

ACCOUNTING

(THE ADVANTAGES AND DRAWBACKS OF A BUDGET)



Each company has its own budget. It is not a coincidence, since a budget and budgeting (the process of carrying out a budget) are the foundation of a well-planned activity of any enterprise. What is a budget? What are the different types of a budget? According to one of the definitions, “a budget is a financial document used to project future income and expenses” (E-conomic). In other words: “A budget plans future saving and spending, as well as planned income and expenses” (E-conomic). A budget may be also defined as “a plan expressed in dollar amounts that acts as a road map to carry out an organization’s objectives, strategies and assumptions”.

Depending on the specific purposes and the areas of use, there are several types of budgets. The first type is the cash flow budgets. The mentioned budgets are to tell about how much income it might be in the future. The purpose of the second type, the sales budgets, is to help to receive information about the value of the sales in the future. Sales budgets are very useful in order to plan expansion and investment. The third type, called the project budgets, is used to detail the costs of the project, which is scheduled. The last one is the production budgets. Their main purpose is to provide detailed information of the costs of producing any product. Moreover, “budgeting is usually prepared for short, mid-range, longer term time periods”.

THE ADVANTAGES OF A BUDGET

A budget has a number of benefits, as it copes with the task of planning and allocation of finance. Let us denote its advantages:

- A budget helps to gather all the necessary information for a business

plan, since it includes all the expenses and items that are required for start-up. It gives the information about how much money (to hire staff, rent an office) and resources (equipment, furniture, etc.) you will need in order to start your own business.

- A budget helps to cooperate with the lender. If you need to borrow some money for your start-up, the budget will be very useful. Due to the budget, one might receive information not only about how much money is needed to start a business, but also for the first few years of the business management. Moreover, “a reasonable budget can increase your credibility with your lender”.
- A budget provides information about how much money you can spend each month, and how much money you can get through your business.
- A budget contains information about future financial costs, such as staff salaries. Hence, it allows one to see how much money is necessary to manage the business.

Budgeting leads to planning, a coordinating and organizing role of the director, promotes initiative, provides a means of control.

THE DRAWBACKS OF A BUDGET

Despite its rather significant benefits, the budget also has its drawbacks. First of all, “the operation of budgets can become inflexible. For example, sales may be lost if the marketing budget is strictly adhered to at a time when competitors are undertaking major promotional campaigns”. Another problem is that “budgets have to be reasonably accurate to have any meaning. Wide differences (or variances) between budgeted and actual figures can demotivate staff and call the whole process into question”.

One of the drawbacks of the budget is also that it can cause discontent among the employees. Quite often, employees are unhappy with the budget. It is particularly observed at the level of divisions or departments. Many

employees are suspicious of the introduction of budgeting systems, believing that it is little more than an exercise in cutting costs, and perhaps even a sign of impending reduction of working hours, staff reductions, etc. It is not surprising that such discontent grows stronger, if the budgets are meager and tough. The last drawback is slow progress. The developing of an effective budget system does take a while. The most part of the budgets that were prepared needs to be corrected, because of lack of experience and the availability of over optimistic judgments.

CONCLUSION

A budget has a number of very important benefits that can ensure a successful business management. There are planning, forecasting and monitoring among them. Though any budget may have its drawbacks (it may be inflexible and cause dissatisfaction among staff), each company needs to use budgets in order to make the business management effective. There are several main reasons. The first reason is that the budgets are a reliable method for monitoring the expenditure of the organization. This is of particular importance since the cost control is a priority both in commercial and non-profit organizations. Without a budget, the organization can quickly get out from under the financial control. Some people use the funds wastefully, leaving little money for important goals. Without a budget, there is no systematic information on the availability of funds to cover mandatory costs.

The second one is that a budget gives an idea of the state of business in the organization. The manager after the analysis of the budget can make the conclusion about the justification of spending, and, hence, can propose the methods for more effective use of the budget.

The third one is that the budgets are also a good way to evaluate the business performance. If actual revenues are consistent with the projected ones, and the costs do not exceed the amount in the budget, it is a good indicator of performance. The budget is also a means of motivation, because it acts as a problem. People tend to perform real budgets.