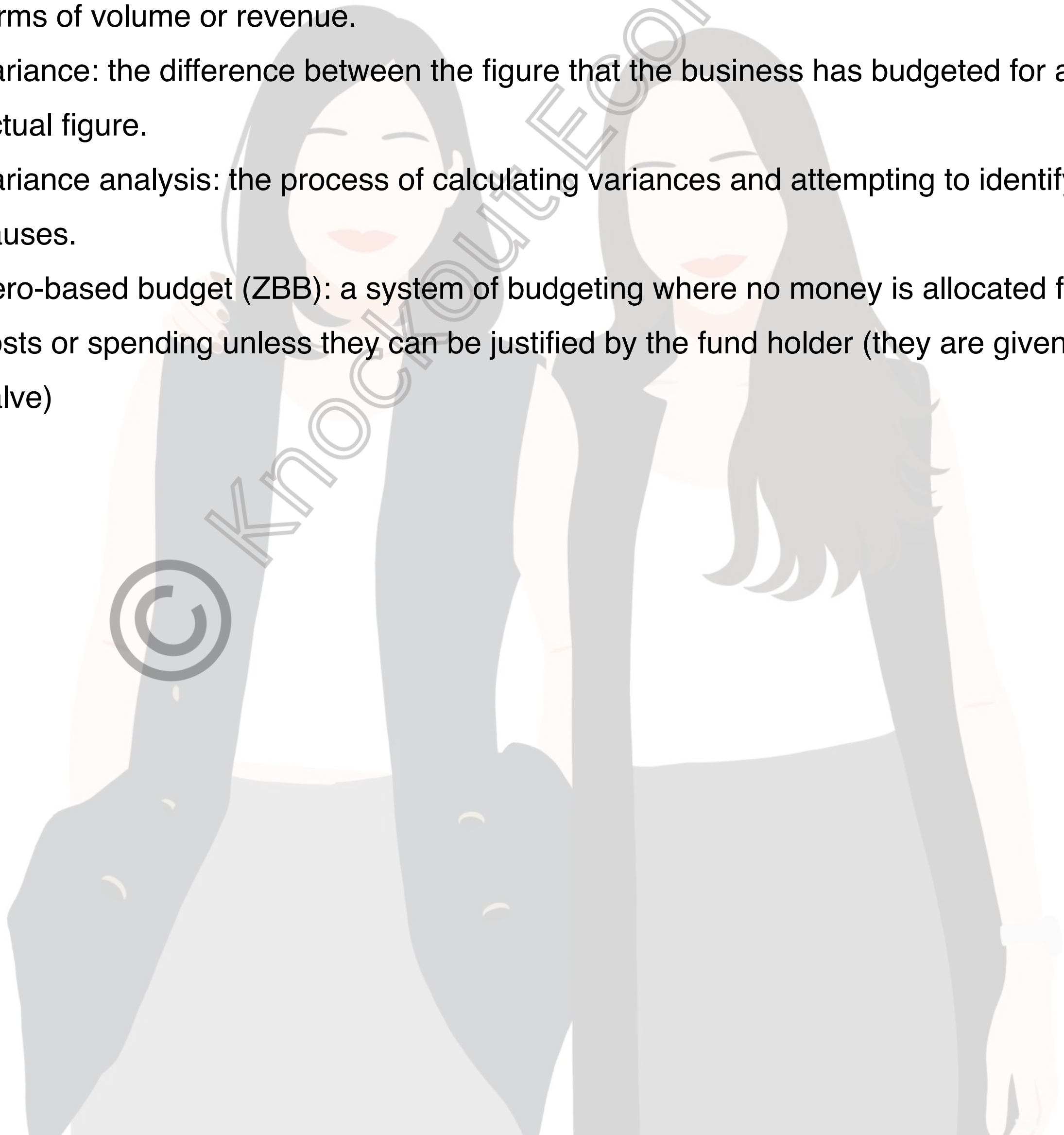
Chapter 33 Budgets

Key terms

1. Budget: a quantitative economic plan prepared and agreed in advance.
2. Budgetary control: business system that involves making future plans, comparing the actual results with the planned results and then investigating the causes of any differences.
3. Historical figures: quantitative information based on past trading records.
4. Opportunity cost: when choosing between different alternatives, this is the benefit lost from the next best alternative to the one chosen.
5. Production cost budget: a firms planned production cost for a future period of time.
6. Sale budget: a firm's planned sales for a future period of time- can be measured in terms of volume or revenue.
7. Variance: the difference between the figure that the business has budgeted for and the actual figure.
8. Variance analysis: the process of calculating variances and attempting to identify their causes.
9. Zero-based budget (ZBB): a system of budgeting where no money is allocated for costs or spending unless they can be justified by the fund holder (they are given zero valve)



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1. Budgeting is when financial plan is calculated for costs and revenue, enabling comparisons with actual cost, revenue later.

- Budget will show the money needed for spending and how this might be financed.

The purposes of budget

1) Control and monitoring; Budgeting allows management to control the business.

2) Planning; think ahead & anticipates problems and solutions.

3) Coordination; Budgeting is one way in which managers can coordinate and control activities of the many areas of the business.

4) Communication; Planning allows the objectives of the business to be communicated to the workforce. It shows priorities of the business & cost.

5) Efficiency; Budgeting gives fin ahah control to lower level of management.

6) motivation; fear of failing to reach budgeted targets can be an incentive to the workforce.

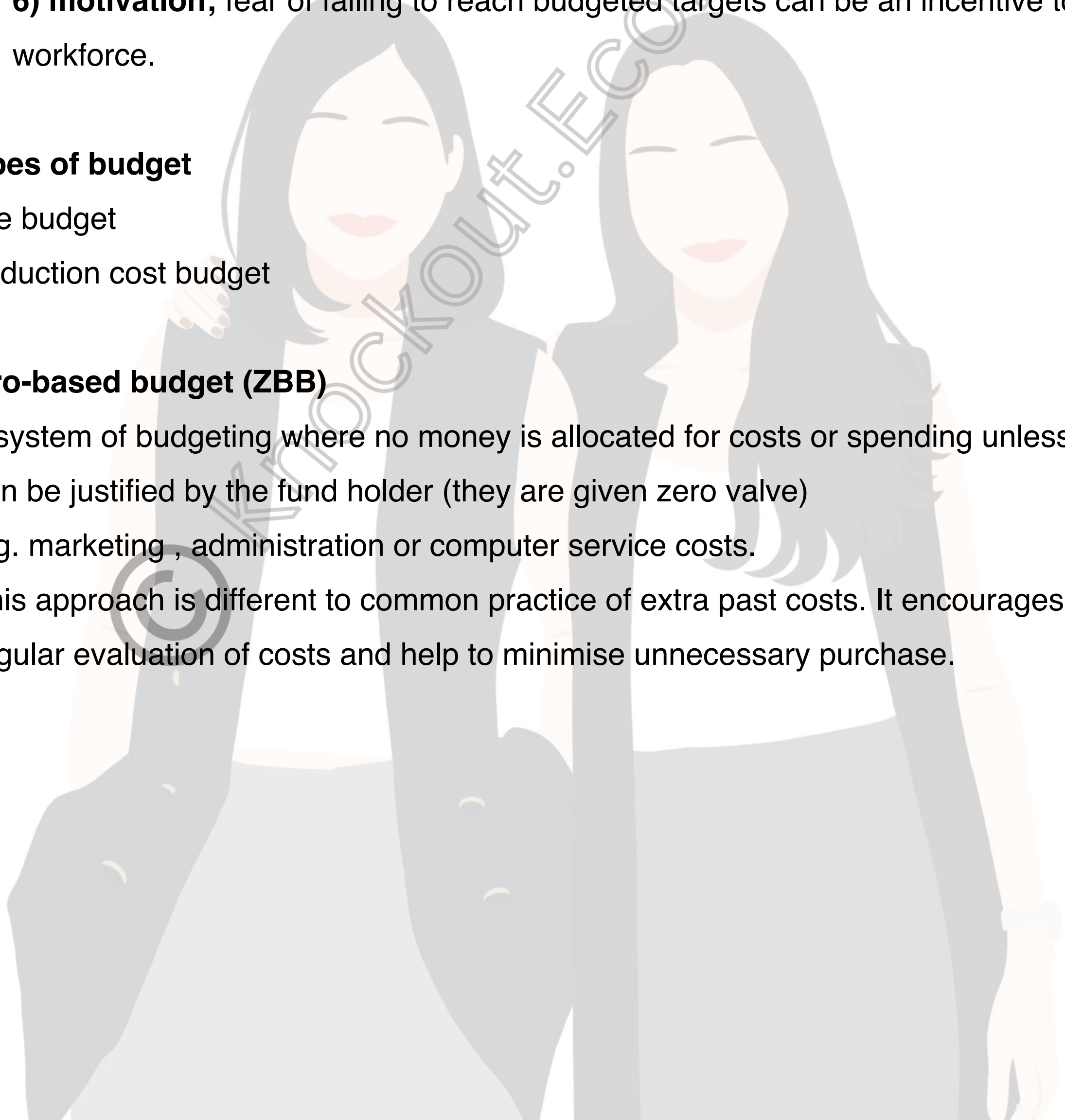
2. Types of budget

1) sale budget

2) production cost budget

3. Zero-based budget (ZBB)

- a system of budgeting where no money is allocated for costs or spending unless they can be justified by the fund holder (they are given zero valve)
- e.g. marketing , administration or computer service costs.
- This approach is different to common practice of extra past costs. It encourages the regular evaluation of costs and help to minimise unnecessary purchase.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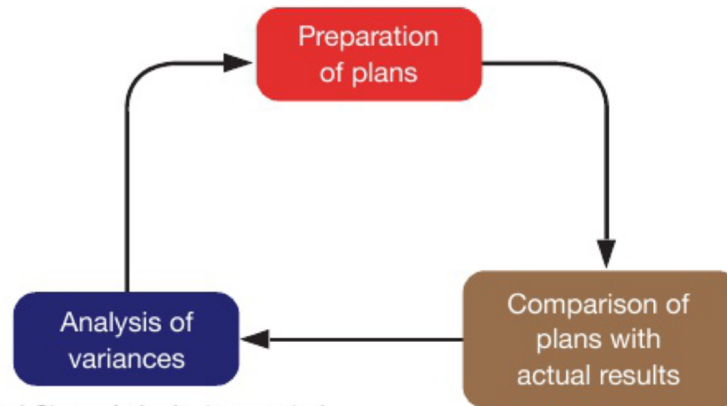
4. Using budget

Budgetary control or budgeting involves a business using budgets to look into the future, starting what it wants to happen, and then deciding how to achieve these aims.



▲ Figure 1 Stages in budgetary control

1. **Preparation of plans**
2. **Comparisons of plans with actual results**
3. **Analysis of variances**
    - variance analysis involves trying to find reasons for differences between actual and expected financial outcome.

5. Variances

- A variances in budgeting is the difference between the figure that the business has budgeted for and the actual figure.
- Variances can be favourable (F) or adverse (A)

    ↳ **Favourable variances**: when the actual figures are better than budgeted figures.

    ↳ **Adverse variances**: when the actual figures ane worse than budgeted figures.

6. Using variances in decision making

↳ If variances are adverse, it will be necessary to take action to ensure the adverse variances are avoided in the future.

↳ If variances are favourable, the business can learn from understanding the reasons why this has occurred and can introduce strategies and systems to help continue performance improvements in the future.

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