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Budgeting and Controlling – Part 12

The Process of Budget Compilation, Step 1: Determination of Forecasting

The series of the articles Budgeting and Controlling has dealt in detail with the components of a complete budget of an enterprise – profit plan, finance plan and budgeted balance sheet – and the correlation between them.

This and the following articles will cover the practical procedure in the framework of budget compilation, as well as the contents of the corresponding planning steps.

In the framework of budget compilation the following procedure of individual planning steps has proved valuable.

Step 1:
Forecasting/
budgetary predicting
Step 2:
Planning of fixed costs
Step 3:
Planning of sales and contribution margin
Step 4:
Planning of liquidity

In contrast to step 2, planning of fixed costs, step 3, planning of sales and contribution margin and step 4, planning of liquidity which all demonstrate active planning steps, step 1, forecasting solely serves the preparation of all these planning activities. Forecasting is the preliminary step to active planning of profit and liquidity of an enterprise.

Forecasting, put directly right before the following-up active planning steps, is based on the consideration that in the actual execution of compiling the figures of the budget, it is normally easier to build on pre-defined real values when drawing up the budget, than to start with an empty sheet of paper.

As a first step, forecasting is merely a demonstration of the expected results of the planned year based on available figures of the last business year. Forecasting is a projection of the figures of the business year that preceded the planned year, into the future, without however, having revised these figures.

When determining forecasting, the already appraised closing balance sheet or the preliminary closing balance sheet resp, of the business year that preceded the planned year is taken as the opening balance sheet of the business year that needs to be planned.

Furthermore, the profit and loss account of the business year that preceded the planned year is transferred as the planned profit and loss account, or forecasting profit and loss determination resp, for the planned business year.

This profit and loss account from the latest current business year is at first transferred into forecasting without any changes. All sales, variable and fixed costs equal the values from the latest current business year.

Based on opening balance sheet or preliminary opening balance sheet resp, and under consideration of all effects from the profit and loss account carried forward from the previous year, the new budgeted closing balance sheet or predicted closing balance sheet resp, are automatically provided for the planned year.

Forecasting the result for profit, liquidity and balance sheet for the planned year equals the real budget if no changes in the operating activities of the enterprise are to be expected compared to the previous year. If sales, costs or time allowed for payment of the customers or suppliers do not change etc.

Realistically, there are of course changes in these items to be expected in comparison to the business year previous to the planned year. In this way, these expected changes are to be transferred into the budget step by step and thus one gradually arrives at a complete budget for the planned year.

The series Budgeting and Controlling will be continued with the description of the active planning steps following forecasting: planning of fixed costs, planning of sales and contribution margin as well as planning of liquidity.

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