



EFFICIENT NET INCOME PREDICTION USING BUDGETING

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Received: May 22 th 2021 Accepted: June, 26 th 2021 Published: July, 28 th 2021	Companies seek profitability by making efficient and cost-effective use of resources and labour. To do so, they need financial road maps that illustrate how they'll deploy resources to meet their goals. To put it another way, organisations must budget wisely in order to achieve their objectives. Companies use budgeting to find the most efficient and successful ways for producing money and increasing their assets. Budgeting is the estimation of likely expenditures and income for a given period. Budgeting enables businesses to keep track of their spending and manage resources to maximise earnings. A three-statement model requires that you become accustomed to forecasting income statement line items as you create it. Projection of the revenue statement's main line items should become second nature. The future value of each line item will be influenced by a variety of factors. There are times when it is possible to clone an existing financial model and merely replace the historical values.
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INTRODUCTION

A three-statement model requires that you become accustomed to forecasting income statement line items as you create it. Projection of the revenue statement's main line items should become second nature. The future value of each line item will be influenced by a variety of factors. There are times when it is possible to clone an existing financial model and merely replace the historical values. Companies seek for profitability by making efficient and cost-effective use of resources and labour. To do so, they need financial road maps that illustrate how they'll deploy resources to meet their goals. To put it another way, organisations must budget wisely in order to achieve their objectives. Companies use budgeting to find the most efficient and successful ways for producing money and increasing their assets. Budgeting is the estimation of likely expenditures and income for a given period. Budgeting enables businesses to keep track of their spending and manage resources to maximise earnings.

In the evaluation and analysis of prior trends and data relevant to the company enterprise, intelligent budgeting integrates strong business judgement. This data aids a company in identifying the type of corporate entity necessary, the amount of money to be invested, the type and quantity of people to be hired, and the marketing techniques to be used. Budgeting helps a corporation implement its strategy and undertake continuing performance evaluations by creating both long-term and short-term plans.

The planning cycle is a five-step process that businesses use to design and execute their budgeting

strategies each year. Companies first create a strategic plan that focuses on their long-term objectives and how to attain them. The strategic plan usually covers a five-year period and contains general financial estimates. Second, firms create an annual operating plan that lays out their plans for the coming year in detail. This plan comprises highly exact financial estimates and is frequently referred to as a "budget" by businesses. Third, because things change after the year begins, firms alter their plans, resulting in an adjusted plan. Unexpected and abrupt changes are factored into the revised strategy. Fourth, businesses frequently make forecasts or unofficial projections throughout the year. Businesses, for example, usually forecast their yearly sales around the middle of the year. Fifth, businesses create business plans, which they use to qualify for venture capital and other types of funding. Financial estimates are frequently included in business strategies.

The budgeting process involves a large number of management employees. "Submitters" and "reviewers" are two examples of these participants. "Submitters" and "reviewers" are two examples of these participants. The submitters are typically division managers who prepare and suggest possible expenditure plans to meet company objectives, whereas the reviewers are typically executives, controllers, or accountants who decide whether the proposed budgets and targets are affordable, feasible, and attainable. These jobs, however, are not mutually exclusive: budget proposal writers frequently analyse other proposals, and vice versa.



Income statement projections begin with the top line of the income statement, which makes sense. As you can see, it's a lot of money. Most of the time, the succeeding line items will be dependent on the sales revenue figure as well. Forecasting sales income can be done in a variety of ways. Sales revenue can be modelled as a simple percentage increase from previous years. As a result, any future year's sales revenue is equal to the previous year's sales revenue multiplied by one plus the growth rate. It's also possible to calculate sales revenue as a percentage of GDP or another macroeconomic measure. Accordingly, a regression formula based on historical sales revenue and the input of that year's GDP will be used to calculate revenue for each calendar year (or other metric). Finally, sales income can be modelled as a basic dollar value.

BUDGETING

A financial projection's objective is to assess existing and future fiscal conditions in order to affect policy and programming decisions. A financial forecast is a budgeting tool that displays anticipated data based on historical, current, and future financial circumstances. This will make it easier to recognise potential revenue and expenditure trends that could affect government policies, strategic goals, or community services in the short or long term. The annual budgeting process is incomplete without a forecast. A robust projection enables better financial decision-making and the provision of critical community services. A budget explains a company's plan for accomplishing its goals, whereas a forecast outlines the company's actual results expectations, usually in a much more concise form.

In reality, the prediction is the more essential of the two tools because it provides a snapshot of a company's current status over a short period of time. Prompt action can be done based on the information given in a forecast. Due to significant changes in market conditions, a budget may include targets that are either unattainable or foolish to pursue. If a budget is to be employed, it should be updated more than once a year to stay up with market conditions. Last but not least, in a fast-changing industry where budget assumptions might become obsolete in a matter of months, the last point is crucial.

GROSS PROFIT

A less dynamic and less accurate forecasting technique is this one. This tool is useful for quick and dirty sales revenue estimates. As a next step, anticipate the Cost of Goods Sold (COGS). As a result, we may calculate Gross Profit by subtracting COGS from revenue. Alternatively, Gross Profit can be projected, and then we can calculate Cost of Goods Sold numerically. How to forecast is the same no matter what

category you're looking at, so let's get started! It is most often sufficient to calculate your profit as a percentage of the sales revenue you generate. Cost of Goods Sold (or gross profit) is divided by sales revenue in the past, and this ratio is used to estimate future sales revenue. Another option is to model individual cost of goods items in a more rigorous model. Depending on business operations, these may be broken down into raw materials, work in progress, finished goods, labour costs, direct material costs, or some other line items. Alternatively, they can be forecasted as a % of sales revenue or as entire dollar amounts. SG&A is a single line item in a simple and tidy form.

Percentage-of-sales allows you to achieve this quickly and efficiently. For a more robust model, SG&A may need to be broken down into its component parts, which is a more difficult process. For this reason, there will be various motivations for each line item. So a fixed monetary amount will be more appropriate than a percentage of sales revenue if, for example, rent expense is fixed every month. Ad spending may, however, be associated with sales revenue, making the sales % more realistic in this situation. A "one-off" line expense may also emerge from time to time. More on this can be found in our post on normalising financial statements. It's also worth noting that there are two SG&A expenses that require specific forecasting. In this case, we're talking about depreciation expense and interest expense.

AMOUNT OF DEPRECIATION

As a result of depreciation, the gradual use of machinery and PP&E is tied to their ability to generate income. PP&E has a long-term economic advantage (income), hence the matching principal mandates that their expenses must likewise be accrued over a long period of time. With the use of a depreciation schedule, we can estimate the cost of depreciation. If any capital expenditures have been made, the opening and closing amounts of PP&E are shown. We can find historical depreciation costs by looking at historical balances and capital expenditures. Depreciation and capital expenditures can then be predicted using these values.

Foreseeing depreciation costs on a budget can be done using a percentage of the opening balance or any of the depreciation accounting techniques that are available. With an understanding of the company's policies, we can apply straight-line depreciation or accelerated depreciation immediately to arrive at the appropriate expense values.

The interest expense is calculated using the debt schedule. This calendar lays out each individual obligation on its own timetable, and it may also include a summary schedule that totals all amounts and interest payments. Interest expense is calculated by multiplying each period's opening balance by the interest rate. The



interest expenditure is then put back to the opening balance, and any principal repayments are subtracted to arrive at the closing balance.

EXPENSE FOR TAXES

Finally, we'll look at the last line item to see if there's any tax charge. Tax expense is calculated as a percentage of pre-tax earnings (EBT). The effective tax rate, often known as the cash tax rate, is a percentage. By deducting all previous expense line items from sales income, EBT can be calculated. We can anticipate future tax expense by multiplying EBT by the previous effective tax rate.

CONCLUSION

Companies seek for profitability by making efficient and cost-effective use of resources and labour. To do so, they need financial road maps that illustrate how they'll deploy resources to meet their goals. To put it another way, organisations must budget wisely in order to achieve their objectives. Companies use budgeting to find the most efficient and successful ways for producing money and increasing their assets. Budgeting is the estimation of likely expenditures and income for a given period. Budgeting enables businesses to keep track of their spending and manage resources to maximise earnings, demonstrating to banks, investors, and shareholders that they have a strategy for getting where they want to go. In reality, the prediction is the more essential of the two tools because it provides a snapshot of a company's current status over a short period of time. Prompt action can be done based on the information given in a forecast. Due to significant changes in market conditions, a budget may include targets that are either unattainable or foolish to pursue. If a budget is to be employed, it should be updated more than once a year to stay up with market conditions. Last but not least, in a fast-changing industry where budget assumptions might become obsolete in a matter of months, the last point is crucial.

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