ResearchGate

See discussions, stats, and author profiles for this publication at: https://www.researchgate.net/publication/315485910

Business Budgeting

Article · March 2017

CITATIONS
0

READS
13,658

1 author:

David F Amakobe
W500G INC

30 PUBLICATIONS **2** CITATIONS

SEE PROFILE

Some of the authors of this publication are also working on these related projects:

Project Doctoral Program at Colorado Technical University View project

All content following this page was uploaded by David F Amakobe on 29 March 2017.

The user has requested enhancement of the downloaded file.

The Budgeting Process and its Impact on the Strategic Plan – Valley View Hospital

David F Amakobe

Author's note

This paper was written as part of the DBA course work at Colorado Technical University for BADM810-1701C-01 Financial and Managerial Accounting for Decision Making course by

Professor Joseph Cappa, PhD

March 2017

Introduction

This paper deals with a real client with whom I am working to rehabilitate a hospital. I have however changed the name and budgetary numbers to protect their plans, but I have maintained the reasoning and underlying principles. I start with a review of the theory of corporate budgeting in the literature review section that immediately follows this introduction. In the application section, I look at the components of a budget. In the master, operating and capital budget sections that follow each other, I explain the details that compose a corporate budget with specific reference to the hospital budget. The Pro Forma Section provides the proforma statement from the hospital budget I prepared with the assumptions provided from the hospital documents and discussions with management. In conclusion, I find that in making a budget, management has to make some key assumption upon which to build their future expectations. These forward-looking statements may come to pass, but sometimes the future turns out very differently.

Literature review (a discussion of the current literature)

Budgeting is the decisions on the level of expenditures and the repartition of resources among organizational subunits (Lepori, Usher, & Montauti, 2013). It is a critical organizational process, which is closely related to key choices concerning strategic priorities and to resources acquisition strategies. The process concerns choices on what to produces for the market and how to produce and provide it. It involves estimates on how much resources will be required to provide the goods and services and the prices such goods and services will generate in the market. Budgeting can, therefore, be defined as an organizational process through which centrally available financial resources are divided among organizational subunits and type of expenditures (Lepori et al., 2013). Corporations owned by private investors have a clear objective of increasing the monetary value of the corporations for the owners while those that are not for profit (NFP) have the objective or service mission (Mukherjee, Al Rahahleh, Lane, & Dunn, 2016).

A business budget has to have estimates of the unit volume of production or sales, the unit cost of the production and the unit price of sales for a specific term or period (Ross, Westerfield, & Jordan, 2016). The budget then has to have performance measures that will guide execution, mostly cost volume profit (CVP) analysis as well as analysis that help management to make choices between alternatives like net present value (NPV), internal rate of return (IRR) and modified the internal rate of return (MIRR).

A business that is a going concern should break even or make a profit on every transaction unless a conscious decision is made to do a loss leader transaction, any case the loss leaders should lead to a profitable transaction. A budget should, therefore, have a pro forma profit and loss (P&L) that shows net sales, the cost of goods sold (COGS), general sales expenses (GSE), taxes and projected net income (Ross et al., 2016).

Application

The basic components of a budget are sales, expenses, personnel, loans, investments, and the assumption made in outing together the budget. The assumptions management make in assembling a budget could include the annual growth rate of expenses among others. They also include the distribution of both sales and costs, the salary ranges of personnel, target unit prices, target unit costs, sales volume, rates of bad debts, personnel strength, the cost of loans, terms of loans and the product lines. Management has to establish these and many more criteria before they can embark on assembling a budget that moves the organization in the direction they aspire.

Master Budget

The master budget is the projected cash budget report. The beginning cash balance added to cash collected from customers makes the total cash available for the budget period. The cash outflows are obtained in two steps: Total production outflows which include direct materials, direct labor, variable overhead and fixed overhead is added to total selling and administration outflows which include variable S&A and fixed S&A. These outflows are then subtracted from the total available cash to get cash available from normal operations. Investment outflows are added to cash from normal operations to obtain cash available after investments. Income tax, Bond interest payments, and dividends make miscellaneous cash outflows, which when added to cash available after investments create cash before loans or line of credit if any (Cox, 2014).

Operating Budget

The operating budget consists of sales and marketing costs, the operating expenses, the human resources costs and the human capital costs. We estimate that the hospital will incur two hundred dollars a months on communication; this will grow at an annual rate of 3%. We also forecast that the hospital website will cost five hundred dollars in the first months and also incur a monthly expense of $59 growing annually at 5%.

The hospital will need to maintain liability insurance at $1500 per month. It will have miscellaneous expenses of $1200 per month, office supplies will cost $500 per month, postage, and ship $500, pharmaceuticals will cost $10,000 monthly, rent $1000 monthly, travel $1010, Medical Imaging $6000 monthly and Laboratory Medicine $5,000 monthly. All these expenses will grow at a 3% annual over five years.

The Hospital plans to retain the services of three consultants over a sixty months period. A Hospital Management consultant will cost $8,000 per month, HR& Staffing Consultant will cost $6000 per month, and African Wood Inc. will cost $5000 per month. The hospital has 160 establishment posts at different monthly rates ranging from $140,000 per year for the chief executive officer to $10000 per year for clerks. Twenty-six registered nurses and 70 Licensed practical nurses make the core of the human resources.

The hospital will be offering 12 services that they will charge their patients. The first is Basic inpatient Bed Occupancy at $250 per day which costs the hospital $50 daily to provide. Following closely is the amenity Bed Occupancy at $450 per day which costs the hospital $150 daily to provide. Doctors bedside visits at $650 per visit at the cost of $350 to the hospital and nursing services at $350 per occupied bed per day costing $100 to provide are next. Medical Imaging unit price $400 at a unit cost $250, and Laboratory Medicine at $350 costing $102 come next. Ambulance & EMT at $500 at $200 cost to the hospital, Occupational therapy at $300 costing the hospital $150, and Dental Services at $700 at a unit cost of $550 follow closely. Pharmacy services at $300 at a unit cost of $100, Orthopedic services at $400 costing $200 to the hospital, and finally funeral home services at $500 costing the hospital $100. The hospital anticipates that 15% of all services will result in bad debts except pharmacy which will be at 25%, orthopedic at 10% and funeral home at 75%.

The Hospital has to pay 5% royalties to the Church of God mission for both basic and amenities bed occupancy for founder’s shares. The hospital has 25-year agreement to pay one of the consultants 25% royalties on both medical imaging and laboratory medicine billings. Lastly, by agreement, all funeral home billings generate 15% royalties to a consulting company that installed the facilities.

Capital Budget

a) Phase1: Rehabilitation of Out-Patient Block, Administration Building, and Pharmacy, Laboratory Radiology & grounds and Staff houses. Estimated Cost: US$ 52,588.00

b) Phase 2 Rehabilitation of Main Hospital Block Maternity and Pediatrics Ward, General Ward, Kitchen & Laundry Services, Purchase Ambulance and Apply perimeter fence. Estimated Cost: US$ 98,950.00

c) Phase 3 Rehabilitation of Minor Hospital Block, Additional In-patient beds, Operating (Minor/Main Theatre), MCH Clinic, and Emergency/Casualty & Mortuary Estimated Cost: US$ 97,582.00

d) Phase 4 Rehabilitation of Sub-specialties—Ophthalmology, Orthopedics, Dental, and ENT. Estimated cost: US$ 94,588.00

e) Phase 5/6 Rehabilitation of School of Nursing, Lecture Halls, Dining room, and Dormitories. Estimated cost: US$ 995,120.00

Conclusion

In carrying out this assignment, I learned that budgeting is simply putting the organization's plans in numerical terms and adjusting them for viability. The process of reducing organizational objectives into executable and measurable tasks that achieve the objectives and mission in fixed time periods. In making a budget, management has to make some assumption of the future otherwise known as forward-looking statements or predictions which may be true or may not materialize, but it least they have a basis upon which to reference their performance. The budget serves as a road map upon which the performance of the hospital will be judged. Each section of the hospital has target costs and revenue to achieve or upon which variences must be explained.

Valley View Hospital Pro Forma Financial Statements
Prepared March 21, 2017

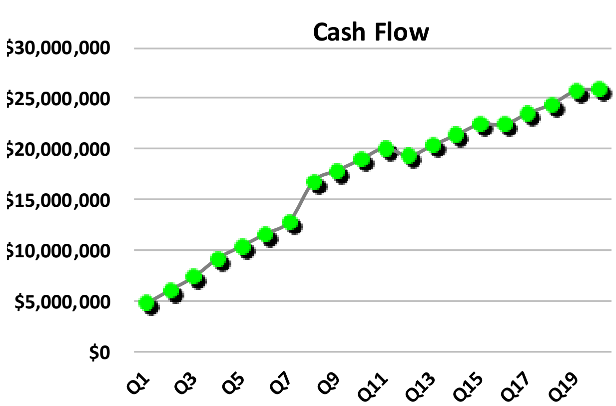
Profit & Loss	Year 1	Year 2	Year 3	Year 4	Year 5
Net Sales	**$68,855,400**	**$68,878,440**	**$68,878,440**	**$68,878,440**	**$68,878,440**
COGS	$30,742,278	$30,754,728	$30,754,728	$30,754,728	$30,754,728
Gross Profit	**$38,113,122**	**$38,123,712**	**$38,123,712**	**$38,123,712**	**$38,123,712**
Expenses	$29,847,660	$30,165,017	$30,478,292	$30,807,230	$31,152,613
EBITDA	**$8,265,462**	**$7,958,695**	**$7,645,420**	**$7,316,482**	**$6,971,099**
Amort., Dep., & Int.	$95,607	$146,959	$179,251	$158,787	$126,971
Taxes	$2,777,751	$2,655,990	$2,538,498	$2,481,438	$2,498,128
Net Income	**$5,392,104**	**$5,155,746**	**$4,927,672**	**$4,676,258**	**$4,346,001**

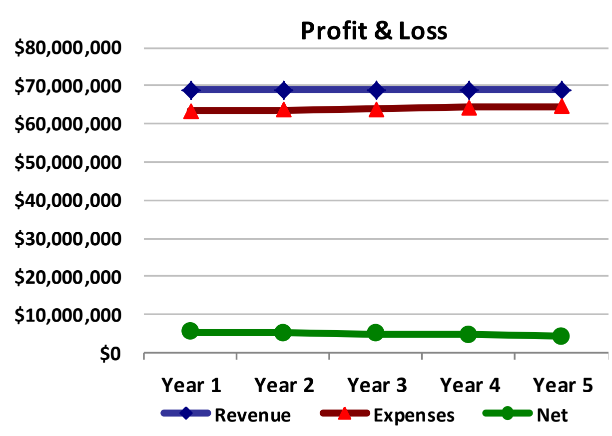
Cash Flow	Year 1	Year 2	Year 3	Year 4	Year 5
Net Income	**$5,392,104**	**$5,155,746**	**$4,927,672**	**$4,676,258**	**$4,346,001**
Changes from:					
Operating	$8,099,424	$5,140,301	$4,947,571	$4,788,239	$4,450,844
Investing	($67,588)	($278,950)	($1,842,702)	($1,098,588)	($1,000,000)
Financing	$1,212,951	$2,705,909	($571,191)	($620,670)	$0
Cash Inc. / (Dec.)	**$9,244,787**	**$7,567,260**	**$2,533,678**	**$3,068,982**	**$3,450,844**
Beginning of Period	$0	$9,244,787	$16,812,047	$19,345,725	$22,414,707
End of Period	**$9,244,787**	**$16,812,047**	**$19,345,725**	**$22,414,707**	**$25,865,551**

Balance Sheet	Year 1	Year 2	Year 3	Year 4	Year 5
Assets					
Current	$9,244,787	$16,812,047	$19,345,725	$22,414,707	$25,865,551
Non-Current	$65,362	$337,890	$2,140,849	$3,129,093	$4,002,123
Total Assets	**$9,310,149**	**$17,149,936**	**$21,486,574**	**$25,543,800**	**$29,867,674**
Liabilities					
Current	$2,705,093	$2,683,225	$2,663,382	$2,665,020	$2,642,893
Non-Current	$997,951	$1,191,860	$620,670	$0	$0
Total Liabilities	**$3,703,044**	**$3,875,086**	**$3,284,052**	**$2,665,020**	**$2,642,893**
Equity	$5,607,104	$13,274,851	$18,202,522	$22,878,780	$27,224,781
Total Liab. & Equity	**$9,310,149**	**$17,149,936**	**$21,486,574**	**$25,543,800**	**$29,867,674**

Valuation	$68,855,400	$68,878,440	$68,878,440	$68,878,440	$68,878,440
Revenue (1x multiple)					

Investment		**Loans**		**Cash**	
Founder	$110,000	Total	$1,633,828	Breakeven	January, 2018
Preferred	$50,000	Interest Paid	$421,869	Least Cash	$3,333,199
Common	$2,567,000	Principal Repaid	$1,633,828	Most Cash	$26,224,749
Total	**$2,727,000**	End Balance	$0		





References

Cox, P. (2014). Master Budget Project: Analysis of Cash Budget Report. *Strategic Finance, 95*(9), 52-53.

Lepori, B., Usher, J., & Montauti, M. (2013). Budgetary allocation and organizational characteristics of higher education institutions: a review of existing studies and a framework for future research. *Higher Education, 65*(1), 59-78. doi:10.1007/s10734-012-9581-9

Mukherjee, T., Al Rahahleh, N., Lane, W., & Dunn, J. (2016). The Capital Budgeting Process of Healthcare Organizations: A Review of Surveys. *Journal of Healthcare Management, 61*(1), 58-77.

Ross, S. A., Westerfield, R. W., & Jordan, B. D. (2016). *Fundamentals of corporate finance* (Eleventh Edition. ed.). Dubuque: McGraw-Hill Education.

View publication stats