

Learning Aim B

Budgeting

Learning Objective: To be able to describe the purpose of budgeting

What is a budget?

A budget is a **plan of money** coming **in** and going **out** over a period of time.

Example of a budget

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Income	£	£	£	£	£	£
Part-time job	50	50	50	50	50	50
Pocket money	20	20	20	20	20	20
Total income	70	70	70	70	70	70

Spending	£	£	£	£	£	£
Clothes		30			30	
Music	15		15		15	
Friends	15	15	15	15	15	15
Mum's birthday			20			
Total spending	30	45	50	15	60	15

Income – spending	40	25	20	55	10	55
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The purpose of budgeting

Budgeting helps people (and businesses) to get what they want by planning.

It is a process of setting targets for spending and revenue over a future period of time.

They are used in many business situations such as:

- Forecasting start up costs
- Introducing a new product or more capital for a business like a factory
- Forecasting sales revenue.

The main purpose is to ensure that the business is in control of its revenue and expenditure so it makes a profit.

Budgets should be realistic, achievable and challenge all staff.

Budgeting and budgetary control

After setting the budget, there must be a system in place to ensure targets are met. This is **budgetary control** and can be achieved by:

1. Measuring actual performance regularly
2. Giving this information to the budget holder, who checks for differences between planned target and actual performance. They can then take action.
3. If this works then next month the performance should be better and match the targets set.

Activity

Discuss what actions a business could take if budgetary control showed that;

1. The sales figures were much lower than expected
2. Although we bought the same number of units, the cost of purchases every month from our supplier has increased by 20%.
3. Due to many products being damaged by employees not being careful, the labour costs i.e. wages have increased by 50% each month so new products can be made.
4. The business planned to buy a new van for £10,000 in April, but the old van broke down in February so they bought the new one then. This means the business has no cash to pay the bills in February and March.

For each of the above situations, what would be the consequences to the firm if they had not used budgetary control and did not know about the problem?

Risks of not completing a budget or an inaccurate one

- Hard to plan when it needs to bring in more money like an overdraft or loan.
- The business may be in a position where they cannot pay their bills.
- Inaccurate budgets may be based on wrong data and mistakes like New Coke!