

# AKTUELL

INFORMATIONEN DER **BTV** ÜBER BANK UND WIRTSCHAFT

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## **Budgeting and Controlling** **Prof. Werner Seebacher (PhD)**

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**The article series Budgeting and Controlling will be continued in the publication “unternehmen” beginning with part 14.**

## Budgeting and Controlling – Part 1 New Legal Obligation for Corporations

The Insolvency Law Amending Statute (Insolvenzrechtsänderungsgesetz, IRAEG) in 1997 has brought about a range of novelties and changes in the fight against insolvencies in the Austrian legal situation. One of these changes was the introduction of the Law for the Reorganization of Enterprises (Unternehmensreorganisationsgesetz, URG).

The accompanying amendments in the Stock Corporation Law and the Law on Limited Liability Companies have not been recognized in its full application and thus, have been hardly implemented. This amending statute refers to regulations concerning the content design of accounting which was expanded by a considerable aspect – the aspect of future. The new regulations must be understood as an obligation for compiling a budget forecast.

The regulations are identical in § 82 of the Stock Corporation Law and § 22 article 1 of the Law on Limited Liability Companies and expand the obligations of the executive board or the managing directors resp to ensure: "... that accounting and internal control systems meet the requirements of the enterprise." These new regulations are applied on

all corporations: Public Limited Companies (UK)/Stock Corporations (US), Private Limited Companies (UK)/Closed Corporations (US) and Limited Partnerships with Limited Companies as General Partner.

How should this demand for an appropriate accounting and internal control system for all corporations be understood? If you look at § 81 of the Stock Corporation Law and § 28a of the Law on Limited Liability Companies you can clearly see what the requirements are. They define exactly in what way the managing directors or CEOs resp have to report to the supervisory board. The managing directors' duties include reporting on the future development of the company's situation, in terms of assets, financial state and earnings situation with a forecast once a year and at least quarterly, concerning course of business and situation of the company compared to forecast and future development. Furthermore, immediate reporting action is to be taken when particular circumstances occur.

The required forecast is defined as budgeted balance sheet, planned profit and loss account and planned cash flow state-

ment. They are understood as the elements of Integrated Profit and Finance Planning: profit plan (planned profit and loss account), finance plan (planned cash flow statement) and budgeted balance sheet.

The required report on the course of the business and future development has to be created at least quarterly and extends the duties of the management by another substantial aspect – systematic controlling, which is now obligatory for the management. It must contain a budget at the beginning of the business year consisting of profit plan, finance plan and budgeted balance sheet, business reports during the year (at least quarterly if not monthly) and comparison of actual data with originally budgeted data (plan/actual comparison) as well as a revised forecast based on these data, again consisting of profit plan, finance plan and budgeted balance sheet. All planned budgets, comparisons of planned/actual data and forecasts must be based on clearly documented and evident planning fundamentals and connections.

The new regulations demand what should go without saying for any

entrepreneur: occupation with the future of the enterprise – in the framework of concrete written-down and adopted budgets, consequent comparisons of planned/actual data and currently revised forecasts to be able to appraise the current situation and the further development of profit and liquidity of the company and to respond quickly to any deviation from the plan.

The next articles of the series Budgeting and Controlling will cover establishing a complete budget of an enterprise and the procedure in the framework of budget compilation.

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## Budgeting and Controlling – Part 2

### The Components of a Complete Budget of an Enterprise

The first article of the series Budgeting and Controlling (BTV-Aktuell 3/1999) has dealt with the new legal regulations obliging corporations to compile a budget. The second part covers the components of a complete budget of an enterprise in more detail.

A complete budget of an enterprise should present the future development in terms of assets, financial state and earnings situation. The development of the assets of an enterprise is shown in the budgeted balance sheet, the development of the financial state in the framework of a finance plan and the development of the earnings situation in a profit plan.

Profit plan, finance plan and budgeted balance sheet, if they are compiled together and all relations and connections between the individual plans have been taken into consideration, are also called Integrated Profit and Finance Planning. One component alone cannot exist in this Integrated Profit and Finance Planning, each is influenced by the two others.

Compilation of the profit plan is the first step in the framework of Integrated Profit and Finance Planning. Based on sales and

variable and fixed costs, the planned result (profit or loss) of the enterprise is determined.

Building on the result of the profit plan, the finance plan is determined. In the framework of the finance plan, liquidity or solvency is planned which means expected liquidity surplus or liquidity deficit resp. The finance plan starts with the planned profit or loss of the profit plan and results in planned liquidity surplus or liquidity deficit for the enterprise for the planned year.

For compiling the finance plan an appraised profit plan must be available. The result of the finance plan can, however, have an impact on the profit plan, namely by liquidity surplus or liquidity deficit. Deficits must be financed, a surplus can be assessed or used for repaying loans. This may, however, have an impact on the profit plan in form of a change in the amount of interest paid or income from interest. With these changed expense or income items the planned result of the profit plan (profit or loss) also varies. Thus, the basis for the finance plan is different and the finance plan must be revised.

This is what is meant with Integrated Profit and

Finance Planning: the result of the profit plan has an impact on the finance plan and the result of the finance plan influences the profit plan. In this way, an exact solution can only be compiled by several successive compilations of profit plan and finance plan. Thus, profit plan, finance plan and also budgeted balance sheet must be compiled in several steps.

The third step in Integrated Profit and Finance Planning is the compilation of the budgeted balance sheet. Basing on the opening balance sheet at the beginning of the business year and under consideration of all changes from the finance plan that effect liquidity, the budgeted balance sheet is compiled for the end of the planned year. The budgeted balance sheet represents the absolute values in the balance sheet at the end of the planned year, the finance plan represents the changes in liquidity or solvency. Thus, the finished or at least preliminary opening balance sheet, as well as an already compiled finance plan, form the basis for a budgeted balance sheet. It happens frequently that finance plan and budgeted balance sheet are compiled simultaneously; every change in the finance plan immedi-

ately changes an item from the opening balance sheet to the budgeted balance sheet.

The calculations described above lead to a complete budget of an enterprise consisting of profit plan, finance plan and budgeted balance sheet. To gain more information of the development of an enterprise within the year, the three components profit plan, finance plan and budgeted balance sheet must be compiled quarterly or monthly. Only in this way, the current development of the enterprise concerning assets, financial state and earnings situation can be planned and assessed correctly.

The next articles of the series Budgeting and Controlling will deal with the detailed structure of profit plan, finance plan and budgeted balance sheet.

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## Budgeting and Controlling – Part 3 The Structure of a Profit Plan

The first two articles of the series Budgeting and Controlling have covered the contents of the new legal obligations for budget compilation (BTV-Aktuell 3/1999) as well as the individual components of the complete budget of an enterprise (BTV-Aktuell 4/1999). In this article and the following ones the detailed structure of profit plan, finance plan and budgeted balance sheet are dealt with. This article begins with the description of the profit plan and how to deal with issues that require special consideration.

The first stage in a company's budget is calculating a profit plan. Projected sales, variable costs and fixed costs are contrasted against one another in the profit plan.

In its simplest form, a profit plan has the following structure:

Sales
- Variable costs
<hr/>
= Contribution margin
- Fixed costs
<hr/>
= <b>Operating result</b>

The differentiation in fixed and variable costs is important for the structure of a

budget, above all for the considerations that can be derived from the budget for the enterprise. It is, therefore, necessary to differentiate principally between long-term and short-term consideration.

In the long run, all expense items are controllable. In the framework of budget compilation, the budgeted period normally refers to one year or one business year. In this short-term period a separation into fixed and variable costs according to simple decision-oriented considerations has proved most valuable.

When taking these considerations into account, variable or proportional costs are those costs that vary automatically according to changes in sales or income. This means, that variable cost are rising when sales are increasing and fall when sales are going down.

All other costs that do not adapt to changing sales situations automatically, are called fixed costs. Of course, they can be modified but they do not change automatically. This means, that when fixed

costs are changed a concrete decision must be made for modification and to indicate the extent.

Fixed costs: change follows a decision

Variable costs: change happens automatically.

Consequent separation into fixed and variable costs is crucial for the considerations that can be derived from the budget of an enterprise to interpret plan-modifications and statements of ratios.

Only when all cost items according to the described criteria are incorporated into the budget (Fixed costs: change follows a decision, Variable costs: change happens automatically when sales change) statements of ratios like minimum turnover, volume range and price range can be interpreted correctly. With these ratios the scope for action of an enterprise can be presented.

In the next article of the series Budgeting and Controlling the above mentioned ratios minimum turnover, volume range and price range will be reflected more closely.



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## Budgeting and Controlling – Part 4

### Ratios in the Profit Plan

After describing the structure of a profit plan in the last article of the series Budgeting and Controlling (BTV-Aktuell 1/2000), in this one three ratios are reflected in more detail which can be determined based on the profit plan: minimum turnover, volume range and price range. These ratios allow a quick statement on profitability and scope for action of an enterprise.

#### Minimum Turnover

Minimum turnover is the key ratio in the profit part and specifies the minimum amount of sales a company must have, to ensure that variable and fixed costs of the company are covered.

A result of exactly zero can be achieved after covering variable and fixed costs of a company.

Minimum turnover is also called Break-Even and the following formula can be used for its determination:

$$\text{Minimum turnover} = \frac{\text{Fixed costs}}{\text{Contribution margin} / \text{Sales}}$$

#### Volume Range

The ratio Volume Range is also called margin of error and is closely related to minimum turnover.

Volume range shows by what percentage a company's turnover may decrease on the basis of constant trade margins or gross charges resp, without making a loss. A zero result is attained, whereas the decrease for sales only results from a volume reduction. All other factors remain constant: sales price per unit, variable costs per unit and all fixed costs.

The following formula is used to ascertain volume range and is shown as a percentage:

$$\text{Volume range} = \frac{\text{Planned turnover} - \text{Minimum turnover}}{\text{Planned turnover}} \times 100$$

A positive ratio means that a certain range in the sales volume exists. A negative ratio means that the break-even point has not been reached and thus, the sales volume must be increased by a corresponding percentage to attain a positive result.

#### Price Range

Similar to volume range, price range shows by how many percent a company's turnover may decrease to just attain a zero operating result.

In contrast to volume range, price range emanates from the effects of dropping sales prices, when sales volumes, variable costs and fixed costs remain unchanged. Price range is also called return on sales.

The following formula is used to calculate price range (in a percentage):

$$\text{Price range} = \frac{\text{Operating result}}{\text{Sales}} \times 100$$

A positive ratio means that a certain price range exists before a zero result is attained. A negative ratio means that the sales price must rise to attain the break-even point.

With the help of the three described ratios, a first statement on the profitability and the scope of action of an enterprise can be provided, all based on the profit plan.

After the presentation of the profit plan the following articles of the series Budgeting and Controlling will cover the next steps in the framework of budget compilation: liquidity or finance planning.



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## Budgeting and Controlling – Part 5

### Liquidity Planning

The last two articles of the series Budgeting and Controlling have dealt with the structure of profit plan (BTV Aktuell 1/2000) and with the determination and interpretation of ratios based on the profit plan (BTV Aktuell 2/2000). In this part of the series Budgeting and Controlling the next step in the framework of budget compilation will be covered: liquidity or finance planning.

The two key elements of liquidity or finance planning are finance plan and budgeted balance sheet.

The finance plan immediately follows the profit plan. In the finance plan the liquidity or solvency resp of a company is planned. It is based on the planned operating result of the profit plan. In the framework of compiling the finance plan various procedures can be adhered to, but all have one goal in common: determination of liquidity of the enterprise.

The result of the finance plan is the planned liquidity surplus or liquidity deficit of the enterprise. This surplus of means of payment (cash) can be assessed or the accrued deficit of means of payment must be financed. Income from interest of the assessment or financing of interest paid has an

impact on the profit plan. This additional deficit or income results in an improvement or a deterioration of the planned result in the profit plan. Basing on the result of the finance plan the profit plan must be revised in several items.

It is crucial for further planning steps that changed results of the revised profit plan create a new basis for the finance plan which leads to a mutual influence of profit plan and finance plan: the result of the profit plan is the basis for the finance plan. The result of the finance plan, namely liquidity deficit or surplus, influences the profit plan by way of the interest rate. Compilation of profit plan and finance plan must be determined iteratively in several calculating or planning steps to take all factors into account.

Based on the finance plan the next step determines the budgeted balance sheet of an enterprise. Basis for compiling the budgeted balance sheet is the opening balance sheet or at least a preliminary opening balance sheet. Every item of the finance plan changes the opening balance sheet to a budgeted balance sheet. When the finance plan has been appraised and at least a preliminary opening bal-

ance sheet exists, with the finance plan completed, all data and figures which lead from an opening balance sheet to a budgeted balance sheet are available.

Finance plan and budgeted balance sheet are often compiled simultaneously. The budgeted balance sheet takes the actual reporting date as starting point: the result is the budgeted balance sheet at the end of a business year. The finance plan covers a period of time: the result is the planned liquidity surplus or liquidity requirement in the course of the planned year.

Whereas the budgeted balance sheet always contains absolute values like an opening balance sheet or a closing balance sheet of an enterprise the finance plan only presents changing values. Every positive or negative figure in the finance plan shows a liquidity improvement or liquidity deterioration which results from this item in the planned year, in comparison to the beginning of the planned year.

As mentioned above, in the framework of compiling the finance plan, various procedures or systems can be adhered to which all have one goal in common: determination of

liquidity or solvency of the enterprise. The following articles of the series Budgeting and Controlling will continue with finance or liquidity planning. The components and the structure of a finance plan will be presented in detail.



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## Budgeting and Controlling – Part 6 The Finance Plan

The topic of the last article of the series Budgeting and Controlling (BTV-Aktuell 3/2000) was liquidity planning. The principal correlation between finance plan and budgeted balance sheet was described there, a detailed presentation of a finance plan, however, was not yet given. This article will describe the structure of a finance plan more exactly.

In the finance plan, basing on the planned operating result (profit or loss) from the profit plan the liquidity of an enterprise is planned. From a number of different procedures in the framework of compiling finance plans, one successful way of application in enterprises has been chosen for presentation.

The structure of the finance plan described, is made up in four steps which each assesses one particular sector of the enterprise from the point of view of liquidity.

The first part of this finance plan is called cash flow. In this step the result of the profit plan which forms the basis for the compilation of the finance plan is re-determined in cash flows. The planned profit or loss of the profit plan is corrected by the

expense of the profit plan which is no cash-drain from the enterprise and by the income from the profit plan which forms no in-payment.

The way to review the enterprise changes: based on profit calculation which presents the result of the enterprise either as profit or loss, the viewpoint towards liquidity or solvency alters. All considerations focus on the planned liquidity surplus or liquidity deficit.

The second part of the finance plan described is called working capital. In the sector of working capital, the effects of changes in the short-term sector of the enterprise are covered, which have an impact on liquidity, eg changes in stock, receivables and liabilities.

The third step is called long-term sector and takes all changes into account which affect the solvency of an enterprise from a long-term point of view, eg investments and raising and redeeming of long-term liabilities.

The fourth and last part of the finance plan described, is called shareholder sector. It contains all effects of the specific

activities of the shareholders on the solvency of the enterprise, namely deposits of the shareholders into the enterprise or withdrawals paid out to the shareholders from the enterprise.

The four parts Cash Flow, Working Capital, Long-term Sector and Shareholder Sector are finally summed up and lead to a total liquidity surplus or liquidity deficit of the enterprise. The surplus can be assessed, the deficit must be financed.

The next articles of the series Budgeting and Controlling will review the sectors of the finance plan which have been covered so far, in more detail: cash flow, working capital, long-term sector and shareholder sector.



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## Budgeting and Controlling – Part 7 Components of a Finance Plan: Cash Flow

The last article of the series Budgeting and Controlling covered the structure of a finance plan (BTV-Aktuell 4/2000). In the finance plan, based on the planned operating result of the profit plan, (profit or loss), liquidity or solvency of an enterprise are planned. A highly application-oriented form of a finance plan was chosen from various forms. This structure, described in the last article, divides the finance plan into four sectors: cash flow, working capital, long-term sector and shareholder sector.

In this and the following articles of the series Budgeting and Controlling these sectors of the finance plan will be reviewed in more detail.

The first part of these calculations of a finance plan is called cash flow. The basis for cash flow is the result of the profit plan (profit or loss). It is corrected by expense or income items which were incorporated in the profit plan but are no cash flow from the enterprise or into the enterprise. Typically they include depreciations, provisions and reserves.

### Cash flow:

Corporate result  
after tax  
+ Depreciations  
+ Formation of provisions and reserves  
– Retransfer of provisions and reserves

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= Cash flow

According to the form of determining the finance plan as described here, the result of the cash flow shows the result of the profit plan after re-determining it in cash flows. The planned profit or loss of the profit plan is increased by expenses of the profit plan that decreased the result of the profit plan but were no withdrawal from the enterprise. Furthermore, the planned profit or loss of the profit plan is reduced by the income which has increased the result of the profit plan but was no deposit into the enterprise. The viewpoint changes: in the profit plan the operating result of the enterprise is presented as profit or loss, in the finance plan and thus in the determination of the cash flow, the actual cash flow is presented which results in a liquidity surplus or liquidity deficit of the enterprise.

When other methods of determining finance plans from the one described here are chosen, the term Cash Flow is also used for other sub-totals. To avoid misinterpretations it is of considerable importance to check the underlying figures of any method of determination exactly before interpreting the figure referring to cash flow.

The series Budgeting and Controlling will be continued with the description of further parts of the finance plan: working capital, long-term sector and shareholder sector.



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## Budgeting and Controlling – Part 8

### Components of the Finance Plan: Working Capital

The previous articles of the series Budgeting and Controlling dealt with the principle structure of a finance plan (BTV Aktuell 4/2000) and the description of the first sector of the finance plan, cash flow (BTV Aktuell 1/2001).

In this article the second sector of the finance plan Working Capital will be reviewed in more detail.

Whereas in the determination of cash flow the result (profit or loss) of the profit plan is corrected by expense or income of the profit plan that contributed to determining the profit plan but demonstrate no cash flow out of or into the enterprise, working capital covers the short-term changes that affect solvency of an enterprise. Examples are changes in stock, receivables or liabilities.

The following are the main points which result in an alteration in working capital: Positive values improve liquidity, negative values deteriorate liquidity.

#### Working Capital:

- Increase of stock
- + Decrease of stock
- Increase of receivables
- + Decrease of receivables
- + Increase of liabilities
- Decrease of liabilities
- Increase of other current assets
- + Decrease of other current assets
- + Increase of other liabilities
- Decrease of other liabilities

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= Working Capital

The sector Working Capital is of considerable importance for the planning of liquidity of an enterprise because the operating business activities of the enterprise affect the changes in working capital.

In this way, increasing sales result, when constant time is allowed for payment for the customers, in an increase in receivables. If this also leads to increasing purchases and stock, liquidity in the warehouse

sector of an enterprise gets worse because of higher stock. An increase of liabilities improves liquidity in the same way as decrease of receivables. Furthermore, the effects of received payments on account and deposits paid must be taken into consideration.

Together with cash flow, long-term sector and shareholder sector, working capital results in planned liquidity deficit or liquidity surplus of an enterprise.

The series Budgeting and Controlling will be continued with the two further sectors of a finance plan: long-term sector and shareholder sector.



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## Budgetierung und Controlling – Part 9

### Components of the Finance Plan: Long-term Sector and Shareholder Sector

The last articles of the series Budgeting and Controlling have dealt with the first two sectors of the finance plan, with cash flow (BTV Aktuell 1/2001) and working capital (BTV Aktuell 2/2001).

The result of cash flow is the planned profit or loss of the profit plan, re-determined in cash flows. In working capital short-term changes with consequences on liquidity of an enterprise are covered. Examples are changes in receivables, liabilities and stock.

The two remaining parts of the finance plan are the long-term sector and the shareholder sector.

In the long-term sector the changes in liquidity with a long-term effect are considered: investments, loans and long-term liabilities.

#### **Long-term sector:**

- Investments
- + Increase of long-term liabilities
- Decrease of long-term liabilities

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= Long-term sector

Positive values mean improvement of liquidity, negative values mean deterioration of liquidity.

The shareholder sector covers deposits into the enterprise and withdrawals out of the enterprise, with corporations: increase of capital stock and distributions of profits or dividends resp.

#### **Shareholder sector:**

- + Deposits
- Withdrawals

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= Shareholder sector

A complete finance plan according to the approach that was used here, covers the four mentioned sectors: cash flow, working capital, long-term sector and shareholder sector and when summing them all up they lead to liquidity surplus or deficit of the enterprise:

#### **Finance plan:**

- I Cash flow
  - II Working capital
  - III Long-term sector
  - IV Shareholder sector
- 
- V Surplus/Deficit



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## Budgetierung und Controlling – Teil 10 Correlation between Profit Plan and Finance Plan

The recent articles of the series Budgeting and Controlling have dealt with the topic finance plan (BTV-Aktuell 4/2000) and the individual sectors of the finance plan: with cash flow (BTV-Aktuell 1/2001), with working capital (BTV-Aktuell 2/2001) and with long-term sector and shareholder sector (BTV-Aktuell 3/2001).

The result of the determination of liquidity or a

finance plan resp is the determination of liquidity surplus or deficit.

- I Cash flow
  - II Working capital
  - III Long-term sector
  - IV Shareholder sector
- 
- V Surplus/Deficit

In this article the correlation between the finance plan and the upstream profit plan shall be demonstrated. In the demonstra-

tion of the correlations the following factors are to be taken into consideration.

In the first step the profit plan is compiled. The result after tax of the profit plan is the basis for the finance plan at the same time. The result of the finance plan, liquidity surplus or deficit, must be financed or can be assessed. It affects the profit plan through interest paid or received. Via time

allowed for payment of receivables and liabilities, however, the working capital in the finance plan is affected over the variable parts of the profit plan (sales and variable costs).

Together with the profit plan the following approach for the integrated demonstration of profit and liquidity is made:

### Profit plan

Sales  
- Variable costs

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= Contribution margin  
- Fixed costs

---

= Operating result  
- Corporate income tax

---

= Corporate result after tax

### Finance plan

Corporate result after tax  
± Corrections

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I Cash flow

II Working capital

III Long-term sector

IV Shareholder sector

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V Surplus/Deficit

The finance plan above (according to Egger and Winterheller) represents one approach from a number of possibilities for the determination of a company's liquidity or solvency. Although all determinations of individual cash flows differ, they all have one thing in common:

they demonstrate liquidity or solvency of a company resp, however, the methods and approaches to determine liquidity vary.

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## Budgeting and Controlling – Part 11

### Correlation between Finance Plan and Budgeted Balance Sheet

A complete budget of an enterprise consists of the components profit plan, finance plan and budgeted balance sheet. The correlation between profit plan and finance plan has already been presented in the series Budgeting and Controlling (BTV-Aktuell 4/2001). The current article deals with the correlation between finance plan and budgeted balance sheet.

The correlation which is to be presented here, results from the relationship between opening balance sheet, finance plan and budgeted balance sheet.

A precondition for compiling finance plan and budgeted balance sheet is availability of an appraised or at least preliminary opening balance sheet.

Opening balance sheet, budgeted balance sheet and closing balance sheet are based on a certain reporting date for reviewing the enterprise. The finance plan refers to a time span for reviewing the enterprise. The reviewing period for the finance plan is a business year or a planned year resp.

Whereas opening balance sheet as well as budgeted balance sheet or closing balance sheet always co-

ver absolute values, the finance plan consists solely of changing values. Every positive figure in the finance plan shows improvement of liquidity, every negative figure in the finance plan shows decrease of liquidity, which results from this item in the course of the planned year in comparison to the beginning of the planned year.

Based on the opening balance sheet at the beginning of the business year and under consideration of all changes affecting liquidity of the finance plan, the budgeted balance sheet is compiled for the end of the planned year.

Every value of the finance plan changes one item of the opening balance sheet towards the budgeted balance sheet. In the opening balance sheet eg, the stock level of receivables is presented for the beginning of the planned year. The finance plan shows through a positive or negative sign before the item receivables by how much the receivables increase or decrease and whether this results in a liquidity improvement or deterioration. The budgeted balance sheet, however, shows the planned amount of receivables for the end of the planned year.

The opening balance sheet shows the balance sheet at the beginning of the planned year, it contains stock level values or absolute values resp.

Assets	Liabilities
Fixed assets	Equity
Current assets	Liabilities

The finance plan shows the planned changes with an effect on liquidity in the business year, it contains changing values:

- I Cash flow
  - II Working capital
  - III Long-term sector
  - IV Shareholder sector
- 
- V Surplus/Deficit

The budgeted balance sheet shows the projected balance sheet at the end of the planned year, it contains stock level values or absolute values

Assets	Liabilities
Fixed assets	Equity
Current assets	Liabilities

Together with the opening balance sheet, the finance plan and the budgeted balance sheet present the planned development and the planned state of liquidity of an enterprise for any certain date.



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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 plan-

ning 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 fore-

casting 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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## 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 person-

nel 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 book-keeping account. It can, however, also build on planning the costs for personnel per employee based 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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