

Operational Cost Budgeting

November 2022



What is an Operating Budget?

A budget which consists of all revenues and expenses over a period of time (typically a quarter or a year) which an organization uses to plan its operations.

It is prepared in advance of a reporting period as a goal or plan that the business expects to achieve.



Components of an Operating Budget

1. Revenue

- Revenue is usually broken down into its drivers and components. It's possible to forecast revenue on a year-over-year basis, but usually, more detail is required by breaking revenue down into its underlying components.
- Revenue drivers typically include:
 - Volume (units, contracts, customers, products, etc.)
 - Price (average price, per unit price, segment price, etc.)



Components of an Operating Budget

2. Variable costs

After revenue, variable costs are determined. These costs are called “variable” because they depend on revenue, and are often calculated as a percentage of sales.

Variable costs often include:

- Cost of goods sold
- Sales commissions
- Freight
- Direct labor
- Direct selling costs
- Payment processing fees
- Certain aspects of marketing



Components of an Operating Budget

3. Fixed costs

After variable costs are deducted, fixed costs are usually next. These expenses typically do not vary with changes in revenue and are mostly constant, at least within the time frame of the operating budget.

Examples of fixed costs include:

- Rent
- Insurance
- Management salaries and benefits
- Head office
- Telecommunication
- Utilities



Components of an Operating Budget

4. Non-cash expenses

- An operating budget often includes non-cash expenses, such as depreciation and amortization.
- Even though these expenses don't impact cash flow (other than taxes), they will impact financial reporting performance (i.e. the figures a company reports at the end of the year on their income statement).



Components of an Operating Budget

5. Non-operating expenses

Non-operating expenses are those that fall below Earnings Before Interest and Taxes (EBIT) or Operating Income.

Examples of expenses that may be included in a budget are:

- Interest
- Gains or Losses
- Taxes

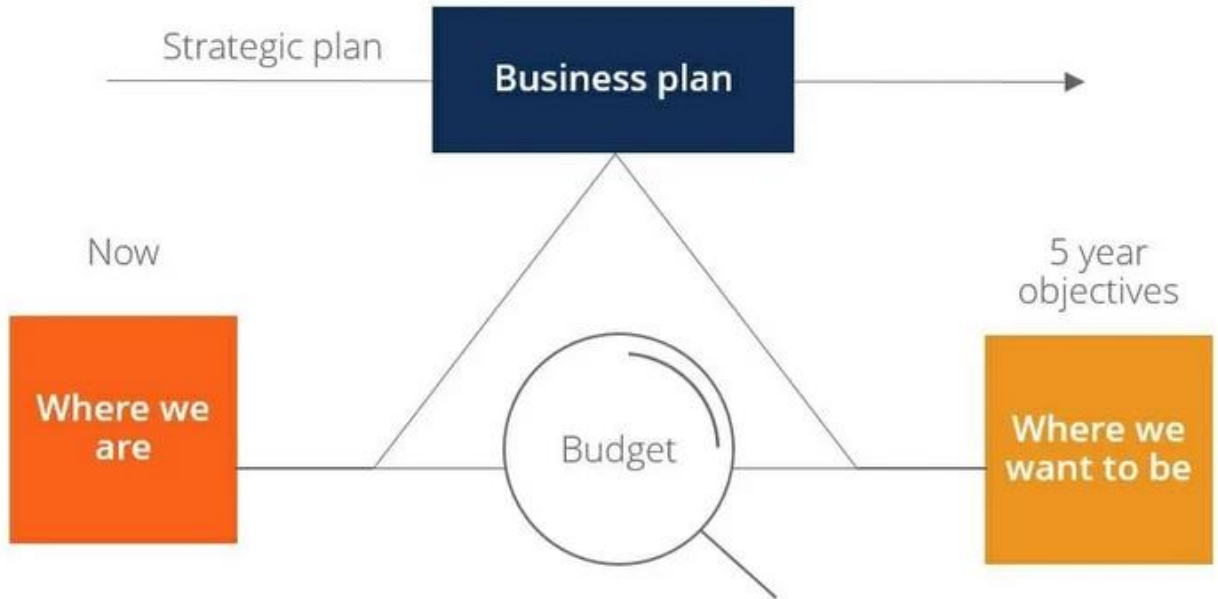


Components of an Operating Budget

6. Capital costs in an operating budget

- Capital costs are usually excluded from an operating budget.
- The term *operating* refers to a statement of operations (income statement) which does not include capital expenditures.
- Most companies prepare a separate budget for capital investments.

Importance of Budgets





Thanks!
Any questions?