to be able to afford that now. So you must back off spending, or maybe back off
hiring some new head count or things of that nature. But that’s a step to take so you’re not adding more expense to your revenue. Postpone new projects. This is kind of what we said in the previous step, to back off any spending as far as capital expenditures are concerned, or you’re buying a new building, or whatever is coming down the pike, you might need to postpone new projects until the revenue has increased. And finally, and this is the last step you want to take, is reduce labor expense. What that is code for is layoffs, or even closing a plant or building. If you’re not selling the product or services that you’re producing, then you want to reduce labor expense. And layoffs and closing down a plant, I’m sorry to say, is probably the fastest and easiest way to do that. It’s the sad truth, and this is often the one that many upper management take as far as changing their budget outlook.

[End of recording.]