

*PREPARING FOR 2010: INTEGRATING
THE BUDGETING PROCESS
WITH KEY PERFORMANCE METRICS*

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Agenda

- Budgeting
 - Overview
 - Why to budget?
 - Telling the ‘Story’
 - Limitations
- Types of budgets
 - Strategic
 - Operating
 - Cash flow
- Key metrics
- Monitoring and reforecasting budgets
- Sharing tools and techniques
- Summary

Successful Firms Take Budgeting Seriously!

A survey of 402 firms in nine industry categories indicates that successful firms:

- Encourage company-wide commitment to budgets
- Identify connections between immediate, medium-term, and long-range budgetary objectives,
- Develop detailed procedures for budget preparation, and
- Analyze variances in the budget and correct them.

TEN Steps to Successful Budgeting

1. Commitment by **senior management** to the budgeting process
2. Establishment of **realistic** budgetary goals
3. Assignment of budgetary objectives **within** managers' responsibility ranges
4. Assessment of senior management's goals **prior** to preparing departmental budgets
5. Identify how **short-term** objectives **help** to achieve long-range goals

TEN Steps to Successful Budgeting

6. Treatment of the budgeting process as a **major company project**
7. **Standardization** of the routine aspects of the budgeting process
8. **Regular reviews of actual** operating results in **comparison** to budget
9. **Discipline** of mid-level managers who play "budget games," and
10. **Periodic auditing** of the budgeting process.

Why Budget and Forecast?

- Results indicate how your business should perform if operating plans are followed and known events take place
- Decision making tool
 - Identifies operational efficiencies and inefficiencies
 - Provides a plan for the most productive and profitable use of resources
- Enables performance assessment of the operation of the business and its managers

Why Budget and Forecast?

- Set Goals and Expectations for everyone!
 - Utilization
 - Realization
 - Billings
 - Cash Collections
 - Expenses
- Reviews Capacity for people, space and technology (Cap Ex)
- Determines how much cash the Company will need before it needs it!
- Establishes a Capital Retention Program

Why Budget and Forecast?

- Forces managers to do **planning**
- Basis for **controlling** what happens within the organization.
- Helps **coordinate** the activities of the various units that make up the business.
- **Communication** tool– managers exchange information on ideas, etc.
- **Motivating** tool – if the process involves management not just finance

Budgets should Tell a Story and Answer Questions!

- How much money will the Firm make next year?
- What clients, industries and projects will help us achieve our goals?
- Who will help the Firm reach its' goal?
- How many FTE's will be needed to do the work?
- How much will we pay them?
- Do we have enough cash to achieve the Firms goals?
- What metrics are acceptable?
 - Utilization
 - Multipliers
 - Overhead rates



Limitations of budgets

- Only estimates, not statements of facts.
- No substitute for sound management practices.
- Need to be amended if circumstances change.
- Preparation does not guarantee success.
- Aspects of people's behavior may undermine the value of the process.

Types of Budgets- Not just a P&L

- Strategic
 - People and Customers
 - ✓ Organization chart for people
 - ✓ Projects, relationships, customers, industries & services
- Operating
 - Income Statements, Annual (One, Three & Five Years), Monthly
- Cash Flow
 - Balance Sheet



Strategic Budgeting

- What is the long-range plan:
 - Organic growth vs. acquisition
 - Succession planning
 - Ownership transition
- Who are the key PEOPLE?
 - Identify the ‘A’ players and future leaders
 - Get the right people on the BUS and KEEP them there
- Focus on the Customer
 - Niche markets / industry focus
 - Services
 - Getting the right projects
 - BD / Marketing – focus on relationships

Operating Budgets

- Identifies Sales Goals
- Calculate Capacity
 - Direct Labor dollars and hours
- Budgets expenses
 - Considers historical costs, goals, initiatives, etc
- Budgets discretionary expenses
- Budgets Profits
- Note: Budgets should be formatted consistent with your Company's P&L

Budgeting Revenues

- Budget revenues according to three measures:
 - People: Hours X Rate X Utilization Target %
(staffing capacity)
 - Clients: Which clients are growing, which are declining and by how much?
Backlog and bookings review to start
 - New Business: Origination targets – How much new business will we generate this year?
- Distinguish between cash basis and accrual basis revenues
- If firm is growing this is even more important as there will be a greater difference between billings and collections.

Budgeting Expenses

- Budgeting expenses:
 - Current expense levels + % increase
 - Seasonality
 - New people
 - Additional space
- Compensation costs
 - Technical Staff Salaries – tie to Revenue
 - Administrative Staff
 - Payroll Taxes and Employee Benefits
- Rent
 - Space required for People?
- Marketing costs
 - Any additional marketing required to grow business?

Cash Flow Budget

- Profit and Loss is an ESTIMATE ... Cash is real
- Statement of Cash Flows details cash inflows and outflows related to a company's operating, investing, and financing activities over a period of time.
- Often a company's value is determined by cash flow
- Cash flow is manageable
 - Maintain enough cash on hand to meet business needs
 - Maximize return on surplus cash
 - Manage Debt
 - Budget for Cap Ex
- Sets goals for:
 - A/R and WIP Days Outstanding
 - Driving down debt
 - Capital retention / planning

Identify/Focus On the Key Metrics

- What are the key metrics?
 1. Effective Labor Multiplier
 2. Utilization
 3. Net Revenue / Employee
 4. Overhead as % of DL / revenues
 5. Staffing / Capacity – Total Available Hours vs. Projected Hours Booked
 6. Discretionary net profits
 7. Cash / Collections (WIP / AR Days)



Identify/Focus On the Key Metrics

- Look at the Key Metrics by:
 1. Employee (how productive, profitable is each person)
 2. Project (treat each project as a part of the whole)
 3. By Division (why are some better than others)
 4. At the entity level

Identify/Focus On the Key Metrics

- Targeted metrics vs. PLAN
 1. The targets should cover the Company's costs plus an acceptable level of profit
 2. The best firms budget for "best of class" results
 3. The targeted metrics should put pressure on the managers and employees to hit their GOALS.
 4. If current PLAN indicates LOWER than expected targeted metrics consider changes: adjust staffing, reduce overhead and close more business.



Capacity (Hours)

- Direct labor budgets are an essential part of A/E firms
- Budget hours, dollars, utilization for all staff
- What is prior history – last year’s performance?
 - Do you know your available capacity?
 - Does it match up with your backlog?
 - What is the average NSR per employee?
- What are expectations?
- What is required “ramp up” for new people?

Monitor and focus on variances

- If expenses are exceeding the budget, consider cutting back on costs
- If revenue is below target, focus on why-who is not hitting their goals
- Monitor employees by periodically comparing their performance to the budget
- Keep super-performers on track.
- Cash collections (see Cash Budget)

Budget Variances

- **Significant variances** (exceed an acceptable limit) are investigated by the manager of the division / sub-unit. What is considered significant varies from business to business.
- **Reasons for variances** are numerous but fall into two main groups:
 1. are a result of external factors that management have no control over, and
 2. are a result of internal factors that management maybe able to change.

Budget Variances

What to do with budget variances:

- Meet with underperformers to review how to increase performance
- Analyze goals and adjust, if needed (reforecasting)
- Hold underperformers accountable –
 - Some companies have ‘3 strikes your out’ rule
- Achieving targets/goals should be part of compensation package.

FINAL Budgeting Tips

- Keep it SIMPLE. As overly complicated budget process is going to reduce the level of BUY IN
- Start the budgeting process early (most companies will have this done 1-2 months prior to the end of current fiscal year)

FINAL Budgeting Tips

- This should be a collaborative process between ALL groups / divisions but finance should DRIVE the budget process
- CASH IS KING - The budget should focus on the balance sheet.