

Budgeting

Ugh, budgeting is one of those topics we'd rather avoid, but in business, it's an absolute necessity. To prepare a reasoned and thoughtful budget, an accountant must start with a broad-based critical analysis of the most recent actual performance and position of the business by the managers who are responsible for the results. Then the managers decide on specific and concrete goals for the coming year. It demands a fair amount of management time and energy. Budgets should be worth this time and effort. It's one of the key components of a manager's job.

To construct budgeted financial statements, a manager needs good models of the profit, cash flow and financial condition of your business. Models are blueprints or schematics of how things work. A business budget is, at its core, a financial blueprint of the business. Budgeting relies on financial models that are the foundation for preparing budgeted financial statements. Those statements include:

--Budgeted income statement (or profit report): This statement highlights the critical information that managers need for making decisions and exercising control. Much of the information in an internal profit report is confidential and should not be divulged outside the business.

--Budgeted balance sheet: The connections and ratios between sales revenue and expenses and their corresponding assets and liabilities are the elements of the basic model for the budgeted balance sheet.

--Budgeted statement of cash flows: The changes in assets and liabilities from their balances at the end of the year just concluded to the projected balances at the end of the coming year determine cash flow from profit for the coming year.

Budgeting requires good working models of profit performance, financial condition, and cash flow from profit. Constructing good budgets is a strong incentive for businesses to develop financial models that not only help in the budgeting process but also help managers in making strategic decisions.