

BREAK-EVEN ANALYSIS

SEE *Cost-Volume-Profit Analysis*

BROKERS AND DEALERS

SEE *Financial Institutions*

BUDGETS AND BUDGETING

A budget is a financial plan for the upcoming period. A capital budget, on the other hand, involves an organization's proposed long-range major projects. The focus of this section is on budget. Public and private entities both engage in the budgetary process. A government budget starts with the projection of sources and amounts of revenue and allocates the potential receipts among projects and legislatively mandated programs based on projected needs and public pressure. Government entities actually record budgets in the accounting records against which expenditures can be made.

A budget is a quantitative plan of operations that identifies the resources needed to fulfill the organization's goals and objectives. It includes both financial and nonfinancial aspects. Budgeting is the process of preparing a plan, commonly called a budget. A master budget is comprised of operating budgets and financial budgets. Operating budgets identify the use of resources in operating activities. They include production budgets, purchase budgets, human resources budgets, and sales budgets. Financial budgets identify sources and outflows of funds for the budgeted operations and the expected operating results for the period. Some variations of budgets are continuous budgets and continuously updated budgets. Rather than preparing one budget for the upcoming year, in a continuous budget one updates the budget for the following twelve months at the end of each month or each quarter. Such a budget remains more current and relevant. A good budget uses historical data as a base and for reference but at the same time incorporates anticipated costs and volumes based on a comprehensive knowledge and understanding of both internal and external factors that affect the business.

COMPONENTS OF THE MASTER BUDGET

The master budget includes a sales budget, which shows expected sales in units and in dollars. A merchandising firm needs to budget for the goods it needs to purchase for resale; these purchases become its cost of sales. A manu-

facturing organization's master budget includes a production budget, which uses the sales budget and inventory levels anticipated at the beginning and end of the period to determine how much to produce.

The production budget needs to be exploded into budgets for direct material, direct labor, and manufacturing overhead. Direct material and direct labor are items clearly identifiable in the finished product. Manufacturing overhead includes all costs of manufacturing *except* direct material and direct labor, such as machine depreciation, utilities, and supervision. The direct material budget explodes the production into basic ingredients; quantities to be purchased are anticipated based on expected inventory levels at the beginning and end of the period. With the help of the purchasing department, the prices for the needed materials are computed to arrive at the material purchases budget. The direct labor budget uses industrial engineering guidelines and production needs to estimate labor requirements. The human resources department provides the labor rates for the skill levels required. Overhead costs are estimated based on production level and appropriate cost drivers (i.e., the factors that cause costs to vary). Some overhead costs are considered variable because they vary with the level of output. Others are considered fixed because the level of output does not affect the amount of those costs. For example, the production supervision cost is assumed to be the same regardless of how much is produced within a shift in a plant. One can, then, estimate production costs and cost per unit for goods to be produced. Cost of goods sold can be determined based on the inventory levels of finished goods. Selling and general administration costs are then estimated, taking into consideration those costs that vary with sales, such as sales commission, as well as fixed costs that remain the same regardless of the level of sales, such as office rent. The information put together so far gives one all one needs to prepare a forecasted income statement.

At this point, the cash budget is developed. This item starts with cash at the beginning of the period plus cash that will be generated through collection of receivables, cash sales, and other sources minus anticipated minus cash disbursements, which include payroll disbursements, payment for taxes, and accounts payable depending on the terms for payment. The resulting cash balance may be negative if there are more disbursements than receipts, in which case borrowing needs are determined. A positive cash balance may be more than needed for operating expense. Such excess cash may be deposited in a temporary investment account. The final part of master budget preparation is the forecasted balance sheet, where the anticipated cash balance, investments, accounts receivable, inventory, fixed assets, accounts payable, wages

payable, taxes payable, long-term liabilities, and equity accounts are recorded to assure that the two sides of the equation balance; that is, $\text{assets} = \text{liabilities} + \text{equity}$.

THE BUDGETING PROCESS

Budgeting is, or should be, the result of teamwork. A top-down budget is a budget that is essentially imposed on the organization by top management. This may be an efficient way to prepare a budget but because of lack of participation by the employees, such budgets often bring with them a level of employee resentment and resistance that leads to problems in implementation of what is proposed. Employees do not feel a sense of ownership in a budget in which they have not been participants. A participatory, or bottom-up budget, on the other hand, starts with the employees in each department determining their needs and requirements in order to achieve the company goals. Because employees feel a sense of ownership in such budgets, they attempt to meet or exceed those expectations. A balance between the two extremes can often be achieved. Top management should be involved in setting the tone and providing the guidelines and parameters within which the budget will be set. Incentives should be put into place so that those who achieve or exceed the budgetary expectations will receive suitable rewards for their efforts.

There must also be guidelines to discourage budgetary *slacks* and abuses whereby the requested budget amounts are in excess of anticipated needs in order for the department to look better and reap some rewards. A very tight budget, on the other hand, may prove discouraging and unattainable. No matter what approach is taken, it is important to realize that the budget should serve as a map and guideline in anticipating the future. Top management must take it seriously in order for the employees to take it seriously as well. At the same time, the budget should not be seen as a strict and unchangeable document. If opportunities arise, circumstances change, and unforeseen situations develop, there is no reason why the budget should be an impediment to exploring and taking advantage of such opportunities. Many companies form a budget committee to oversee the preparation and execution of the budget. The budget can also be seen as a tool that helps in bridging the communications gap between various parts of the organization. Sales, production, purchasing, receiving, industrial relations, sales promotion, warehousing, computing, treasury, quality control, and all other departments see their roles and understand the roles of the other players in achieving the goals of the organization. Such participation also necessitates budget negotiation among the various parties to the budgetary process until the budget is finalized. Goal congruence occurs when the goals of the employees and the goals of the company become intertwined and meshed together. A budget that

does not consider the goals of the employees often fails. The finalization of the budget requires acceptance by the affected departments and approval and sign-off by top management. If circumstances change due to factors such as change in product mix, costs, selling prices, negotiated labor rates, or engineering specifications, there may be a need for budget revision.

OTHER BUDGETING TECHNIQUES

An incremental budget is a budget that is prepared based on prior-year figures, allowing for factors such as inflation. Although such an approach is used by some government entities, most people frown upon such a practice because it is contrary to the whole notion of a budget, which is supposed to be a calculated and wise anticipation of the future course of events with due consideration of all potential factors. A zero-based budget, on the other hand, is a budget that does not take anything for granted. It starts from point zero for each budgetary element and department each year and attempts to justify every dollar of expenditure. Although some industries had implemented such a method earlier, it was first used in preparing the state of Georgia's budget in the early 1970s and was later used to prepare the federal budget in late 1970s during President Carter's administration. However, it was soon abandoned because the paperwork generated and timeframe necessary to do this task proved to be too cumbersome for the federal government. *Kaisen* budgeting, a term borrowed from Japanese, is a budgeting approach that explicitly demands continuous improvement and incorporates all the expected improvements in the budget that results from such a process. Activity-based budgeting is a technique that focuses on costs of activities or cost drivers necessary for production and sales. Such an approach facilitates continuous improvement. An easily attainable budget often fails to bring out the employees' best efforts. A budget target that is very difficult to achieve can discourage managers from even trying to attain it. So budget targets should be challenging and at the same time attainable.

MONITORING THE BUDGET

A flexible budget modifies the budget to the actual level of performance. Obviously, if the original budget is prepared for say, 1,000 units of a product, but 2,000 units are produced, comparing the original budget to the actual volume of output does not provide meaningful information. Accordingly, the budgeted costs per unit for all variable costs can be used and multiplied by the actual volume of output to arrive at the flexible change proportionately to the level of output for the former and to the level of sales for the latter cost. Fixed costs, such as rent, however, do not normally change with the level of production or sales.

These budgeted costs, therefore, are not adjusted and left intact even though the volume of sales and output may be different from the originally budgeted levels.

Ultimately, a good budget is one that not only uses good budgeting techniques but is also based on a sound knowledge of the business as well as the external factors that affect it. The budget serves as a planning tool for the organization as a whole as well as its subunits. It provides a frame of reference against which actual performance can be compared. It provides a means to determine and investigate variances. It also assists the company in planning again based on the feedback received considering the changing conditions. An attainable, fair, and participatory budget is also a good tool for communication, employee involvement, and motivation.

SEE ALSO *Financial Forecasts and Projections*

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BUREAU OF LABOR STATISTICS

“Is employment below or above the level of last month?” “What has happened to prices during the past month?” Such questions—and thousands of others about a wide range of labor-related topics—are answered by personnel of the Bureau of Labor Statistics (BLS). When the BLS was established by Congress on June 27, 1884, its mission was stated in these words: “The general design and duties of the Bureau of Labor shall be to acquire and diffuse among the people of the United States useful information on subjects connected with labor, in the more general and comprehensive sense of that word, and especially upon its relation to capital, the hours of labor, social, intellectual, and moral prosperity.” The BLS is an independent

national statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the citizens of the United States, the U.S. Congress, other federal agencies, state and local governments, businesses, and labor. The president appoints the head of the BLS, the commissioner, with approval by the Senate for a specific term that does not coincide with that of his administration.

The BLS is distinct from the policy-making and enforcement activities of the Department of Labor. The BLS is impartial, with a strong commitment to integrity and objectivity; its data have credibility because of the standards maintained throughout the agency. The major areas of BLS activity are:

- Employment and unemployment
- Prices and living conditions
- Compensation and working conditions
- Productivity and technology
- Employment projections
- Safety and health statistics

Employment and unemployment. In addition to monthly figures on employment and unemployment, the BLS does a comprehensive breakdown of the age, sex, and racial and ethnic composition of the work force as well as of industries and occupations in which the workers are employed. Other characteristics are also tracked, including patterns of regional employment and the extent of participation in work by teenagers, blacks, Hispanics, women, and older Americans.

Price and living conditions. Each month the Consumer Price Index (CPI) and the Producers Price Index (PPI) are prepared. The BLS also reports how households spend their incomes.

Compensation and working conditions. Comprehensive studies of employee compensation—wages and benefits—are undertaken that relate to occupations, industries, and areas of the country. An initiative begun in 2000 produces national employment cost indexes, employment cost levels, and employee benefit incidence.

Productivity and technology. This office produces productivity measures for industries and for major sectors of the U.S. economy. Additionally, it provides comparisons for key BLS labor statistics series as well as training and technical assistance in labor statistics to people from other countries.

Employment projections. There is much interest in the projections provided by this unit of the BLS. Information about future employment growth—and the nature of that growth—is of critical importance to public officials, busi-