

OPTIMIZE YOUR BUDGETING PROCESS

TRAINER

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CONTENT

- ✓ 1. Complaints and weaknesses about the budgeting process
- ✓ 2. Designing the effective budget
- ✓ 3. Optimizing the budgeting process
- ✓ 4. Conclusion

MODERNIZE YOUR BUDGETING PROCESS

1. COMPLAINTS AND WEAKNESSS

WHY A NEGATIVE ATTITUDE TOWARDS THE BUDGET?

Budgeting process in a Web era...



(Not much evolution in almost 100 years!)

REALITY...

A **long** (the goal is 2 months but it takes 8) and **tedious** (demonstrated by the number of iterations) process, requiring a lot of **overtime** from many employees (especially from Finance which needs to consolidate an **incredible amount of Excel files**), where the **rules and guidelines established** during the budget process are **circumvented**, resulting in a budget **not based on the business rules** that were initially proposed ...



Before

BUDGETING PROCESS...



After

COMMON COMPLAINTS

Time and Effort

- It takes way too long and costs too much!
- Too many iterations!
- Involves too many people!

Demotivates

- By the time the process is finished, I don't recognize my numbers!
- Doesn't fit the objectives I am evaluated on!
- I don't have the resources to achieve these objectives!
- Doesn't help me manage!
- Contains allocations that are out of my control!

Outdated

- Not updated often enough, sometimes only yearly!
- Casted in stone, but the market changed!
- Outdated before it's finished!

Encourages dysfunctional behavior

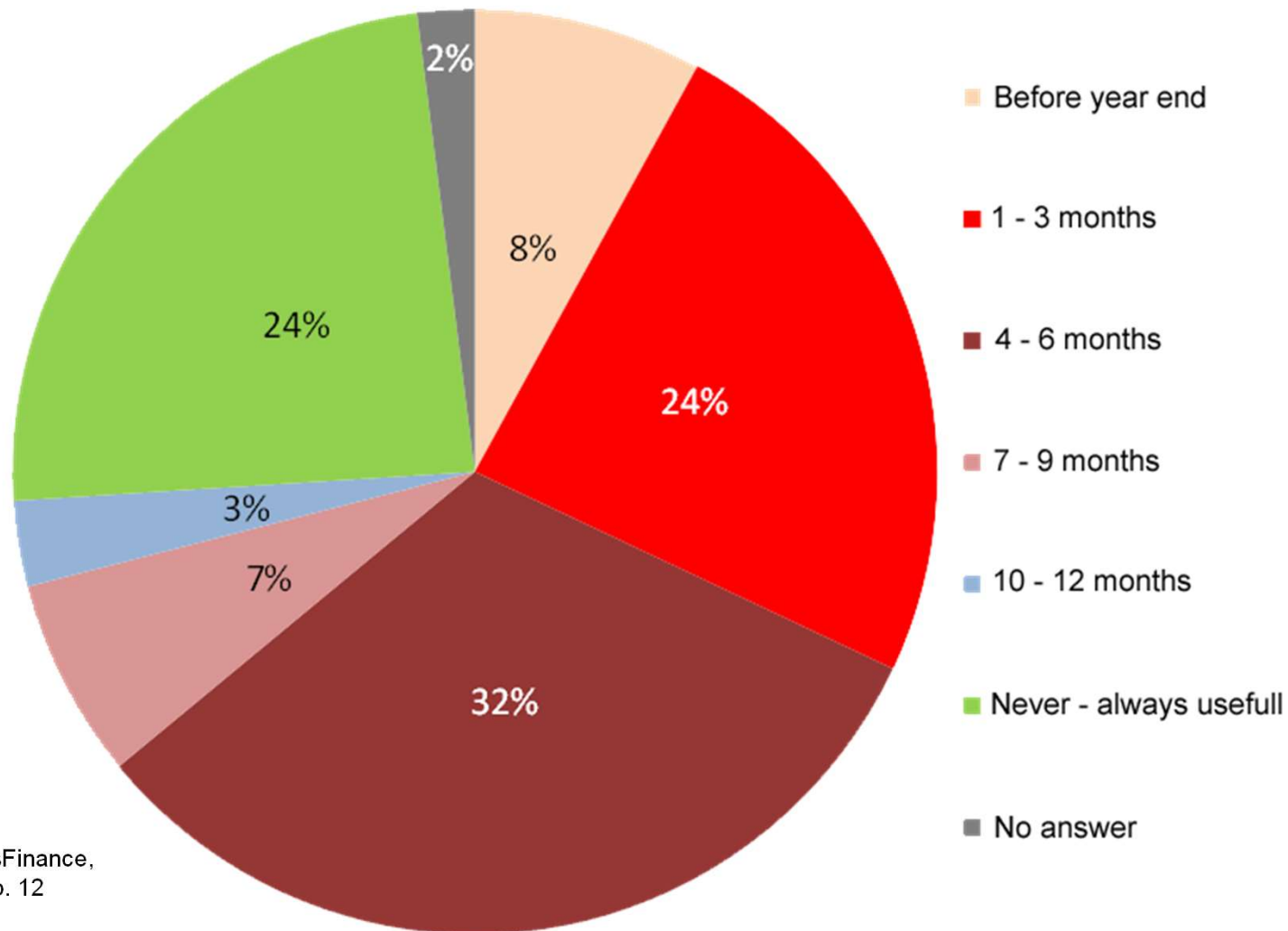
- Encourages politics and bad behavior!
- Doesn't encourage information sharing, and favours silos!

Harmful

- Rarely aligned with strategy and often contradictory!
- Based on unfounded presumptions and/or rough estimates!
- Based on simple Org structure instead of processes!
- Reduces flexibility and obstructs change!
- Focused on reducing costs instead of creating value!
- Doesn't add much value!!

ARE THESE COMPLAINTS VALID?

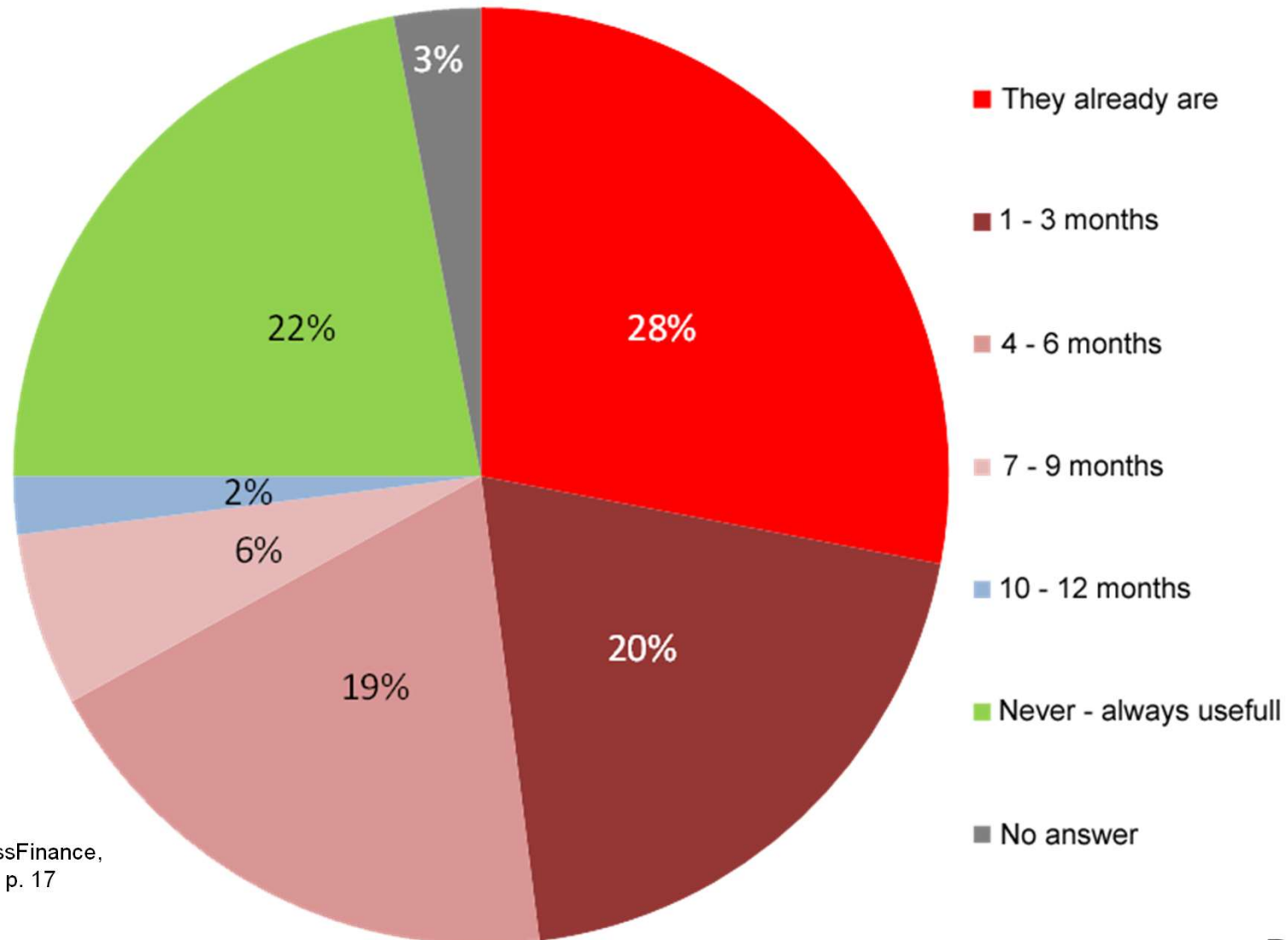
When does your budget usually go out of date?



Source: BusinessFinance,
Mai / Juin 2009, p. 12

ARE THESE COMPLAINTS VALID?

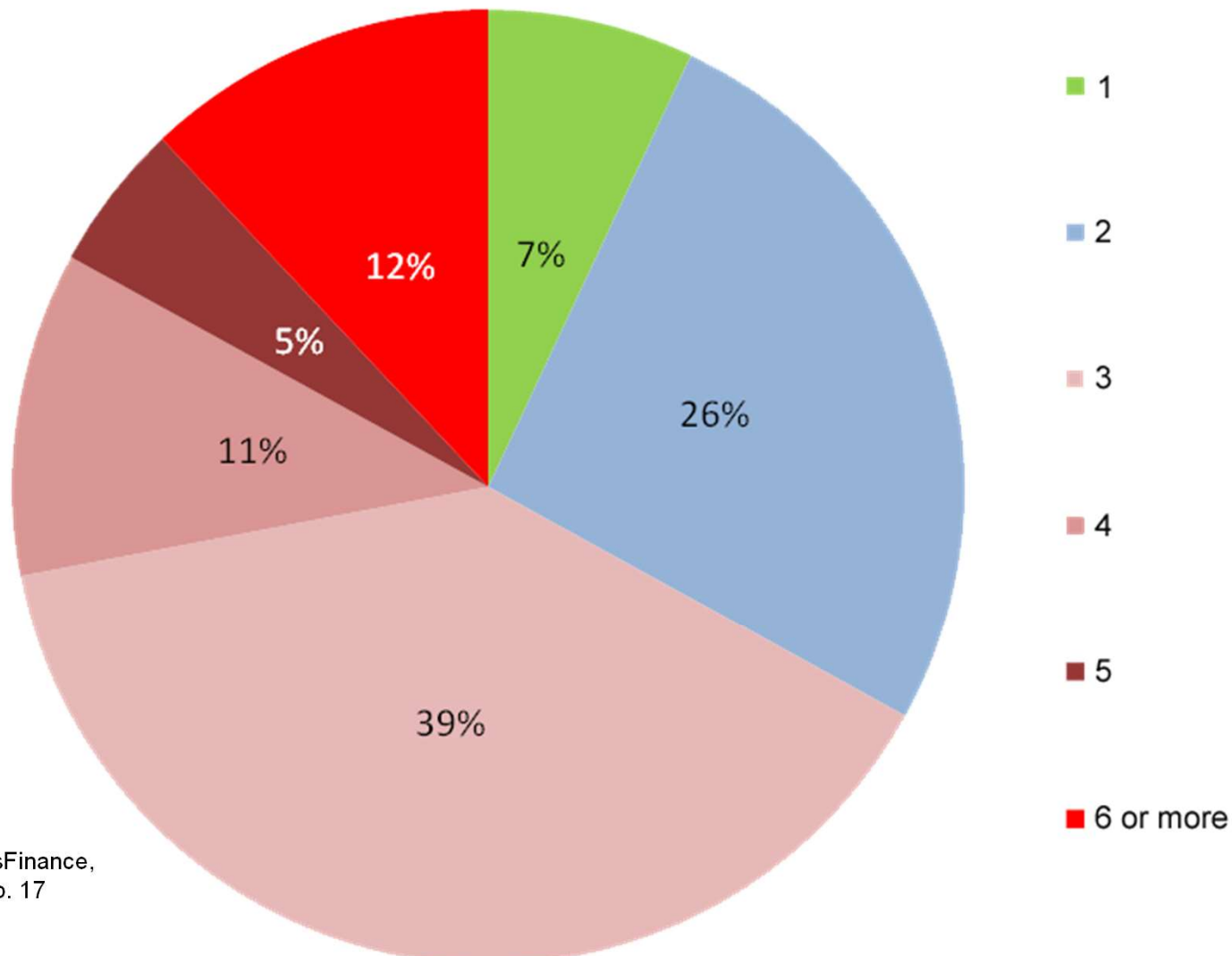
When do you think your objectives will be outdated?



Source: BusinessFinance,
Mai / Juin 2009, p. 17

ARE THESE COMPLAINTS VALID?

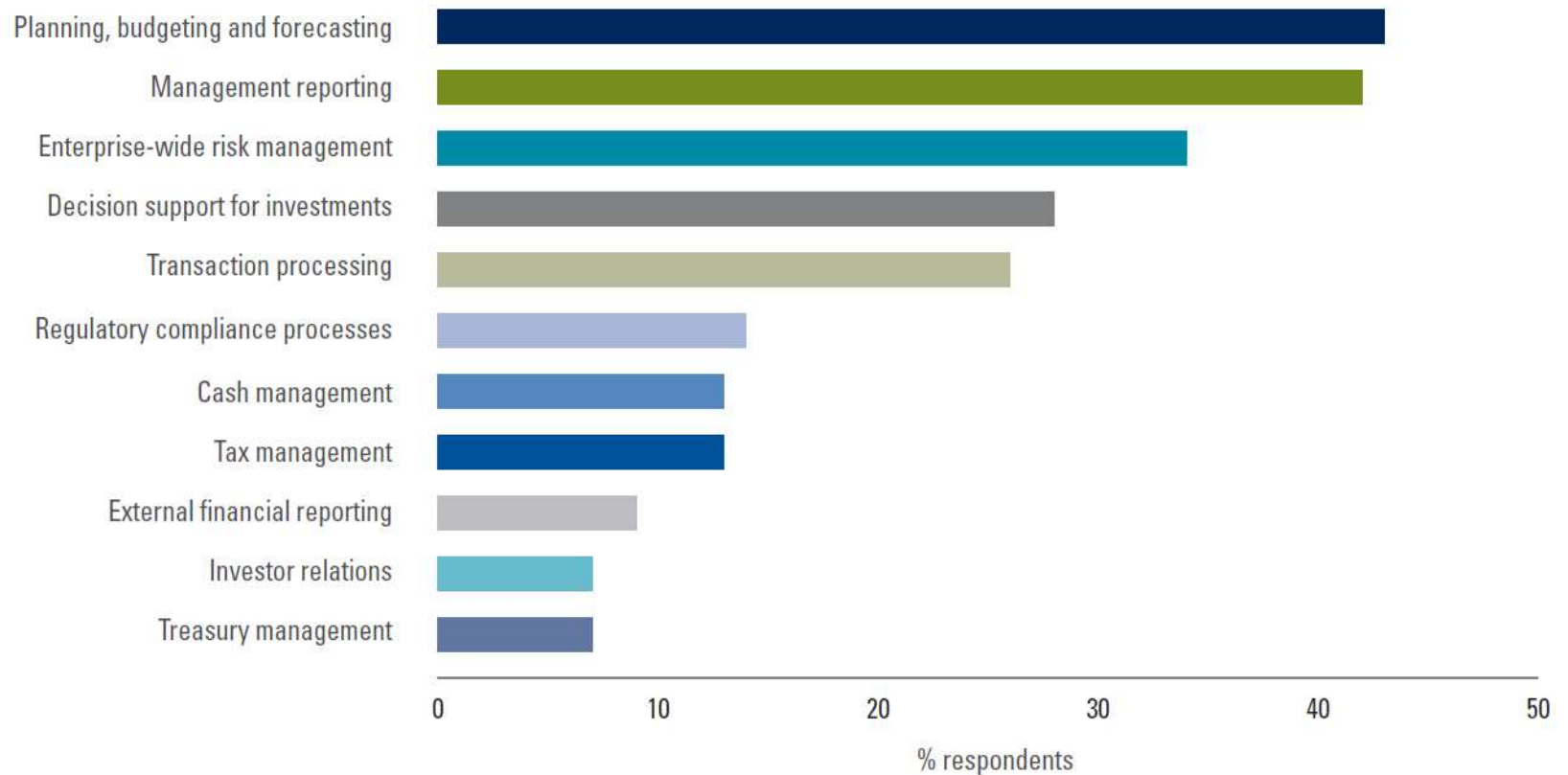
How many budget versions are produced before final approval?



Source: BusinessFinance,
Mai / Juin 2009, p. 17

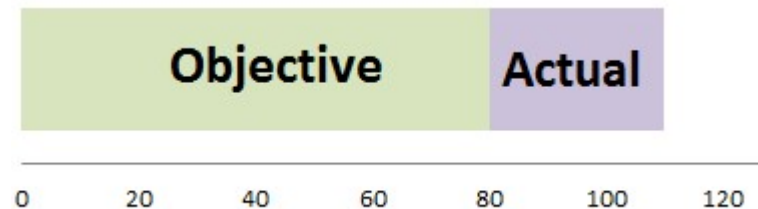
ARE THESE VALID COMPLAINTS?

Where is finance most dissatisfied with its current capabilities?



Source: Economist Intelligence Unit, 2006

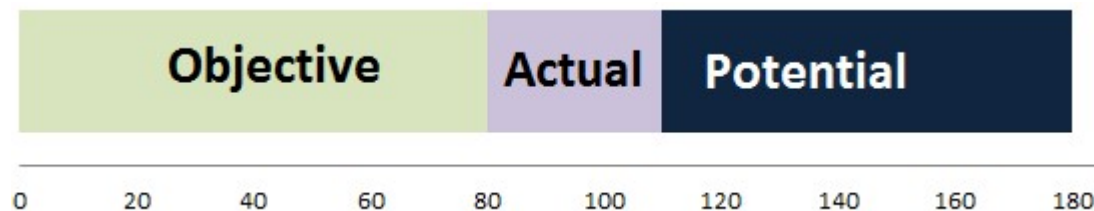
BUDGET: THE MANAGERS' FRIEND?



- ✓ The organization greatly exceeded its (budgetary) goals; congratulations to the managers!

WHAT THIS STORY DOESN'T TELL....

- ✓ In order to be stay within budget, managers failed to make the investments required to capture the potential market. When you compare the actuals with the market potential, the resulting performance is actually sub-standard!



Efficient organizations compare themselves to the market, not to a fixed budget

- ✓ This illustrates the importance of having flexibility in the budgeting process and being able to make rapid changes when necessary.

IT'S NO WONDER THAT....

80% of organizations are not satisfied with their budgeting process.¹

- ✓ The majority of organizations use a model from the industrial era, geared towards increasing efficiency. The model is poorly suited to today's complex reality where we need to increase efficiency and manage complexity.

1. Source: Economist Intelligence Unit Ltd., 2000, Beyond Budgets, Business Europe, 40, 9, p. 4

OPTIMIZE YOUR BUDGETING PROCESS

2. DESIGNING THE EFFECTIVE BUDGET

2. DESIGNING THE EFFECTIVE BUDGET

Role of Finance in the budgeting process

- ✓ Finance is responsible for the budgeting **process**
 - Not responsible for the results
 - Each manager should be accountable for the information provided, Finance is accountable for a well-piloted process

- ✓ What that means :
 - Finance should often question its budgeting process
 - Finance should get support from high-level management in order to facilitate participation from the managers
 - Finance must know and explain the numbers to high-level management, but not defend them if challenged

2. DESIGNING THE EFFECTIVE BUDGET

Role of Finance in the budgeting process

- ✓ Complexity:
 - Keep in mind that the budgeting process is one of the more coordination intense process of any organization
 - Because it is so complex, the natural reflex is to continue things the way they are if fear of « breaking the thing »

2. DESIGNING THE EFFECTIVE BUDGET

- ✓ 2.1 Elements influencing design choices
- ✓ 2.2 Linking strategy and budget
- ✓ 2.3 Top – down, bottom – up and hybrid approach
- ✓ 2.4 Budgeting responsibilities
- ✓ 2.5 Decentralization, budgeting responsibilities and costing
- ✓ 2.6 Level of detail of the budget
- ✓ 2.7 Update frequency
- ✓ 2.8 Scenarios
- ✓ 2.9 Budget and risk management
- ✓ 2.10 Performance bonus

2.1 – ELEMENTS INFLUENCING DESIGN CHOICES

Strategy of the organization

- ✓ The strategy of the organization will influence the design choices:
 - Cost leadership ➔ rigorous budgeting process, heavy on control
 - Innovation leadership ➔ Simple budgeting process

Stability of the environment

- Turbulent environment = harder prediction
 - Managers on the front line are often better suited to identify trends
 - Bottom-up budgeting
 - Higher level of detail
- Stable environment = Easier prediction
 - Detail where there is value

2.1 – ELEMENTS INFLUENCING DESIGN CHOICES

Types of services

- ✓ Same budgeting approach for everyone ?
 - Ex. : Administration vs operation

Information Security

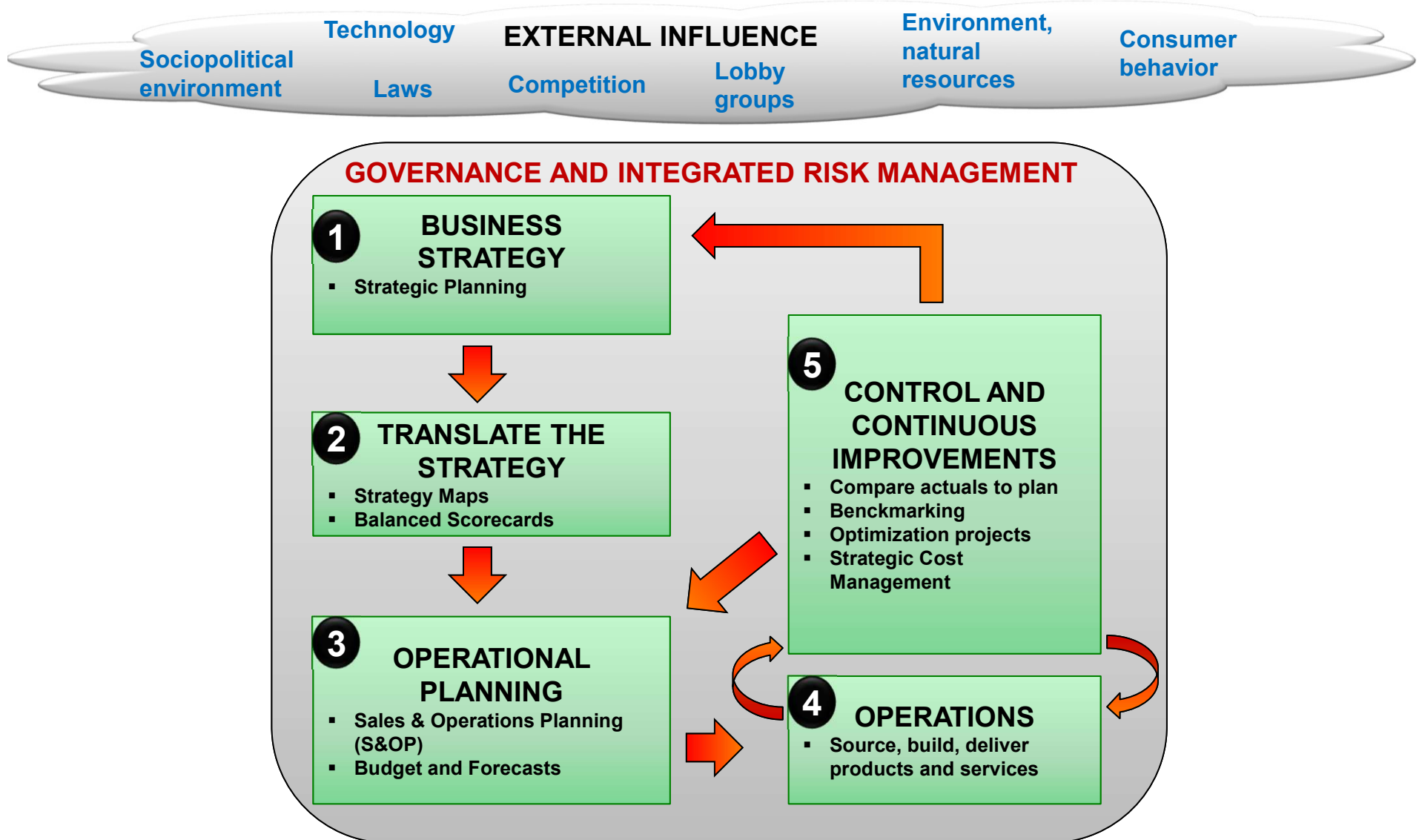
- ✓ Labor
- ✓ Industrial secrets
- ✓ Counterfeits products
- ✓ Classified information (ex: contacts)

Organizational culture

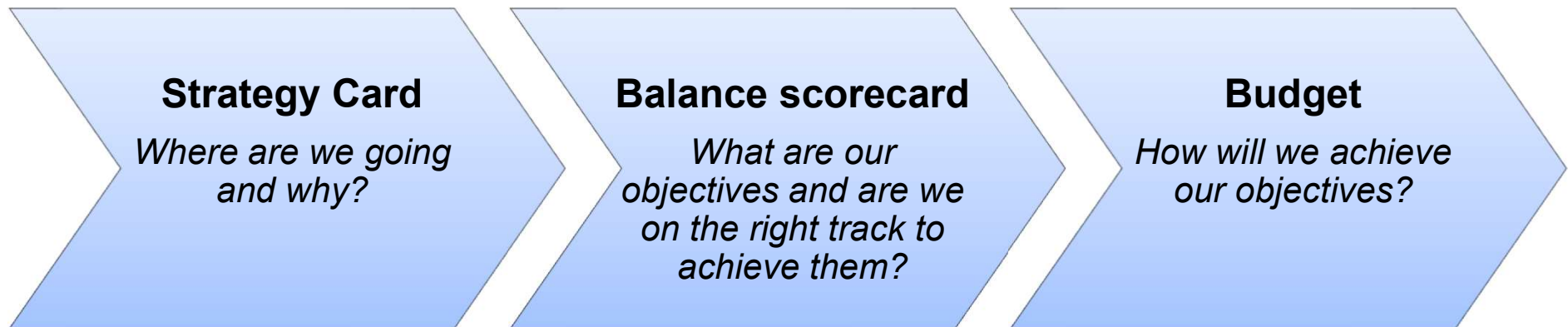
- ✓ Management style



2.2 LINKING STRATEGY AND BUDGET

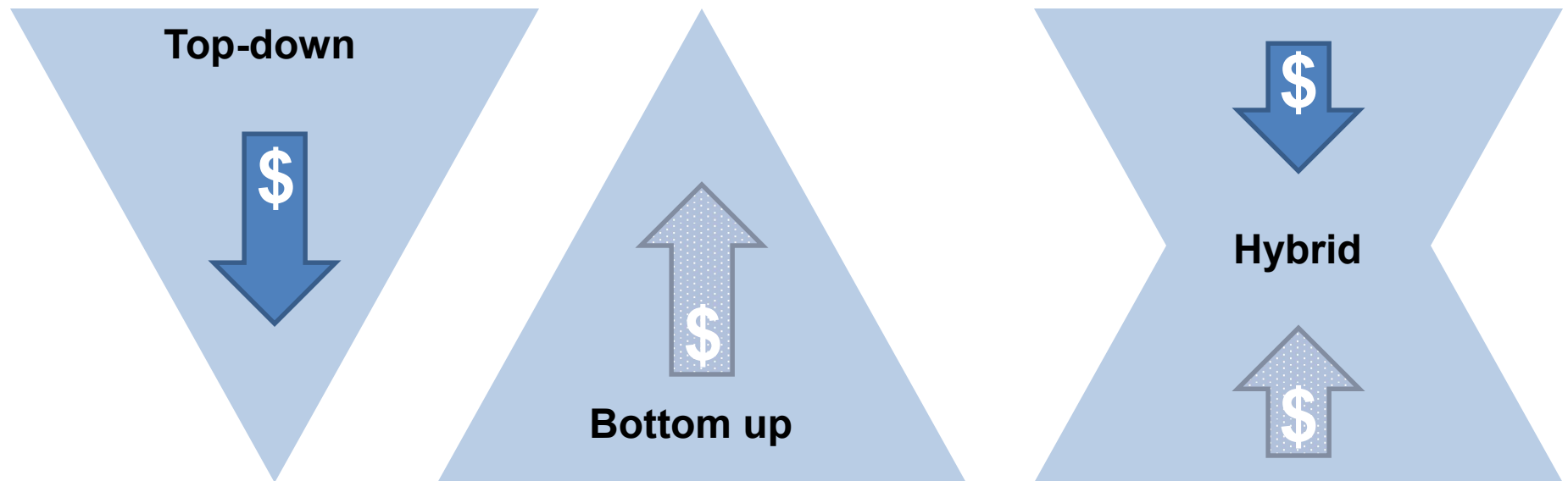


2.2 LINKING STRATEGY AND BUDGET



2.3 TOP-DOWN VS BOTTOM-UP

Which is best ?



Budget imposed by Management



Manager's budget

2.3 TOP-DOWN VS BOTTOM-UP

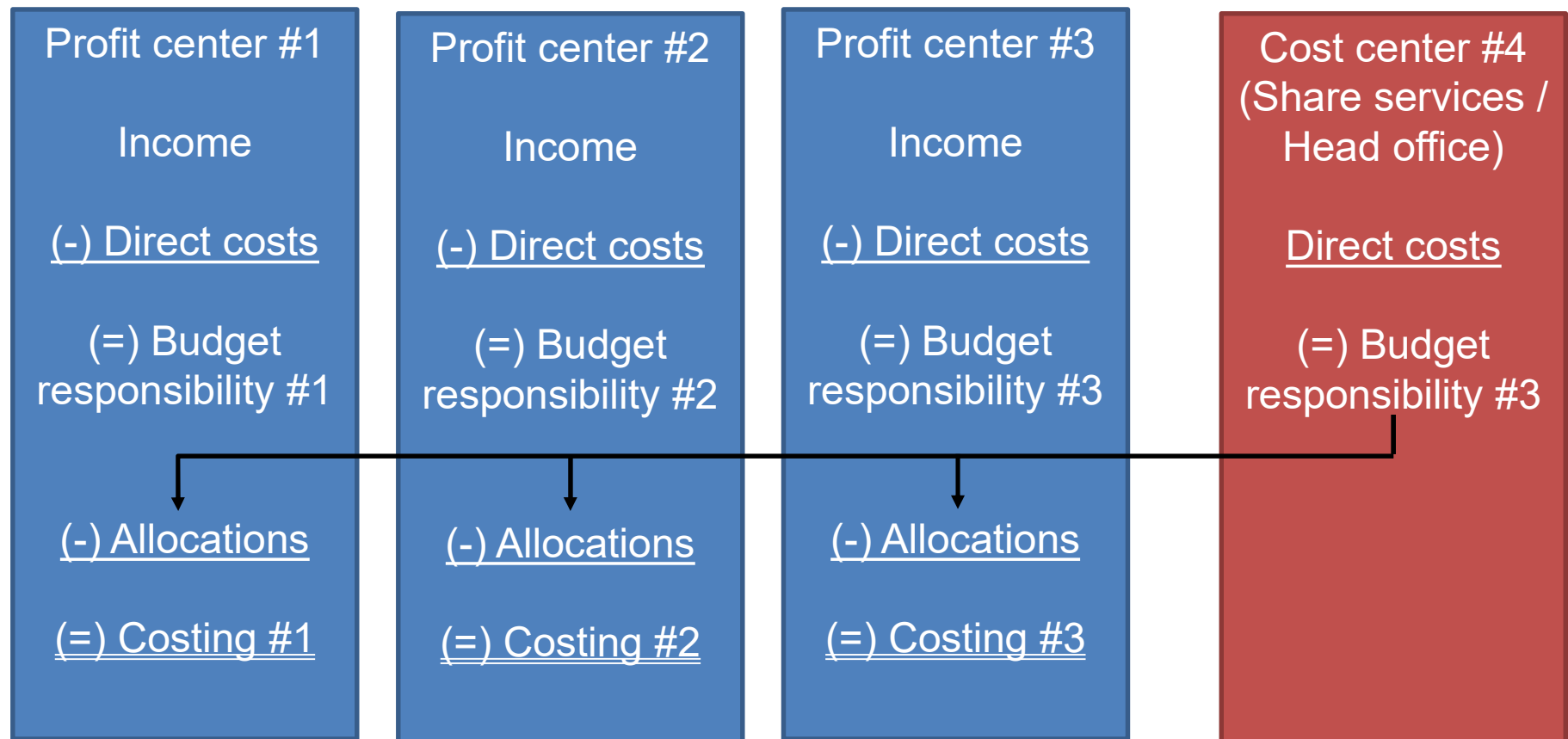
Characteristic	Top-Down	Bottom-Up	Hybrid
Style	Centralized, controlled	Decentralized, collaborative	Hybrid and collaborative
Objectives	Ambitious	Comfortable	Balanced
Iterations	One	Multiple	Multiple
Speed	Fast	Slow	No so fast
Coordination required	Little	A lot	A lot
Ownership	Little	Good	Good
Alignment with strategy	Aligned	Can be	Usually
Opportunity identified by the operations	Might be neglected	Shared	Shared
Innovation	Risk of repression	Shared	Shared

2.4 BUDGETING RESPONSIBILITY

Who should budget what ?

- ✓ Who has the responsibility of the cost ?
- ✓ Who has a better understanding of the cost behavior ?
- ✓ Are there comparable costs that could be benchmarked internally ?

2.5 DECENTRALIZATION, BUDGETING RESPONSIBILITY AND COSTING



2.6 LEVEL OF DETAIL OF THE BUDGET

- ✓ Design elements to consider when addressing the level of detail:
 - Efforts needed by collaborators to provide information;
 - How fast does the initial budget expire ;
 - Level of detail of the variance analysis;
 - Does the chosen level of detail helps managers .
- ✓ Using the G/L accounts level of detail is often the easiest approach for Finance.
- ✓ A hybrid approach is recommended.

2.7 UPDATE FREQUENCY

- ✓ Update prediction when disrupting event affects the organization
- ✓ Keep in mind that people are working toward respecting the allocated budget.

2.8 SCENARIOS

- ✓ Ask managers to indicate the financial impact of best and worst case scenario
- ✓ Steps :
 - 1) Close the budgeting process
 - 2) Responding to certain volumetrics, ask key managers to provide insight on their cost behavior
 - 3) Consolidate the scenarios and use for variance analysis during the year
- ✓ Having costing implemented helps to calculate the impact of theses scenarios

2.9 BUDGET AND RISK MANAGEMENT

- ✓ Most organization invest time and effort in evaluating risks incidence and financial impact, but won't budget a reserve to help alleviate the impact of the risk
- ✓ Steps :
 - 1) Identify the risks the your organization is exposed to
 - 2) Analyse the risks
 - 3) Evaluate the risks
 - Financial impact of the risk becoming a reality
 - Probability of the occurrence of the risk
 - 4) Treat the risk

2.9 BUDGET AND RISK MANAGEMENT

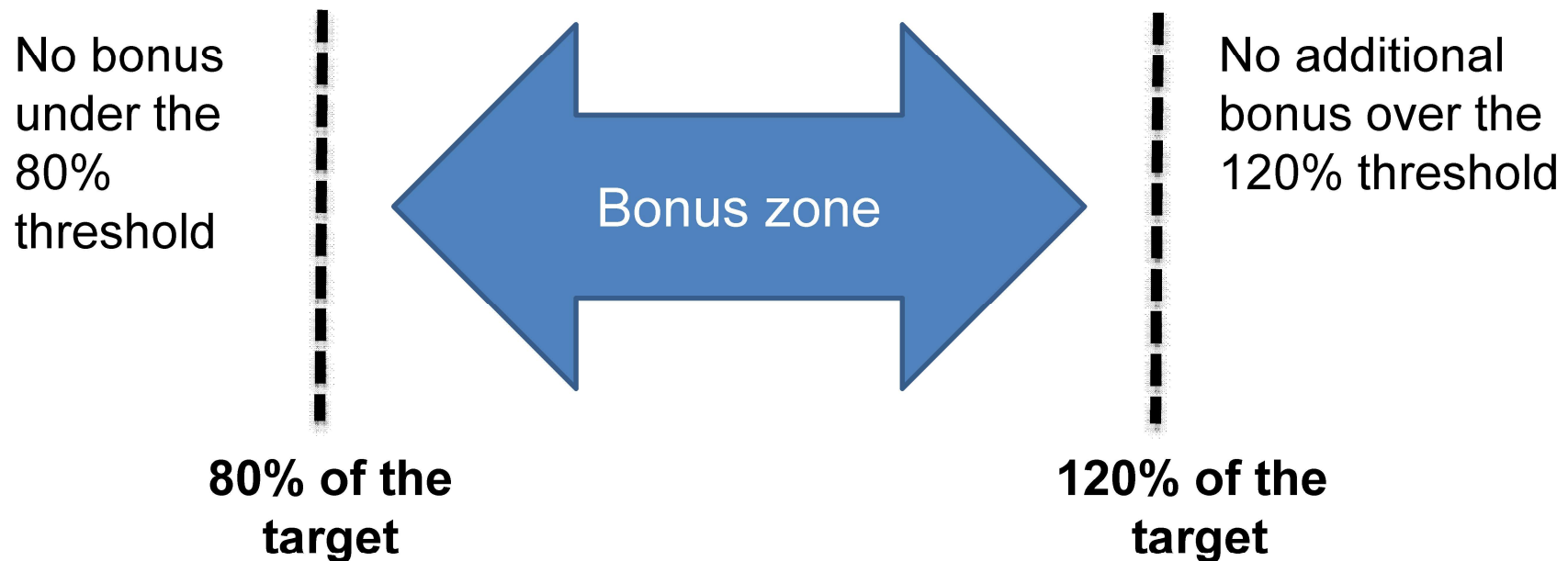
- ✓ Link with the budget :
 - The sum of the financial impact * the probability of occurrence of all risk should be kept in a reserve to better prepare the organization

Example :

Risk	Description	Financial impact	Probability of occurrence	Reserve
R1	Personnal data leak	100M\$	5%	5,000,000\$
R2	Politicaly driven reorg.	20M	30%	6,000,000\$
R3	Collection system crash	5M	10%	<u>500,000\$</u>
Reserve to budget				11,500,000\$

2.10 PERFORMANCE BONUS

- ✓ Are people rewarded financially when respecting or beating their budget in your organization ?



2.10 PERFORMANCE BONUS

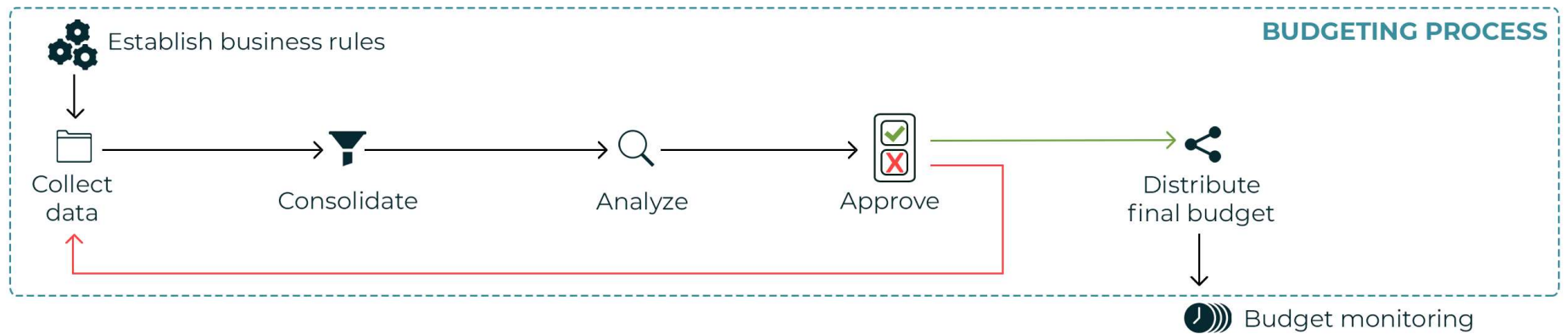
- ✓ Common manipulation technique to look out for:

Behavior	Examples
Plan for an easy high performance	<ul style="list-style-type: none">> Exaggerate expenditures when budgeting> Undervalue sales volumetrics> Omit to budget :<ul style="list-style-type: none">> Sales price adjustments> Cost reduction program.
Work around the thresholds	<ul style="list-style-type: none">> Pressure clients to accelerate sales, and delay purchasing> Accelerate spendings at the end of the year
Information presentation	<ul style="list-style-type: none">> Choose to disclose or not important information> Manipulate numbers to show better performance than reality

MODERNIZE YOUR BUDGETING PROCESS

3. BUDGETING PROCESS

BUDGETING PROCESS



MANAGING THE PROCESS EFFICIENTLY

Business rules and documentation

- ✓ Have a checklist of who does what and when during the process
- ✓ Plan a high-level calendar
- ✓ Agree upon objectives
 - Make sure there is a linkage between strategic objectives, operational objectives, and financial objectives
 - Prepare a high-level estimation of revenues and expenses and have them approved by senior management
- ✓ Agree upon the budgeting approach and roles and responsibilities
 - Assess if the budgeting approach should be changed
- ✓ Plan the process (budgeting hypothesis, detailed calendar, budgeting instructions to managers, training session for new managers)
- ✓ Ensure support is available during the process



MANAGING THE PROCESS EFFICIENTLY

Business rules and documentation

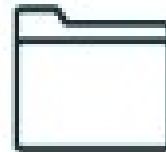
- ✓ Organize and centralize documentation supporting the process
 - ✓ Budgeting instructions
 - ✓ Training documents
 - ✓ One pager documenting the templates mechanics
- ✓ Have appropriate template for the appropriate user
 - ✓ Budgeting a call center operation is much different than budgeting a finance department



MANAGING THE PROCESS EFFICIENTLY

Data gathering

- ✓ Huge performance gains can be obtained if the budgeting process is decentralized, many managers participate in the process, and inefficient data gathering tools are used (i.e., data is not stored in a centralized database)
- ✓ It is collectively the most time-consuming part of the process
 - ✓ 3 iterations x 2 weeks per iteration x 100 managers = 600 weeks worth of attention
- ✓ Templates must be efficient, easy to use, bug free and help manager budget
- ✓ Offer support during the data-gathering phase
 - Clear and succinct directives
 - Point of contact for support
- ✓ Monitor the evolution
 - Being able to detect and act on late starters can cut on iterations time
 - Monitor the budget evolution and the strategic objectives achievement



MANAGING THE PROCESS EFFICIENTLY

Consolidation



- ✓ This step add absolutely no value to the process
 - ✓ Extends the budget timeline
 - ✓ Delays strategic decision-making
 - ✓ Disconnects managers from what should be a helpful budgeting tool
 - ✓ Introduces significant risks of errors into the process
- ✓ Minimize as much as possible
- ✓ Done automatically, sometimes on-the-fly, with budgeting systems
- ✓ If Excel is used, think of the architecture of your templates so that consolidation is facilitated
 - Each template should feed a second tab in a shared data format between all templates
 - Pivot tables are excellent for consolidating and presenting information

MANAGING THE PROCESS EFFICIENTLY

Analysis



- ✓ The step that should be maximized
- ✓ Analysis should be made on more than the bottom line
 - ✓ Bank ratios
 - ✓ Comparable cost examination
 - ✓ Extraordinary increases
- ✓ Budgeting software enables users to view and compare various data sets (initial budget, budget iteration n , forecast, actuals, and so on), which accelerates the analysis phase
- ✓ No matter the tool used, recurring analysis and controls should be automatized
 - ✓ Preconfigured reports pointing on the shared database
 - ✓ Reports providing information on known anomalies available via drill through capabilities

MANAGING THE PROCESS EFFICIENTLY



Approval

- ✓ An audit functionality (which user did what changes to which account, old value, new value, date/time stamp) can be enabled in most budgeting software
- ✓ A subset of accounts can be approved (i.e., labor is approved and locked, managers can continue working on other accounts)
 - Analysis of a subset of the budget is therefore possible even if the budget is not 100% finalized
- ✓ Have an approval process coherent with budget responsibilities
 - ✓ Traditionally, made vertically
 - ✓ Center of competence approach for certain expenditure can be very efficient

MANAGING THE PROCESS EFFICIENTLY





Distribution of finalized budget

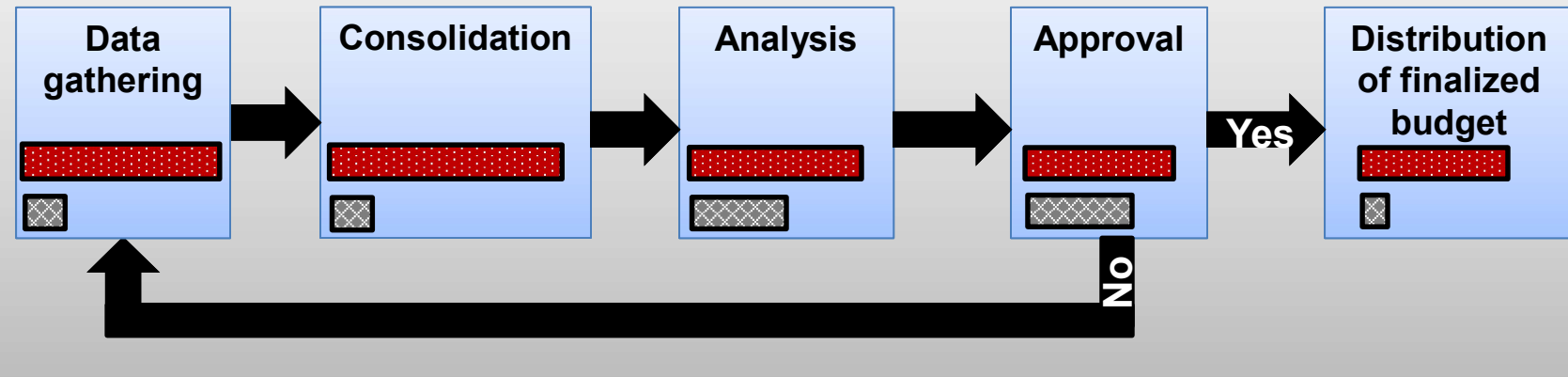
- ✓ Often overlooked in the budgeting process of organization
- ✓ Return the final budget to the managers, and explain centrally made adjustments
- ✓ Modern budgeting systems enables end users to consult on demand their budget, actuals, forecast and other financial information
 - No distribution is required, once the budget is finalized, simply enable the data set in the reports and managers will have access to information according to their user rights

BUDGET PROCESS: PRE- AND POST-OPTIMIZATION

Choices impacting budgeting process

Budgeting process

  Business rules and documentation



Effort:



Pre-optimization



Post-optimization

Post-budget (control)

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QUESTIONS?

THANK YOU!



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