Finance & Performance Management

Budgeting and Forecasting: Issues and Leading Practices

accenture

High performance. Delivered.

• Consulting • Technology • Outsourcing

Building finance and performance management mastery with superior budgeting and forecasting capabilities

By Stephen Hunt, Accenture

Accenture's ongoing research into the characteristics of high-performance businesses reveals a strong correlation between those companies that achieve finance mastery and those that surpass their peers in overall business performance. Finance executives of leading companies continually strive for greater efficiencies and effectiveness in their finance operations. And they foster a value-centered culture that motivates and enables employees throughout the enterprise to create shareholder value at every turn.

In this value-driven environment, the adoption of leading budgeting and forecasting practices is critical to achieving finance mastery and, ultimately, high performance.

Ask most CFOs and finance directors to describe an ideal forecasting and budgeting process, and they'll likely portray it as part of an overall integrated performance management framework, ultimately driven by value-based measures. At the same time, however, they'll admit that achieving this vision involves a significant transformation to their current forecasting and budgeting processes, systems and organization. Accenture's experience shows it can take, depending on complexity, anything between one to three years to fully implement and embed these changes.

Meanwhile, finance organizations face a more immediate problem. Legacy systems and processes that have been in operation for the past 10 years are often broken. Despite significant efforts, they can no longer support the dynamic changes affecting the business. Increasingly, then, the question becomes, "What practical steps can we take to improve or replace existing processes and systems?"—usually combined with "before we start the next budgeting cycle."

The good news is that the solutions deliver significant and usually exponential benefits. However, any tactical solutions should not detract from pursuing a longer-term strategic forecasting and budgeting solution that is aligned to overarching business requirements and supports the organization's ongoing efforts to achieve high performance. In fact, tactical efforts that deliver quick wins and visible benefits are essential in obtaining support and sponsorship for an overall strategic initiative.

As with any long-term solution, successful tactical initiatives require strong executive sponsorship, a robust and proven approach, a persuasive business case, and a significant change to the way the organization views and operates the forecasting and budgeting process.

Articulating the Issues

Although issues with the existing forecasting and budgeting process and systems are often well-known, it is important to fully document and communicate their impact to gain executive sponsorship, drive momentum for change, and ensure that the benefits are understood (see Figure 1). This is especially true since many of the benefits are qualitative and focus on accuracy and accountability.

Frequency and Timeliness

Annual forecasting and budgeting cannot keep pace with today's dynamic business environment because the information produced is often out-of-date and irrelevant. Managers need to be able to understand and respond quickly to the impact of competitive forces and rapid changes affecting their business. Yet most organizations fail to forecast the financial impact of these changes fast enough.

All too often, the end-to-end process takes too long. Quarterly forecasts take two to five weeks to finalize. Budgets are often not finalized until well into the actual year to which they apply. Similarly, the time taken to produce each iteration of the forecast or budget is too long, frequently taking days and sometimes weeks. In today's environment, the impact of any change to the financials needs to be understood within the day or even the hour.

It is surprising that the need for faster delivery of forward-looking forecasts and budgets has not received more attention, especially in light of the time and effort spent implementing ERP solutions and the drive toward a faster close, which, by definition, provides backward-looking information.

Flexibility

Most forecasting and budgeting processes and systems lack sufficient flexibility to accommodate the reorganizations, divestitures, mergers and acquisitions that have become the hallmark of contemporary business. These changes need to be modeled and reflected within forecasting and

Figure 1. Budgeting and Forecasting Issues

budgeting systems, both in the future and also retrospectively to ensure relevant prior-year comparisons. Without this flexibility, finance professionals spend significant time and effort restating the numbers.

In recent years, this effort has become so immense that more and more organizations choose not to make restatements, deciding instead to highlight them via footnotes within the forecast and budget documentation. This creates historical comparisons and trend analyses that hold questionable value.

In addition, most systems are not flexible enough to accommodate the demand for multiple views of forecast and budget information. Consequently delivering slice-and-dice views of data and what-if analyses requires time-consuming, offline data manipulation.

Cost and Effort

The cost of existing forecasting and budgeting processes is significant and appears to be growing every year. Accenture's Planning for Value research study, conducted in conjunction with Cranfield University found that the budget process for lower-quartile companies takes longer than six months. Similarly, $1 billion companies take, on average, 25,000 man-days to complete their budget. By reducing this effort, companies can free up time to focus on other initiatives that drive greater value and high performance. This finding is supported by research at the Cranfield School of Management, which found that companies that successfully addressed their planning and forecasting issues saw an average share price growth of 116 percent over three years, 221 percent over five years and 373 percent over ten years.

Accountability and Ownership

The finance function is so involved in forecasting and budgeting that it becomes the owner of the process rather than the facilitator. "These are not my numbers" is a regular cry heard when operational management reviews forecasts and budgets. This has much to do with last-minute changes made without the agreement of all those involved.

Transparency and Access

Lack of accountability also relates to the lack of transparency and access to information offered to operational management. Operational managers work hard to produce information but may receive little or no feedback after the numbers are submitted and, thus, cannot easily view the forecast and budget information presented to senior management. Often they are also unable to access the data for modeling or examination. As a result, they see the forecasting and budgeting process as an effort by the finance function to collate and aggregate bottom-up data, turning it into "just another management request for information."

Accuracy and Version Control

Forecasts and budgets are often inaccurate. Despite technological advances, most organizations use a patchwork of spreadsheet models to undertake their forecasting and budgeting, with multiple hand-offs and revisions throughout the process. Inaccuracies arise due to lack of version control, transposition of numbers, and unallocated numbers ("buckets") with aggregated data not equaling the sum of their parts. The impact is significant, leading to a lack of confidence in both the numbers and the ability of the finance function to deliver.

This impact extends to the analyst community as well, creating potentially a far greater cost to the organization. Empirical research tells us that shareholder value is materially affected when companies fail to provide accurate projections of business performance.

Finance Skills and Morale

Trying to manage such a problematic process often takes a toll on those involved and has a negative impact on how the finance function is perceived. Though forecasting and budgeting is often managed and operated by highly qualified finance professionals, the function can be relegated to nothing more than a factory for producing numbers. Rather than focusing on delivering value-added analysis, the finance function spends a disproportionate amount of time and effort cranking the numbers through multiple iterations using ill-equipped mechanisms and processes.

In summary, these issues combine to deliver a forecasting and budgeting process that takes too long, costs too much, and is too manually intensive. To make matters worse, the resulting forecast or budget is typically inaccurate, lacks accountability, and is out-of-date by the time it is produced.

Applying Leading Practices

Although much has been written about leading practices in budgeting and forecasting, most of it has been academic and theoretical (see Figure 2). Now, however, technological advances make it possible for companies to implement capabilities that bring these practices—and their benefits—to life.

Figure 2. Budgeting and Forecasting Leading Practices

Organizations that recognize the link between high performance and forecasting and budgeting mastery are increasingly adopting the following practices. Importantly, no one practice offers a remedy for all the issues outlined above. Only by implementing a combination of these practices can organizations really begin to overcome the forecasting and budgeting problems they face.

Rolling Forecasts

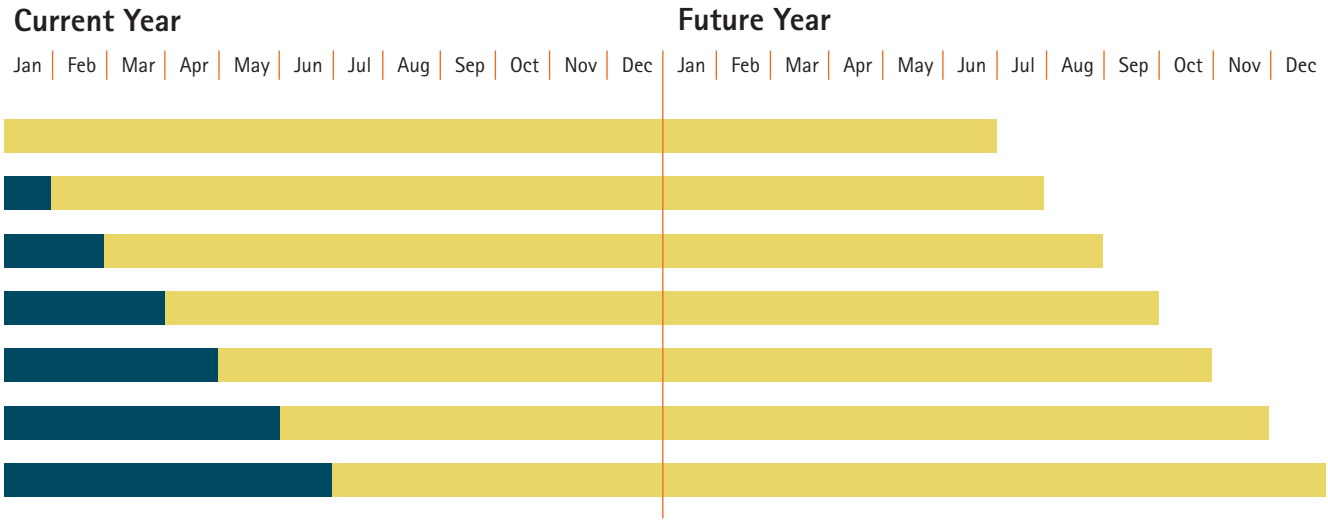
Traditionally, the budget process has been a one-off event, albeit a long and arduous one. Forecasts, though more frequent, remain a series of one-off quarterly events.

Significant gains can be made from eradicating this single period/annual mindset and moving to a rolling forecast approach. Operations do not switch off on December 31 each year and start afresh on January 1.

Customers do not think of business in this way, so why should finance organizations monitor and manage the business in such discrete timeframes?

The first step in implementing rolling forecasts is to define what is meant by a "true rolling forecast." Figure 3 best illustrates the concept of an 18-month rolling forecast. As each additional month's actual information is finalized, the forecast is updated to provide an additional month's forecast, thus always providing an 18-month projection into the future.

Figure 3. A True Rolling Forecast – Blue bars indicate actual results



The move to rolling forecasts provides a number of benefits, in particular:

Reducing or eliminating the traditional approach of the previous period plus an uplift. This approach forces the individuals undertaking the forecasts to update their business projections each month and embed the activity in monthly procedures;

Helping to eliminate the annual mind-set and focus on the current year, acknowledging that the business functions as an ongoing operation and needs to be managed accordingly;

Providing a continual 18-month, for example, business outlook at all times, enabling management to take remedial action as forecast business conditions change;

Eliminating the unrealistic December-to-January gap that appears when next year's budget is calendarized for the first time. By undertaking rolling forecasts, the December-to-January forecast is no different than any other two-month period; and

Reducing or potentially eliminating the annual budgeting process. At the normal budget time, management will already have a very good idea of what the following financial year will look like from their latest rolling forecast. For example, an organization operating an 18-month rolling forecast will already have, at the end of the second quarter, a complete projection for the next financial year.

Perhaps most notably, rolling forecasts serve as a mechanism to promote a culture in which value creation and measurement is foremost in the minds of the employees throughout the organization. Accenture's research revealed that such a value-centered culture not only distinguishes high performance businesses from their peers, but also serves as the core foundation upon which finance's contribution to an organization rests.

Rolling forecasts engender financial thinking and enable value-oriented metrics to pervade the organization, becoming the common language of the company. This, in turn, guides decisions and actions that lead to high performance.

An alternative to a true rolling forecast is a "fixed period rolling forecast." Although this approach has the benefit of ensuring that forecasts are updated monthly, the benefits just described are not fully realized because the forecast remains focused on the current period. The key problem with this approach is that the business still has a fixed horizon—with associated performance management implications.

Increasingly, high-performance businesses have moved or are moving toward rolling forecasts. This is no small achievement. Usually there is significant cultural attachment to the forecasting and budgeting process, so the transition to rolling forecasts should not be underestimated. A budgeting process, for example, that starts in March and ends in August can become a raison d'être for the finance organization during this period, with much political power and control associated with the process.

In adopting rolling forecasts, a number of practical issues must be addressed. Most importantly, the transition to rolling forecasts cannot be done in isolation. It is not simply a matter of repeating on a monthly basis what is currently undertaken quarterly or semi-annually. This message must be communicated early in the process, or managers will worry that they "won't be doing anything else but forecasting all day."

Transitioning to an 18-month rolling forecast immediately can prove difficult, especially if the new process involves operational managers who have not directly participated in the forecasting process before. If the organization conducts forecasts semi-annually or less frequently, moving to

a quarterly forecast first is a sensible option. If the organization forecasts quarterly, an approach to transition would be to first move to a rolling forecast with the required detail for the first six months and then to quarterly totals for the remaining period.

In reality, the organization may be unwilling to completely discard quarterly forecasting or annual budgeting activities. Indeed, more detail may be required for quarterly forecasting and annual budgets due to external reporting requirements. Rolling forecasts do not remove this need, but they do provide management with timely information to support business decisions. Over time, the existing spiked quarterly effort will—and should—reduce as the rolling forecast becomes embedded in the monthly management of the business.

Increased Participation

Driving down the forecasting and budgeting process to operational managers has gained more ground as the best way to ensure accurate and reliable forecasts. Historically, any suggestion of this approach would have been met with disbelief, giving rise to visions of even more data aggregation, longer cycle times and increased manual handovers. However, technological advances in recent years, most noticeably web-based technology, have given rise to a number of solutions that are highly scalable to hundreds and even thousands of end users. As a result, the forecasting and budgeting capability can be placed in the hands of the business. The advantage of this is obvious—those who can produce the best projections of business activities are those who undertake and are responsible for those activities.

For example, a bank with a large branch network may have the finance function carry out forecasting and budgeting activities at a regional or group level, using tools and techniques available only to them. Today's web-based solutions enable the process to be driven down to the regional or even branch manager by providing little more than access to an Internet browser.

Of course, as with any new initiative, delivering sufficient practical training to the end users is essential for successful adoption of the new solution. Training should not be limited to the new technical solution, but also to the underlying concepts of forecasting and budgeting. A recent example of a forecasting and budgeting implementation saw the users receive a half-day training session, only 15 percent of which was targeted at the use of the technical solution. The majority of the session was focused on such basic concepts as "What is a forecast?", "What is the organization trying to achieve with the forecast?", and "Where and how do you get the underlying information?" This type of training is critical to instilling a value-centered culture that drives high performance.

Detail Linked to Accountability

Another leading practice involves linking budget details to those items that end users are actually accountable for and which they control. In short, keep it simple and relevant. Traditionally, finance professionals have relied heavily on line-item detail. In fact, Accenture's Planning for Value research study found that bottom-quartile companies budget for more than 250 items. Projecting at such a level of granularity is not only unrealistic but also unwieldy. In contrast, by linking detail to accountability, accuracy will likely increase as operational managers forecast or budget items that they manage and discuss on a day-to-day basis.

Returning to the banking example, suppose that the regional finance function currently undertakes a forecast of regional and branch profitability. When driving down forecasting and budgeting to the branch management level, there is little point in forcing branch managers to forecast profitability, since they have no

control over the pricing of mortgages or savings products their branch sells or the cost of funds associated with them. What the branch or regional manager is accountable for, however—and acutely aware of—is the number of mortgages and savings accounts sold and managed by the branch.

Practically, the roles and responsibilities of operational managers should be assessed to understand what common elements of the business model they are accountable for and—just as importantly—for what elements they are not.

Driver-Based

Driver-based forecasting and budgeting enables the underlying business model to be encapsulated within a standardized and structured forecast and budget capability. The benefits can be significant and include:

- Releasing potentially hundreds of business users from building and maintaining individual, usually spreadsheet-based, forecast and budget models.
- Allowing common parameters to be incorporated within the models, eliminating the need for end users to forecast items for which they are not responsible.
- Ensuring transparency and providing modeling capabilities to operational managers.
- Providing management with the confidence that forecasts and budgets are derived from one common modeling methodology and set of algorithms.

In addition, thought should be given to incorporating an upward reporting and governance process for forecasting and budgeting into the model. To support this, many of the new technical solutions provide for multiple hierarchies and online workflow control.

Using the banking example, a driver-based modeling capability provided locally to branch management would incorporate common information on price, cost of funds and central allocations. Local branch management could then forecast the volumes of savings and mortgage products, as well as branch costs. With these forecasts, managers could calculate branch profitability. Similarly, individual branch profitability would then aggregate automatically through the reporting hierarchies to provide regional, divisional and country profitability.

Finance executives wanting to implement driver-based forecasting and budgeting must make a concerted effort to ensure that various business stakeholders understand the business model and processes and can translate them into the appropriate driver-based model.

End-User Analysis

Advances in forecasting and budgeting applications enable analysis and reporting capabilities—not just data collection—to be deployed to a larger and widely distributed base of operational end users. Previously, finance was the only function with access to modeling tools, such as spreadsheets and business objects, and the training and skills to use them.

In the banking example, a branch manager using a local forecast or budget model could undertake what-if analyses to assess scenarios for deploying branch staff to different activities. Providing analytical capabilities to local operational managers gives them tools to manage and track their local business. This helps empower local management and ensures buy-in to the new forecasting and budgeting process.

Again, this requires upfront investment to understand the business requirements of both operational management and senior management. This ensures that operational managers receive a model with reporting and analytical capabilities that help them run their local business. Building only the analysis required by the corporate center into the forecasting and budgeting tool will compromise the end users' perception and successful adoption of the solution.

The Way Forward

While no one particular leading practice solves all the issues, leveraging a combination of practices enables operational managers to adopt forecasting and budgeting processes as key management tools.

To facilitate this greater level of involvement from operational management, forecasting and budgeting processes and systems must be timely, relevant, and useful to end users. No longer should the budget process be a one-off event that is rushed through as an administrative chore.

In an ideal world, forecasting and budgeting processes and systems become so embedded at the operational level that aggregating results for management is merely a byproduct of a value-centered culture. In this scenario, operational managers use highly effective forecasting and budgeting tools in their normal management routines to achieve finance and performance management mastery and establish a solid foundation for high performance.

Accenture is a global management consulting, technology services and outsourcing company. Committed to delivering innovation, Accenture collaborates with its clients to help them become high-performance businesses and governments. With deep industry and business process expertise, broad global resources and a proven track record, Accenture can mobilize the right people, skills and technologies to help clients improve their performance.

Author

Stephen Hunt is a senior manager in the Accenture Finance & Performance Management service line in London and is a subject matter expert in performance management areas including budgeting, forecasting, strategic planning and management information.

This article was first published by the CFO Project. Reprinted by permission.

Contact Us

To find out how Accenture can help you benefit from the opportunities offered by tax-efficient operating models, contact us at:

fpm.service.line@accenture.com
or via www.accenture.com/fpm