How to avoid the twenty major mistakes corporate accountants commonly make every year

by David Parmenter

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Finance needs to break through the Catch-22

Too many accountants fail to leave any legacy systems when they move on. They are simply good processors, performing each month-end as slow as the one before, overseeing a long and tedious annual planning process, and producing reports that are seldom read.

Joseph Heller's iconic 1961 book introduced a new phase into our language "Catch 22" which the Oxford English Dictionary defined as:

> "A situation in which a desired outcome or solution is impossible to attain because of a set of inherently illogical rules or conditions"

I see many finance teams in this situation. The late monthly accounts, the long, drawn-out annual planning process and annual reporting cycle leave no time to break this cycle - a perfect Catch 22.

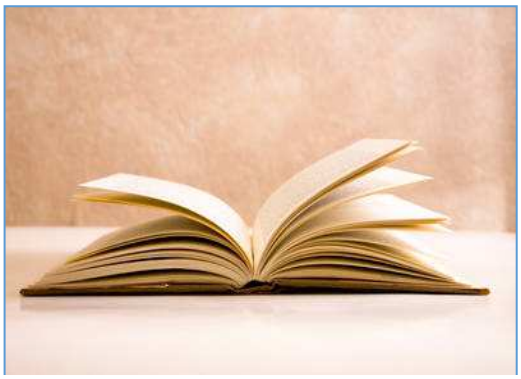
The finance team needs to create time for change, to have more time to implement. Where do we find this time? We find it by adopting the lean processes used by our peers.

Through benchmarking and then delivering courses to finance teams I have discovered many better practices, from corporate accountants across the world. This paper covers the top twenty practices that our clever peers have adopted. These top twenty practices are set out by subject matter rather than their importance.

1. Have less than 50 account codes for the P/L

Show me a company with less than 50 account codes for their P/L and I will show you a management accountant who has seen the light. However, I have seen many charts of accounts with more than 300 expense account codes in the G/L, with up to 30 accounts for repairs and maintenance creating a volume like the one shown in Exhibit 1.1.

Exhibit 1.1 The chart of accounts that is certainly not lean



Why is it that the least experienced accountant volunteers for re-setting the chart of accounts? I think I know the answer! All the wise owls duck for cover. Yet, the chart of accounts sets the Finance team up for disaster in many ways. It determines how we report and set targets.

Common sense goes out the window, the CFO eyes just glaze over at the chart of accounts progress meetings, the objective to reduce the account codes by over 40% gets lost and slowly but surely, just like the budget instructions, the chart of accounts takes on a life of its own.

Action:

Do not breakdown costs into a separate account unless they represent at least 1% or greater of total expenses. This will reduce your costs to somewhere between 40 to 60 account codes.

Do not break revenue in separate codes unless revenues represent over 5% or greater of total revenue. This will reduce your revenue to somewhere between 15 to 20 account codes.

Only have separate project accounting for major projects, say over 3% of total annual expenditure. All other projects can be put in a bucket called "other projects". This leaves the project manager to spend, where it is necessary, providing they live within their total budget for these minor projects.

Have larger buckets and when you are asked a stupid question ask them what decision is going to be made based on the information requested or tell them the answer is '42'. A skilled management accountant can always investigate 6 weeks of expenditure and then annualise the number. Remember whatever the answer is you can assume it is a true and fair view, besides nobody else is going to follow you into that canyon!

> *"Appoint a hardnosed 'keeper of the chart' who can ensure that the following disciplines are continually maintained"* Quote from a wise CFO

2. Forecasting out six quarters on a rolling quarterly basis, on a quarterly basis

Typically, corporate accountants have reforecast the year-end numbers every month. This is flawed on a number of counts. Firstly, why should one bad month, one good month translate into a change of year-end position. We gain and lose major customers, key products rise and wane; this is the life cycle we have witnessed many times. Secondly, the forecast is a top-top forecast with little input and no buy-in from the budget holders. Thirdly, two months before year-end management appear to ignore the oncoming year. Fourthly management and the Board know whatever number you have told them is wrong. You will change it next month!

Action:

Forecast quarterly six quarters ahead using a planning tool (not Excel) as it is a commonly accepted better practice. The trick to this rolling forecasting is to make it a fast light touch, so managers can do it quickly. Quarters 2 to 6 are not the important ones. The key is to get quarter one correct.

Please read Appendix 1 which is an extract from my whitepaper on the topic.

3. Setting monthly budgets a quarter ahead – not from the annual plan

As accountants we like things to balance and our work to be neat and tidy. Thus, it appeared logical to break the annual plan down into twelve monthly breaks before the year had started. We could have been more flexible. Instead we created a reporting yardstick that undermined our value to the organisation. Every month we make management, all around the organisation, write variance analysis which I could do just as well from my office. "it is a timing difference…." "we were not expecting this to happen", "the market conditions have changed radically since the plan" etc.

Action:

If you still need to perform an annual planning process you can at least remove the need for twelve monthly targets arising from this process. We should instead report against more recent targets derived from quarterly rolling forecasting process. This change has a major impact on reporting. We no longer will be reporting against a monthly budget that was set, in some cases 17 months, before the period being reviewed.

Access my IBM papers on this topic (from the download).

Please read Appendix 1 which is an extract from my whitepaper on 'quarterly rolling planning'.

4. Budget holders funded quarterly not via the annual plan

Doing an annual plan is daft enough but to compound it with asking budget holders what they want and then, after many arguments, giving them an 'annual entitlement' to funding is the worse form of management we have ever presided over.

I use portioning out a birthday cake at a nine-year old's party to explain the stupidity of an annual plan.

The nine-year old's birthday cake

A clever parent says to Johnny, "Here is the first slice, if you finish that slice, and are not going "green around the gills" and want more, I will give you a second slice". Instead, what we do in the annual planning process is divide the cake up and portion all of it to the budget holders. Like 9 year olds, budget holders lick the edges of their cake so even if they do not need all of it nobody else can have it. Why not, like the clever parent, as the budget holder "What do you need for the next three months?" and fund them on the agreed amount. Each time we can apportion the amount that is appropriate for the conditions at that time.

Action:

The better practice is to say to a budget holder we will be aware of your annual request but will only fund you on what you need to run the next quarter. This small but significant change means:

- 'Spend it or lose it' can no longer work; budget holders find it nearly impossible to hide their reserves in the next three-month period.
- Budget holders are encouraged to seek funding for initiatives that were not in the annual plan, as long as they have a sound fit with the organisation's strategic objectives.
- The budget holders will soon realize the futility of spending so much time fighting for an annual entitlement they will never get. They will remove themselves from the annual politics which is annual planning and spend the time forecasting each quarter, where the real action occurs.

Please read Appendix 1 which is an extract from my whitepaper on the topic.

5. Avoid budgeting at account code level

What made accountants ever conceive that we needed to set budgets at account code level. It was done by our forefathers so we duly followed in the well-trodden steps. It makes no sense.

Having budgets at account code level has encouraged budget holders to allocate expenditure to accounts that have spare budget available rather than code to the account that is already over budget. This activity undermines the purpose of the G/L which is to account for costs and revenue in the right areas.

Do you need a budget at account code level to track performance? If you have good trend analysis captured in a reporting tool you have all the control you need. We need to apply Pareto's 80/20 rule and budget at a higher level, what I call a category level which includes a number of G/L codes.

Action:

Limit the number of categories in a budget holder's (BH) budget to no more than twelve. Have a budget category line if the account code is over 10% of the total e.g. show revenue line if account code is over 10% of the total revenue. If the account code is under 10% consolidate it with other account codes until it forms a category representing over 10% of the total.

Map the account code expenditure history to these categories – a planning tool can easily cope with this issue without the need for a revisit of the chart of accounts.

Please read Appendix 1 which is an extract from my whitepaper on the topic.

6. CEO makes a two-week timeframe for doing an annual plan non negotiable

The annual planning process is not adding value, instead it is undermining an efficient allocation of resources, encouraging dysfunctional budget holder behaviour, negating the value of monthly variance reporting and consuming huge amounts of time from the Board, senior management team, budget holders, their assistants and of course the finance team.

When was the last time you were thanked for the annual planning process? At best you have a situation where budget holders have been antagonized, at worst, budget holders who now flatly refuse to co-operate!

Like a laboratory rat we go down the same pathway each year to find there is no cheese, no passing 'Go' and collecting £200, just mayhem. The annual planning process may have worked for Julius Caesar, who could predict success, but certainly not for us.

The nightmare of three to four months arguing over resource allocation when nobody knows the answer, the endless cut-back rounds, the game playing, the spend–it or lose-it-mentality is not befitting the 21st century. The only thing holding us back as corporate accountants for making this change are:

- committing the time to understand the solution
- learning how to sell change
- finding the gap in our busy workload to make it happen

Action:

The extermination of the annual plan was first written about by Jeremy Hope of 'Beyond Budgeting' fame. To test the hypothesis that organisations would thrive without an annual plan he went about searching for organisations that have never had the process in the first place. These organisations exist and are thriving. The beyond budgeting movement has many converts and the best place to start this journey is to read Jeremy Hope's articles, any search of the www will find many!

Read Jeremy Hope's work "Reinventing the CFO: How Financial Managers Can Transform Their Roles and Add Greater Value", Jeremy Hope, Harvard Business School Press, 2006

Please read Appendix 2 which is an extract from my Whitepaper on the topic.

7. Producing informative reports that are read

Many management reports are not a management tool; they are merely memorandums of information. Too many of our reports are issued well after the horse has bolted. As a management tool management reports should encourage timely action in the right direction, by reporting on those activities the Board, the management and the staff need to action.

Many monthly finance reports, prepared by the finance team, are never read. They include endless detail, often a result of having a common template for all subsidiaries regardless of size. The result is a consolidated pack with a four to five page essay, consolidated numbers and a copy of each subsidiary's submission. I once saw a 140 page pack!

Action:

Reduce the finance pack down to fewer than ten pages. Eliminate the essay and simply have a small comments box on each statement. Only have one page to summarise the subsidiaries results and only include the large ones and any other that are in trouble. Small subsidiaries that are performing well do not need to be included in the pack.

> "Educate and engage with senior and middle management. Find out and assess what they really need to know to manage the business and ruthlessly eliminate the eye sight ruining worthless pages that engineers and middle management are so fond of." Quote from a wise CFO

Please read Appendix 3 which is an extract from my whitepaper on the topic.

Appendix 1: Quarterly rolling forecasting and planning

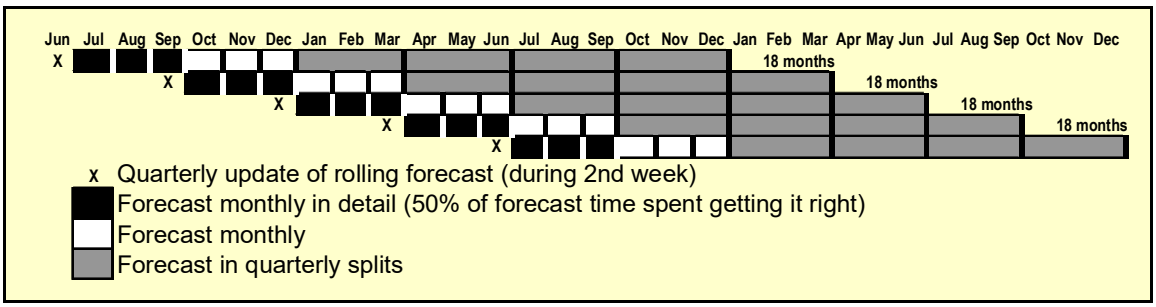
What is a quarterly rolling forecast (QRF) process?

The quarterly forecasting process is where management sets out the likely revenue and expenditure for the next 18 months. Each quarter, before approving these estimates, management sees the bigger picture six quarters out. All subsequent forecasts while firming up the short-term numbers for the next three months also update the annual forecast. Budget holders are encouraged to spend half the time on getting the detail of the next three months right, the red zone as shown in exhibit 1.1, as these will become targets, on agreement. The balance of the time then to be spent forecasting the remaining next five quarters.

Each quarter forecast is never a cold start as they have 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 overall time spent in the four quarterly forecasts during a 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 How the rolling forecast works for an organisation (June year-end)



The process quarter by quarter for June year-end organisation

December we forecast out to year-end, with monthly numbers, the remaining period in quarterly breaks. Budget holders obtain approval to spend January to March numbers subject to their forecast still going through the annual plan goal posts. The budget holders at the same time 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 we reforecast to year-end and the first quarter of next year with monthly numbers, 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.

For the annual plan, budget holders will be forecasting their expense codes using an annual number and in quarterly lots for the significant accounts such as personnel costs. Management review the annual plan for next year and ensure all numbers are only broken down into quarterly lots and this is stored in a new field in the planning tool called "March 20XX forecast". This is the second look at the year so the managers have a better understanding. On an ongoing basis you would only need a two-week period to complete this process, if you followed the process set out below.

June we can reforecast the end of June numbers and we should be able to eliminate the frantic activity that is normally associated with the "spend it or lose it" mentality. Budget holders are now also required to forecast the first six months of next year monthly and then on to Dec , 4 quarters on in quarterly numbers. 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 07 forecast". This updated process should only take one elapsed week.

September 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 07 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.

The time is right for QRF and QRP

The time is right for quarterly rolling forecasting and quarterly rolling planning as the standard annual planning process:

- takes too long,
- is too costly
- is not focused on performance drivers,
- is not linked to strategic outcomes or 'critical success factors',
- leads to dysfunctional behaviour, building silos and barriers to success
- undermines monthly reporting (monthly budgets are poor targets)
- is not appropriate for a dynamic company in a rapidly changing environment

The answer is to "throw away the annual budget and its associated processes, smart organisations do not do an annual planning process anymore". These smart organisations have moved to using quarterly rolling planning.

Definitions

Quarterly rolling forecasts (QRF) normally go out 6 quarters, involve budget holders in providing a "light touch" forecast covering their 10-12 main categories which become the future months reporting benchmarks

Quarterly rolling planning (QRP) takes QRF a step further - budget holders are now funded quarterly based on their forecast, for the next quarter, once it has passed through a rigorous quality assurance process.

Categories - These are groups of account codes e.g. Budget holders will forecast personnel costs instead of forecasting at account codes salaries and wages, Income taxes, holiday pay, contract workers, temporary staff etc

The quarterly rolling planning is a process that will revolutionise any organisation whether public or private sector! It removes the four main barriers to success that an annual planning process erects. An annual funding regime where budget holders are encouraged to be dysfunctional, a reporting regime base around monthly targets that have no relevance, a three month period where management are taken away from making money, and the remuneration system based on an annual target. The only thing certain about an annual target is that it is certainly wrong; it is either too soft or too hard for the actual trading conditions.

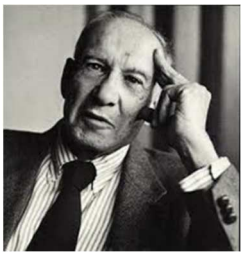
The critical building block is the quarterly rolling forecast. This paper will explain why the QRF is the most important management tool of this decade and why the rolling forecasts of the past are a different beast to the 21st century QRF.

The foundation stones of a rolling forecasting process

There are a number of QRF foundation stones that need to be laid down and never undermined. You need to ensure all the construction of the QRF model is undertaken upon the following foundation stones:

1. Abandoning processes that do not work
2. The QRF model should be built by in-house resources
3. Separation of targets from realistic forecasts
4. A quarterly process using the wisdom of the crowd
5. Forecast beyond year-end (e.g., six quarters ahead)
6. The monthly targets are set, a quarter ahead, from the QRF
7. A quarter-by-quarter funding mechanism
8. The annual plan becomes a by-product of the QRF
9. Forecasting at category level rather than account code level
10. The QRF should be based around the key drivers
11. A fast light touch (completed in an elapsed week)
12. Built in a planning tool – not in a spreadsheet
13. Design the planning tool with four and five week months
14. Invest in a comprehensive blueprint

Abandoning processes that do not work



Management guru Peter Drucker[i] who I consider to be the Leonardo de Vinci of management, frequently used the word '*abandonment'*. I think it is one of the top ten gifts Drucker gave us all. He said

"Don't tell me what you're doing, tell me what you've stopped doing."

He frequently said that abandonment is the key to innovation, in other words, the key to fast forecasting process.

In planning many of the processes are carried out, year-in year-out because they were done last year. When staff question why do we do this the answer being "There must be a reason".

All the previous givens with regards forecasting need now to be challenged and all the inefficient processes thrown out. Here is a list, by no means complete of what needs to be abandoned:

Using Excel	Forecasting in Excel, just because we are good at it
At account code level	forecasting in detail, at account code level and to the dollar
Only forecasting to year-end	Only forecasting to the current year-end as if next year did not exist
An annual entitlement	Giving budget holders an annual entitlement, they have not got a clue as what the next year is really going to be, nor do we in Finance
Forcing numbers	Forcing the annual plan to be the same number that the Board want to

	see - we have just lied!
A three month process	A three month process when it can be done in two weeks – both will be wrong. You may as well be wrong quickly!
Setting the monthly targets	Setting the monthly targets from the annual plan - since we cannot see into the future this breakdown of the annual plan has always been a stupid activity
Written instructions	Annual plan written instructions – nobody reads them and if they say they have don't believe them.

Your time is limited, so don't waste it living someone else's life. Don't be trapped into living with the results of other people's thinking. Don't let the noise of other's opinions drown your own inner voice"
Steve Jobs

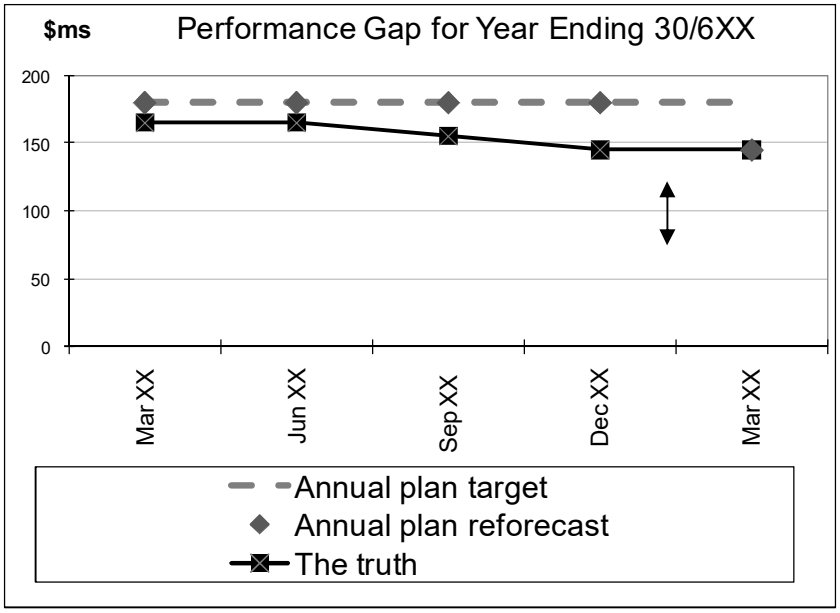
Separation of targets from forecasts

It is important that the Board and management separate out in their minds the difference between a target — for example, the board wants a $200m net profit next year — and the annual plan forecast of $180m. It serves no purpose to lie to the board by fixing the annual plan to come up with $200m when you know it cannot be achieved. This is hiding the performance gap.

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 performance gap should be reported to the Board so they can direct their attention to strategic decisions to manage the short fall. The Board have every right to say the stretch target is the basis for the bonus.

Exhibit 1.2- 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 1.2: Reporting what the Board want to hear



A bottom-up process using the "wisdom from the crowd"

Many forecasts have little input and no buy-in from the budget holders. We do not have the time, process or tools to get the budget holder involved. Instead most forecasts are prepared by the Marketing and Finance team talking amongst themselves and with senior management. I call these forecasts a "top-top" forecast.

There has been a major breakthrough in forecasting from the writer James Surowiecki in his book "*The Wisdom of the Crowds*". He points out *"a large group of people are often smarter than the smartest people in them".* The reason being that:

- Much trend information is being seen at the workface, products piling up unsold, product returns, customer comments, etc which is not being tapped.
- Less motivation to forecast what management want to see
- A small group of forecasters can only process a tiny fraction of the information available whereas a crowd could take "in an almost unlimited harvest of data".

This theory was tested by 'Best Buy' America's leading consumer electronics retailer:

- Gift card business: 95% accurate by experts, 99.5% by group average
- Holiday season sales for the whole group, 93% accurate by experts, 99.9% by group average

In another example an internet gambling organisation had picked the winner in but one of the States Senate elections. The favourite in each state was a direct reflection of all the bets placed and thus a perfect representation of the collective "wisdom of the crowd".

In Best Buy the forecasts are now prepared by selected staff at the workface who are invited who provide anonymous forecasts directly into a system. They are provided with some basic trend information with the incentive of the recognition and a prize if their forecast is the nearest to the actual figure.

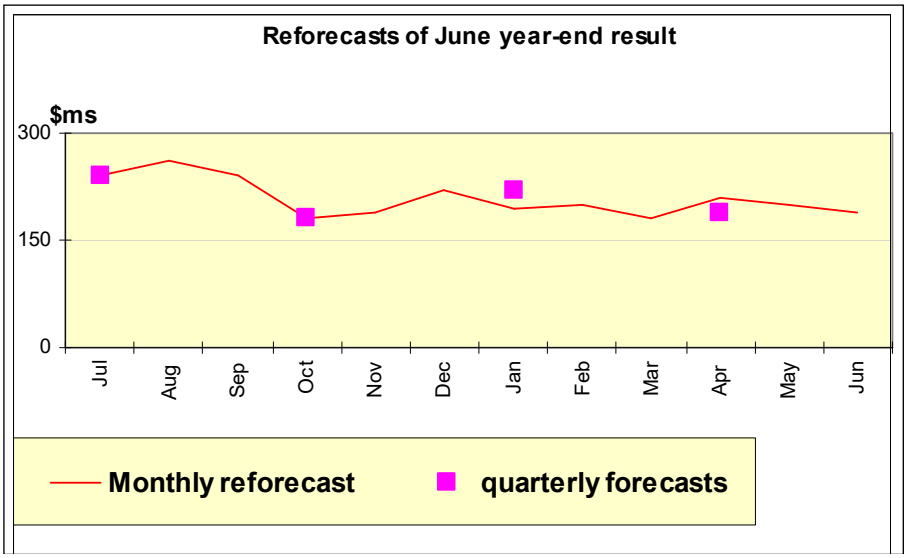
A process performed quarterly

Many forecasts have little input and no buy-in from the budget holders. We do not have the time, process or tools to get the budget holder involved. These forecasts I call a top-top forecast, the finance team talking amongst themselves and with senior management.

Typically management have reforecast the year-end numbers on a monthly basis. Why should one bad month, or one good month translate into a change of the year-end position? We gain and lose major customers, key products rise and wane; this is the life cycle we have witnessed many times. Besides if you change your forecast each month management and the Board know whatever number you have told them is wrong –you will change it next month! As shown in Exhibit 1.3 we now have only four re-forecasts done a year, instead of the twelve updates.

Only businesses that are in a volatile sector would need to forecast monthly e.g., the airline industry. Even for these organisations you do not need to get all budget holders to participate in a monthly reforecast. You may be able to limit this extra work to sales and production with the major all embracing cycle still being quarterly.

Exhibit 1.3: quarterly re-forecasting



Forecast past year-end (e.g., six quarters ahead)

Typically corporate accountants have reforecast only to year-end. Two months before year-end management appear to ignore the oncoming year. A foundation stone of a QRF process is forecasting for a rolling period that passes through the year-end barrier. There are various options as to how far forward you go, these include:

- Forecasts always two years ahead –this is particularly relevant where the business is very seasonal and much activity happens in the last quarter
- Forecast six quarters ahead
- Variations such as four or five quarters ahead

I advocate the six quarter ahead (18-month) rolling forecast regime, as it has some substantial benefits that include:

- You see the full next year half way through the current year, e.g. the third quarter forecast can set the goal posts for next year's annual plan
- The QRF is consistent each time it is performed, as opposed to organisations who always look ahead for two financial years (the QRFs will vary between 15 to 24 months)
- Your annual plan is never set from a cold start as you have seen the whole financial year in the previous quarter's reforecast.

The monthly targets are set, a quarter ahead, from the QRF

As mentioned earlier it is a myth that we c**ould set meaningful monthly targets from the annual plan.**

We instead should report against more recent targets derived from quarterly rolling forecasting process. This process will give us the monthly targets for the next quarter. It is important to realise that monthly targets are not set any further out than the quarter ahead. In fact information for quarters 3,4,5 and 6 are set only quarterly. In other words we patiently wait until the relevant quarter is upon us before putting the BHs estimates in the reporting tool.

This change has a major impact on reporting. We no longer will be reporting against a monthly budget that was set, in some cases 17 months before the period being reviewed.

As an organisation matures in this environment targets for departments that respond directly to the customer demands become flexible. Their progress is measured by observing ratios, cost per unit etc. To understand more read Jeremy Hope's work[ii] and Jeffery Liker's The Toyota Way[iii].

BHs funded a quarter-by-quarter and not from the annual plan

As mentioned it is a myth that we needed to give budget holders an annual entitlement to spend. The key to a better allocation of resources is to fund budget holders on a rolling quarter - by - quarter basis. In this process the management asks, "Yes we know you need $1 million for the year and we can fund it, but how much do you need in the next three months?" At first the budget holder will reply, "I need $250,000 this quarter." The management team replies, "How is this? Your last five quarterly expenditures have ranged between $180,000 and $225,000". "Pat, you are two team members short and your recruiting is not yet underway, realistically you will only need $225,000 tops"

It will come as no surprise that when a budget holder is funded only three months ahead the funding estimates are much more precise and there is little or nowhere to hide those slush funds.

This means that the approval process through the senior management team (SMT) will be quicker as the SMT are approving only the annual number and can adjust the quarter - by - quarter allocations as the conditions and environment dictate.

By funding quarterly, and not yearly, the quarterly rolling planning process thus highlights "free funds" that can be reallocated for new projects earlier on in the financial year.

The released funds can fund new initiatives that the budget holder could not have anticipated at the time of the budget round. This will get around the common budget holder dilemma "We cannot undertake that initiative, though we should, as I did not include it in my budget". In the new regime the budget holder would say "I will put it in my next update and if funds are available I am sure I will get the go-ahead".

This more flexible environment, as long as it is communicated clearly and frequently to budget holders will have good buy-in. The logic of quarterly rolling funding can be shown in an analogy.

> ***The quarterly rolling funding process has a lot in common with the cutting of a nine - year - old ' s birthday cake. A clever parent says to Johnny, "Here is the first slice. If you finish that slice and want more, I will give you a second slice. " Instead, what we do in the annual planning process is divide the cake p and apportion all of it to the budget holders. Budget holders behave like the nine year olds who lick the edges of their cake so even if they do not need all of it nobody else can have it. Why not, like the clever parent, give the managers what they need for the first three months and then say, "What do you need for the next three months?" and so on. Each time we can apportion the amount that is appropriate for the conditions at that time.***

The annual plan becomes a by-product of the QRF

With quarterly rolling forecasting one of the quarters also generates the annual plan. The QRF process will allow you to have a quick annual planning process, as:

- Budget holders will become more experienced at forecasting (they are doing it four times a year), and they have already looked at the next year a number of times
- Politics is taken out of the annual planning cycle as budget holders realise that they no longer obtain an annual entitlement. There is no use demanding more than you need as the real funding is sorted out on a quarter-by-quarter basis where slush funds cannot be hidden.
- The third quarter forecast firms up both the fourth quarter's funding and the annual plan numbers
- The CEO supports the guillotined process
- There is no point spending too much time as the next quarter's forecast is a more up to date view of the future.

Organisations who have truly adopted the Beyond Budgeting principles, developed by Jeremy Hope[iv], also will throw out the annual plan target. Why should one view of year-end be any better than a subsequent more current view? The March quarter forecast, which sets the annual plan for a June year-end organisation, is no longer called the annual plan, but simply the March quarter forecast. The board will want to monitor the extent of forecast creep, and this can be easily shown in a graph.

Detail does not lead to a better prediction of the future

As already mentioned it is a myth that we needed forecast at account code level. A forecast is a view of the future. It will never, can never, be right. *"It is better to be nearly right than precisely wrong"* John Maynard Keynes.

Looking at detail does not help you see the future better; in fact, I would argue it screens you from the obvious.

Counting the trees in a forest

Imagine that you have been asked to count the trees in a state forest that consists of 100 square miles of trees. You have two choices, the detailed way and the "helicopter" way.

For the **detailed way,** you could set up 10 teams of seven people. Each team is assigned 10 square miles and is given satellite navigation equipment, a different colour of spray paint, safety gear, camping equipment and provisions for three weeks or so. The teams update their count each night on a spreadsheet. At the end, the counts are consolidated, and some data is left out because the counters in some teams forgot to load all their spreadsheets into the workbook. The final count, therefore, is wrong, although no one knows that.

For the **helicopter way,** satellite imaging is used to select five sample areas that are 1/1000 of the forest. The staff are assigned to five bigger teams, and each counts their area in a day. The count of the five areas is averaged and then multiplied by 1000. The answer is wrong. But it was wrong quickly and is still a good approximation. For forecasting, the helicopter way is usually the better option unless you are forecasting payroll where managers can forecast by their staffs' actual salaries.

While precision is paramount when building a bridge, when every small detail needs to be right, a forecast should concentrate on the key drivers and large numbers.

Following this logic, it is now clear that as accountants we never needed to set budgets at account code level. We simply have done it because we did it the previous year. You can control costs at an account code level by monitoring trend analysis of actual costs over 15- 18 months.

Rules I have developed:

- limit the categories that budget holders must forecast to no more than 12
- select the categories that can be automated, and provide these numbers
- separate out a forecasting line in the model if an account is over 10% of total expenditure or revenue e.g. show revenue line if revenue category is over 10% of total revenue. If account code is under 10% amalgamate it with others until you get it over 10%. I call these **categories**. Thus a category will have a number of account codes within it. See Exhibit 1.6 for an example.
- map the G/L account codes to these categories – a planning tool can easily cope with this issue without the need for a revisit of the chart of accounts.
- Invest more time on the accurate forecasting of personnel costs by requiring each manager to review current staff levels and salaries. They are to schedule any known leaving dates for any staff who are moving on, any planned salary increases due to promotions, and the expected starting salary and date for all new staff. See Exhibit 1.7 for an example.

Exhibit 1.6: How a forecasting model consolidates account codes

Forecasting at Account Code Level		Forecasting at Category Level	
Stationery	40,556		
Uniforms	23,325		
Cleaning	11,245		
Miscellaneous	17,654	Consumables	110,000
Consumables	12,367		
Kitchen supplies	2,134		
	107,281		110,000

Exhibit 1.7 Example of the payroll forecasting worksheet

Employee Name	Position Grade	Department	Annual Salary	Override Salary	Start Month	End Month
Jump, John	Junior	Sales team 1	45,000	50,000	Jun	
Host, Chris	Sales	Sales team 1	70,000			
Big, Terry	Sales	Sales team 1	68,000			Aug
Etc		Sales team 1				

The QRF should be based around the main events / key drivers

A forecasting tool needs to be based on the main events / key drivers and thus the finance team should be able to quickly inform management of the impact should there be a major change with any of these drivers. In-depth interviews with the Senior Management Team (SMT) coupled with some brainstorming will quickly identify the main drivers which may include:

- What if we contract in size e.g. stop production of one line, sell a business?
- What if we grow through acquisition?
- What if we lose a major customer?
- What if there is a major change to key economic indicators e.g. interest rates, inflation, oil price, exchange rate?
- What if a major overseas competitor sets up in our region?
- What are the plant capacity ramifications from gaining a large increase in business e.g. collapse of a major local competitor?

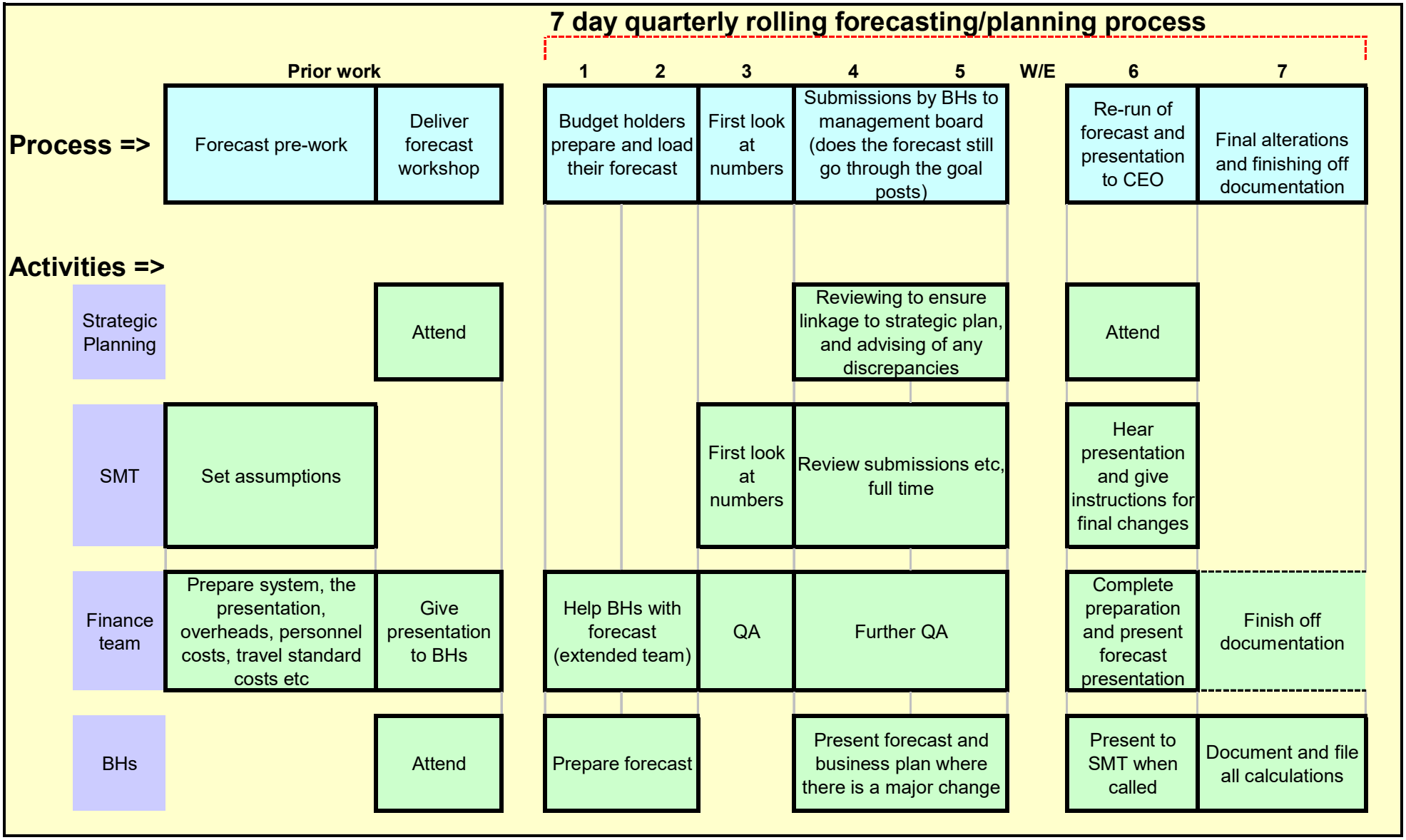
If you have second guessed the likely SMT requests and have designed the model around them you will have a planning tool that can quickly model the implications of such changes robustly.

American Express found that their forecast has principally based around two drivers, customer numbers and average customer spend.

A fast light touch (an elapsed week)

QRFs should be performed within five working days (see Exhibit 1.8), with the one exception that the fourth quarter forecast, which creates the annual plan (see Exhibit 2.1) will have one extra week for additional negotiations and quality assurance.

Exhibit 1.8: Timetable for a seven day forecast



QRFs can be quick because:

Reliability	Consolidation is instantaneous with a planning tool
Pareto's 80/20	The model is based on Pareto's 80/20 and the "keep it simple" (KIS) principle.
	Budget holders can enter numbers directly into the planning tool after training as the model is based around Pareto's 80/20 principle, focusing on the major items, events, drivers etc
	Because forecasting is at category level, only 12-15 categories are forecast by a budget holder.
	Only need monthly data for the first two quarters
Quarterly repetition	The quarterly repetition aids efficiency
Prework	Repeat costs can all be standardised for the whole year, e g Dublin to London return flight € 250, and overnight in London € 280
Extended support	There will be one-to-one support by expanding the budget team
Exception based approval process	New funding requests or error prone forecasts require an audience with the Forecast Approval Committee

Jeremy Hope sees no reason why the forecast process could not be done in a day in a financial services organization, where there is no physical supply chain and inventories to manage. For more complex businesses, Jeremy Hope believes that these forecasts can be done in several days."[v]

Based on a planning application – not Excel

Forecasting requires a good robust tool not a spreadsheet, built by some innovative accountant, which now no one can understand. Often the main hurdle is the finance team's reluctance to divorce itself from Excel. It has been a long and comfortable marriage albeit one that has limited the finance team's performance.

Why Excel is inappropriate

Spreadsheets have no place in forecasting, budgeting and many other core financial routines. Spreadsheets were not designed for many of the tasks they are currently used to accomplish. In fact, I often remark in jest at workshops that many people, if they worked at NASA, would try to use Microsoft Excel for the US space program, and many would believe that it would be appropriate to do so. A spreadsheet is a great tool for creating static graphs for a report or designing and testing a reporting template. It is not and never should have been a building block for your company's planning systems. The high level of errors in spreadsheets is the main reason why. A major accounting firm pointed out that there is a 90 percent chance of a logic error for every 150 rows in an Excel workbook.[vi]

A decade ago, the electronic spreadsheet was still state-of-the-art for the budgeting process and the only practical option for most midsize companies. However, what might have started as a simple budget model often grew into a spreadsheet that soon got out of control. Moreover, considering the time and effort required to turn that mass of spreadsheets into a coherent budget, they should not have been considered "inexpensive." With the introduction of dedicated planning tool software for all sizes of organizations, spreadsheets are not the optimal approach any longer.

Rule of 100

I believe you can build a forecasting model in a spreadsheet application and can keep it within 100 rows without much risk. Pass this threshold and you expose yourself, your finance team and the organisation. Lean finance teams require robust tools, not spreadsheets that were built by an innovative accountant and that, now, no one can understand.

I always ask in workshops, "Who has a massive spreadsheet written by someone else that you have to pray before you use it?" You can see the pain in the instant response. Most people know that the person who built the spreadsheet certainly was not trained in operational systems design. The workbook will be a collage of evolving logic that only the originator has a chance to understand.

Often, the main hurdle is the finance team's reluctance to divorce itself from the spreadsheet programme. It has been a long and comfortable marriage, albeit one that has limited the finance team's performance.

Career limiting

Acquiring a forecasting and planning tool is the major step forward, and one that needs to be pursued, not only for your organisation's future, but also for the future careers of the finance team. Soon, a career prerequisite is likely to be planning tool experience, and, conversely, being a spreadsheet guru is likely to be career limiting.

To those readers who believe a spreadsheet is still appropriate, I say to them, why not build your general ledger in a spreadsheet programme and while you are at it, all your operations systems? Try explaining to the CEO that only one person knows how these systems work and he or she left four years ago. You might as well clear your desk now.

New planning tools are being built all the time and this table, on Exhibit 1.9, is certainly out of date at the time of you reading it. The table is not intended to be a comprehensive list as this would be a paper in itself. The following "search string" Planning tools + Quarterly rolling forecasting + applications will help unearth many applications.

Exhibit 1.9: Some of the planning tool providers and their applications

Tier	Package Name	Website	Cloud option	Free Trial / Demo
3	A3 Modelling	www.a3solutions.com	Yes	Free model
3	Active Planner	www.epicor.com	No	Demo, Webinars
1,2,3	Adaptive Planning	www.adaptiveinsights.com	Yes	Free trial
2,3,	Alight Planning	www.alightplanning.com	No	Demos
2,3	Anaplan	www.anaplan.com	Yes	Demos
3	Big Boss	www.bigbosssoft.com	No	Free trial
3	BizBudg Online	www.bizbudg.com	No	Free trial
1,2,3	BOARD International	www.board.com	No	Demo, Webinars
2,3	Budget Maestro	www.centage.com	Yes	Free trial

3	Calxa Premier	www.calxa.com	Yes	Guarantee
3	Castaway	www.castawayforecasting.com	No	Demo
1,2	Cognos TM1	www-03.ibm.com	Yes	Demo only
2,3	Budget Maestro	www.centage.com	No	Free trial.
2,3	Forecast5	www.forecast5.com/	No	Free trial, Webinars
2,3	4cast Pro	4Castsolutions	No	Free trial
2,3	Forecast Server	www.vanguardsw.com	No	Webinar
2,3	GIDE Financial Modelling Suite	www.capterra.com/budgeting-software	No	Free trial for 30 days
1,2	Host Analytics EPM Suite	www.hostanalytics.com	yes	Demo only
1	Hyperion Planning	www.oracle.com	Yes	Video, Pod and on line chat
2	Infor CPM Planning and Budgeting	www.infor.com	No	Demo only
3	Invest for Excel	www.datapartner.fi/en	No	Free trial
2,3	Jedox	http://www.jedox.com	Yes	Free trial
2,3	Kepion	www.kepion.com	No	Free trial
2,3	Maxiplan	www.maxiplan.com.au	No	No
2,3	Mondelio 6.3	www.mondelio.com	Next version	No
2,3	Planguru	www.planguru.com	Yes	Free trial
2,3	PowerBudget	www.chameleon.com.au	No	Demo
2,3	PowerPlan	www.powerplan.com	Yes	Whitepapers
1,2,3	Prophix11	www.prophix.com	No	Demo, Webinars
2,3	Questica Budget	www.questica.com	Yes	Demo
2,3	Quantrix	www.quantrix.com	Yes	Free trial
2,3	Rocket CorPlanning	www.rocketsoftware.com	No	Videos
2,3	Sage 50 Forecasting	www.sage.co.uk/sage-50-forecasting	No	Free Trial
1, 2,3	SAS Financial Management	www.sas.com	No	Whitepapers
2,3	Tagetik 4	www.tagetik.com	Yes	Demo only
2,3	Visual cash Focus	http://www.cashfocus.com	No	Free trial
2,3	Whitebirchs	www.whitebirchsoftware.com	yes	Demo

Common problems with spreadsheets

Senior management is often blissfully unaware of the risks they take every time they rely on information from large spreadsheets.

Some of the common problems with spreadsheets are:

Broken links or formulas	An individual might add or eliminate a row or column so that, when a group of spreadsheets is rolled up, the master spreadsheet is taking the wrong number from the one that was modified.
Consolidation errors	Often, a spreadsheet will lock up or show a screen full of "REF", "REF" "REF" errors, because it was not designed to be a tool for handling a rollup of dozens of different worksheets.
Input of the wrong numbers	Entering the wrong number can happen in any process, but spreadsheet-based systems often require rekeying of information, which can produce data inconsistencies. A spreadsheet might use a look-up table that is out of date or an entry might have been inadvertently or mistakenly overwritten.
Incorrect formulas	A subtotal might omit one or more rows, columns or both. An individual might overwrite a formula because they believe theirs is more accurate. Or, someone might use an outdated spreadsheet. Or, allocation models might not allocate 100 percent of the costs. Allocation methods might be inconsistent.
No proper version control	Using an outdated version of a spreadsheet is very common.
Lack of robustness	Confidence in the number a spreadsheet forecast churns out is not assured. Many times you cannot check all the formulas because they can be found in any cell of the spreadsheet.
Inability to accommodate changes to assumptions quickly	What would you do if your CEO asked, "If we stopped production of computer printers, what would be the financial impact? I need the answer at the close of play today." Your spreadsheets are not able to provide that quick answer.
Design is by accounting staff who are not programmers	Most accounting staff have not been trained in system documentation and quality assurance, which you expect from a designer of a core company system.
Lack of corporate office control	Many people in a business can use spreadsheets to create their own forecasts at a ridiculous level of detail. This can lead, as a friend once said to me, "To the march of a million spreadsheets."

New CFO finds an error

A financial controller came to me with a great tale. He had just completed the annual budget that his team had been working on for many weeks long into the night and on weekends. Proudly, one Friday afternoon, he walked into the office of the recently appointed CFO and announced the first cut of the annual plan. The CFO spent five minutes looking at the plan and after quickly calculating some numbers said, "This annual plan is wrong; the numbers do not make sense." The financial controller was taken aback, because he had made a special effort to conduct quality assurance on the numbers, and he had done comparisons to last year's plan, along with a few other things. He had wanted to

make the best impression. The CFO called him over to look at his brief calculation, "Pat, we know the planned sales have been signed off already, gross profit margin historically has been around x percent, overheads are roughly $XX, and thus, I am expecting a number around $XX- $YY." The financial controller could only agree.

That weekend, the team poured over the spreadsheet, which was enormous and included the consolidation of many worksheets from many sources. Late on Sunday, they experienced a "eureka" moment. An error was found and rushed to the financial controller. As they processed the correction, they looked with disbelief because the new number was within the outline the CFO had suggested. Pat said to the team "We have a pretty smart CFO; let's see how long this error has been around. Please look at the last two year's annual plan models."

As Pat recalled to me, with a wry smile, the error had been in the plans for the previous two years and had gone completely undetected.