What Is a Budget?

A budget is an estimation of [revenue](https://www.investopedia.com/terms/r/revenue.asp) and [expenses](https://www.investopedia.com/terms/e/expense.asp) over a specified future period of time and is usually compiled and re-evaluated on a periodic basis. Budgets can be made for a person, a group of people, a business, a government, or just about anything else that makes and spends money.

Understanding Budgeting

A budget is a microeconomic concept that shows the trade-off made when one good is exchanged for another. In terms of the bottom line—or the end result of this trade-off—a [surplus budget](https://www.investopedia.com/terms/b/budget-surplus.asp) means profits are anticipated, a [balanced budget](https://www.investopedia.com/terms/b/balanced-budget.asp) means revenues are expected to equal expenses, and a [deficit budget](https://www.investopedia.com/terms/b/budget-deficit.asp) means expenses will exceed revenues.

To manage your monthly expenses, prepare for life's unpredictable events, and be able to afford big-ticket items without going into debt, budgeting is important. Keeping track of how much you earn and spend doesn't have to be drudgery, doesn't require you to be good at math, and doesn't mean you can't buy the things you want. It just means that you'll know where your money goes, you'll have greater control over your finances.

KEY TAKEAWAYS

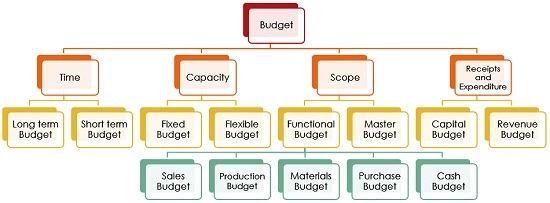
* A budget is an estimation of revenue and expenses over a specified future period of time and is utilized by governments, businesses, and individuals.
* A budget is basically a financial plan for a defined period, normally a year that is known to greatly enhance the success of any financial undertaking.
* Corporate budgets are essential for operating at peak efficiency.
* Aside from earmarking resources, a budget can also aid in setting goals, measuring outcomes, and planning for contingencies.
* Personal budgets are extremely useful in managing an individual's or family's finances over both the short and long term horizon.

Features of Budget

1. It is an estimate of the economic activities of an entity which related to a specified future period.
2. It must be written and approved by the appropriate authority.
3. It should be modified or corrected, whenever, there is a change in circumstances.
4. It plays the role of a business barometer that helps in measuring the performance of the business by comparing actual and budgeted results.
5. It is prepared on the basis of past experiences and trends in the business.
6. It is a business practice, which is used to forecast the operating activities and financial position of the business.

Budget is used to fix targets in monetary terms and control the deviations if any. Further, it can also be used as a basis to measure the performance of the organization.

Classification of Budgets

[](https://businessjargons.com/wp-content/uploads/2018/03/types-of-budget.jpg)

1. ***Based on time***
   * **Long-term Budget**: The budget designed by the management for a long-term, i.e. three to ten years is called as long-term budget.
   * **Short-term Budget**: As the name suggests, the budget which is prepared for a period ranging from 1 to 2 years, is called short-term budget.
2. ***Based on Capacity***
   * **Fixed Budget**: The budget created for a fixed activity level, i.e. the budget remains constant regardless of the level of activity, is called as fixed budget.
   * **Flexible Budget**: The budget which changes with the change in the level of activity is a flexible budget. It identifies the fixed cost, semi-variable cost and variable cost, to show the expected results at different volumes.
3. ***Based on Scope***
   * **Functional Budget**: The budget which is concerned with the business functions is called as functional budget. It can be further classified as:
     + - **Sales Budget**: Sales budget is used to determine the quantity of anticipated sales and the expected selling price per unit.
       - **Production Budget**: It is prepared to indicate the production for the specified period and is expressed in the units of outputs produced.
       - **Materials Budget**: The budget prepared to show the quantities of direct material and raw material required to manufacture the finished product.
       - **Purchase Budget**: Purchase budget is designed to estimate the quantity and value of different items to be bought at different points of time, considering the production schedule and inventory required.
       - [**Cash Budget**](https://businessjargons.com/cash-budget.html): The budget highlights the cash needed by the business in a specified period, taking into account all the receipts and payments of the business.

Apart from those discussed above, there are other functional budgets also, i.e. plant utilization budget, direct material usage budget, factory overhead budget, production cost budget, cost of goods sold budget, selling and distribution cost budget, administration expenses budget, etc.

* + **Master Budget**: Once all the functional budgets are created, then the financial officer will prepare a master budget. It is an integrated budget that reflects the estimated profit and loss and financial position using Budgeted Profit & Loss Account and Budgeted Balance Sheet of the concern.

1. ***Based on Receipts and Expenditure***
   * **Capital Budget**: The budget takes into account the estimated capital receipts and expenditure of the business for a specified period.
   * **Revenue Budget:** The budget that covers all the revenue receipts and expenses of a particular financial year is a revenue budget.

A budget acts as a map for the future economic activities of the business, which are prepared as per the policies of the different organizational functions. It aims at making optimum utilisation of the capital and other resources of the organization.