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Budgeting and Controlling – Part 13

The Process of Budget Compilation, Step 2: Planning of Fixed Costs

In the last article of the series Budgeting and Controlling the recommended order of planning steps in the framework of a budget compilation was demonstrated. Furthermore, the first step in this procedure, forecasting has been dealt with in more detail. (BTV-Aktuell 2/2002)

In this and the following articles the successive active planning steps – planning of fixed costs, planning of sales and contribution margin, as well as planning of liquidity will be covered, all based on forecasting.

Basis for the active adoption of all planning considerations is always the following procedure.

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

So, planning of fixed costs is based on forecasting. Forecasting as a pre-stage to the active planning steps in the framework of budget compilation incorporates the figures of the business year previous to the planned year. The result of forecasting is the purely mathematical extrapolation of all figures for the planned year without taking any active planning steps into consideration. Forecasting determines result, liquidity and balance sheet of the planned year under the precondition that no changes in the basic data of the budget such as sales, costs, production, time allowed for payment etc occur in comparison to the business year previous to the planned year.

In forecasting, the structure and figures underlying the budget are set up that will be revised in the next planning steps. In this way, forecasting demonstrates only the basis for the consequent planning activities such as planning of fixed costs, planning of sales and contribution margin, as well as planning of liquidity.

The first active planning step in the framework of budget compilation is, therefore, planning of fixed costs.

The sequencing of the step planning of fixed costs before the step planning of sales and contribution margin is based on the fact that planning of fixed costs is mostly considerably quicker and easier than estimating realistically how sales might develop in the planned business year, which is difficult at most times.

The future development of rents, costs for personnel and depreciations is normally easier to estimate than that of sales.

In addition to planning of fixed costs a target for the point of break-even is set in the budget which must either be reached or exceeded in the framework of planning of sales and contribution margin in order to make profit. This must of course be based on the structure of fixed costs in the budget.

When planning the fixed costs, a planned value for the planned business year is determined, based on the values carried forward from the previous business year. Each item of fixed costs is revised in the framework of planning of fixed costs.

The planning per every item of fixed costs can mean a structuring of the planning according to each cost type or bookkeeping account. It can, however, also build on planning the costs for personnel per employee basing on the data of the payroll or on planning of interest paid per bank account. In this planning step, every single item of fixed costs is planned in every detail, either based on the values of the previous year or, to be able to estimate the development in the course of the time, principally based on the values of the previous year, but compared to the figures of several previous business years.

The result of planning of fixed costs is a revised profit plan whose items: sales, variable costs and contribution margin still equal the values of forecasting, all items of the fixed costs, however, are already planned values.

These revised figures of planning of fixed costs form the basis for the next step, planning of sales and contribution margin, which will be described in the next article.

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