

BUDGETING

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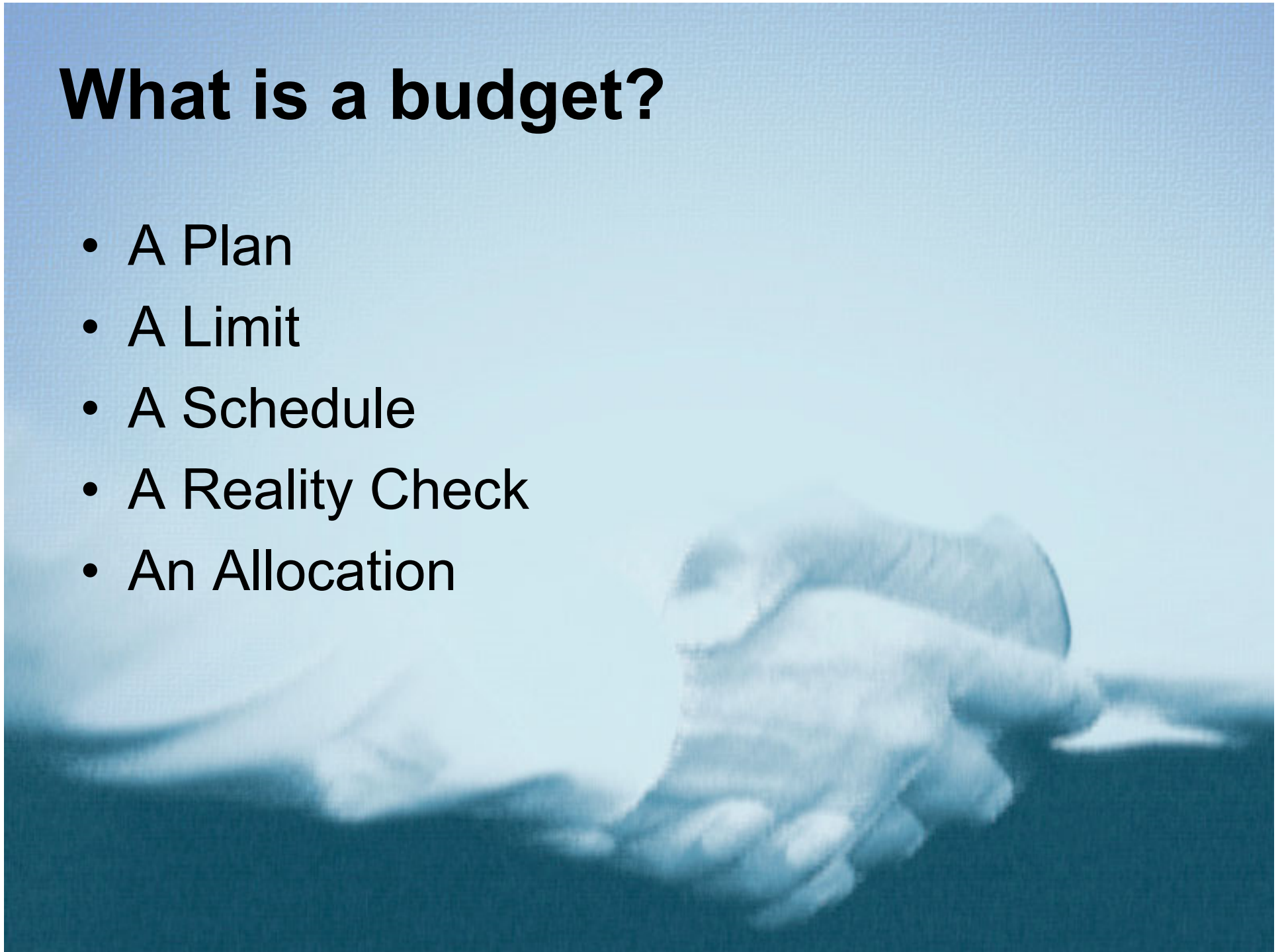
Budgeting

An important Project Management Tool



What is a budget?

- A Plan
- A Limit
- A Schedule
- A Reality Check
- An Allocation



Budget – a definition

“A planned expression of money”

Wright.D 1994 “A practical foundation in costing” Routledge

For a defined activity

Shows;

- Income & Expenditure
- Total estimated costs
- Defined period of time

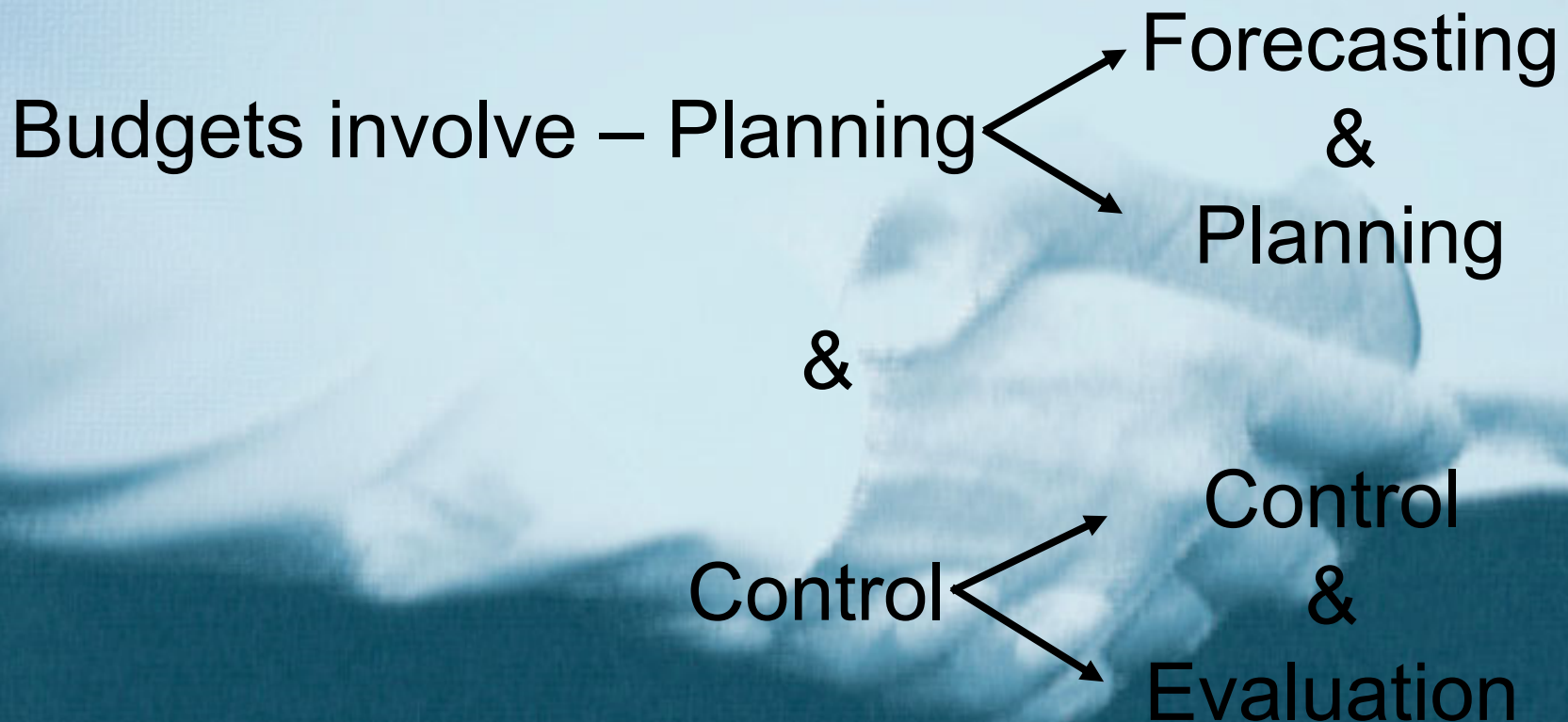
Another definition

A budget process is a system of rules governing the decision-making that leads to a budget, from its formulation, through its legislative approval, to its execution.

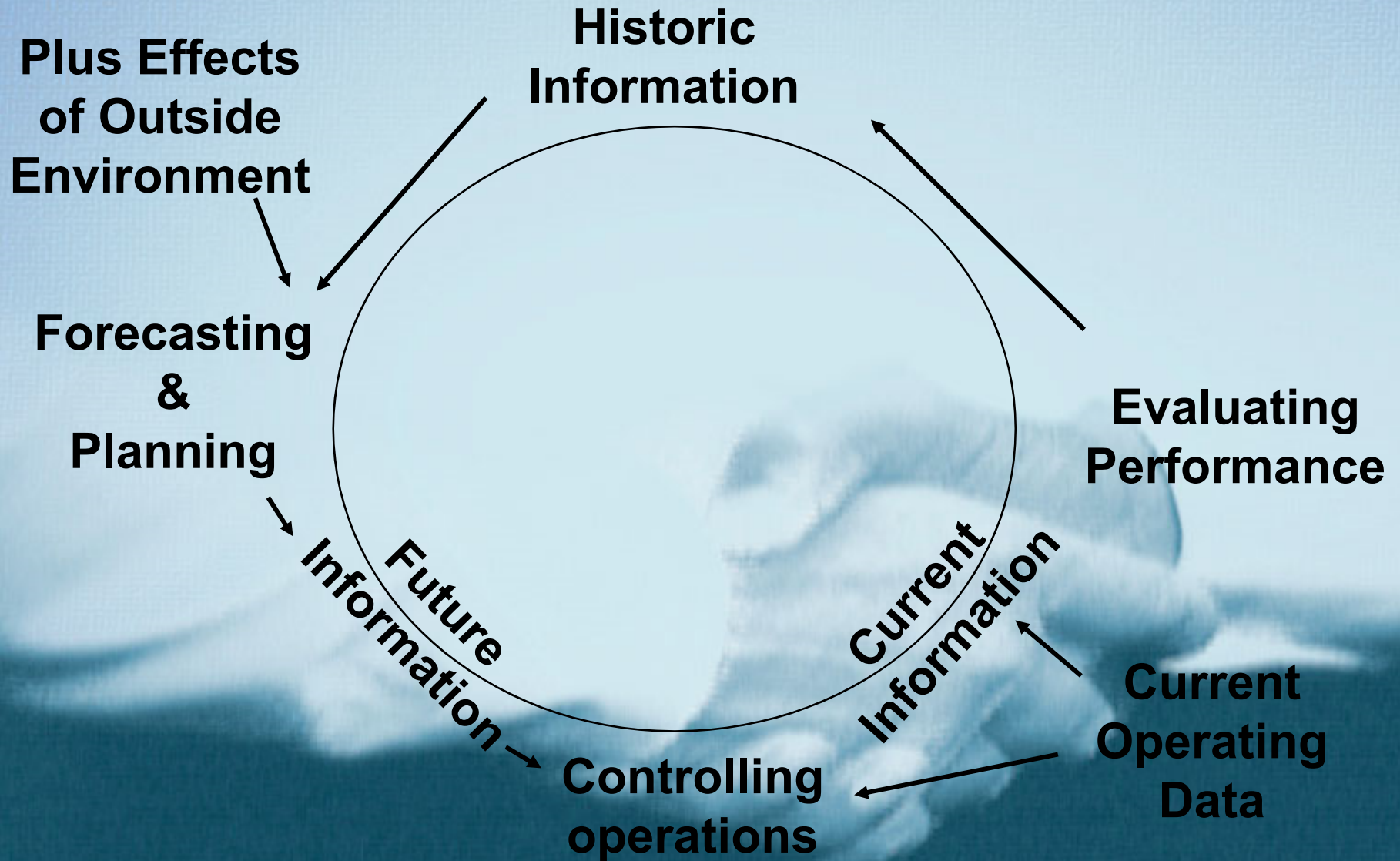
Karl-Martin, Ehrhart, Roy Gardner, Jürgen von Hagen, and Claudia Keser
Budget Processes: Theory and Experimental Evidence, November 2000

More definitions

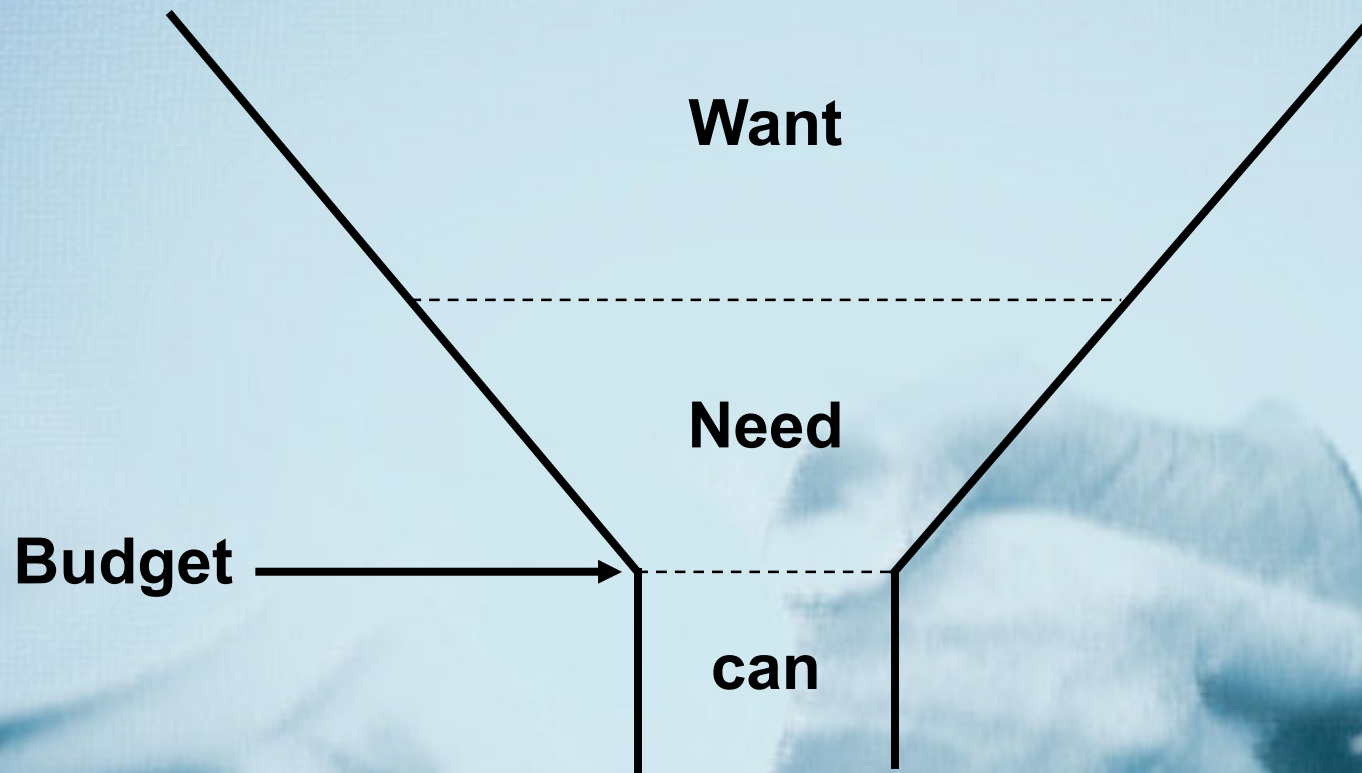
Budget = Quantitative expression of a plan



Budgeting in Context



A budget helps



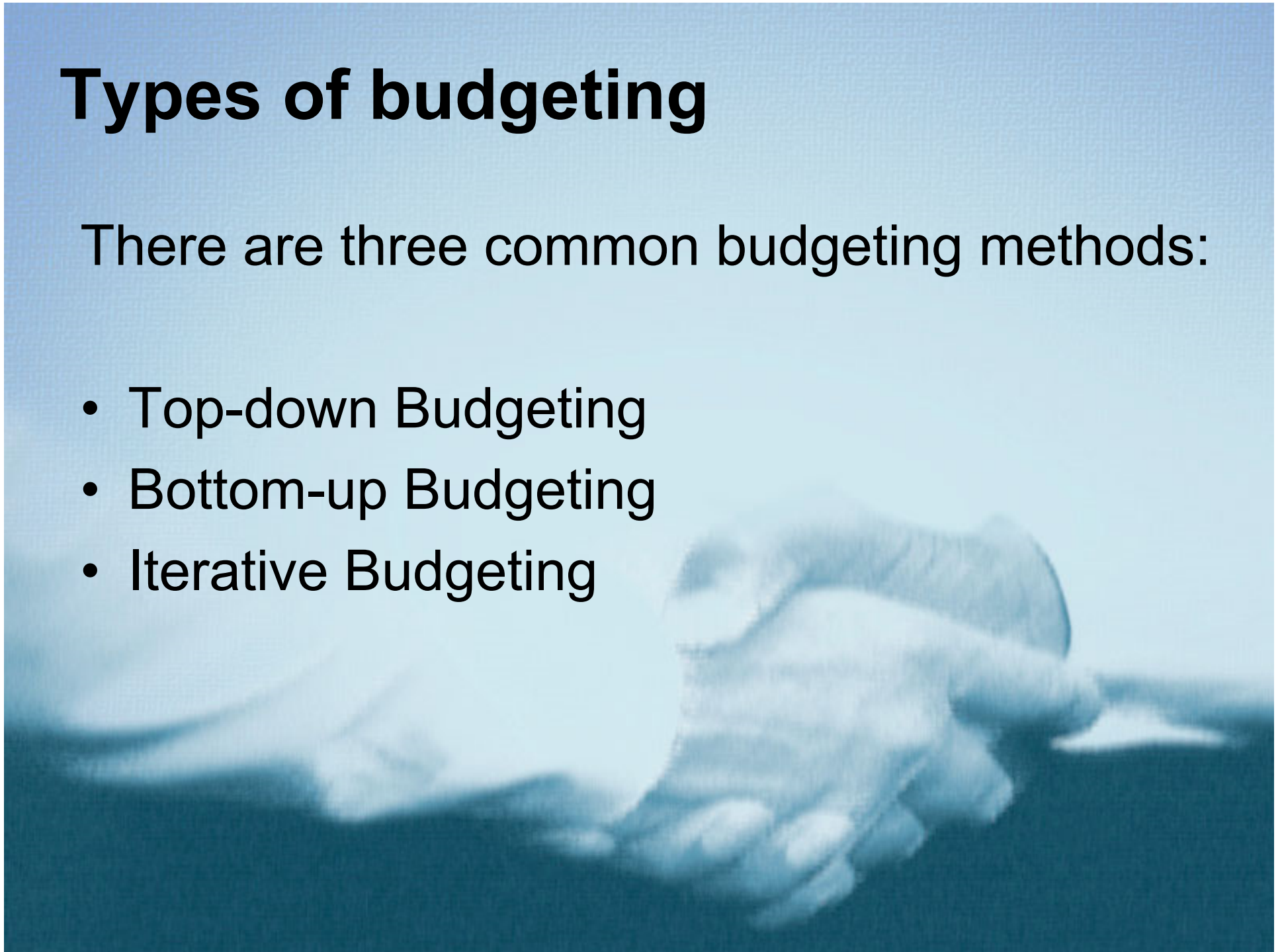
Why use a budget?

- Stay within a limit
- Control
- Forecasting
- Delegate
- Prioritise Wants, Organise Needs,
- Within the realm of what we Can

Types of budgeting

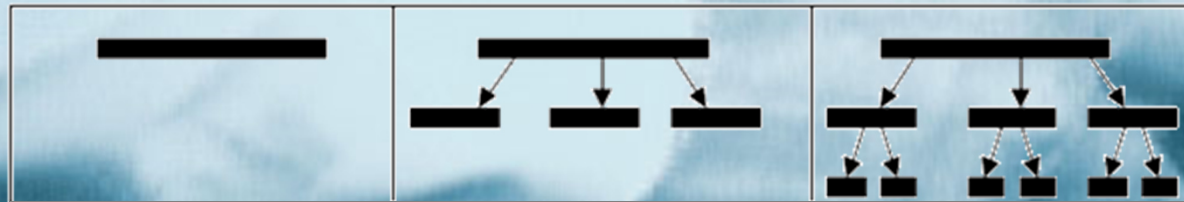
There are three common budgeting methods:

- Top-down Budgeting
- Bottom-up Budgeting
- Iterative Budgeting



Top Down Budgeting

Top-Down Budgeting is the term given to a budgeting process based on estimating the cost of higher level tasks first and using these estimates to constrain the estimates for lower level tasks



Top Down Budgeting

A crucial factor for successfully implementing this method for estimating budgets is the experience and judgement of those involved in producing the overall budget estimate.



Top Down Budgeting

- Organisations need the ability to allow:
 - Financial Managers to establish centralised budgets to control organisation spending.
 - Project Managers to establish projects budgets that consume the centralised organisation budget and control project spending.

Top Down Budgeting

- Takes less time
- Promotes upper-level commitment
- Involves no multilevel participation
- Lower management better understands what upper management expects
- Presented down the ladder

Top Down Budgeting

- Disadvantages
- Translating long-range budgets into short-range budgets.
- Problems scheduling projects in a "sub-optimal way" to meet the strategic goals
Result of top management's limited knowledge of specifics of project tasks and activities

Top Down Budgeting

- Disadvantages
- Competition for funds among lower-level managers, try to secure adequate funding for their operations.
- May cause unhealthy competition.
This process is a zero sum game--one person's or area's gain is another's loss.
- Subordinate managers often feel that they have insufficient budget allocations to achieve the objectives

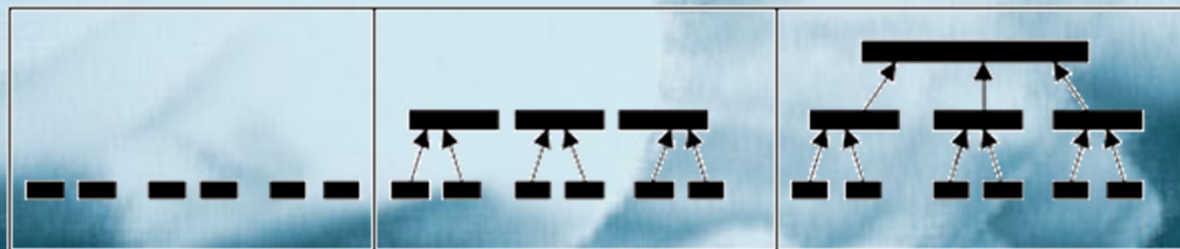
Top Down Budgeting

- Advantages
- Aggregate budget is quite accurate, even though some individual activities subject to large error
- Budgets are stable as a percent of total allocation and the statistical distribution of the budget is also stable leading to high predictability
- Small costly tasks don't need to be identified early in this process - factored into overall estimate

Bottom Up Budgeting

Sometimes called Zero Based Budgeting

- Bottom-up budgeting begins with identifying all the constituent tasks that are involved in implementing a project and working out the resources and funding required by each



Bottom Up Budgeting

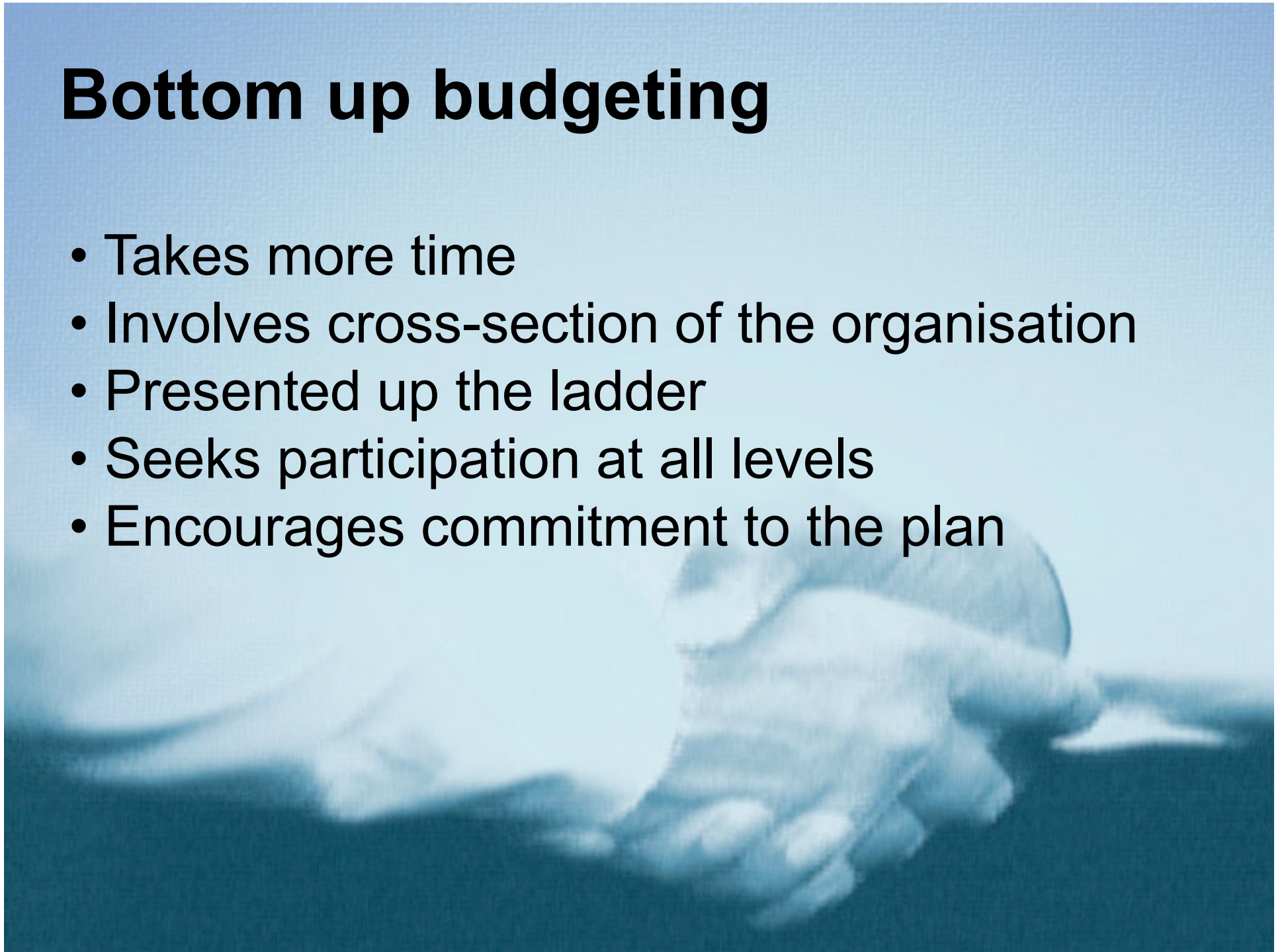
- Provides the opportunity to create organisation level budgets by rolling up project budgets
- Create centralised project level budgets from their sub-project budgets (WBS)

Bottom Up Budgeting

- This method of budgeting provides the following benefits:
 - Project Managers have the flexibility to define their project budgets independently
 - Financial Managers have the ability to centrally review the total project budget/s

Bottom up budgeting

- Takes more time
- Involves cross-section of the organisation
- Presented up the ladder
- Seeks participation at all levels
- Encourages commitment to the plan



Bottom Up Budgeting

- Disadvantage
- Top management has limited influence over the budgeting process,
- Individual tend to overstate their resource needs because they suspect that higher management will probably cut all budgets by the same percentage

Bottom Up Budgeting

- Disadvantage
- More persuasive managers sometimes get a disproportionate share of resources
- A significant portion of budget building is in the hands of the junior personnel in the organisation
- Sometimes critical activities are missed and left unbudgeted

Bottom Up Budgeting

- Advantage
- Is in the accuracy of the budgets for individual tasks
- Clear flow of information
- Use of detailed data available at project management level as basic source of cost, schedule, and resource requirement information.
- Participation in the process leads to ownership and acceptance

Iterative Budgeting

Iterative – to repeat or do again

A combination of top-down and bottom-up budget building

Higher project level estimated (top down)

Lower level costed (bottom up)

The two costs negotiated and reconciled

Iterative Budgeting

- Disadvantage
- Is in the relative inefficiency and time consuming nature of the negotiations over the budgets.
- Process may not work well when communication channels are either informal or blocked between lower-level managers and senior management

Iterative Budgeting

- Advantage
- It promotes employee involvement and stimulates a high degree of information flow between those involved in the project at different levels
- Both senior management and lower level managers closer to the actual process participate in the budgeting process

Top Down vs. Bottom Up

- Top-down ↔ Bottom-up
- Problems of Bottom-up Budgeting
 - Difficult to control aggregate spending
 - Allocations may not be optimal
 - Hard to keep multi-year perspective

Top Down & Bottom Up Compared

- Bottom-up

- Annual
- Time consuming
- Ownership of proposals is specific
- Reactive

- Top-down

- Multi-year
- Delegated authority
- Creates joint ownership of proposals
- Proactive

Activity Orientated Budget

- The traditional budget is activity based
- Individual expenses classified and assigned to basic budget lines e.g. phone, materials, personnel, clerical, utilities, direct labour, etc
- Diffused control so widely that it was frequently non-existent

Task Orientated Budget

- Also known as Program Budgeting
- Aggregates income and expenditures across programs (projects)
- The project has its own budget

Task Orientated Budget

- Pure project organisation, the budgets of all projects are aggregated to the highest organisational level
- Functional organisation income/expense for each project are shown

Planning Programming Budgeting System (PPBS)

- The system focuses on funding those projects that will bring the greatest progress toward organisational goals for the least cost
- Basically a Program and Planning Budgeting System

Planning Programming Budgeting System (PPBS)

- Identification of goals and objectives for each major area of activity - planning
- Analysis of the programs proposed to obtain organizational objectives - programming
- Estimation of the total costs for each project, including indirect costs. Time phasing of costs is detailed.

Planning Programming Budgeting System (PPBS)

- Final analysis of alternative projects in terms of costs, expected costs, expected benefits, and expected project lives.
- Cost/benefit analyses are performed for each program so programs can be compared with each other and a portfolio of projects can be selected for funding

Budget Planning linked to Project Activity

- Only way a detailed budget can be produced
- Can monitor budget usage against project activity
- Can be done when the project schedule has been determined

Completion Times, Project Activities, Costs

- Direct relationship of these items
- Will affect the final budgeted figure
- Is a “trade off”



Budgetary Control

The ability to control anticipated expenditures for your project using a project cost budget.



Budgetary Control

The Projects Budgetary Controls feature includes the following:

- Flexible Setup of Controls
 - Defines Control Amounts
 - Defines Control Levels
- Funds Check - Performs the available funds verifications.
- Maintenance of Available Balances - Maintains the available balance for each project budget line.

Budgetary Controls

- Actual Transactions;
are recorded project costs.
Examples include labour, expense report, usage and miscellaneous costs.
- Commitment Transactions;
are anticipated project costs.
Examples include purchase requisitions and purchase orders or contract commitments.

Features of an effective budget

1. Accurate forecasting
2. Based on organisational goals
3. Information is timely and accurate
4. Formed with multilevel input
5. Regular reviews are built-in

Problems with budgeting

- The process is too long
- There is a lot of game playing
- Business decisions change but the budget does not
- People in charge of budget are held accountable in areas where they have no responsibility
- Applying an arbitrary percentage to prior period actual

Analysing Variance

- Budget deviation analysis (variance analysis) regularly compares what you expected or planned to earn and spend with what you actually spent and earned.
- Variation analysis can help greatly when detecting how well you're tracking your plans, how much to accurately budget in the future, where there might be upcoming problems in spending.

Example of a variance report


Date: June 30, 2006

Account: Product Development

MONTH TO DATE

ACCOUNT	REF.	ACTUAL	BUDGET	VARIANCE	%
SALARIES	5025	£48,000	£43,750	- £4,375	- 10
TRAVEL	6442	£1,500	£1,200	- £300	- 25
SUPPLIES	5320	£500	£700	£200	28.5

Benefits to checking variance

- Understand the reason for the differences
 - Prepare a more accurate budget in the future
 - Evaluate budget goals
 - Isolate problems
 - Identify weak areas
 - Motivate managers
 - Communicate with all levels
 - Forecast
- 

Response to budget warnings

1. Freeze spending
2. Freeze activity
3. Put off “unnecessary” projects activity
4. Re-schedule/cost your project
5. Downsize your project