SIT50416 Diploma of Hospitality Management

SITXFIN004 Prepare and Monitor Budgets

Student Handout

SITXFIN004 Prepare and Monitor Budgets

This unit describes the performance outcomes, skills and knowledge required to analyse financial and other business information to prepare and monitor budgets. It requires the ability to draft and negotiate budgets, identify deviations, and manage the delivery of successful budgetary performance.

The unit applies to all tourism, travel, hospitality and event sectors. The budget may be for an entire organisation, for a department or for a particular project or activity.

It applies to senior personnel who operate independently or with limited guidance from others and who are responsible for making a range of financial management decisions.

ELEMENTS	PERFORMANCE CRITERIA
Elements describe the essential outcomes.	Performance criteria describe the performance needed to demonstrate achievement of the element.
1. Prepare budget information.	1.1. Determine and confirm scope and nature of required budgets. 1.2. Identify, access and interpret data and data sources required for budget preparation. 1.3. Analyse internal and external factors for potential impact on budget. 1.4. Provide opportunities for colleagues to contribute to budget planning process.
2. Prepare budget.	2.1. Draft budget based on analysis of all available information. 2.2. Estimate income and expenditure and support with valid, reliable and relevant information. 2.3. Reflect organisational objectives within draft budget. 2.4. Assess and present options and recommendations in a clear format. 2.5. Circulate draft budget to colleagues and managers for input.
3. Finalise budget.	3.1. Negotiate budget according to organisational policy and procedures. 3.2. Agree on and incorporate modifications. 3.3. Complete final budget in a clear format within designated timelines. 3.4. Inform colleagues of final budget decisions and application within relevant work area, including reporting and financial management responsibilities.
4. Monitor and review budget.	4.1. Regularly review budget to assess actual performance against estimated performance and prepare accurate financial reports. 4.2. Incorporate all financial commitments into budget and budget reports. 4.3. Investigate and take appropriate action on significant deviations. 4.4. Analyse changes in internal and external environment and make necessary adjustments. 4.5. Collect and record relevant information to assist in future budget preparation.

Prepare a budget

Budgets are one of the most important business financial statements. If planned and managed well, a budget allows you to monitor the financial impact of your business decisions and operational plans.

What is a profit and loss budget?

The profit and loss budget is a summary of expected income and expenses. It is usually prepared annually although the period can be shorter or longer, depending on what you are going to use the budget for.

Income and expense information is set against the business operating plans for the budget period.

Your accountant can help you prepare the budget but you need to understand how it has been developed. You also need to know how to monitor your business outcomes against the prepared budget so that you're tracking if your business is achieving the goals and remaining profitable.

Steps for preparing a profit and loss budget

Start by understanding your business goals and involve key staff. This ensures your budget is aligned to your goals and is prepared and reviewed by the appropriate people.

Document and follow a process for preparing an annual budget. Steps could include:

1. review the approved business operating plan and note all required activities for the budget period
2. separate activities into existing and new for the new budget period
3. identify and document all assumptions that have been made for the budget period
4. review prior year's profit and loss statements by regular periods (monthly, quarterly etc.)
5. prepare the profit and loss budget for the selected period using the Financial statements template.

Monitor and manage your profit and loss budget

Where the profit and loss statement is prepared on a monthly basis, the budget will need to be separated into months for the budget period.

Regular monitoring of the budget against actual results provides information on whether your business is on track to meet the goals you were aiming for when you first prepared your budget.

When the actual results vary from the budget

At the end of each month, compare the actual results from the profit and loss statement with the budgeted results. Note and analyse any variances, with explanations. Categorise all variances as either a 'timing' or 'permanent' variance.

- **a timing variance** is where the estimated result did not occur but is still expected to happen at some point in the future
- **a permanent variance** is where the expected event is not likely to occur at all.

This information will help minimise future variances. You'll be able to implement new or improved activities to ensure you are still able to achieve the strategic goals of your business.

http://www.business.vic.gov.au/money-profit-and-accounting/financial-processes-and-procedures/how-to-create-a-business-budget-plan

Steps in Preparing an Operating Budget

Collecting just a few calculations will help you prepare a successful operating budget.

Preparing an operating budget requires a balancing act of analyzing the existing data of your company's sales and expenses, and forecasting the numbers for the year ahead. While it is unlikely that your budget forecasting will be completely accurate, having an operating budget helps you figure out where to allocate funds, which departments are over- or under-performing, and how to better budget for the future. By breaking down the elements of profit and expense into digestible sections you will be able to prepare an operating budget.

Sales

A majority of your operating budget number-crunching will revolve around expenses, but once those are collected they will be compared to your total sales. You can break up your sales results by quarter or by month, whichever works best for you. You can use a simple spreadsheet file to keep track and total your findings. Analyze your previous year to predict your sales for the next. Pay special attention to events that make your numbers vary. For instance, if you have a season that is more profitable than other seasons, then you can assume that there will be a similar percentage increase in sales next year at the same time. If you have a new product debuting that will have an expected jump in sales, reflect the expected percentage increase in that future month on your spreadsheet.

Cost of Goods

Use a similar prediction method to forecast what your goods will cost for future quarters or months. Account for expected fluctuations in sales, as that will affect your purchases for your

goods. Once you have your totals for the expected cost of goods, subtract that total from the expected sales. Your sales total minus your cost of goods total is your gross margin. Now that you have this number you can use it against totals of all your other costs to predict your operating income.

Other Costs

Depending upon the size of your company, you will have any number of other operating costs to estimate. Some examples include payroll for employees, insurance for employees, overhead costs for maintaining a physical shop or warehouse, travel fees, and research and development costs. Record your previous expenses in the categories relevant to your business and use those numbers to predict the expenses over the course of the next year. Subtract that total from your gross margin to determine your operating income.

Taxes

Now that you have estimated your operating income, you can estimate your annual taxes. When you subtract your predicted taxes from your likely operating income you will discover your business's net income, the final step in the preparation of your operating budget. As you progress over the next fiscal year, compare your profits and expenses to those you predicted in your operating budget. If you did not use as much money as you expected in certain areas, move that money to other areas. If you are showing losses, you may need to consider layoffs or cutbacks on fringe benefits to compensate better next year.

http://smallbusiness.chron.com/steps-preparing-operating-budget-61547.html

Monitoring the budget

Budgets help entrepreneurs set financial goals – and review actual performance against these goals.

Because a budget is an estimate of future numbers based on current information, your business’s actual performance should be similar to the budgeted amounts. Actual performance, however, will never be exactly the same as the budget. It will come close, fall short, or exceed the budget.

Your job is to monitor the budget to answer these questions:

- How close did the business come to the budgeted figures?
- What adjustments, if any, should be made to the current year's budget?
- What adjustments, if any, should be made to budgets in future years?
- What changes, if any, should be implemented to improve performance?

The budget should be monitored regularly throughout the year: quarterly, monthly, or even weekly. Reviewing the budget will help you identify problems before they cost the business too much time or money.

How often you review the budget depends on your confidence in the figures and the risk associated with not meeting the budget. For example, if you must meet a certain budget in order to meet your loan obligations, the risk of falling short is high.

You might consider adjusting the current year's budget at various intervals throughout the year. Many businesses re-evaluate their budgets halfway through the year. This way they can assess the actual results so far and adjust the budget to more accurately represent real expectations.

Stop and Think

Carol Frank, author of the book *Do As I Say Not As I Did!*, hosts a quarterly retreat for her management team at Avian Adventures, a Dallas company that creates premium bird cages. At the retreat, the team reviews budget variances between estimated amounts and actual quarterly figures. Based on this analysis, the team reviews and adjusts the budget for the rest of the year.

Falling Short of Budgeted Figures

When your business does not meet budgeted figures, start by reviewing the business strategy that formed the basis for the budget. Some aspect of implementing your business strategy did not happen as expected. Did you misunderstand the market? Did you have too little information? What do you know now that will change the budget in the future? Can you still plan for profitable performance based on this business strategy?

You also need to take a hard look at the budget figures, paying close attention to the major components of profitability—Sales, Cost of Goods Sold, and Operating Expenses. Maybe you met your Sales goals and understood the Cost of Goods Sold, but misjudged Operating Expenses. Evaluate the changes you must make to future budgets to include this new knowledge.

Exceeding Budgeted Figures

Entrepreneurs would prefer to exceed the budget, rather than fall short. A considerable variation between forecasted amounts and actual amounts, however, places doubt in the budgeting process. Exceeding the budget by a great deal implies that the budget was either too easy or inaccurate. In either case, review each of the major components of profitability to determine where the variations occurred. When you discover the reasons for your discrepancies, form a more accurate future budget that will be more helpful in guiding your financial plans.

http://www.entrepreneurship.org/resource-center/monitoring-the-budget.aspx

Here are 10 reasons why, and how, budgets can cause your company problems:

1. Budgets are time consuming and expensive
Despite the advent of powerful computer networks and multi-layered models, budgeting remains protracted and expensive. The average time consumed is between four and five months. It also involves many people and absorbs up to 20 to 30 percent of senior executives'

and financial managers' time. Some organizations have attempted to place a cost on the whole planning and budgeting process. Ford Motor Company figured out this amounted to $1.2 billion per annum.

Trending

- Value Pricing: The Timeless Debate
- Can Collaboration Technology Help Keep Clients?
- Improving Your Audit Process, Part 5

2. Budgets provide poor value to users
The perception of the value provided by the budgeting process varies widely. In one firm it was apparent that the group board thought the budget gave them control, whereas operating managers thought it was completely irrelevant to their needs. One of the primary reasons that financial directors rank budgetary reform as their highest priority is that their staffs spend too little of their time adding value. One conclusion from a 1999 global best practices study was that finance staff spent 79 percent of their time on "lower value-added activities" and only 21 percent of their time analyzing the numbers.

3. Budgets fail to focus on shareholder value
Budgets focus on internally negotiated targets which tend to be incremental changes from the previous period's outcomes. The result is a target that is inwardly comfortable to you, yet appears outwardly difficult to your superior. There is no focus on the maximization of customer or shareholder value.

4. Budgets are too rigid and prevent fast response
The evidence suggests that only 20 percent of firms change their budgets within the fiscal cycle. Another survey result shows that 85 percent of management teams spend less than one hour per month discussing strategy

5. Budgets protect rather than reduce costs
"Use it or lose it" is the manager's mantra. Not spending the budget is a cardinal sin in most organizations. The result is that superiors invariably question why the resource is needed and are understandably reluctant to allow it to pass into the budget for the next period

6. Budgets stifle product and strategy innovation. "Never take risks." It is just not worth it. If it's not in the budget, you might be exposed. Anyhow, if you did take a risk and it worked out well, your superior probably thought of it first! And if it didn't work out, your job might be on the line .

7. Budgets focus on sales targets rather than customer satisfaction
Though everyone wants to satisfy customers, that is not how they are measured and rewarded. So they meet the sales target, persuade customers to buy their products, and convince them that their slow-moving stock really is a great deal!

8. Budgets are divorced from strategy
According to a recent cover article in Fortune magazine, around 70 percent of companies surveyed were poor at executing strategy-a massive indictment of the performance management capabilities of budgets.

9. Budgets reinforce a dependency culture
The way to survive and prosper in a budgeting environment is to do what you're told, meet the budget (but never beat it!).

10. Budgets lead to unethical behavior
Managing the results (also known as cooking the books) is a frequent outcome of budgeting. Many finance managers are well versed in "managing the slack" and feeding it into the results when needed. However, as we have seen, this practice can border on outright fraud

http://www.accountingweb.com/practice/team/10-reasons-why-budgets-cause-problems

Whilst budgets are widely used to in business, you should appreciate that they have some important limitations.

In particular:

- Budgets are only as good as the data being used to create them. Inaccurate or unreasonable assumptions can quickly make a budget unrealistic
- Budgets can lead to inflexibility in decision-making
- Budgets need to be changed as circumstances change
- Budgeting is a time consuming process – in large businesses, whole departments are sometimes dedicated to budget setting and control
- Budgets can result in short term decisions to keep within the budget rather than the right long term decision which exceeds the budget
- Managers can become too preoccupied with setting and reviewing budgets and forgetting to focus on the real issues of winning customers

Budgets can also create some behavioural challenges in a business

- Budgeting has behavioural implications for the motivation employees
- Budgets are de-motivating if they are imposed rather than negotiated
- Setting unrealistic targets adds to de-motivation
- Budgets contribute to departmental rivalry - battles over budget allocation
- Spending up to budget: it can result in a “use it or lose it” mentality - spend up to the budget to preserve it for next year
- Budgetary slack occurs if targets are set too low
- A “name, blame and shame” culture can develop - but managers should be answerable only for variations that were under their control

http://www.tutor2u.net/business/reference/budgets-limitations-and-potential-problems

INCOME	**Actual**	**Difference**	
Net sales	600	200	-400
Interest income	600	800	200
Asset sales			0
Donations received			0
Rental Income			0
Total	**1200**	**1000**	
EXPENSES	**Actual**	**Difference**	
200	300	100	
Advertising			0
Bad debts			0
Cash discounts			0
Delivery costs			0
Depreciation			0
		0	
Insurance			0
Interest expense			0
Payroll expenses			0
		0	
Office supplies			0
Postage			0
Rent or mortgage			0
Sales expenses			0
		0	
Office Supplies			0
Taxes and licenses			0
Telephone			0
Utilities			0
Salaries and wages			0
		0	
Travel			0
Other			0
Total	**200**	**300**	
NET INCOME			1000