

Budgeting Best Practices

David Brode
Minotaur Financial
1919 14th Street, Suite 510
Boulder, CO 80302
(303) 444-3300
david@brode.net
www.brode.net

I. Summary

This article discusses techniques to increase the accuracy and utility of the budget through implementing budgeting best practices which will minimize the effort required from all participants.

Specific recommendations are to plan and review at a higher level than is traditional, create a process efficient enough to be conducted quarterly, and ensure spending can be tracked against the budget.

II. Budgeting Principles

The budget is primarily a measuring stick, not a forecast. The real forecast is set forth in the strategic plan. Thus the annual budget is only useful for filling in details which we can track against. Furthermore, only budget a line item if the accounting system can report against it. The budgeting exercise is useless if you cannot track progress against the budget numbers.

Avoid excessive detail. Pareto was right: 80% of the issues are in 20% of the items. When budgeting, identify and focus on the high-impact items only. Have the discipline to let other items remain lower priority. There's a limit to how detailed the budget should be. Getting down to each postage stamp is not useful, neither is going to full general ledger detail. The proper balance is somewhere above that, where you can see trends in major categories but not be forced to forecast dozens of line items.

Headcount costs deserve a detailed look. Salary should be planned at the employee level. When listing employees, be sure to code them by department/group so the expenses can appear in the group's final budget. Benefits and taxes should be calculated according to general rules and charged to the department/group. If the charges are part of G&A's budget, then no manager has the ability to control this line item. Managers need to realize that adding \$100K in salary adds another \$12K (for example) automatically in taxes/benefits.

Other categories should follow the 80/20 rule. One recent client was budgeting over forty items for each department. Relatively simple analysis showed that 15 categories accounted for 90% of expenses. So these categories were budgeted directly and the remaining categories were budgeted using one "Other" line. Should corporate require displaying detail for the extra 25 accounts, create an allocation process to fill out detailed general ledger accounts from the Other line using historical ratios. Granted, it is an extra step, but the time savings up front from not focusing on minor items frees up the time to do this simple process at the end.

Plan often. Annual plans are a relic of a bygone era. Conditions change rapidly and require us to respond rapidly. Fortunately, we have the technology to do so. Budgets should be re-set quarterly and the annual budget process should not be significantly different from the quarterly budget forecast. Of course this raises issues about whether managers will sandbag the last three quarters of the forecast since it will be redone in three months, but there are numerous ways to discourage this behavior.

III. Management Challenges

Conduct reviews at a higher level. It is easy to get caught up in reviewing lots of details because it seems more accurate. This discourages actually thinking hard about how the business really works and how the business can be improved. The best forecasts (and analyses of business practices) are done at a level significantly higher than the greatest level of accounting detail.

Review economics, not line items. In reviews, stick to the 80/20 analysis. If senior management has difficulty accepting that we have 10% of expenses in “Other”, we need to have the analysis showing how that has been historically true and they cannot slice it out just because it says “Other”. The argument is that it is a waste of time to show 25 more accounts worth of detail when we know that all these piddly accounts inevitably add up to 10%. This will take management fortitude.

In general, senior management needs to keep focus during the process and not ask for immaterial details. It really messes up the work of Finance and annoys department heads..

The reverse is true when meeting with department heads. Focus on the big things and let the “Other” line go so long as the percentage of other expenses is reasonable. In fact, we should probably tell them what the percentage is and forbid them from changing it.

Use targets. In the end, the final numbers for the budget are often set from the top. So it makes sense to know give managers that number up front and have them try to create a budget which fits into those parameters. Practically, this means creating expense targets for each department or group **before** they fill out their budget. As much as possible, get manager buyoff to the initial target. Then they just have to produce details which add up to the target.

One typical problem is that senior management will review the results multiple times, so everyone does the same work again and again. Using targets properly to cut down these unproductive cycles.

Get good analysis out of Finance. Typically, the process gets so rushed that Finance just delivers consolidated numbers. To get analysis of the budget two

related things must happen. First, give department heads firm deadlines for submitting quality results. These deadlines need teeth. Second, give Finance enough time to do the analysis. All too often, the departments get more time and it comes out of Finance's analysis time. This can't happen!

Enforce the integrity of the process. Track spending and enforce rules that managers can spend only in accordance with quarterly budgets. Closing this loop ensures that department managers will take the process seriously.

IV. Budgeting System Analysis

How good is your budgeting/forecasting system? Minotaur Financial offers a complimentary 20-point review of your company's systems. To get a report on your materials, contact David Brode at (303) 444-3300 or email to David@Brode.net.

About Minotaur Financial

Minotaur Financial is a 12-year-old consulting company based in Boulder, Colorado with expertise in finance and financial systems development. Minotaur Financial customizes financial models to support fund raising, M&A, and strategy development, designs and implements planning, budgeting, and reporting software systems for operating companies, and has served as a corporate finance advisor to startups through Fortune 500 companies.