The Art of Budgeting

How to easily and efficiently Budget your Capital Expenditure, Profit & Loss, Cash Flow and Balance Sheet.

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Relevance

- RBA, Business Failure in Australia:
  - 30% in the first year
  - 73% in the first five years
- Dun & Bradstreet:
  - 2,898 businesses collapsed in the June 2011 Quarter, up 25% over 2010;
  - Firms between 1 and 49 employees were hit hardest.
- Every commercial enterprise needs to budget:
  - Any legal structure (ST, P, T, Pty Ltd, Ltd)
  - Any Industry Sector
  - Wherever located in the country

The Budgeting Steps

- Step 1: Budget Methodology
- Step 2: Assumptions & Objectives
- Step 3: Capital Expenditure
- Step 4: Profit & Loss
- Step 5: Cash Flow
- Step 6: Balance Sheet

Step 1: Budget Methodology

- Traditional budgeting, Top/Down approach: Using the last known figures and adjusting for changes/objectives starting with Revenues);
- Traditional budgeting, Bottom/Up approach: Using the last known figures and adjusting for changes/objectives starting with Profits all the way up to Revenues);
- ‘Zero based Budgeting’: Starting with a blank sheet of paper and determining what Revenues and Expenses/Overheads should be.

Step 1: Budget Methodology

- Traditional budgeting:
  - Quicker, Easier
  - But business may overpay for services (Telecommunications, IT providers, etc.)
  - Can result in increased inefficiencies and ineffective processes
- ‘Zero based Budgeting’:
  - Longer process
  - More efficient at reducing expenses
  - Better to allocate resources to functions and processes that have the best outputs

Step 2: Assumptions & Objectives

- Begin with the assumptions you have taken and the objectives you have set:
  - Marketing & Sales Objectives (Market share, Marketing campaign, New products, Customer Satisfaction Level)
  - Production Improvements (Defects reduction, Quality control)
  - Financial Objectives (Profitability, Stock Turnover, Creditors' Days)
  - Expenses Up or Down (Wages, Advertising,…)

Step 3: Capital Expenditure Budget

- Purchase of a Fixed Asset or addition to the value of an existing Fixed Asset
- Capitalisation (in the Balance Sheet) for assets with a value over \$100 / \$1,000 / \$4,000 (country regulations vary) and a useful life beyond the end of the financial year
- Not a Tax Deduction in the year of acquisition, but depreciated over several years
- <u>Full cash flow effect</u>, but limited tax deduction

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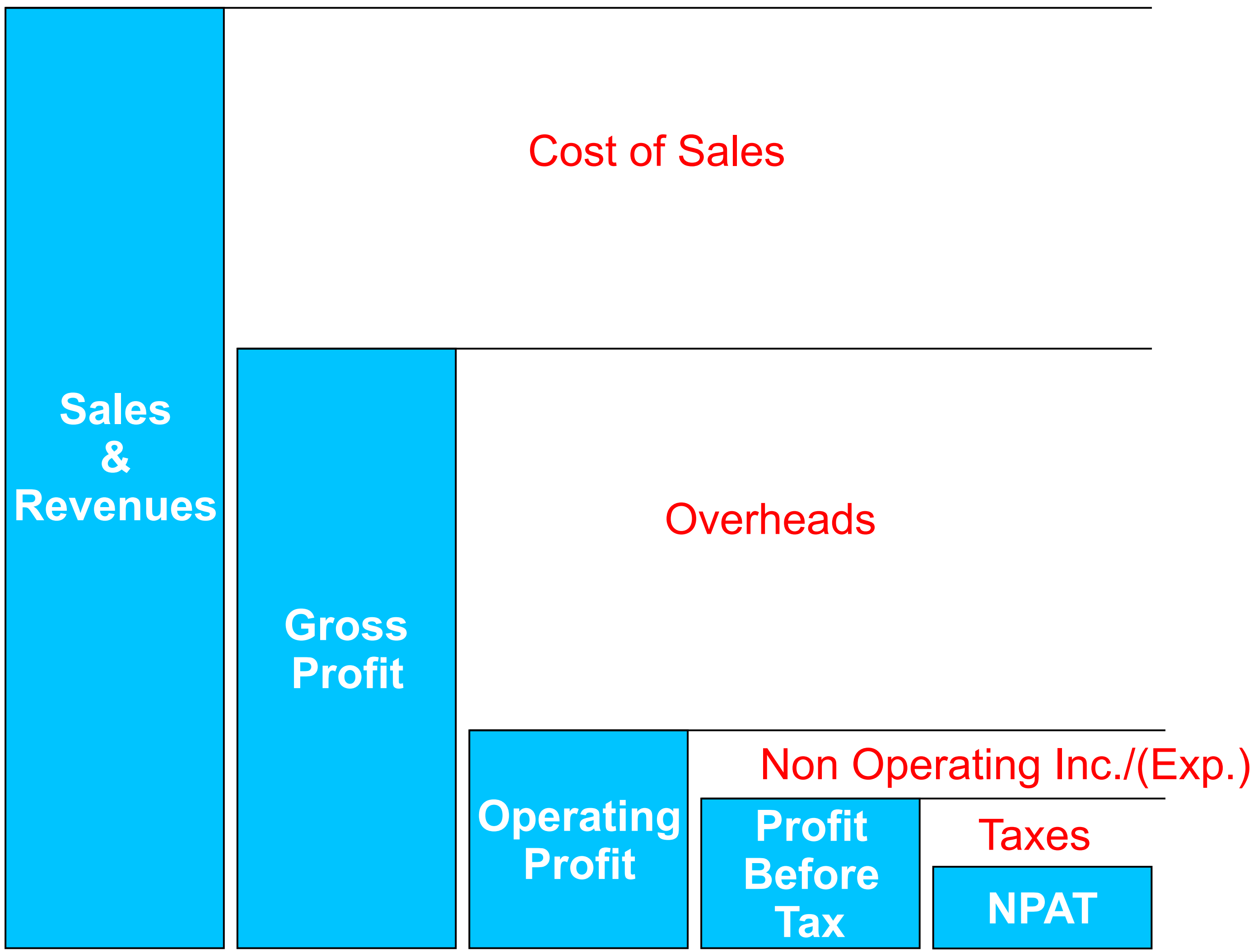
Step 3: Capital Expenditure Budget

- You need to decide/budget:
  - Which item?
  - When?
  - Leasing? (P&L ➔ Impact spread over several Years)
  - Outright Purchase? (Cash Flow + B/S ➔ Full impact in one hit?

Step 4: Profit & Loss Budget



Step 4: Profit & Loss Budget

- Either using the last known P&L and adjusting for changes starting with Revenues (Traditional budgeting);
- Or using the last known P&L and setting the objectives starting with of Profits, all the way up to Revenues (Traditional budgeting with emphasis on Profits);
- Or starting with a blank sheet and determining Revenues and Expenses/Overheads (Known as 'Zero based Budgeting').

Step 5 = Cash Flow Forecast

	P1	P2	Etc.
Proceeds from Sales			
Other Cash In (Sales of PP&E, Funding)			
Total Cash In			
Purchased of Goods			
Rent, Telecom.			
Wages			
BAS Payment			
Total Cash Out			
Net Cash Movement			
Opening Balance			
Closing Balance			

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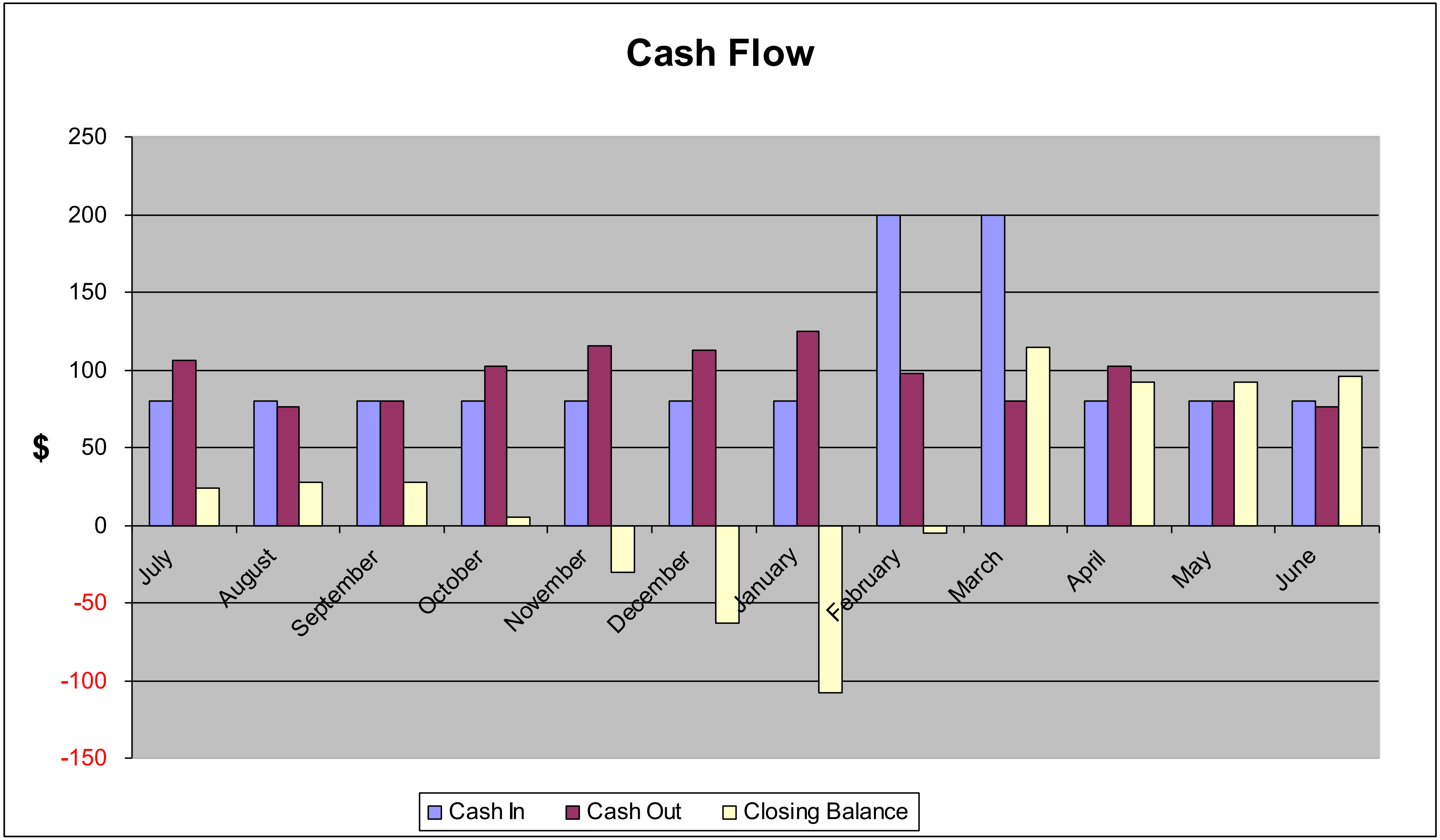
Step 5: Cash Flow Forecast



Step 6: Balance Sheet Budget

Current Assets
Cash
Debtors
Inventories
Other Current Assets

Fixed Assets
Property Plant & Equip.

Current Liabilities
Overdraft
Creditors
GST & Tax Liabilities

Long Term Liabilities
Long Term Borrowings
Long Term Provisions

Equity

The Right Budget Process

	Start Up	Small Business	Medium Size	Large Business
Methodology			✓	✓
Objectives	✓	✓	✓	✓
Capex	✓	✓	✓	✓
Profit & Loss			✓	✓
Cash Flow	✓	✓	✓	✓
Balance Sheet			✓	✓

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