

Budget

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Budget Framework

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Budget Framework

The ultimate objectives of any enterprise in business are to make consistent profits and remain in operations in the long run. However, this cannot be achieved without a sound and realistic plan for every physical year. A budget is an estimate of the revenues and expenditure in a business over a set period, with the difference between the two components being profit or loss.

Even with no past records regarding a firm's financial performances and statements, there are basics to accounting and planning that can be vital in the drafting of a budget plan. Being able to define the presumed expenses and the expected returns goes along to drafting the budget plan. There is the profit and loss statement, which has one category for revenue and five categories to record the various expenses.

Profit & Loss Statement

Revenues	Expenses
Y	Direct expenses X
	Direct labor XX
	Indirect expenses XXX
	Indirect labor XXXX
	Miscellaneous expenses XXXXX
Revenue total – Expenses total = operating profit / loss	

The difference of the totals from the two sides of the statement is what gives either the operating profit or loss i.e. before tax and bonuses to employees. In the event where a new manager in a facility does not have past facility records necessary for budgeting, historical benchmarks for budgeting will be very significant. Most facilities operate at an average profit rate of +10% with an operating expense rate of +90%. Salaries and statutory deductions

account for the largest portion of the total expenditure accounting for 60% of the expenses.

These expenses need to be paid month after month and thus should be the basic component in the budget plan.

Certain key performance indicators will be crucial in predicting expenses in this case where there are no financial records for the facility to refer to. These include utilization rate, net multiplier, payroll multiplier, and overhead rates. These rates happen to be the same for most organizations so they will guide in the budget estimations.

Utilization rate is calculated as $\text{direct labor} / \text{total labor}$. It answers the question on how much dollar works for the actual clients' projects. A general benchmark range for this metric is 60-65% of the total dollar labor. Net multiplier is calculated as $\text{net revenue} / \text{direct labor}$. It measures the return on direct labor dollar and it has been 3.0 for decades. Payroll multiplier is calculated as $\text{utilization rate} \times \text{net multiplier}$ with the historical benchmark being 1.8-1.95. Overhead rate displays the expenses outside the clients' projects and is calculated as $\text{total indirect expenses} / \text{total labor}$. These metrics are the fundamentals in expenses determination and revenues speculation thus very important in budget formulation.

Reference

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