**Should You Revisit Your Forecast as the End of the Quarter Approaches?**

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As they come to the end of the first quarter of the year, many Los Angeles and Southern California business owners may discover that their first-quarter results are significantly less than what they had budgeted. If so, they may be wondering how they're going to get back on track. On the flip side, other owners may discover that they have exceeded budget expectations — and are wondering how they will maintain this positive momentum and keep their managers and employees motivated.

Either scenario points to a business problem that is actually very common, but is rarely acknowledged: the limitations of the traditional budgeting process. In an article published in Harvard Business School Publishing's *Balanced Scorecard Report*, Professor Peter Horvath and Dr. Ralf Sauter detail some of the problems and limitations associated with traditional budgeting:

***The process is inefficient and inflexible.*** It takes too long and consumes too many management resources. In fact, research shows that senior managers spent up to 20 percent of their time and finance departments spend up to 50 percent of their time on budgeting.

***The budget quickly becomes obsolete.*** Due to their annual focus, budgets are often outdated as soon as they're implemented.

***The process doesn't motivate the right behaviors.*** Instead of motivating employees to act entrepreneurially and in the company's best interest, it often fosters bureaucracy and dysfunctional behavior. Also, managers can be motivated to pad expense numbers and lowball revenue and profit targets so their departments look better.

***The process is out of sync with the strategic plan and long-term company goals.*** It emphasizes financial performance over the pursuit of long-term strategy, focusing managers on the next year-end instead of medium-term strategy execution. And managers tend to focus more narrowly on department goals rather than broad company goals.

## Going "Beyond Budgeting"

A better approach is a budgeting process that's referred to as "beyond budgeting." This process takes traditional budgeting several steps further in terms of flexibility, management style, decentralization, and performance measurement.

Going beyond budgeting involves creating a *rolling* forecast, instead of the static annual budget that is traditionally prepared by most companies. Such a rolling forecast uses quarterly financial results to update a forecast that goes out for five or six quarters. Every three months, the forecast is revised based on the most recent quarter's actual financial and operational results. This enables companies to make more agile spending decisions that are governed by real-time risks and opportunities, not by an outdated document that was prepared more than a year ago and is now essentially obsolete.

 

In essence, the rolling quarterly forecast becomes a living, breathing document that more accurately reflects the realities that are occurring in your business right now, rather than the "best guesses" made months ago by managers and department heads that were based on assumptions that may have already proven to be inaccurate. The benefits include aligning the budget with your company's overall strategic plan, more flexibility in adjusting goals based on actual results, the ability to make better decisions that are based on up-to-date results, and having more time to spend on forward-looking strategic planning.

To create a rolling forecast, you will do detailed monthly forecasting at the account level only for the next quarter, not for the entire year. Quarterly forecasting is done on a more broad basis for the next four or five subsequent quarters. At the end of each quarter, a new and updated forecast is prepared for the next three months, based on the current financial picture — or in other words, what really happened over the last three months. Subsequent quarters' forecasts are also updated, but not in detail.

Another thing to keep in mind with regard to rolling forecasts is the importance of not falling into the common trap of planning to your budget, instead of budgeting to your plan. Budgeting-to-plan involves making spending decisions based on your current and projected budget, rather than on the potential opportunities your spending decisions might yield.

**Switching is a Process**
Making the switch from traditional budgeting to rolling forecasting will be a process — it's not something that usually happens overnight. Therefore, you should carefully examine how the switch will affect the budgeting and forecasting process, target setting, resource allocation, and incentive compensation plans. Other areas to examine are how it might affect the way teams and departments interact, changes to team and individual accountability, and modifications to the company's overall mission.

In the *Balanced Scorecard Report* article, the authors question whether or not the traditional budgeting process will survive in the 21st century. Citing Peter Drucker's observation that corporations of the future will be held together and controlled by strategy, rather than along product and service lines, they predict that management systems of the future, including budgeting, will be completely different from the "traditional, detail-oriented, bureaucratic system developed nearly a century ago."

**Concluding Thoughts**
If your first-quarter results are significantly less than what you had budgeted, or if you have exceeded your budget expectations, you may be coming to realize the limitations of the traditional budgeting process. A better approach is to go "beyond budgeting" by creating a rolling forecast, instead of the static annual budget that is traditionally prepared. An outsourced CFO services provider can help you make the transition from traditional to rolling forecasting and budgeting.

**About CFO Edge**
CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 Ext 101.