



## **Best-practice budgeting**

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## Abstract

Let's face it—budgeting isn't going to make the top of any manager's "Favorite Things to Do" list. Yet each year, companies make substantial investments in developing a comprehensive annual budget, spending heavily for specialty software, staff overtime and temporary help for data entry. Perhaps even more costly (but less quantifiable) are the countless hours that senior managers, accountants, financial analysts and department managers spend to prepare, revise and consolidate budgets.

For many companies, a spreadsheet is the tool of choice for budgeting. Although spreadsheets are tremendous personal productivity tools, their numerous shortcomings prevent them from adequately managing a budgeting process of any significant size or sophistication. Enterprise planning and analysis solutions from IBM can take the headaches out of budgeting with tools for analysis, modeling and collaboration—the cornerstones of modern-day planning.

## Overview

In a perfect world, the huge investments of time and money in the budgeting process would deliver excellent returns. But, since we don't live in a perfect world, too often:

- We spend more time creating a budget than analyzing it.
- The budget bears little or no relation to our underlying business plan.
- After the budget is approved, no one looks at it again.
- Budget holders dislike the tedious and lengthy process of creating, revising and submitting documents.
- Budget holders attribute adverse variances to the finance department and favorable variances to their own performance and managerial skill.

This paper suggests a framework for re-thinking the budgeting process to help you maximize budgeting benefits and minimize budgeting pain. It is based on the knowledge IBM has acquired by analyzing corporate budgeting cycles and studying best practices for many years.

And for the bottom line, more effective budgeting leads to more effective planning and forecasting, which in turn leads to business optimization, improved response to market and improved positioning for new opportunities and market leadership.

## Planning vs. budgeting vs. forecasting

Because executives, managers and finance professionals often use related terms interchangeably, it's worth a moment to consider a few fundamentals:

- **Planning** is a strategic prediction of business performance at a summary level. Usually, planning is the province of a few savvy senior managers charged with making sure the company responds to changing market conditions and opportunities, balancing assets with opportunities. Accordingly, the process can be fairly frequent and must be completed quickly.
- **Budgeting** is planning distributed to individual areas of responsibility in a business. As a result, many more people are involved and work at a much greater level of detail. Budgeting is a slower exercise, often taking weeks and performed once – maybe twice – a year. And these days, the budget may be out-of-date as soon as it's approved.
- **Forecasting** is essentially a re-casting of the budget – perhaps in summarized form – to reflect changing market conditions, strategic plan alterations, error corrections and revised assumptions in the original approved budget. Companies typically re-forecast monthly or on an ad hoc or event basis in this unpredictable economy, with the process executed by a handful of finance personnel.

Table 1 summarizes the key aspects of planning, budgeting and forecasting.

	<b>Centralized or Decentralized</b>	<b>Level of Detail</b>	<b>Frequency</b>	<b>Speed</b>
Planning	Centralized	Summary	Often	Quick
Budgeting	Decentralized	Highly detailed	Annual	Slow
Forecasting	Combination	Mostly summary - light detail	Monthly or ad hoc	Quick

*Table 1. Key aspects of planning, budgeting and forecasting*

## Business problems

Given its broad reach, budgeting is where dramatic improvements affecting the greatest number of employees can be made. Yet, budgeting is not popular in many organizations because managers see the process as a time-consuming and recurring setup for executive blame and recrimination over negative outcomes that they could neither predict nor control.

## Stakeholder pain

Few people in an organization are immune from the pain of budgeting. However, the stakeholders most likely to get a splitting headache from the process are budget holders, senior management, the finance department and the IT department. This section takes a look at how budgeting affects these stakeholders in more detail.

### **Budget holders**

Budget holders – the P&L center managers – dread the onset of a budget cycle, the extra work it will entail and the consequences of getting things wrong. If previous experience has taught them that the budget is likely to be a platform for shame and abuse, they might treat it as a game where they compete with their peers to obtain the most easily achievable targets. The winner will be the one most adept at hiding sandbags – significant over-or-under estimations that will help them mask inefficiency and ineffectiveness.

Such maneuvering aside, budget holders can find themselves with a formidable problem: how to predict – sometimes in vast detail – variables that they cannot control and may not even understand. Budget holders might be expected, for example, to budget for a range of costs relating to occupancy that are based on centrally negotiated contracts for rent, maintenance, utilities and so on. Many times, non-financial managers are asked for unfamiliar financial information, rather than the physical cost and income-drivers that they understand so much better.

Problems grow even worse if budget holders feel they are working in the dark, unaware of strategic organizational goals. Not only do they miss the guidance that such information offers, but also they can be de-motivated by the suspicion that senior management has a hidden agenda.

An inadequate budgeting process provides little benefit to budget holders by focusing, as it does typically, on the mechanics of data collection rather than transparency and easy participation. And such a process tends to create much additional work in terms of data re-entry and version control.

### **Senior managers**

Senior managers also regard the budget with a mixture of suspicion and frustration. First, they can be concerned that the budget bears little relation to their carefully prepared strategic plans. This reinforces any misgivings they have that budget holders are quietly padding the budget with sandbags and fears that, as in previous years, the budget will contain substantial inaccuracies.

As a result, senior managers become frustrated by the inability to track underlying assumptions and identify and eliminate the sandbags. An inadequate budgeting system may provide little direct access for decision makers, making it difficult to track progress. It can also prevent changing conditions – such as a revised management hierarchy or product portfolio – from being reflected in the budget.

A common concern is that the whole budgeting process takes too long. Management is forced to take precious time away from operational duties, and the business suffers. The budget is not finalized before the start of the financial year, and as soon as it is completed, it is out-of-date, perhaps because another hiccup has occurred in the global economy and therefore strategic goals have shifted or organizational structure has changed.

In addition, executives worry that the predictions they are making to the board and other key stakeholders are not sufficiently substantiated by the targets to which their managers are committed.

#### **The finance department**

The finance department bears the burden of being viewed as the department or division responsible for managing company performance. Like senior management, the finance department is also frustrated by time gobbling budget cycles. Weeks and months are spent struggling with the mechanics of the process – chasing submissions, checking for incomplete or invalid data, trying to track and control versions – while responding to endless queries from all those involved.

Finance staff must also work long hours to complete their tasks on time. Staff workload is even more stressful, because intensity increases towards the end of the cycle amid struggles to incorporate last minute changes and respond to analysis requests as the budget is finalized.

Finance staff often grapple with myriad problems in fine-tuning the budgeting system itself, which might have been painfully complex to create. Even worse, the system might have been inherited from an ex-colleague, and home-grown systems are extremely difficult to maintain when changes are required in the middle of the budgeting cycle. As a result, an increasing level of manual intervention may be needed to deal with tasks that should be performed automatically. And once the budget is in order, staffers may have to re-key the budget data into another system to support variance reporting.

### The IT department

There is a fourth party involved in the budgeting process – the IT department. IT also takes a jaundiced view of the budgeting process, because it creates an unwelcome peak in demand for processing and network resources. IT might also be called upon to help untangle complicated spreadsheet-based systems that bog down at a critical point in the budget cycle. IT also has the role of pulling in the many sources of data needed for an accurate picture.

### Where does budgeting go wrong?

If budgeting is so important and so prevalent, why does it go so wrong? Most often, difficulties are rooted in the budgeting methods. There are two common approaches:

- **Base plus.** Many – even most – organizations simply take the prior year’s actuals and make arbitrary adjustments. If the business is in a stable, perhaps even regulated, market, the approach has some validity. Unfortunately, in the current economy with its global pressures (or some other root issue), there aren’t many businesses operating in such a static environment. The result is often a wildly inaccurate budget with little management commitment and little relevance to the strategic plan.
- **Zero base.** When base plus fails, many organizations move to a “zero base” budget. This method essentially takes the complete chart of accounts from the general ledger and asks each manager to predict figures for each line item. The result is that managers spend far too much time worrying about minutiae and making random guesses for line items about which they know very little. Again, the budget can be wildly inaccurate and irrelevant to the company’s strategic goals.

So what are the options? Some sophisticated techniques, such as activity-based costing (ABC), can provide dramatic improvement in accuracy but might only address isolated issues. They can provide clarity in understanding overhead costs; however, they don't address budgets for sales, margins, cash requirements and other important metrics. Unfortunately, as a result of these shortcomings, senior managers can often throw up their hands and simply impose a budget on the organization. That budget might relate well to the strategic plan, but its accuracy is questionable and it will lack the commitment of managerial budget holders further down the organizational hierarchy.

## Business drivers: Budgeting adds real value

Despite such challenges and issues, virtually no major corporation forsakes the budgeting cycle. There is too much risk in the end result to run a business without a financial plan. For one, a budget is a fundamental strategic tool for delegating authority throughout an organization. It ensures that managers clearly understand the quantifiable parameters used to judge their performance and it alerts managers to areas requiring corrective action.

In addition, for many organizations, the budget routinely serves as foundation for periodic forecasts. In its simplest form, a forecast is a revision of the budget – perhaps at a more summary level – that reflects changing business conditions, reassessment of key budget assumptions or perhaps a significant review of the strategic plan. Although most of the variables in a budget will be financial, there is every reason to include data relating to non-financial goals, which may determine much of the income and expenditure detail that dominates most budgets.

Budgeting is also valuable to organizations because it:

- Helps develop an understanding of business drivers and constraints
- Substantiates information for external use
- Identifies mismatches and exceptional changes
- Supports the strategic plan

### **Understanding of business drivers and constraints**

To succeed, an organization must build a clear view of the inter-relationships that drive and constrain its business performance. Too many confuse budgeting with collecting huge volumes of data, adding it all up and then arguing about the results. By focusing on the mechanics of the budgeting process, it's easy to miss one of its greatest benefits: the identification of the factors vital to an organization's success and the way those factors relate to the key performance indicators used to measure company success.

Success factors, often best understood by stakeholders within each department, can include lending rates, production capacity, number of field sales representatives, franchisee recruitment rate, number of meals served or inventory limits. A common understanding of such factors from the entire organization provides a sound basis for decision making. Knowledge of their relationship to other measures (such as revenue per head, customer retention or employee turnover rates) makes it easier to establish causes when actual performance deviates from the budget.

### **Substantiation of information for external use**

Although a budget is rarely published outside an organization, certain external parties – such as investors or creditors – will expect your budgeting system to provide detailed support for the business projections supplied. And auditors certainly want to know that the budgeting process ensures a sound basis for the management control mentioned previously.

Furthermore, board members, shareholders and potential investors will welcome the assurance that the summarized business plans they receive reflect a budget sufficiently detailed to support management decision-making. Especially in a public company, it's vital that predictions given to market analysts are based on well-prepared budgets (and forecasts).

**Identification of mismatches and exceptional changes**

When the budgeting process touches all parts of a business – through marketing, sales, product development, customer service, IT, HR and operations – it becomes relatively easy to identify and eliminate mismatches. Can production facilities generate the quantities you intend to sell? Can HR recruit people at the rate you need to expand your customer services yet hold down costs? Is there sufficient cash to cover expansion of your APAC operations?

Managers of any business will occasionally disagree or “push back” over resource allocations. If there are no arguments, it is possible that overall targets are too soft or that managers are not taking the budget seriously. The budgeting process helps limit conflicts to a discrete period in controlled conditions and forces agreement on a solution. The benefit is that arguments can be regarded as “settled” so that they do not drag on endlessly. The budgeting process also empowers budget holders for the year, because they have provided input, negotiated points of contention and gained a sense of autonomy.

In addition, the budget helps project year-over-year changes and can highlight exceptional growth or decline. Dramatic deviations can stem from simple data entry errors, but – more seriously – can also arise from erroneous assumptions touching business growth and development. Has the rate of change been budgeted at a level that is unachievable? Does the predicted rate of change force consideration of ripple effects – for example, the need to upgrade the computer network to support a significant increase in employee headcount?

### Support for the strategic plan

When they create summarized plans for performance over several years, senior managers get a long-term view of their business. In today's stormy business environment, it is likely they will have to change these plans frequently to analyze the potential impact of changing market conditions and opportunities. Often, they will produce several versions of the same plan to reflect a range of potential values for uncontrollable variables, such as interest and exchange rates and changes in consumption behaviors.

It follows that the budget should closely reflect the latest strategic plan. If there are discrepancies, the plan might be flawed, or perhaps senior management's key aims are misunderstood by the rest of the organization. The budget acts as a "sanity check" for the strategic plan and as a means of building management commitment to high-level, long-term goals. In a way, the budget becomes a self-fulfilling prophecy, because managers committed to it are far more likely to deliver performance in line with established targets.

### The solution: A best-practice model for budgeting

The purpose of enterprise planning is to help managers see the financial implications of various business scenarios. It is a continuous and rapid cycle that provides a near-real-time response. Indeed, the "most likely" business plan scenario often becomes the target for the upcoming budget cycle. Unfortunately, current budgeting practices do almost the opposite: they provide a response that is often outdated before it is even finalized.

Consider a typical budgeting scenario: Before creating a budget, managers and the finance department look at the last year's actuals to budget to understand gaps, overages, changes to plan and more. After that, the finance department provides guidance, gets everyone's agreement on assumptions and drivers and sets the level

to which budgeting will occur. Then the budgeters and department managers engage in back-and-forth dialogs or iterative processes and several reviews, until they reach an agreement. At this point, the budget is submitted to the finance department. As you can see, this does not encourage a real-time response or a comprehensive view of the budget and how each department's plans might affect others.

In a best-practice model for budgeting, the first step is to create a view of the business plan with enough detail for rigorous evaluation. For example, in the budget, a company might define headcount and compensation down to the individual level.

Once actuals start to roll in, managers and analysts can identify variances and understand their underlying causes if they have a well-designed budget. Actuals reporting is a highly centralized process; GL results are typically downloaded into a data mart for specialized reporting. With these reports, users should be able to drill down to the transaction level. For instance, marketing managers might want to see all advertising expenses by line item.

If the variances are significant, finance might consider creation of a new centrally managed forecast with summary level detail. For example, headcount and compensation might only appear as aggregate figures among all departmental expenses, rather than a figure for each individual employee.

Given the different but interrelated uses of plans, budgets and forecasts – along with actuals – many organizations require separate models to produce each deliverable. A best-practices model for budgeting provides an effective method for integrating and linking data between these different models, such as between actuals and

forecasts. It provides the flexibility to model your business accurately, can cope with multiple users and adapts easily to rapid change. Some key features of best-practice budgeting solutions are:

- **Multi-dimensional budgeting.** You want the ability to see revenue by customer, channel, period, product or region, for example, or expenditures by region, branch, department or season. And you want the budgets from the different parts of your company to align with the company's key financial targets.
- **Fast adaptation to changing constraints, assumptions and structures.** For example, if you're halfway through the budgeting cycle and you've acquired a new subsidiary or want to add new products, your budgeting solution needs to adapt rapidly and smoothly – and cover all departmental input.
- **Easy data import and export.** You need a budgeting solution that integrates easily with performance management applications for reporting, consolidation and scorecarding or common ERP systems and databases.
- **Simplicity for non-programmers to build models.** You want a budgeting solution that is user-friendly and user manageable, offers a choice of user interfaces and requires no arcane programming languages and little-to-no IT involvement.
- **Interactive simulation.** You need to be able to work iteratively, trying various scenarios with real-time responsiveness.

**Spreadsheets for budgeting? Think again!**

For many companies, a spreadsheet is the tool of choice for budgeting. Although spreadsheets are tremendous personal productivity tools, their numerous shortcomings prevent them from adequately managing a budgeting process of any significant size or sophistication. Consider:

- **Spreadsheets are two-dimensional.** Best-practice budgeting is inherently multi-dimensional. For example, you might want to budget revenue by customer, product, month and version.
- **Spreadsheets are hard to maintain.** In budgeting, speed is essential for staying abreast of business changes. A simple change such as adding a department or cost center can mean updating hundreds of spreadsheets and macros – which is neither quick nor easy.
- **Spreadsheets don't integrate well with other systems.** You'll want to import and export budget data to and from other sources, such as GL, ERP or HR systems. Spreadsheets are not designed to accomplish this with speed and efficiency.
- **Spreadsheet models are difficult to share.** The spreadsheet is inherently a single-user tool. Because there is no simple way to consolidate data from different sources, it's not only difficult to share data with other systems, but it is also difficult just to share data among different worksheets and workbooks.
- **Spreadsheet models are hard to understand.** If you've ever used a complex spreadsheet prepared by someone else, you know how tough it can be to understand its rationale, heuristics and objectives. And chasing cell references around a spreadsheet or workbook to understand just one formula can be an exercise in frustration.

In addition, a best practice budgeting model uses the right tools to ensure that a comprehensive picture is created, builds a budget modularly and multi-dimensionally, provides the right level of detail, limits budget holder input to decision points and uses different techniques for different needs.

**The right tools for the job:  
Analysis, modeling and collaboration**

Budgets are very much about control and this requires accuracy in the underlying data. The best way to ensure that accuracy is to rely on a best-practice budgeting model that provides tools that enable analysis, modeling and collaboration.

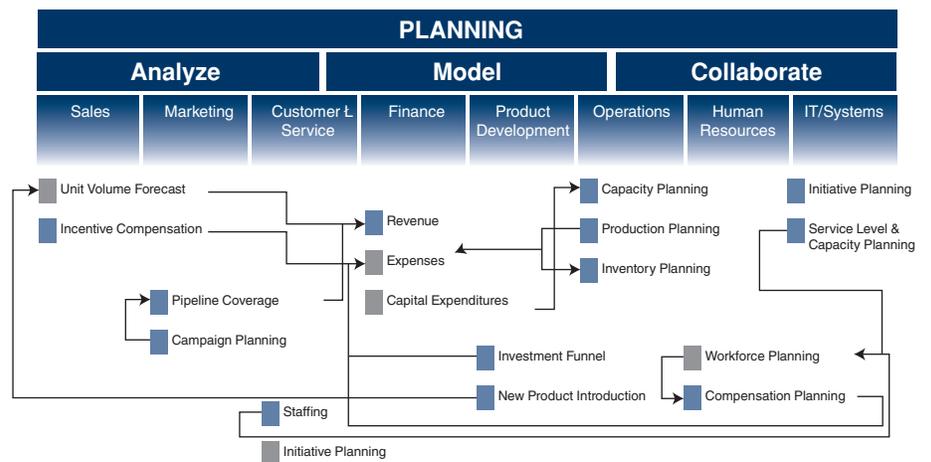


Figure 1. A solution providing analysis, modeling and collaboration is the dynamic nervous system for best practice budgeting and performance management

With deep analysis, you can validate plan assumptions, meet the dynamic needs of your organization and apply a fact-based approach to the budgeting process. Even before budgeting and forecasting, you can do a thorough analysis, exploring performance gaps, validating your company’s drivers and defining what-if scenarios, such as organizational changes, product family changes, channel mix changes and more.

With advanced modeling capabilities, you can facilitate the rapid adoption of best practices such as driver-based planning and rolling forecasts while meeting your company’s unique budgeting and forecasting processes and needs. With a modeling approach, everyone is on the same page because all budgeters have a consistent set of data and metadata. One key to budgeting is to understand cost allocations.

Performance management solutions, with flexible modeling at the core that reflect a company's business, enable that company to create rules to automate the allocations, no matter how complex.

With collaborative capabilities and familiar interfaces, your organization can develop timeframe-appropriate budget and plans, have high participation and can work with high data volumes. Rich workflow helps you manage processes – and with connectors and links, you can start small and work your way up until you've included your entire enterprise.

### **Build a budget modularly and multi-dimensionally**

Because the typical budgeting process can be overwhelming, a strategy for breaking it into more manageable pieces is critical. Different areas of your organization have different needs. A modular budget recognizes varying requirements and makes it easier to distribute the workload to numerous stakeholders.

The advantages are many:

- People with specialized skills, insight and knowledge can build different modules of the budget.
- Dividing the budgeting process significantly reduces cycle time.
- You can complete the most important modules first and focus on less important ones as time permits.
- New participants can learn the budget application a module at a time.
- Maintaining – and improving – the model is easier with a modular structure.

A multi-dimensional budget model reflects the way people really think. You might want to view revenue by product, by customer, by month or by country. With a multi-dimensional budget, you use a model flowchart to show how components logically link together – a useful tool for explaining the budget to new employees

or senior managers. Most budget holders will be especially interested in a personal workflow that takes them step-by-step through the actions that they must complete. A collection of simple, menu-driven process steps eliminates questions like, “What macro do I run?” or “What model do I open?”

### Don't drown in detail – find the sweet spot

Think of this practice as, “Beware of the Paperclip Counter.” The point is that there are diminishing returns in providing detail. As Figure 2 shows, you want to budget to a level of detail that maximizes insights while minimizing the costs of delivering them.

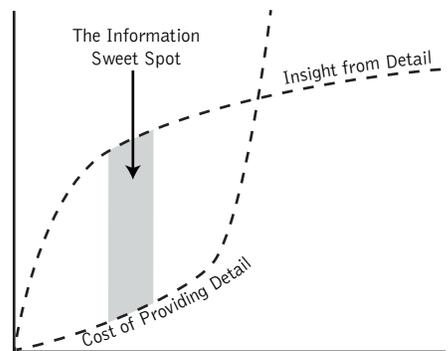


Figure 2. The information “sweet spot”

One of the main frustrations – for accountants and budget holders alike – is the level of detail they are asked to create. As hardware and software power increases, the problem worsens. Overzealous accountants want to fit increasing levels of detail into their budget models. As a result, budget-holders become victims of such time-consuming micro-management. And sadly, overly granular levels of detail offer little value and questionable accuracy.

For example, why demand the exact date of a new hire, when the month of a new hire will do? Or—why require detailed line items when a subtotal is sufficient? On the other hand, there is a danger that a budget can be too summarized and provide insufficient detail. The art of budgeting is to find the “sweet spot,” that is, the cross-over point (which will differ for virtually every organization and managerial style).

### **Limit budget holder input to decision points**

Given the mountains of details that can suffocate budget holders, the best strategy for securing their input and cooperation is to make the process as simple as possible. One of the key strategies for simplifying budgeting is to limit budget-holder input solely to the decisions that they themselves must make. Such a strategy:

- Reduces workload
- Forces explicit, rather than implicit, assumptions
- Forces consistent application of assumptions throughout the budget
- Enables assumptions to remain in the hands of experts with specialized knowledge and to hold them accountable

Here’s a simple example: In many multi-national companies, budget holders are asked to submit their figures in a standard corporate currency. The implications are not trivial:

- If the finance department supplies exchange rates, budget holders must perform all currency calculations.
- If no exchange rates are supplied, budget holders must assume an exchange rate, making it impossible to evaluate subsequent variances in actuals because the exchange rate is undocumented.

- Different budget holders with the same local currency might assume different exchange rates, so the budget is inconsistent.
- Budget holders are likely not the best people to estimate future exchange rates and may not have easy access to the specialized expertise required.

A budgeting solution based on best practices would enable users to contribute information in their own currency and would perform conversions automatically.

Another strategy is to require budget contributors to use drivers that are key to their area of the business. Because most budget holders aren't accountants, a requirement to budget for an income statement might not yield even vaguely realistic outcomes. But by limiting contributors to familiar business drivers, accuracy is greatly enhanced.

For example, a critical budget line item for most managers is salary. But asking non-financial managers for salary projections can be a big mistake: Estimates can be wildly inaccurate and susceptible to "fat" that hides extra funds. Far better for a manager to indicate the number of people she plans to hire, fire or transfer. A designated budgeting solution can use centralized assumptions to calculate direct-expense implications automatically.

**Use different budgeting techniques for different needs**

A best-practices approach to budgeting applies different budgeting techniques for different areas of your chart of accounts. Consider, for example, employee costs. Decisions from budget holders will differ between current and new employees. For existing employees, you can download a list of employees and their annual salary and other attributes from the GL or HR system. The technique is to budget incrementally for these attributes, with input required only for changing attributes.

For a current employee, answer questions like:

- When will she get a raise?
- How big will her raise be?
- What tax rates should be applied to her salary?
- When and by how much will her benefits change?
- When will she leave the department?

For new employees, there are additional questions:

- What month will he join?
- What is his annual salary?
- What will be his benefits?
- What is the justification for recruiting him?

The budget-holder should answer some of these questions. Executives should deal with others. For example, applying payroll tax rates is a centralized matter. For a visualization, see Table 2.

Budget Holder	Budget Holder or Central	Central
Assignment of purchase volume (or amount)	Listing of items to be purchased	Listing of asset categories
Assignment of purchase period	Assignment of asset category	Assignment of purchase prices
		Assignment of asset category life
		Depreciation assuming no capital expenditure
		Depreciation Method for each asset category (e.g. straight line)
		Payment terms by asset or asset

Table 2. The decision-making process

Another example is depreciating assets. One of the most discretionary parts of the budget is capital spending. This does not often get the attention it deserves because of its relatively low impact on the P&L. However, its cash flow impact can be significant. There are several different methods for handling the capital budget and resulting depreciation calculation.

You need to collect information from budget holders or from group departments (such as purchasing for predicted asset prices) so that your budgeting system can calculate depreciation and cash flow based on capital spending. If cash flow is important to the business, you may need to perform extensive sensitivity analysis.

#### **Driver-related costs (and revenues)**

Try to relate costs to drivers (for example, headcount) so that budget holders can budget something understandable and controllable; the financial impact of such assumptions should be calculated automatically.

For most purposes, there are two types of costing:

- **Centrally allocated:** This method is common when costs have a stepwise relationship to driver volume as shown in Figure 3. For example, if one cost center adds a few more employees, it does not mean you have to go out and rent new space. It just means you have to squeeze in a few more desks. But if all cost centers increase headcount, a decision to increase office space is a budgeting decision to be made centrally. If rent is allocated to different cost centers based on headcount, individual budget holders should not have to budget for rent. The rent for the entire budget should be input centrally – usually from an agreed-upon contract, and the individual allocations calculated based on budgeted headcount.
- **Volume x rate:** Volume x rate costing is the method to use when there is a linear relationship between driver volume and costs as shown in Figure 3. For example, adding a few employees will probably result in an increase in telephone costs. A

budget holder would not budget for telephone costs – a rate per employee would be applied to headcount budgeted earlier. This rate can be a default supplied centrally (possibly based on history) which the budget holder may be empowered to edit.

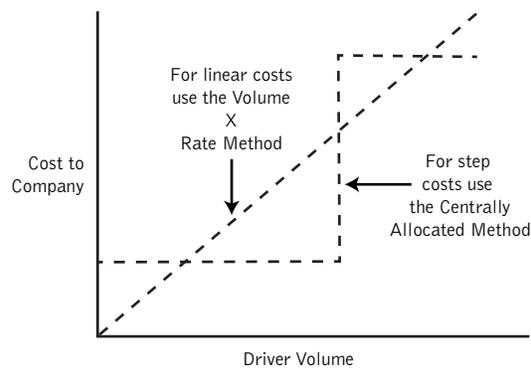


Figure 3. The decision-making process

### Costs not related to drivers (and revenues)

When a cost item cannot be associated with a driver, other budgeting techniques have to be used. As noted previously, the most common approaches are base plus and zero base.

In the base-plus model, the budget line item is derived from the actual expenditure in a previous period. This is typically used for items with high volume, low discretion and low unit costs. The budget holder merely indicates a percentage or dollar difference. A useful advancement of this technique is if the budget holder can do it just for the full year and if a known seasonality curve can be applied.

For the zero-base model, the budget holder is asked to budget in detail the expenses for certain cost lines. This technique should be used when expenditure history is not necessarily a good guide to the future and the expenditure is highly discretionary, low volume and high unit cost. For example, a budget holder might be asked to give details of a proposed software expenditure, which might include items such as purchase of a new GL system.

## How to judge the excellence of your budgeting process

The excellence of your budgeting process can be determined by these criteria:

- **You are able to deal swiftly and effectively with change.** Both during the budget cycle and as the financial year progresses, you will need to reassess the budget to reflect ongoing movement in underlying assumptions, mistakes made in the original budget and fundamental changes to your business direction and structure. Wherever possible, such change should be achievable by flexing the budget, and an effective budgeting system will easily adapt to significant re-alignments in the organization and the marketplace it serves.
- **Your budget is consistent with the strategic plan.** The budgeting system makes it easy to compare your budget with the strategic plan and identify anomalies. Reconciliation is possible by either making top-down adjustments to the budget or adjusting the strategic plan to agree with bottom-up budget changes.
- **Every budget holder feels empowered by clearly agreed-upon boundaries.** The key here is “agreed-upon.” The motivation of individual budget holders to contribute effectively to the budgeting process and subsequently to deliver performance in line with, or better than, their targets is critical. You can maximize motivation if budget holders can contribute their judgment on the variables that they control and understand how to use a system that makes the most effective use of their time.
- **Your budget has been completed on schedule.** A common criticism of budgeting is that it takes too long and that it always seems to overrun the time allotted. Participants’ motivation – and the quality of their input – drains quickly when the intensive exercise appears to be unending. Using the right software, budget deadlines can be met with a process measured in weeks rather than months.

- **Everyone agrees that the process was worth the time and effort.** Your company cannot achieve this somewhat nebulous objective overnight. Those making the budget should subject it to continuous improvement based on detailed feedback at the end of each budget cycle, from all parts of the organization. The feedback mechanism should consist of a brief questionnaire, which will generate useful ideas for improving the budgeting process and will also help build commitment to the budget cycle.

### IBM Cognos software connects budgeting with critical factors that drive company performance

Many software solutions have been developed to simplify the task of budgeting; however, choosing the right one can be complicated. Certainly, a solution that is easy to use is an important consideration, as is the ability to customize to meet particular business needs. But even more important is how well the software enables you to connect budgeting with other critical functions that drive company performance – monitoring and measuring results, analyzing performance and planning for multiple scenarios. And if a budgeting software solution can't easily tie together data from organizational divisions, enable flexible modeling and what-if scenarios and facilitate communication throughout your company, chances are it will be ineffective.

IBM offers world-class budgeting solutions specifically designed to improve enterprise performance. With enterprise planning and analysis solutions powered by IBM Cognos 8, you can address specific issues or collectively support performance management initiatives. Your business drivers are tied to your budgets and forecasts, not hidden away in a drawer somewhere.

An IBM Cognos enterprise planning and analytics solution can help you link data between all the departments, centralize meta data and data and business rule definitions are recorded and accessible, rather than hidden, tacit or implied. You can also extend your enterprise resource planning investments with connectors to ERP systems.

IBM Cognos enterprise planning solutions offer familiar spreadsheet and Web interfaces for a broad range of users. These enterprise planning solutions also provide the capability to analyze, model, and collaborate as a basis for your budgeting processes.

The effectiveness of IBM Cognos solutions is evidenced in our customer base, which includes nine of the top 10 consumer goods companies, 80% of the top 25 pharmaceutical companies worldwide, nine of the top 10 banks in the U.S., and many more. Enterprises have saved millions with IBM Cognos software and solutions and cut lengthy budget cycles by months.

## Conclusion

Despite its challenges and issues, virtually no major corporation can forsake the budgeting cycle. There is too much value in the end result to run a business without a financial plan. Budgets are fundamental strategic tools for delegating authority throughout an organization, ensuring that managers clearly understand the quantifiable parameters used to judge their performance. In addition, for many organizations, the budget routinely serves as foundation for periodic forecasts. In its simplest form, a forecast is a revision of the budget – perhaps at a more summary level – that reflects changing business conditions,

IBM can take the headaches out of budgeting with tools for analysis, modeling and collaboration – the cornerstones of modern-day planning. With enterprise planning and analysis solutions powered by IBM, your company has dynamic control over the process and you don't have chinks in your budgeting: Plans from all corners of your company are linked together, from top to bottom and bottom to top, so that budgeting and forecasts can be performed rapidly and with increased accuracy. Greater visibility into where you are heading creates greater control, more choices, and greater opportunity.



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## About IBM Cognos BI and Performance Management

IBM Cognos business intelligence (BI) and performance management solutions deliver world-leading enterprise planning, consolidation and BI software, support and services to help companies plan, understand and manage financial and operational performance. IBM Cognos solutions bring together technology, analytical applications, best practices, and a broad network of partners to give customers an open, adaptive and complete performance solution. Over 23,000 customers in more than 135 countries around the world choose IBM Cognos solutions.

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