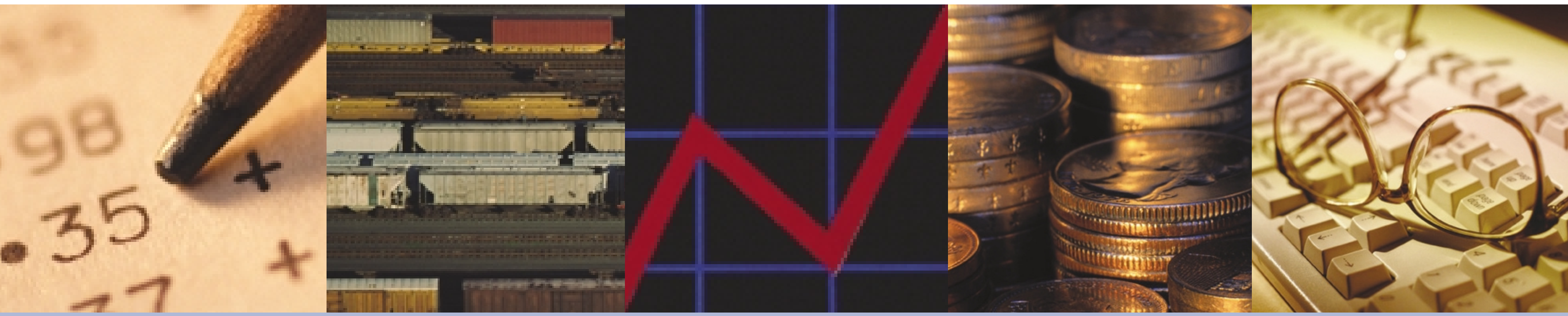
Faculty of Finance and Management



Better Budgeting

A report on the Better Budgeting forum from CIMA and ICAEW

July 2004

Price: £15.00

CHARTERED INSTITUTE OF MANAGEMENT ACCOUNTANTS www.cimaglobal.com Tel: +44 (0)20 7663 5441 Fax: +44 (0)20 7663 5442

Tel: +44 (0)20 7920 8486 Fax: +44 (0)20 7920 8784

Better Budgeting

This publication is based on the Better Budgeting forum held at Chartered Accountants' Hall, London, on 24 March 2004. The event was jointly sponsored by the Faculty of Finance and Management of the Institute of Chartered Accountants in England and Wales and the Chartered Institute of Management Accountants.

Any enquiries about this publication should be addressed to:

Danka Starović
The Chartered Institute of Management Accountants
26 Chapter Street
London SW1P 4NP
Telephone: +44 (0)20 8849 2342
E-mail: danka.starovic@cimaglobal.com

or to:

Chris Jackson
The Faculty of Finance and Management, ICAEW
Chartered Accountants' Hall,
PO Box 433, Moorgate Place,
London EC2P 2BJ
Telephone: +44 (0)20 7920 8486
E-mail: chris.jackson@icaew.co.uk

For further details about CIMA and the Faculty, please see the inside back cover. The publication was produced by Silverdart Ltd (see back cover) on behalf of CIMA and the Faculty.

ISBN 1-84152-286-4

Foreword

Chris Jackson, head of the Faculty of Finance and Management, ICAEW.

Danka Starović, senior technical issues manager of the Chartered Institute of Management Accountants.

This dual-badged publication has been produced jointly by ICAEW and CIMA. It is being distributed as a *Special Report* by ICAEW's Faculty of Finance & Management and as a *Technical Report* by CIMA.

The publication aims to present the latest thinking on budgeting from thought leaders, finance directors and financial controllers from large and respected companies. A list of companies that participated is included on page 6.

On 24 March 2004, ICAEW and CIMA held a joint round table event at Chartered Accountants Hall. The intention of the gathering was for senior members of both institutes to discuss some of the practical issues and challenges they face in planning and budgeting. The event was introduced by Paul Druckman, deputy president of ICAEW (now president) and chaired by Charles Tilley, the chief executive of CIMA.

The two institutes agreed to work together because budgeting is an important issue for professional accountants in business. The collaboration doubled the intellectual input and halved the cost. It was experimental and – as the feedback showed the evening to be a success – we hope to repeat it.

The evening started with presentations from Dr Mike Bourne of Cranfield School of Management, Dr Peter Bunce of the Beyond Budgeting Round table and Dr Stephen Lyne and Professor David Dugdale from the University of Bristol. They set the scene for the day by presenting the results of their research and highlighting the latest thinking on the subject.

In the ensuing round table discussions, participants highlighted examples of best practice in their own organisations, as well as suggesting areas deserving of further research or improvement. The debate was lively, and, if there was one overall conclusion of this session, it was that budgeting is alive and well, though practice is evolving with new tools and techniques.

The event was held under 'Chatham House' rules, ie participants could be open in the knowledge that their comments would not be attributed to their companies, many of whom were large and well-known.

We are grateful to the speakers and in particular to the finance directors and financial controllers who found time to take part and thus provide the content for this publication.

One of the most important objectives of the day for both CIMA and ICAEW was to engage with members and develop relationships and partnerships with them. In this way, members can help guide the institutes' agendas as well as draw support for their businesses in the future. The conclusions of the day's discussions were recorded for publication for the benefit of wider membership. ■

ROUND TABLE DISCUSSIONS

Debating the traditional role of budgeting in organisations

Participants in the Better Budgeting forum discussed a range of issues relevant to the central theme, debating possible ways of improving the budgeting process and highlighting areas for future research.

In most organisations, finance 'owns' the budgeting process

The afternoon's discussion aimed to explore the budgeting theory and practice from the unique perspective of the finance function. In most organisations, the finance department 'owns' and administers the budgeting process. Accountants are therefore first in the line of fire for its perceived shortcomings and are charged with making the necessary changes.

The debate, led by CIMA and ICAEW facilitators, was an opportunity for a frank and confidential exchange of views amongst senior finance professionals about these and other issues related to budgeting. This summary is not an attempt to be prescriptive about how budgeting ought to be done and we are aware of the limitations of our sample size. It is simply an attempt to provide a snapshot of the current best practice in some of the UK's leading organisations.

The budget is dead, long live the budget

Various research reports allude to widespread dissatisfaction – yet the debate showed that budgets are alive and well

If you were to believe all that has been written in recent years, you'd be forgiven for thinking that budgeting is on its way to becoming extinct. Various research reports allude to the widespread dissatisfaction with the bureaucratic exercise in cost-cutting that budgeting is accused of having become. Budgets are pilloried as being out of touch with the needs of the modern business and accused of taking too long, costing too much and encouraging all sorts of perverse behaviour.

Yet if there was one conclusion to emerge from the day's discussions, it was that budgets are in fact alive and well. Not only did all the organisations present operate a formal budget but all bar two had no interest in getting rid of it. Quite the opposite – although aware of the problems it can cause, the participants by and large regarded the budgeting system and the accompanying processes as indispensable.

Research in organisations seems to suggest that this is a commonly held view and that traditional budgeting remains widespread. Some claim that as many as 99% of European companies have a budget in place and no intention of abandoning it (Kennedy and Dugdale 1999:22 quoted in Vuorinen).

A framework of control

CIMA's *Official Terminology of Management Accounting* defines a budget as: 'a quantitative statement for a defined period of time, which may include planned revenues, assets, liabilities and cash flows. A budget provides a focus for the organisation, aids the co-ordination of activities and facilitates control.'

It is this last point that the participants singled out as the main reason why budgeting continues to add value in their organisations. Quite simply, it provides an overall framework of control without which it would be impossible to manage.

Large companies in particular would struggle to plan, co-ordinate and control without such a framework. But, even in small companies, a budget can provide a road map detailing where the business is, where it wants to go and how it can get there.

Of course, this does not mean that a budget can prepare the company for every eventuality. Any budget is based on a set of assumptions that may change as soon as it's published. Keeping an eye on the potential risks and changes in the environment is essential – as one delegate noted, budgeting may provide you with a map but if you drive with your eyes closed, you will crash anyway.

The delegates were keen to point out that there are also disadvantages to having formal controls in place. Some thought that budgets can stifle the entrepreneurial, risk-taking culture that, ultimately, can be responsible for value creation. It can, for example, force businesses to abandon new projects because the resources for the year have already been allocated. In addition, trying to perfect control systems can lead to an excessively inward focus at the expense of competitive awareness and agility. The participants agreed that companies need to counteract this with a culture that values openness and flexibility.

From cost-cutting to value creation

There was an almost unanimous agreement amongst those present that budgets have undergone some significant changes in the last 20 or so years.

Then, the emphasis was on centralised and highly bureaucratic cost control which lead someone to remark that while sociologists see control as a problem, accountants see it as a solution. Now, it seems that budgets are used more often to contribute directly to value creation. They inform strategy implementation, risk management and resource allocation and are generally regarded as an integral part of running a business.

The participants agreed that budgeting has been evolving to meet the changing needs of modern business. Instead of abandoning it altogether, it seems that companies are simply adapting it. This is not unusual – research shows that over 60% of companies claim they are continuously trying to improve the budgeting process to meet the demands set for management in creating sustainable value (Ekholm and Wallin, 2000, quoted in Vuorinen).

'One man's budget is another man's rolling forecast'

It quickly became obvious that, as one participant put it, "one man's budget is another man's rolling forecast". What people refer to when they talk about budgeting could in reality be very different things.

But in general, for many of those present on the day, the budget is prepared once a year and supplemented by regular forecasts as well as different ways of capturing non-financial performance data.

In fact, it could be said that the use of various tools to complement the traditional budget is precisely what allowed it to become more flexible and dynamic.

Budgets have undergone significant changes over the last two decades

Forecasting

The increasing use of forecasting, in particular, has meant that budgets have become more forward-looking and better linked to strategic planning. In fact, the rolling forecast emerged as one tool in widespread use that almost all the participants – but especially those in companies that operate in fast-changing environments – regarded as useful.

Several participants thought that, in their companies, forecasting is in fact more important than budgeting. Because the assumptions on which the budgeting numbers are based change so quickly, they depend on forecasts which are updated more frequently.

However, a detailed budget still provides a basis to work from, especially if something goes wrong. It acts as an anchor – although things change along the way, it is important not to lose sight of what was budgeted in the first place.

Forecasts are regarded as being high-level plans, whereas budgets contain more detail. One participant referred to budgeting as being about "looking into boxes you rarely open". Interestingly, it is precisely this opportunity to discuss issues with other parts of the organisation that for many represents the real benefit of budgeting. Setting objectives and targets for the year ahead can only be done through a great deal of inter-functional co-ordination.

Companies increasingly use forecasting – and some see it as more important than budgeting

It is almost as if the process itself is more relevant than the actual numbers – as the delegates noted, the detail often becomes irrelevant after the first quarter anyway. There was a strong feeling that this bottom-up approach to budgeting was an opportunity for everyone to think and talk about the factors influencing the performance of a business. As one participant put it: "it is important to get together and discuss issues. I know we should be doing this all the time but the budget forces you to do it".

Better co-operation should result in better budgets

In addition, better co-operation between different functions should result in better quality budgets that take less time to prepare. Those 'closer to the coalface' will have better assumptions on which to base the numbers. This in turn should lead to fewer iterations in the preparation of budgets.

How often forecasts are done largely depends on the nature of the business and the environment in which it operates. A fast-changing industry such as telecommunications would need constant updating whereas, say, a not-for-profit organisation with relatively predictable annual revenues would only need to do a fixed budget annually.

Non-financial performance measures

Participants were apprehensive about non-financial measures

The participants acknowledged the importance of non-financial data but were somewhat apprehensive about its lack of integrity and the resulting loss of control. They agreed that coming up with non-financial performance measures and targets isn't in itself difficult, but linking those clearly to financial strategy and results was much more problematic.

This is particularly obvious in the context of the now ubiquitous balanced scorecard. Many companies found the cause-and-effect linkages between the four quadrants of the scorecard – financial, operational, customer and learning – difficult to prove. They often do not have any degree of empirical underpinning, so strategy is based on intuition rather than fact. The participants admitted that there is still a long way to go before non-financial data can be completely trusted.

Technology

New technology has moved companies away from 'silo' mentality – but has also generated daunting data volumes

Part of the reason why budgeting practice was able to evolve is because it has been supported by new technology which has changed the way data is collected and stored in organisations. In some cases, enterprise-wide systems have increased both the speed and the accuracy of budgets and forecasts.

Both are crucial – frequent reforecasting, for example, is simply not possible if it takes the finance department months to collect and reconcile the relevant data. In addition, working from a single data set can help align budgets to operational plans and strategic objectives – it ensures a visibility of assumptions that have gone into decision-making.

New technology has also helped companies move away from organisational culture characterised by functional divisions and 'silo' mentality. Managers using off-line spreadsheets, for example, can end up disconnected from other parts of the business that would impact on their planning.

Last but not least, speed and accuracy mean that budget holders have more time to focus on activities which really add value to the business rather than on collecting data and ensuring its integrity.

There have been negative effects of technological changes too. For example, some maintained that enterprise resource planning (ERP) systems have led to a higher degree of centralisation which is at odds with the more bottom-up, participative nature of the more recent budgeting practice. This seems to contradict the promise of new technology to make data more widely available and more transparent. Others pointed out that the pace of technological change outstrips the more gradual and organic culture change so there will often be a disconnect between the two.

Plus, the sheer amount of data such systems are capable of generating is daunting. One delegate said that his company's state-of-the-art new platform was abandoned after only two years because the unnecessary data it was producing was resulting in micro-management. More data means it is tempting to keep adding to the budget – and prudent accountants may be particularly guilty of this. "You need to be very brave to take things away", noted one participant.

Culture and incentives

Organisational culture is by far the biggest influence on how formal systems and processes operate in practice. Fostering the right culture, whatever that may be in the context of individual companies, was recognised as one of the most important factors in the success or otherwise of budget practice. Unsurprisingly, the discussions offered no 'silver bullet' solution to creating the kind of environment where the budget is free of sub-optimal behaviour and skewed incentives. According to delegates, if the less centralised budgeting is to survive, it needs to be supported by a culture of trust and empowerment. But the difficulties of creating a system of accountability that isn't plagued by blame and mistrust – as is frequently the case with budgeting – were openly acknowledged.

Commitment at the highest level is crucial to making changes to the process. However, the ever-shortening tenure of an average chief executive officer (CEO) was seen as more of a threat than an opportunity – a new CEO may be in the best position to make radical changes but he/she may be unwilling to try a new and perhaps more radical approach to performance management and put their reputation on the line. In any case, culture and attitudes take longer to change than the average time a CEO spends in a job.

Pay and reward structures were seen as by far the biggest influence on people's motivation. Few of the companies had remuneration tied to achievement of budgetary targets – although this is recognised as common practice – acknowledging that it can result in dysfunctional behaviour. It can also lead to budgeting becoming a way of negotiating pay. Instead, in some companies, pay is deliberately linked to other targets. For senior executives, this can be total shareholder returns relative to peers.

The weight of City expectations

As part of the wider debate about the purpose of budgeting, one of the main issues discussed was the relationship between the numbers contained in budgets and forecasts and those disclosed formally – and signalled informally – to capital markets and to City analysts in particular. Does the pressure of City expectations and the desire to meet them mean that there is a risk of a gap between the two?

Internal forecasts – which are often 'stretch' targets used to motivate and sometimes incentivise employees – could become the basis of what is communicated to analysts and therefore of analysts' own predictions. It is not difficult to imagine a situation in which a company feels under pressure if those targets are then not reached.

Alternatively, the opposite could happen with companies deliberately communicating a lower figure to the City to ensure forecasts are met. Either way, there is potential mismatch.

Few companies would admit to artificially smoothing their earnings to meet analysts' forecasts yet research has shown that this happens on a regular basis. Short-term actions can often produce the results to meet profit expectations. If that fails, anything from mild cosmetic enhancements to aggressive earnings management can be used to get the 'right' number.

The participants were unanimous in saying that there needs to be a clear line of sight between the numbers used to run the business and those communicated externally. They argued that if the analysts' forecasts differ wildly from their own, companies need to understand why and act immediately to correct any discrepancies. Management credibility is rooted in good communication with the City and the key is to be honest and realistic.

Despite this, there was an admission that the way companies control their relationship with the City has become an important part of their overall strategy. The dynamics of relationships has changed, with investors – and other stakeholders – becoming more demanding.

The participants conceded that external expectations, chiefly from analysts and fund managers, always play a part in how companies are managed. This is, to a certain extent, inevitable as long as those expectations do not end up being translated into unrealistic internal targets. The onus is on companies to communicate with honesty and integrity. The resulting trust in management will mean their messages stand less chance of being misunderstood.

Conclusion

Budgeting is evolving, rather than becoming obsolete. Although it has changed, the change has been neither dramatic nor radical. Instead, we have witnessed incremental improvements, with traditional budgets being supplemented by new tools and techniques. Forecasting has become an important tool to manage the continuously

Less centralised budgeting needs a culture of trust and empowerment

Management credibility is rooted in good communication with the City

Investors are more demanding – and companies must have honesty and integrity changing environment. We have also seen a shift from the top-down, centralised process to a more participative, bottom-up exercise in many companies.

It is a pragmatic message that won't appeal to everyone. But those who call for a more fundamental change, including abandoning budgets altogether, should take comfort from the fact that it is precisely their critique that exposed many of the inherent problems of traditional budgeting. It is likely that this inspired at least some of the changes mentioned. As always, instead of following the consultants' or academics' advice by the book, companies pick and choose according to their individual circumstances.

Budgeting is evolving, rather than becoming obsolete – it depends on trust and transparency

There is a real opportunity for finance to raise its game in this area and become more of a business partner by encouraging understanding of budgets across the organisation. There was no consensus about whether the finance function should own or simply facilitate the budgeting process. But the participants thought that its role should be to educate other parts of the organisation about what value-creating decisions are – and how they are not necessarily the same as profit-making ones. It also needs to supply the information and analysis required to support these decisions.

In the end, good budgeting comes down to trust, integrity and transparency. It may not add value directly but, as someone remarked on the night, "there are certain things that can't be achieved any other way". ■

The following companies were represented at the Better Budgeting forum

Allen & Overy LLP	DHL Worldwide Express	Procter & Gamble
Armstrong Laing Group	DIAM International	Rank Hovis Ltd
Atos KPMG Consulting	ESAB	Research International
BAA plc	Ford Premier Automotive Group	J Sainsbury plc
BAT	GlaxoSmithKline	Samsung
BBC	Jaguar	Three Valleys Water
Bellis-Jones, Hill Group	Jarvis	TNT Express Services
Beyond Budgeting Round Table	Land Rover	Unilever
BUPA	Partners for Change	University of Bristol
Cranfield School of Management	Pelican Shipping Limited	WSP Group plc
Celltech Pharmaceuticals Limited	PGA European Tour	

PRESENTATION 1

Driving value through strategic planning and budgeting

The first presentation was given by **Dr Mike Bourne**, director of the Centre for Business performance at Cranfield School of Management. He described recent studies by Cranfield into the budgeting processes of major European organisations.

In 2001, Cranfield University teamed up with Accenture's Finance and Performance Management Service line to undertake a large worldwide review of planning and budgeting. They focused on 15 companies in the US and Europe which had already made adjustments to their budgeting practice. In addition, the researchers reviewed over 100 academic and practitioner books on the subject.

The results showed a widespread dissatisfaction with the budgeting process (see box, right). The catalogue of complaints was the usual one: the process was too time consuming, too costly, too distorted by gaming, too focused on cost control and so on. Most significantly, budgeting seemed almost totally divorced from the company's overall strategic direction.

Criticisms of the budgeting process

- Budgets are time-consuming and costly to put together.
- Budgets constrain responsiveness and flexibility and are often a barrier to change.
- Budgets are rarely strategically focused and are often contradictory.
- Budgets add little value, especially given the time required to prepare them.
- Budgets concentrate on cost reduction and not on value creation.
- Budgets strengthen vertical command and control.
- Budgets do not reflect the emerging network structures that organisations are adopting.
- Budgets encourage 'gaming' and perverse behaviours.
- Budgets are developed and updated too infrequently, usually annually.
- Budgets are based on unsupported assumptions and guesswork.
- Budgets reinforce departmental barriers rather than encourage knowledge sharing.
- Budgets make people feel undervalued.

The aim of the research was to try and establish what constitutes best practice in planning and budgeting in those companies that have already made adjustments to their processes. Unsurprisingly, the researchers found that there was no uniform view – instead, companies reported a variety of approaches and reform priorities. Some are managing without budgets, some are separating budgeting from re-forecasting, some are aiming for fast closing, and so on.

The research team did, however, identify some underlying principles common to all the companies investigated. These are not tools or techniques as such – rather, they seem to represent a more general philosophy and a new approach to budgeting by leading companies, which:

- *have an external focus* – what matters at the end of the day is their performance against competitors, not their results against an already out-of-date budget. The targets are linked to external benchmarks, not past performance, and the incentives are deliberately separated from budgets. This serves to eliminate some of the gaming that blights the traditional budgeting process;
- *are explicitly focused on strategy* – they know that better financial performance ultimately comes from having and maintaining competitive advantage in the market place, not from better financial management in itself. This strategic orientation means that leading companies frequently use strategy-related scorecards designed to measure more than just the financial targets;
- *invest in IT systems which generate a common set of numbers throughout the company* – very often this is not the case and time is wasted trying to reconcile numbers or

Companies have a range of approaches to budget reforms – but there are some common underlying principles get data from different, often incompatible, applications. Creating a single view eradicates the unnecessary duplication of effort;

- *use explicit forecasting models, separate from their financial management systems* – the assumptions underlying those models are made clear at every step of the way. This means they can be changed in response to environmental triggers to produce a new, equally accurate forecast. A company is afforded a higher level of speed and flexibility; and
- *put their efforts into managing future results, not explaining past performance* – they realise that endless scrutiny of past results adds little value. Instead, they try to forecast variances before they occur and focus on taking actions that really do drive value. Many of those actions will be non-financial, which highlights the limitations of traditional budgeting.

The research is critical, but does not call for abandonment of budgets

Even when all the above elements are present, the researchers point out that real change will be unachievable without a high degree of trust. Under the old budgeting system, control was exercised by business units and divisions reporting their actual performance and variances and the head office used this information to predict year-end results. By contrast, leading companies now trust their managers to tell them what they will achieve.

Finally, although the research as a whole is critical of the budgeting process, the project does not amount to a call to abandon budgets altogether. Instead, it highlights the level of improvement that can be achieved even with relatively simple modifications and a great deal of trust. ■

For further information, see: www.som.cranfield.ac.uk/som/cbp/Research_Report.pdf

PRESENTATION 2

The 'beyond budgeting' journey towards adaptive management

Dr Peter Bunce, director of the Beyond Budgeting Round Table, Europe, outlined the reasons for looking further than traditional methods of performance measurement and management.

BBRT suggests that budgets are a 'relic from an earlier era'

The Beyond Budgeting Round Table (BBRT) is at the centre of a movement to help organisations continuously improve their performance in a business environment that is market led, highly competitive and unpredictable, and in which intellectual capital is the key strategic resource. It has been in existence since 1998 with its origins in the UK, but it now has many members from the rest of Europe, the US and Australia.

The BBRT is the combination of a new concept ('beyond budgeting') and a community ('round table'). The BBRT community is an independent research collaborative that shares its knowledge across its global network through conferences and workshops.

The BBRT starts off with the same catalogue of complaints about the failures of budgeting as some of the other studies – it is too time-consuming, too expensive and completely out of tune with the needs of today's managers. Because it contains a mix of fixed targets and financial incentives, it drives people to behave in ways that may be at odds with the needs of the organisation.

The BBRT also warns that budgets are a 'relic from an earlier era'. The problems they cause will be particularly acute in companies that are trying to move away from the command and control culture and become more flexible. In a way, the budgeting process acts as a protective shield blocking any attempt to change.

The BBRT maintains that 'better budgeting' is not an answer – it merely speeds up the current flawed process and perpetuates the 'fixed performance contract' and centralised control.

The BBRT solution is radical – the only way the inherent contradictions of the budgeting process can be resolved is by scrapping it altogether. It goes on to cite a number of companies that have 'broken free from the shackles of budgeting and its culture of gaming and misinformation'. They no longer produce an annual detailed plan determining the allocation of resources or what the business units need to make or sell. Neither do they use such a plan for performance evaluation and rewards. They have abandoned the fixed performance contract, where individual incentives are based on the achievement of fixed targets.

BBRT research into these companies has resulted in two sets of principles that define adaptive performance management (see box, right). The first six 'process' principles support adaptive management processes that enable enterprises to be more responsive to their competitive environment and customer needs. The second six 'leadership' principles support greater devolution of responsibility to teams accountable for improving customer outcomes relative to peers and competitors.

The organisations that have 'gone beyond budgeting' have an implicit performance contract with rewards given with hindsight based on relative measures (compared to the competition and the market) rather than fixed targets. This relative improvement contract is underpinned by the six key adaptive process principles.

The practical implementation of these principles effectively leads to the transfer of responsibility from the centre to individual business units. The aim is to enable and encourage local decisions, where employees are free to both make mistakes and find solutions.

For such devolution of responsibility to work, there needs to be a great deal of trust at all levels of the organisation. This is not dissimilar to the notion of trust flagged by the Cranfield University research. But BBRT maintains that trust and the resulting empowerment – where staff are free to exercise discretion – are not possible with budgets still in place, because the entire system perpetuates central command and control.

Beyond budgeting – principles for adaptive performance management

Process principles

1. Goals	Set aspirational goals aimed at continuous improvement, not fixed annual targets.
2. Rewards	Reward shared success based on relative performance, not on meeting fixed annual targets.
3. Planning	Make planning a continuous and inclusive process, not an annual event.
4. Controls	Base controls on relative key performance indicators (KPIs) and performance trends, not variances against a plan.
5. Resources	Make resources available as needed, not through annual budget allocations.
6. Co-ordination	Co-ordinate cross-company interactions dynamically, not through annual planning cycles.

Leadership principles

1. Customer	Focus everyone on improving customer outcomes, not on meeting internal targets.
2. Accountability	Create a network of teams accountable for results, not centralised hierarchies.
3. Performance	Champion success as winning in the marketplace, not on meeting internal targets.
4. Freedom to act	Give teams the freedom and capability to act, don't merely require adherence to plan.
5. Governance	Base governance on clear values and boundaries, not detailed rules and budgets.
6. Information	Promote open and shared information, don't restrict it to those who 'need to know'.

Many companies that have gone 'beyond budgeting' use rolling forecasts in addition to performance contracts. The forecast is created every few months and rolls beyond the year-end, so differs from a budget in that it doesn't impose a fixed 'finish line' at the end of a fiscal year. It is based on a few key variables (or 'key performance indicators') that can be compiled quickly and accurately, resulting in a more flexible and timely forecast.

> Many companies that have moved 'beyond budgeting' use rolling forecasts

Targets and goals are not embedded in such a rolling forecast. The forecast shows what will happen, based on certain facts and assumptions. Management then have to compare this to the targets and goals to ascertain the gaps and determine how these are to be managed.

BBRT is keen to stress that going 'beyond budgeting' is not about new 'tools' or 'techniques'. It is a management philosophy based on a set of principles developed from real cases leading to adaptive performance management.

Going beyond budgeting is a management philosophy

The tools already exist – eg, balanced scorecards, rolling forecasts, customer relationship management, benchmarking, shareholder value models, enterprise wide information systems and activity based management amongst others. But by and large, they have failed to deliver on their promises because the underlying processes haven't been changed to accommodate them.

The potential of those models has, in effect, been 'neutralised by the powerful antibodies of the budgeting immune system. Budgeting, perhaps more than any other process, defines the cultural norms inside an organisation.'

There is no simple recipe to implement 'beyond budgeting'. The steps chosen will depend on each company's culture, structure, history, IT infrastructure and so on. But there are lessons to be learnt from the pioneers. In many cases, it is simply about managing change – building and selling a case and creating a shared vision for the future. ■

For further information, see: www.bbrt.org

PRESENTATION 3

Beyond budgeting or better budgeting?

The final presentation was given by **Dr Stephen Lyne**, senior lecturer in accounting and management at University of Bristol, and **Professor David Dugdale**, professor of management accounting at University of Bristol. They presented the results of their recent survey into attitudes towards budgeting.

The survey investigated the current use of budgets in medium and large companies. It attempted to identify the changes that have taken place over the last five or so years, against the background of the debate about the merits of budgeting.

Criticism of budgeting is primarily made by non-financial managers

Some experts have mounted wide-ranging critiques of the manner in which budgeting systems are typically implemented. The process can often be bureaucratic and expensive, budgeting can fail to meet the needs of managers in competitive environments and budget systems can lead to managerial 'gaming' of the numbers. In practice, recommendations to go 'beyond budgeting' often involve virtually abandoning budgeting. These criticisms are primarily made by non-financial managers who have to 'suffer' at the hands of management accountants persisting in implementing outdated budgeting procedures.

This project found little evidence to support these views. There seems to be no widespread dissatisfaction with traditional budgeting. Instead, managers generally see budgets as important, especially for planning, control and evaluation. There is also a high degree of agreement between financial managers (FMs) and non-financial managers NFMs) on the role and importance of budgeting.

The research project was based on a survey mailed to companies in the South-West of England. By concentrating on companies where the financial manager was a member of Bristol Centre for Management Accounting Research (BRICMAR), an overall response rate of 40.1% was obtained.

Perceptions of the importance of budget uses by 40 financial managers

	Not very important or almost irrelevant (%)	Fairly important (%)	Very important or extremely important (%)
Overall	**5.1**	**23.1**	**71.8**
Planning	2.5	25.0	72.5
Control	5.0	20.0	75.0
Co-ordination	17.5	37.5	45.0
Communication	17.5	35.0	47.5
Authorisation	10.0	40.0	50.0
Motivation	37.5	30.0	32.5
Performance evaluation	12.5	22.5	65.0

A completed questionnaire was requested from both a financial and a non-financial manager in each company. In 40 companies a finance manager responded and in 21 of these a completed questionnaire was also received from a non-financial manager.

The first research question sought to determine whether FMs and NFMs had different attitudes to budgeting in their companies. The overwhelming yet surprising finding was that these two sets of managers gave very similar answers throughout the questionnaire.

The only significantly different responses related to the time consuming nature of budgets and their realism and importance:

- FMs agreed more strongly with the statement that 'budgets are too time-consuming for the results achieved'; and
- NFMs agreed more strongly that 'budgets are unrealistic' and 'budgets are too inaccurate: more resources and technology needs to be devoted to them'.

Perhaps these results reflect the fact that FMs actually do most of the work in preparing, disseminating and updating budgets. NFMs do not necessarily see budgets as overly time-consuming and counterproductive.

All 40 FMs confirmed that their companies set budgets, typically starting the process four to six months before the start of the financial year. Some 80% agreed that there were frequent revisions to the budget during the budgeting process. More than 90% reported both month and year-to-date figures showing budgets, actual results and variances. Fewer reported results for the previous year although 80% showed some past year data for comparison (either actual figures, variances or both). About 75% of the respondents also reported that their companies provide some estimate of the out-turn for the current financial year.

The chosen sample of FMs revealed a near universal view that budgets are important (see box, above). However, budgets can still have unfortunate consequences and, in view of the bad press that budgeting has received in recent years, it might be expected that managers would be unhappy with their budgeting systems on a number of counts. But the results do not support such expectations. Around 55% of respondents reported some form of change in the past five years and a number of themes emerged from their written comments, eg:

- greater involvement of junior management in budgeting processes;
- more detailed analysis; and
- intensification of the use of budgets.

In only one company did there seem to be a less intensive approach to budgeting with monthly sales targets abandoned in favour of

Financial managers say that budgets are important – and most report changes to the process in the last five years a six monthly target. This was intended to encourage managers to maximise monthly sales (rather than simply meet the budget). These results seem to be in direct contrast to the BBRT critique.

The importance of standard costing and variance analysis seems to be diminishing

Budgeting has become more important in recent years, as have a number of 'modern' ideas, such as the balanced scorecard. The survey also suggests that the importance of standard costing and variance analysis seems to be diminishing. However, while traditional budgeting is now more likely to be combined with increased use of non-financial indicators, its demise seems unlikely.

The researchers suggest that budgets can be analysed on two dimensions: implementation, control and evaluation; and planning. Also, negative attitudes to the consequences of budgeting can be analysed on six dimensions: bureaucracy; poor culture; gaming; rigidity; causing conflict between realistic and challenging targets; and having a historical, constraining orientation.

This analysis also identified four dimensions in respondents' attitudes to certainty/uncertainty: certainty of actions; certainty of outcomes; uncertainty of outcomes; and uncertainty in the environment.

The authors point out a number of associations:

Satisfaction is greatest where budgets are taken seriously

- in competitive, uncertain situations junior managers were more likely to be involved in budgeting processes. In relatively stable environments junior managers were less likely to be involved;
- the dangers of excessive centralisation were flagged by a strong correlation between top management driving the budget process and perceived bureaucracy and the inhibition of junior managers;
- there was a significant correlation between sophisticated IT and top management driving the budget. However, there was also a positive correlation between sophisticated IT and both the involvement of junior managers and multiple budget iterations. The researchers conclude that IT can facilitate greater managerial involvement and a more complex process;
- in relatively predictable environments budgets are likely to be more important for control (not planning) and managers tend to disagree with pejorative statements about budgeting; and
- when there is more uncertainty, budgets become less important for control and more important for planning. A realistic budget is sufficiently challenging to managers. There are likely to be more iterations during preparation of the budget and, perhaps because of this, greater scope for managerial gaming.

The researchers identified significant correlation between managers' satisfaction and certain contingent variables:

- satisfaction was greatest in stable environments where budgets were taken seriously, especially for control and evaluation; and
- conversely, satisfaction was lower in more uncertain situations and when the budget process was perceived to be bureaucratic or the cause of de-motivation and a culture of blame.

In the light of the findings, one can imagine two 'ideal types' of budget process:

- in stable circumstances, the budget might be prepared efficiently with few iterations and little junior management involvement. There may be dangers in excessive centralisation; and
- in competitive, uncertain situations, the budgeting process might involve several iterations with greater involvement of junior managers. There may be dangers of complexity and gaming. ■

A full working paper on which this briefing paper was based can be accessed at the BRICMAR web site: www.ecn.bris.ac.uk/www/ecsrl/bricmar.htm

Bibliography

Accenture and Cranfield School of Management (2001) *Driving value through strategic planning and budgeting*, www.som.cranfield.ac.uk/som/cbp/P&B%20Report.pdf

Ahmad, N N M, Sulaiman, M, and Alwi, N M (2003) *Are budgets useful? A survey of Malaysian companies*. Managerial Auditing Journal, vol 18 no 9.

Barrett, R (2003) *The search for prophet ability.* Financial Management, June.

Barrett, R (2004) *Traditional budgeting tools may not be enough*. Faculty of Finance and Management of the ICAEW, January.

Bourne, M, Neely, A and Heyns, H (2002) *Lore reform.* Financial Management, January.

Carlson, B and Palaveev, P (2004) *Budget brawn*. Journal of Financial Planning, March, vol 17 no 3.

Cassell, M (2003) *Can we budge it? (beyond budgeting).* Financial Management, November.

Fanning, J (2000) *21st century budgeting*. Faculty of Finance and Management of the ICAEW.

Gahagan J (2003) *Reaching for financial success (integrating budgeting, planning and other systems).* Strategic Finance, November, vol 85 no 5.

Gould, S (2003): *Beyond budgeting: blowing up the budget*. Insight, April. www.cimaglobal.com/newsletters/archives/bb.htm

Hope, J and Fraser, R (2003) *Beyond budgeting: how managers can break free from the annual performance trap*. Harvard Business School Press.

Hope, J and Fraser, R (2003) *Who needs budgets*. Harvard Business Review, February.

Howard, M (2004) *Go figure*. Financial Management, March.

Hunt, S W (2003) *Tactical issues & best practice solutions in budgeting*. Financial Executive, December, vol 19 no 9.

ICAEW (2003) *Prospective financial information – guidance for UK directors*, available as PDF at www.icaew.co.uk/bettermarkets, or printed copies from 020 7920 8634.

Jensen, M C (2003) *Paying people to lie: the truth about the budgeting process*. European Financial Management, September, vol 9 no 3.

Meall L, (2003) *Bye, bye budget (budgeting software)*. Accountancy, September, vol 132 no 1321.

Neely, A (2002) *Business performance measurement*. Cambridge University Press.

Neely A, Bourne M, and Adams C, (2003) *Better budgeting or beyond budgeting?* Measuring Business Excellence, vol 7 no 3.

Prendergast, P (2000) *Budgets hit back*. Management Accounting, January.

Prendergast, P (1997) *Budget padding: is it a job for the finance police?* Management Accounting, November.

Prickett, R (2003) *Beyond budgeting case study 1: the private company*. Financial Management, November, p24.

Smith PT, Goranson C A, and Astley M F (2003) *Intranet budgeting does the trick*. Strategic Finance, May, vol 84 no 11.

Steele, R and Albright, C (2004) *Games managers play at budget time*. MIT Sloan Management Review, Spring, vol 45 no 3.

Vuorinen, I (2004) *The evolvement of organisational control systems*, paper presented at the 27th Annual Congress, European Accounting Association, Prague, 1-3 April 2004.

About the Faculty

The Faculty of Finance and Management is one of five specialist faculties established by the Institute of Chartered Accountants in England and Wales (ICAEW) and caters for the professional needs of members working in industry and commerce and practising as consultants in this field. We offer members up-to-date business ideas, the latest management tools, techniques and information from an independent viewpoint, to help them be effective and to continue their professional development.

For further information visit:
www.icaew.co.uk/fmfac

About CIMA

The Chartered Institute of Management Accountants (CIMA) represents financial managers and accountants working in industry, commerce, not-for-profit and public-sector organisations. Its key activities relate to business strategy, information strategy and financial strategy. CIMA is the voice of over 80,000 students and 62,000 members in 155 countries. Its focus is to qualify students, to support both members and employers and to protect the public interest.

For further information visit:
www.cimaglobal.com

The Chartered Institute of
Management Accountants
26 Chapter Street
London SW1P 4NP

Telephone: +44 (0)20 7663 5441

www.cimaglobal.com

The Faculty of Finance and
Management, ICAEW
Chartered Accountants' Hall,
PO Box 433, Moorgate Place,
London EC2P 2BJ

Telephone: +44 (0)20 7920 8486

www.icaew.co.uk/fmfac

Better Budgeting

... is produced on behalf of CIMA and the ICAEW Faculty of Finance and Management by Silverdart Ltd, Unit 211, Linton House, 164-180 Union Street, London SE1 0LH. Tel: 020 7928 7770; fax: 020 7928 7780; contact: Alex Murray or Gabrielle Liggett

TECPLM3227