The annual budget:
Is there a better way?

talentia Software

Inspiring progress

The annual budget: Is there a better way?

Finance's role is evolving in line with the quickening pace of business. Increasingly, practitioners – especially senior professionals operating at Board level – are now striving to support strategic objectives and work collaboratively with other departments to achieve corporate goals. Time is a precious commodity and as such the large investment of resource required to research, develop and edit an annual budget and maintain version control throughout the process is a growing concern.

A significant number of finance professionals interviewed as part of a 2015 KPMG/ACCA survey described the corporate budget as politically agreed and not linked to operational reality. Furthermore, many also stated that the annual budget quickly becomes irrelevant as the financial year progresses. Are attitudes towards the process changing, or does the annual budget still play a valuable role?

'There are few processes that generate as much disdain in an organisation than the annual budget,' says Tom Willman, global practice leader for finance advisory at The Hackett Group. 'Many companies build an annual plan that ends up being irrelevant and out of date by the time it is approved, due to changing market conditions.'

The pitfalls of an annual approach

Annual budgets serve an essential purpose, making sure that necessary funds are available to cover future investment and growth plans following careful evaluation of business performance. However, the annual budget's inflexibility is now somewhat at odds with the fast-moving culture of many companies.

Developing an annual budget forces an organisation to predict revenues and expenditure at the start of a financial year and agree what will be needed for the next 12 months. That is no easy task, and is a growing challenge in the face of an ever-changing economy.

The benefit of planning in this way is that it enables measures and structure to be put in place to facilitate growth and expansion. However, it can also have its disadvantages. Instead of frequently re-allocating resources in line with the changing corporate landscape, sticking solely to an annual budget can actually constrain a business, potentially stifling the full extent of its growth.

Use it or lose it: encouraging a dangerous mentality

When viewed in isolation, annual budgets can hamper performance by limiting risk-taking and strategy. Great ideas may be delayed or, worse still, not even presented to management if they appear to be outside the scope of an agreed pre-determined budget. Setting a budget so far in advance can not only reduce 'blue-sky thinking,' but may also mean key market opportunities are overlooked.

Perhaps more worrying still, an annual budget can also encourage unsuitable, short-term purchasing decisions as well as a dangerous 'use it or lose it' mentality. Departments working to a strict annual budget will typically look to make sure that it is spent in full during the financial year for fear of having their future funds reduced.

Known in the UK as March Madness and in the US as September Madness, researchers Jeffrey Liebman and Neale Mahoney noted that "unspent funding may not only represent a lost opportunity but can also signal a lack of need to budget-setters, decreasing funding in future budget cycles." Their report also found that "the quality of services and products bought at the end of the fiscal year was lower than for the rest of the year because of the rushed nature of the purchases." While by no means a new concern, this clearly highlights the need for a more dynamic and time-sensitive approach.

The shift towards rolling forecasts

By its very nature, the annual budget will only ever be deemed accurate when viewed retrospectively: the process simply does not allow for unforeseen global events or disasters that can have a big impact on the economy. The use of manual spreadsheets for budgeting also remains commonplace and the danger of this is the high probability for human error, with version control an onerous and time-consuming manual task. Ensuring that parties contribute data within clear, closely-controlled parameters is absolutely essential to achieving data accuracy during the budgeting process.

Corporate environments rarely remain static and the rise of big data means that huge swathes of information can be accessed in real-time. Against this backdrop, the use of rolling forecasts is growing. This allows targets to be readily adjusted based on actual corporate progression and the very latest available data, dealing with the realities of business today. Finance professionals recently quizzed by CEB echoed the importance of this, citing "timeliness" as one of the most important attributes of their forecasting process, with 26% stressing the importance of "accuracy."

Great ideas may be delayed or, worse still, not even presented to management if they appear to be outside the scope of an agreed pre-determined budget. Setting a budget so far in advance can not only reduce 'blue-sky thinking,' but may also mean that key market opportunities are overlooked.

A forward-thinking approach to budgeting

The annual budget remains important but its role has changed. A recent survey revealed that 17% of finance leaders find the annual budgeting process to be very valuable but do not use it as an absolute baseline measure. While the budget focuses on broad revenues, costs, profit, headcount by department and other key organisational KPIs, rolling forecasts support this by drilling down into more depth. Used in this way within a Corporate Performance Management (CPM) solution, rolling forecasts provide what is needed to make informed, data-led decisions on an ongoing basis.

CPM solutions are now streamlining processes and offering advantages over traditional budgeting-led software – especially where multiple stakeholders are involved. Within a CPM model, all those feeding into the process will complete a clearly-defined and controlled template with the information required, supported by workflows, to turn this information into rolling forecasts that compare a company's actual performance against its budgeted performance. This encourages an efficient, collaborative approach between departments, and the benefits are clear at all levels.

For a Financial Controller, the ability to access all information in one location allows for figures to be thoroughly analysed to assess business performance. For a Chief Financial Officer, robust reporting tools are an essential step in making sure that figures stand up to close external scrutiny, as well as ensuring that financial information can be used to shape organisational strategy.

This allows it to be compared with the latest actual figures. It also provides the necessary consolidation process, by calculating aggregate figures for each level in the organisation in each business unit. It also drives cost and other allocations.

The use of rolling forecasts is growing. This allows targets to be readily adjusted based on actual corporate progression and the very latest available data, dealing with the realities of business today.

Anticipating future corporate challenges

Forward-thinking organisations are now looking beyond the annual budget to measure corporate performance and anticipate future challenges. Looking at success purely in terms of budgets can overlook elements that are core to a company's performance and growth, including client retention, staff turnover and the reputational and productivity impact that these areas can have if not closely monitored.

Replacing the high-level budgeting process is not the answer but equally using an annual budget as the primary performance measurement method is not enough for fast-growing businesses; the process is inefficient and can even get in the way of progress. With finance professionals now expected to do more with non-financial data, looking at the numbers in isolation can mask corporate challenges and the preparation required to meet the future. Profitability alone does not necessarily reveal the full picture.

Budgeting-led software also tends to focus on internal examination but to really grow competitor activity, macro industry issues and market share must all be examined; doing so allows for flexible budgets and rolling forecasts, based on real-time analysis of the wider market. To thrive in today's corporate environment, companies must move away from placing such an onus on the annual budget. Comprehensive reporting that provides vital analysis on a company's health is the only way to avoid the pitfalls of introspective planning.

Talentia CPM

Talentia's CPM product suite includes:

Budget Reporting

Gathering, processing and reporting of budget data, it ensures the organisation can construct a customised data repository, easily model its budget rules according to its business and quickly implement a collaborative work environment enabling all users to efficiently perform all tasks relating to budget management.

Consolidation Reporting

New standards of compliance, increased transparency and traceability of financial data are putting ever greater pressure on the time available in each reporting cycle. Consolidation reporting transforms data into consolidated financial information through automated processes to increase the speed and reliability of financial reporting. It enables, for example, the ability to compare and reconcile between management and statutory reporting; consolidate according to any accounting and reporting standards; and analyse information according to legal & internal management structures.

Reporting Dashboard

A unique collaborative solution that securely integrates the process of reporting financial and operational information for better business performance analysis. CPM dashboards increase efficiency by enabling the reporting process to be carried out reliably and on time through the creation of instant reports relating to measuring performance, monitoring Key Performance Indicators and analysing information e.g. 'what if' scenarios.

E-Pilot

A data validation workflow tool that organises the process of gathering and validating the data needed for producing the consolidated financial statements, management reports and budget/forecasts with fast and easy configuration. It can be customised for each reporting cycle, enable the user to see the status of the validation process, and contribute to moving it forward according to their specific authorisation level. Additionally, it streamlines users' work by facilitating the completion of all tasks necessary to produce a periodic report.

E-Collect

In managing the quality of data, e-Collect can facilitate and automate the collection, mapping, conversion, validation and loading of financial and non-financial data coming from other systems. It enhances the CPM software and is dedicated to supporting data upload via the web.

Intercompany Reconciliation

A powerful solution that manages large intra-group checking and reconciling in real-time. Talentia Intercompany significantly reduces the time to close, consolidation and reporting and enables the finance department to focus its efforts on analysing performance.

About
TALENTIA SOFTWARE

Talentia Software is an award-winning international supplier of HR and finance software solutions, with over 25 years' experience striving to always deliver the best possible service to customers worldwide. The product range includes Human Capital Management solutions with Talentia HCM, and Corporate Performance Management solutions with Talentia CPM (consolidation, reporting and budgeting). The group supports more than 3600 customers in over 30 countries, ranging from SMEs to large international organisations. Located in the UK, France, Italy, Spain, Portugal and Greece, together with a network of partners across Europe, the USA, South America, Australia, Asia and Africa, Talentia delivers and supports customers globally.