

Budget Forecasting: Definition, Best Practices & Tools



KEY TAKEAWAYS

- Budget forecasting blends budgeting and financial forecasting to project future revenue and expenses using historical data, economic conditions, and market trends.
- Budgeting is short-term, structured, and expectation-driven, while forecasting is long-term, dynamic, and continuously updated.
- Four quantitative forecasting methods—straight-line, moving average, simple linear regression, and multiple linear regression—help predict performance depending on the available data and complexity of factors.
- Effective financial planning relies on accurate forecasting to set goals, manage cash flow, guide decision-making.
- Budget forecasting uses both quantitative and qualitative methods, supported by budgeting approaches like top-down, bottom-up, zero-based, rolling forecasts, and what-if scenarios.
- Automation and AI tools enhance forecasting through real-time data, predictive analytics, automated cost optimization, scenario planning, delivering faster insights and greater financial accuracy.

Setting both short and long-term goals is an essential part of running your business. To track their progress in meeting those goals, companies typically use various budgeting and forecasting methods.

But budgeting and that, when combined, become budget forecasting.

So, what is budget forecasting? In this article, we'll explain the difference between budgeting and forecasting, what steps are involved in the budget forecasting process, and how to use the latest tools, including AI, to make the process easier.

What is a Budget Forecast?

A budget forecast, commonly known as a financial forecast, evaluates financial performance and economic conditions to better project future revenue and expenses.

A combination of a forecast and a budget, the budget forecast uses historical data, current economic conditions, and market trends for strategic planning and enhanced decision-making.

When used together, the budget forecast helps project more accurate revenue and expenses, better manage cash flow, and help companies reach their short-term and long-term goals.

What Are the Key Differences Between Budget Planning and Forecasting?

Though related, budget planning and forecasting are two different financial tools.

Budgeting is more rigid, concentrating on the near future, while forecasting looks at the big picture, studying trends, current economic issues, and making long-term predictions based on those estimates.

> Budget vs Forecast

Budget	Forecast
Fixed financial plan	Updated projection
Set before the period	Revised during the period
Defines targets	Predicts outcomes
Used for control	Used for planning
Can be static or dynamic	Dynamic and constantly updated

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Budgeting	Forecasting
Provides an outline of expectations for a specific period of time - usually a single fiscal year	Is used to provide a big-picture view of the company's financial health
Quantifies revenues and expenses expected for that particular timeframe	Uses historical data and outside economic factors to determine revenue and expenses
Creates a baseline to compare actual revenue and expenses to	Looks at trends and overall outcomes
Can be static or dynamic	Is always dynamic and constantly updated as historical and outside factors change
Is used in conjunction with a financial plan, including setting goals	Is used to adjust financial expectations

When you create an annual budget, revenue and expenses are estimated for the

upcoming year based on historical data, along with the impact from changing circumstances.

For instance, if you're adding additional product lines, it makes sense to base your budget revenue for the upcoming year on historical data, with an increase in revenue to reflect the additional product line.

With forecasting, you're predicting future trends and using that information to create a long-term forecast for your business.

For example, when you create a five-year strategic plan, you're using historical data from your business as well as information derived from economic drivers and trends to forecast future financial performance.

Unlike a budget, a forecast can change as conditions change.

What are the Four Common Types of Forecasting?

The four most common types of forecasting are all quantitative, meaning that they rely on data that can be measured and analyzed, such as historical data from previous periods.

> Four types of Forecasting



Straight-Line Forecasting
Projects future growth at a constant rate



Simple Linear Regression
Predicts outcomes using one variable



Moving Average Forecasting
Uses recent data to smooth fluctuations



Multiple Linear Regression
Predicts outcomes using several variables

1. Straight-Line Forecasting Method

The straight-line forecasting method is the least complicated approach, using prior performance to estimate future results.

This method is typically used by established businesses with years of data to reference.

To use this method, start with current performance, such as revenue or cost of goods sold (COGS) totals, and forecast future performance using your company's current growth trends.

For instance, if your company has regularly grown at 3% annually, and your current annual revenue is \$5 million, you would use the following calculation to forecast revenue for the next five years.

$$\text{Year 1: } \$5,000,000 \times (1 + 0.03) = \$5,150,000$$

$$\text{Year 2: } \$5,000,000 \times (1 + 0.03) = \$5,304,500$$

$$\text{Year 3: } \$5,304,500 \times (1 + 0.03) = \$5,463,635$$

$$\text{Year 4: } \$5,463,635 \times (1 + 0.03) = \$5,637,544$$

$$\text{Year 5: } \$5,637,544 \times (1 + 0.03) = \$5,806,670$$

Straight-line forecasting's biggest advantage is its simplicity.

Unfortunately, if your company has not seen consistent growth or has not been in business for a significant amount of time, using this method may not prove useful.

2. Moving Average Forecasting Method

Instead of using average performance over a year, the moving average forecasting method uses average performance over a much shorter period of time, such as days, weeks, or months.

This lets you identify short-term patterns, such as revenue for a single month or sales growth over three months.

For this example, a retailer has sold 512 units in January and 725 units in

February, and can calculate the moving average by adding the two months' totals and then dividing them by 2 to project what sales will be in March.

$$(515 + 725) / 2 = 620$$

While the moving average forecasting method is helpful if product sales vary widely, it may not be the most accurate projection for companies whose product sales follow an established pattern, such as increased seasonal sales.

It's also not a useful method for long-term projections, but it can work well for short-term operational forecasting.

3. Simple Linear Regression Forecasting Method

The simple linear regression method looks at how one variable, such as product sales, directly impacts another variable, like profit. Because product sales volume has a direct impact on profit, using this method can help identify pricing or valuation issues.

Using a simple model, you can see how much profit is created by increased sales. If the model shows that for every \$10,000 increase in sales, you're earning a \$3,300 increase in profit, you can project that for every sales dollar received, you'll earn \$0.33 in profit.

This makes it easy to predict profit after each sale. For instance, if you have a \$20,000 sale, you can calculate how much profit you'll earn.

$$(\$20,000 \times (\$ / \$3,300 / \$10,000)) = \$6,600.$$

The simple linear regression method does a good job of quantifying the relationship between two related variables, such as product sales and profit, but it doesn't take any other factors into consideration.

4. Multiple Linear Regression Forecasting Method

The multiple linear regression method is the most complex of all of the forecasting methods, using more than two independent variables when making projections.

For instance, a farmer may want to better understand how rainfall, temperature, and fertilizer affect crop growth.

Multiple linear regression uses a complicated formula that requires statistical knowledge and the use of built-in forecasting capability in your accounting or financial software.

How Can Accurate Forecasting Help with Financial Planning?

Accurate forecasting allows businesses to track their spending habits, manage revenue, and project financial challenges. It also provides new business owners with the information necessary to complete a business plan.

➤ How Budget Forecasting Helps Financial Planning



Set & Track Financial Goals



Strengthens Decision-Making



Supports Cash Flow Management



Aligns Budgets With Future Needs

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Below are four distinct advantages of effective forecasting:

Allows You To Set and Track Financial Goals

A budget allows you to account for increasing (or decreasing) revenues, planned and unplanned expenses, and profit goals.

Helps Manage Cash Flow

Creating a budget helps you manage cash flow through challenging times, such as slow months or after a large expenditure, or when a large influx of cash is

received, ensuring there is enough cash available for both scenarios.

More Informed Decision-Making

An accurate budget allows management to make better decisions. For instance, knowing when sales are slower can allow management to cut costs in anticipation of lower revenue.

Assists With Future Forecasting

An accurate budget created today helps facilitate better forecasting in the future, since accurate financial data is key to better forecasting.

What Are the Methods of Budget Forecasting?

Budget forecasting uses one of two methods: quantitative and qualitative. Quantitative methods rely on measurable data that can be statistically analyzed. Qualitative methods, such as external business conditions, opinions, and market conditions, are often subjective and cannot be quantified.

> Quantitative vs Qualitative Forecasting

Quantitative Forecasting	Qualitative Forecasting
Uses historical data	Uses expert judgment
Data-driven approach	Experience-driven approach
Best for stable patterns	Best for new or uncertain conditions

Quantitative Methods

Including:

- Historical data analysis
- Moving averages
- Regression analysis
- Financial modeling

Qualitative Methods

Including:

- Top-down
- Bottom-up
- Qualitative forecasting

Other budgeting methods can be used as well, including incremental budgeting, zero-based budgeting, and activity-based budgeting.

Businesses may also opt for a working budget, which, like a forecast, is updated regularly instead of remaining as a static document.

What Are the Steps of the Budgeting Process?

To start preparing a budget, you'll need access to your financial statements, such as your balance sheet and income statement.

If this is the first budget you've prepared, you'll need to rely on estimates, but those who have already prepared a budget in the past can use those numbers as a baseline and adjust them up and down as needed.

Assess last year's budget for accuracy and make any needed adjustments. You'll also want to adjust for changes made during the year such as moving to a less expensive building or adding staff members.

> Budgeting Process Steps



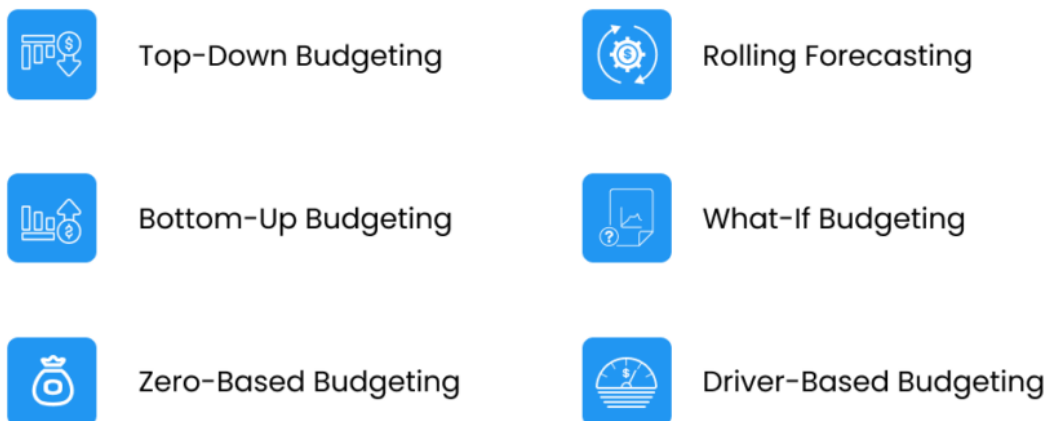
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When you're ready to get started, you can follow this roadmap:

1. Determine Which Budget Approach To Use

Before starting your budget, determine the type of budget approach you wish to use.

> Types of Budgeting Approaches



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Common budget approaches include:

- Top-down budgeting
- Bottom-up budgeting

- Zero-based budgeting
- Rolling forecast
- What-if scenario
- Driver-based budget

Once you determine the approach you wish to use, you can get started on your budget.

2. Set Goals and Objectives

Next, you'll need to establish your company's goals and objectives using SMART goals. This means goals which are specific, measurable, achievable, relevant, and time-bound.

By setting SMART goals, you're able to set the timeframe that the budget will cover, along with establishing the specific metrics you wish to achieve.

3. Draft the Budget

To start drafting your new budget, you'll need to:

- Calculate all revenue streams from product and/or service sales, investment income, and any other income that is expected.
- Identify both fixed costs, such as rent and salaries, along with variable costs like commissions and raw materials.
- Identify and include a safety net for any unexpected expenses that may crop up throughout the year.
- Obtain departmental input if creating a bottom-up budget or project revenue and expenses to coincide with stated goals.

4. Review the Completed Draft

Depending on the type of budget you're creating, the revision process may be quick, or it may be the longest part of the creation process, with the CFO and other interested stakeholders approving the budget.

5. Monitor and Adjust the Budget Regularly

Regularly monitor your budget and make adjustments as needed. Variance

analysis is an important part of the budget management process, allowing you to view budgeted amounts versus actual results to see where your projections are most accurate, while identifying areas that need adjusting.

What Tools are Available for Effective Budget Forecasting?

Automation is the best tool you can use for effective budget forecasting, starting with PLANERGY, a comprehensive spend management software that provides the tools you need to create accurate budget forecasts and financial statements.

> Tools for Budget Forecasting



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Spreadsheets



Accounting software



FP&A Software

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like PLANERGY provide real-time expenditure versus budget data, while giving visibility and standardizing data exchange. This offers the transparency a business needs to generate accurate reports and forecasts.

Integrated accounting software applications like QuickBooks, Xero, and Sage also offer solid budgeting and forecasting capabilities. to keep data aligned.

Spreadsheet software like Microsoft Excel can also be used when creating budgets, but doing so increases the risk of manual data entry errors.

Finally, there are specialized financial planning and analysis (FP&A) platforms available that offer advanced capabilities such as financial modeling.

Extremely powerful, this type of forecasting software is better suited to larger

organizations with more complex needs.

How to Use AI in Budget Forecasting

The introduction of automation and machine learning in cloud-based applications has helped reduce the burden of time-consuming, repetitive tasks.

› How AI Supports Budget Forecasting



Predictive Analysis



Scenario Planning



Automated Cost Optimization



Expense Tracking



Real-Time Adjustments

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But AI can also be used to streamline budget planning processes using the following:

Predictive Analysis

AI can quickly identify patterns, seasonal shifts, and external circumstances, and make budget adjustments accordingly.

Automated Cost Optimization

Who doesn't need an easier way to manage costs? AI can easily identify red flags such as inflated pricing or increased labor costs.

Real-time Budget Adjustments

Instead of making manual budget adjustments periodically, AI can update budgets

automatically based on live data.

Scenario Planning

An economy in flux or market saturation can quickly impact a business. AI allows you to easily incorporate multiple scenarios into your planning, so you'll be prepared for all possibilities.

Improved Expense Tracking

The best way to manage expenses is in real time. AI allows you to quickly flag inappropriate expenses to ensure compliance with spending rules, while simplifying the receipt management and reporting.

Budget Forecasting is a Must for All Businesses

Business owners understand that budget forecasting is essential for keeping company finances on track. Regardless of the type of budget you're creating, using the proper tools streamlines the entire budget creation process, improves financial outcomes, and provides the most accurate, up-to-date view of your company's financial health.

What's your goal today?

1. Use PLANERGY to manage purchasing and accounts payable

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- Read our case studies, client success stories, and testimonials.
- Visit our "Solutions" page to see the areas of your business we can help improve to see if we're a good fit for each other.
- Learn about us, and our long history of helping companies just like yours.

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