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Practical Procedure in the Framework of Budget Compilation

and in the Framework of Constant Controlling in Comparison of Planned/Actual Data and Forecasting



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1 Components of a complete budget of an enterprise

A complete budget that should show the expected future development of an enterprise consists of three key components: profit plan, finance plan and budgeted balance sheet. These key components are normally supplemented by ratios that allow a quick statement on result, liquidity and financing of the enterprise.

The profit plan forms the first component of the budget of an enterprise. Basing on planned sales, planned variable and fixed costs are deducted and lead to the planned result before or after income tax resp.

The finance plan is the next step after compiling the profit plan¹. Based on the planned result after tax from the profit plan, liquidity or solvency resp is planned in the finance plan. There are different procedures in the framework of compiling the finance plan, but all systems have one goal in common: compiling liquidity of the enterprise.

Based on the finance plan, the budgeted balance sheet of an enterprise is compiled in the next step. Basis for compiling the

budgeted balance sheet at the end of the planned year is the opening balance sheet or at least a preliminary opening balance sheet, if there is no completely finished opening balance sheet available at the date of budget compilation. Basing on this opening balance sheet, every item of the finance plan changes the opening balance sheet to the budgeted balance sheet.

Ratios of an enterprise are determined according to one of the three planning elements: profit plan, finance plan and budgeted balance sheet on the one hand, or from a combination of the values of the three planned elements on the other hand. Typical ratios of the profit plan are eg, minimum turnover, volume range and price range². An important key ratio which is often determined in different ways is called cash flow. It is often compiled differently and has, therefore, to be questioned. Cash flow is compiled from the finance plan. Based on balance sheet and budgeted balance sheet, the equity ratio is determined. A combination of the figures from the profit plan and the budgeted balance sheet results in the determination of the ratios Return on Equity and Return on Investment.

2 The Process of Budget Compilation

In the framework of budget compilation the following procedure of sequencing the individual planning steps has proved successful in the application: forecasting, planning of fixed costs, planning of sales and contribution margin and planning of liquidity.

Forecasting³ is the first step in the process of budget compilation. It transfers the figures from the year previous to the planned year. The result of forecasting is a purely mathematical extrapolation of the planned year but no active considerations are incorporated into the budget. 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 and time allowed for payment, compared to the previous year, occur. With this first step the structure and figures which form the basis for the budget are set up, to be revised in the next planning steps actively. Like that, forecasting forms the basis for the consequent planning activities – planning of fixed costs, planning of sales and contribution margin, as well as planning of liquidity.

This first active planning step in the framework of budget compilation is planning of fixed costs. When planning the fixed costs per fixed cost item, a planned value for the planned business year is determined from the values carried forward from the previous business year. Each individual item of fixed costs is revised in planning of fixed costs. The result of planning of fixed costs is a revised profit plan, in which the items sales, variable costs and contribution margin still equal the values of forecasting, all items of fixed costs are already planned values.

Basing on these figures which are revised in planning of fixed costs, planning of sales and contribution margin follows as the next step. The completed step of fixed



costs planning results in a first new basis for planning of sales and contribution margin. In the course of this planning step, sales and variable costs must be planned which results in a contribution margin that now leads to the planned result before or after tax after deducting fixed costs. Depending on the amount of the planned fixed costs and the expected result, a target for the necessary size of sales, variable costs and contribution margin will be derived. This target for achieving the planned result through the necessary sales and contribution margins forms the basis for the detailed planning of sales and contribution margin which leads to a revised profit plan in several steps and thus, forms the basis for finance and liquidity planning.

Liquidity planning is based on an already completed profit plan. Components of liquidity planning are finance plan and budgeted balance sheet. Finance plan and budgeted balance sheet are often compiled simultaneously. When the finance plan has been compiled and at least a preliminary opening balance sheet exists, then all data and figures are available with the finished finance plan, which leads from the opening balance sheet to the budgeted balance sheet. The finance plan results in the planned liquidity surplus or deficit of the enterprise. This surplus or deficit can either be financed or assessed. The amount of interest paid or received results in an impact on the profit plan. It leads to an improvement or deterioration of the planned result. Basing on the result of the finance plan, the profit plan might have to be revised again.

3 Planning Cycle

The planning cycle⁴ of an enterprise which starts with budget compilation at the beginning of the business year, will be supplemented by the following steps in the course of the business year:

- by comparisons of real, actual data with the originally planned values and
- by revised forecasts based on these comparisons of planned/actual data for the remaining period of the planned year

The individual elements which form the total planning cycle are the following: budget compilation, comparison of planned/actual data, deviation analysis, extrapolation and revised forecast.

The planning cycle starts with budget compilation consisting of profit plan, finance plan and budgeted balance sheet carried out in several steps, as shown above. The date of budget compilation is either previous to the planned business year or takes place in the course of the planned business year. What speaks in favour of a previously compiled budget compilation is the fact that a complete plan for the current business year is available at the beginning of exactly this business year. A substantial aspect in favour of budget compilation in the course of the current business year is complete availability of all data and figures of the latest completed business year and thus the most updated figures of the enterprise.

Comparisons of planned/actual data are carried out in the course of the planned year, normally quarterly or even monthly. In the framework of comparison of planned/actual data, the planned results that were originally compiled at the beginning of the business year, are compared to the actual data. This comparison of planned/actual data is a purely static comparison of planned figures to actual data; the statement is only valid for the period of time for which actual data are already available. Statements on the future development of the enterprise are not made in the framework of pure comparison of planned/actual data, only in the steps following the comparison of planned/actual data, such as extrapolation and revised forecast.

A deviation analysis should be carried out in the framework of comparison of planned/actual data which should provide information on the kind and dimension of the deviation, and the reason why actual data deviate from the planned ones. Like that, the deviation analysis serves as a preparation for the revision of the budget in the forecast.

Whereas the comparison of planned/actual data demonstrates the pure comparison of planned values to actual values and no future aspect is considered yet, the future part of the planned business year is also regarded in the framework of extrapolation. Based on the original plan, the planned values are replaced by real, actual data in the framework of extrapolation, the remaining figures of the planned year stay the same as in the original budget. Like that, the pure comparison of planned/actual data can be supplemented, the effect of actual data on the total planned year can be estimated under the pre-condition that the remaining business year develops according to the originally planned budget. In the extrapolation, expected changes for the remaining business year are not taken into account, yet. A revision of the budget does not take place, yet. Insofar, the extrapolation demonstrates a purely static element of the planning cycle, similar to the comparison of planned/actual data.

The active planning element turns up again in the revised forecast. Here, most of the work has to be done in connection with comparison of planned/actual data, deviation analysis, extrapolation and revised forecast. In the revised forecast, the original budget which was supplemented by actual data that were collected in the course of extrapolation, is revised. All planning items which were originally incorporated into the budget, which have been set against each other in comparison of planned/actual data, which were analysed according to their deviation from the planned values to the actual values, and which finally result in an extrapolation, are reviewed exactly and if need be, revised for the remaining period of the planned year. Tendencies that can be derived from the actual values for the business year, new findings on the future development of the enterprise and new planning considerations and expectations are incorporated into this revised forecast. A completely new set of figures is compiled for profit plan, finance plan and budgeted balance sheet, based on actual data and all considerations for the future development of the enterprise in the planned year.

The profit plan described above including comparison of planned/actual data, deviation analysis, extrapolation and revised forecast is repeated constantly in the course of the planned year, either quarterly, monthly or in case of extraordinary events that necessitate a revision of the original budget.

4 Necessary Basic Sources for Budget Compilation

To be able to begin with compiling a budget, certain sources should be available to serve as a basis for budget compilation. These sources include balance sheets, profit and loss accounts, lists of account balances, sources of the payroll, statistics on sales, use of goods and contribution margin, statistics on production, calculations for products or projects, loan contracts, redemption plans, investment plans as well as available budgets, planning considerations or part-budgets of individual sectors of the enterprise from previous years or even the currently planned year.

As the compilation of the profit plan forms the first step in budget compilation those sources that refer to the profit part of the enterprise, are crucial for structuring the budget. First of all, this is a profit and loss account, if possible the most current one, as well as a current list of account balances. Structuring the budget normally begins with structuring the individual expense types. It is advisable to follow the structure of the profit and loss account or the list of account balances basically and also, to provide a planning item for each individual expense type. Like that, in the planning meeting a comparison to the values of the previous year or years resp can be made per each expense item that needs to be planned, and trends and developments can be taken into account.

A deviation from the structure of the budget described above can be recommended in the framework of the individual expense items, above all the items purchase of goods or use of goods resp, personnel expenses, interest expenses and

related bank charges under certain circumstances.

Planning of items such as purchase of goods or use of goods resp, should be carried out together with planning of sales and thus, they are not applied in the first step of planning or structuring of fixed expenses.

Furthermore, a deviation from the structure of the profit and loss account or list of account balances resp can be recommended for planning personnel expenses. Personnel expenses are structured in the profit and loss account and the list of account balances into wages and salaries, social insurance contributions etc. This structure supports the operating procedure in a planning meeting only to a limited amount. For this purpose, a structure of the planning according to employees has proved successful. Here, wages and salaries are planned inclusive of non-wage labour costs, monthly. The basic source of information for structuring and planning according to employees is the payroll.

A further recommendation for a deviation from the structure of the profit and loss account or the list of account balances resp, can be applied on structuring the planning of interest paid and the respective bank charges. In the area of interest paid a structure of the planning according to the individual bank accounts has proved successful. If necessary, bank charges are also planned according to this system. Information for the planning of the individual items can be taken from loan contracts and redemption plans.

Planning of sales, variable costs and contribution margins are normally rather difficult when the structure of the profit and loss account or the list of account balances is adhered to as, mostly, there can be no detailed information derived as to products, groups of products or sales areas. In this area a structure is recommended that adheres to statistics of turnover, contribution margin, purchasing, and statistics of sales and production. Planning considerations in this area can of course be based on calculation of products or projects resp.

After structuring the planning of profit, finance or liquidity planning resp is sub-structured in the next step. This is often supported by loan contracts and redemption plans as well as by investment plans. On top of this, it is useful to have as detailed information as possible about payment habits of the customers or own payment habits towards suppliers resp when planning receivables and liabilities. Knowledge of changes in stock can be derived from the already mentioned statistics of purchasing, sales and production which were carried out in the framework of structuring the planning of sales and contribution margin.

5 Necessary Sources for the Preparation of Comparison of planned/actual Data and Forecasting

In the framework of comparison of planned/actual data the originally planned values are compared to the real, actual figures. Actual data that are compared to the planned values in the course of the business year are derived from the sources described in the previous chapter. The sources of the data for preparing the comparison of planned/actual data and revised forecast are mainly taken from the list of account balances. The data that have been collected in the course of the business year, are pulled from the list of account balances according to each account and compared to the respective planned values. This information covers the major part of the comparison of planned/actual data.

Additional information from other sources are always necessary when the planning was carried out according to different criteria from those described above. These additional sources are: sources of the payroll and statistics referring to sales, use of goods and contribution margin. Apart from them, lists of purchases, sales and production as well as information on customers, suppliers and bank accounts are used as additional sources of information.



The figures that are taken from the above mentioned sources of the payroll and statistics must however, be matched to the ones that appear in the respective items of the lists of account balances. A cross comparison to the data that have been derived from various sources is crucial as it might happen that apart from other differences there is a time difference between the individual months, if data are taken from different sources. ■

¹ As to the significance of planning of profit and finance, see Schlager, J. eg: Insolvenzprophylaxe bei mittelstaendischen Unternehmen als Aufgabe von StB und WP, in: *Der Wirtschaftstreuhänder*, 5/1993, page 22; Kropfberger, D.: Forschungsbericht zum Forschungsprojekt „Einsatz von Controlling- und Planungsinstrumenten in der Praxis ein Vergleich zwischen Oesterreich und Grossbritannien“, page 22 ff.; Mayr, A.: Controlling fuer Klein- und Kleinstunternehmen – eine Aufgabe fuer Wirtschaftstreuhänder?, in *Der Wirtschaftstreuhänder*, 6/1999, page 32 ff.; Markschlaeger, A.: Mindestanforderungen an ein Informationssystem im Gewerbebetrieb, in: Mayr, A./Stiegler, H.: *Controlling-Instrumente fuer Klein- und Mittelbetriebe in Theorie und Praxis*, Linz 1997, page 257 ff.

² Compare Egger, A./Winterheller, M.: *Kurzfristige Unternehmensplanung*, 10 th edition, Vienna 1999, page 62 f., page 152 ff.

³ Compare Hahn, D.: *Planungs- und Kontrollrechnung – PuK*, 3 rd edition, page 35 f.

⁴ Compare this also to the model by Dobler, T./Koebler, W.: *Planrechnungen im Unternehmen*, Stuttgart 1997, page 17 ff. and a very detailed model by Hahn, D.: *Planungs- und Kontrollrechnung – PuK*, 3 rd edition, page 122 ff.