

WILEY CORPORATE F&A

HANDBOOK OF BUDGETING

Sixth Edition

WILLIAM R. LALLI, CPA

Handbook of Budgeting

Sixth Edition

WILLIAM R. LALLI

Editor

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The Wiley Corporate F&A series provides information, tools, and insights to corporate professionals responsible for issues affecting the profitability of their company, from accounting and finance to internal controls and performance management.

Foreword

The idea of budgeting often brings fear, even loathing, to the minds of most persons. Perhaps that is because many of us were first introduced to the term by trying to figure out how to spend our seemingly unfairly small “allowances” as children. It was not easy to figure out how much candy we could buy and still go to the movies on the weekend. These days our children buy more movies (and video games) than they attend, but the principles (and the sweets) are the same.

In its simplest sense, budgeting is any plan, usually expressed in financial or mathematical terms. As an expression of expectations, a budget generally aligns resources with needs to accomplish a specific goal. As mileposts and measuring sticks, budgets provide invaluable benchmarks that can be used every day in reacting to management challenges.

Some see budgets as a necessary evil, but in reality they are underrated tools that can greatly enhance any business process.

The greatest value of budgets—arming management with key decision-making tools—is often overlooked. To the uninitiated, a budget succeeds or fails based on how close actual results compare to expectations. While it is great fun to predict the future accurately, to win a bet as they say, life’s best lessons are often learned in analyzing why you were wrong.

In reality, analyzing the reasons actual results differ from expected results is a far more useful tool than the often disappointing attempt to accurately predict the future. This cannot be done effectively without a budget to compare things to. Like the weather, financial futures are difficult to predict and sometimes correlate only with predictions as result of an accident, good luck or otherwise. Were these assumptions wrong? Were needs incorrectly calculated? Did the business environment change? Did the world change? Was a better method or process discovered? Were there unanticipated challenges? By studying what is different and the reasons for differences, we can continually improve both performance and our ability to predict the future. We have certainly come a long way in improving our ability to predict the weather, but expectations for accuracy have also increased. Similarly, the art and science of budgeting has advanced dramatically over the years since the handbook was first published. Revisions in this edition reflect alterations and improvements comparing these budgets to older ones.

Budgets are clearly not just for children to manage their allowances and meager earnings. They are not just for big businesses either, as some would incorrectly perceive. Budgets are for everyone.

In modern times, budgets are often (unfortunately) utilized only by midsize businesses when they are in trouble. They would likely be in trouble less frequently if they used budgets more often. Certainly there is less superficial need to manage resources when revenues seem to flow effortlessly well beyond the costs needed to sustain a business. The lack of need in these cases is invariably only superficial; easy money is a fleeting concept. Darwinian pressures on business provide survival only to the fittest and most prepared.

As can be learned by studying the various budgets in this book, time, money, and processes can be budgeted. Planning for the future enhances our understanding of the present. Budgets reduce the chances of repetition of past errors, and while nothing can prevent the commission of new errors or the introduction of new challenges, effective budgeting can lead to the preparedness necessary to deal with adversity and opportunity when either is on your doorstep.

This handbook is a resource that will help you identify the right type of budget to use and which tools to implement in actually completing the budget and provide insight into analyzing your budget against actual expectations.

David A. Lifson, CPA
Crowe Horwath LLP



David Lifson, CPA, is a partner with Crowe Horwath LLP and leads the New York City tax and business consultancy practice, where he develops business strategies and personal financial plans utilizing both his and the firm's broad range of accounting, audit, tax, and business consulting backgrounds, both domestically and internationally. He specializes in advising clients on managing various types of business change within tax, economic, and other related constraints and dealing with the tax compliance challenges that accompany change. This includes starting or closing a business; buying, merging, or selling one; or trying to change or value an existing operation.

Mr. Lifson is the recipient of the American Institute of CPAs 2009 Arthur J. Dixon Memorial Award, the accounting profession's highest award in the area of taxation. He has chaired the Tax Executive Committee, served as a member of the AICPA Board of Directors and on its council, and has chaired or served on various committees, task forces, and technical resource panels over the years. He is also a former president of the New York State Society of CPAs and has served in various capacities on its behalf. Mr. Lifson has chaired the Small Business and Self Employed subgroup of the Internal Revenue Service's Advisory Council (IRSAC) while serving on the council. IRSAC meets regularly to advise the Commissioner of the IRS and key IRS group leaders on how to administer the tax system effectively.

Preface

THE NEED TO IMPROVE YOUR BUDGETING PROCESSES

Despite advances in technology and finance, we have not reached the limit of knowledge or made the most advanced achievements in reaching our financial goals. That is a definition of a frontier that we face in these times.

There are many types of budgeting, and most of them are covered in this book. The need for sound, dependable information as the basis for quality decision making based on reliable budgets, I contend, has never been stronger. That is the reason I proposed revising this book to present this sixth edition of the *Handbook of Budgeting*.

I could report on the state of the economy and economic trends, citing a variety of sources and experts; however, my only point is that in bad times more than in good times, budgeting can be key to an entity's survival or prosperity.

This book is intended as a business tool. I shall leave it to the academicians to analyze what might work better. Instead, our authors present 35 chapters of tried-and-true experiences taken from frontline business exposure that will enlighten you as to how you may incorporate real changes in your environment.

I became the second editor of this book after its founding editor died. One reason I was selected to replace him was due to the extensive work I was doing at the time in the budgeting area for delivering continuing professional education to senior financial executives. One day at a conference, an attendee approached me, realized I was the book editor, and paid me the highest compliment I ever received. She told me that she worked with a copy of the book open on her desk.

There is no outer limit in any field of endeavor, especially one in which the opportunities for research and development have not been exploited. This is the new frontier that must be met with technology and information management in finance in modern times which companies must master in order to survive and prosper. Use every tool at your disposal.

THE FORECAST ON BUDGETING

The *Handbook of Budgeting* has been revised in this sixth edition to retain some "ever-green" knowledge from previous contributors, augmented by new experts on new topics.

More contributions from corporate perspectives translate into more opportunities for you to take this information to your team and to implement the lessons this book contains company-wide.

Chief financial officers, chief information officers, chief operating officers; vice presidents of finance; controllers and assistant controllers; directors and managers of budgeting, forecasting, financial planning, analysis, business planning, strategic planning, performance measurement, and finance; financial consultants; budget analysts; and financial analysts will all find that this book has been designed with their specific needs in mind.

Our contributors and I believe that budgeting is the most important component of an overall dynamic business planning process. When it is combined with available technology, you may quickly analyze its impact on your business, which will lead you to more effective decisions that improve the profitability of your company.

Please note that the term “budgeting” is used in its broadest context and includes the major process components of strategic planning, target setting, operational planning, financial planning, reporting, and forecasting.

According to research referred to in the pages of this book, forward-looking companies spend significantly more time (44 percent of the total time spent in planning) on forecasting and action-planning activities that can actually improve business performance. They also focus on what is important by implementing best practices throughout the planning process.

You will also find information in the *Handbook of Budgeting* on the latest business-planning software that allows you to develop budgets quickly by employing Web-based technology to process information over the Internet. Companies that use the latest technology can also quickly assess the impact to their bottom line based on competition, economic slowdowns, and consumer behavior. Always remember that the consequences of inadequate action planning and forecasting can be severe when a company's performance fails to meet Wall Street expectations.

It is the intention of John Wiley & Sons, Inc., that the *Handbook of Budgeting* will help you to meet the challenges of this new frontier.

William Rea Lalli, Editor

January 2012

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