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How to Build a Budget that Actually Works

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Want to improve your budget results? Try a new approach. We recommend using facts, trends, and other telling data to drive results rather than relying on the same tired process year after year. Here are three strategies that yield better and/or more realistic results for future projections.

1. Zero based budgeting

For everyone who remembers Jimmy Carter, this is not a new approach. The methodology of preparing a budget from zero means that each budgeted amount is based upon projections or assumptions related to the current year. Sales data should be based on number and average size of orders going forward with existing assumptions and seasonality considered. Labor should be based upon the number of Full Time Equivalent (FTE) employees at each level with the traditional allocations of fringe and common service departmental allocations.

2. Industry averages

Comparing your budgeted revenue per employee, growth rate, or spending by category to established industry averages is a great reality check for internally developed figures. This analysis may lead to reconsider your strategic allocation of resources. Finding out that the industry average for Technology or Marketing as a percentage of total spending is 10% higher than your first draft can lead to asking the right questions to keep you more competitive.

3. Backward job costing

Job costing always involved allocating common costs to the jobs performed based upon a unit of measure that best related to the item you were trying to allocate. Payroll expense, direct labor hours and square footage were commonplace factors. Tying yourself to allocating on those factors, however, may not be the best fit for your business. People allocate based upon those factors because that information is easily available. Looking at the budgeting process backwards, by determining what exactly are the best measures to allocate particular costs, will sometimes lead to wishing that you had kept track of a certain metric which you may have never tracked before. For instance, number of returns, average shipment size, average number of hours spent on a warranty claim, direct labor hour differences based upon range of size, number of units shipped, total weight shipped, average customer order, customer etc. Many of these metrics can usually be tracked within your accounting software, and now is the time of year when you can think about what information you would have liked to have available, and implement the tracking mechanism.

Building from the ground up, comparing your results to your competitors, or coming up with better information are three ways to improve your results, make your company "lean", and maximize your resources.