ESTABLISHMENT OF BUDGETING AT THE ENTERPRISES

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Company without budgeting can be compared with tourists without a compass. In modern economy conditions budgeting is not just a system showing the level of business processes organization.

Budget is the key instrument of management process. Today almost all companies either commercial or not for profit prepare budgets.

Budget is the process of production and financial planning of future company's operations. Unlike accounting forms (i.e. balance sheets and profit and loss statements) budgets reflect the forecast of the enterprise's future activity for the period according to its strategy. When the results are achieved we can estimate the level of the goal achievement an make the decision on the necessity of the correction.

So the budget is the complex of interlinked balanced plans of the enterprise and its divisions in natural and monetary items which unites financial and investment activities of the enterprise and which allows to compare the cost and the result got in different intermediate periods and for whole period.

Moreover budgeting serves as the instrument of the enterprise's strategy realization. It allows to adjust strategic company goals with tactical plans of their achievement and supports the implementation of these plans connecting them to the operative processes.

Budgets allow to save for main managements tasks:

1) Setting objectives for the nearest and long-term prospective
2) Coordination of the company' work and making it transparent
3) Deviation management and control
4) Personnel motivation

The process of budgeting can be divided into two parts which are the preparation of operational and financial budgets.

Operational budget includes sales budget, purchase budget, direct material cost budget, overheads budget, direct labour cost budget, sales expense budget and administrative expense budget, profit and loss statement budget.

Financial budget is the plan which reflects the sources of funds and directions of their use. Financial budget includes investment and credit budgets, cash flow budget and balance sheet budget.

The methods of budget preparation are the following.

Traditional method of the budget preparation is based on the previous period activity with some corrections caused by the change of some factors which are expected to effect the enterprise's activity in the next period.

Zero based budgeting means the preparation of budget without any using of the previous data. It is often used for new enterprises or expending the company's capacities.

Activity-based budgeting means preparation of budgets for the key activities.

In practise it is preferably to combine these methods.

Sometimes fact level of the capacity use does not equal the planned one so the estimation of current and planned results can be incorrect.

One of the ways of settling this problem is using flexible budgets where planned revenue and expenses are recalculated for the current volume achieved during the period. The difference between the current value and the value foreseen in the budget is the deviation. The deviations calculated in such a way give us more valuable information than deviation calculated using statistic budget. Using the results of deviations analysis helps managers in planning and control of operating activity.

The process of budgeting establishment at the enterprise starts with analysis of its organisational structure. Analysis of the organisational structure of the organisation allows to point the centers of financial responsibility which will not necessarily correspond its hierarchical structure. Then we should chose a person from each centre who will be responsible for preparation, timely presentation and execution of budget. We should also chose the coordinator whose liabilities will include the following:

1) taking all budgets together into the main budget;
2) its approval by management;
3) informing responsible persons with the last approved numbers;
4) organizing meetings on the budget policy of the enterprise.

Generally budget coordinator is the financial manager.

Then the participants of the budgeting process discuss the implemented system of budgeting together. This should be reflected in the budgeting standard. The budgeting standard is the document where the following items are pointed being approved by all participants:

1) order of preparation and terms of presentation of budget to the coordinator;
2) terms and procedure of budget approval;
3) scheme of deviation analysis;
4) the order organizing planned and unplanned meetings.

The standard of budgeting may have some changes if necessary which should be approved by all the participants of the budgeting process i.e. the budget committee.

Then each person responsible for budgeting of his department instructs the department regarding using new or previously used reporting forms, terms of their preparation and analysis if it is necessary.

Next step is defining the list and the content of budgeting reports, frequency and form of their presentation according to peculiarities of business. For example, information on the bank cash balance is an every day need while it is enough to control raw material consumption once a week. The budgets will differ by their form. For instance purchasing department should prepare budgets both in natural and monetary items and chief of the production department will present the information in natural items only.

When all the forms and terms of budget preparation and analysis are agreed in accordance with business processes we start to implement software for fastening and making budget process reliable and transparent.

So the above measures lead to the enterprise process of budgeting.

The starting point is the sales budget, according to which the production budget is developed then the budget of material purchase is created, then we prepare sales and administrative expense budget. As the result the profit value is got.

The data of the profit and loss statement, starting balance sheet and capital cost budget allow to prepare the most necessary budget cash flow.

Quite another process takes place in service organisations. Their budgets do not contain so big material cost element as production ones.

Their budget can be prepared in the following way. At first the sales value is forecasted. Then all cost of the order which can be classified as direct expense for this order either fixed or variable are deducted.

Now we get the amount of the contribution margin but not in its traditional meaning (i.e. it is not the difference between the sales and variable costs). This contribution margin will be close to EBITDA (earnings before interest and tax, depreciation and amortisation).

This contribution margin should cover about 30% of fixed salary which is one of the biggest expense articles in service firms. Then about 30% of fixed office costs like rent and telephone expense.

With 20% of the contribution margin good managers try to cover expense for the company and its personnel development.

And if they were lucky in this reporting period their dividends should be the rest 20% of the contribution margin.

Today budgeting becomes an important instrument of enterprise strategy implementation by business processes coordination and effectiveness rise.