Any owners get into business because of a strong interest in the products or services they want to provide. A florist may get into business because of a love for flowers and art. A veterinarian may start a practice because of a love for animals. Once a business is underway, it must be and remain financially strong. If the income is insufficient to pay the bills, the business will not be in existence very long! Careful budgeting and accurate record keeping are essential for profitability.

**Objective:**

Explain the purposes of budgets and proper record-keeping principles.

**Key Terms:**

- budget
- fixed costs
- variable costs
- enterprise budget
- partial budget
- whole-business budget
- expenses
- revenue

**Show Me the Money!**

The purpose of a business is to make money for its owner. The owner relies on the profit from the business to provide for his or her family, grow the business, hire more employees, or purchase other businesses. For a business to be profitable, the business manager needs very accurate information about the money going out and the money coming in. This is achieved through budgeting and record keeping. Accurate record keeping shows exactly where the business is financially, while proper budgeting predicts where the business will be in the future. All this information is taken into account when making management decisions, such as whether to
purchase new equipment, try out a new product or service, or stop providing an existing product or service. Financial management depends on the availability of accurate information.

**BUDGETING: A BASIS FOR MANAGEMENT DECISIONS**

A *budget* is a financial plan. Whether for a household or a business, a budget helps in planning for all the income and expenses expected to be incurred over a certain period, such as a year.

Knowing that either the revenue or the expenses are fairly accurate is very helpful when creating a budget. For instance, a salaried employee knows how much income to expect for the following year and can develop a household budget of expenses to come in at or below the level of income. This assures that the worker will not run out of money. A business owner may have a very good idea of expenses, such as labor and input costs, and know what types of revenue must be generated to break even or make a profit.

A budget is created by subtracting the expenses from the income, or revenue. A proper budget should show a profit. If a profit cannot be predicted with a given budget, then it does not make sense for the business owner to operate under that plan. Decisions should be made that will increase revenue or decrease costs so that the business can be profitable. This may involve developing a budget that covers several years instead of just one. A budget assists a business manager in making decisions to assure that a business is profitable.

**Revenue and Expenses**

*Revenue* is income to a business from all sources. *Expenses* are all costs, both fixed and variable.

*Fixed costs* are those expenses that remain constant regardless of the number of units produced or their corresponding sales. Therefore, fixed costs per unit decrease as production or sales increase. Examples of fixed costs are machinery, equipment, full-time employee salaries, and business insurance. If you are in business, you have these expenses whether you produce or sell no products or lots of products. Let’s consider a crop input company, such as a fertilizer dealership. The company may have 4 sprayers, 8 supply trucks, 10 employees, and 4 buildings. These must be paid for even if they are not being used. A certain number of production or sales units is needed to break even with

*FIGURE 1. A fertilizer applicator would be part of a fertilizer dealership’s fixed costs.*
these costs. Additional production or sales after breaking even allow the costs to be spread over a larger number of units.

**Variable costs** are those expenses that are in proportion to increased production or sales. With no production or sales, a business has no variable costs, but as production or sales go up, so do the variable costs. Variable costs may include the cost of buying the products that are being sold, fuel costs, the cost of part-time employees or overtime, and sales bonuses. Using our fertilizer dealership as an example, variable costs would include the cost of buying the fertilizer from the wholesaler for retail sale to the producer, the cost of fuel for the trucks and sprayers, the cost of overtime or part-time employees needed as a result of more sales, and bonuses for the salespeople. As sales increase, all these costs go up.

**Types of Budgets**

All revenue and costs must be considered for the type of budget to be developed. Three common types of budgets are whole-business budgets, enterprise budgets, and partial budgets.

**Whole-Business Budget**

A **whole-business budget** considers all aspects of a business together to determine overall profit potential. A large business may have several enterprises, or divisions, that serve unique segments of the business. Our fertilizer dealership mentioned earlier may have a seed division, a fertilizer sales division, an application or service division, and a soil testing division. These may all complement each other, but each may also be responsible for generating sales to cover the costs of the individual enterprise. A whole-business budget would consider all divisions as a whole to determine overall business profitability. This type of budget allows the management to see the “big picture” of the overall business. One enterprise may not be particularly profitable by itself, but if it provides increased sales to other enterprises within the business, it may be a very positive aspect of the business.

**Enterprise Budget**

An **enterprise budget** takes each segment of a business by itself and identifies the revenue and expenses related to that enterprise. A business may want the enterprises within it to be self-sufficient, or a business may produce its own raw materials and want to develop a budget to show the cost of the inputs. For example, a pork producer may grow all the corn fed in the operation. The enterprises of corn and pork are separate, but they are also considered complementary. To analyze the profitability individually, an enterprise budget for each may be created. This will help identify the costs involved in the individual enterprises rather than in the business as a whole. The farmer may find through developing an enterprise budget that corn can be bought less expensively from someone else. The farmer may then decide that focusing only on the pork operation would be more profitable.

**Partial Budget**

A **partial budget** is used to calculate the expenses and revenue associated with making a change in a business. A partial budget can help determine the additional profit or loss that
would result if an enterprise were expanded, a new enterprise were added, a change in production practices were instituted, or new equipment were purchased. A partial budget should answer four questions:

- What additional returns are possible?
- What costs would be reduced?
- What additional costs would be incurred?
- What revenue would be lost?

A hay producer may consider going into the custom baling business. A partial budget could be developed that would show whether this would be a wise decision. The partial budget would include increased revenue from custom baling; additional costs of supplies, labor, and fuel; and potential lost revenue from doing baling instead of something that is currently being done.

**RECORD-KEEPING FUNCTIONS AND PROCEDURES**

The best way to have an accurate budget that can serve as a management tool is to use accurate information in preparing it. Record keeping is the process of maintaining accurate, detailed information about the financial and operational actions of a business. Accurately knowing where expenses occur and revenue is generated is valuable in making decisions that can lead to a more profitable business. Comparing the performance of the business with its performance in previous years or with that of similar businesses allows the manager to identify decisions that should have been made differently to generate a better profit.

Financial records are necessary to identify profit or loss, financial progress, or net worth; to assist with the planning of cash needs; to provide documentation for income-tax purposes; and to provide information needed to obtain a loan. Good record-keeping systems start with documentation. Every transaction that takes place between a customer and a business should have written documentation. This may consist of a receipt for the purchase of supplies; a scale ticket for a bulk product sold or bought, such as grain or fertilizer; an invoice that accompanies a request for payment; or even a canceled check, which can prove that a transaction occurred. Documentation serves as proof of purchase or delivery of a product that the selling company can use for billing purposes and that the buyer can use for business purposes or for making a return. Having written documentation prevents errors and makes both the buyer and the seller aware of what they have agreed to.

Advancements in technology allow much of this documentation to be handled by computers. Bar codes and scanners can be used by employees to identify prices, manage inventory, and track customers. Printed receipts are made available to customers while information about sales is stored in a computer. All the data can be summarized to give a manager an accurate picture of inventory, sales, and customer traffic. The documentation provided allows the business to verify tax responsibilities, such as sales tax or income tax. Computerized record keeping makes it possible for bookkeepers and accountants to generate reports for a business at the
click of a computer mouse! This instant access to financial information allows a business manager to react more quickly to changes in sales data or production information.

Record keeping is important not only for financial matters but for operational matters as well. Record keeping involves the accurate documentation of employee time cards, sick days, and pay raises. It also involves documentation required for the regulation of the particular type of business. For example, the fertilizer dealership mentioned earlier is required to keep accurate records of the application of herbicides and fertilizers. These records include the person doing the work, the time of day, the weather conditions, and the field conditions. A grain farmer may keep detailed records on tillage, fertilization, planting, herbicide use, and harvest for use in making future decisions.

Operational record keeping is helpful in the development of an operations budget. This type of budget helps make sure the company will have the necessary cash flow to operate effectively. Again, computerized record systems are very valuable and are becoming standard in many operations because of their efficient ability to instantly generate the information that a manager may need to know.

Summary:

Budgeting is one of the most important management tasks in any business. Budgeting allows a business to forecast its potential success or failure and to adjust management decisions for increased profitability. Whole-business, enterprise, and partial budgets are used to find different kinds of information, but each can identify the profit potential of the business as a whole or in response to a management decision.

Record keeping is an important management tool that is necessary in evaluating the performance of a business, verifying tax and sales records, and identifying areas of strength or weakness. Computerized record-keeping systems have made the task of bookkeeping and operations management more efficient.
Checking Your Knowledge:

1. Describe the differences between the three types of budgets discussed in this E-unit.
2. Explain the difference between fixed and variable costs. Identify three fixed costs and three variable costs for a business in your community.
3. Identify four reasons for having an accurate record-keeping system.
4. Describe the differences between financial and operational records. What purpose do the operational records serve?

Expanding Your Knowledge:

Interview a person who is responsible for bookkeeping or accounting at a business. What does the individual do? What types of information is he or she recording? What types of reports is the person required to generate regularly? Write a report on your findings.

Web Links:

Ec Ed Web—Controlling Costs
http://ecedweb.unomaha.edu/lessons/euse1.htm

Record Keeping and Cash Flow
http://www.gofso.com/Premium/BS/fg/fg-Records.html