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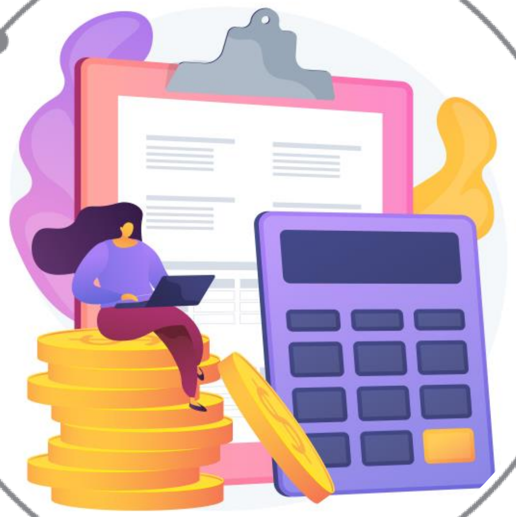
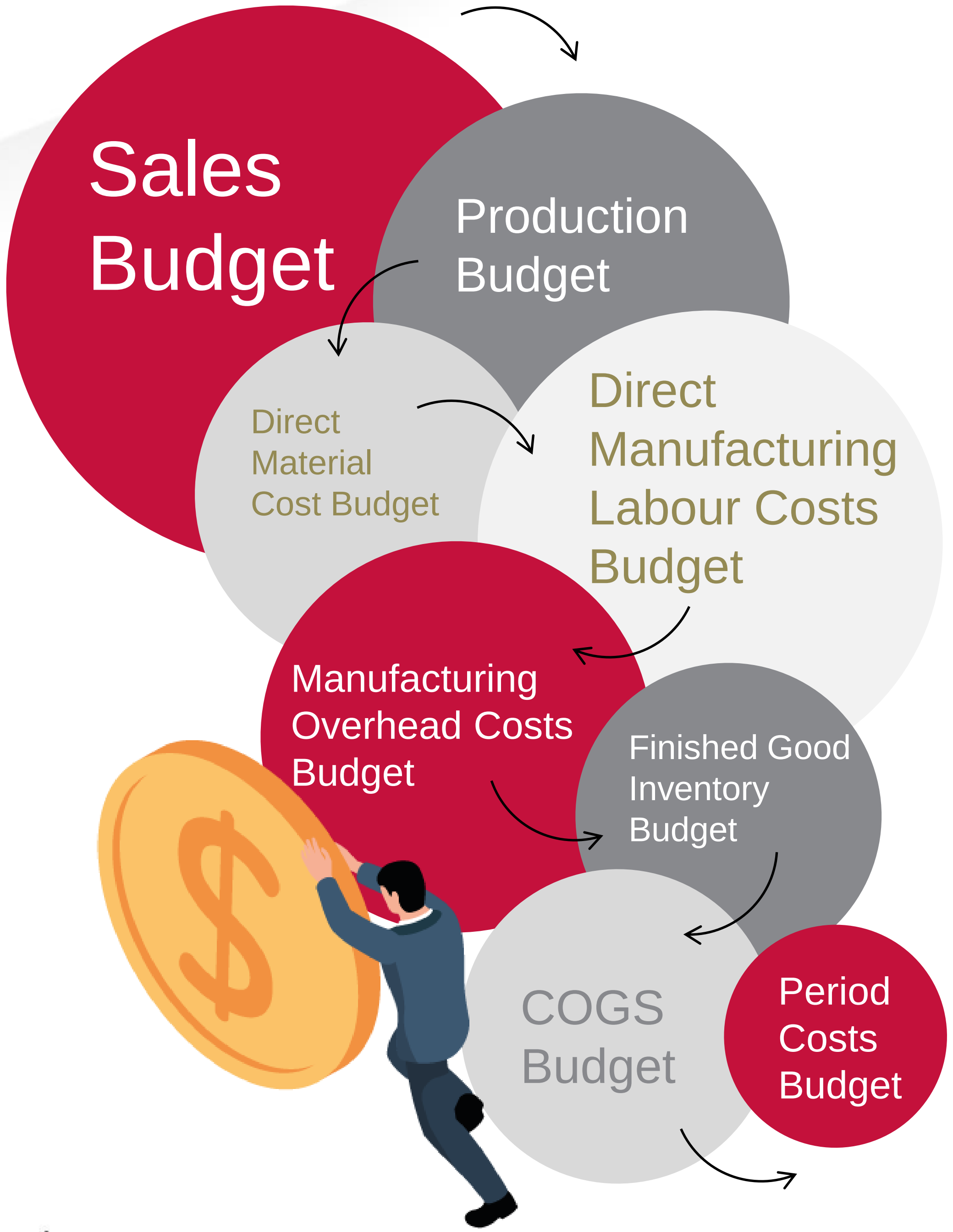
Operational Budgets in Manufacturing Company





Preparing Operational Budgets in a Manufacturing Company

- Prepared in a **specific order**, because some figures in budgets are based on figures calculated in previous budgets.
- Starting point for the operating budget is the **sales budget**, because **production levels depend on the level of units sold**.
- **Cost of production** such as direct material, direct labour and manufacturing over head costs, depend on production levels.
- The forecast level of sales units generally drives the operating budget.
- Steps in this process are summarized on the left:

Steps in preparing operational budgets

Step 1: Sales Budget

- Gather information about the market, competitors and customers through a customer relationship management (CRM) or sales management system.
- Use statistical methods, such as regression and trend analysis, and probability distributions, to forecast future sales.
- Engage market research firms to forecast sales levels.

Step 2: Production Budget

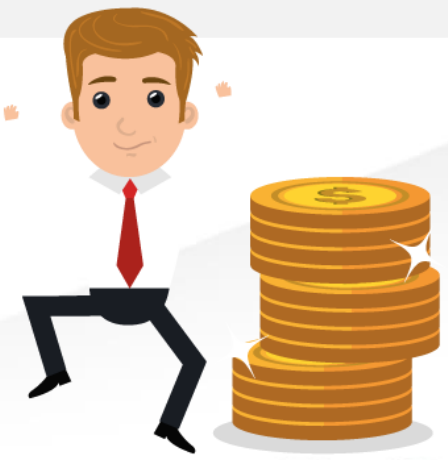
- The number of finished good units that need to be manufactured is determined.
- This number is driven by the level of forecast sales unit and the company policy regarding finished goods inventory.
- Number of units to produce will be the estimated sales (+) ending finished goods inventory, (-) opening finished goods inventory.

Step 3: Direct Materials Costs Budget

- Two sets of quantities and costs of raw materials used; (1) For units used; (2) For units purchased.
- Different components of raw material to manufacture the finished product, separate budgets are prepared for each component for both cost of materials used and materials purchased.
- Quantity of direct material that will be used is linked to the number of finished goods need to be purchased, forecast for each period in the production budget.

Step 4: Direct Manufacturing Labour Costs Budget

- Total direct labour hours for all stages of production phase and the direct labour costs are calculated.
- Direct labour budget also linked to the production budget.
- Cost of labour to produce finished goods is directly related to the number of units produced.



Steps in preparing operational budgets

Step 5: Manufacturing Overhead Costs Budget

- Manufacturing overhead costs are separated based on their behaviour; variable or fixed.
- Separating these costs is important in analyzing and explaining any differences between actual and budgeted costs.
- To calculate the budgeted variable costs, predetermined departmental overhead rates are used.

Step 6: Finished Goods Inventory Budget

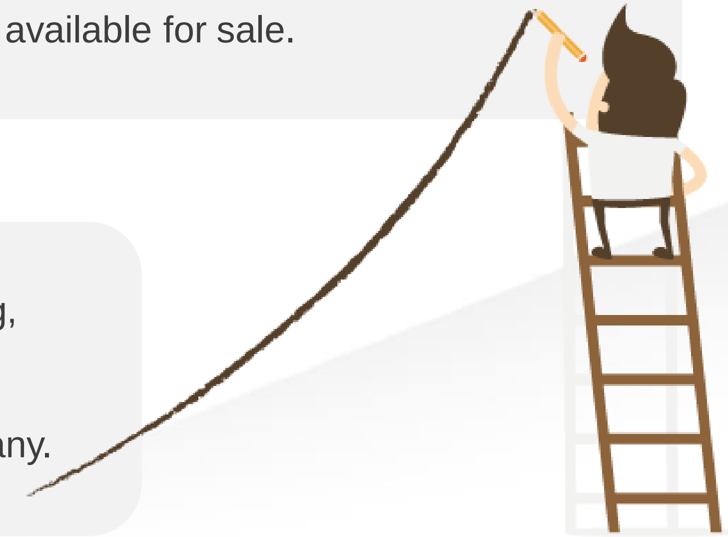
- To calculate the cost of finished goods, the number of units in inventory at the end of a period is multiplied by the costs of goods manufactured.
- This budget first link to the production budget, where quantities of finished goods inventory figures are shown.
- Secondly, cost of goods manufactured per unit are obtained from the following three budgets: direct materials, direct labour and manufacturing overhead costs.

Step 7: Costs of Goods Sold Budget

- To calculate the budgeted cost of goods sold (COGS), the budgeted costs of manufacturing need to be determined.
- The sum of the total cost of direct materials used, (+) the direct labour costs plus the total manufacturing overhead costs.
- The budgeted opening finished goods inventory is (+) to the budgeted cost of manufacturing to get the cost of goods available for sale.
- The ending finished goods inventory is (-) to determine the budgeted COGS.

Step 8: Period Costs Budget

- Can either be prepared as separate budgets for each cost component such as research and development, marketing,
- distribution, and administration costs.
- Can be combined into one budget.
- Costs and expenses included in this budget are all the cost of non-manufacturing overhead or activities of the company.
- Similar to Step 5, cost in this budget can be separated between fixed and variable components.



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