Introduction

Do you know that 96% of businesses in Britain employ less than 20 people? Many of these firms do not have a full-time accounts department. The owner usually employs a book-keeper who simply runs the day-to-day accounting records so that the business can function. The records are then made available to the external accountant who prepares the annual accounts at the end of each financial year.

But is this enough in today's competitive world? The answer is a resounding *'No'*!

You need financial information to run the business. However you cannot use the annual accounts because:

- they arrive *too late*. By the time you see your accounts, you could be well into the new financial year. Much could have changed. How do you know whether you are still trading profitably?

- they don't contain sufficient information for management control. Annual accounts are a summary of last year's events. You need more detailed information to run the business. The information should be available to you as and when it happens.

How do you get hold of this up-to-date management information? How do you use it to help run the business? The answer is budgeting. Don't feel intimidated by budgeting. As you will see later, budgets are simply a collection of numbers which help you run the business better.

In essence, budgeting involves:

- planning what you would like to happen to the business in the coming year
- keeping an eye on progress, usually on a monthly basis.

Business money is generally controlled on two documents. These are:

- the cash flow forecast
- the profit plan.

We will look at the cash flow forecast in Section 3 of this book and the profit plan in Sections 5 and 6.

Although businesses need a cash plan and a profit plan, financial reporting rarely stops there. In addition, most businesses need special reports on key areas like debtors, creditors, stock, wages etc. We will look at these key reports in Section 7.

Budgets are designed to make information available to owners, managers and other employees within the business. If they are to succeed, they should be as clear and simple as possible. Try to avoid pointless jargon and complication. If you need an accountant to understand your budgets, you are definitely doing something wrong! Everyone should be able to understand the figures.

Before looking into cash and profit budgeting in detail, let's have a quick look at the way in which responsibility is allocated in a budgeting system. This is covered in the next section.

About Budgets

Let's have a look at the way in which a business organises itself to use the numbers produced by the management accounting system.

Budgeting aims to *involve* employees at all levels in the business. This is achieved by delegating as much responsibility as possible. Budget holders need to be involved in setting next year's targets and also in meeting those targets. Here are the steps of budgeting.

1 Delegate Responsibility

Decide who is responsible for what. Then delegate as much responsibility as possible.

Most businesses are started by one or two people. Initially the owner has to do everything himself (or herself) because there is nobody else to delegate the work to. There is a real danger however that 'doing everything' becomes the norm. Employees get frustrated when the owner or manager refuses to give them proper responsibility. *However the boss must delegate if the business is to grow*.

Delegation involves:

- making a single person responsible

- teaching that person how to manage their job

- staying in contact to help when they have problems.
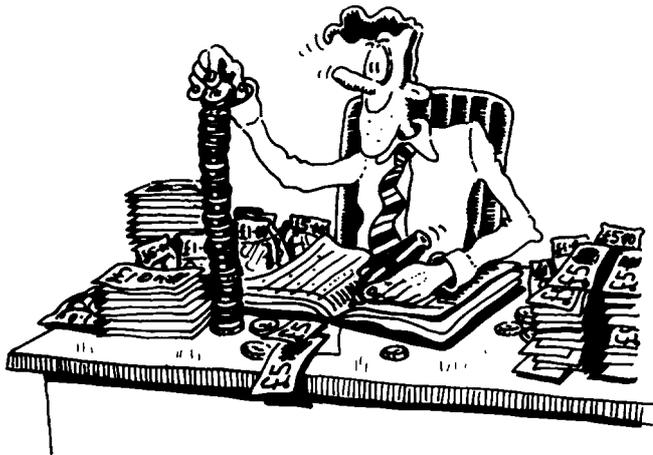
A Budget Holder?

With good delegation, each employee will grow into the job. Who knows, they may make a better job than the boss ever did! The most powerful form of delegation is to give the employee *all* the tools to do the job. This includes control over the money reserved for that activity. This makes the employee a *budget holder*.

2 Plan the Master Budget

Set broad targets for the coming year (covering items like sales, costs, profit). Let everyone know what these broad targets are. This is called the master budget.

The best time to plan the budget for the new year would be in the final month of your old year. How do you do it?

First review the current year:

- has the year been successful?
- has the cash flow been good or bad?
- have there been any major problems which have affected profits?

Taking into account the above factors, start to prepare a draft cash budget and a draft profit budget.

Next:

- you will need to allow for inflation
- you will need to consider whether you will be spending money on new equipment
- will you be planning to expand?

Taking these points into consideration, you can then amend your budgets again. Even at this early stage, talk to staff and find out their views. You will be surprised at the value of their opinions.

3   Break the Master Budget down into Mini Budgets

A mini budget is the responsibility of one person. Check that each mini budget is feasible within itself and doesn't conflict with the others. Budgets are all about *commitment*. People feel more committed to targets which they have worked out for themselves. Who knows more about the budget holder's area of responsibility - the boss or them?

Having asked someone to work out their mini budget, the owner or manager needs to spend time running through the budget in some detail because:

- the mini budget needs to relate to the master budget.

- the owner/manager may be able to contribute something from his or her longer experience.

- the owner/manager can act as a sounding board. Even if unable to contribute much detail, they may be able to help budget holders clarify their thinking on their area of responsibility.

- the owner/manager can look out for the 'optimist' and the 'pessimist'. The optimist plans for the best case, which he is unlikely to achieve in practice. The pessimist 'pads' his budget. This will give the budget holder an easy ride over the next 12 months but it won't do much for the firm.

Each mini budget should make sense in the light of past performance. It should be challenging but achievable.