How do you manage your budgeting process? Can you look beyond the legacy?

THE INTRODUCTION:
The client in question is a group entity of a global giant leading in power and energy management solutions. It operates in three business categories: power electronics, automation, and infrastructure and has three manufacturing facilities with a strong presence across India.

THE PROBLEM:
The company seeks to make its budgeting framework more realistic and practical. Accordingly, the requirement is to review its budgeting process comprehensively along with other controlling aspects so that the differences between budgeted and actual values can be minimised.
Furthermore, re-configuration of the budgeting framework into the SAP-ERP system (SAP-FI-FM) is also needed to enable its alignment with the SAP system.

THE SOLUTION:
Budgeting is the tactical implementation of a company's strategic plan to deliver financial and operational goals. An organisation needs to translate its long-range strategic plan into a detailed set of expected revenues and expenses that can be measured to track performance. Therefore, performance analysis becomes easier as goals are to be achieved within a predetermined period which is reflected through budgets as roadmaps.
The management can deliberate on deviations from budgeted targets, and remedial action can be taken promptly in case of significant variations. Thus, budgets ensure that the company's income is carefully spent and appropriately invested to achieve the desired business outcomes.

The following processes give a bird's eye view of budgeting activity in the company in question:

- **Analysing management objectives:** The company follows a top-down approach [1] in budgeting; as a result, the management perspective is of utmost importance. The level at which the management sets goals is based on various factors, including the previous year's business trends, analysing changing market scenarios like market demand, acceptability, technology innovation, commodity pricing, etc., and availability of skilled manpower.

- **Analysing sales:** Top-line feasibility is of utmost importance in deciding the sales target. Therefore, these figures are determined after brainstorming relevant factors, such as sales volume, sales trends, product profitability, production capacity, product portfolio, selling and distribution channels, market research, pricing policy, advertisement and sales promotion policy, etc.

- **Analysing raw material consumption**

The raw material cost is decided based on the trend analysis and commodity pricing anticipations in line with the revenue budget. Further, extensive back calculations can also be performed to derive procurement requirements using the material bill of materials (BOMs). Therefore, accurate material consumption can be predicted based on sales orders and material requirement planning (MRP) functionality.

- **Analysing conversion cost**
  Conversion cost primarily consists of two costs – direct labour and manufacturing overheads. The factory labour cost is computed based on the production labour hours required to achieve the revenue targets. Trend analysis and inflation impact on the wage increase also play an important role in arriving at the exact figure. In addition, the indirect cost (overheads) relating to production is based on previous years' trends and any additional specific expenses projected for the current year's estimates.

- **Analysing employee headcount**
  Headcount requirements are analysed at all levels of the organisation based on the existing business and new opportunities/ prospects. The organisation chart – employees - are linked with the responsibility and profit/ cost centres. Based on the estimated headcount, the cost is budgeted.

- **Analysing administrative costs and selling and distribution costs**
  These costs are generally linked to revenue. Therefore, they are computed based on past trend analysis and future forecasts relating to inflationary conditions and new business opportunities (new contracts in the pipeline).

- **Analysing the current year's budget estimates with the previous/ current year's actuals**
  Variance analysis of different budgeted items with the actuals is performed regularly and reported to the management. Significant variances are resolved. The revised estimates are then monitored so that further escalations can be avoided.

THE RESULTS:
After in-depth deliberations and continuous collaboration with the client for over a month, our team at Chandra Wadhwa & Co. developed a detailed-oriented budgeting support system to help determine more accurate budgets. Major actions taken in this respect were:

- Identification of areas that are not considered in the budgets
- Inclusion of Inventory obsolescence provision in the budget
- Inclusion of Notional Finance costs in budget comprising 8% of (Average Accounts Receivables + Average Inventory – Average Accounts Payables)
- Defining responsibility team against budgetary estimates
- Finetuning/ Aligning the general ledger (G/L) accounts with the commitment items in the SAP funds management module.
- Finetuning/ Aligning the responsibility centres with the fund centres in the SAP funds management module.
- Defining funds management tolerance limit messages of **warning at 90% budget usage and error at 100% budget usage**

Budgeted P/L and Ratio Analysis Extract with Responsibility Status

	Description	Responsibility for providing budgetary estimates
A	**Production Value**	**Production Team**
1	Material Cost	Production Team
2	Subcontract FEE - SB	Production Team
3	Conversion Cost	Production Team
	- Direct Labor	Production Team HR Team (Headcount Nos and Rate)
	- Manufacturing Overhead	Production Team Inward Logistic Team Procurement Team Quality Team For IDL - HR Team (Headcount Nos and Rate)
4	Scrap	Production Team
5	Provision	Production Team
A = 1 to 5	**Total Manufacturing Cost**	
B	**Manufacturing Profit**	
	Operating Revenue	**Sales Team**
1	Sales Return & Allowance	Sales Team
2	**Total COGS**	MFG - Production Team Trading - Material Procurement team
3	- Other Cost (excl Warranty)	MFG - Production Team Trading - Material Procurement team
4	- Warranty Cost	MFG - Production Team Trading - Material Procurement team
B = 1 – (2 to 4)	**Gross Profit**	
5	R&D Exp	R&D Department HR Team (Headcount Nos and Rate)
6	Selling Exp	Sales Team Outward Logistic Team HR Team (Headcount Nos and Rate)
7	Management	Administration, Facility, Corp Management Team HR Team (Headcount Nos and Rate)
8	SDE-Corp	Finance, IT, Legal, HR, Support and Shared function team HR Team (Headcount Nos and Rate)
9	GSA Non-Region	Globe Team for all related shared burdens to the IND company
(5 to 9)	**Operating Expense**	
10	Non-OP Income	Finance team
11	FINANCIAL COST	Calculated field - By System itself

	Description	Responsibility for providing budgetary estimates
B – (5 to 9) + 10 – 11	**Net OP Profit**	
	Ratio Analysis	
	Return on Net Asset %	Calculated field - By System itself
	SCRAP OF WIP	Production team
	Q Cost; % of Net Sales	Quality Team
	Overdue AR; Aging Days	AR Team
	AR; Turnover Days	AR Team
	AP; Turnover Days	AP Team
	Stock & Turnover Days	Sales and Production Team
	Cash-to-Cash Conversion	Calculated field - By System itself
	Fixed Assets	Finance Team
	DL Cost; Headcount	HR
	IDL Cost; Headcount Production	HR
	IDL's Cost; Headcount Admin, Management etc.	HR
	IDL's Cost; Headcount - Sale	HR
	IDL's Cost; Headcount - R&D	HR
	Total Headcount; DL/IDL Rate	HR

FOOTNOTES

1. ^ Understanding the budgeting approaches:

- Top-Down
This process involves the creation of the budget by the company's senior management based on the company's objectives. The departmental managers are assigned the responsibility for its successful implementation. Every department can create its budget based on the company's broader budget allocation and goals.

This approach's advantage is that the lower management saves time and has a ready-made budget. They hardly participate in the preparation of the central budget. The senior managers' experience, coupled with past-performance figures, comes in handy in such budgeting processes.

- Bottom-up

This budgeting process starts at the departmental level and moves to higher levels. First, every department within the company must prepare plans for its proposed activities for the next budget period and estimate the costs it will incur. Then, these individual budgets are combined to create a bigger all-inclusive budget.

The budgeting process with this approach can be lengthy and time-consuming. However, employees and managers are more motivated to achieve the budget goals since they have prepared them. They have complete knowledge of what the budget expects them to do and how to achieve that. Therefore, such budgets tend to be more accurate and closer to the actual situation.

FREQUENTLY ASKED QUESTIONS:

Q. What is budgeting process management?

A. Budgeting process management is the process of planning, creating, and implementing a budget for a company. It involves setting financial goals, analysing expenses and revenue, creating a budget plan, and monitoring progress towards financial goals.

Q. Why is it important to manage the budgeting process?

A. Managing the budgeting process is important because it helps companies achieve their financial goals, maintain financial stability, and make informed business decisions. By managing the budgeting process, companies can identify areas where they can reduce costs, optimise spending, and increase revenue.

Q. What are some challenges associated with traditional budgeting processes?

A. Traditional budgeting processes can be time-consuming, complex, and prone to errors. They may also rely heavily on historical data and assumptions, which may not accurately reflect current market conditions or business needs. Additionally, traditional budgeting processes may need more flexibility, making it difficult for companies to adjust to changes in the business environment.

Q. What is legacy budgeting?

A. Legacy budgeting refers to the traditional, time-consuming, and complex budgeting process that relies heavily on historical data and assumptions. It often lacks flexibility and may not accurately reflect current market conditions or business needs.

Q. What are some strategies for managing the budgeting process beyond the legacy?

A. Strategies for managing the budgeting process beyond the legacy include implementing rolling forecasts, using data analytics to make informed decisions, involving multiple stakeholders in the budgeting process, and adopting a continuous planning approach. These strategies can help companies increase agility, optimise spending, and make more informed business decisions.

Q. How can technology be used to improve the budgeting process?

A. Technology can improve the budgeting process by automating routine tasks, providing real-time data analytics, facilitating collaboration and communication between stakeholders, and allowing for more accurate forecasting and scenario planning. By leveraging technology, companies can streamline the budgeting process, reduce errors, and make more informed decisions.