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# Budgets and Budgeting

**South West Arts Marketing**  
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## **BUDGETS AND BUDGETING - A TOOL FOR FINANCIAL PLANNING**

- A budget: 'A statement of allocated expenditure and/or income, broken down into specific headings, for a certain period, project or set of activities'.
- A budget forecast: 'A statement of expected expenditure and/or income based on the best information available, broken down into specific headings for a certain period, project or set of activities'.

**(Definitions after Malcolm Secrett (1993))**

**Hence:**

- '**The Budget**': the Chancellor's annual statement to the House of Commons on the Government's spending and income plans;
- Your household or personal budget: How much money you expect to receive within a particular period and how you plan to save or spend it;
- A business's budgets: Income and/or expenditure laid out according to the various income streams or cost areas.

## **BUDGETING IS PLANNING**

- Financial Statements (documents such as Balance Sheets and Income and Expenditure accounts) are:
  - a record of past events and the relevant financial performance;
  - retrospective, historical documents;

And

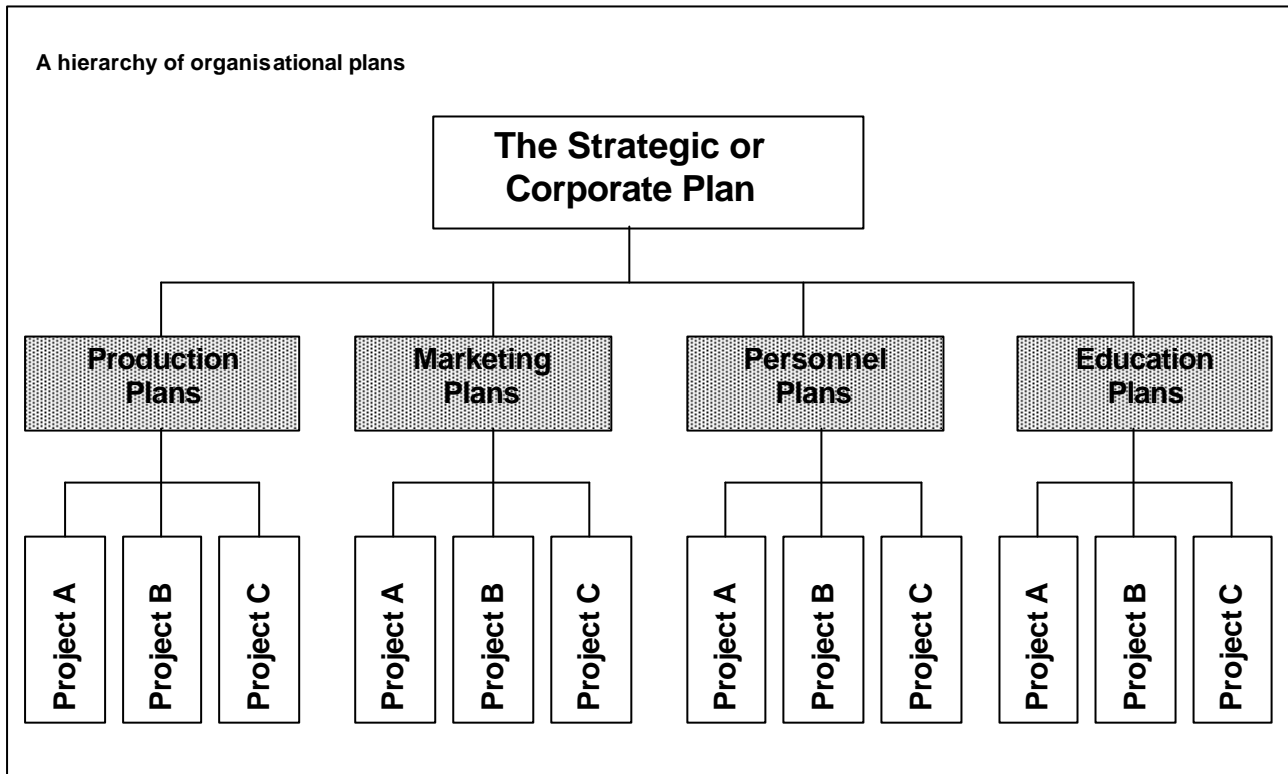
- a statement of how things actually were after the event, and thus cannot be amended without a time machine.
- Budgets and Budget Forecasts:
  - a projection of events which are still to come with their related income and expenditure;
  - an estimate of something which is still to happen;
  - could therefore be amended or revised.

## **BUDGETS ARE *COSTED* PLANS**

- Budgets are part of an organisation's overall plans.
- They represent a financial interpretation of strategic or operational plans.

## ORGANISATIONAL PLANS

- Exist as a hierarchy or family tree:

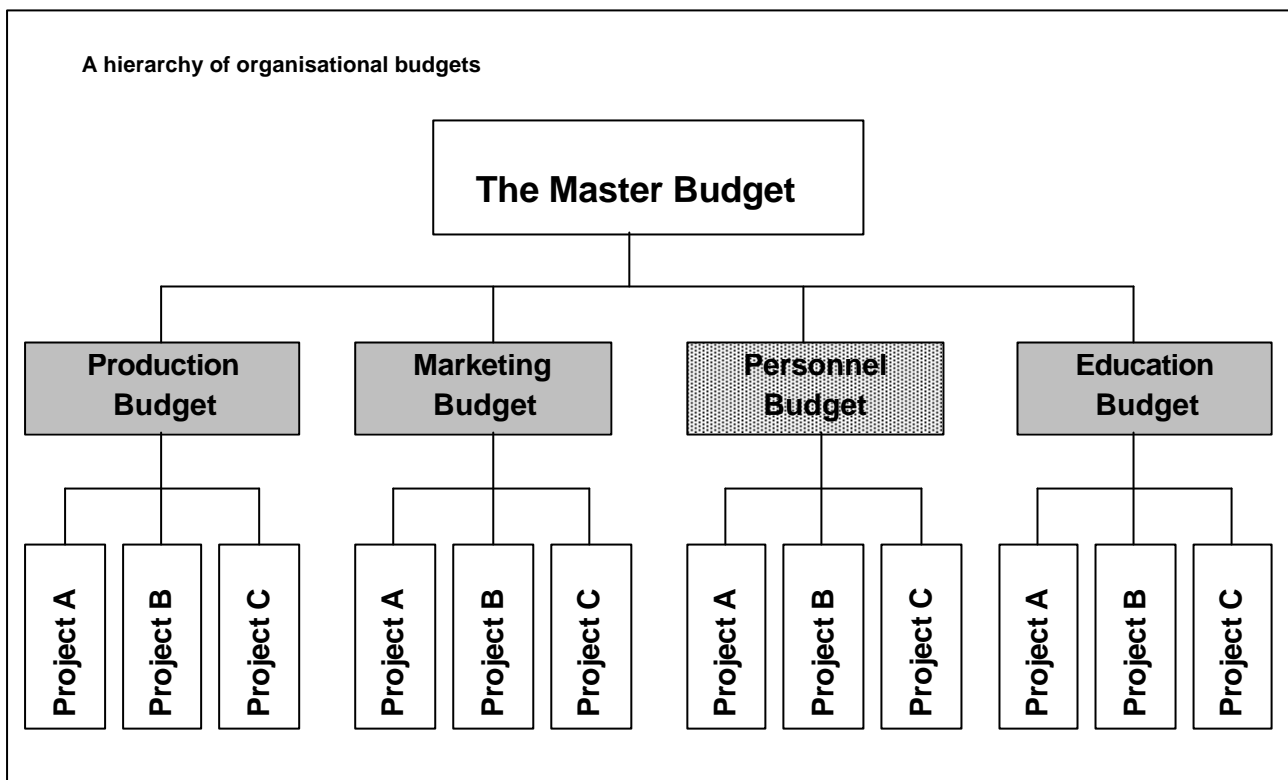


An organisation that plans effectively, will inform its operational, activity and 'front-line' plans with the organisation's overall aims by 'cascading' them downwards from the overall strategic plan, so that front-line operations play a part in fulfilling those overall goals.

In the diagram above the projects referred to in the hierarchy can also be considered to be the ongoing activities within each department of the organisation and under each plan. If the projects / activities are to be achieved they must individually be achievable and measurable within a specified time limit and the staff and resources available. Once successfully completed these activities will pave the way for the organisation to achieve its strategic and corporate objectives. All staff should realise their own importance within this structure.

## ORGANISATIONAL BUDGETS

- Also exist as a hierarchy which reflects (or is the 'twin') of the corresponding plans and activities, by virtue of the fact they is a financial interpretation of its strategic or operational parallel:

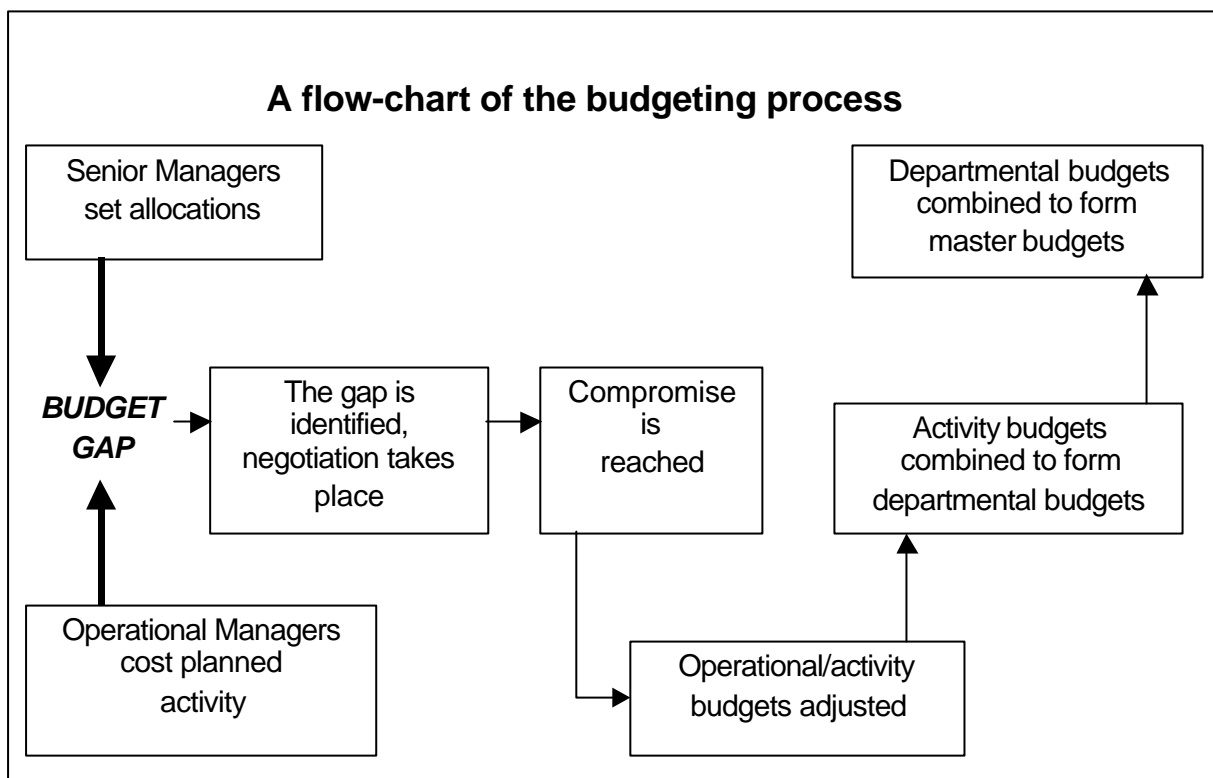


Or in simple English what you plan to spend within your budgets should be thought of and prepared at the same time as the organisational plans because they should echo what you are doing in your actual activities within each department of your organisation.

As with the organisation's plans, the overall financial goals of the business should be cascaded to every level, ensuring that even front-line expenditure or income makes some contribution to the overall financial aims of the Company e.g. the usher who sells programmes for a show is making a contribution to the marketing of that show by selling programmes and showing people to their seats, but can also be seen to be an expenditure because of the wages the organisation will have to pay out.

## THE BUDGETING PROCESS

- Senior managers allocate costs and income targets to departments.
- Departmental managers cost the activities planned at their level in the organisation.
- The gap between the two is identified and a negotiation takes place on the basis of priority.
- Compromise figures are agreed and operational budgets adjusted.
- The final master budget is compiled, 'bottom up', by combining departmental projects and activities to produce departmental budgets and by combining departmental budgets to create the master budget:



**NB: Not all activity (or departmental) budgets will show costs with their related income. (e.g. The income generated by using the marketing budget may actually appear in the income budget for the box office). However, once all subsidiary budgets have been aggregated, to form the master budget, matching costs and income will be shown together.**

### **SOME POSSIBLE USES OF BUDGETS**

- To assess the relationship between anticipated costs and anticipated income and to assess whether the likely final position (the '**outturn**') is positive (a '**surplus**') or negative (a '**deficit**').
- To set targets for expenditure costs.
- To set targets for income, or to identify areas of income shortfall.
- To provide a financial agenda for various activities.
- To act as a mechanism for co-ordinating management actions and reconciling conflicting priorities.
- To act as an incentive for management performance by setting visible objectives and targets.
- To provide quantified parameters against which management performance will be judged.

## COPING WITH UNCERTAINTY: REVISIONS AND CONTINGENCIES

- No matter how precise a forecast is, or how detailed the calculations which are made, forecasts are still crystal ball gazing.
- Unless you are a clairvoyant, a projection is still a guess or estimate of what is actually going to happen.
- The chances of an initial forecast being **wrong** are very high.
- However, certainty increases as the time from the predicted event decreases:
  - 1996 - I predict that green aliens from the Planet Zog will land in Trafalgar Square in 2010. You question my sanity.
  - 1998 - Existence of life on Zog proved by scientists. You consider my forecast as a little less ludicrous.
  - 2005 - A recent increase in UFO sightings is found to be due to day-trippers from Zog. You further revise your opinions of my prediction and me.
  - 2010 - A news flash reports that a Zogian spaceship is descending over the National Gallery. You wish you'd put money on my initial forecast.

## REVISING FORECASTS TO DEAL WITH THE INHERENT UNCERTAINTY

- The degree of certainty in a forecast increases as time passes and additional, or more solid, information is obtained (i.e. as the project or event moves from being a prediction to being history).
- To reduce uncertainty in a forecast it needs revising to be more accurate, up-to-date and solid, as further information becomes available.
- This means:
  - Not treating a budget as a sacred artefact cast in stone;
  - Having mechanisms in place to monitor developments;
  - Being willing and able to make revisions as necessary on the basis of new data.

## USING CONTINGENCIES TO LEGISLATE AGAINST UNCERTAINTY

- A **contingency**: a 'just in case', 'what if' budget heading showing money allocated as an 'insurance' against a rainy day.
- Conventionally c. 10% of the overall cost of a particular budget.

- Contingencies should be 'released' as revisions are made and it becomes clear that they might not be needed.
- Unspecified contingencies have an inherent inaccuracy. (How are you intending to spend them?).
- An itemised, specified contingency according to intended *use* and *priority* is therefore more effective:

<b>Contingencies</b>	<b>£ (000s)</b>
<b>Essential (should allow for)</b>	
Overrun on production costs	3
Additional emergency mailings	1.5
<b>Desirable</b>	
Top-up poster campaign	1
Extra rehearsal days	3
<b>Luxuries</b>	
Glitzy press event	1
Staff Xmas Bonus	1
	—————
	10.5

- The low priority contingencies should be given up or released first.

## **WHAT GOES IN, WHAT'S LEFT OUT**

- Two fundamental requirements of a budget forecast:
  1. The ability to understand it easily;
  2. A capacity to check it's accuracy through comparison with the real world and in order to make revisions.
- Figures and headings should therefore be:
  - relevant;
  - shown at an appropriate level of detail;
  - checkable.

- Building in relevance (or leaving out irrelevance):
  - headings must be relevant to the broad purpose of the budget. Including poster costs in a budget devoted to a direct mail campaign will not add anything except extraneous detail, which will blur understanding.
- Finding the appropriate level of detail or definition:
  - This budget may well be adequate:

<b>Rural Venues Tour 1994</b>	<b>£ (000s)</b>
<b>Income</b>	25
<b>Expenditure</b>	20
<b>Surplus/(Deficit)</b>	5

But, if later information shows that the venue hire is likely to cost £5k more, this would be difficult to revise because we can't see how much was put in for hires in the first place. Because of this lack of detail, it is also hard to assess this new information's significance.

- It is just as possible to go to the other extreme. Consider this stationery budget for an imaginary RAB:

<b>Eastlands RAB: Stationery 1994</b>	<b>£ (000s)</b>
<b>Paper</b>	2,200
<b>Envelopes</b>	500
<b>Binding Materials</b>	400
<b>Pens</b>	200
<b>Paper Clips</b>	40
	3,340

- Is anyone going to spend time monitoring the cost of the paper clips?
  - If not, the real data necessary to check and revise the budget will not be available.
  - If yes, couldn't they be using their time more productively?
  - And unless this RAB has a major problem with 'paper clip migration', will a variation in this line of the budget make a significant and material difference to the overall outcome?
- Too few headings or lines in a budget will make it difficult and tedious to find out what revisions need to be made in the light of the new data, and where to make them.
  - Too many headings make it difficult to collect and monitor information relating to a particular line. Equally it increases the chances that a heading will be insignificant and not make a material difference to the overall outcome.

### **SOME RULES OF THUMB**

- If a single budget forecast is likely to be large and unwieldy, consider splitting it into sub-budgets.
- Decide the level of detail at which items will have a significant impact on the whole. (Generally you should only include headings which are equal to 0.5% or more of the overall income or expenditure).
- Assess how many headings would provide clarity and accuracy without denuding necessary detail (aim for no more than 30 cost and 30 income headings).

### **ONE LAST CONTRIBUTION TO BUDGET USABILITY: ASSUMPTIONS**

- Because building a budget means *estimating* things, it is important to record the assumptions made in producing those estimates, so that:
  - anyone coming to it afresh can understand your reasoning;
  - the author returning to it after a long period can understand how they arrived at the figures without having to recalculate them.

#### RECORDS OF ASSUMPTIONS SHOULD BE:

- Detailed and specific in relation to the underlying calculations (e.g. Advance sales based on 75% of capacity, overtime calculated at 8 days @ £350);
- Kept with, on, or easily accessible from, the budget document itself.

## ASSUMPTIONS MAY ALSO RELATE TO THE SENSITIVITY AND FIRMNESS OF PARTICULAR HEADINGS:

- If a budget stands or falls according to whether its sponsorship target is met, then the budget is incredibly **sensitive** to achieving this particular target. This fact needs to be shown along with the assumptions, since it enhances the reader's understanding of the risks inherent in adopting and operating this budget.
- If the sponsorship income has not been confirmed yet, this is less **firm** than if the money was already in the bank. The potential instability in the budget should be noted somewhere as well, again, to allow the reader to assess the risks involved.

## BUILDING A BUDGET

- 1 Decide what the budget's purpose is:
  - to monitor and control expenditure;
  - to link revenue to costs;
  - an exploration of a 'what-if' scenario;
  - to test the overall viability of the project;
  - some other purpose...
- 2 Read the operational plan to which it relates or talk to the people involved.
- 3 List **all** of the cost and income aspects the plan will entail.
- 4 Fill in the numbers: either on the basis of past experience and performance (i.e. how much did something similar cost last time) or by way of well-informed estimates.
- 5 List all the assumptions relating to underlying calculations, sensitivity and firmness.
- 6 Check the outturn: is income greater than expenditure (i.e. a surplus), or vice versa (a deficit):
  - Does it fit with the department or organisation's overall budget?
  - Does it contribute to the achievement of the intended aims?
  - Is the outturn congruent with the budget's overall purpose?

If the answer is no, then either the operational plan will have to be changed, or the income and expenditure figures (and assumptions) adjusted. Remember budgeting is an iterative, circular, process and may require a number of trial and error cycles through the building process before a satisfactory budget can be obtained.

## **ABUSING BUDGETS: BUDGETARY PATHOLOGIES AND OTHER DYSFUNCTIONAL BEHAVIOURS**

All organisations are political arenas, beset by interplays of influence and struggles for power.

- Organisations are made up of people who, being human, can get tired; bored, or complacent; become lazy; and cut corners.
- Budgets are a key weapon and focus of power in organisational infighting.
- Budgetary effectiveness can be denuded by human frailty.
- Be aware, therefore, of some of the abuses and dysfunctional behaviours that can relate to budgets.

### **THE SEVEN DEADLY SINS OF BUDGETARY ABUSE**

- **1 Territorialism**  
'It's not coming out of my budget'. (Actually it is not their budget it is the organisation's).
- **2 Lack of ownership**  
A particular budget is nobody's responsibility or falls between two stools. The result: nobody checks it, nobody monitors it.
- **3 Under-projecting income**  
If a manager does better than projected, he or she is often congratulated or rewarded. So they deliberately under-estimate income so as to increase their chances of exceeding the projection. The result: the organisation's overall range of activity is denuded because there has not been an accurate estimate of the money coming into it.
- **4 Over-costing**  
In order to be rewarded for controlling costs and to 'watch their backs', managers deliberately over-estimate costs. The result: financial resources, which could have been used elsewhere, are tied up somewhere where they are not actually needed.
- **5 Swollen contingencies**  
Similar to over-costing. Setting aside too much as an insurance policy so as to watch ones back, results in money being tied up when it could be used elsewhere.
- **6 Incrementalism**  
Building a budget takes a lot of effort. However a knee jerk reaction, which cuts corners, is to take last year's budget and increase all the headings by a given percentage. This makes no allowances for any changes in the organisation's operations or environment and preserves previous assumptions in aspic. The more incrementalism happens, the more unrealistic budgets become with basic assumptions not being questioned. A far preferable approach is **zero-based budgeting**: i.e. taking a clean sheet of paper and starting from scratch, thus rethinking aims and assumptions anew.

- **7 The year-end spending orgy**

Especially found in public sector organisations or Local Authorities, where next year's budget allocation is based on how much a department actually spent this year. Managers who have controlled their costs effectively throughout the year, end it by blowing all the remaining cash in their budget on non-essential items so as to protect their budget allocation (and the power and influence it brings), for next year. Responsibility for solving these pathologies lies with senior management and overall policy.

**Generally a good and effective budget is one that is accurate.**

In a sense coming in under-budget is as much of a sin as is coming in over-budget. The imprecision of both means that the organisation is having to allocate its resources on the basis of imperfect information.

## **A NOTE ON ASPECTS OF FINANCIAL TERMINOLOGY**

**A number of terms and concepts introduced so far, or arising from, the budgeting exercise, demand explanation or definition.**

- One of the main things a budget will show is the basic relationship between an organisation's or project's planned expenditure (its **costs**) and its expected income.
- The 'outturn' is thus found by calculating the **INCOME** minus (-) the related **EXPENDITURE**.
- When **INCOME** is greater than **EXPENDITURE**, the result is a positive figure and the relevant organisation or project is said to have made a **SURPLUS** (or 'profit').
- When **INCOME** is less than **EXPENDITURE**, the result of the calculation is a minus (i.e. negative) figure and the organisation or project is said to have generated a **DEFICIT** (or 'loss').

## **Budgets and budgeting - A tool for financial planning**

### ***Practical Example***

#### **Building the 'Meet the Author' week budget**

**Your group is the Executive Committee appointed by the Director of the Langton Gallery of Contemporary Art to organise this year's 'Meet the author' week. These weeks were invented by the Director three years ago to provide seven evenings of readings by the actual authors, (one a night), from contemporary poetry and fiction. Despite a shaky start these events have proven to be increasingly successful, with the last two years actually making a slight surplus for the Gallery.**

A particularly popular innovation has been the 'Meet the Author After' events: nightly receptions with cheese and wine held in the Gallery, when the particular author involved mingles with some of those who attend the readings.

This year the programme of readings will feature six different authors, with the woman widely expected to be the new poet laureate undertaking two poetry readings on successive nights. All of the authors have asked for a fee of £1,500 pounds including travel, apart from the poet laureate designate who, being a personal friend of the Director is accepting £2,000 in total for the two nights. The Gallery is also providing a night's accommodation after the readings to each author at a top local hotel (cost £60 per evening).

There are no additional cost implications for keeping the building open at night apart from the overtime costs for the 20 staff who will have to be present (calculated at £30 per employee for each evening), and the extra costs of lighting and heating the building during the evenings (estimated at £700 for the whole week). However it should be noted that it is estimated that the costs of publicising the week will amount to £2,000 for leaflets, posters and advertising. Furthermore the Director is keen to have a prestigious opening press launch for the week which is likely to cost another £1,500.

The Gallery is licensed to hold 500 people. The year before last saw attendances per evening of 250, whilst last year this increased to 300. It might be expected that the 'poet laureate' events will do better than average since the woman concerned has appeared on the 'Late Show'.

About half of the people attending tend to stay for the reception afterwards, and it has already been estimated that the cost of cheese and wine per person will work out at £5 per head. Thus the entry prices have been set at £5 for the reading alone and £12 for the reading and the reception.

**The Director wants to make another surplus this year, and now is waiting for your group to propose a budget. Therefore you should:**

1. **Construct a basic budget for the event;**
2. **Estimate what sort of attendance will be needed for the week to break-even, i.e. so that costs will equal its income. (There's no need to be exact, the Director just needs a general idea);**
3. **If the constructed budget does not allow a surplus (or indeed break-even), what tactics or charges should be put in place to bring the event into surplus?**

**Notes and workings**

**Solution to Example:**  
**Building the 'Meet the Author' Week Budget**

**ATTENDANCE ASSUMPTIONS**

**Scenario A: assume**

Attendances of 350 a night for non-poet laureate nights  
 & 400 a night for poet-laureate nights, thus income =

Non-poet laureate attenders, no reception (175 x 5 x 5):	4,375	
Non-poet laureate attenders, with reception (175 x 5 x 12):	10,500	
Poet laureate attenders, no reception (200 x 2 x 5):		2,000
Poet laureate attenders, with reception (200 x 2 x 12):	<u>4,800</u>	
		21,675

**Scenario B: assume total sell out (!)**

Attendances of 500 for all events

Non-reception attenders (250 x 7 x 12):	8,750	
Reception attenders (250 x 7 x 12)		<u>21,000</u>
		29,750

**DRAFT BUDGET**

**Scenario A      Scenario B**

**COSTS**

**Authors**

Fees	5 @ £1,500	7,500	7,500
	2 @ £1,000	<u>2,000</u>	<u>2,000</u>
Accommodation	7 nights @ £60	420	420

**Venue**

Overtime	7 nights @ £30 x 20 staff	4,200	4,200
Heat & Light		<u>700</u>	<u>700</u>
		4,900	4,900

**Publicity**

Print etc		2,000	2,000
Press Launch		<u>1,500</u>	<u>1,500</u>
		3,500	3,500

<b>Catering</b>	@ £5 per head	6,375	8,750
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<b>TOTAL COSTS</b>		<u>24,695</u>	<u>27,070</u>
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<b>TOTAL INCOME</b>		21,675	29,750
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<b>SURPLUS/(DEFICIT)</b>		<u>(3,020)</u>	<u>2,680</u>
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