

Skillbook

How to Manage a Budget

Career
Skills



Mindtools

How to Manage a Budget

Skillbook

This Skillbook is published by Mind Tools Ltd.
21 Young Street, Edinburgh, Scotland, EH2 4HU.

Copyright © Mind Tools Ltd, 2025.
All rights reserved.

Version 4.0.

This Skillbook is protected by international copyright law.
You may use it only if you are a Mindtools member or have
received it under corporate license.

If you have any queries, please contact us at
mtecustomerservices@mindtools.com.

Contents

1.	Introduction	1
2.	The Purpose of a Budget	2
3.	The Budgeting Cycle	4
4.	Preparation and Planning	6
5.	Negotiation and Approval	15
6.	Implementation	17
7.	Monitoring and Review	18
8.	Key Points	22

1. Introduction

Knowing how to manage and stick to a budget isn't just a career skill. It's a life skill, too!

But knowing how to set a budget accurately can be tricky. Get it right and you'll be able to achieve what you want and stay financially secure. But, get it wrong, and you could find yourself in deep water, particularly if it's company money that you're managing.

So what exactly is a budget and how does it help organizations?

Essentially, a budget is a financial plan that allows you to track and monitor the flow of money in and out of your team or organization. Budgets are critical for allowing organizations to monitor progress over time, by comparing actual financial performance against projected figures.

But budgets also have another critical function – they enable organizations to devolve power by giving managers the flexibility to run things their way (within reason).

In this Skillbook, we'll explore:

- The purpose of a budget.
- How to set an accurate budget, including some of the different methods you can use to do this.
- How to negotiate a budget.
- Effective methods for reviewing and monitoring your budget.

2. The Purpose of a Budget

Budgets can be used for a variety of things, from setting out team or project expenses to forecasting sales goals and analyzing a company's financial performance.

It's essential that your budget has a clear and direct purpose. So, the first thing you'll need to do before jotting down any facts and figures is to decide what the main aim of your budget is. For example, it may allow you to:

- **Plan ahead.** You can use past income and cost figures, along with knowledge of your products and market, to generate sensible projections and goals for the following month, quarter or year.
- **Monitor performance.** Budgets enable you to monitor your current performance and ensure that your spend and income are in line with your targets or projections. They also allow you to compare your current performance with past years', so that you can track and measure progress year-on-year.
- **Check assumptions.** Budgets give you an "at a glance" insight into your current and previous years' income and costs. This means it's much easier to identify trends that could affect your future performance. You can then adjust your projections to take these issues into account. This also ensures that goals and objectives remain workable.
- **Spot opportunities for savings.** Comparing performance year-on-year also makes it easier to identify opportunities for cutting or spreading costs. For example, if one team underspent on their budget, this money could be diverted to another area of the business where it can be better spent.
- **Allocate resources.** Setting budgets also enables you to think about the different projects and team activities that are being planned over the next year. And how money should be spent across these to enable your organization to meet its key goals.



Action:

Think about why you want to set a budget and how it will help your organization or team to meet its key goals and objectives. Write down the main purpose of your budget. Then, jot down a sentence or two about how your budget will help the organization to meet its wider goals and objectives, in the spaces provided below.

The main purpose of this budget is...

Blank space for writing the main purpose of the budget.

This budget will enable the organization to meet its goals and objectives by...

Blank space for writing how the budget will enable the organization to meet its goals and objectives.

3. The Budgeting Cycle

Setting a budget accurately can be tricky! Overspend, and your bottom line may be severely impacted. But, underspend, and you could be unwittingly diverting money away from other areas of your business that need it.

Budget management is a valuable skill that can improve not only the operational efficiency of your organization and team, but also your career prospects.

Remember that the budgets you set will likely be reviewed by senior leaders. Proving that you can stick to a budget **and** run your team efficiently demonstrates a number of great skills, including strategic thinking, forward planning and project management.

In fact, in many organizations, your ability to stick to a budget is often linked to your personal performance and goals. And even if your role doesn't involve budget setting, knowing how the budget process works can help you to better understand how financial decisions impact your organization's strategy.

In this chapter, we'll look at a four-step process you can use to set up and manage business and organizational budgets, which is known as "The Budgeting Cycle."

The Budgeting Cycle

The Budgeting Cycle (see figure 1, below) demonstrates the four key stages that you'll likely go through when setting a budget. These are:

1. Preparation and Planning.
2. Negotiation and Approval.
3. Implementation.
4. Monitoring and Review.

You can apply the Budgeting Cycle to the day-to-day work your team does, or to specific projects.

In the next four chapters, we'll look at each stage of the Budgeting Cycle in more detail, and explain how you can use it to draw up an accurate budget.

Figure 1. The Budgeting Cycle



4. Preparation and Planning

In this first stage of the Budgeting Cycle, you'll need to do some research and decide on the process you'll use to create your budget.

You may be the one responsible for creating the budget, but that doesn't mean that you have all of the answers. So, you'll need to spend some time gathering information from key stakeholders across your organization. These may include:

- **The Finance Team.** Even if you're only making small changes to your budget, a great place to start is with your finance team. They can provide valuable expertise on things like recruitment costs, VAT or capital expenditure, as well as on limiting factors, such as market trends or economic fluctuations. They will also have a broad view of how your budget fits in with other team or organizational budgets, and how these in turn support the mission of your company. Finance teams often allocate business partners to specific departments, so it's worthwhile reaching out for input and support early in your budget-setting process.
- **Your Team.** Your team members will likely be a great source of information, particularly if you're drawing up a departmental budget. They may well have a better idea than you of what activities, projects and expenses will need to be covered. But be sure to consider the accuracy and motivations of their suggestions. People can sometimes be over- or under-optimistic about what is achievable within a set budget.
- **Other Teams.** Your budget will likely impact other teams' budgets, and vice versa. For example, there's no point budgeting for a high volume of sales if these sales can't be met because you don't yet have the manufacturing capability in place. In contrast, there's no point producing a high volume of products, if you simply have no hope of selling them. Don't be afraid to ask around for advice from other heads of department or colleagues in different teams. This will ensure that your budget is realistic and practical. And it demonstrates that you can take a broad strategical view of the organization and its overall mission.

Incremental Budgeting Vs. Zero-Based Budgeting

You'll also need to decide on the budget approach that you'll use.

If you have access to the previous budget, you may want to make incremental adjustments to it. This is known as Incremental (or Traditional) Budgeting.

Alternatively, you may need to "start from scratch." In this case, Zero-Based Budgeting (ZBB) may be most suitable.

It's worth checking with your finance department about which approach your company prefers to use before you start drawing up your budget.

Now, let's take a look at the two different types of budgets in more detail, and the pros and cons of each.

Incremental (or Traditional) Budgeting

With this type of budget, you start by looking at last year's budget. Then, you adjust each cost or item based on the changes that you expect to see in the coming year.

One of the main reasons businesses opt for traditional budgets is that they're relatively quick and easy to prepare. They tend to suit established businesses that are relatively stable and, in particular, small businesses, as they require little or no expertise to produce.

A full list of the pros and cons involved in incremental budgeting can be seen below.

Incremental (or Traditional) Budgeting	
Pros	Cons
Easy to draw up with minimal financial expertise.	Traditional budgets are generally carried out only once before the start of the fiscal period. This means that they often don't get revisited, forcing managers to follow the same budget, even when things change.
Promotes decentralization by allowing managers to prepare budgets for their respective departments.	Because they're decentralized, they can be open to manipulation. Managers may inflate expenses to get favorable results, or create "budget slack" that they don't need and which could have been diverted elsewhere.
Provides a good reference point for the activities of the business. This can help managers of different departments to understand their roles better – and what the organization expects of them and their teams.	They can make it harder for innovation and creativity to flourish. The bulk of the budget tends to be allocated along the same lines year after year, even if there's a strong business case for innovation.
Figures are based on proven, existing knowledge, enabling people to generate sensible projections of income and costs.	They may perpetuate poor decisions made in the past, as they're based on the previous year's budget and performance. This means it's possible that mistakes and unwise spending allocation can be carried over into the new period.

Although incremental budgeting is easier than zero-based budgeting, it's not as simple as copying and pasting last year's figures. You'll also need to include figures for new initiatives that you've planned, such as new equipment, recruitment costs, or project fees.

To help get you thinking about what factors you'll need to consider when drawing up your new budget, complete the activity in the Action box.



Action:

If you've decided to prepare an incremental budget, you'll still need to check that your new projections are accurate. Start by answering the questions below. Jot down any notes and figures that may help. You can refer back to these when you come to prepare your final budget.

Budget Questions	Information and Figures
What do you anticipate your organization's revenue to be this year?	
Do you need to spend more on marketing or commissions to achieve these revenue figures?	
Are you expanding into a new territory? What are the expenses involved in this?	
Do you need to provide cost-of-living wage adjustments, or factor in bonus payments to staff salaries?	
Are utility or raw material costs increasing or reducing?	
Are there any other factors you expect to vary that could impact your budget, e.g. the economy or the market?	

Zero-Based Budgeting

With zero-based budgeting (ZBB) you review every dollar you want to include in your budget from the bottom up. Essentially, this means that your budget process starts from zero every year, and you must consider and justify each expense individually.

Although zero-based budgeting takes a lot more upfront effort than incremental budgeting, it can help to create a workplace culture of cost efficiency, because every penny has to be accounted for.

A full list of pros and cons of zero-based budgeting can be found below.

Zero-Based Budgeting	
Pros	Cons
ZBB involves a deep analysis of your spending habits. This forces you to look at your department's activities and seek out more cost-effective ways of achieving them, e.g. outsourcing or using freelancers.	ZBB takes a lot of energy and attention, as every expense needs to be evaluated and reviewed. This can be time consuming, so some managers may be reluctant to do it.
Makes it difficult for managers to inflate budgets artificially, because every cost must be justified.	Increases competition between departments. Managers may feel driven to skew their budgets to ensure that their department receives a "fair share" of the organization's resources.
Eliminates waste and duplication across the organization.	Justifying expenses can be difficult, particularly if there are areas of the business that don't produce immediately tangible results, such as research and development.
Encourages you to determine your departmental or organizational goals and prioritize spending according to these. This can also help you to allocate funds to the areas of the business that need it the most.	Organizations need to train managers in the ZBB process, which can take additional effort and time.

In zero-based budgeting you'll also need to create a "Decision Package" for every essential activity you want to include in your budget.

This will help you to explore different ways of performing tasks or activities, and to find cost-effective alternatives.

You can discover more about how to create a Decision Package on the following page.

Once you've decided on the essential activities that you want to include in your budget, you'll need to create a Decision Package. This helps you to analyze whether it's more cost effective to include this activity on your budget, move it to a different departmental budget, or outsource it.

A Decision Package should include the following information:

- The activity's cost.
- Its purpose.
- Alternative ways to achieve this purpose.
- Performance measurements.
- The consequence of not performing the activity or performing it differently.



Action:

Create a Decision Package for one or more of the essential activities that you want to include in your zero-based budget. Write down the budget activity that you want to analyze, then pull together the information you'll need for your Decision Package in the spaces provided below.

Budget Item/Activity:	
Cost:	
Purpose:	
Alternative ways of achieving this purpose:	
Performance measurements:	
Consequences of not performing activity/ performing it differently:	

Once you've created your Decision Packages, you'll need to pass them to your finance director or head of department who will then rank all the packages from each department in order of their benefit to the company and their alignment to corporate objectives. This allows the company to decide how much to spend and where to spend it. Resources are then allocated based on priority order.

Although this process requires a lot of upfront effort and time, it does allow organizations to gain full cost-control over their activities and ensure money is spent efficiently.

Identify Timescales, Income and Costs

Once you've got all of the information you need, and decided on the approach that best suits you, it's time to start drawing up your budget. This means estimating your timescales, income and costs.

Timescales

Every company will have different timescales that they work to when setting budgets. For example, one organization may like to set out all budgets for the whole year at the start of its fiscal period, while another may prefer to reforecast and adjust budgets every quarter.

Check with your finance team about the correct timescales you need to follow, so that you know the deadline for budget submissions and approval before you start planning. Otherwise you may miss the budget window.

Income

Look at the range of income sources that you have available:

- Are you generating income or are you allocated a set amount of money at the start of each year?
- Are you likely to get all of the money promised, or will some of it fail to materialize?
- Are there any financing options available? Would the finance team be able to offer you advice on these options?

Costs

Now think about the costs that your budget will need to cover. These generally fall into two main categories:

- **Fixed costs** – these include regular costs that your organization needs to pay, no matter what. For example, permanent staff costs, insurance, or rental and lease payments.
- **Variable costs** – these costs are dependent on your organization's level of work and can vary as a result. For example, special project costs, capital investments, or commissions.

When drawing up your final budget, it's often useful to group your costs under key headings. For example, for fixed costs, key headings tend to include:

- Staffing (e.g. wages, pensions, training).
- Expenses (e.g. company car, travel).
- Buildings (e.g. rent, repairs, insurance).
- Utilities (e.g. phones, heating).
- Legal costs.
- Materials (e.g. stationery, telephone, raw materials).
- Other business costs (e.g. insurance, subscriptions etc.).



Action:

Start putting your budget together by listing sources of income, as well as fixed and variable costs, in the table on the following page.

Remember to add in the date period that these budget items cover (usually this is a year, but budgets can also be monthly or quarterly).

It may also be helpful to add in the income and costs that were recorded from the previous year. You can add these figures into the column labelled "Previous Year."

Finally, calculate percentage variance between your previous year and current year. This will help you to identify areas where you may have been over- or under-optimistic.

Budget Statement: Income and Estimated Costs

Income	Previous Year _____	Current Year (Estimated) _____	% Change
Sales			
Capital Investment			
Total Income			
Costs			
Fixed Costs			
Staffing			
Expenses			
Buildings costs			
Utilities			
Legal			
Materials			
Other			
Total Fixed Costs			
Variable Costs			
Project costs			
Capital expenditure			
Total Variable Costs			
Total Costs			

Record Your Assumptions

You'll likely make a number of assumptions when you come to draw up your budget. For example, if you're drawing up a sales budget, figures might depend on current manufacturing output or a healthy economy.

It's a good idea to record the assumptions you make along with your budget statement. This will make it easier to explain if any variances occur later.



Action:

Write down a list of assumptions that underpin the income and costs that you estimated in your budget statement on page 10 in the spaces provided, below.

Assumptions

1.

2.

3.

4.

5.

5. Negotiation and Approval

Most organizations have a limited amount of funds, so if you need a bigger budget than the one on offer, you'll need to put your negotiation skills to good use!

Gaining buy-in from the board is perhaps the most critical stage of the Budget Cycle. Much of the art of managing a budget is using negotiation skills to get what you need.

There are five key things you can do to negotiate a budget effectively:

1. Back up your decisions.
2. Perform a Cost-Benefit Analysis.
3. Build trust.
4. Be accurate
5. Prepare to compromise.

1. Back Up Your Decisions

You need to be able to justify each item in your budget and how you'll use the funds that you want to deliver on your team and business objectives. Your budget will likely be better received if you can clearly show how your expenditure is in line with the organization's strategic goals. A good way to approach this is to demonstrate what will happen if you **reduce** your budget.

2. Use a Cost-Benefit Analysis

If you haven't chosen the cheapest options available for certain budget items, it's more important than ever that you can explain why this is.

A cost-benefit analysis lets you compare the benefits of a certain course of action with the costs associated with it. This technique is particularly helpful if you need additional funds for research and development or for additional project work.

3. Build Trust

A bit of “wiggle room” or slack is fine, but if you overestimate too much, you may find that your budget gets cut significantly in the future. Excessively padding expenses to make up for shortfalls in other areas may also be seen as underhand, and will only end up eroding trust between you and senior financial decision makers in the long term.

4. Be Accurate

Check, check and triple check all of the figures that you’ve included in your budget before submitting them for final approval. If there are any errors or inaccuracies, it could raise doubts about the validity of your budget proposal.

5. Be Prepared to Compromise

It’s unlikely that all your requests will be met in full. So it’s a good idea to work out, beforehand, which aspects of your budget are most important to you, and which you’re willing to compromise on. That way, when you enter into the negotiation, you’ll be more prepared for setbacks and more confident when discussing areas that may need to be cut or reduced.

Tip:



If you want to brush up on your negotiation skills before submitting your budget for approval, read our articles [Negotiation Skills](#) and [Win-Win Negotiation](#).

6. Implementation

Now it's time to implement your budget. During this stage, you'll need to think carefully about how you'll track expenditure and ensure that you stay on-budget.

The implementation (or execution) of your budget will usually start at the beginning of your organization's fiscal accounting period.

In most cases, business operations are performed following the budget approval. This means that you'll need to carefully and regularly track the expenditures you log against your budget. Doing this can provide a number of benefits:

- You'll quickly be able to identify areas where you're overspending or underspending, which will help you to manage your remaining funds more effectively.
- It will ensure financial accountability.
- The data you record can be helpful when you come to plan future budgets.

Your organization may already have a system in place for tracking budgets. If not, be sure to keep your own records and spreadsheets updated regularly (at least once a month), and set up a file where you can save relevant files, such as receipts and invoices.

There are also a number of handy budget tracker apps that organizations can use to keep tabs on their expenses. For example, Concur, Quickbooks or Freshbooks.

7. Monitoring and Review

Your budget is a plan. But, as with every plan, things don't always go the way you expected. That's why it's vital to regularly monitor and review your budget.

Budget monitoring needs to be one of your top priorities, so be sure to ring-fence some time every week or month to log new expenses and review your progress. Sometimes it can be useful to hold a regular budget meeting with your team or with individual team members, particularly if an unexpected expense has arisen.

The main benefit of regularly reviewing your budget is that it will allow you to detect any early warning signs that things are not going to plan. And, if you do detect a budget variance, it's vital that you look into it and take remedial action immediately!

A Variance Analysis can help here. It enables you to calculate and investigate budget variances, so that you can fix any issues as soon as they crop up.

A Variance Analysis can be undertaken for any item in your budget and allows you to compare actual figures against budgeted figures for a specific time period. You can also use it to determine the size of the variance and the reason for it.

An example of a Variance Analysis for a team's travel expenses can be found on the following page.

Example: Variance Analysis for Team Travel Expenses

Month	Budgeted Figure	Actual Figure	Absolute Variation	% Variation	Reason/Actions Taken
January	\$1,000	\$900	(\$100)	(10%)	<i>Unexpected discount received on hotel booking due to seasonal promotion.</i>
February	\$1,000	\$1,010	\$10	1%	<i>Unbudgeted increase in hotel fee.</i>
March	\$1,200	\$1,425	\$225	19%	<i>Hotel price increase and additional hire car charges due to company car breakdown.</i>
Subtotal	\$3,200	\$3,335	\$135	4%	<i>Negotiating with company car lease hire company to establish if a substitute car should be provided for free in case of breakdown. Variance for hotel price increase deemed too small to merit budget adjustment.</i>



Action:

Complete your own Variance Analysis for an item on your budget using the template provided on the following page.

The example above provides a monthly Variance Analysis, but you can choose any time period you wish, e.g. weekly, monthly, quarterly, or annually.

Time Period	Budgeted Figure	Actual Figure	Absolute Variation	% Variation	Reason/Actions Taken
Subtotal					

There are many reasons why a budget variance can occur. For example:

- **Your assumptions are incorrect.** Things may have changed since you first created your budget. If they've changed dramatically, you may need to consider revising it to account for their impact.
- **Data has been corrupted.** It may seem obvious, but it's always worthwhile checking that your spreadsheets and documents are intact and correct. It could be that the variance is down to a technical error, rather than an over- or underspend.
- **You aren't getting "value for money."** Often variances can occur because your suppliers have put up their prices. This may mean that you're no longer getting the best value for money, so it's always worthwhile checking whether another supplier could offer you a more competitive deal.

- **Existing commitments aren't being taken into account.** Do you have a way of checking what has already been purchased so that further entries can't be added once you've reached the full budget allocation? If not, it might be worth setting up a system that notifies you and your team when you're getting close to your budget limit. If not, it's easy for spending to get out of hand.
- **Timings aren't right.** Revenues and expenditures happen at different times of the year. For example, you may pay for a one-off annual subscription during one month. If this is the case, you should divide the total amount by the number of periods within your budget (e.g. 12 to get a monthly budget amount). Otherwise it can end up skewing figures.
- **Invoices aren't being logged correctly.** It may be that mistakes have been made or expenses have got through without the correct authorization, resulting in an overspend. Alternatively, team members may have forgotten to claim for overtime or expenses. Emphasize the importance of logging things correctly and promptly. Sometimes it can be useful to put in place deadlines for expenses to be claimed (e.g. three months) to encourage people to log things on time.
- **Purchase orders don't match invoices.** If invoices aren't checked thoroughly it can lead to expenditures being authorized that aren't correct, which can cause a variance.
- **Authorization procedures are lax.** Generally, purchasing authority should be delegated to selected individuals in your team or organization to ensure that a robust and consistent authorization process is in place.
- **Your team has taken on new work.** You may have had to spend additional funds on new and unexpected activities during the budget period. If this happens, you have two options – either you cut back on these new activities, or you request that your budget be increased to account for the unexpected influx in work.

If you're concerned that you'll go over budget, it's best to talk to your finance team or senior management right away.

You may be able to negotiate for more money, or even move money between budgets, to account for the variance. And always be sure to take forward your learnings from the current budget period into the next one. Doing this will improve the accuracy of future budgets and enable you to manage your finances more effectively going forward.

7. Key Points

Managing a budget can feel like a lot of responsibility. But when you do it successfully, you can create value for your team and your organization.

For an organization to make the profit that it wants, it's vital that all departments stick to the budgets they've drawn up – after all, budget overruns come straight out of profit. So, when you come to set a budget, it's important to be as accurate as possible in order to prevent this.

First and foremost, it's essential that your budget has a clear focus – how will it help your team to perform its duties and reach its objectives? And how does this fit in with your organization's wider corporate strategy?

A great way to set and manage your budget is by using the Budget Cycle, which has four key steps:

1. Planning and Preparation. During this stage you need to gather all of the relevant information, choose an approach that works best for you (incremental budgeting or zero-based budgeting), and estimate your timescales, income and expenditures.

2. Negotiation and Approval. You'll need to gain final approval for your budget from the finance department or senior leaders before it can be implemented. This may require some back and forth, so be clear on the areas that you can and cannot be flexible with.

3. Implementation. You'll also need to set up a process that allows you to effectively and accurately track and monitor expenditures and progress.

4. Monitoring and Review. Regular monitoring of your budget will be required to help identify, understand and prevent variances. You may need to adjust your budget if significant variances are identified – which may require further negotiation.