Rapid Annual Planning - The Budgeting Process in Two Weeks or Less

by David Parmenter

Contents

1. Background

The annual planning process is part of the trifecta of lost opportunities for a corporate accountant. The other two being the year-end accounts and the monthly accounts processes. All three exercises keep the corporate accountant locked into processing and reporting leaving little time for added value activities. It is interesting to note that we seldom get thanked for preparing the annual accounts, for controlling the annual planning process or for preparing the month-end accounts.

In fact, I believe that annual planning, as businesses use it today, is one of the greatest mistakes companies have made since 1494, the year Pacioli wrote about double-entry bookkeeping in Summa de arithmetica, geometria, proportioni et proportionalità. We need to do it quickly and then migrate to a rolling planning process.

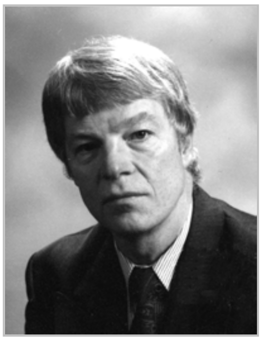
1.1. Why Annual Planning / Budgeting Is Not Advisable

Annual planning process is an anti-lean process.It should be replaced because it:

1. Takes too long and costs too much.
2. Does not help run the business as it is out of date as soon as the ink has dried
3. Leads to dysfunctional behaviour, building silos and gaming the system
4. Encourages decisions about the year ahead to be made too early and often prevents 'value adding activities' taking place as they were not in the budget
5. Is a bad yardstick for evaluating performance thus undermining the effectiveness of monthly reporting (monthly budgets are poor targets)
6. Often has allocations that budget holders have no control over
7. Is based on planning and central control which has MacGregor’s theory X as its base - that you cannot trust people

Smart organizations do not have an annual planning process anymore. Instead, they use quarterly rolling planning.

1.2. Jeremy Hope- thought leader with rolling planning



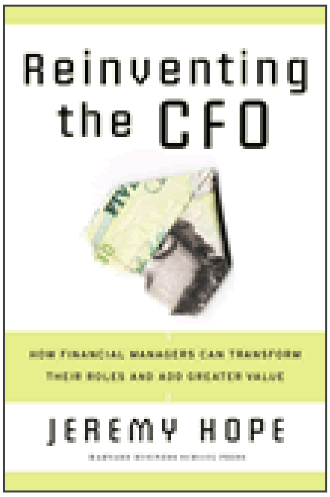
Jeremy Hope was the world’s foremost thought leader on corporate accounting issues, he sadly passed away a few years ago. Hope had an uncanny ability to always be at least five years ahead of what better corporate accounting practices should be. Hope has stated that not only is the budget process a time consuming, costly exercise generating little value, but it also, and more important, is a major limiting factor on how your organization can perform.

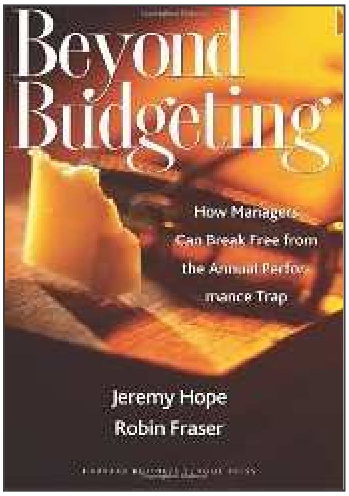
Here are some of his quotes that challenge the very concept of budgeting.

“So long as the budget dominates business planning a self - motivated workforce is a fantasy, however many cutting - edge techniques a company embraces.”

“The same companies that vow to respond quickly to market shifts cling to budgeting — a process that slows the response to market developments until it is too late.”

“It’s no secret that annual budgeting processes are time consuming, add little value, and prevent managers from responding quickly to changes in today’s business environment.”





Hope and Fraser in their beyond budgeting book[i], pointed out that the annual budgeting process was doomed to fail. If you set an annual target during the planning process, typically 15 or so months before the last month of that year, you will never know if it was appropriate, given that the conditions of that year will never be guessed correctly.

Beyond Budgeting in New Zealand: A Major Road Contracting Company

I was presenting Beyond Budgeting and key performance indicators (KPIs) in New Zealand and was introducing myself to the managing director of a large road contracting company. He politely informed me that he was mainly interested in hearing the KPI part of my presentation, as the beyond budgeting session was of little interest as they were already doing it. In fact, the group had never had an annual planning process. He said if the group could predict when it was going to sunny and when it was going to rain, annual planning would be useful.

The business encompasses concrete, transport (local and rural), fuel distribution, and roading. The group has around 1,000 staff members and a consistent profit growth, the envy of many larger organizations.

The growth path has been either to grow from scratch or buy existing family companies. As the CEO says, expansion is often driven by opportunity. It has 23 companies as well as many joint ventures.

The business has different performance tables depending on the size of operations, so the companies can compare with one another. Each table shows the ranking of the operations within that table with reference to some key ratios. The ratios they monitor include:

- Return per km — revenue and cost per km
- Margin per litre
- Delivery cost per litre
- Concrete cost per cubic meter
- Cubic metre delivered by pay hour

Monthly reports are short and based on major cost categories (not at detail account code level). They do not waste time showing a consolidated result each month; this is done at year-end only.

There is much delegation to the other offices, which manage staff levels within given limits, set staff salaries, and choose which suppliers to use (providing there is not a national contract in place).

There is an in-depth case study on Svenska Handelsbanken and Bulmer cider in the electronic media that supports this paper.

Sadly, Jeremy Hope passed away but his movement is very active, I would recommend you view Bjarte Bogsnes' presentation on 'Beyond Budgeting – business agility in practice' www.youtube.com/watch?v=boXYC5HR2DI

1.3. The Long Tail of COVID 19

Nobody knows how the long tail of COVID-19 will depress economic conditions: The following is, however, being talked about by experts:

- In a recent study half of non-retired adults say the economic impact of the coronavirus outbreak will make it harder for them to achieve their long-term financial goals. This impact on their pension will play out in years to come.
- May temporarily lock resources in unproductive sectors delaying the reallocation towards fast-growing industries.
- Innovation could be impaired through lower spending on research and development by both the public and private sectors.
- Idle capital assets have been declining in value, and this cost may not be fully accounted for.
- Many small service businesses around the world have been operating on a marginal basis. Their tipping point, cash reserves, will be very delicate for some time to come.
- De-globalisation will gather speed as companies reduce reliance on China, which may encourage an adverse reaction.
- The process of accelerated de-globalization is also likely to accelerate de-dollarization. The key aspect of de-dollarization will contribute to the rising US inflation and interest rates.
- The financial reverberation, in household's disposal income will last for a number of years to come.

I would argue that there has never been a better time to challenge the use and cost of annual planning.

1.4. Two Weeks Sounds Impossible

The future for your organization is quarterly rolling planning (QRP) which is briefly covered in this paper and in detail in a whitepaper that can be acquired from my website. However, it will take upwards of nine months to implement QRP and your annual planning cycle may be just around the corner. So, this toolkit will help you achieve two milestones:

- A two-week annual planning process - sounds impossible yet it is achieved.
- Help adopt the better practices that will be carried over into quarterly rolling planning and forecasting.

1.5. The Quarterly Planning and Forecasting Process (based on a June year-end)

In a quarterly forecasting process, management determines the likely revenue and expenditures for the next 18 months. The focus is on what is happening in the forthcoming quarter but with an eye to the bigger picture six quarters out. The quarterly forecast thus updates the annual forecast but gives a view of the next financial year. Each quarter forecast is never a cold start because management has reviewed the forthcoming quarter a number of times.

Provided you have appropriate forecasting software, management can do their forecasts very quickly; one airline even does this in three days. The average time spent on the four quarterly forecasts during any given year is five weeks.

Most organisations can use the cycle set out below if their year-end falls on a calendar quarter end. Some organisations may wish to stagger the cycle say May, August, November, and February. I will now explain how each forecast works using a June year-end organisation.

Exhibit 1.1 shows how the quarterly rolling process works for a June year-end organization. The dark shaded zone is the forecast for the next quarter and the most important part to get right. The light shaded zone is the second quarter, which is forecast monthly, and this forecast should be reasonably right. Budget holders will be re-forecasting this period next quarter. The mid shaded zone is only forecast in quarterly breaks, and budget holders are told not to spend too much time second guessing these quarters. As a guide, budget holders should spend 60 percent of their time on the first quarter because they will become targets, 20 percent on the second quarter and 20 percent on the remaining four quarters.

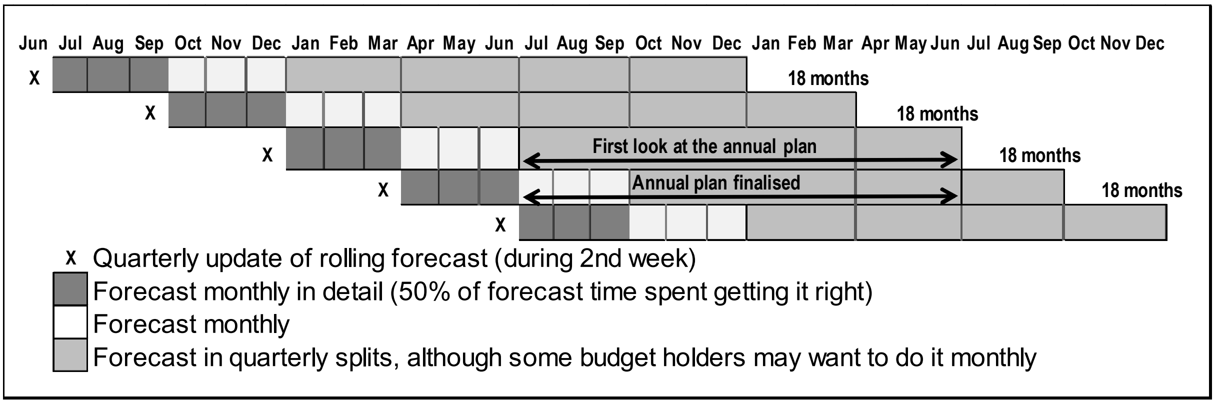


Exhibit 1.1: How the rolling forecast works for an organization with a June year-end

December update

In the second week of December, budget holders forecast to the end of the year, with monthly numbers, and the remaining period in quarterly breaks. They obtain approval to spend January to March numbers subject to their forecast becoming part of the annual plan. At the same time, they forecast next year's numbers for the first time. Budget holders are aware of the expected numbers and the first cut is reasonably close. This is a precursor to the annual plan. This forecast is stored in the planning tool.

March update

In the second week of March, budget holders re-forecast to year-end and the first quarter of next year with monthly numbers, and the remaining period in quarterly breaks. Budget holders obtain approval to spend April to June numbers. The budget holders at the same time revisit the December forecast (the last forecast) of next year's numbers and fine-tune them for the annual plan. Budget holders know that they will not be getting an annual lump sum funding for their annual plan. The number they supply is for guidance only.

June update

In the second week of June budget holders are now required to forecast the first six months of next year monthly on to December, and then in quarterly numbers for the remaining four quarters. Budget holders obtain approval to spend July to September numbers provided their forecast once again passes through the annual goal posts. This is stored in a new field in the forecasting tool called "e.g., June 14 forecast." This update process should only take one elapsed week. We can, if useful for management, reforecast the June numbers so we give management a heads up on the year-end which is a fortnight away.

September update

We reforecast the next six months in monthly numbers, and quarterly to March six quarters on. Budget holders obtain approval to spend October to December numbers. This is stored in a new field in the planning tool called "e.g., September 14 forecast". This update process should only take one elapsed week.

You will find that the four cycles, in a given financial year, take about five weeks, once management is fully conversant with the new forecasting system and processes.

1.6. Leaving a Legacy

All corporate accountants need to leave a legacy before they move on, in other words have made a permanent improvement to the organization. Yet many corporate accountants are not producing enough added value to their organization, in other words they are failing to make a difference. I know this, from observation and my own personal experience. How many accountants, on leaving the organisation, receive an outpouring of loss from the senior management team and budget holders?

Most of us have done a good job as a processing machine, but little time has been invested in being a business partner to budget holders and senior management. The better practices discussed in this paper are based around the wisdom and better practices of over 4,000 accountants who I have met through my workshops in Ireland, UK, Scotland, Singapore, Malaysia, Australia and New Zealand.

1.7. Getting the Balance of Work Right

As exhibit 1.2 shows the change in focus should mean we are working smarter not harder. This change in workload will, over time, lead to the formation of a smaller but more experienced accounting team.

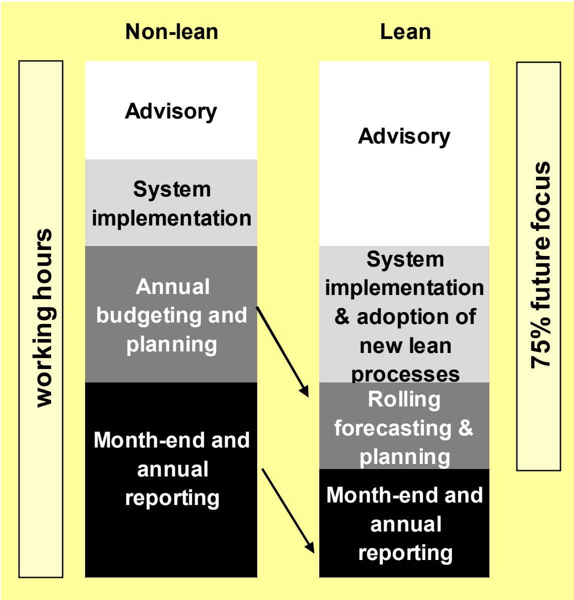


Exhibit 1.2 Getting the balance of work right

Exhibit 1.3 shows the impact of this shift away from processing into more service delivery work. The major change for the annual planning process is the breaking of it up into four quick cycles a year.

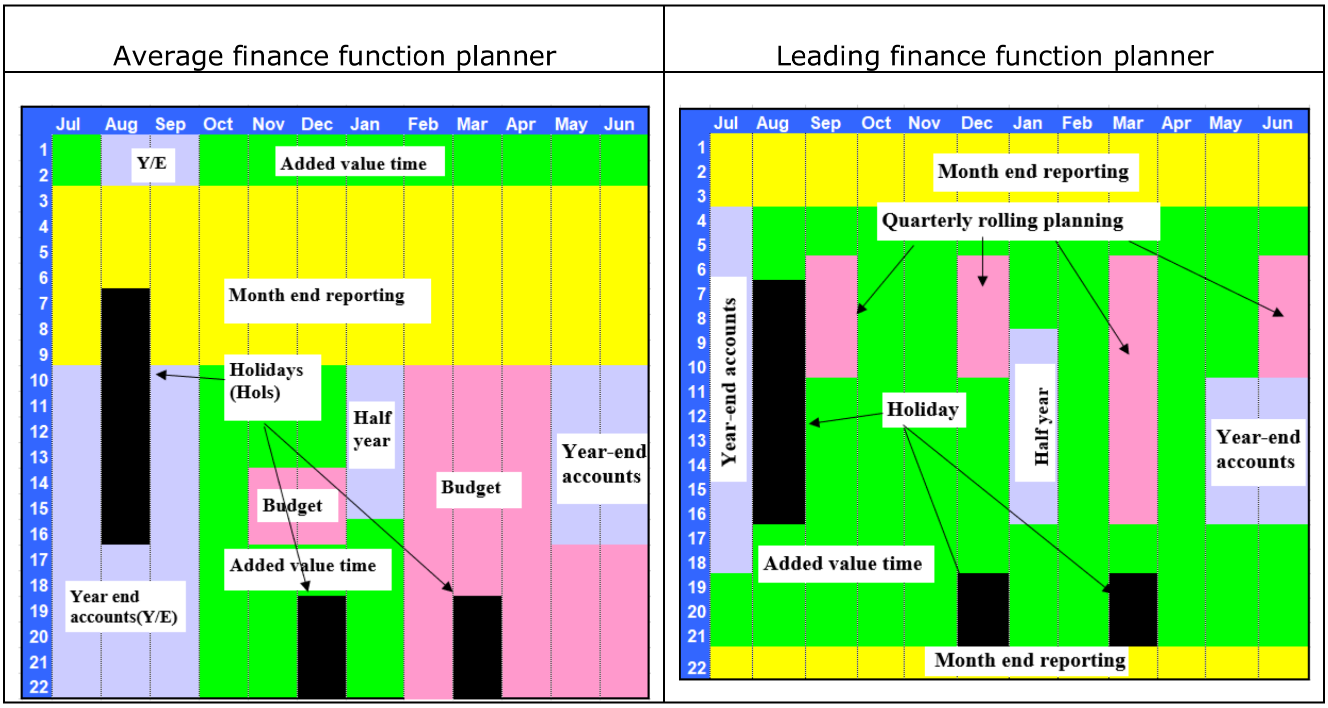


Exhibit 1.3 How the year's workload will change (based on a June year-end)

1.8. The Costs of a Drawn-Out Annual Plan

The costs of a typical annual plan include:

- months where the management accountants are simply buried in the multi versions of the annual planning model
- inefficient allocation of resources as sane budget holders become dysfunctional requesting funds they do not need
- all levels of management tied up in endless arguments discussing a period no one can predict
- little or no client management, by the finance team ,during this time and thus bad habits are picked up by budget holders

> *"It's no secret that annual budgeting processes are time consuming, add little value, and prevent managers from responding quickly to changes in today's business environment"*
>
> Quote from Jeremy Hope of Beyond Budgeting fame[ii]

In order to create a change in the way the SMT, Board and management address the annual planning process you need to establish what is the full cost of the annual planning process including all Board, management and staff time and all those external costs (audit fees, printing costs, PR and legal fees etc). Exhibit 1.4 shows how to calculate the costs of an annual planning process. The times are estimates and show what a 300 to 500 FTE public company may be investing in their annual plan preparation.

I base the costing on 42 productive weeks a year having removed holidays, training and sick leave. SMT's available time is only 32 weeks for the year as you have to take off the time they spend travelling and in meetings going nowhere quickly.

	General Managers	CEO	CFO	Accounting & Planning	Budget Holders
Staff involved	4 to 6	1	1	3 to 5	50 to 70
	Estimated total number of weeks worked				
Budget Process (incl rework)	4 to 6	3 to 4	3 to 4	10 to 25	100 to140
Re-Budget Process (if done)	1 to 2	0.5 to 1	0.5 to 1	5 to 10	50 to 70
Reporting Against Budget	2 to 4	0.5 to 1	0.5 to 1	5 to 10	150 to 210
Re-Forecasting Y/E Result (>6 Times a Year)	1 to 2	0.5 to 1	0.5 to 1	3 to 5	100 to 140
No.of Weeks Worked	8 to 14	4.5 to 7	4.5 to 7	23 to 50	400 to 560
Average Salary Cost	$250,000	$400,000	$250,000	$120,000	$100,000
Average productive weeks	32	32	32	42	42
Personnel costs only	$50-90k	$60-90k	$30-40k	$60-150k	$1.0m-1.3m
Annual cost	**$1.2m to $1.7m**				
Over next ten years	**$12m to $17m**				

Exhibit 1.4 cost of the annual planning process

1.9. A Quick Annual Plan Is a Good Annual Plan

A fast annual planning involves all business units within the group playing 'the same score'. On an international poll top performers are managing completion inside a month as shown in Exhibit 1.5.

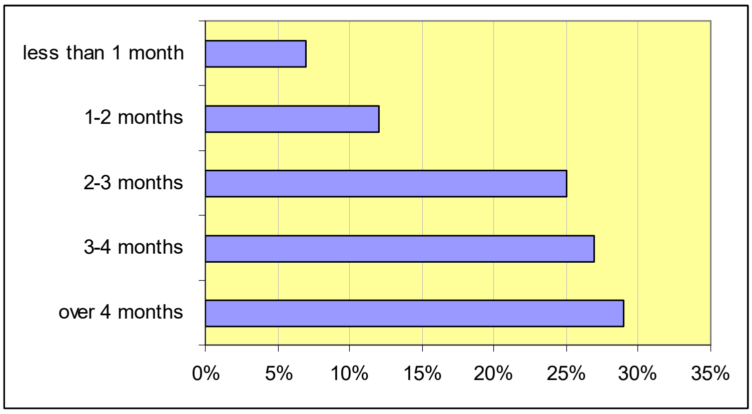


Exhibit 1.5 Speed of annual planning (Source: webcast poll)

Exhibit 1.6 shows a rating scale for the timeframe to have the annual plan completed (timed from the date Budget holders are given access to the annual planning tool).

Exhibit 1.6 Annual planning timeframes

Exceptional	Outstanding	Above average	Average
Less than two weeks	2-3 weeks	3-5 weeks	6-8 weeks

2. The Foundation Stones of an Annual Planning Process

There are a number of foundation stones that need to be laid before we can commence a project on reducing the annual plan to two weeks.

1. Separation of targets from the annual plan
2. Bolt down your strategy beforehand
3. Avoid monthly phasing of the annual plan
4. The annual plan does not give an annual entitlement to spend
5. Budget committee commit to a "lock-up"
6. Budget at category level rather than account code level
7. Get it wrong quicker
8. Built in a planning tool—not in a spreadsheet
9. Plan with periods that are either 4 or 5 weeks long

2.1. Separation of Targets from the Annual plan

It is so important to tell management the truth rather than what they want to hear. Boards and the senior management team have often been confused between setting stretch targets and a planning process. Planning should always be related to reality. The Board may want a 20% growth in net profit, yet management may see that only 10% is achievable with existing capacity constraints.

The key is to remove any deliberate manipulation related to performance bonuses. In a working guide on 'Designing Performance Bonus Schemes' I point out that any performance bonuses should be paid on performance compared to the market rather than to an annual plan. We want management to be extracted from the annual charade of making a target easy, so their bonus is secured.

By reporting a gap, we are saying to the Board that based on expected customer demand, the existing products/ services and the relevant prices there is a shortfall. Please help us find the missing profit." The Board then might need to acquire some profit by purchasing a new subsidiary or bring forward the development of a new product, increase prices etc.

Exhibit 2.1 shows where management have forced the plan prepared in March to meet the target set by the Board. Each subsequent reforecast continues the charade until in the final quarter reforecast, performed in March the following year, the truth is revealed.

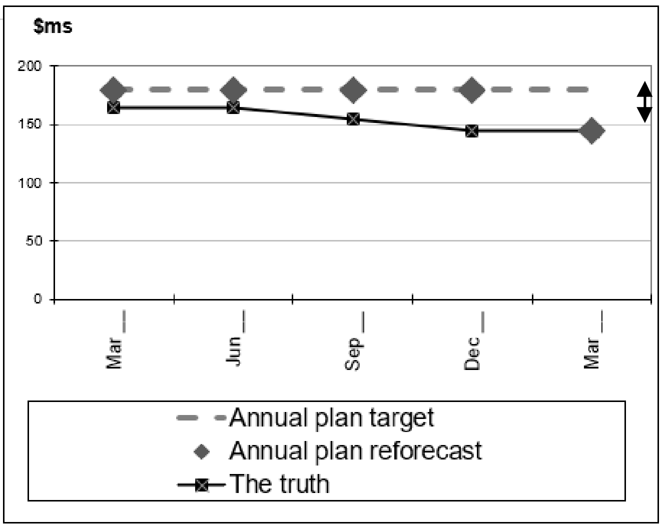


Exhibit 2.1: Reporting what the Board want to hear

2.2. Bolt Down Your Strategy Beforehand

Leading organizations always have a strategic workshop out of town. Normally Board members will be involved as their strategic vision is a valuable asset. These retreats are run by an experienced external facilitator. The key strategic assumptions are thus set before the annual planning round starts, also the Board can set out what they are expecting to see.

Great management writers, such as Jim Collins, Tom Peters, Robert Waterman, and Jack Welch, have all indicated that prominent organizations are not great because they have the largest strategic plan. In fact, it is quite the reverse; the poor-performing organizations are the ones that spend the most time in strategy and the dreaded annual planning process.

Jack Welch, in his book *Winning*[iii], talks about how he stopped business units writing large strategic documents and delivering drawn-out presentations. He forced all strategy plans to fit on to five slides. I have set out my interpretation of his slides and also include the thoughts from Jim Collins, see Exhibit 2.2.

3.7. Prepare a Simple Reporting Template for The Annual Plan

Annual plans often end up in elaborate reports. The feeling is, "Since we spent so much time on it, we better do a great job of the write-up." In reality, nobody reads these documents. It is far better to have the documentation left mostly in presentation format along with a key summary page for each business and one for the consolidation. We do not need to report the annual plan to the board in monthly splits. A quarterly analysis of the annual plan will suffice, as shown in Exhibit 2.3.

3.8. Have Trend Graphs for Every Category Forecasted

Better quality can be achieved through analysis of the trends. There is no place to hide surplus funding when a budget holder has to explain why the forecast trend is so different from the past trend. The graph shown in Exhibit 3.8, if made available for all the categories budget holders are required to forecast, will increase forecast accuracy. Budget holders will want to ensure their forecasts make sense against the historic trend.

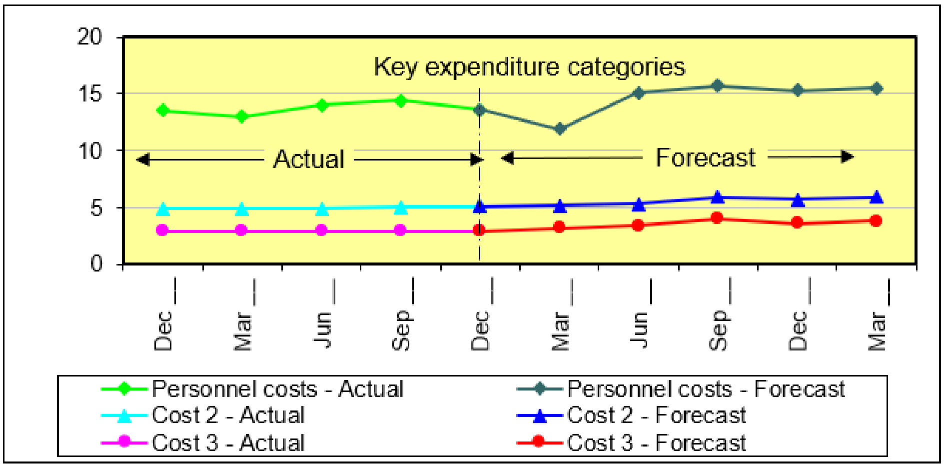


Exhibit 3.8 Forecast expenditure graph

3.9. If Using a Spreadsheet Simplify the Model to Make It Robust

As explained, forecasting requires a good robust tool, not a spreadsheet built by some innovative accountant that no one can understand now. However, you may not have the time to replace the existing Excel model. A new planning tool will take at least six months to research, acquire, and implement for organizations with over, say, 500 full-time staff. In this case, you can modify your Excel model by:

- Improving the revenue predictions by focusing in on major customers' demand for the major products. You can automate the rest of the sales based on historic relationships between sales of minor products and major products and sales to minor customers to those made to major customers.
- Budgeting at category rather than account code level thus eliminating many lines
- Forecasting the annual plan using quarterly figures, rather than monthly, (hiding two of the monthly columns for each quarter)
- Consolidating via the G/L instead of the spreadsheet (if you can add the category headings easily into the G/L)

3.10. Expand Your Team, as Budget Holders Will Need One-to-One Support

Many budget holders will need one-to-one support. Yet I have shown in Exhibit 2.5 that we are to do this all in three working days. We thus need to expand the support team. Some suggestions to expand your team are:

- Get all qualified accountants involved, even those not working in the finance team (e.g., get the CFO involved as well).
- Ask the auditors to loan some auditor seniors from their local offices to cover those remote locations—the audit seniors will be grateful for being involved in an interesting task (those who have been auditor will know what I mean).
- Bring in some temporary staff with budget experience.
- For smaller budget holders, the senior accounts payable staff would be ideal.
- Offer remote budget holders one-on-one training with virtual meeting technologies.

Thus, all budget holders, wherever they are located, who need help can be supported during the three-day window for data entry.

3.11. Hold a Briefing Workshop for all Budget Holders

Never issue budget instructions, for you already know they are never read. Follow the lesson of a leading accounting team that always holds a briefing workshop at which attendance is compulsory. With today's technology, you also can hold the workshop simultaneously as a webcast so budget holders in remote locations can attend, albeit electronically.

Hold a "budget preparation" workshop (see Exhibit 3.9 for an agenda example) covering how to complete the input form and explaining why budget holders do not need to forecast monthly numbers, only quarterly; the three-day window; the daily update to the CEO; and the fact that late returns will be career limiting. Stress that the bigger items should have much more detail. Explain why you have automated some of the categories and the help they will receive, and so forth. Make sure that at the workshop, the CEO makes the following clear.

Fast, light touch	▪ Everybody has to cooperate to achieve the three-day window to enter data. ▪ Late forecasting will be a career-limiting activity.
Help at hand	▪ Help will be provided on a one-to-one basis. ▪ How to use the planning tool (attendees will already have some training on this). ▪ Forecasting by the categories and why some categories are now automated.
The level of detail required	▪ What BHs should include in their presentation to the budget committee. ▪ No monthly breakdown in the annual plan, as the monthly numbers are to be set just before each quarter starts. ▪ Stress the fact that only the more material categories will have more detail (e.g., payroll). ▪ Sales forecast has been already made and is _________.

Exhibit 3.9 Annual budget Briefing workshop agenda

Location: _______________

Date and Time: _____________

Suggested attendees: All budget committee, all business unit heads, all management accountants, and all budget holders

Requirements: event secretary, desktop for every seven attendees, data show, two white boards

8.30 A.M.	Welcome by CEO and why changing the annual planning processes is non-negotiable.
8.40	**Setting the scene**- topics covered include: ▪ Why we cannot afford the current annual budgeting process ▪ Better practice stories and research we have done ▪ Some of the major flaws with the annual budgeting process ▪ The new rules which the focus group has vetted ▪ Proposed two-week process ▪ The setting of monthly targets in the quarterly rolling forecasts The senior management team may wish to leave after this session.
9.30	**Present the new planning tool.**
10.00	**Workshop 1**: **Looking at the planning tool.** In small groups, no more than seven, each attendee gets a chance to play with the tool. Each group has a member from finance facilitating this process.
10.30	Morning break.
10.50	**Feedback on the package from the workgroups**
11.20	Wrap up of workshop by CFO reminding about deadlines, help available and to keep to the bigger picture.

4. Selling the Change to the Senior Management Team, Finance Team and Board

Xxxxxx

Finance teams around the world have wanted to embrace lean practices but are weary as many initiatives both inside the finance team and in other teams fail far too often.

4.1. Steve Zaffron and Dave Logan

Steve Zaffron and Dave Logan in their book *"The Three Laws of Performance"* [viii] have written a compelling book that explains why so many of these initiatives have failed. The first law is **"How people perform correlates to how situations occur to them."** The writers point out that the organisation's "default future" which, we as individuals just know in our bones, will happen – will be made to happen. Thus, in an organisation, with a systemic problem, the organisation's staff will be driven to make initiatives fail, so that the default future prevails. The key to change is to recreate, in the organisation's staff minds, a new vision of the future, let's call it an "invented future".

4.2. Stage 1: Establish a Sense of Urgency

In 1996, John Kotter published *"Leading Change"*[ix], he had an eight-stage process for creating major change and I want to discuss each Kotter stage while at the same time, embedding Saffron and Logan's thinking.

Here we need to appeal both to the intellectual and the emotional sides of the executive team. The process of getting the executive team on board requires first, a well-prepared elevator pitch, a masterful sales presentation to obtain of permission to run a focus group to assess, validate and scope the proposed initiative (Kotter's stage two).

4.2.1. The Elevator Speech

The 20 second elevator speech is designed to capture the attention of the targeted decision maker. The term came about in management books describing how you need to be able to get a point across in an elevator ride, as sometimes this is the only chance you may have to get through to a decision maker.

It must be ready so that when you ambush the CEO you are well practised and ready. The aim is, as they walk away, that they ask you to come to their office in the next few days to discuss this further. An elevator interaction might go like this.

In answer to the question "How are you?" you might say.

"I am troubled". "Why is that?" being the natural response from the CEO. To which you reply, "I have just been looking at _______________and I have estimated that over the next 10 years we will be spending £__M and £__M on this if we do nothing. I have been researching a new approach, tried and tested elsewhere, which would save much of this cost. I just need 15 minutes of your time to explain this."

I recommend you practise your elevator speech at least 20 times so that it is focused and no longer than 20 seconds.

4.2.2. The Selling Change Presentation

Assuming we may now have got a certain level of interest we now have to prepare a presentation based around the emotional drivers of the audience that is aiming to get the SMT to agree to the next stage. As Kotter, said we need to create a sense of urgency and connect both intellectually and emotionally. This task requires training, practice and quality preparation.