2.3.10. Budgeting

The Budget is a formal document within which the project is identified, and the point in time at which it is authorized in terms of the ever-important funding phase**.** It is a key document for exercising control over company costs, for projecting cash flow needs, and for pricing work. In other words it helps to allocate money for your needs while preventing overspending and waste.

The budget is a control tool which is used to control expenditures. A budget shows you exactly where your money goes and provides a spending plan that lets you save. In other words a budget is simply a projection of your income and expenditures during a specific period of time. It represents the manager's best numerical guess of future operations.

Typically the projection covers a year and is broken into separate mini-projections for each month or week. The annual budget allows the manager to predict overhead and profit recovery needs for an accounting period, and the periodic budget (monthly) allows the manager to control company costs and project cash needs.

Because there are two types of costs involved in operating a construction business-project cost and company cost, two types of budgets are required. They are called the project budget and the company budget respectively. The project budget represents the numerical plan of the cost of resources to construct a given project. The company budget represents the numerical plan of resources used to operate a construction business for a given period of time. This budget is often referred to as the budgeted income statement or the pro forma income statement.

BUDGETING PROCESS

The budget process is composed of a series of quantitative and qualitative decision making steps. These steps are as follows.

- Determine the profit requirements for the operating period in question. The profit requirement can be determined using one of the three methods; the stipulated sum, the profit to earnings, or the return on investment methods.
- Forecast the firm's cost structure for the budget period. The firm's cost structure is defined as the amount of fixed cost and the amount of variable cost expressed as a percent of the earnings.

- The fixed costs can be forecasted rather accurately. They include cost items such as salaries, insurance, rent, depreciation, repairs and maintenance etc. which can be negotiated and or established at the time before the budgeting process occurs.
- The relationship of variable costs to earnings is established by the income statement for a given accounting period. In the aggregate it reflects the firm’s efficient use of resources on projects as related to the price of the projects. They include items such as advertising, auto and truck expenses, communications, interest, office supplies, taxes etc.
- Calculate the earnings required to yield the required profit.
- Complete the budget by multiplying all variable cost percentages by the earnings.
- Analyze the budget for attainability. If the earning volume exceeds the market share, the financial capacity, or the ability of the employee expertise, then the budget is not attainable. The budget should be revised until it is attainable.

PURPOSE OF BUDGETING

- Provides a financial plan for the period. It tells you how much cash is available, when it is available and for how long.
- Ensures liquidity by providing estimates of the amount of cash available for disbursements.
- Establishes a framework for negotiation.
- Saves interest cost on borrowed money.
- Makes a political statement.