



## MANUFACTURERS AND DISTRIBUTORS: KEEP YOUR BUSINESS PLAN ACCOUNTABLE WITH A BUDGET



Coauthored by Stephen Reed, CPA, Director  
Daniel P. Kraybill, Senior Accountant  
Manufacturing & Distribution Services Group  
Cowan, Guteski & Co., P.A.

**P**reparing and using a budget is one of the most important tools available for driving a manufacturing, distribution or wholesale company to success. A budget is nothing more than a plan that is expressed in financial terms. It communicates management's goals and objectives to every level of the company and equally serves as a tool for business owners to macromanage the operations. When used properly, it shows the employees their role in the company's success and allows them to compare their performance to management's expectations. It provides the accountability of a business plan as it converts the qualitative ideas to quantified measurements.

Successful business models begin with management's ability to demonstrate intelligent behavior or the act of visualizing the future in which it can build expectations and determine the activities and resources required to achieve those expected results. Being able to visualize the future is a key component of the expertise of a strong management team, and is based on its knowledge of the industry and the external factors that affect the business. From this visualization, the executives should have expectations for their company that can be documented in a formal business plan, which serves as an agreement between all managers as to how they are going to accomplish the expected results. It provides a yardstick to measure performance and serves as an incentive to perform more efficiently.

The business plan is a narrative of the qualitative items that focus on the company's goals and objectives, and is the first part of creating a budget. It should include as much detail as possible and be broken down by the smallest department that management intends to hold accountable with measureable goals. Once the business plan is completed, management can move forward with preparing the budget by converting all of the items in the plan to quantified amounts. This conversion process can be completed by identifying the key variables responsible for the direct cause of the goals and objectives, and applying management expertise and historical data to them. As an example, assume one of management's objectives is to increase sales by 10%, which has two key variables: price and units sold. With the identification of these variables, managers can now apply their knowledge of the industry, competition and customers to determine which option would give them the best probability of achieving the objective. When budgeting for sales, be sure to consider both internal items (plant capacity, workforce availability, product quality, etc.) as well as external items (industry trends, economic conditions, government policies, etc.)

A budget needs to be broken down by each accountable department, and should be completed by department in the following order: sales, production, purchases, direct labor and overhead. By starting at the department level, management can easily identify the key variables applicable to that department and determine accurate amounts accordingly. By starting with the sales department and following the recommended order, management will be guided through the following departments by the preceding department.

The sales budget should be presented by number of units and sales price and is determined by management's prediction of the demand for the product to be sold. This is followed by the production budget which uses a basic formula that ties into the sales budget with the number of units to be sold. The formula is the number of units to be sold plus the number of units desired in ending inventory less the number of units in beginning inventory, which equals the number of units to be produced. The purchases budget shows direct material purchases that are sufficient to meet the production needs. It is calculated first in whole units, and then broken down into direct material components and dollar amounts. The direct labor budget is next and is based on standard hours needed to produce the number of units shown in the production budget. The final budget is the overhead budget which requires management to determine the best predictor (i.e. machine hours, labor hours, etc.) for the variable portion. It is shown in dollar amounts for fixed and variable portions accordingly. By starting with the sales budget, management can work through the departments using key variables from the preceding budget to determine accurate amounts.

Each department manager should, on a regular basis, compare his/her department's actual results to the budget. All significant variances should be investigated, and a report should be prepared noting the cause. All of the department budgets should be combined into one total budget for upper management along with the variance reports. This will allow members of upper management to track the performance of the company in a quick and efficient manner and give them the ability to react to problems incurred. For example, the predicted sales budget might be higher than the actual sales; therefore, an adjustment to all of the following department budgets needs to be made before the company produces too many items and incurs unnecessary costs. By regularly updating and reviewing the budget, management can more efficiently run the company and effectively allocate its resources. No matter what size a company is, to be successful it needs to have a business plan with a budget. Without a budget, the company lacks the ability to measure its performance and stay accountable.

*About Cowan, Guntjeski & Co., P.A.*

*As a diversified certified public accounting firm, Cowan, Guntjeski & Co. is committed to being an active partner in its clients' growth by delivering value beyond accounting, innovative solutions and consistent exceptional service. If you need assistance in preparing a business plan or budget, contact Stephen Reed, CPA, Director – Manufacturing & Distribution Services Group at 732-741-2624 extension 216 or by e-mail at [sreed@cowanguntjeski.com](mailto:sreed@cowanguntjeski.com) or contact Daniel P. Kraybill, Senior Accountant – Manufacturing & Distribution Services Group at 732-349-6880 extension 145 or [dkraybill@cowanguntjeski.com](mailto:dkraybill@cowanguntjeski.com). You can also visit our Web site at [www.cowanguntjeski.com](http://www.cowanguntjeski.com) for more information on the services available to meet the unique needs of the manufacturing and distribution industries.*

