BUDGET

Budgets are "financial and for quantitative statements, prepared and approved to a defined period of time, for the policy to be pursued during that period for the purpose of attaining a given objective".

OR

It is a comprehensive and coordination statement expressed in monetary or quantitative terms, reflecting the policies of a company and determining its operation in respect of a particular time period.

Budget is an estimate of revenue and expenditure for e forthcoming fiscal year. Budget is a plan to be followed of how much money will be spent over a period of time in relation to the money available and for the purpose of attaining determined goals. A budget is a long term plan. Budgeting is the formulation of plans for a given future period.

THE BASIC ELEMENTS OF BUDGET ARE:

1. It is a comprehensive and inter related plan.
2. It can be expressed in financial as well as quantitative terms
3. It is a future plan for future resources and operations.
4. It is a future plan for a specific time period and objectives of the organization.
5. It is prepared in advance and is derived from the long term strategy of the organization
6. It is expressed in quantitative from, physical or monetary units, or both.

CHARACTERISTICS OF A BUDGET:

A good budget is characterized by the following:

1. Participation: involve as many people as possible in drawing up a budget.
2. Comprehensiveness: embrace the whole organization.
3. Standards: base it on established standards of performance.
4. Flexibility: allow for changing circumstances.
5. Feedback: constantly monitor performance.
6. Analysis of costs and revenues: this can be done on the basis of product lines, departments or cost centres.

TYPES OF BUDGET:

1. **FIXED BUDGET:** a budget which is independent on the level of turnover is known as fixed budget. It is based on one set of condition, one volume of output and simple collection of cost e.g. advertising budget, office administrative budget or maintenance budget.

2. **FLEXIBLE BUDGET:** a budget which may be change with the change circumstances and condition is called a flexible budget. It contains different estimates in different assumed situations e.g. labour budget.
3. LONG TERM BUDGET: a budget which is prepared for a long period of time which could be 1 to 5 years is known as long term budget. E.g. capital budget

4. **SHORT TERM BUDGET:** a budget which is prepared for a short period which is less than 1 year like monthly, weekly or daily is known as short term budget e.g. seasonal budget.

5. **CAPITAL BUDGET:** which is prepared for the acquisition of assets of the organization is known as capital budget. E.g. acquisition of land, building or expansion plan. Investments in property, buildings and major equipment are called capital expenditures. These are typically substantial expenditures both in terms of magnitude and duration. The magnitude and duration of these investments can justify the development of separate budgets for these expenditures. Such capital expenditure budgets allow management to forecast future capital requirements, to keep on top of important capital projects, and to ensure that adequate cash is available to meet these expenditures as they become due.
6. **REVENUE BUDGET:** a budget which is prepared for regular income as well as expenses in known as revenue budget. The revenue budget is a forecast because it is based on projecting future sales. Managers must take into consideration their competitors, advertising budget, sales force effectiveness and other relevant factors, and they must make an estimate of sales volume. Then, based on estimates of demand at various prices, managers must select an appropriate sales price. The result is the revenue budget.

7. **EXPENSE BUDGET:** Found in all units within a firm and in not-for-profit and profit-making organisations alike. Expense budgets list the primary activities undertaken by a unit to achieve its goals and allocate a dollar amount to each. Managers give particular attention to so-called fixed expenses & that is, those that remain relatively unchanged regardless of volume. As production drops, the variable expenses tend to control themselves because they fall with volume.

8. **CASH BUDGET:** An estimate of a company's cash position for a particular period of time. Cash budgets are forecasts of how much cash

the organisation will have on hand and how much it will need to meet expenses. This budget can reveal potential shortages or the availability of surplus cash for short-term investments.

9. **OPERATING BUDGET:** A business's forecasted revenues along with forecasted expenses, usually for a period of one year or less. Line items in your operating budget may include:
    - Labour budget: The total labour cost to be expended for a set period of time calculated by taking every person in an organization, department, or project and multiplying the number of hours they are expected to work by their wage rates.
    - Sales budget: An estimate of the quantity of goods and services that will be sold during a specific period of time.
    - Production budget: A forecast that starts with the sales budget's estimates of the total number of units projected to be sold, then translates this information into estimates of the cost of labour, material, and other expenses required to produce them.
    - Expense budget: An estimate prepared for travel, utilities, office supplies, telephone, and many other common business expenses for a given period.
    - Capital budget: The total costs and maintenance fees planned for your company's fixed assets.

10. **ZERO BASED BUDGET (ZBB):** If the approach adopted in the formulation and preparation of budgets is based on current level of operations or activities, including current level of expenditure and revenue, such budgeting is known as traditional budgeting .This type of budgeting process generally assumes that the allocation of financial resources in the past were correct and will continue to hold good for

the future as well. In most cases, an addition is made to the current figures of cost to allow for expected (or even unexpected) in-creases. Consequently, the budget generally takes an upward direction year after year, in spite of generally declining efficiency. Such a system of budgeting cannot be expected to promote operational efficiency. It may, on the other hand, create several problems for top management. Some of these problems are:

Programmes and activities involving wasteful expenditure are not identified, resulting in avoidable financial and other costs.

- Inefficiencies of a prior year are carried forward in determining subsequent years' levels of performance.
- Managers are not encouraged to identify and evaluate alternative means of accomplishing the same objective.
- Decision-making is irrational in the absence of rigorous analysis of all proposed costs and benefits.
- Managers tend to inflate their budget requests resulting in more demand for funds than their availability. This results in recycling the entire budgeting process.

Thus, the traditional budgeting technique may be quite meaningless in the present context when management must review or re-evaluate every task with a view to utilize the scarce resources in a better manner or to improve performance. The technique of zero base budgeting provides a solution for overcoming the limitations of traditional budgeting by enabling top management to focus on priorities, key areas and alternatives of action throughout the organisation.

The technique of zero base budgeting suggests that an organisation should not only make decisions about the proposed new programmes, but should also review the appropriateness of the existing programmes from time to time. Such a review should particularly be done of such responsibility centres where there is relatively high proportion of discretionary costs. Costs of this type depend on the discretion or policies of the responsibility centre or top managers. These costs have no direct relation to volume of activity. Hence, management discretion typically determines the amount budgeted. Some examples are: expenditure on research and development, personnel administration, legal advisory services.

Zero base budgeting, as the term suggests, examines or reviews a programme or function or responsibility from 'scratch'. The reviewer proceeds on the assumption that nothing is to be allowed. The manager proposing the activity has, therefore, to justify that the activity is essential and the various amounts asked for are reasonable taking into account the outputs or results or volume of activity envisaged. No activity or expense is allowed simply because it was being allowed or done in the past. Thus according to this technique each programme, whether new or existing, must be justified in its entirety each time a new budget is formulated. It involves:

- dealing with particularly all elements of mangers' budget requests
- critical examination of on-going activities along with the newly proposed activities
- Providing each manger a range of choice in setting priorities in respect of different activities and in allocating resources.

ADVANTAGES OF ZERO BASE BUDGETING:

1. It provides the organisation with systematic way to evaluate different operations and programmes undertaken. It enables management to allocate resources according to priority of the programmes.

2. It ensures that each and every programme undertaken by managers is really essential for the organisation, and is being performed in the best possible way.
3. It enables the management to approve departmental budgets on the basis of cost-benefit analysis. No arbitrary cuts or increase in budget estimates are made.
4. It links budgets with the corporate objectives. Nothing will be allowed simply because it was being done in the past. An activity may be shelved if it does not help in achieving the goals of the enterprises.
5. It helps in identifying areas of wasteful expenditure and, if desired, it can also be used for suggesting alternative courses of action.
6. It facilitates the introduction and implementation of the system of `management by objectives'. Thus it can be used not only for fulfilment of the objectives of traditional budgeting, but also for a variety of other purposes.

It is contended that zero base budgeting is time consuming. Of course, it is true, but it happens only in the initial stages when decision units have to be identified and decision packages have to be developed or completed. Once this is done, and the methodology is clear, zero base budgeting is likely to take less time than the traditional budgeting. In any case, till such time the organisation is properly acclimatized to the technique of zero base budgeting, it may be done in a way that all responsibility centres are covered at least once in three or four years.

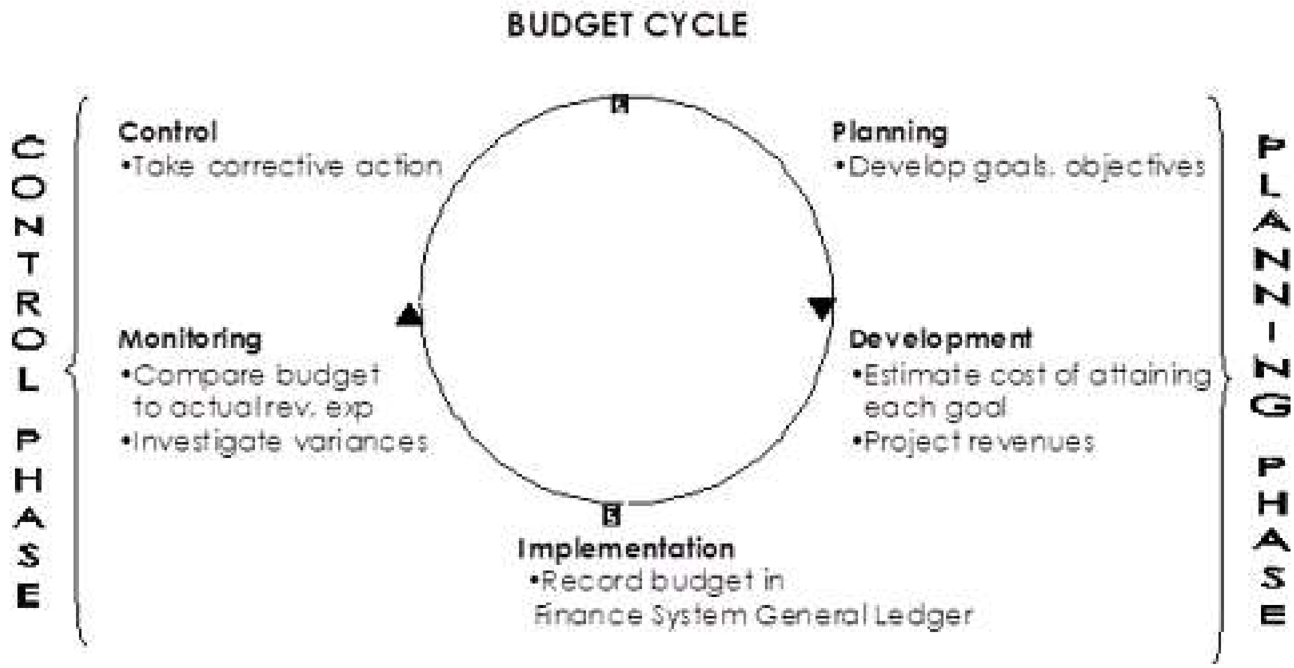
Zero base budgeting as a concept has become quite popular these days. The technique was first used by the U.S. Department of Agriculture in 1962. Texas Instruments, a multinational company, pioneered its use in the private sector. Today, a number of major companies such as Zerox, BASF, International Harvester and Easter Airlines in the United State are using the system.

THE BUDGET CYCLE

Budget Cycle describes a process of budget planning and control which includes the actions of developing a financial plan, comparing the financial plan to actual performance, and taking corrective action to bring substandard performance into line with the plan or adjusting the plan to reflect changing financial conditions.

The budgeting process is a cycle comprised of two main phases: the planning phase and the control phase. The planning phase identifies the goals to be attained during the fiscal year, and the financial plan (budget) necessary to achieve them. The control phase focuses on actual performance towards achieving the plan. It involves implementation, monitoring and control functions. The control phase emphasizes a comparison between the budget and the actual revenue and expense activity as recorded in the Finance System and displayed on the monthly statements. When actual revenue and expense varies from the plan articulated by the budget, the control phase will then include corrective action. Corrective action might involve adjusting the budget to reflect the actual financial activity, adjusting revenue projections and collections, or adjusting expenditures.

The following diagram illustrates cycle.



B. Working With the Budget throughout the Budget Cycle

In your departmental finance role, you are likely to be involved in each and every step of the budget cycle.

Planning and Development

The budget must be well conceived and based upon a combination of historical data and future financial projections. During this step of the budget cycle, employees who handle the day-to-day finances for a department are often asked to provide information to management about past and anticipated revenues, expenses and transfers.

Implementation

Verify that the budgets recorded in the Finance System at the beginning of each fiscal year are correct. Contact your area accountant if you find errors or if you have questions.

Monitoring

Revenue and Expense Statement Detail

Revenue and Expense Statement Summary

Balance Sheet Summary and Balance Sheet Detail

Control

Departmental management must be informed when the "budget to actual" comparison indicates a significant deviation, or when the balance sheet indicates an unfavorable balance, so that appropriate corrective actions can be initiated.

Although reports are made available to all who possess a fiscal role on a FOPPS, if you notice a problem or a potential problem developing in budget, it's best to err on the side of caution and inform management rather than assume they noticed it during their review. This makes for good interactive teamwork within the department.

ORGANISATION FOR BUDGETING

The setting up of a definite plan of organisation is the first step towards installing budgetary control system in an organisation.

- Budget Manual should be prepared giving details of the powers, duties, responsibilities and areas of operation of each executive in the organisation. This document:

- charts the organisation
- Details the budget procedures
- contains account codes for items of expenditure and revenue
- timetables the process
- Clearly defines the responsibility of persons involved in the budgeting system.
-

Budget Controller: Although the Chief Executive is finally responsible for the budget programme, it is better if a large part of the supervisory responsibility is delegated to an official designated as Budget Controller or Budget Director. Such a person should have knowledge of the technical details of the business and should report directly to the President of the Chief Executive of the organisation.

Budget Committee: The Budget Controller is assisted in his work by the Budget Committee. The Committee may consist of Heads of various departments, viz., Production, Sales Finance, Personnel, Purchase, etc. with the Budget Controller as its Chairman. It is generally the responsibility of the Budget Committee to submit, discuss and finally approve the budget figures. Each head of the department should have his own Sub-committee with executives working under him as its members.

Fixation of the Budget Period: Budget period' means the period for which a budget is prepared and employed. The budget period depends upon the nature of the business and the control techniques. For example, a seasonal industry will budget for each season, while an industry requiring long periods to complete work will budget for four, five or even larger number of years. However, it is necessary for control purposes to prepare budgets both for long as well as short periods.

Budget Procedures: Having established the budget organisation and fixed the budget period, the actual work or budgetary control can be taken upon the following pattern:

- Key Factor: It is also termed as limiting factor. The extent of influence of this factor must first be assessed in order to ensure that the budget targets are met. It would be desirable to prepare first the budget relating to this particular factor, and then prepare the other budgets.
- Making a Forecast: A forecast is an estimate of the future financial conditions or operating results.
    - Any estimation is based on consideration of probabilities. An estimate differs from a budget in that
    - the latter embodies an operating plan of an organisation.

A budget envisages a commitment to certain objectives or targets, which the management seeks to attain on the basis of the forecasts prepared. A forecast on the other hand is an estimate based on probabilities of an event. A forecast may be prepared in financial or physical terms for sales, production cost, or other resources required for business. Instead of just one forecast a number of alternative forecasts may be considered with a view to obtaining the most realistic, overall plan.

Preparing Budgets:

After the forecasts have been finalised the preparation of budgets follows. The budget activity starts with the preparation of the sales budget. Then production budget is prepared on the basis of sales budget and the production capacity avail-able. Financial budget (i.e. cash or working capital budget) will be prepared on the basis of sales forecast and production budget. All these budgets are combined and coordinated into a master budget. The budgets may be revised in the course of the financial period if it becomes necessary to do so, in view of the unexpected developments, which have already taken place or are likely to take place.

Choice between Fixed and Flexible Budgets:

A budget may be fixed or flexible. A fixed budget is based on a fixed volume of activity. It may lose its effectiveness in planning and controlling if the actual capacity utilisation is different from what was planned for any particular unit or time e.g. a month or a quarter, The flexible budget is more useful for changing levels of activity as it considers fixed and variable costs separately. Fixed costs, as you are aware, remain unchanged over a certain range of output. Such costs change when there is a change in capacity level. The variable costs change in direct pro-portion to output. If flexible budgeting approach is adopted, the budget controller can analyse the variance between actual costs and budgeted costs depending upon the actual level of activity attained during a period of time. This will be explained in detail a little later.

Placement and approval of budget: budget is forwarded by the management and final approval is given by the chief controller.

ADVANTAGES OF BUDGET:

1. Compels management to think about the future, which is probably the most important feature of a budgetary planning and control system. Forces management to look ahead, to set out detailed plans for achieving the targets for each department, operation and (ideally) each manager, to anticipate and give the organisation purpose and direction.
2. Promotes coordination and communication.
3. Clearly defines areas of responsibility. Requires managers of budget centres to be made responsible for the achievement of budget targets for the operations under their personal control.
4. Provides a basis for performance appraisal (variance analysis). A budget is basically a yardstick against which actual performance is measured and assessed. Control is provided by comparisons of

actual results against budget plan. Departures from budget can then be investigated and the reasons for the differences can be divided into controllable and non-controllable factors.

5. Enables remedial action to be taken as variances emerge.
6. Motivates employees by participating in the setting of budgets.
7. Improves the allocation of scarce resources.
8. Economises management time by using the management by exception principle.
9. It brings about efficiency and improvement in the working of the organisation.
10. It is a way of communicating the plans to various units of the organisation. By establishing the divisional, departmental, sectional budgets, exact responsibilities are assigned. It thus minimizes the possibilities of buck-passing if the budget figures are not met.
11. It is a way of motivating managers to achieve the goals set for the units.
12. It serves as a benchmark for controlling on-going operations.
13. It helps in developing a team spirit where participation in budgeting is encouraged.
14. It helps in reducing wastage's and losses by revealing them in time for corrective action.
15. It serves as a basis for evaluating the performance of managers.
16. It serves as a means of educating the managers.

17. Eliminates uncertainty.

18. Result of various brain so better planning.

19. Optimum use of capital resources.

20. Easy availability of working capital.

21. Effective coordination

22. Responsibility can be pin pointed 23. Co-ordination among various department

24. Used as a control tool by management.

LIMITATIONS OF BUDGET:

Budget are estimated and can never be hundred per cent accurate.
Budget cannot guide as to what action should be taken. The initiative and creativity in an employ may be hampered if the bosses stick to budget strictly.
It can be misused by bosses to find fault in the employees.
Useless for the firm where policies, processes, techniques are changing frequently. It is time consuming and involves expenses. Very costly for the small firms. It fails at times as there are so many factors which are not under management control.

Budgets can be seen as pressure devices imposed by management, thus resulting in:

- bad labour relations
- Inaccurate record-keeping.

Departmental conflict arises due to:

- Disputes over resource allocation
- Departments blaming each other if targets are not attained.

0. It is difficult to reconcile personal/individual and corporate goals.

1. Waste may arise as managers adopt the view, "we had better spend it or we will lose it". This is often coupled with "empire building" in order to enhance the prestige of a department.
2. Responsibility versus controlling, i.e. some costs are under the influence of more than one person, e.g. power costs.
3. Managers may overestimate costs so that they will not be blamed in the future should they overspend.

PREPARATION OF FRONT OFFICE BUDGET

The starting point in the process of budgeting is the preparation of the sales budget. The sales budget is the most critical budget because the volume of sales has an important bearing on all variable and semi-variable costs, as indeed on cash inflows and outflows of the business. It is clear, therefore, that there is no point in attempting to prepare any budget unless and until the sales budget has been prepared.

Before the preparation of the sales budget, it is essential to examine all the key factors (also known as limiting factors). These are factors, which operate to limit the volume of output/sales. It will be found, of course, that in market-oriented business the most important key factors operate on the revenue, rather than cost, side of the business. Thus, whilst in cost-oriented business, key factors such as shortages of materials, non-availability of skilled labor and general labor shortages are often are the most critical key factors, in market-oriented business such key factors are secondary Importance.

PRINCIPAL KEY FACTORS (ELEMENTS IN PREPARATION OF BUDGET)

Accommodation Available: This is one of the most critical key factors operating in hotels. When all the rooms are sold, it is impossible to increase the volume of room sales except through an increase in room rates. When the sales budget is being prepared it is essential to examine patterns of occupancy to establish what level of room sales may realistically be expected during the forthcoming budget year. Where there is a high degree of room sales instability, evidenced by pronounced swings in occupancy rates, it is desirable to examine the possibility of shifting demand from peak to off-peak periods.

Economic Forecast: This will illustrate the general business conditions both locally and nationally including the general economic climate, political/governmental climate, proposed/likely pending legislative changes or alterations to present laws which may together or in part have an effect on the hotel's business, either directly or indirectly via its guests.

Shortage of Labor: This particular key factor is potentially powerful, but there is no evidence that it exerts much influence on the volume of hotel sales. In some locations labor shortages may, in fact, be a severe limiting factor. It seems that such locations are rather exceptional.

Irregular Operational Changes: Although more significant items such as maintenance and repair will be incurred under a particular plan which may stretch for three, four or five years. The scheduling of such expenditure is still reviewed when budgeting to include unusual items; for example, complete change in linen, china, or other major capital items. Each department of the hotel is required to justify abnormal items, and management to access their effect on operations and to decide on which items to sanction and which to defer.
Major expenditure may necessitate the borrowing of funds.

Tariffs: Once the current year's operation has been reviewed together with the factors which may affect future business, management will examine the rate structure within the hotel – including rooms, food and beverage, and other services provided. The governing factors when such reviews take place is the determination of the right price in order to obtain a maximum return from its facility – that is the maximum rate available without a major reduction in volume. Each rate is examined individually to ensure that this maximum is possible.

Quality of Management: This is an important key factor. Its operation is not, however, evident over shorter periods. Over long periods, of course, the quality of management will have a direct and powerful influence on the volume of sales.

Consumer Demand: Consumer demand is often found to be a potent key factor. Its operation may be due to several reasons. The price level of the establishment may be too high, and this may result in a low ASP (Average Spending Power). Where the price level is thought to be the reason for insufficient consumer demand, it is essential to subject all the tariffs and menus to thorough scrutiny, and examine room sales, menu items offered to customers, as well as profit margins. Insufficient consumer demand may also be due to competition. In order to remedy this it is imperative to examine the external environment of the business. Where insufficient consumer demand obtains over long periods, it is essential to undertake a through re-appraisal of the whole marketing policy in relation to the existing location.

Other Key Factors: In addition to the key factors dealt above, several others may operate to restrict the volume of sales. Insufficient capital may make it impossible for a company to acquire further units and thus increase its turnover. For the same reason an establishment may find it difficult to maintain its facilities at an appropriate level of comfort, etc., through insufficient expenditure on repairs, replacements and other items which add to the décor and atmosphere of the establishment. Management may, as a result of its own policy, exclude certain types of customers. From what has been said it will be clear that there are a variety of key factors. It is for each establishment to identify the key factors limiting its sales and take steps to remove their negative effect on the volume of sales.

HOW A BUDGET IS PREPARED

Since, for the scope of this course, only a Rooms Division Department budget shall be prepared, the Rooms Division manager shall only estimate next period's room revenue, and direct expenses. Putting it in other words, the Rooms Division Manager shall not care about estimating capital expenses (i.e. Indirect Expenses) since in responsibility accounting; a manager is responsible and liable only for his department!

The Rooms Division Manager shall first forecast demand for rooms for the next period in question, and then might use historical averages, industry average… to estimate Room Revenue and Room Direct Expenses

ESTIMATING ROOM REVENUE:

By using an appropriate forecasting method, the Rooms Division Manager can forecast demand measured in room nights. Later, the Rooms Division Manager shall multiply the total room nights by the Average Room Rate (ARR), either using hotel historical or industry averages, to come up with the estimated Room Revenue.

estimate the room allowances figure and subtract it from the estimated total room revenue to come up with the net room revenue.

Financial information of previous years often serves as the foundation on which rooms' revenue is forecasted. One method of rooms revenue forecasting involves an analysis of rooms revenue from past studies. Rooms Revenue Summary for Hotel A Year Rooms Revenue Increase in Rooms Revenue % Increase

1999	Rs. 10,00,000	-----	
2000	Rs. 11,00,000	Rs. 1,00,000	10 %
2001	Rs. 12,10,000	Rs. 1,10,000	10 %
2002	Rs. 13,31,000	Rs. 1,21,000	10 %

The above data shows yearly increase in net rooms revenue for the hotel. From 1999 to 2002, the amount of rooms revenue increased from Rs. 10,00,000 to Rs. 13,31,000, reflecting a 10% yearly increase. In future, conditions appear to be similar to those of the past, the rooms revenue for 2003 would be budgeted at Rs. 14,64,000 – a 10% increase over 2002 amount.

Rooms Revenue Statistics for Hotel B

Year	Room sold	Occ %	Avg. daily rate	revenue
2008	30,660	Rs 1000	Rs 3,06,60,000	70%
2009	31,974	Rs 1040	Rs 3,32,52,960	73%
2010	32,412	Rs 1080	Rs 3,50,04,960	74%
2011	32,850	Rs 1140	Rs 3,74,49,000	75%
2012				

Another approach to forecasting rooms revenue based on the revenue projection on past rooms sales and average daily rooms sales. Above statistics is of Hotel B which has 120 rooms. The table shows the occupancy percentage increased by 3% in 2000. 1% in 2001, and 1% in 2002. Average daily room rates increased by Rs. 40, Rs. 40 and Rs. 60 respectively over same periods. Considering the future conditions to be similar, a rooms revenue forecast for 2003 may be based on a 1% increase in occupancy percentage (to76%) and Rs. 60 increase in the average daily room rate (to Rs. 1200). Given these projections, the following formula can be used to forecast rooms revenue for the following year

Forecasted Rooms Revenue

= Rooms Available X Occupancy % X Average Daily Rate

$$= (120 \times 365) \times \frac{76}{100} \times \text{Rs. } 1200$$

= 4380 X 0.76 X Rs. 1200

= Rs. 3,99,45,600

This simplified approach to forecasting rooms revenue is intended to illustrate the use of trend data in forecasting. A more detailed approach would consider the variety of different rates corresponding to room types, guest profiles, days of the week, and seasonality of business. These are just a few factors that may affect rooms revenue forecasting.

ESTIMATING DIRECT EXPENSES:

· Direct Expenses (i.e. Variable Costs) in the Rooms Division Department can be divided into 4 categories:

1. Wage Expenses (Hourly Wage * Estimated Total Labor Hours needed)
2. Frills (i.e. Free of Charge Replenished Room Items)
3. Material (i.e. Cleaning Supplies, Utensils…)
4. Laundry & Linen Expenses (Cost of pressing, cleaning, pressing, storing…)

· The Rooms Division Manager might consider country averages, and or historical averages, along with current hotel / labor union collective bargaining contracts for the coming period, suppliers' price increase intentions, the relative change of local currency against some major foreign currencies, to estimate department direct expenses.

Most of the expenses of Front office is Direct Expenses. They vary in proportion to rooms' revenue. Past statistics is used to calculate the percentage of rooms' revenue that each expense item may represent. These percentage figures are applied to the budgeted rooms' revenue to estimate expenses.

Expense Categories as Percentage of Rooms Revenue for Hotel B

Year	Salary & Wages	Laundry, Linen & Guest Supplies	Commission & Rsv. Expenses	Other Expenses
1999	16.5%	2.6%	2.3%	4.2%
2000	16.9%	2.8%	2.5%	4.5%
2001	17.2%	3.0%	2.6%	4.5%
2002	17.4%	3.1%	2.7%	4.6%

The above data shows the most common Front Office expenses. When these costs are summed up and divided by the number of occupied rooms (Room Count), the Cost Per Occupied Room is determined.

Based on these past data the percentage of rooms revenue for each expense category is projected for the budgeted year 2003:

Salary And Wages - 17.6 %

Laundry, Linen & Guest Supplies - 3.2 %

Commission and Reservation Expenses - 2.8 % Other Expenses - 4.7 %

Using these, expenses can be calculated as follows:

Salary And Wages

$$\text{Rs. } 3{,}99{,}45{,}600 \times \frac{17.6}{100} = \text{Rs. } 70{,}30{,}425.60$$

Laundry, Linen & Guest Supplies

$$\text{Rs. } 3{,}99{,}45{,}600 \times \frac{3.2}{100} = \text{Rs. } 12{,}78{,}259.20$$

Commission and Reservation Expenses

$$\text{Rs. } 3{,}99{,}45{,}600 \times \frac{2.8}{100} = \text{Rs. } 11{,}18{,}476.80$$

Other Expenses

$$\text{Rs. } 3{,}99{,}45{,}600 \times \frac{4.7}{100} = \text{Rs. } 18{,}77{,}443.20$$

From the above figures it is evident that there is a rise in coast which will reduce profitability. Therefore, one of the outcomes of the budget processes will be to identify where costs are rising and why are they rising. So, a plan can be developed to control them. Since most Front Office expenses vary proportionately with rooms revenue (and therefore occupancy), another method of estimating these expenses is to estimate variable costs per room sold and then multiply these costs by the number of rooms expected to be sold.

Rooms Division Department Item Budgeting (Illustration)

Expense Items	2002	%	2003	%	2004	%	2005	%
Wage / Benefits	$525,600	7.80%	$638,750	8.44%	$821,250	9.69%	$1,006,990	10.53%

Laundry/Linen	$257,975	3.83%	$264,044	3.49%	$277,594	3.27%	$284,979	2.98%
Materials	$44,224	0.66%	$45,265	0.60%	$46,599	0.55%	$46,859	0.49%
Frills	$773,924	11.48%	$784,410	10.36%	$791,980	9.34%	$788,952	8.25%
Total Expense	$1,601,723	23.76%	$1,732,469	22.89%	$1,937,423	22.85%	$2,127,781	22.25%
Room Revenue	$6,740,020	100.00%	$7,569,331	100.00%	$8,477,890	100.00%	$9,563,060	100.00%

In this example, first we have forecasted the revenue for the budget year (i.e. 2005), which is $ 9,563,060. In order to estimate the item expenses, we should first establish a standard (i.e. Percentage of Total Revenue). The average of the historical percentage item expense is the best standard that we can use. The average can be simple, moving average, or weighted average. The last column in the above table indicates these standards. Now, in order to budget the item expenses for year 2005, we multiply the last year expenses by the percentage standards that we established. Here, the percentage standards become the company expenditure objectives.

BUDGETARY CONTROL:

- A control technique whereby actual results are compared with budgets.
- Any differences (variances) are made the responsibility of key individuals who can either exercise control action or revise the original budgets.
-

BUDGETARY CONTROL AND RESPONSIBILITY CENTRES:

These enable managers to monitor organisational functions.

A responsibility centre can be defined as any functional unit headed by a manager who is responsible for the activities of that unit.

There are four types of responsibility centres:

1. Revenue centres : Organisational units in which outputs are measured in monetary terms but are not directly compared to input costs.
2. Expense centres :Units where inputs are measured in monetary terms but outputs are not.
3. Profit centres : Where performance is measured by the difference between revenues (outputs) and expenditure (inputs). Inter-departmental sales are often made using "transfer prices".
4. Investment centres : Where outputs are compared with the assets employed in producing them, i.e. ROI.

ADVANTAGES OF BUDGETING AND BUDGETARY CONTROL:

There are a number of advantages to budgeting and budgetary control:

- Compels management to think about the future, which is probably the most important feature of a budgetary planning and control system. Forces management to look ahead, to set out detailed plans for achieving the targets for each department, operation and (ideally) each manager, to anticipate and give the organisation purpose and direction.
- Promotes coordination and communication.

- Clearly defines areas of responsibility. Requires managers of budget centres to be made responsible for the achievement of budget targets for the operations under their personal control.
- Provides a basis for performance appraisal (variance analysis). A budget is basically a yardstick against
  - which actual performance is measured and assessed. Control is provided by comparisons of actual results against budget plan. Departures from budget can then be investigated and the reasons for the differences can be divided into controllable and non-controllable factors.
- Enables remedial action to be taken as variances emerge.
- Motivates employees by participating in the setting of budgets.
- Improves the allocation of scarce resources.
- Economises management time by using the management by exception principle.

REFINING BUDGET PLANS

Departmental budget plans are commonly supported by detailed information gathered in the budget preparation and recorded on worksheets and summary files. These documents should be saved to provide an explanation of the reasoning behind the decisions made while preparing departmental budget plans. Such records may help resolve issues that arise during the budget review. These support documents may also provide valuable assistance in the preparation of future budget plans.

If no historical data are available for budget planning, other sources of information can be used to develop a budget. For example, corporate headquarters can often supply comparable budget information to its chain affiliated properties. Also, nation accounting and consulting firms usually provide supplemental data for the budget development process. Many hotels refine expected results of operations and revise operational budgets as they progress through the budget year. Reforecast is done when there is a significant variance between the budgeted and actual figures. Such variance may indicate that conditions have changed and hence the budget should be brought into line.

BUDGET TRICKS OF THE TRADE

When your expenditures exceed your budget, you can do several things to get back on track:

- Review your budget. Before you do anything else, take a close look at your budget and make sure that the assumptions on which it is based are accurate and make sense in your changing market. If your market is growing quickly, you may need to adjust up your estimates. Sometimes, it's the budget — not the spending — that is out of line.
- Freeze spending. One of the quickest and most effective ways to bring spending back in line with a budget is to freeze expenses such as pay raises, new staff, and bonuses.
- Postpone new projects. New projects, including new product development, acquisition of new facilities, and research and development, can eat up a lot of money. However, if you are too zealous in curbing spending when you need to develop new products or services to compete, the result can be disastrous for the future growth and prosperity of the company.
- Lay off employees and close facilities. This is the last resort when you're trying to cut expenses. Although these actions will result in an immediate and lasting decrease in expenses, you also face an immediate and lasting decrease in the talent available to your organization. Productivity and morale of remaining employees may also suffer.