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TOPIC: BUDGET

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INTRODUCTION OF BUDGET

Budget is an Annual Financial Statement of yearly estimated receipts and expenditures of the government in respect of every financial year. Budgeting is the process of estimating the availability of resources and then allocating them to various activities according to a pre-determined priority

A **budget** is a calculation plan, usually but not always financial, for a defined period, often one year or a month. A budget may include anticipated sales volumes and revenues, resource quantities including time, costs and expenses, environmental impacts such as greenhouse gas emissions, other impacts, assets, liabilities and cash flows. Companies, governments, families, and other organizations use budgets to express strategic plans of activities in measurable terms.[1]

Preparing a budget allows companies, authorities, private entities or families to establish priorities and evaluate the achievement of their objectives. To achieve these goals it may be necessary to incur a deficit (expenses exceed income) or, on the contrary, it may be possible to save, in which case the budget will present a surplus (income exceed expenses).

In the field of commerce, a budget is also a financial document or report that details the cost that a service will have if performed. Whoever makes the budget must adhere to it and cannot change it if the client accepts the service.

A budget expresses intended expenditures along with proposals for how to meet them with resources. A budget may express a surplus, providing resources for use at a future time, or a deficit in which expenditures exceed income or other resources.

WHAT IS A BUDGET?

A budget is a financial plan that outlines the expected income and expenses for a defined period.

In business context, Budget can be a roadmap guiding resource allocation to achieve organizational goals and objectives efficiently. It also includes assumptions of future fund needs, setting spending limits, and minimizing debt. A well-structured budget provides a clear picture of income and expense sources, which helps keep track of expenses to maintain financial stability. In addition, it assists in identifying cost-cutting areas and saving for potential investments in the future.

Review the budget regularly to ensure its relevance to the changing market conditions. So, the budget helps businesses and individuals make well-informed financial decisions and control their overall financial health.

WHAT ARE THE DIFFERENT TYPES OF BUDGETS COMMONLY USED IN ORGANIZATIONS?

Organizations use different budgets to manage their finances depending on their size, industry type and financial needs. The most common types of budgets are as follows:

1. Operating budget: It highlights the day-to-day expenses and revenue of the organization and typically includes salaries, utilities, marketing expenses, and salary projections.

2. Capital budget: It helps organizations assess their financial feasibility for capital projects by recording their long-term investments in equipment, machinery and infrastructure.

3. Cash budget: It helps track the organization's incoming and outgoing cash flows and predict cash surpluses to meet financial obligations.

4. Master budget: It includes all the individual budgets of different departments or divisions and is the organization's overall financial plan.

5. Flexible budget: It is a budget that incorporates minor adjustments based on the changing environment, like variations in sales and production levels.

6. Zero-based budget: Every expenditure is justified by analyzing it from scratch. This approach helps in optimizing resource allocation by reducing unnecessary costs.

7. Sales budget: It predicts the expected sales volumes and revenue for the period and is the basis for planning production and setting sales revenue targets.

8. Expense budget: The planned expenses for various departments, like marketing, sales, research and development, and office.

9. Project budget: It is the budget of a specific project and includes expenses, project profitability and strategies for cost-cutting.

10. Departmental budget: The budget allocated to each department helps the managers plan their expenses to achieve the organizational and departmental objectives efficiently.

IMPORTANCE OF HAVING A BUDGET

1. FINANCIAL CONTROL

It is one of the crucial financial planning tools as it helps organizations set goals by analyzing the various sources of income, expenses, and savings target. This makes it easier for the organizations to understand their financial viability and allocate resources.

2. EMERGENCY PREPAREDNESS

A well-planned budget can help navigate through sudden financial roadblocks by allocating a part of resources and money to the emergency budget. This emergency budget acts as a safety net, reducing the increased reliance on debt or external sources of funds during crisis times.

3. IMPROVED CASH FLOW MANAGEMENT

A budget also helps track the cash inflows and outflows, ensuring enough liquidity. It also helps organizations in efficient payroll processing, inventory management, and maintenance of vendor payment records. Enhanced cash flow management helps reduce stress and maintain financial stability.

4. PERFORMANCE EVALUATION

They serve as benchmarks for effective evaluation of financial performance. Organizations compare the actual output with the budgeted predictions to gain insights into their financial health. It also helps assess their spending habits and sources of revenue and take proactive measures to bridge the gaps in their financial performance.

5. COMMUNICATION AND ACCOUNTABILITY

The budget promotes a culture of transparency and accountability within the organization. Effectively communicating the budget to stakeholders like investors, partners, and employees helps create a collective sense of financial understanding. This also helps increase responsibility and accountability among the employees as they are aware of the allocated resources and budgets and pool their efforts to achieve the objectives and goals.

WHAT IS BUDGET FORECASTING AND PLANNING?

Budget forecasting and planning is preparing a budget for the future period based on predicted income and expenses. It helps organizations in making financial decisions.

Budget forecasting

It predicts the financial conditions in the upcoming times and involves many techniques. The main aim of this activity is to plan the organization's roadmap and set realistic financial goals.

It includes techniques like:

1. **Historical analysis:** The past financial data is thoroughly analyzed to identify common patterns and trends.

2. **Statistical models:** Models like regression and time series analysis are used to predict financial variables.

3. **Market research:** It helps understand customer behavior, industry trends, and market dynamics that can impact the organization's revenue.

Scenario analysis: Evaluating scenarios like market fluctuations, law changes, climatic changes, or new business ventures and their eventual impact on the financial stability of the organization.

Budget planning

It is the process of creating a financial plan for a period including expected income, expenses, and financial objectives. It helps the organizations in financial decision-making.

It consists of the following steps:

1. Setting an organization's short-term and long-term financial objectives by defining savings targets, debt minimization goals and revenue targets.

2. Estimating the future income sources like salaries, investments, etc., based on the market dynamics.

3. Identifying various expenses categories like fixed costs, variable costs, and discretionary spendings.

4. Allocating resources across various categories of expenses based on potential impact and availability.

6. Regularly monitoring and reviewing the budget to accommodate necessary changes and requirements.

How to build a budgeting plan?

A budget plan combines financial knowledge, collaboration skills, strategic thinking, and a proactive approach. The critical steps to creating a robust budget plan are:

Step 1 - Set financial goals

Clearly define the financial objectives like revenue targets, cost reduction goals, and profit margins. Aligning them with the overall organizational strategic objectives is essential.

Step 2 - Gather financial information

Gather financial data from past financial statements, sales and expenses reports, and cash flow statements to create a comprehensive financial picture. This helps to gain crucial insight into the organization's financial performance and acts as the foundation for the plan.

Step 3 - Identify the various sources of revenue

Identify the primary sources of revenue, like sales of products or services, investments, or grants, along with evaluating each revenue source's growth potential and reliability to make realistic projections.

Step 4 - Analyze expenses

Analyzing the organization's expenses across personnel, operations, marketing, and research and development. Organizations can use this data to identify common overspending trends or cost-saving opportunities.

Step 5 - Prioritize spending

Carefully allocate resources to various departments based on the organization's priorities and financial goals. Determine the necessary expenses to eliminate overspending without impacting the organization's performance.

Step 6 - Create a budget structure

Creating a comprehensive budget structure with revenue projections and expense categories and aligning it with the operational strategies of the organization.

Step 7 - Determine budgeting period

Finalize the budget plan's time frame by considering the industry type, financial cycle and other factors. The period may be monthly, quarterly, or annually.

Step 8 - Establish budgeting guidelines

The next step is to define all the guidelines to be followed, like the assumptions, methodologies, or techniques and document them to maintain consistency and transparency throughout the process.

Step 9 - Monitor and review

Review the budget plan and compare it with pre-established figures at regular intervals. This helps in analyzing any slight deviations and making the necessary changes to the plan according to the business needs.

Step 10 - Communicate the plan

Communicate the plan to all the organization's relevant stakeholders to avoid confusion or misconceptions. Also train various departmental heads in effectively managing the budget, so they work together towards the shared purpose and vision.

How can budgeting assist in controlling and monitoring expenses?

Budgeting helps organizations in controlling and monitoring expenses in the following way:

It helps categorize the expenses under various subheadings that assists management in identifying areas of overspending.

It also assigns specific spending limits to each category, encouraging every department to behave financially responsible.

It helps organizations make informed expenditure decisions as they are crucial to assessing the potential impact of each proposed expense.

Organizations can detect any early signs of financial instability by closely reviewing the expenses and addressing trivial issues that might escalate into significant crises.

It also helps organizations constantly update their processes to adapt to the changing business environment quickly.

What are the potential benefits of implementing a budgeting process?

The key benefits of implementing a budgeting process are as follows:

It helps instill a sense of financial discipline and conscious spending habits within the organization.

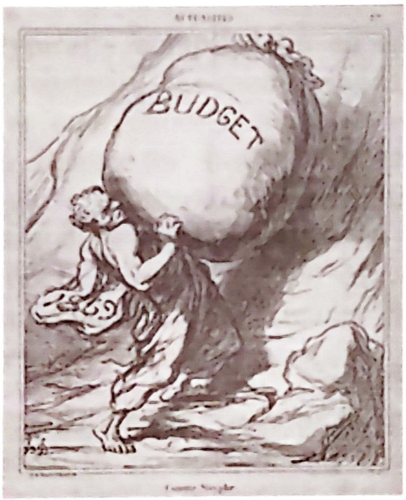
It allows organizations to control expenses and minimize unnecessary spendings, improving overall financial stability.

Organizations can evaluate their financial performance efficiently, identify improvement areas, and make changes when necessary.

It helps organizations plan their future endeavors by projecting the incomes, expenses and profits associated with projects.

It also facilitates a culture of transparency, accountability, and coordination among departments by aligning individual financial goals with organizational strategies.

CORPORATE BUDGET



The budget of a business, division, or corporation is a financial forecast for the near-term future, usually the next accounting period, aggregating the expected revenues and expenses of the various departments – operations, human resources, IT, etc. It is thus a key element in integrated business planning, with measurable targets correspondingly devolved to departmental managers (and becoming KPIs; budgets may then also specify non-cash resources, such as staff or time.

The budgeting process requires considerable effort, often involving dozens of staff; final sign-off resides with both the financial director and operations director. The responsibility usually sits within the company's financial management area in general, sometimes, specifically in "FP&A". Professionals employed in this role are often designated "**Budget Analyst**", a specialized financial analyst function.

Organisations may produce functional budgets, relating to activities, and / or cash budgets, focused on receipts and payments. Incremental budgeting starts with the budget from the previous period, while under zero-based budgeting activities/costs are included only if justified. Under all approaches expected sales or revenue, is typically the starting point; [7] this will be based on the business' planning for the period in question. Directly related elements and costs are typically linked to these (activity based costing may be employed). Support and management functions may be revisited, and the resultant "fixed" costs, such as rent and payroll, will be adjusted, at a minimum, for inflation. Capital expenditure, both new investments and maintenance, may be budgeted separately; debt servicing and repayments likewise. The master budget [7] aggregates these all. See Financial forecast, Cash flow forecast, Financial modeling § Accounting.

Whereas the budget is typically compiled on an annual basis - although, e.g. in mining, [9] this may be quarterly - the monitoring is ongoing, with financial and operational adjustments (or interventions) made as warranted; see Financial risk management § Corporate finance for further discussion. Here, [7] if the actual figures delivered come close to those budgeted, this suggests that managers understand their business and have been successful in delivering. On the other hand, if the figures diverge this sends an "out of control" signal; additionally, the share price could suffer where these figures have been communicated to analysts.

Criticism is sometimes directed at the nature of budgeting, and its impact on the organization. [10][11] Additional to the cost in time and resources, two phenomena are identified as problematic: First, it is suggested that managers will often "game the system" in specifying targets that are easily attainable, and / or in asking for more resources than required, [7] such that the required resources will be budgeted as a compromise. A second observation is that managers' thinking may emphasize short term, operational thinking at the expense of a long term and strategic perspective, particularly when [12] bonus payments are linked to budget. See Strategic planning § Strategic planning vs. financial planning.

- TYPES OF BUDGET **Sales budget** – an estimate of future sales, often broken down into both units. It is used to create company and sales goals.

- **Production budget** – an estimate of the number of units that must be manufactured to meet the sales goals. The production budget also estimates the various costs involved with manufacturing those units, including labor and material. Created by product oriented companies.
- **Capital budget** – used to determine whether an organization's long-term investments such as new machinery, replacement machinery, new plants, new products, and research development projects are worth pursuing.
- **Cash flow/cash budget** – a prediction of future cash receipts and expenditures for a particular time period. It usually covers a period in the short-term future. The cash flow budget helps the business to determine when income will be sufficient to cover expenses and when the company will need to seek outside financing.
- **Conditional budgeting** is a budgeting approach designed for companies with fluctuating income, high fixed costs, or income depending on sunk costs, as well as NPOs and NGOs.
- **Marketing budget** – an estimate of the funds needed for promotion, advertising, and public relations in order to market the product or service.
- **Project budget** – a prediction of the costs associated with a particular company project. These costs include labour, materials, and other related expenses. The project budget is often broken down into specific tasks, with task budgets assigned to each. A cost estimate is used to establish a project budget.
- **Revenue budget** – consists of revenue receipts of government and the expenditure met from these revenues. Revenues are made up of taxes and other duties that the government levies. Various countries and unions have created four types of tax jurisdictions: interstate, state, local and tax jurisdictions with a special status (Free-trade zones). Each of them provides a money flow to the corresponding revenue budget levels.[13]
- **Expenditure budget** – includes spending data items.
- **Flexibility budget** – it is established for fixed cost and variable rate is determined per activity measure for variable cost.
- **Appropriation budget** – a maximum amount is established for certain expenditure based on management judgement.
- **Performance budget** – it is mostly used by organization and ministries involved in the development activities. This process of budget takes into account the end results.
- **Zero based budget** – A budget type where every item added to the budget needs approval and no items are carried forward from the prior years budget. This type of budget has a clear advantage when the limited resources are to be

allocated carefully and objectively. Zero based budgeting takes more time to create as all pieces of the budget need to be reviewed by management.

- **Personal budget** – A budget type focusing on expenses for self or for home, usually involves an income to budget.

The Government of India's Finance Ministry, spearheaded by the Finance Minister, revises the national budget every year. The FM announces new financial policies, tax laws, and most importantly, the plan to enhance the country's GDP. Essentially, the budget is an annual financial statement outlining the estimated government expenses and the revenue the government expects to accumulate in the upcoming financial year. Based on how feasible the estimated income and expenses are, the government categorises the budget into three types.

Let's understand the 3 types of budgets in this article.

What Are The 3 Types Of Budgets?

Budgets can be categorised into the following three types:

1. **Balanced Budget**

A budget is deemed a balanced one if the expected government expenses equal the estimated government receipts during a given financial year. Most classical economists back this type of budget as it is based on the virtue of "living within one's means". To put it simply, a balanced budget emphasises the idea that a government's expenditure should never exceed its collected revenue. While the approach for a balanced budget seems ideal in helping to achieve economic balance and maintain financial discipline, such a budget does not ascertain financial stability. This is especially true during times of deflation, recession, and economic depression. Thus, while it may be easy to balance the anticipated expenses and revenues, it is quite challenging to practically implement such a balance.

Here are some reasons why a government would choose to strive for a balanced budget:

- **Economic stability:** A balanced budget contributes to overall economic stability by aligning government revenues with expenditures. It helps prevent excessive borrowing, inflation, and other economic imbalances to foster a more resilient and predictable economic environment.
- **Debt management:** Maintaining a balanced budget is crucial for effective debt management. Avoiding persistent budget deficits helps prevent the accumulation

of excessive public debt. It helps in reducing the burden on future generations and ensuring fiscal sustainability.

- **Interest rates:** A government with a balanced budget may benefit from lower interest rates. By demonstrating fiscal responsibility, it instils confidence among investors and lenders, leading to favourable borrowing terms and reduced interest costs on government debt.
- **Long-term economic growth:** A balanced budget tends to support long-term economic growth by promoting responsible fiscal policies. It allows for strategic investments in infrastructure, education, and healthcare without compromising the financial stability of the government.

2. **Surplus Budget**

The second of the three types of budgets is the surplus budget. The budget presented by the government is considered a surplus budget in case the revenue expected by the government exceeds the expenditure the government makes during a given financial year. It essentially means that the government's gains or revenue from the taxes paid by citizens are higher than the amount spent by the government on public welfare and development. A surplus budget thus indicates that a country is financially affluent. The government typically implements a surplus budget during periods of inflation as this type of budget helps reduce the aggregate demand in the country.

A surplus budget has its advantages:

- **Debt reduction and prevention:** Surplus budgets provide an opportunity to reduce existing debts and prevent the accumulation of new ones. Allocating surplus funds toward debt repayment may enhances the government's financial standing.
- **Creation of reserve funds:** Surplus budgets can allow for the establishment and augmentation of reserve funds. These funds can act as buffers to safeguard against future economic uncertainties, natural disasters, or other emergencies.
- **Lower taxation pressure:** Surplus budgets can also reduce the need for frequent tax increases. With ample revenues exceeding expenditures, governments may refrain from imposing additional or increased taxes. Reduced tax fosters a positive economic environment and encourages consumer spending and business investments.
- **Strategic investments:** Governments can use surplus funds for strategic investments in infrastructure, education, healthcare, and other critical sectors. These investments can stimulate economic growth and thereby create employment

opportunities.

3. **Deficit Budget**

The third category among the three types of budgets is the deficit budget. A budget is deemed a deficit one when the expected government expense exceeds the revenue the government expects to accumulate in a given financial year. A deficit budget is the ideal fit for developing economies – India, for instance. Such a budget is especially beneficial during recession as it helps to generate additional demand while boosting the economic growth rate of the nation.

In a deficit budget, the government plays a vital role in incurring the excessive expenditure to enhance the employment rate. As a result, the demand for goods and services increases, which further helps revive the economy. The government covers the cost via public borrowing, such as issuing government bonds or by withdrawing funds from the reserved surplus accumulated.

While deficit budgets may have their concerns, they can serve specific purposes:

- **Stimulating economic growth:** During economic downturns or recessions, the government may intentionally run deficit budgets to inject funds into the economy. Increased public spending stimulates demand, encourages investment, and helps revitalise economic activity.
- **Infrastructure development:** Deficit budgets allow the government to fund critical infrastructure projects, such as roads, bridges, and public facilities. These investments contribute to long-term economic development, job creation, and improved quality of life for citizens.
- **Social welfare programs:** The government use deficit spending to finance social welfare programs, including healthcare, education, and poverty alleviation initiatives. Also the government may offer subsidies to reduce the debt burden among the underprivileged sections of society.

As a taxpayers, it helps us to understand the three types of budgets and the other vital aspects of it. Knowledge about the budget helps us understand the Union Budget better when the FM announces it in February. Note that all three types of budgets have distinct advantages and demerits. Thus, the government takes great care to strike the right balance while creating the budget plan.