Annual profit budget

Financial budgeting is simply the expression of business plans in financial terms.

The Profit Budget shows the expected income, expenditure and profit over the budget period. It tells you how much profit is likely from your expected level of trading.

Budgeting lets you diagnose problems in advance. For instance, your budget may not provide you with adequate profit. You can then decide on an appropriate course of action. One of the great benefits of budgets is that they enable comparison to be made between actual results and plans, in terms of dollars and cents.

However, it is crucial to the success of your budgeting program to have accurate and timely financial information, and to understand what it means. Without these factors you won’t be able to detect major changes promptly, take early action to correct unfavourable situations, or capitalise on favourable ones.

You don’t have to be an accountant to prepare financial budgets or an expert in financial analysis to interpret them. The actual preparation and use of the budgets in a small business is not a complex technical task and is well within your grasp. It is preferable to budget each month for 12 months to take into account monthly and seasonal trends in sales and expenditure.

The profit budget does not reflect your cash position. It contains non-cash items such as depreciation, creditors which you have not paid, invoices raised but for which no cash has been received. It also excludes any payment of loans.

Having completed your profit budget you must assess your Cashflow Forecast to determine if you have sufficient cash to meet your debts as they fall due.

Use this Profit Budget as the basis of your Cashflow Forecast.

Provisions for GST

To obtain an accurate Profit and Loss Budget, exclude GST when calculating and inserting amounts for Sales and all Expense Items.

This also applies when calculating:

- Your gross profit margin (see Step 4).
- Your break-even analysis.
- Other financial management ratios.

Exclude GST from all amounts. Otherwise these ratios will be inaccurate (they will be under or overstated).

Please note that the GST attributes of each business will vary and therefore, specific advice from your taxation advisor is strongly recommended.

How to use this Annual Profit Budget

Step 1

Calculate your estimated annual sales at (A) and divide into monthly sales.

Note: Take into account seasonal or monthly trends.

Step 2

Total Material Used (B) is calculated by adding Purchases to Opening Stock, then subtracting Closing Stock. When calculating purchases, remember to take into account the extra stock required prior to seasonal sale increases.

Step 3

Calculate your costs of Sales (D) by adding Total Material Used to Total Labour (Direct Labour and Sub-contractors) – ie D = B + C.

Step 4

Calculate your Gross Profit by subtracting Cost of Sales from Sales (A – D). Work out your Gross Profit percentage at (f) by using the following formula:

$$\textbf{Gross Profit \%} = \frac{\textbf{Gross Profit \$} \times \textbf{100}}{\textbf{Sales}} = \frac{\textbf{(E)} \times \textbf{100}}{\textbf{(A)}}$$

Step 5

Calculate your Net Income (G) by adding your Gross Profit (E) to any Other Income that you may earn. Other income that has not been derived from sales could include profits from the sale of business assets (plant and equipment, shares, bonds).

Step 6

List your estimated overhead expenses. Divide your annual expenses into monthly amounts which should be calculated using two methods.

1. Those expenses which are “fixes” – those that do not vary according to sales or general business activity (eg Rates and Tax, Rent and Outgoings, Licences and Permits, Insurance).

   The anticipated cost for 12 months should be divided by 12 to determine the monthly proportion of the “fixed” expense.

2. Those expenses which are "variable" – those that do vary according to sales and business activity (eg Advertising, Credit Card Fees, Electricity and Telephone) should firstly be calculated to reflect your planned business activity. Then the projected costs relating to specific months should be included in the relevant monthly columns, eg advertising costs will be higher in months requiring greater promotion. Other months will reflect the cost of "normal" advertising – Credit Card Fees will be budgeted at a higher level in strong sales months.

   Any amounts taken by the owner/s from the business for personal living and other expenses are classified as "drawings" (ie an advance against Profits) and these are not included in the Profit Budget.

Step 7

Calculate your Net Profit (Before Tax) at (I) as follows:

Net Profit (Before Tax) = Net Income (G) - Total Overheads (H)

Tax is normally calculated on how much profit you make. Make sure that you put aside enough cash (by using the Annual Cash Flow Forecast) to pay your taxes. This would also include making provision for both PAYG and GST. We recommend that you engage a competent taxation advisor to assist you with minimising your tax payments and complying with Australian Taxation Office laws.

Break-even analysis

Identify the minimum sales level that you will need to achieve break-even (not make a profit or loss). Calculate this for the beginning of the year and again at the end of the year for comparative purposes. Use the Gross Profit percent calculated at Step 4.

$$\textbf{Break-even sales} = \frac{\textbf{Total Overheads}}{\textbf{Gross Profit Margin \%}} = \frac{\textbf{(H)}}{\textbf{(F)}}$$

Further information

The following fact sheets provide further information on these issues:

- Accounting records you should keep

Annual Profit Budget

		July	August	September	October	November	December	January	February	March	April	May	June
Sales	(A)												
Less Direct Costs													
Opening Stock													
Plus Purchases													
Less Closing Stock													
Total Material Used	(B)												
Direct Labour													
Sub-Contractors													
Total Labour	(C)												
Cost of Sales	(D)												
Gross Profit	(E)												
Gross Profit %	(F)												
Other Income													
Net Income	(G)												
Less Overheads													
Accountant's Fees													
Advertising													
Bank Charges													
Cleaning													
Commisison Paid													
Credit Card Fees													
Depreciation													
Discounts Allowed													
Donations													
Electricity and Gas													
Fees and Licences													
Freight													
Insurance													
Interest													
Lease Payments													
Motor Vehicle Expenses													
Printing and Stationery													
Postage/Telephone/Fax													
Rent and Outgoings													
Repairs and Maintenance													
Security													
Staff Amenities													
Training Costs													
Subscription													
Travel Expenses													
Wages (Gross)													
Other Income													
Total Overheads													
Net Profit Before Tax													