

Effective Budgeting- The Necessities

By Libby Bierman, Analyst, Sageworks, Inc.

For the typical consumer, “budget” can be a daunting word both because of the restrictions it puts on discretionary spending and because of the work involved in developing and maintaining such a plan. Financial professionals likely view the word “budget” differently. It could seem like an exciting afternoon to some (for those with a real penchant for numbers) while, to others, it is still an intimidating necessity.

Whichever disposition you may have, it is a process you should not avoid. Ken Elliott, a consultant at the [WSU Kansas SBDC](#), has been working with small business owners for years to help them [effectively manage cash flows](#). Elliott warns “Too many small business owners think that budgeting is simply spending as little as possible and that the lowest price is always easy to discern, so they fail to spend any time doing it.” He goes on: “A little time spent on budgeting will open up spending options for the business and in the long run make it more competitive and more profitable...successful businesses budget.” If your company is small or specialized, you may be able to capture all your analysis within one, comprehensive budget. But, as you grow, you will likely have to expand your budget to budgets, specific to campaigns or departments.

Sageworks recommends you ask the following questions to help you effectively prepare a corporate budget.

What is the company’s goal? Before you open up a spreadsheet, consider first what the organization has defined as its goal for the year or the time period being budgeted. Is the focus on increasing margins? Expanding a new department? Clearly these are priorities set by management and they impact resource allocation, but these priorities should also shape your expectations for the coming year’s disbursements.

Where does the company historically spend money? To start budgeting for the future, you need to look at the past. Refer to the company’s financial statements for the past two periods. If you are preparing an annual budget, the periods should each be one year long and consecutive. Categorize this financial data into one of three categories: Revenue, Direct Costs associated with sales, and Overhead Costs. As much as possible, include subaccounts; for example, rather than “postage” as an overhead expense, break it down by market served. These details will be invaluable moving forward as you inevitably try to trim spending. Review credit card and bank account statements to ensure you do not overlook additional subaccounts. Then, load all this data into a projection tool or a spreadsheet, with each column representing one period.

What is the best way to forecast? Assuming the time periods are the same duration, determine what changed from period to period by calculating the percentage change. Applying these growth percentages again will give you excellent baseline projections for the budget for next period.

How will COGS change as a percentage of sales as the company grows? If sales grow at 15% over the budgeted year, is it reasonable to expect COGS to stay at 65% of sales? Probably not since some costs are fixed and specific to a relevant range. Look at the current correlation between sales growth and COGS growth to predict if that correlation will hold over time, and if it will not, include that adjustment in the budget.

What else should you consider? Do not let historical numbers be the only influence on your budget. Other influences are seasonal or cyclical changes to sales or large expenditures that were not an issue during the two periods of your analysis. Will the office space need renovation in the coming year? Remember, also, the management-set priorities mentioned earlier; were resources in the budget appropriately allocated? At this point, it is important to have other members of the

management team review your tentative budget to ensure all their initiatives are accounted for and to solicit buy-in.

If expenditures and revenues occur as planned, will the company be in good shape? Now that you have a rough idea of how the year should go, will the company be in a good financial position at year-end? If so, skip ahead to the next paragraph. If not, then analyze all your anticipated expenditures to identify areas that could be more efficiently managed. One way to identify improvable areas is to use [industry benchmarks](#) to see how the business compares to peers. Elliott points out that “Successful budgeting involves knowing approximately what the industry standard is and then doing better than the average, but to do better, business owners have to plan out what to spend on and then find alternative sources (vendors) and ways (how to finance if it’s on credit).”

Assuming expenditures and revenues do *not* occur as planned, will the company be in good shape? Expenses cannot always be predicted, so the year’s budget may not go according to plan. If cash flow is predicted to be tight, refine your budget to include more conservative outflows.

Over time, how well do you keep to the budget? Elliott recommends frequent review: “Successful budgeting means calendaring in a little time each week. This can really help keep spending in check and force you to spend more wisely.” If not weekly, at least review your budget before making large investment decisions.

The above questions will not necessarily yield a perfect budget, but hopefully they provide a sufficient framework to make corporate budgeting seem less daunting. Once you progress into more complex budgets, do not be afraid to call in reinforcements. Your external accountant is, most likely, eager to take on [more than tax returns](#) and well-equipped with forecasting tools.

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