

## Operating Budget Template

An operating budget in any size business is more than just an estimate of total company revenue and expenses for the year, it is a tool for setting sales targets and for adjusting as market conditions change. An operating budget is also essential for decisions about hiring additional employees, determining pay raises and bonuses, and for planning benefits packages. Before a company's fiscal year starts, an operating budget determines what they need to do to earn the expected profit.

Each next year's budget should build on what happened the year before, however market volatility in recent years has many business owners reworking their yearly budgets from scratch. If you have just started a small business and are building your first budget, this type of "zero-based" budgeting is a good place to begin.

Once you have found a template that works for you: it's time to get to work!

### Top Down vs. Bottom Up Budget Building

You can build a budget from the top down, starting with estimated revenue and calculating how much in expenses you can afford, or from the bottom up, beginning with expenses and determining how much revenue you will need to meet them. Both approaches require a lot of guesses or estimates at yearly expenses and a hopeful approach to daily/monthly/yearly revenue and gross profit targets. An annual budget is better than no budget, but a quarterly or monthly budget is more efficient and helps you to make live changes.

Remember: Breakeven is the minimum revenue needed to meet your budget. What you earn needs to be enough to cover all COGS and overhead, then you will bank a net profit, too.

If you can estimate overhead and profit for the coming year, and you know your historical gross margin, use this formula to calculate breakeven:  $(\text{overhead} + \text{profit}) \div \text{gross margin} = \text{breakeven}$

If you don't know your historical gross margin, estimate breakeven using the industry standard 30% gross margin.

Example:  $\$175,000 \div 0.30 = \$583,333.00$

### SAMPLE BUDGET

This sample budget meets the needs of a craftsman or a small, two to three-person company with basic overhead expenses. As a company grows, a more detailed budget becomes essential and it is always recommended that you consult with an accountant or bookkeeper who can give you guidance on your budget.

### Budget Line Items

**Owner or Operator's Salary:** Start with a realistic number — an amount that meets your personal needs but also reflects your responsibilities as a business owner. If you're working both in the field and in the office, separate those figures, even if you must guess. Your pay for working in the office should show up in Variable Costs, and your pay for working in the field should go into Cost of Goods Sold.

Paying yourself as an owner helps you calculate the true cost of running the business and helps an owner plan to replace him or herself. Allow for the difference between gross pay and what you take home after taxes.

**Variable Costs:** A corporate expense that changes in proportion to production output. Variable costs increase or decrease depending on a company's production volume; they rise as production increases and fall as production decreases. Examples of variable costs include the costs of raw materials and packaging.

**Cost of Goods Sold:** Everything that is consumed by a project — material, subcontractors, labor goes in this line item. Use “invoice” costs, before your markup is applied.

**Note:** Keep as much labor and supervision expense “above the line” in COGS. Keep total COGS at or under 70% of revenue.

**Labor:** All labor costs for employees must include “labor burden”, which is everything you pay over and above employee wages. It includes payroll taxes, workers’ compensation, cell phone, computer and vehicle allowances, training, holiday vacation and sick pay. Labor cost could even include company events or parties.

**Fixed Costs:** Part of “overhead,” these are the costs to keep your doors open, even if you haven’t got any work or customers. Fixed costs don’t vary much year to year, regardless of revenue, but there may be monthly differences and fluctuations. It’s important to keep office or administrative labor in overhead; field labor belongs in COGS.

**Variable Costs:** These costs change depending on revenue. For example, more work means more labor hours paid, which means higher liability insurance and workers’ comp payments. Budget for marketing and include owner labor (plus burden) for hours worked networking, selling, estimating and communicating with vendors by phone or email.

**Gross & Net:** Now it’s time to see if your budget actually works and leave any profit. To find out, subtract COGS from revenue. The amount left over must at least cover overhead and should also leave something extra: this is your net profit. If it doesn’t work out this way, you must first cut expenses and increase revenue immediately. This is essential for keeping your business going.

The Gross to Net formula is used to calculate the net (pre-tax) amount if the user enters a gross amount (total expense amount, including taxes) for an expense. A Gross to Net formula should be defined for each expense code to which taxes apply.

**Design & Supervision:** In addition to direct field labor, this budget itemizes design and supervision labor that can be billed to specific jobs, as well as all associated labor burdens.

**Overhead Labor:** Time spent working with tools is always a direct cost, but design project development, and supervisory labor can be a direct cost or overhead. All employees should use a timecard to track actual hours; otherwise, apply a percentage of total salary to account for how time is spent.

There are many other factors that make an operating budget functional and relative to your business. While every budget is different, it’s important to keep it up to date so that all of your reporting is accurate, and you can plan for the immediate future. Once your business grows, consider investing in software that has budgeting, payroll and accounting features that will keep your business in line and set you up for success.