

# Controlling a Budget

## GETTING STARTED

Controlling budgets is a headache for businesses of all size. Many smaller businesses start off on the right foot by putting in place a good book-keeping system, but then fail to exercise proper financial control and end up in trouble. The only way to make sure that you make a profit is to control the budget efficiently. To do this, you need to estimate your sales income reasonably accurately, estimate your costs precisely, and keep both under control. You also need to charge the right price for your end product in your chosen market(s). It is important systematically to collect all financial documents in a methodical way, and keep all your figures up to date on a daily basis. This actionlist will look at some of the most common problems in controlling a budget, and suggest ways to tackle them.

## FAQS

### What is budgeting?

Each year you should prepare a business plan for the business, including your best forecast of sales. A budget is simply that forecast turned into figures. In other words, it is an estimate of sales income together with the costs required to produce those sales.

### What is financial control?

Financial control is different to book-keeping. Book-keeping is about recording the figures—in other words income and expenditure, receipts and payments, and assets and liabilities. Accurate book-keeping, of course, is a pre-requisite for effective financial control, and computerized accounting packages make accurate book-keeping far easier.

You then, however, need to use the figures as a basis for effective financial control. It can be difficult to keep the complete picture in your head all the time, so calculating a few simple ratios or using a graph are both good techniques to help you keep up to date.

## MAKING IT HAPPEN

### Set Targets

Each year, set objectives and prepare a business plan. Define your objectives in financial terms, as well as in terms of marketing, quality, and people. If a venture capitalist or business angel has invested in your business, his or her primary concern will often be the rate of return on investment (often referred to in financial documents as “ROI”). If you’ve invested your own money into the business, you may be expecting smaller returns initially, planning for your business to provide higher returns over a longer period.

## **Keep the Books**

A reliable, easy-to-use accounting system is essential for straightforward effective financial control. Make sure that you keep proper records. The information to record includes: any sales orders received; invoices issued by the business for sales; purchase orders placed by the business; invoices received by the business for purchases; cash receipts, and cash expenditure. Turning this information into graphs, tables, and charts can help to reveal trends, which in turn will help you to revise your forecasts and future planning. A range of accessible computer software, such as Microsoft Excel, will help you to do this.

## **Carry Out a Monthly Check**

Bring the cash book up to date and carry out a bank reconciliation every month. The cash book balance represents the business's liquidity; it is the cash immediately available to the business.

Prepare an operating statement by combining the revenue, direct costs, and overhead costs. This records income and expenditure (as does the profit and loss account), not receipts and payments. It ignores some items such as depreciation or bad debts. Each month, you should compare your actual performance with your forecast both for the month and, ideally, for the year to date. You can then look at some simple ratios and the variances.

## **Analyze the Available Information**

Carry out a ratio analysis. Do this by defining your costs as a percentage of the sales income. This gives you a very quick method of determining whether or not you are on target. If your costs are rising as a percentage of your sales income, then you know that you have a problem to address. Consider your gross profit margin. If the margin is falling, it could be a sign of trouble. Ask yourself the following questions. Has wastage increased? Have costs increased? Monitoring changes closely will help you to react to any problems, preventing them from escalating any further.

Then carry out a variance analysis. A variance is the difference between your target and your actual performance. Variance analysis looks at the differences themselves, rather than comparing different figures, as happens in ratio analysis. Review figures for: sales, inquiry and order position; material and labor usage; overheads; cash position/cash forecast; stock; and capital expenditure. As you work through the analysis, remember that analyzing variances means thinking about more than just differences in cash; there may be major variances even though the overall cash position remains more or less as forecast. Make sure you understand why the figures are changing. There are various possible reasons; for example, it is possible for a reduction in raw material cost to be cancelled by increased wastage?

## **Manage Cash**

The operating statement shows the net trading profit but does not show the liquidity (that is, the cash position of your business, and the ability to meet payments). It is important, therefore, that you also prepare a monthly cash-flow statement. This reflects when money is received or paid out and includes items such as drawings, VAT, or tax, which are not

regarded as trading expenses. All the figures should be readily available from the cash book.

Remember the importance of actively controlling the budget. Generating the figures is only the first part of the process; you must then take some action. Keep a tight grip on anyone that owes the business money (your debtors). If the level of debtors rises, this could be because your sales are increasing or because your debtors are taking longer to pay. Make sure you define in your terms of trade how quickly you expect debtors to pay, and then ensure that they stick to these guidelines. Put processes in place to deal with late payments or debtors who continually delay their payments.

Similarly, try not to get on the wrong side of your suppliers by taking too long to pay *them*, as they may withdraw your credit facilities. To gain the most benefit, you need to take the maximum amount of credit possible without abusing your agreed terms. Take care to ensure your PAYE and VAT payments are made on time, otherwise you could incur substantial penalties.

Controlling your debtors and creditors carefully will ensure that you're controlling your working capital carefully. If you're building up large sums of cash, do something worthwhile with them, even if only to move it to an account that pays you a better rate of interest. If you expect to need additional working capital, for example because debtors are rising as your sales increase, then talking to the bank—or your investors—early will reassure them that you really are in control of your business, and they will be more likely to help.

Watch your stock levels carefully. Consider how much stock you have tied up in raw materials, work in progress, and finished goods. If you have too much stock, you may be using excessive storage space and tying up money that could be used in other ways.

## **WHAT TO AVOID**

### **Setting too many targets**

Choose a small number of appropriate targets and focus on a handful of key issues, such as revenue growth, profit, and cash flow. Compiling and analyzing huge amounts of information can be time-consuming and not always of great use if the major points are buried underneath too much detail.

### **Letting your books get out of date**

You need up-to-date financial records before you can control your budget properly, so record transactions accurately and promptly.

### **Losing track of cash**

The key to making a profit is through the careful control of cash, so that you can pay your debts as they fall due.

## **FOR MORE INFORMATION**

Small Business—Information and Cash Flow: [www.credit-to-cash.com](http://www.credit-to-cash.com)