



***A survey of UK corporate
budgeting: The Report***

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Highlights

The survey of budgeting in the UK has been completed by directors and senior managers in 123 major organisations in both public and private sectors. The survey gives an insight into current budgeting practices, into the budgeting problems that organisations face, and into respondents' thoughts for improvement.

What is the budget used for, and is it successful?

Most organisations use budgeting for a wide range of purposes - but are only partially successful in meeting any of them. The biggest gap between high importance and low performance occurs in the inability of the budget to enable organisations to translate the strategy into costed plans.

Is the board playing its part?

43% of respondents feel that their boards or equivalent senior management group are not doing their job as far as the budget is concerned. Boards either fail to provide leadership in setting strategy, or in ensuring that the budget supports the direction in which they want to take the organisation. Or they fail to give clear guidance as to the complexion of the budget, or review budgets ineffectively without challenging to ensure that budget holders have thoroughly explored options and opportunities.

How much effort is required to produce the budget?

The average time to produce the budget is 3.7 months. The average number of iterations (being "formal" submissions to the Board or senior management) is 2.8. 20% of organisations go through five or more such iterations before agreement. In addition to the formal submissions, budgets go through many reviews before presentation to senior management.

Why are budgets rejected by the board/senior management?

The main reason for budgets being rejected is cost centre managers ignoring the corporate strategy. 71% of organisations suffer this problem, which is somewhat disconcerting given that, overall, respondents regard the translation of strategy into costed plans as the most important aspect of the budgeting process. 69% of organisations have budget submissions rejected because of implied or explicit disagreements between budget holders and the board/senior management about how effectively or efficiently resources can be used.

Does it matter if budgets are constructed top-down, bottom-up or a combination of both?

Apparently not. Irrespective of approach, budgets take the same time to produce, with the same number of iterations, and are judged to be just as useful.

In terms of budgeting, are there any differences between the sectors represented in the survey?

The findings suggest that budgeting is an all-pervasive, catholic activity that unites all sectors of the economy. Even the procedures, views and judgments of those in the public and private sectors do not show any statistically significant variations from one another.

How detailed are the budgets that organisations produce?

The median number of detail lines, calculated from the product of the median number of cost centres (50) and the median number of ledger code lines (25) is 1,250. Many respondents share concerns about balancing the level of detail needed with the complexity of the budget. They describe modifications to the process so as to provide more detail in important areas and less where costs are not as significant. In fact, organisations tailor what they do to the circumstances they face to a significant extent, resulting in highly diverse approaches.

Is budgeting integrated with other management processes?

Few organisations attempt to produce a detailed budget for more than one year. Longer term projections are frequently conducted through a separate planning process. Poorly linked budgeting and strategic planning processes are part of the cause for the high number of budget iterations required to gain agreement.

How accurate does the budget turn out to be?

44% of organisations budget to within $\pm 5\%$ of actual revenues and costs, which is a staggeringly good result. Despite this, 83% revise their budgets during the course of the year. The more accurate the budget, the more valuable overall respondents think their budget to be.

Exactly half respondents report that there is a point in their budget year after which people regard the budget figures as being outdated and, for practical management purposes, ignore them. For these respondents, the average period into the budget year when this occurs is $4\frac{1}{4}$ months. They still take an average of 3.3 months preparing their budgets, involving 2.7 formal budget iterations. No doubt some of the effort of producing the budget, if not most of it, goes into the numbers relating to the last $7\frac{3}{4}$ months of the year, the period for which “people regard the budget figures as being outdated and, for practical management purposes, ignore them”.

Do organisations assess the risks of their budget being wrong?

64% of respondents conduct no formal risk assessment, or think that risk assessment is insufficiently rigorous.

Is performance against the budget reviewed?

Over 90% review budgets monthly, producing reports detailing the reasons for major variances. 77% think that periodic review of performance against budget is important or essential. 84% think reviews are at least adequate, and 55% consider them well or excellently done. Nevertheless, there is widespread concern that corrective action is not adequate. There is a demand for making reviews more formal so that action plans are recorded and reviewed, and so that budget holders can be held more accountable for their budgets.

Is the budget revised during the budget year?

83% of respondents formally revise the budget during the course of the year. On average, they do so $4\frac{1}{4}$ times a year. 13 respondents revise their budgets 12 times a year, but only two of them – that’s less than 2% of the whole sample - do so using monthly rolling budgets.

Many organisations retain a use for the original budget figures, despite revised ones being available. Generally, the revised figures are used for reviewing plans and for crafting announcements to stakeholders. The original budget is retained for assessing managers’ performance and, predominantly, for bonus calculations. In fact exactly half the organisations that revise their budgets retain the original budget as the basis of bonus calculations.

Do respondents agree with the usual criticisms levelled at budgeting?

We offered respondents 17 regularly-heard criticisms of conventional budgeting and asked them whether they thought the criticisms applied to the way budgeting was conducted in their organisations. Responses ranged from complete agreement to complete disagreement on every single criticism. However the mean response overall was slight disagreement.

Nevertheless, is there a better way?

We asked respondents to say what changes they would like to introduce in their budget process. Overall, respondents offered a total of 445 changes that on average they thought were well worth introducing. 82% of respondents offered at least one change. On average, each respondent suggested 3.6 changes.

There is frustration with conventional annual budgeting and a significant call for a fundamentally different approach. The most popular proposal is for a rolling forecast/budget (ie one whose end date keeps rolling forward so that the period ahead that the budget covers remains constant). 17% have already adopted this approach. Another 19% of respondents thought that this would be a significant improvement - although most have yet to take any steps to change, and are concerned about the effort involved.

The most popular themes are:

- Finance people must give more financial support to business planning; provide better analysis and understanding; give cost centre managers/budget holders more support and guidance, and worry less about control (28 proposals)
- Budget holders must get more involved in their budgets, and be more accountable for them (25 proposals)
- Introduce rolling forecasts (23 proposals)
- The board/senior management must make strategy/goals clear and communicate them (15 proposals)
- Introduce proper budgeting and reporting software instead of using spreadsheets (but cost may be prohibitive) (15 proposals)
- The board/senior management must check that the budget conforms to business plans/strategy, and not just look at money or pet projects (14 proposals)
- The board/senior management must be more involved in open, constructive review, and develop alternative tactics, not just accept results (13 proposals)
- Finance people must be more involved with/driven by front line operations, and understand the business (12 proposals)
- Having reviewed performance, develop action plans and make sure that actions are carried out on time and followed up (12 proposals)

If there are better ways of budgeting, what are the barriers to change?

The attitude of people and their unwillingness to change is the dominant theme. It was raised by 48% of those who responded to this question. People's unwillingness to change applies both to finance people and to others, mainly senior management, throughout the organisation.

Lack of time (20%) and the difficulty in establishing quantified benefits (16%) are the next most significant barriers.

Conclusions

We offer here some conclusions on the findings of the survey.

Most organisations use budgeting for a wide range of purposes - but are only partially successful in meeting any of them.

One might have expected that, for a major, cross-organisational exercise like budgeting, organisations would have a clearly focused view on its purpose, but this doesn't seem to be the case.

The wide range of objectives set for budgeting by most organisations may compromise the success of all of them. Managers faced with conflicting objectives will have to choose a path between the good of the organisation and their personal success. The behaviours of budget holders created by these conflicts of interest may in part explain why the success of budgeting is seen as being only partly achieved.

The elapsed time and the number of iterations to complete budgets is excessive

An average of 2.8 formal reviews and iterations represents a great deal of diversionary effort throughout the management structure of the organisation for a considerable period of the year – 3.7 months on average. Momentum is difficult to sustain and, most importantly, circumstances are likely to change significantly over the period. Iterations seem less to do with improving the quality of the budget and more to do with reconciling differing views between cost centre managers and senior management and the board.

The budgeting process is poorly defined and poorly communicated

Many organisations seem to be taken by surprise every year when budgeting starts. Planning, documenting and communicating the process are rushed and the roles and responsibilities of those involved are left unclear. The opportunity to improve the effectiveness of budgeting year-on-year is therefore missed.

The budgeting process lacks sufficient challenge to the status quo

Although adding a stage of formal challenge into the budgeting process in order to test budget holders' proposals is likely to increase the elapsed time, it aids transparency and communication and clearly works for some organisations. Formal challenge could also influence managers' behaviour and reduce the "game playing" that is often observed.

The main reason for budgets being rejected is budget holders ignoring the corporate strategy

Overall, respondents regard the translation of strategy into costed plans as the most important aspect of the budgeting process. But every year, the managers of 71% of organisations ignore the strategy to such an extent that their budget attempts are rejected. If they do this in respect of the budget, which they know will be scrutinised by the board, will they also ignore the strategy over issues that are less visible to senior management? What, cumulatively, are the implications for the organisation's chances of delivering its strategic intent?

The percentages for a poorly-communicated strategy (67%) and an ill-conceived strategy (that is one where the financial implications of the strategy are unacceptable) (63%) are similarly substantial, and the implications no less daunting.

One of the problems is that the budget, in its conventional form, is so familiar to all that people are not shaken by statistics such as this. But an annual ritual that so starkly reveals the gaps in understanding and judgment between those who set down strategy and intended financial outcomes, and those who are expected to deliver them suggests a house divided.

Few organisations attempt to produce a detailed budget for more than one year. Longer term projections are frequently conducted through a separate planning process

Poorly linked budgeting and strategic planning processes are part of the cause for the high number of budget iterations required to gain agreement.

44% of organisations budget to within ±5% of actual revenues and costs

We are surprised by the reported accuracy of the budget, namely that 85% of organisations are within ±10%. We have already seen that the average elapsed time to prepare the budget is 3.7 months. This means that, taking average numbers, 44% of organisations predict costs and revenues to within ± 5% more than 5 quarters ahead! This seems to contradict the finding that we describe later that over 80% of respondents regard budget revision as essential during the course of the year. It also appears to contradict the finding that, for half the respondents, the budget figures are effectively abandoned after 4¼ months of the year.

A possible explanation is that, when budgets are used as targets, those targets nearly always end up soft enough to ensure that managers don't fall short of the budget. In these circumstances, there is no advantage, and probably

some disadvantage (tougher targets next year) in exceeding budget. Furthermore, hitting a cost target (rather than a revenue target) often requires little or no action.

Organisations know that they cannot expect to forecast accurately in a complex and rapidly changing world, and that what they must do is continually monitor the internal and external environment and be prepared for speedy change. The difficulty is to devise a budget process that recognises this fact and that minimises the effort wasted in looking so far ahead that accurate prediction is unlikely.

Reviewing budget performance is essential and is generally at least adequately carried out, but variances cannot always be explained and corrective action is not always forthcoming

Of all the sections of the survey, respondents seem most happy with the way that performance against budget is reviewed. On reflection, we failed to ask an important supplementary question: *How well do you act upon the correctly identified reasons for variance against budget?* We say this because there is widespread demand for making reviews more formal so that action plans are recorded and reviewed, and so that budget holders are held more accountable for their budgets.

Budget revisions begin almost as soon as the original budgets are agreed, and continue throughout the year

Many organisations treat initial budgets with a high degree of scepticism despite the large amount of effort involved, the high level of detail, and the lengthy period required to produce them. The initial budget is viewed as a “base line” from which it is easier to make the inevitable revisions.

The question remains, is the effort involved in the initial budget preparation justified and would not a rolling budget be a more effective and accurate approach? Apparently not, because only two organisations out of the total sample of 123 roll forward on a monthly basis. Nevertheless, of all the 445 proposals for change, the third most popular theme was to introduce rolling forecasts.

Despite the fact that most organisations conduct many budget revisions during the year, the original budget is still seen as the “benchmark” for many

The main reasons for reporting against original budgets seem to be based on the concept that the original budget is a commitment or contract between different levels of management. Keeping to that commitment, or keeping others to it, is seen as demonstrating financial control and good management practice. This is particularly the case where head office or external stakeholders are concerned.

This view may have merits where management can control and reduce adverse variances. In the situation where events occur outside management control (quite often a subjective judgment), or positive variances could be achieved, there is little to be gained. Indeed, there is a great deal to be lost as managers ignore arising opportunities and threats, or play the “game” of phasing sales and expenditure, simply to meet budgets.

Exactly half the organisations in the survey that revise their budgets retain the original budget as the basis of bonus calculations. The reason why bonuses are so often based on the original budget is clear. If you start with the premise that the budget represents a target revenue and cost statement for the year, then organisations feel comfortable offering a portion of the resulting profit to managers as an inducement to hitting targets. If they don't hit the targets, they don't get the bonus, so it is a risk-free offer. Once you allow the target to move, the risk of giving away more than you can afford arises.

This explanation lends support to the often-expressed view that the budget is as much a mechanism of pay negotiation as anything else (despite vehement denial by our respondents). It also lends substance to the argument that the budget stifles the flexible, dynamic management that we are told today's organisations need. This is because the biggest influence of managers' behaviour – their pay – rests on meeting targets that, 4¼ months into the year, “people regard ...as being outdated”.

This bonus issue reminds us of the first finding of the report, namely that the budget performs quite well on all its purposes, but not particularly well on any. Is the budget meant to be a demanding target, with rewards for achievement, or a considered judgment of the most likely future? One solution to this dilemma is to make the budget the latter, and to find another, separate mechanism by which to remunerate managers. This frees the budget to concentrate on accomplishing fewer really important tasks well.

The usual criticisms levelled at budgeting are by no means universally accepted

Some of the responses appear to contradict other findings. For example, the strongest disagreement is to the suggestion that the budget is used as a pay-bargaining mechanism. Yet 66% of respondents say that their budget is used for bonus calculations.

However, the scoring overall is consistent with the sanguine view that respondents have expressed about how well their budgets perform. Interestingly, the two criticisms attracting biggest support are directed at people behaviour or role, namely of cost centre managers and of the board. Criticisms of the budget process itself tend overall to be rejected.

Changes proposed by respondents

This is the part of the survey where respondents really came into their own. Their proposals for change – all 445 of them – came in response to question 30, so it is a testament to their staying powers. Proposals have been grouped under six categories, reflected in our comments here.

Board/Senior Management

In essence there is strong criticism of the board: 43% of respondents feel that their boards are not doing their job as far as the budget is concerned. They either fail to provide leadership in setting strategy, or in ensuring that the budget supports the direction in which they want to take the organisation. Or they fail to give clear guidance as to the complexion of the budget. Or they review budgets ineffectively without challenging budget holders to ensure that they have thoroughly explored options and opportunities.

It is right, we feel, to be concerned. For many organisations the budget is an important, maybe the major instrument for creating plans and for regular review of corporate performance. If the basis of that planning and review is flawed, lacking in board scrutiny and not bound to the strategy, how can the organisation practice effective stewardship of its operations?

Finance people

Given that most of the respondents are members of the finance function, they are not uncritical of their own performance. In fact, we find it encouraging that finance people are not sitting back blaming the rest of the organisation for any shortcomings the budget may have. On the contrary, respondents provide a clear, positive message that finance people have to get out there and make it happen.

Cost Centre Management

The overriding impression given by these proposals is of disengaged budget holders, unwelcome victims of what is to them a meaningless and time-consuming task. Getting them engaged will be no mean feat. A key way of doing so is to get away from budgets that are based on last year's numbers, and that take no account of strategy and of plans to change. It will help if the Board itself doesn't just look at the numbers, as has already been pointed out, and if reviewing performance against budget isn't just a numbers game either.

Reforecasting/rolling forward the budget

Why is the proposal to introduce rolling forecasts, as opposed to simply re-forecasting, so popular? In conventional budgeting, the budget year is divided into 12 months each with its own figures for costs, revenues and non-financial measures. As the months go by, the forward visibility of what the organisation is attempting to achieve shrinks to zero.

Towards the end of the budget year, two generally unhelpful consequences of this approach arise. One is that the detailed planning of things whose lead time extends beyond the end of the budget year, for example recruitment or ordering raw material, becomes difficult because detailed plans for the next budget year haven't yet been approved.

The other is that people delay important expenditure or pre-book revenue simply to improve the look of the outturn figures for the year – the “accruals effect” as one person put it - upsetting both customers and suppliers. Rolling forecasts can ameliorate both these adverse effects.

For others, the major attraction of a rolling forecast is that it reduces dramatically the effort otherwise required for the preparation and acceptance of the annual budget, much of which is wasted when the original budget is abandoned.

A third factor sitting behind many of the proposals is that managers are not involved in the re-forecasting process. In many organisations, it seems that re-forecasting is done principally by the Finance department at a high level, and reported to the board. Clearly, under these circumstances, re-forecasts will suffer from the lack of on-the-spot involvement of managers and will not make them responsible for subsequent performance.

The nub of it is that we need to replace a process that involves looking forward only once a year, and looking backwards 12 times a year, with one that continuously looks forward. And it needs to look forward with the intimate involvement of line managers. After all, management is a continuous process, and so too should be the budget.

A key feature of rolling budgets is that they represent a radical departure from convention, whereas all the other proposals represent merely improvements – albeit in some cases significant ones - to the existing process. Instead of a single do-or-die effort once a year, rolling budgets require a regular and frequent reappraisal and a shuffle forward to keep the 12 months visibility. This has profound implications for processes and systems. As far as the budget is concerned, it is replacement rather than repair. There is much interest in espousing monthly rolling budgets, but only 2 out of 123 organisations have done so. Decision time looms.

Reporting performance against the budget and taking action

The proposals paint a rather sorry picture: we spend all this time and effort creating a budget so we know where we are going and what we are trying to achieve; but we haven't got the systems to be able to report progress in time to detect variation from the plan and to do something about it; on top of that, we don't conduct the reviews very professionally, and no-one writes down what we decide to do.

Maybe we exaggerate, but that's the flavour. No wonder so many want rolling forecasts and a more formal review process.

A few respondents, but only a few, refer to the need to understand better the key drivers that influence results. This is a disappointingly low number because, although speedy variance analysis using clever software might well be advantageous, finding insights into the underlying causes of variations from plan can be much more valuable: it is the insights that can cause changes both tactically and strategically in an organisation, changes that can make much more substantial differences than can the superficial identification of variances.

Systems and Information Technology

Budgets are usually based on the data held in the general ledger and related sales and purchase ledgers, data such as the chart of accounts, products, customers, cost centres and accounting codes.

But budgets are almost always constructed and manipulated using separate systems. This is because standard accounting systems do not support the specialist requirements of budgeting for data collection and collation from budget holders, for control over iterations, for re-forecasts, and for the flexible reporting against budget.

Spreadsheets are the most common budgeting tool because they provide flexibility, can be interfaced to most proprietary systems, and are available and familiar to budget holders. They are also cheap. Without being asked, 20% of our respondents mentioned that they relied heavily on spreadsheets. It is hardly surprising that the Marketing Director of a major supplier of Budgeting and Reporting tools lamented: "Our biggest competitor is Excel".

Improving the IT to support budgeting has two main barriers:

- The scarcity of suitable functionality in proprietary accounting software
- The difficulty in making a business case for investment in IT to improve budgeting

Respondents were generally pleased with their investments in IT, but it was the role of the various players in the budgeting process that, quite rightly, attracted most of the change proposals.

Barriers to changing the budget process

With many competing priorities for cash, investment in improved budgeting is clearly not seen as ranking high on the list. This is perhaps not surprising: once completed, the annual budgeting process is, like occasional toothache, soon forgotten. The benefits in terms of manpower savings of making the process more efficient are spread thinly across the organisation and are difficult to turn into tangible staff reductions. Other benefits, such as providing a good forecast to guide us through the year, are difficult to quantify.

Let's consider the barriers in the context of respondents' top four proposals for change.

1. *Finance people must give more financial support to business planning; provide better analysis and understanding; give cost centre managers/budget holders more support and guidance, and worry less about control (28 proposals)*

Surely it is within the gift of the finance director to make this change – it doesn't require anyone outside Finance to be convinced of the benefits or to be cajoled into action. To be yet more challenging, the proposal sounds suspiciously like getting Finance to do its proper job. So what are the internal training resources and indeed the professional institutes who provide the Finance qualifications and who lay down the examination syllabuses doing?

2. *Budget holders must get more involved in their budgets, and be more accountable for them (25 proposals)*

If Finance people manage the first proposal successfully then this one, which strikes us as much more daunting than the first, should be a great deal easier to accomplish. Another major factor associated with the role of budget holders is the way that the board makes them accountable. We feel sorry for the poor old budget holders in many organisations. They are made to do a great deal of work producing a budget that everyone knows will be out of date 4¼ months into the budget year. Then their pay for the year is linked to meeting targets that were fixed in the original budget, and that become impossible or absurd to achieve as the year goes by. So alongside the need to provide mechanisms for making budget holders accountable, such as appropriate meetings and the meaningful presentation of performance data, there needs to be a review of exactly what they should be accountable for, and how they should be rewarded.

3. *Introduce rolling forecasts (23 proposals)*

The respondents didn't mention it, but the usual reaction to the proposal to roll the budget forward by one month every month is along the lines: "It takes 3.7 months to produce the annual budget, and you expect us to repeat this every month. It can't be done!". Clearly, the introduction of effective rolling forecasts requires a significant change to the budget process, not a minor adjustment. It is replacement, not repair.

In our experience, there are three key elements to developing a workable rolling forecasting process:

- a means of identifying which elements of the budget are likely to suffer unforeseen and significant change, so that monthly reviews can concentrate on re-forecasting them
- improving forecasting techniques for the elements that are changeable. In some cases, this means identifying accurate volume drivers where links exist between the driver and the resource being budgeted. In others, it means developing better forecasting models that include and rationally process all relevant market data
- a system to enable and support the process of reviewing, revising and advancing the budget in a way that is appropriate to the needs and circumstances of the organisation, and that restricts itself to the basic needs.

4. *The board/senior management must make strategy/goals clear and communicate them (15 proposals)*

The last of these key proposals is one of a series that requires the board and senior management to ensure that the budget underpins the strategy. This is a far cry from boards manipulating the numbers to make an acceptable bottom line result. It is no easy matter to convince a board that confronting the financial implications of their strategy and challenging the plans on which budget holders base their budgets is ultimately more effective than simply pressing budget holders to achieve tough financial targets. Better perhaps to pursue the other proposals first: getting budget holders and finance people to work closer together on financially-meaningful plans, particularly on a rolling basis, should provide the demonstrable evidence of a better way that the board will then accept.

All these key proposals are closely interlinked. This is because the preparation, review and revision of the budget are parts of a single process, albeit a large one. The proposals relate to different aspects of that process, and therefore interact with one another. So the changes cannot be planned and implemented in isolation – their designs need to be co-ordinated.

So where does all this leave us? Introducing improvement to the budgeting process seems to have fallen at the first fence with a widely-held perception that people will not accept any change. But respondents to this survey make clear that change is required and would be beneficial. And if *they* can see the advantages, why should others in the organisation, who probably have a more jaundiced view of the whole process, not welcome improvements?

The suspicion is that the reality of trying to change the budgeting process has not been put to the test. If one accepts that the budget process is "owned" by the finance function then the responsibility for bringing about improvement, for forcing through change despite the apathy, must rest there.

Final remarks

The analyses of the answers given by respondents of the survey speak for themselves. The judgment as to whether these answers represent a process that works provides an anomaly.

On the one hand, the overall assessment of the budget as summarised in Figure 2, page 2 is positive: the budget performs a wide range of important functions.

On the other hand, the responses to specific questions taken in isolation reveal significant problems and shortfalls. For example, 43% of respondents feel that, as far as budgeting is concerned, their boards are underperforming.

Furthermore, the range of suggested improvements to the way budgeting is carried out is vast – 3.6 proposals from each respondent on average - and judged, overall, to be well worth doing.

As an example of the anomaly, one head of Financial Planning suggested that the following would be well worth doing: *“Get the cost centre managers trained. Assign more responsibility. Introduce punishment for not meeting budget.”* However, when invited to say how important it is that his budget provides a means of punishing managers who fail to achieve their targets, he replied *“not much use”*.

Perhaps the appropriate interpretation of this apparent contradiction is that things work reasonably well, but that, with the right magic wand, they could be a great deal better. Maybe our respondents fall into the “If it ain’t broke” camp.

In a busy world, will the need for improvement and reform lead to action or will more urgent and higher-profile initiatives intervene?

The barriers to change that respondents provide give a clue to the answer. One Finance Director sums it up with the response: *“People are sceptical of the benefits, and budgeting never seems as high a priority as doing the ‘real’ work”*.

48% of the barriers mentioned are to do with people’s poor attitude to change, compared to only 16% that mention that proposals are too costly or the benefits not clear. But these two types of barrier, together with *‘Making time available’* that got 20% of the mentions, are different manifestations of the same issue: convincing people who already have a lot to do that the change is worth it.

Take, for example, the two most popular proposal themes:

- Finance staff should give more financial support to business planning; better analysis and understanding; more support and guidance (to cost centre managers), less control
- Involve cost centre managers (budget holders) more (in the budget process), and make them accountable for their budgets

On the face of it, good common-sense stuff. But how compelling? One can respond to that question with more common-sense benefits to do with things like better financial planning, properly costed plans in line with strategy, and having well-focused managers. But it is very difficult to build a quantified business case that demonstrates that the investment in time and training that the proposals demand will provide an acceptable financial return.

In our view, the common-sense case for change is overwhelming. Why? We can’t help thinking that the conventional budget reflects a bygone era of heavy financial control and slow, predictable change. Perhaps this is still the world of some of our respondents. But for most, the budget is a shackle, slowing down change, absorbing precious resource and sapping morale.

In particular:

- we fail to see how the budget can be a basis both for determining pay and for producing an objective plan for delivering the strategy
- the arguments for rolling the budget forward on a regular basis to give adequate planning visibility and to involve budget holders on a continuous basis seem overwhelming
- the effort of the annual budget production process is ponderous and largely wasted

1 Introduction

1.1 Purpose of the survey

It is generally accepted that budgets play an important role in company management. They are usually the main formal mechanism for capturing planned revenues and costs in the organisation. They provide, or should provide, the means of assessing the financial implications of the organisation's strategy. And regular reviews of outturn against budget enable progress to be monitored, and suitable adjustments made.

It is also well known that the creation of budgets absorbs a large amount of management time and can attract a wide range of other criticisms. As a result, there is much talk about the need to change the budgeting process.

Despite the talk, there is remarkably little known about how the budget is conducted across British organisations, and about what the managers involved in budgeting – those in Finance who manage the process; the decision-makers in senior management and on the board; and the budget holders themselves – think about it.

This survey seeks to fill that gap. Through responses from 123 UK organisations, it examines:

- why and how budgets are compiled
- how risk is assessed and how budgets are reviewed
- how organisations react to variations from forecast and how budgets are revised
- how budgets are used for planning and control
- where budgets go wrong and how they can be improved

1.2 Profile of respondents

The survey was completed by directors and senior managers from 123 major organisations operating in the UK in both the public and private sectors. These organisations have an average annual income or revenue of nearly £550 million and 5,000 employees. Their combined annual revenues are in excess of £65 billion – that's 6.6% of the UK's GDP - with total employees of 610,000 - some 2.2% of the total UK labour force.

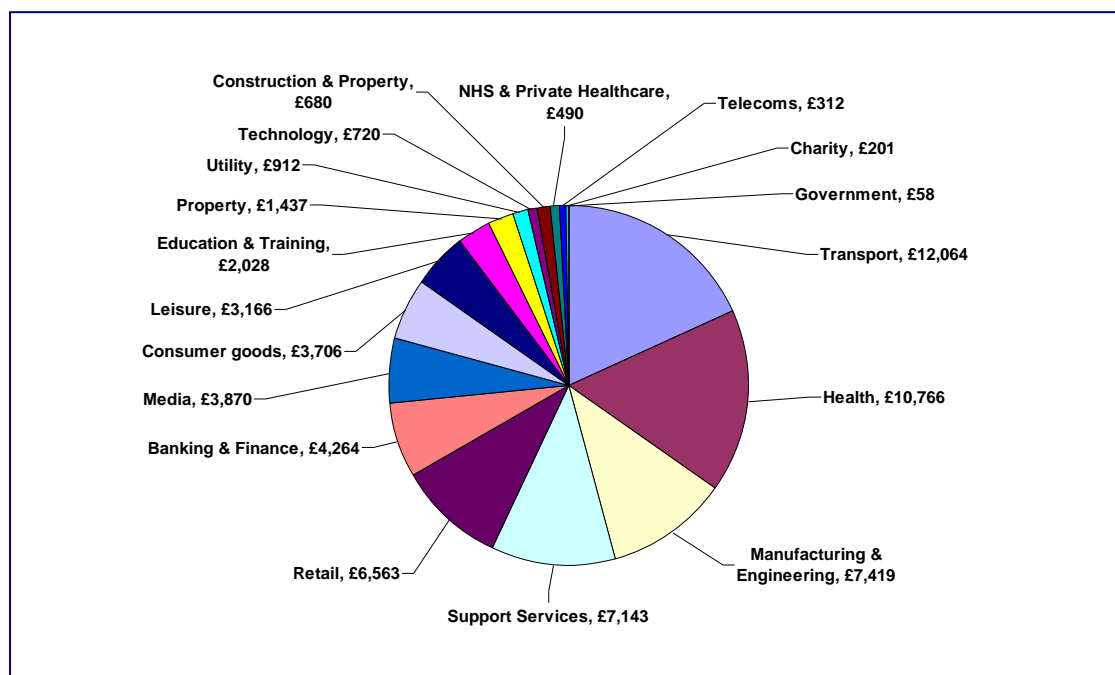


Figure 1: Annual revenues by sector (£M)

Sectors represented in the survey are shown in Figure 1 above.

Sector definitions are those adopted by *The Times* newspaper for publicly quoted companies. The following additional sectors were added for public sector activities and charities:

- Government (4 respondents) - representing central and local government;
- Education & Training (19 respondents) – largely made up from universities in higher education;
- NHS and Private Healthcare (2 respondents) – One public and one private healthcare organisation;
- Charities (2 respondents) – two “not for profit” organisations.

Further information on respondent profiles appears in Appendix B.

1.3 Quality of responses

The perseverance of respondents was astonishing: all of the 123 who returned the survey answered right to the last question and commented generously on their chosen answers. In fact most respondents seemed to get more involved as they worked their way through the survey, providing increasingly fuller explanations. One gained the impression that this was an important subject.

The large number of respondents, together with the full and careful answers they gave, has contributed greatly to the validity of this report. It has allowed us to include copious quotes that explain, in respondents’ own words, the meanings behind the analyses. It has also provided much more statistically-valid analysis than is normally the case in a survey of this type.

2 Creating the budget

2.1 Why budget?

FINDING: MOST ORGANISATIONS USE BUDGETING FOR A WIDE RANGE OF PURPOSES - BUT ARE ONLY PARTIALLY SUCCESSFUL IN MEETING ANY OF THEM

Respondents were given a list of potential benefits that a budget might provide, and asked whether they sought to get those benefits from *their* budget. For the benefits they identified, they were then asked how important they thought each benefit was, and the extent to which they felt their organisation achieved it (which we have called performance). An analysis of responses is shown in Figure 2 below.

Figure 2: Purposes of budgeting

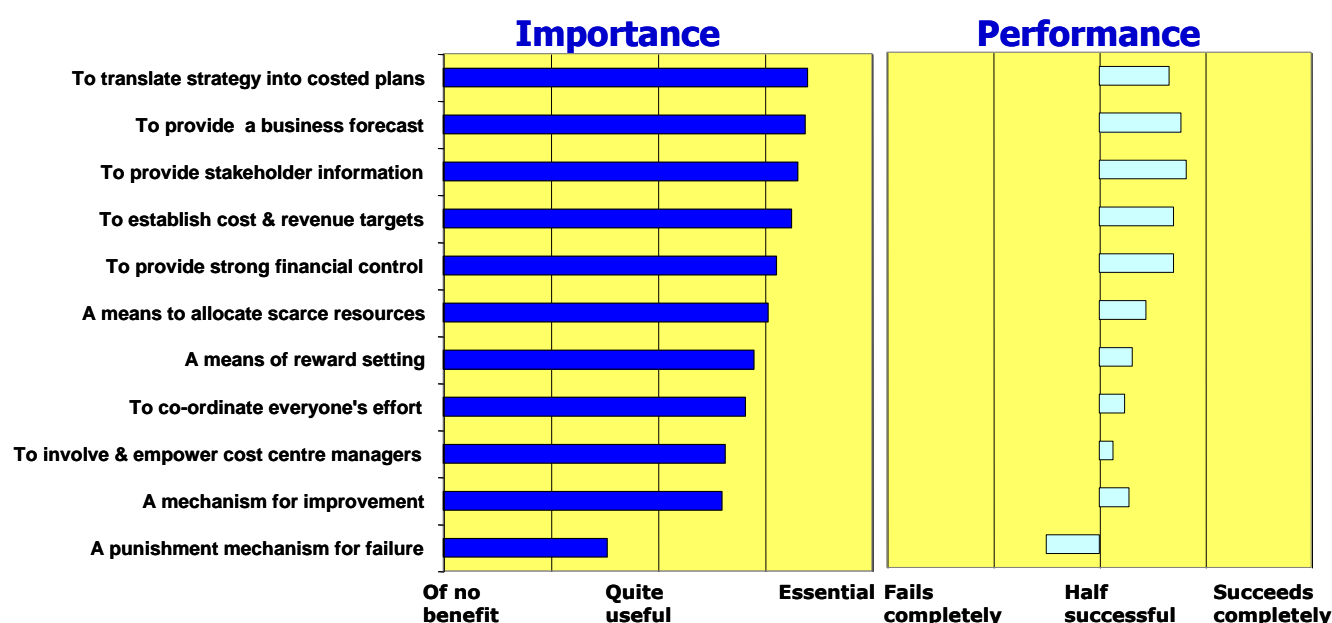


Figure 2 shows that organisations feel they get reasonable success from the budget process across a wide range of benefits, but nothing approaching complete success on any measure.

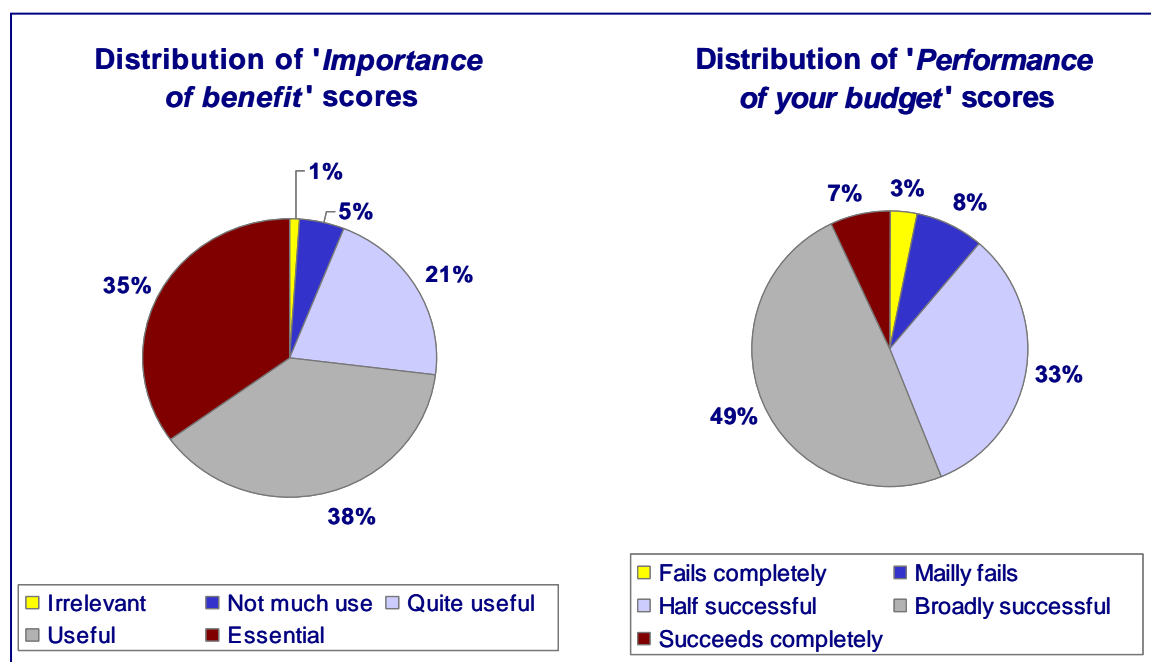


Figure 3 indicates the spread of importance and performance scores across all the range of benefits.

Figure 3: Distribution of importance and performance scores for the list of possible benefits

Not all respondents use budgets to try to achieve all the eleven purposes listed in Figure 2, but on average they try to achieve at least eight. Over 90% cited six or more. So organisations expect many benefits from their budgeting process.

In fact the average scores shown in Figure 2 conceal a wide range of views, particularly on the performance scoring, where almost all purposes were scored between 0 (fails completely) and 4 (succeeds completely). This seems to suggest that there are successful best practice techniques in use, but that they are either well-guarded, or for some reason cannot be transported to other organisations.

An alternative explanation for why organisations seek a wide range of benefits but achieve complete success on very few lies in the fact that the benefits put before respondents fall broadly into three categories:

- those to do with financial planning (x4)
- those to do with getting good performance out of managers (x5)
- those to do with getting good co-ordination and control of the finances (x2)

It could be argued that these three categories hamper one another. For example:

- doing a proper forecast requires candour about most-likely outcomes, whereas targets usually involve demands that might not be met
- exerting strong financial control might compromise the ability either to meet targets or to achieve the strategy

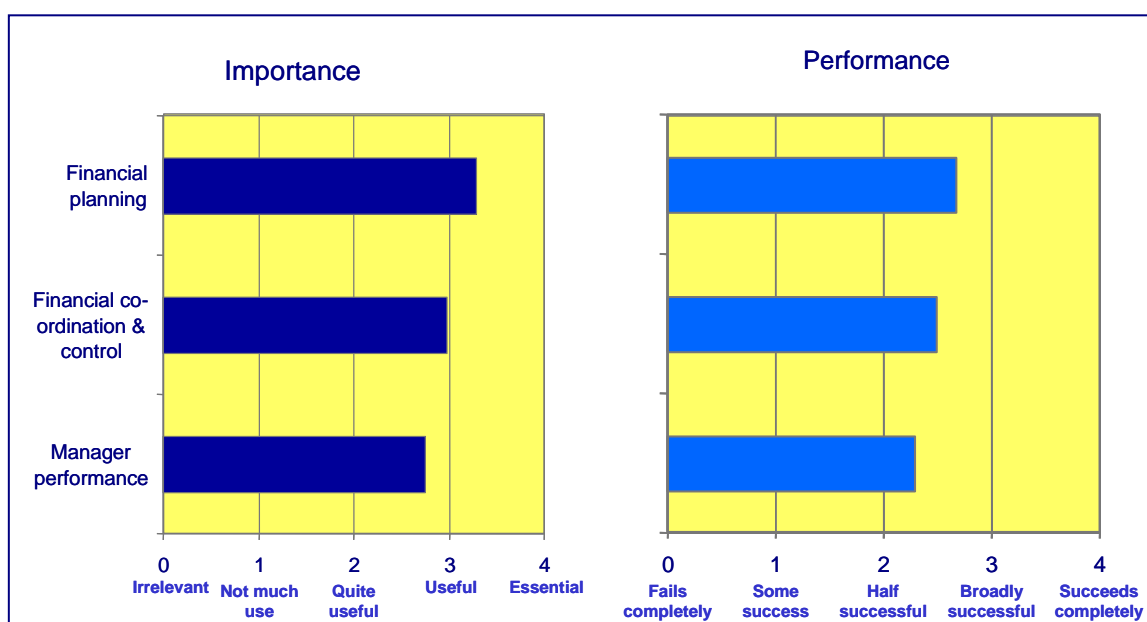
Nevertheless, all respondents picked combinations of benefits from all three categories.

Perhaps it is because these three categories hamper one another that organisations achieve such variable results across the purposes that they believe to be important, despite many years of practice.

Three of the four benefits in the financial planning category are deemed most important in Figure 2, and are seen as broadly successful. The two co-ordination and control benefits occupy the middle ground in importance and performance, and three of the five manager performance benefits are judged least important, and least well done. So there is a clear ranking of the three categories in both importance and performance: financial planning followed by control and co-ordination, followed by manager performance. This is illustrated in Figure 4.

Figure 4: Importance and performance by category

The most successfully performed benefit, although not by much, appears to come from enabling organisations to talk to their stakeholders with confidence about their future financial performance. This is interesting in that it is the only benefit that is not internally focused and operational.



The scores for one benefit that we suggested stood out as being significantly less important and less successful than the rest: *“The budget provides a means of punishing managers who fail to achieve their targets”*. It was seen as having some use, but not much, and as being only partially successful. The next least successful benefit was to make cost centre managers feel involved and empowered.

Where are the biggest disappointments in which the gap between high importance and low performance is greatest? The largest gulf occurs in the inability of the budget to enable organisations to translate the strategy into costed plans. This is closely followed by the budget failing to provide a proper forecast that guides the organisation through the year and failing to help allocate scarce resources across the business.

We looked at the differences in scoring between respondents who were in the finance function and those outside it. Differences between the two groups were generally very small in scoring both importance and performance. Astonishingly, in our view, non-financial people thought on average that the budget performed slightly better on all eleven purposes than did those from the finance function. Perhaps this is because finance people have greater

expectations of the budget process and are therefore more dissatisfied with its shortcomings. Certainly the gap between importance and performance was wider for finance people than for those not in Finance in all but one case (*viz. making cost centre managers feel involved and empowered*).

What do we conclude?

One might have expected that, for a major, cross-organisational exercise like budgeting, organisations would have a clearly focused view on its purpose, but this doesn't seem to be the case.

The wide range of objectives set for budgeting by most organisations may compromise the success of all of them. Managers faced with conflicting objectives will have to choose a path between the good of the organisation and their personal success. The behaviours of budget holders created by these conflicts of interest may, in part, explain why the success of budgeting is seen as being only partly achieved.

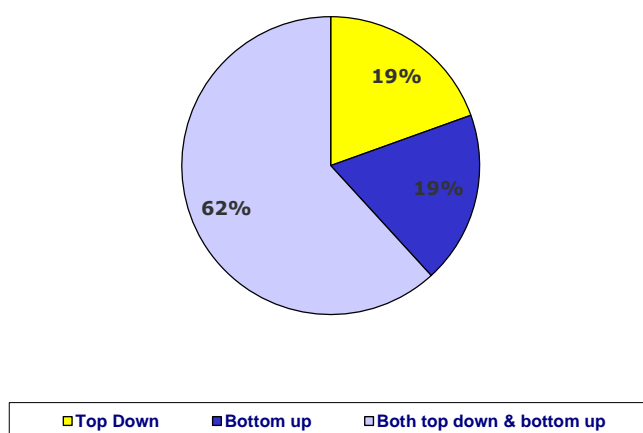
2.2 Approach and level of detail

FINDING: A COMBINATION OF TOP DOWN AND BOTTOM UP APPROACHES TO CREATING THE BUDGET IS MOST POPULAR

Respondents were asked if the process of creating their budgets was primarily top-down, bottom-up or an equal combination of top-down and bottom-up.

The responses are summarised in Figure 5. Top down, bottom up or a combination of both?

Further analysis revealed the following features behind the response:



- A combined top-down, bottom-up approach suggests an attempt to get consensus from top to bottom of the organisation, which implies more iterations and a longer time to create the finished budget. However, there is no statistically-significant difference between the number of iterations undertaken, nor the length of time taken, whichever approach is adopted¹.
- Those using a top-down approach only, tend to be smaller organisations - on average half the size in terms of turnover and employees - compared with those using a bottom up approach. However, the average number of

See appendix C1

employees of the top-down organisations is over 3,000, and their average annual income/revenue is almost £400 million, so they are hardly tiny.

- Some sectors seem to favour different approaches from the average distribution. The health sector (supplying goods and services related to health, and mainly pharmaceutical companies) strongly favours a combined approach. Utilities are predominantly bottom up, whereas Education & Training organisations show an unusually strong top-down preference.
- There are some concerns that a top down approach, unless carefully managed, could lose the ownership of cost centre managers and discourage improvement or change, as the quotes in the box below suggest.
- Despite this, there is no statistical correlation between the approach taken and the perceived benefits derived from the budget. The top-down approach *per se* does not worsen the achievement of the benefits associated with manager performance, nor does it help give better financial co-ordination and control; nor does the bottom-up approach give better manager performance.

What do we conclude?

“[Imposed] ..budgeted costs restrict managers who are then reluctant to invest in process improvement and in generating additional revenue” – Financial Accountant

“Very much top down - more bottom up budgeting would empower budget holders” – Management Accountant

“Managers need to take more ownership of the budget and not be driven by finance” – Financial Controller

One might have expected that something as significant as the approach taken would have a marked bearing on at least one measure associated with the budget. But neither the number of iterations of the budget, nor the time taken to create it, nor even the perceived quality of the finished article is affected.

Perhaps organisations get used to a particular approach, and end up with the budget they want whatever route they choose to take.

FINDING: MANY ORGANISATIONS CONTROL THE LEVEL OF DETAIL, IN TERMS OF NUMBERS OF COST CENTRES AND ACCOUNTING LINES, FOCUSING ON THE MOST IMPORTANT AREAS

We asked respondents how many cost centres they had, and the most usual number of code lines that a cost centre manager has to budget for. In summary, the response we got was as follows:

- The average number of detail lines, calculated from the product of the number of cost centres (300) and number of ledger code lines (40) is 12,000. The very large organisations in the survey, who consolidated many divisions and locations, distort this number and a median of 1,250 is more representative (50*25 - median values)
- There is clearly a tendency for the number of cost centres and ledger codes to grow “like topsy”. Consequently, many respondents share concerns about balancing the level of detail needed with the complexity of the process. They describe modifications to the process so as to provide more detail in important areas and less where costs are not as significant. Some are planning one-off actions to reduce excessive detail.

In fact, organisations tailor what they do to the circumstances they face to a significant extent, resulting in highly diverse approaches.

"Many figures are generated from the accounts. Budget holders asked to confirm the chances" – Finance Director

"IT budgeting is activity based" – Group Financial Controller

"We have changed our budgeting procedure over the past few years. It is now more centralised and done by the senior management team on an activity basis, ie sales directors look at sales line only. We do not send out budget packs like we used to do for individual managers to complete. – Finance Controller

"For overhead costs, the finance function will suggest an amount to the budget holder. This is due to most costs being fixed once number of employees established" – Financial Director

"Further groupings within some cost centres, eg product/course types. Some costs budgeted across the college." – Management Accountant

"Each business unit [cost centre] has a gross margin P&L to complete and some additional devolved overhead budgets, eg, professional fees" – Finance Manager

"Salary budgets are overlaid centrally by Finance" – Finance Director

"The use of code lines depends on the type of budget being controlled. For example a capital project will have a different structure to ongoing operating expenditure" – Director Asset Management

"Ultimately budgets are loaded at detailed line level. Review tends to be at a more summary level" – Finance Director

"We do not have standard budget forms but standard questions/meetings with budget holders to manage this process" – Financial Director

"Some cost centre managers' areas, such as production are more complicated than others, so "code lines" vary" – Financial Director

"20 is average. Variable depends on activities we decide to budget for" – Group Financial Controller

"The overhead is managed across company....A forecast model is maintained for projects - across company." – Head of Accounts

"Budgets are usually 'rolled over' from previous year." – Finance Manager

"Cost centre managers do not solely budget on cost centres, but also on activity" – Senior Management Accountant

"There are 400 Income & Expenditure accounts. [The] Plan is to reduce these to about 40 for the next budget round" - Management Accountant

"Despite budgeting in detail, 60% of our operating expenses are staff related and would probably use around 20 lines of code" – Group Finance Manager

"60 is the absolute maximum. Most budget holders would deal with 20-25" – Regional Financial Controller

"We budget in too much detail, eg budget for phone charges and mobile charges separately" – Chief Accountant

"We need to change the belief that a huge level of detail means a better budget" – Director of Finance

- The large amounts of data, and the efforts involved in capturing it, also present a problem when re-forecasting or revising budgets. Only 8% of respondents attempt to re-run the budget in detail, most adopting a top down approach based on changes to key business volumes

What do we conclude?

Materiality seems to be the watchword in getting an appropriate level of detail in the budget. Most organisations are aware that excessive detail increases workloads and causes frustration both for Finance and cost centre managers. They have tailored their budget processes accordingly.

FINDING: IN TERMS OF BUDGETING, THERE ARE FEW DIFFERENCES BETWEEN THE SECTORS REPRESENTED IN THE SURVEY

Wherever feasible, we looked to see if variations in responses were sector-related. With the sole exception of the approach taken to creating the budget, no statistically-valid differences could be identified. This might be due to the fact that, even with a total response of 123 returned questionnaires, some sectors contributed only two or three samples.

What do we conclude?

This finding suggests that budgeting is an all-pervasive, catholic activity that unites all sectors of the economy. Even the procedures, views and judgments of those in the public and private sectors do not show any statistically significant variations from one another.

FINDING: THERE IS A LEVEL OF FRUSTRATION WITH CONVENTIONAL ANNUAL BUDGETING AND A SIGNIFICANT CALL FOR A FUNDAMENTALLY DIFFERENT APPROACH

- The most popular proposal is for a rolling budget - 19% of respondents thought that this would be a significant improvement - although most have yet to take any steps to change, and are concerned about the effort involved. 17% have already adopted this approach.
- Other approaches proposed included:
 - ❖ a zero-based approach – this would force more challenge in to the process;
 - ❖ an approach based on key business driver volumes – to reduce drastically the amounts of data needed;
 - ❖ an activity-based approach – to focus on output volumes rather than input costs.

What do we conclude?

“We are interested in finding an easy way of flexing or rolling forward the budget to keep it relevant” – Company Secretary

“I would like the Group to drop the annual budget process altogether and use rolling forecasts” – Financial Controller

“[We are]..planning to introduce zero-based activity planning and resourcing budget” – Director of Finance

“We need a detailed review of principal business drivers ... including non financial indicators” – Group Financial Controller

“..do not do a budget! Perform quarterly 18 month rolling forecasts...” – Group Finance Director

“linking the budget to an ABC model and product profitability would be useful to really understand the cost base” – Finance Director

“ABC to de-link volume based resource planning from other performance based actions” – Financial Controller

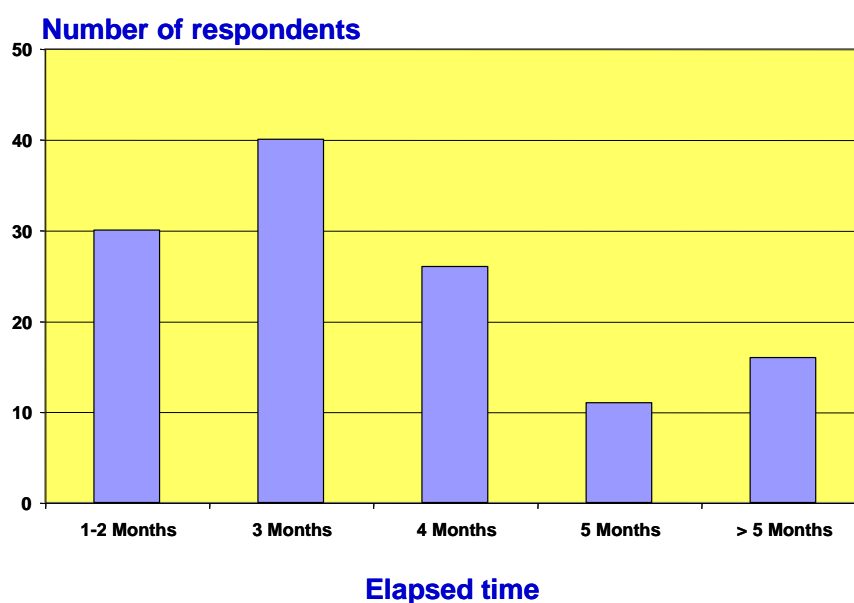
“There is currently no automated procedure for rolling forward. Would require manual recalculations that are time consuming and possibly not cost effective” – Senior Management Accountant

“Get rid of 10 years planning. Introduce rolling forecasts” – Head of Financial Planning

Almost without realising it, many organisations have most of the steps in place to conduct rolling budgets. They spend three to four months creating a budget, go through three or four iterations and then begin a process of re-forecasting (see Section 4). However, few currently take the step of extending the budgeting period forward beyond the budget year. Finding a simple way to do this, and the necessary systems to support this approach, seem to be the main barriers.

FINDING: THE ELAPSED TIME AND THE NUMBER OF ITERATIONS TO COMPLETE BUDGETS IS EXCESSIVE respondents were asked how long it took for the budget to be completed from when budget forms were first issued to when the budget was formally ratified. Figure 6: Elapsed time to complete budgets

- The average time to produce the budget is 3.7 months. 43% of organisations take in excess of three months
- The average number of iterations (being “formal” submissions to the Board or senior management) is 2.8, although a fifth of organisations go through five or more reviews before agreement. It is also apparent that, in addition to the formal submissions, budgets go through many reviews before presentation to senior management
- 22% think there are too many iterations before budget agreement. 4% think there aren’t enough



What do we conclude?

The time taken to complete the budgeting cycle is a drain on management effort for considerable periods of the year. Momentum is difficult to sustain and, most importantly, circumstances are likely to change significantly over the period. Iterations seem less to do with improving the quality of the budget and more to do with reconciling differing views between cost centre managers and senior management/the board.

“The budget is out of date before the period it relates to” – Chief Accountant

“Contraction of the present process to, say 2 months, from present 4+ months” – Finance Director

“Reduce the timescale for agreeing the budget. 4 months is too long. It allows too much time for possible changes to be made” – Managing Director

“Personally, I would like to reduce the time on this activity by about 80%” - Group Financial Controller

“...ineffective use of time and resources to pass budget through so many iterations” – Chief Financial Officer

“To get to these two [versions to the board], I personally must produce at least 6-10 different versions before the whole is formally accepted” – Financial Director

FINDING: THE BUDGETING PROCESS IS POORLY DEFINED AND POORLY COMMUNICATED

- The budget seems to be a poor relation among the key processes in organisations. The commonly documented elements of a process - the flow of information; the people involved; the activities they must undertake; the timescales and performance measures - are absent in many organisations.

What do we conclude?

Many organisations seem to be taken by surprise every year when budgeting starts. Planning, documenting and communicating the process are rushed and the roles and responsibilities of those involved are left unclear. The opportunity to improve the effectiveness of budgeting year-on-year is therefore missed.

FINDING: THE BUDGETING PROCESS LACKS SUFFICIENT CHALLENGE TO THE STATUS QUO

“Process not understood. It is not documented and is a source of frustration for all respondents. Need for clear process, defining role, responsibilities and actions” – Finance Director

“Start of process too late to meet report to plc” – Finance Manager

- A number of respondents thought their process allowed the status quo to be maintained by cost centre managers, and there was no mechanism to challenge this behaviour
- However, a few have introduced formal “challenge” forums and believe it has enhanced the effectiveness of the budgeting process. These require cost centre managers to present and justify their budgets to peers and/or senior management.

What do we conclude?

Although adding additional steps into the budgeting process is likely to increase the elapsed time, it aids transparency and communication and clearly works for some organisations. Formal challenge could also influence managers’ behaviour and reduce the “game playing” that is often observed.

“Cost Centre managers present their budget proposals to a challenge ... This has proved to be very effective” – Finance Director

“Challenge and insist on revision if targets aren't met” – Group Planning Manager

“Managers need to be tasked to deliver change/savings, not allowed to budget for increases year after year” – Group Financial Controller

“Stop playing political games” – Financial Reporting Manager

“Managers produce budgets based on previous year costs with little involvement of future strategy” – Finance Manager

2.3 Linking budget to strategy

FINDING: THE MAIN REASON FOR BUDGETS BEING REJECTED IS COST CENTRE MANAGERS IGNORING THE CORPORATE STRATEGY

Overall, respondents regard the translation of strategy into costed plans as the most important aspect of the budgeting process (see Section 2.1 on page 2). It is surprising to see, therefore, that the most common single reason for budgets being rejected by senior management - although it is a close-run thing - is because cost centre managers ignore the strategy.

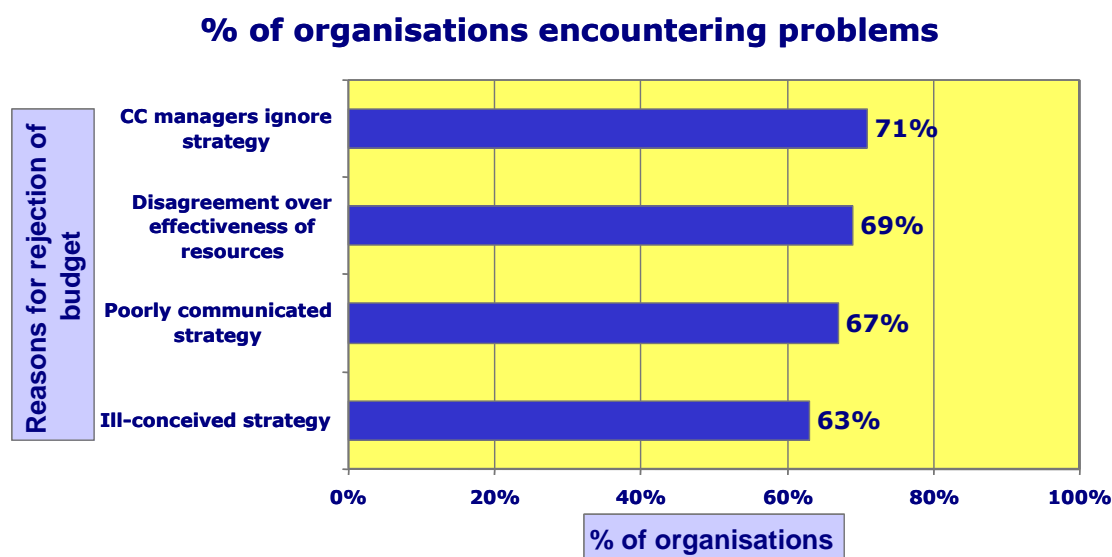


Figure 7: Why budgets are rejected

- The responses indicate a major problem in communicating and/or aligning strategy to budgetary submissions. 69% of organisations have budget submissions rejected because of implied or explicit disagreements between budget holders and senior management/the board about how effectively or efficiently resources can be used
- Other causes of rejection cited included the tendency of managers to “load” budgets, or to maintain the status quo, or to submit optimistic revenue forecasts

What do we conclude?

“Budgets are rarely linked to strategy ... the budget should be a means of delivering strategy, but very few senior executives seem to understand this” – Group Financial Controller

“More interaction [from Board] is needed at the start of the process to make clear objectives and targets” – Director Finance

“...budgets being set at a level which is over-influenced by annual bonus factors – Chief Executive

“Inevitably there is a process of iteration between the aspirations of the board and the resources cost centre managers feel they need to deliver them. It is important this process is open so that when budgets are finalised managers feel they own them and can deliver” – Managing Director

“More dynamic link between reforecast process and five year plan would be great to make the latter a more 'living ,breathing' document” – Financial Director

“...at present, managers maintain the status quo” – Finance Director

“...they [Board/Senior Management] need to be more specific about future strategic direction” – Finance Director

“Managers produce budgets based on previous year costs with little involvement of future strategy” – Financial Efficiency Manager.

We have already reported that *“the average number of iterations (being “formal” submissions to the Board or senior management) was 2.8, although a significant number of responses (20%) went through five or more reviews before agreement. It is also apparent that, in addition to the formal submissions, budgets go through many reviews before presentation to senior management.”*

One might argue that this number of reviews and iterations is not huge, and is even reassuringly low. Nevertheless, it represents a great deal of diversionary effort throughout the management structure of the organisation.

Worse, the reasons for the reviews and iterations reveal fundamental problems: every year, during the annual budgeting cycle, the managers of 71% of organisations ignore the strategy to such an extent that their budget attempts are rejected. If they do this in respect of the budget, which they know will be scrutinised by the board, will they also ignore the strategy over issues that are less visible to senior management? What, cumulatively, are the implications for the organisation’s chances of delivering its strategic intent?

The percentages for a poorly-communicated strategy (67%) and an ill-conceived strategy (that is one where the financial implications of the strategy are unacceptable) (63%) are similarly substantial, and the implications no less daunting.

One of the problems is that the budget, in its conventional form, is so familiar to all that people are not shaken by statistics such as this. Indeed, those who draw attention to them and suggest that improvements are needed run the risk of being branded naïve. But an annual ritual that so starkly reveals the gaps in understanding and judgment between those who set down strategy and intended financial outcomes, and those who are expected to deliver them suggests a house divided.

Difficult questions to answer, but that would be interesting to get answers to, are:

- whether the various iterations actually resolve the differences that led to budgets being rejected, or whether they result in unsatisfactory compromise – the responses recorded in Section 2.1 suggest resolution
- whether organisations that suffer these problems put processes in place to improve future strategy formulation and communication - the fact that the responses represent a repeated annual process suggests not.

2.4 The Budget period

FINDING: FEW ORGANISATIONS ATTEMPT TO PRODUCE A DETAILED BUDGET FOR MORE THAN ONE YEAR. LONGER TERM PROJECTIONS ARE FREQUENTLY CONDUCTED THROUGH A SEPARATE PLANNING PROCESS

- Nearly 60% of organisations generate simpler, less detailed forecasts for periods beyond the immediate budget year
- 40% of these organisations project 3 years ahead and another 32% project 5 years into the future. A brave few, (less than 4%) produce 10 year forecasts
- You might think that some sectors would be more interested in longer-term forecasts than others, but there is no sector preference for the number of future years that are forecast
- In general, future years are summarised versions of the budget year, containing less detail and only analysed by quarter or by year. Unsurprisingly, the further into the future that is projected, the less the detail
- Business planning or strategic planning processes, which are predominantly top down in approach, are also used to forecast future years for many organisations. They are separate from the budget process which is, in many cases, based on information that is more to do with historical performance than with plans

“[We produce]...projections for current year plus 4 future years...in P&L format ” – Finance Director

“We do a SEPARATE 3-5 year forecast exercise” – Chief Executive

“Our three year planning cycle is different and distinct from our budget cycle” – Chief Executive

What do we conclude?

It is likely that poorly linked budgeting and strategic planning processes are part of the cause for the high number of budget iterations required to gain agreement.

2.5 The estimated accuracy of budgets

FINDING: 44% OF ORGANISATIONS GET WITHIN $\pm 5\%$ OF ACTUAL REVENUES AND COSTS (for the average organisation in this survey this means $\pm £27.5m$)

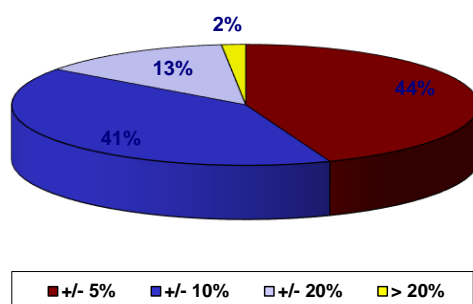


Figure 8: Accuracy of budgeted financial figures

- 44% of respondents think that they achieve financial results that are within $\pm 5\%$ of the budget figures – and 85% are within $\pm 10\%$
- 83% of respondents revise their budgets during the course of the year
- 80% of respondents incorporate non-financial measures into their budgets. These measures are thought to be of similar accuracy to the financial measures
- Headcount was the most-used non-financial measure. Other measures reflect the organisations' key drivers; eg service levels, number of passengers, number of students, stock turns, market share etc.. The use of balanced scorecards and Key Performance Indicators (KPIs) was also used by a number of respondents as the framework for non-financial information
- Exactly half respondents report that there is a point in their budget year after which people regard the budget figures as being outdated and, for practical management purposes, ignore them. For these respondents, the average period into the budget year when this occurs is 4¼ months. That means that each month creating the budget yields 1.2 months in which the budget is useful and that each useful budget month requires 0.7 budget iterations
- We checked whether the predictive accuracy of the budget had a bearing on how valuable the respondents thought their budget to be, in terms of the analysis given in Section 2.1. The better the prediction given by the budget, the more valuable overall respondents think their budget to be. (The results of the statistical test are given in appendix C3). Those who rate the accuracy of their budget to be outside $\pm 20\%$ of the outturn figures judge their budgets to be only 40% as good as those who claim their budget is accurate to within $\pm 5\%$. Those claiming budget accuracy to within $\pm 10\%$, and to within $\pm 20\%$, judge themselves to be 78% as good and 73% as good respectively

What do we conclude?

We are surprised by the reported accuracy of the budget. We have already seen – page 9 - that the average elapsed time to prepare the budget is 3.7 months. This means that, taking average numbers, 44% of organisations predict costs and revenues to within $\pm 5\%$ more than 5 quarters ahead! This seems to contradict the finding that we describe in the next section, that over 80% of respondents regard budget revision as essential during the course of the year. It also appears to contradict the penultimate bullet point above, namely that, for half the respondents, the budget figures are effectively abandoned after 4¼ months of the year. (Not, incidentally, the same half of respondents whose budgets are accurate to worse than $\pm 5\%$: 40% of those whose budgets are accurate to within $\pm 5\%$ still abandon them during the year!).

A possible explanation is that, when budgets are used as targets, those targets nearly always end up soft enough to ensure that managers don't fall short of the budget. In these circumstances, there is no advantage, and probably some disadvantage (tougher targets next year) in exceeding budget. Furthermore, hitting a cost target (rather than a revenue target) often requires little or no action. Unfortunately, this doesn't explain why 40% of those whose budgets are accurate to within $\pm 5\%$ still abandon them during the year.

Nevertheless, even on the figures reported here, many organisations find it difficult to budget accurately. This is despite the time spent on preparing the original budget and the many reviews and iterations that are conducted.

Organisations know that they cannot expect to forecast accurately in a complex and rapidly changing world, and that what they must do is continually monitor the internal and external environment and be prepared for speedy change. The difficulty is to devise a budget process that recognises this fact and that minimises the effort wasted in looking so far ahead that accurate prediction is unlikely. This waste is not limited to the effort of forecasting and then creating the resulting budget – it includes the reviews and the iterations. The 50% of organisations whose budget figures become outdated within the budget period still manage an average of 2.7 budget iterations, and take 3.3 months preparing their budgets. No doubt some of this effort, probably much of it, goes into the numbers relating to the last 7¼ months of the year, the period for which “people regard the budget figures as being outdated and, for practical management purposes, ignore them”.

The finding that the better the prediction given by the budget, the more valuable respondents thought their budget to be is not as obvious as it sounds. In order to undertake the value analysis, we ascribed a 'goodness' score to each respondent's perception of their budget. (Goodness is measured, for this purpose, by summing the product of the scores for importance and performance awarded by respondents for each of the eleven budget purposes (see Figure 2)). So 'goodness' relates to a wide range of budget purposes, not just its predictive powers. There could be two possible explanations for the positive correlation between goodness and predictive accuracy:

- a) part of the process of producing a valuable budget is to make sure that the forecasting is accurate and that effective plans are in place through which to achieve the predictions it contains.
- b) the organisation applies effective controls to make sure that the budget predictions are achieved.

The difference between these two explanations is subtle: as a generalisation, the former explanation might be considered more desirable. It implies that the budget is based on a rational plan that can be varied rationally as events unfold, and that the budget is good because the organisation forecasts and plans well. The latter explanation implies that the starting point is a desired, inflexible result, lacking plans for how to achieve it, to which behaviours must be modified as time goes, irrespective of unforeseen events. In this latter case, the budget is realised, but at the penalty of missing unforeseen opportunities and hitting unforeseen problems.

2.6 Risk assessment

FINDING: RISK ASSESSMENT IS WIDELY THOUGHT TO BE INADEQUATE

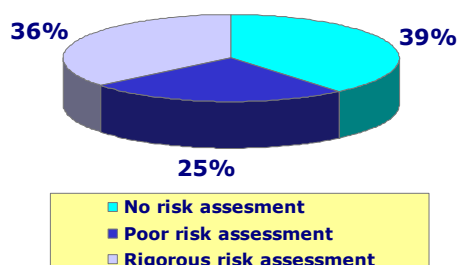


Figure 9: Do you conduct formal risk assessment of the budget and, if so, is it effective?

- 64% of respondents conduct no formal risk assessment or think that risk assessment is insufficiently rigorous
- Of those who conduct formal risk assessment, 40% of them think that the current method is insufficiently rigorous
- All sectors have instances where no formal risk assessment is conducted
- A wide range of risk techniques is employed. These range from rigorous formal procedures to more ad hoc assessments by individuals or panels of senior management. Internal audit departments are responsible for risk assessment in a few organisations. Some regard risk assessment as the responsibility of line management

What do we conclude?

As we will see later, almost all organisations review and revise their budgets during the course of the year. Formal risk assessment procedures could potentially improve budget accuracy and reduce the number of re-forecasts that organisations make. They could also help make change plans more robust, and help organisations react quicker to unforeseen eventualities.

“[We employ a] mixture of formalised review and ad hoc assessment. Process tends to breakdown as budgeting process takes place and top down targets get imposed. The risk attached to delivery of these is often not sufficiently understood” – Managing Director

“Not formalised but we do try and identify significant risks” – Finance Director

“Of course budgets should be risk-assessed but few companies do so, I suspect” – Group Financial Controller

Risk assessment is line management's responsibility and should cover likelihood and consequence of risks at both the inherent and residual levels – Finance Director

Alternatively, the fact that budgets are revised frequently could explain why, despite the concerns expressed, formal risk assessment of initial budgets is not more widely adopted.

3 Reporting and reviewing performance

3.1 Frequency and adequacy of budget review and reporting

FINDING: REVIEWING BUDGET PERFORMANCE IS SEEN AS ESSENTIAL AND IS GENERALLY AT LEAST ADEQUATELY CARRIED OUT, BUT VARIANCES CANNOT ALWAYS BE EXPLAINED AND CORRECTIVE ACTION IS OFTEN LACKING

As reported earlier, respondents see the main purposes of budgeting being to provide costed plans and financial targets, and to enable financial control. By implication, the reporting and reviewing of actual achievements against budgets is a key control process.

- Over 90% review budgets monthly, producing reports detailing the reasons for major variances against budget
- 77% think that periodic review of performance against budget is important or essential
- 84% think reviews are at least adequate, and 55% consider them well or excellently done
- Establishing the root cause of variances is the most common problem cited. Nevertheless, 86% of those who reported variances thought the reasons are identified pretty well or better
- Getting people (generally those outside Finance) to decide and take actions to correct for adverse variances is raised as a regular problem
- In some cases reporting is too slow or inaccurate to be able to respond to variances, but a reasonable proportion of respondents think that this aspect of the process works well
- Managers are not penalised for adverse variances providing there are legitimate causes, and providing they are generally performing well in other respects

“Explanation of variances often focuses too much on “what” rather than “why” – Finance and Information Director

“Variance reporting is good, actions needed from the information is poor” – Chief Accountant

“Reports work at a superficial level not examining underlying causes of variances” – Regional Financial Controller

“Whilst we stare at the numbers, the underlying cause is not identified (often) and acted upon.” – Financial Controller

“This is one of the few processes I am happy about” – Group Financial Controller

“Quicker reporting, as it is always retrospective” – Managing Director

“The budget is not viewed as a performance measurement tool. It is a guideline set once a year to help plan the business” – Chief Financial Officer

“The reporting process too slow therefore it is often impossible to take action” – Financial Analyst

“[We] report against budget weekly but action seems to be slow or non-existent” – Management Accountant

What do we conclude?

Of all the sections in the survey, respondents seem most happy with the way that performance against budget is reviewed. On reflection, we failed to ask an important supplementary question: *how well do you act upon the correctly identified reasons for variance against budget?* We say this because, later in the questionnaire, respondents were asked to suggest improvements to the budgeting process. There was widespread demand for making reviews more formal so that action plans are recorded and reviewed, and so that budget holders can be held more accountable for their budgets.

4 Revising the budget

4.1 Frequency of budget revisions

FINDING: BUDGET REVISIONS BEGIN ALMOST AS SOON AS THE ORIGINAL BUDGETS ARE AGREED, AND CONTINUE THROUGHOUT THE YEAR

Respondents were asked how important they thought re-forecasting/rolling forward the budget is in managing the organisation. Of the 83% of respondents who formally reforecast, doing so is an important exercise, as Figure 10, below, indicates.

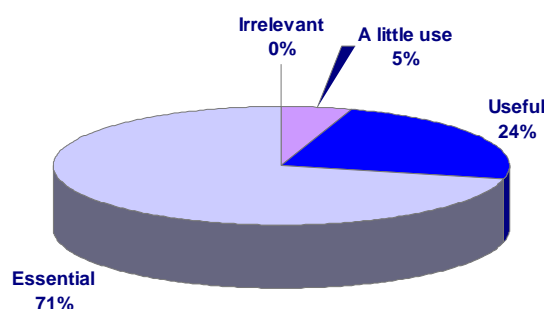


Figure 10: Importance of reforecasting/rolling forward the budget

We also asked how frequently respondents reforecast.

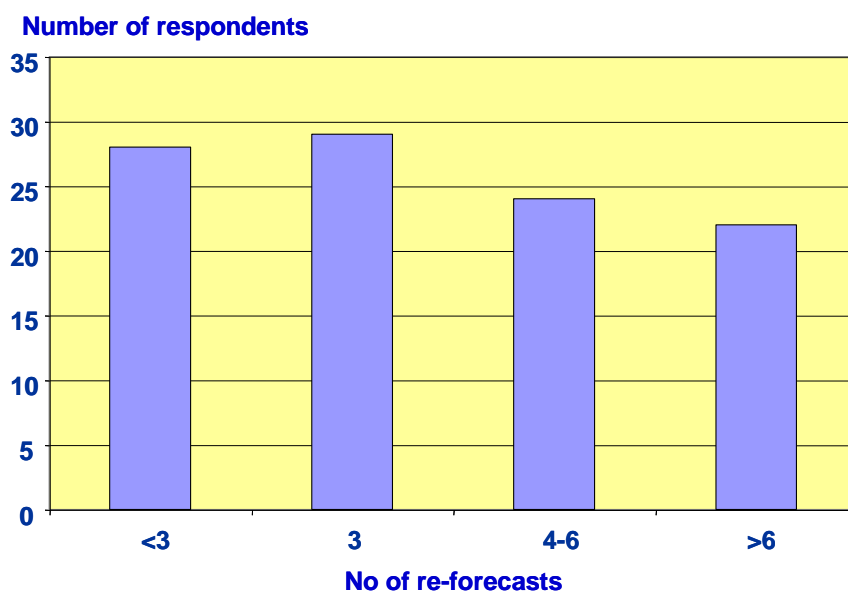


Figure 11: Number of times respondents re-forecast

- 83% of respondents formally revise the budget during the course of the year
- On average, those who do formally revise their budgets do so 4¾ times a year.
- Of those who formally revise their budgets, 80% only revise to the end of the budget year, rather than roll the forecast forward so they are always looking at the next 12 months
- The usual pattern is for quarterly revisions, which effectively means 3 revisions during the year. The third quarter revision tends to focus on delivering year end results.
- 13 respondents revise their budgets 12 times a year, but only two of them – that’s less than 2% of the whole sample - do so using monthly rolling budgets
- 30% also revise their budgets in response to unexpected events
- Of the 20% who don’t revise budgets there is no sector differentiation – almost all sectors have some organisations that do not appear to revise their budgets
- 20% believe that more frequent forecast revisions would be an improvement. This is also reflected in the views that a rolling budget approach would be an improvement on the annual “big bang”

Popularity of method of revising budget

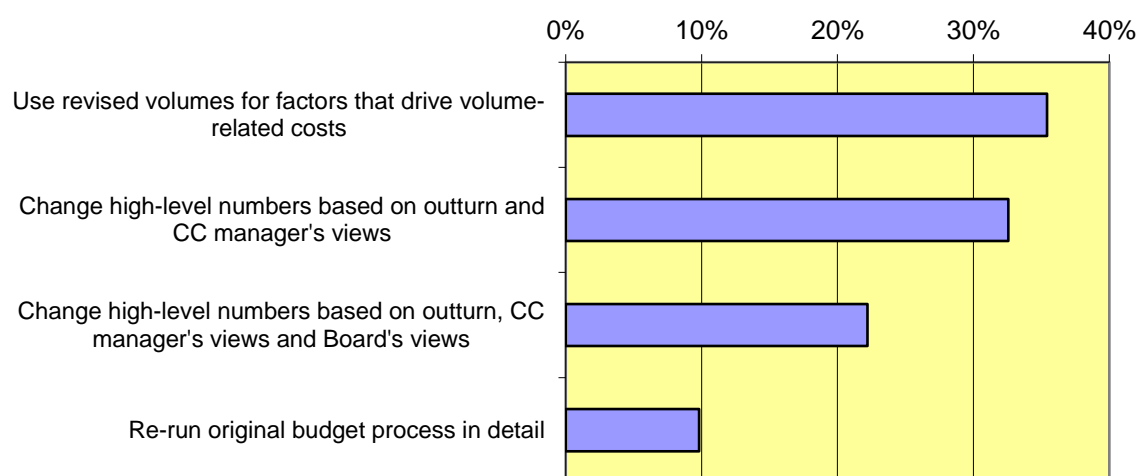


Figure 12: Methods of revising the budget

- Budget revisions are done in a wide variety of ways, depending on the specific circumstances faced. The most popular, as shown in Figure 12, is to flex volume-related costs in direct proportion to the factor that drives them. The next most popular method is to change the high-level numbers based on outturn to date and the views of the cost centre manager. Of those who undertake formal revisions, only 10% attempt to rerun the process in detail. This is hardly surprising given that it takes over three and a half months on average to run the budgeting cycle – although 28% occasionally do so.
- Of those who formally revise their budgets, a quarter think that they don't reforecast quickly enough to meet their organisation's needs. Only 4% think they are hopelessly slow.

What do we conclude?

“Operating conditions are so volatile that original budgeting assumptions are irrelevant” – Managing Director

“There is little point in measuring against targets set up to 15 months ago which have no relevance to today's circumstances” – Financial Controller

“Reviewing a forecast which was made 15 months ago in our industry does not constitute best value practice” – Finance Controller

“For each of the last 2 years we have set headcount budgets in August and by September invoked a headcount freeze” – Finance Director

“Our re-forecasting process usually involves revisiting the detailed cost lines and is extremely time consuming” – General Manager

“Original budgets have never been very accurate but forecasting is becoming more realistic and giving more credible results as managers become used to the process” – Management Accountant

“No business performance can be judged against a fixed budget - when deviations occur for legitimate reasons” – Management Accountant

Many organisations treat initial budgets with a high degree of scepticism despite the large amount of effort involved, the high level of detail, and the lengthy period required to produce them. The initial budget is viewed as a “base line” from which it is easier to make the inevitable revisions.

The question remains, is the effort involved in the initial budget preparation justified and would not a rolling budget be a more effective and accurate approach? Apparently not, because only 2 respondents out of the total sample of 123 roll forward on a monthly basis. But of all the 445 proposals for changing the budget process, the third most popular theme is to introduce rolling forecasts.

FINDING: DESPITE THE FACT THAT MOST ORGANISATIONS CONDUCT MANY BUDGET REVISIONS DURING THE YEAR, THE ORIGINAL BUDGET IS STILL SEEN AS THE “BENCHMARK” FOR MANY

Respondents were asked whether they tend to use the original budget figures, or revised, reforecast figures for a range of management purposes. An analysis of their responses is summarised in Figure 13.

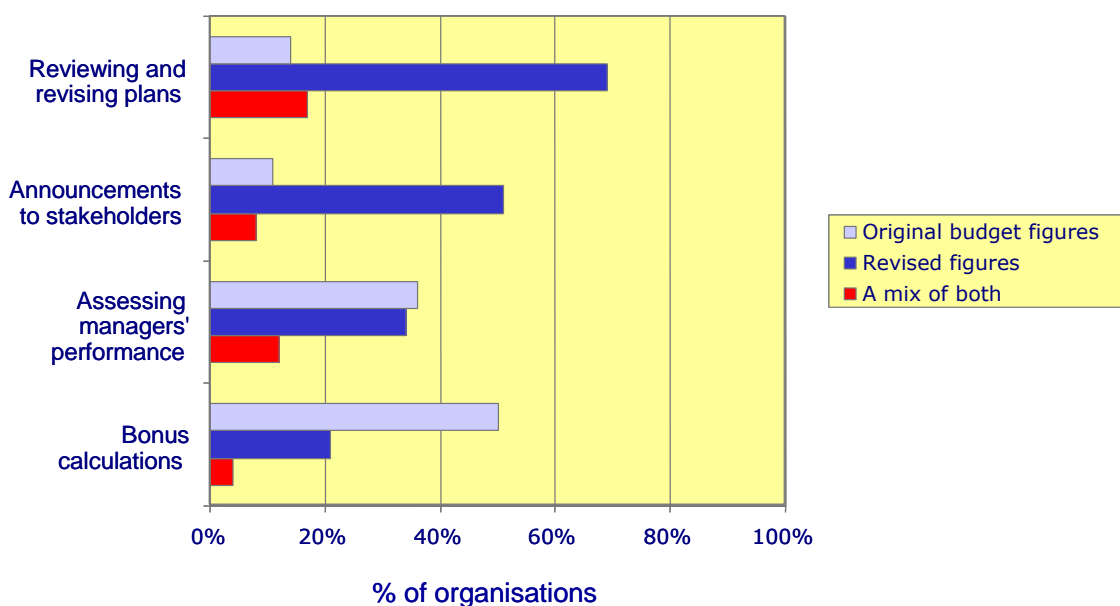


Figure 13: Uses for original and revised budget figures

Many organisations retain a use for the original budget figures, despite revised ones being available. As a generalisation, the figure above shows that the revised figures are used for reviewing plans and for crafting announcements to stakeholders. The original budget is retained for assessing managers' performance and, predominantly, for bonus calculations.

The reasons for organisations hanging grimly on to original budgets even after repeated revisions are not clear from the survey but a number of factors were mentioned:

- Where a Group or Head Office agrees the budgets then these continue to be the figures to meet, regardless of re-forecasts
- In some cases, variance reporting continues against both original and revised sets of budget figures
- Revised forecasts are sometimes “for internal use only”. This probably reflects the expectations of external stakeholders (including “The City”) that organisations will deliver their promises, as define by the original budget. As in the previous bullet point, parallel sets of reporting would seem to be needed
- Where budgets are cash-constrained annually, as in the case of some governmental organisations, individual budget lines are less important than the overall figure. Individual budgets lines can be changed to offset adverse and positive variations, a procedure known as virement

“The original budget is still seen as one of the key financial and management controls in the business. Therefore management performance and bonuses must be based on it.” - Finance Director

“We move to forecasts but still use the budget as a basic benchmark and run two sets of comparables” – Finance Director

What do we conclude?

The main reasons for continuing to report against original budget seem to be based on the concept that the original budget is a commitment or contract between different levels of management. Keeping to that commitment, or keeping others to it, is seen as demonstrating financial control and good management practice. This is particularly the case where head office or external stakeholders are concerned.

This view may have merits where management can control and reduce adverse variances. In the situation where events occur outside management control (quite often a subjective judgment), or positive variances could be achieved, there is little to be gained. Indeed, there is a great deal to be lost as managers ignore arising opportunities and threats, or play the “game” of phasing sales and expenditure, simply to meet budgets.

Exactly half the organisations in the survey that revise their budgets retain the original budget as the basis of bonus calculations. The reason why bonuses are so often based on the original budget is clear. If you start with the premise that the budget represents a target revenue and cost statement for the year, then organisations feel comfortable offering a portion of the resulting profit to managers as an inducement to hitting the targets. If they don't hit the targets, they don't get the bonus, so it is a risk-free offer. Once you allow the target to move, the risk of giving away more than you can afford arises.

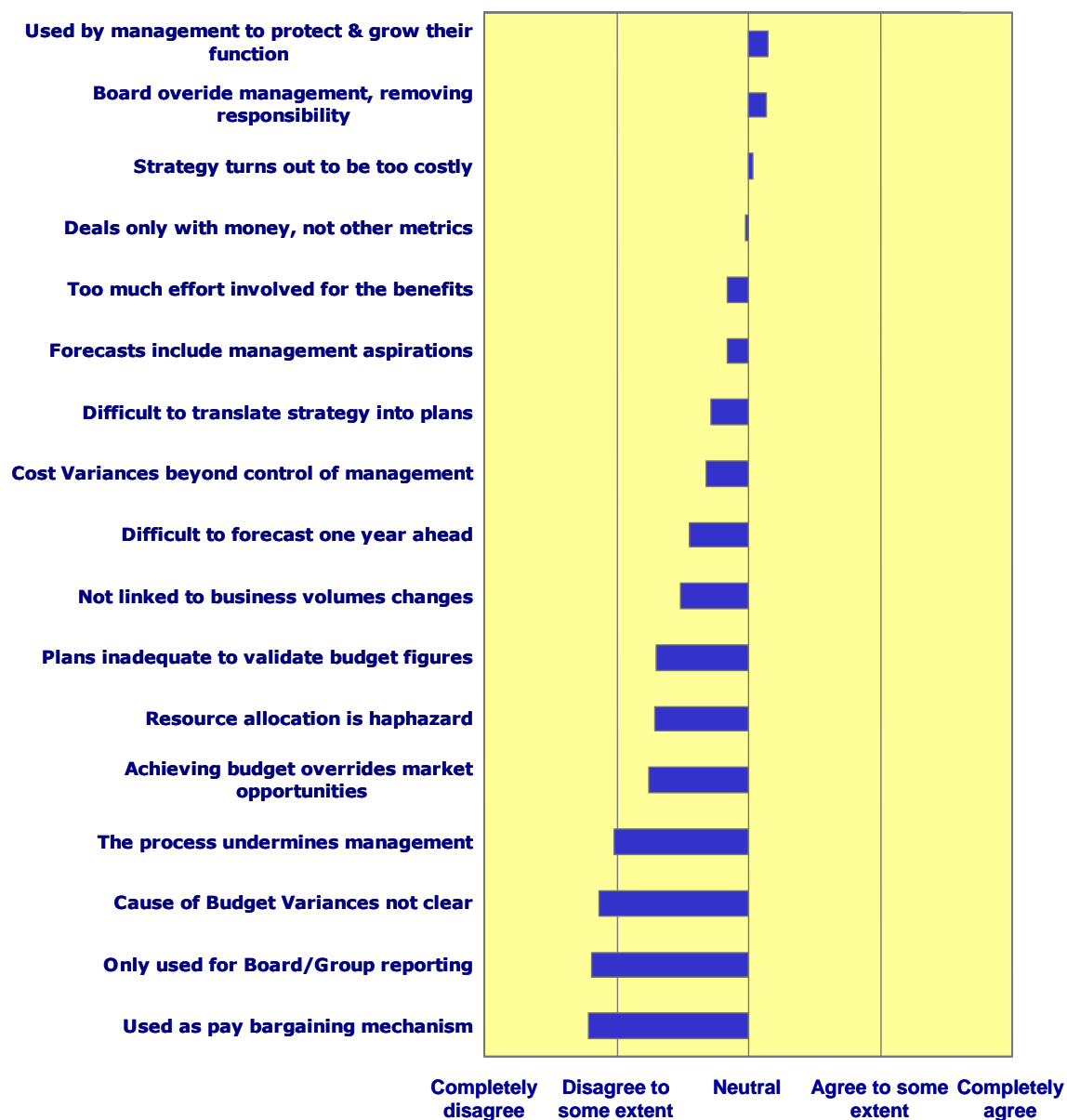
This explanation lends support to the often-expressed view that the budget is as much a mechanism of pay negotiation as anything else (despite vehement denial by our respondents, as we will see in a moment). It also lends substance to the argument that the budget stifles the flexible, dynamic management that we are told today's organisations need. This is because the biggest influence of managers' behaviour – their pay – rests on meeting targets that, 4¼ months into the year, “people regard ...as being outdated”.

This bonus issue reminds us of the first finding of the report, namely that the budget performs quite well on all its purposes, but not particularly well on any. Is the budget meant to be a demanding target, with rewards for achievement, or a considered judgment of the most likely future? One solution to this dilemma is to make the budget the latter, and to find another, separate mechanism by which to remunerate managers. This frees the budget to concentrate on accomplishing fewer really important tasks well.

FINDING: THE USUAL CRITICISMS LEVELLED AT BUDGETING ARE BY NO MEANS UNIVERSALLY ACCEPTED

We offered respondents 17 criticisms of conventional budgeting and asked them whether they thought the criticisms applied to the way budgeting was conducted in their organisations. As you might expect, responses range from complete agreement to complete disagreement on every single criticism. However the mean response overall is slight disagreement. Mean scores for each criticism are illustrated in Figure 14 below.

Figure 14: Do these criticisms of conventional budgeting apply to you?



What do we conclude?

Some of the responses appear to contradict other findings. For example, the strongest disagreement is to the suggestion that the budget is used as a pay-bargaining mechanism. Yet 81 respondents said that their budget was used for bonus calculations – and they disagreed with the suggestion only marginally less strongly than the mean of the total sample.

However, the scoring overall is consistent with the sanguine view that respondents have expressed about how well their budgets perform, as indicated by the responses summarised in Figure 2 on page 2.

Interestingly, the two criticisms attracting biggest support are directed at the behaviour and role of cost centre managers and the board. Criticisms of the budget process itself tend overall to be rejected.

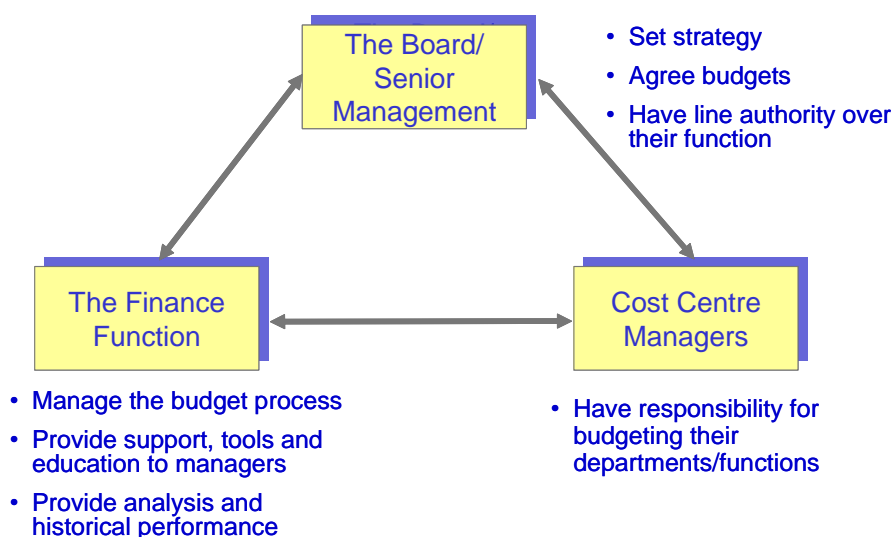
5 Proposed changes to the budget

We asked respondents to say what they would like changed in their budget process, and what change they would introduce. We suggested seven aspects, listed in the table below, under which change might be considered. The table also shows the number of responses provided. In the final column, it gives the average impact, in the judgment of the respondents, on the performance of the organisation overall, were the changes to be introduced.

<i>Aspect</i>	<i>Number of proposed changes</i>	<i>% of respondents proposing change</i>	<i>Judged mean impact of changes</i>
Role of cost centre managers	82	67%	Quite a lot, well worth doing
Role of finance people	66	54%	Quite a lot, well worth doing
Role of senior managers/the board	66	54%	Quite a lot, well worth doing
Creating the budget	61	50%	Quite a lot, well worth doing
Reforecasting/rolling forward the budget	59	48%	Quite a lot, well worth doing
Reporting performance against the budget and taking action	61	50%	Quite a lot, well worth doing
IT systems used to create and/or reforecast the budget, and to report performance against budget	50	41%	Quite a lot, well worth doing
Total	445		

So under every aspect, respondents volunteered a large number of changes that on average they thought were well worth introducing. Overall, 82% of respondents offered at least one change. On average, each respondent offered 3.6 changes.

Over the next few pages of this report we take each aspect in turn and provide an analysis of the proposed changes.



We undertook the analysis by grouping together proposals that are on broadly the same theme so as to identify the popular ones. For each aspect, we include a table that lists the themes. In the interests of space, we have not included every theme, but all themes that got more than one mention are listed, and some themes that were mentioned only once, but struck us as interesting, are included.

This process is unavoidably crude: many proposals contain a subtle twist or nuance specific to the particular circumstances of the organisation in question. In the interests of providing a digestible picture, we have had to omit many points, and we apologise to those respondents who feel that their particular idea has been overlooked.

One respondent appears to suffer most of the known ills of conventional budgeting and was adamant that budgeting ought to be abandoned altogether. Others were content that their organisation has got it about right, although, as the number and importance of suggested changes shows, they are in a minority.

5.1 People and roles in the budgeting process

The three main groups of players in the budgeting process, and their main responsibilities, are shown in Figure 15.

Figure 15: Key players in the budgeting process

We asked respondents to suggest ways in which each of these groups might improve the way they discharge their responsibilities for budgeting.

The Board/Senior Management

These are the decision makers for budget approval. They also provide leadership and direction and decide on the organisation's strategy. Individually, they have line responsibility for their functions.

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Strategy/goals not clear or not communicated	15
Can't or don't check that budget conforms to business plans/strategy - just look at money or pet projects	14
Should be more involved in open, constructive review, and developing alternative tactics, not just accepting results	13
Need to give clearer guidance and objectives/targets before budgeting starts	11
Senior managers not active enough in agreeing to/delivering to budget	5
Should empower operational managers more	2
Commit to budget timetable	2
Should set more realistic and longer term budget targets	1

- There is a widespread sense that boards are too concerned with querying the detailed financial numbers instead of getting the overall strategy right and then making sure that the budget aligns with the strategic direction
- Greater involvement and communication is needed from the board/senior management, both in the early stages before budgets are put together and later when budgets are being reviewed. This reflects the view that the finance function and cost centre managers lack understanding of the top team's thinking
- The board/senior management should provide targets and priorities and should articulate the requirements of the strategy. This is a request for the specific requirements arising from strategic plans, such as sales and service level targets, project priorities and cost constraints

It is thought that these last two actions will reduce the number of iterations, and the frustration of reworking budgets, caused by lack of direction or information.

- Boards should avoid the "10% cut" syndrome by adopting a more focused and rational justification for making cost reductions to budgets
- Budgeting requires many parts of the organisation to meet a demanding timetable where a single participant failing to achieve their deadline can bring the process to a stop. The senior team should provide the leadership and authority within their line management role to ensure timetables and quality of budgets are met
- Boards are criticised for reviewing draft budgets from the narrow perspective of costs and for being too easily swayed by pet projects. They do not check sufficiently that the budget contains plans to meet strategic intent. Nor do they put enough effort into examining alternative strategies
- Senior managers reporting to the board also come in for criticism. They do not scrutinise budgets coming up from their cost centre managers sufficiently, nor accept responsibility for making sure the numbers are delivered

“Clear strategic direction with key priorities agreed” – Group Financial Controller

“Provide visions and leadership. Constructive reviews need more time and effort” – Management Account Manager

“Strategic objectives are still very functional, rather than corporate, which can create a dysfunctional budget. Board/senior management to provide corporate objectives” – Financial Controller

“Senior management input required earlier in the process to avoid multi-iterations” – Finance Director

“Should be proactive in setting strategy rather than reactive to initial forecasts” – Head of Finance

“[The Board should be] ..setting targets so that submissions not rejected out of hand” – Financial Reporting Manager

“Definitive guidelines are given only after the initial 'bottom-up' process has been completed...issue guidelines first to prevent budget holder disappointment when cost restrictions are imposed in 2nd round of budget” – Finance Director

“Stop going for soft targets such as training/marketing and less protection of sacred cows” – Finance Director

“[They should]...realign committee and board meeting dates with the budget and corporate planning preparation timetables” – Director of Finance

What do we conclude?

In essence there is strong criticism of the board: 43% of respondents feel that their boards are not doing their job as far as the budget is concerned. They either fail to provide leadership in setting strategy, or in ensuring that the budget supports the direction in which they want to take the organisation. Or they fail to give clear guidance as to the complexion of the budget. Or they review budgets ineffectively without challenging budget holders to ensure that they have thoroughly explored options and opportunities.

It is right, we feel, to be concerned. For many organisations the budget is an important, maybe the major instrument for creating plans and for regular review of corporate performance. If the basis of that planning and review is flawed, lacking in board scrutiny and not bound to the strategy, how can the organisation practice effective stewardship of its operations?

Finance

This group comprises members of the finance function who are engaged in planning and managing the budgeting process.

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Finance staff should give more financial support to business planning; better analysis and understanding; more support and guidance, less control	28
They should be involved with/be driven by front line operations and understand the business	12
Explain impact on the budget of key business drivers	7
Budget advice, not preparation	7
More challenge to what cost centre managers are proposing	3
Require less detail in the budget by removing unnecessary cost centres and accounting codes	2
Too financial - should include non-financial elements	1
Greater involvement for consistency and detail	1
Generate appropriate models and systems to help managers better understand the business model	1
Better training and tools for those compiling budgets	1
Model alternatives thoroughly	1

- The overwhelming thrust of proposals is to get finance staff out into the organisation giving support, guidance and advice to cost centre managers
- By understanding better how the business operates, finance staff will be better able to analyse and explain the financial implications of business plans and to identify the key drivers of costs
- Through advising and guiding cost centre managers on how to prepare the budget, finance staff can ensure consistency of approach without removing from the cost centre manager the responsibility for budget preparation and the ownership of the outcome

What do we conclude?

"[Finance should]...become less centralised.... involved in the core business activities more" – Management Accountant

"Manage/support process. Give non-financial managers tools to make task easier. ...consolidate and challenge" – Group Planning Manager

"Finance staff do not take the lead in the planning process. This should be changed to make planning the responsibility of the finance director" – Finance Director

"Move away from the 'control' aspect and more towards aiding and advising management" – Principal Accountant

"Need to understand cost drivers. Need to understand all aspects of a very complex business. Need to produce accurate actuals" – Assistant Vice Chancellor

"Reduce level of detail required" – Divisional accountant

Given that most of the respondents are members of the finance function, they are not uncritical of their own performance. In fact, we find it encouraging that finance people are not sitting back blaming the rest of the organisation for any shortcomings the budget may have. On the contrary, respondents provide a clear, positive message that finance people have to get out there and make it happen.

Cost Centre Management

This category, responsible for creating budgets for their departments or functions, will include several layers of management in large organisations. Budgets may be iterated several times before reaching the board or senior management for formal approval.

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Involve cost centre managers more, and make them accountable for their budgets	25
Provide guidance, advice and training to cost centre managers (on the budget process and their role in it; on the cost constraints facing the organisation; on corporate strategies and plans and what that means for them; on how activity driver volumes will affect their costs)	9
Set improvement targets (either cost reductions or plans in line with strategy) for cost centre managers, and include them in performance reviews. Don't let cost centre managers get away with the status quo	9
Don't let cost centre managers rely on Finance to create the budget	6
Make cost centre managers think more realistically when creating their budgets, particularly about expenditure plans	6

Cost centre managers to put more effort into re-forecasting, less into initial budget	4
Improve communications (sometimes vertically, sometimes between cost centre managers)	4
Create business/action plans before budget, and incorporate plans in the budget	3
Cost centre managers to think more corporately, not parochially	3
Introduce flexible budgeting with separation of variable and fixed cost elements	2
Have less detail, and concentrate on the key factors (eg fewer cost centre managers if they have only fixed costs)	2
Prioritise expenditure to allow challenge	1
Stop cost centre managers padding their budgets (eg don't assume additional headcount and Capex from month one)	1
Separate actuals and forecasts from aspirations	1

- The overwhelming proposal is to get cost centre managers more involved and accountable for the budget and the outcome. Several other proposals, such as that to stop cost centre managers relying on Finance to do their budget for them, support this theme. For some, the mood is tough, with talk of targets, punishments and rewards. For others the tone is softer, suggesting a need for guidance, advice and training.

“..at present, managers maintain the status quo” – Finance Director

“Need more financial awareness amongst managers” – Management Accountant

“managers to take more ownership of the budget and not be driven by finance” – Financial Controller

“[We need] a greater understanding of costs and drivers. More presentation of options in budgeting” – Senior Management Accountant

“Budgeted costs restrict managers who are then reluctant to invest in process improvement and in generating additional revenue” – Financial Analyst

“(Managers) focused too much on extrapolation of existing performance, too little attention given to improvement initiatives” – Finance Director

“Prioritise their expenditure to allow challenge of unnecessary expenditure and improve the reiteration process” – Group Financial Controller

“Would like to see cost centre managers incentivised on cost saving initiatives they propose and deliver” – General Manager

“Too little interaction between cost centre managers when drawing together plans. They must talk more to understand dependencies, cause/effect and requirements for support from other departments” – Finance Manager

What do we conclude?

The overriding impression given by these proposals is of disengaged budget holders, unwelcome victims of what is to them a meaningless and time-consuming task. Getting them engaged will be no mean feat.

A key way of doing so is to get away from budgets that are based on last year's numbers, and that take no account of strategy and of plans to change. It will help if the Board itself doesn't just look at the numbers, as has already been pointed out, and if reviewing performance against budget isn't just a numbers game either, as we see next.

5.2 The processes of creating the budget, reporting performance against the budget, and reforecasting the budget

We asked respondents how they would like to change the processes their organisations use to create the budget, to report and assess performance against the budget, and to reforecast or roll the budget forward. Below we analyse the responses.

Creating the budget

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Start budget process later in year	8
More involvement (bottom up) from managers: budget must reflect manager's objectives - the business plan for the cost centre: enables meaningful variance analysis	8
All parties to keep to clearly-set deadlines to prevent rushed and ill-conceived budget production	5
Deeper thought is needed, not just variations on previous year (ie zero-based)	5
Introduce rolling forecasts, so that not created from a fixed base	4
Consistent, standardised formats and documentation	4
Modelling of volume changes (flexible budgeting)	3
Introduce activity-based budgeting, based on future volumes and strategy	3
Need a clearly documented budget-setting process linking all strategic areas that defines roles, responsibilities and actions	2
More user-friendly and transparent, so issues are understood	2
Introduce non-financial measures	2
Start budget process earlier in year	2
Less time preparing, more time analysing and modelling "what-ifs" or scenarios	2
Reduce detail by concentrating on key factors that constitute a high proportion of the budget	1

- Compared to the people roles just discussed, the issue of creating the budget raised a much wider range of themes, none of which dominates the others. Consequently, there is a long tail of themes that are raised only once
- Several people want a shorter budget-creating period in order to prevent early work being overtaken by events. In order to achieve a shorter period, several advocate clear deadlines and strong enforcement. Surprisingly, only one person suggests reducing the detail of the budget by focusing on the key variables rather than a mass of miscellaneous items
- An equally strong desire is for more involvement from cost centre managers. This involvement would be achieved through incorporating their business plans into the budget, rather than allowing or inviting managers simply to vary last year's numbers by a prescribed percentage. An interesting benefit that was advanced in favour of this approach is that it would facilitate meaningful variance analysis when reporting performance against budget
- Another proposal is to flex the budget by modelling volume changes. Some people specifically advocate activity-based techniques for doing this

What do we conclude?

The lack of a dominant theme reflects the fact that many respondents used this heading, *Creating the budget*, as a repository for a wide range of suggestions, almost all of which surface more forcefully under one of the other headings.

The one proposal that doesn't occur elsewhere is that of shortening the budget preparation period. This implies either a less detailed process or a more concentrated effort. We think that most proposers had the latter in mind. This idea seems to clash with another suggestion: deeper thought needed. Perhaps the best solution, which has the potential to overcome both out-datedness and insufficient thinking, is rolling forecasts, which feature next.

"...too many rash assumptions made to ensure predetermined profit figure is achieved. Then become irrelevant to management" – Financial Analyst

"A better structure to the process and an emphasis to keep to deadline dates by all parties." – Managing Director

"Currently last year + or - : deeper thought is needed." – Finance Director

"Need to have rolling forecasts so that not created from a zero base." – Group Financial Controller

"Simple modelling of volume changes" – Finance Director

"Budget must fully reflect objectives of the manager and sensitivities to be clearly understood" – Financial Director

"It is very important that clear timetables are set and adhered to." – Regional Financial Controller

"Very much top down - more bottom up budgeting would empower budget holders" – Management Accountant

"Produced in more detail - it is the business plan for the cost centre. Some managers do it well and get the rewards in meaningful variance analysis" – Group Financial Controller

"Input received, numbers crunched, output modified by board. Need further involvement from managers about how bottom line (or top line) performance can be improved and detailed action plans created" – Finance Director

"Budget process is ad hoc at present. Need a clearly documented budget-setting process linking all strategic areas" – Management Accountant

"Better Group Forecasting System to support the process." – Director of Finance

"More user-friendly and transparent. Introduce non-financial measures. Introduce flexible budgeting. Remove relationship of financial incentives to budget." – Divisional Accountant

"Current process is largely mechanistic, and needs to be more 'zero-based'" – Finance Director

"Budget in too much detail, eg budget for phone charges and mobile charges separately. Would prefer to spend more time budgeting key factors, which make up a high % of budget and have a 'pot' per cost centre for other costs that managers agree to maintain" – Chief Accountant

"ABC please! At least to de-link volume based resource planning from other performance based actions." – Financial Controller

"Process not understood. It is not documented and is source of frustration for all respondents. Need for clear process defining role, responsibilities and actions." – Finance Director

Reforecasting/rolling forward the budget

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Introduce rolling forecast	23
Reforecast quarterly instead of the current, less frequent, rate	5
Greater involvement by managers would aid development of action plans	4
Develop better forecasts to drive the reforecasting	3
More detailed reforecasting of costs and revenues would enable easier assessment of current performance and comparison to original budget	3
Reduce detail in process, freeing up finance time to work with budget holders	2
More regular formal reviews to enforce responsibility and accountability	2
Speed up the reforecasting process	2
Improve definition of reforecasting process requirements	2
Make more dynamic link between reforecast process and five year plan to make the latter more realistic	1
Involve senior operational managers. Currently finance bypass them, talking to cost centre managers and reporting to the board	1
Better "what if" and risk and opportunity analysis.	1
Reflect reforecast in budget statements	1
Budget holders need to be more forthcoming regarding changes. Many wait until they overspend, then raise the issue	1

- The proposal to introduce rolling forecasts dominates respondents' views
- For some, reforecasting is an occasional, ad hoc affair, done mainly by Finance and given little significance. Respondents clearly feel that this is inadequate, and that there should be a redressing of the balance between the annual extravaganza and the occasional weak fillers

“Happens twice a year. Should be quarterly...” – Chief Operating Officer

“Occasional reforecasting is done. Aim to try rolling forecasts.” – Finance Director

“Once completed, the budget is fixed. We are interested in finding an easy way of flexing or rolling forward the budget to keep it relevant.” – Company Secretary

“I would like to see this system [rolling forecast] introduced at a group level and drop the annual budget process.” – Finance Controller

“More ownership taken of the numbers by cost centre managers” – Finance Director

“Extend to a rolling 12 month full forecast plus 6 months key items forecast, ie 18 months in total” – Finance Director

“Done top down only. A degree of bottom up (at least at cost centre level) would aid development of action plans” – Group Financial Controller

“Develop more robust forecast outturn figures and reforecast budget to reflect revised forecasts” – Director of Finance

“Get rid of 10 years planning. Introduce rolling forecast.” – Head of Financial Planning

“Exercises done to some extent in isolation. [Would like] integrated rolling forecast taking external and internal influences into account” – Financial Strategy Manager

“[Would like to] continually look 12 months ahead. In November we only forecast for December” – Chief Accountant

“Reforecasting done at high level and is not always required. Need to define 'reforecasting' process and involve right level of people.” – Finance Director

“Completed at high level only. Difficult to relate to current performance and original budget. Culture of updating forecast and reporting against [it] would be more suitable” – Finance Manager

What do we conclude?

Why is the proposal to introduce rolling forecasts, as opposed to simply reforecasting, so popular?

In conventional budgeting, the budget year is divided into 12 months each with its own figures for costs, revenues and non-financial measures. As the months go by, the forward visibility of what the organisation is attempting to achieve shrinks to zero.

Towards the end of the budget year, two generally unhelpful consequences of this approach arise. One is that the detailed planning of things whose lead time extends beyond the end of the budget year, for example recruitment or ordering raw material, becomes difficult because detailed plans for the next budget year haven't yet been approved. The other is that people delay important expenditure or pre-book revenue simply to improve the look of the outturn figures for the year - the “accruals effect” as one person put it - upsetting both customers and suppliers. Rolling forecasts can ameliorate both these adverse effects.

For others, the major attraction of a rolling forecast is that it reduces dramatically the effort otherwise required for the preparation and acceptance of the annual budget.

The other factor sitting behind many of the proposals is that managers are not involved in the reforecasting process. In many organisations, it seems that reforecasting is done principally by the Finance department at a high level, and reported to the Board. Clearly, under these circumstances, reforecasts will suffer from the lack of on-the-spot involvement of managers and will not make them feel responsible for subsequent performance.

All of this adds pressure for the budget to be much more of a continuous process, intimately involving line managers. After all, management is a continuous process, and so too should be the budget.

Reporting performance against the budget and taking action

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Must develop action plans and make sure that actions are carried out on time and followed up	12
Needs earlier reporting so that timely action can be taken	11
Review needs to be formal to create accountability	10
Needs improved management reporting information and variance analysis	7
Variances should be reported against last YTD or budget, rather than latest forecast, which can be easily flexed to lose variances	2
Variances should be reported against latest forecast rather than budget, which is out-of-date	2
More detailed reviews of actuals vs budget	2
Encouraging a positive process is essential. People need to be open. No surprises must be a key rule	2
Introduce punishments/ rewards for variances	2
Allow for significant outside factors	1
Improve understanding of managers about key drivers that influence results.	1
Needs more understanding of relation between volume and performance	1

- The two main thrust of the proposals are clear. Firstly, reporting needs to be quicker, so that problem variances from plan can be identified, and options explored, in order that corrective actions can be swiftly taken
- Secondly, more professional rigour and urgency needs to be injected into the process. Reviews should be more formal, so that they are taken seriously and so as to create proper accountability in the managers responsible for delivering the results. And actions need to be properly recorded with timescales for follow-up and review

- A strong feature that emerges from the responses relates to how information is reported and how the variance analysis is carried out. Several respondents refer to the need for specialised accounting software to automate the reporting process, so saving time and effort. This is a topic we will pick up in the next section
- Differences emerge as to whether one should report against the original budget or the latest forecast. There are also the inevitable differences on whether the line should be hard or soft: should we encourage managers to be open about what is happening, so there are no surprises, or should we risk driving them underground by introducing a system of punishment and reward for the variances that arise?

*"[We need] good reports. Not enough action taken at an early stage when problems are detected."
– Finance Manager*

*"[Our reviews are] not always followed up with action plans. Needs a formal review process." –
Finance Manager*

*"The forecasting and comparison with actual provides much information that could be acted upon."
– Deputy Finance Director*

"Takes too long to report, [so] less time to react." – Finance Director

*"Reporting process too slow, therefore it is often impossible to take action. Actions should not be
driven by a historical budget" – Financial Analyst*

*"If performance against budget varies by a large amount the budget is dismissed as being out of
date. A rolling budget might eliminate this." – Company Secretary*

*"Mitigation of issues important but budget dead on day 1 of year and forecasts are 'king'" –
Financial Director*

*"Reporting is focused on the reforecast vs budget not actual vs budget. More regular focus on the
actuals." – Finance Director*

"Full financial close would allow more effective monitoring" – Head of Finance

"More accountability created with formal reviews" – Financial Controller

*"Clearly defined reporting and explanation of variances. Action to be taken not defined in writing
with completion dates." – Finance Director*

"[We need to] move towards strategic focus, not tactical." – Financial Controller

*"Improve understanding of managers about key drivers which influence results." – Divisional
Accountant*

*"Budget variances reported late in the process against a budget they don't understand." –
Managing Director*

What do we conclude?

The proposals paint a rather sorry picture: we spend all this time and effort creating a budget so we know where we are going and what we are trying to achieve; but we haven't got the systems to be able to report progress against plan in time to detect variation from the plan and to do something about it; on top of that, we don't conduct the reviews very professionally, and no-one writes down what we decide to do.

Maybe we exaggerate, but that's the flavour. No wonder so many want rolling forecasts and a more formal review process.

A few respondents, but only a few, refer to the need to understand better the key drivers that influence results. This is a disappointingly low number because, although speedy variance analysis using clever software might well be advantageous, finding insights into the underlying causes of variations from plan can be much more valuable: it is the insights that can cause changes both tactically and strategically in an organisation, changes that can make much more substantial differences than can the superficial identification of variances.

5.3 Systems and Information Technology

The themes raised are indicated in the table below.

<i>Theme of proposal</i>	<i>Number of mentions</i>
Introduce proper budgeting and reporting software instead of using spreadsheets (but cost may be prohibitive)	15
Integrate ledger, reporting and planning systems for once-only data entry (although costly and needs training)	12
Only an aid. Cultural issues, such as people owning the result, more important	3
Need forecasting system	3
Replace system to allow quick processing, detect errors and allow analysis.	2
Give better training in the use of software	2
Need to reflect reforecast in system-generated budget statements	2
Ensure new managers have full training on reporting and budgeting systems.	1
Need an on-line system to collate budgets automatically	1
Need an automated system for rolling forward to avoid manual calculations	1
Process is the problem, not technology	1

- The most commonly raised problem is the concern over the wide reliance on spreadsheets. This is due to the lack of integration of spreadsheets with mainstream systems, the inherently risky “DIY” approach that spreadsheets encourage, and the increased likelihood of errors in re-keying and in file transfers. Spreadsheets also make collating budgets from budget holders longwinded
- The second most common problem is the poor integration of existing systems, which causes duplicate data entry and cumbersome data transfers. Both these problems limit opportunities for automating tasks. They suck in resources and slow down the collation and revision of budgets and the production of reports
- A few respondents expressed the view that the process and people issues need to be tackled first, before developing improved systems. Respondents accept that budgeting and re-forecasting will always require a significant level of manual intervention and that IT is not a total solution
- The lack of tools to help scenario planning and “what ifs” is also seen as a problem
- Some respondents report that new, core systems are being introduced into finance, giving rise to expectations that this will improve the situation. Respondents who have introduced specialist analytical and reporting software are generally pleased with the outcome

What do we conclude?

“Huge improvements could be made if we had an effective budgeting tool to remove reliance on Excel” – Finance Director

“We require an IT solution that integrates the budget into the general ledger system” – Group Finance Director

“Systems are generally not integrated - would help enormously if packages spoke to each other” – Management Accountant

“Our business is most unusual. To date no 'software' has been/is available to help in the budget/forecasting process” – Finance Director

“Total reliance currently on Excel. Use of an effective budgeting tool would be an asset” – Finance Director

“Would like to have [better systems], but after dealing with people issues” – Finance Director

“IT is only an aid. Cultural issues more important” – Director, Asset Management

“[We] have just been through a system upgrade – now develop non-standard reports, using report writer tool” – Director of Finance

“Systems can only create trends. Budgeting is all about reviewing current practices and resisting trends. IT can best help review the budget against trends for reasonableness and to report variances” – Group Financial Controller

“Excel works fine” – Financial Director

“Some of the number-crunching could be automated so long as the audit trail of why budgets are updated is not lost.” – Deputy Finance Director

“Reflect reforecast in system-generated budget statements” – Director of Finance

“Need to enable budget holders to get financial info direct from systems rather than rely on accounting staff” – Finance Director

Budgets are usually based on the data held in the general ledger and related sales and purchase ledgers, data such as chart of accounts, products, customers, cost centres and accounting codes. But they are almost always constructed and manipulated using separate systems because standard accounting systems do not support the specialist requirements of budgeting for data collection and collation from budget holders, for control over iterations, for re-forecasts, and for reporting.

Spreadsheets are the most common budgeting tool because they provide flexibility, can be interfaced to most proprietary systems, and are available and familiar to budget holders. They are also cheap. Without being asked, 20% of our respondents mentioned that they relied heavily on spreadsheets. It is hardly surprising that the Marketing Director of a major supplier of Budgeting and Reporting tools lamented: “Our biggest competitor is Excel”.

Improving the IT to support budgeting has two main barriers:

- The scarcity of suitable functionality in proprietary accounting software
- The difficulty of making a business case for investment in improvements to budgeting

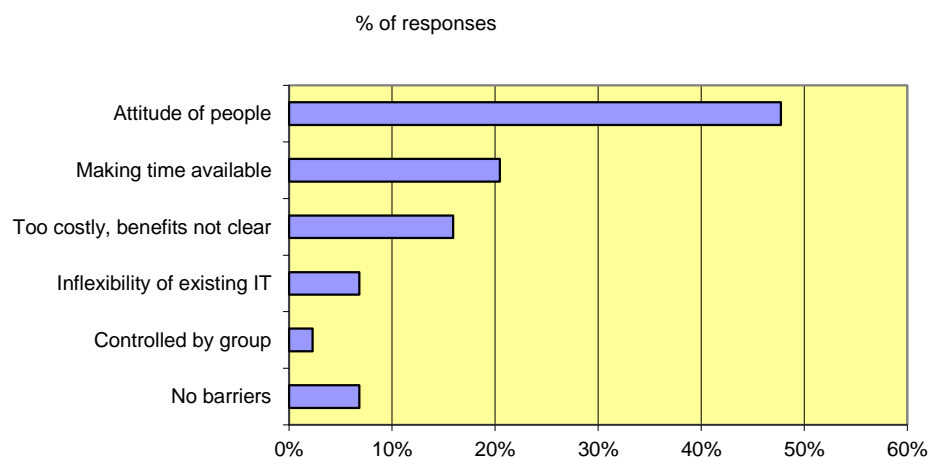
These barriers to improvement are discussed further in the following section.

6 Barriers to change

We asked respondents whether they perceive any barriers to the implementation of their proposals for changing the way the budget is handled in their organisation. 88 of the 101 who had proposed changes responded to the question. To aid analysis, we have categorised the responses under six headings, as listed in Figure 16, below.

Figure 16: Main barriers to change

- The attitude of people and their unwillingness to change is the dominant theme. It was raised by 48% of those who responded to this question. People's unwillingness to change applies to both finance people and to others, mainly senior management, throughout the organisation



- Everyone, but particularly those in Finance, do not have the time required to introduce change
- 2% are following the process defined by their group or Head office and feel that they are powerless to make any change
- 7% are tackling their problems and see no barriers

What do we conclude?

“Greatest difficulties to overcome would be people's attitudes and willingness to change” – Senior Management Accountant

“People's attitude. Cost of software packages” – Management Accountant

“Investment costs - new investment perceived as not being value-adding” – Finance Director

“Cultural issues, reward mechanisms which encourage ‘silo’ thinking, poorly aligned departmental objectives” – Managing Director

“Computing systems, costs, process is controlled by group” – Group Finance Director

“Historic way of doing things with little appetite to change or modernise” – Finance Director

“Time taken to implement new budgeting/IT systems” – Finance Director

“People are sceptical of the benefits, and budgeting never seems as high a priority as doing the ‘real’ work” – Finance Director

“Some of these changes are taking place, new Finance Director is pushing these forward. People's attitude to change is the major factor slowing progress” – Management Accountant

“None. We have started a process of change and are still moving forward” – Director

With many competing priorities for cash, investment in improved budgeting is clearly not seen as ranking high on the list. This is perhaps not surprising: once completed, the annual budgeting process is, like occasional toothache, soon forgotten. The benefits in terms of manpower savings of making the process more efficient are spread thinly across the organisation and are difficult to turn into tangible staff reductions. Other benefits, such as providing a good forecast to guide us through the year, are difficult to quantify

Let's consider the barriers in the context of respondents' top four proposals for change.

1. *Finance people must give more financial support to business planning; provide better analysis and understanding; give cost centre managers/budget holders more support and guidance, and worry less about control (28 proposals)*

Surely it is within the gift of the finance director to make this change – it doesn't require anyone outside Finance to be convinced of the benefits or to be cajoled into action. To be yet more challenging, the proposal sounds suspiciously like getting Finance to do its proper job. So what are the internal training resources and indeed the professional institutes who provide the Finance qualifications and who lay down the examination syllabuses doing?

2. *Budget holders must get more involved in their budgets, and be more accountable for them (25 proposals)*

If Finance people manage the first proposal successfully then this one, which strikes us as much more daunting than the first, should be a great deal easier to accomplish. Another major factor associated with the role of budget holders is the way that the board makes them accountable. We feel sorry for the poor old budget holders in many organisations. They are made to do a great deal of work producing a budget that everyone knows will be out of date

4¼ months into the budget year. Then their pay for the year is linked to meeting targets that were fixed in the original budget, and that become impossible or absurd to achieve as the year goes by. So alongside the need to provide mechanisms for making budget holders accountable, such as appropriate meetings and the meaningful presentation of performance data, there needs to be a review of exactly what they should be accountable for, and how they should be rewarded.

3. *Introduce rolling forecasts (23 proposals)*

The respondents didn't mention it, but the usual reaction to the proposal to roll the budget forward by one month every month is along the lines: "It takes 3.7 months to produce the annual budget, and you expect us to repeat this every month. It can't be done!". Clearly, the introduction of effective rolling forecasts requires a significant change to the budget process, not a minor adjustment. It is replacement, not repair.

In our experience, there are three key elements to developing a workable rolling forecasting process:

- a means of identifying which elements of the budget are likely to suffer unforeseen and significant change, so that monthly reviews can concentrate on re-forecasting them
- improving forecasting techniques for the elements that are changeable. In some cases, this means identifying accurate volume drivers where links exist between the driver and the resource being budgeted. In others, it means developing better forecasting models that include and rationally process all relevant market data
- a system to enable and support the process of reviewing, revising and advancing the budget in a way that is appropriate to the needs and circumstances of the organisation, and that restricts itself to the basic needs.

4. *The board/senior management must make strategy/goals clear and communicate them (15 proposals)*

The last of these key proposals is one of a series that requires the board and senior management to ensure that the budget underpins the strategy. This is a far cry from boards manipulating the numbers to make an acceptable bottom line result. It is no easy matter to convince a board that confronting the financial implications of their strategy and challenging the plans on which budget holders base their budgets is ultimately more effective than simply pressing budget holders to achieve tough financial targets. Better perhaps to pursue the other proposals first: getting budget holders and finance people to work closer together on financially-meaningful plans, particularly on a rolling basis, should provide the demonstrable evidence of a better way that the board will then accept.

All these key proposals are closely interlinked. This is because the preparation, review and revision of the budget are parts of a single process, albeit a large one. The proposals relate to different aspects of that process, and therefore interact with one another. So the changes cannot be planned and implemented in isolation – their designs need to be co-ordinated.

So where does all this leave us? Introducing improvement to the budgeting process seems to have fallen at the first fence with a widely-held perception that people will not accept any change. But respondents to this survey make clear that change is required and would be beneficial. And if *they* can see the advantages, why should others in the organisation, who probably have a more jaundiced view of the whole process, not welcome improvements?

The suspicion is that the reality of trying to change the budgeting process has not been put to the test. If one accepts that the budget process is "owned" by the finance function then the responsibility for bringing about improvement, for forcing through change despite the apathy, must rest there.

Appendix A: CostPerform

CostPerform Ltd is the UK-based channel of supply and implementation support for CostPerform cost and profitability analysis and modelling software developed by QPR CostControl BV in the Netherlands. Using CostPerform helps organisations understand the nature and behaviour of their costs so they can control them better, and so they can improve profitability.

Using CostPerform helps organisations use their resources more effectively – through process improvement, through performance measurement and management, through organisational restructuring, through setting clear responsibilities and processes of accountability that match them, and through transparent decision-making.

In many organisations the budgeting process is a time-consuming and meaningless distraction. Using costing models built with CostPerform transforms the budgeting process into a flexible, continuous process, a support tool that managers find essential. It becomes the vehicle that carries the change plans of the organisation, and it delivers fast, accurate assessments of resource needs as circumstances change.

Gross margins can mask heavy internal costs and are therefore often a dangerously misleading measure of profitability. Using CostPerform means that organisations can identify *net* product and customer profitability, so they know what business is genuinely profitable, and what is not.

Using CostPerform means that facts and accurate information underpin the management of change which helps remove obstacles to progress by engaging people at all levels in the process of improvement.

Appendix B: Sector Definitions

The table below lists the sectors into which we have grouped the organisations that have responded to the survey.

<i>Sector</i>	<i>No of organisations</i>	<i>No of Employees</i>	<i>Annual Revenue (£M)</i>
Transport	7	91,175	12,064
Health	10	78,241	10,766
Manufacturing & Engineering	15	37,084	7,419
Professional & Support Services	7	123,125	7,143
Retail	9	52,210	6,563
Banking & Finance	13	24,370	4,264
Media	4	30,350	3,870
Consumer goods	7	32,700	3,706
Leisure	3	58,160	3,166
Education & Training	19	45,660	2,028
Property	3	1,824	1,437
Utility	6	7,590	912
Technology	4	3,600	720
Construction & Property	3	3,050	680
NHS & Private Healthcare	2	8,800	490
Telecoms	5	2,760	312
Charity	2	9,007	201
Government	4	4,140	58
Grand Total	123	613,846	65,800

Three sectors are not represented in the survey: Industrials; Investment Companies; and Natural Resources.

The figure below shows the distribution of organisations by income/revenue.

Figure 17: Spread of participating organisations' revenues

