

BYOB: Build Your Own Budget

(Now with Forecasting, too!)

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Areas of Interest

- Not-for-Profit Services
- Construction Services
- Internal Controls Specialist
- Retirement Plan Audits
- Manufacturing Services
- Dealer Services

Budgeting vs. Forecasting: Just Semantics, Right?

Budgeting vs. Forecasting

- Budget (framework): Expectations for a company over time (annual)
 - Estimates of revenue/expense
 - Cash flow expectations
 - Reducing debt
 - Compares the actual result to determine the variance
- Forecasting (activity):
 - Data collecting for future budgets
 - Updated periodically (time or triggering event)
 - Indicates a need to make a change in plans
- Frequently done on the same document

Back to Budget Basics: Methodologies

Budgeting Methods

- Incremental budgeting: Taking last year's actual results and applying a percentage up or down to obtain the current year.
 - Pros: simple and easy to understand; good for when your cost drivers remain constant
 - Cons: Likely to perpetuate inefficiencies by disincentivizing leaders to look for ways to cut costs or economize; creates budgetary slack by incentivizing leaders to overstate needs; ignores external factors in the supply chain that drive activity and performance.

Budgeting Methods

- Activity-based budgeting: Begin with targeted revenue and then determine amount of related expenses to achieve a certain net income
 - Pros: Driven by historical data that is easy to obtain (generally); provides additional key metrics like revenue per program
 - Cons: Can be divorced from cash flow where revenues don't stack up requiring course correction on expenses

Budgeting Methods

- Value proposition budgeting: method centers around three key questions
 - Why is this included in the budget?
 - Does this item create value for constituents, staff, the board, and community/stakeholders?
 - Does the value of the item outweigh its cost? If not, is there another reason why the cost is justified?
 - One man's trash is another man's treasure... This is a highly subjective approach, and the final arbiter holds extensive power.

Budgeting Methods

- Zero-based budgeting: starts with the assumption that all program budgets are zero and need to be built each year.
 - Pros: extremely tight process that focuses the organization on essential costs that have a direct impact on program profitability; excellent when there is a need for cost containment like financial restructuring, acquisition, or a global pandemic; frequently weeds out discretionary costs
 - Cons: excessively time-consuming, should be used periodically rather than annually

Budgeting Methods

- Three main types:
 - Imposed budgeting: top-down process where management and the board adhere to organizational goals and imposes goals and constraints on lower levels
 - Negotiated budgeting: a blend between top-down and bottom-up budgeting approaches. Often driven by broad management goals and guidelines but incorporates flexibility for input from managers and staff
 - Participative budgeting: staff and managers make recommendations to management and the board

Controls to Help Prevent and Detect Potential Financial Statement Fraud

- External audit of the financial statements
- Management certification of the financial statements
- External audit of internal controls over financial reporting
- Budget to actual analyses
- Comparison to prior year performance
- Does the management team (not just the CFO) truly understand how to read the financial statements?
- Distribute and discuss financial reports to staff
- Flash reporting and dashboarding: What are our critical metrics, both financial and nonfinancial? What are the critical areas to review?

BYOB: Build Your Own Budget

Step 1: Project Revenue

- Forecast annual, quarterly, and monthly revenues
 - Identify your major revenue sources: grants, memberships, admissions, tuition, parking, contributions, online services, specialty services, nontraditional revenue
 - Layer in industry changes and economic adjustments like COLA
 - Address seasonality: kids out of school (spring break or summer), holiday lights
 - Geography: environmental factors in different locations
 - Consider ancillary services
- Use conservative estimates: will your donor and customer base support projected revenues? Do you have marketing to drive base growth?
- Prior year numbers are a helpful starting point

Step 2: Research Costs

- Begin with fixed costs. Items like rent, utilities, phone, internet, accounting, legal fees, salaries, and advertising/marketing.
 - Consider using average billing for utilities and putting professional services items like accounting, legal, and marketing on retainer for set monthly billing.
- Layer in variable costs like costs of goods sold (inventory, small equipment), hourly labor costs, and commissions.
- Plan for big ticket items like major equipment purchases, vehicles, leasehold improvements, facility construction
 - Often these are part of a CapEx program or funded with loans, but loans have to be repaid and that becomes an additional fixed cost.

Step 3: What are your KPIs?

- Gross profit margin: Gross revenue, less adjustments (AR/AP discounts), less cost of doing business
- Net revenue per program or service
- Budget variance
- Number of new donors
 - Does your organization have a concentration of a handful of wealthy, influential donors? What happens when they die or your organization falls out of favor?
- Average contribution per donor
- Program, fundraising, and management & general ratios
- Inventory, AR, and AP turnover
- Liquidity, current, and quick ratios

Step 4: 12-Month Cash Flows

- Revenue and cash flow are often two totally different things (accrual vs cash basis accounting)
- Allow for payment terms
 - Manage your receivables by collecting cash quickly
 - Utilize payment terms with vendors—discounts for early payment or stretching out payment terms to 60 days instead of paying bills immediately
- Allow for payment methods
 - Make it easy for donors to pay you (online options, merchant services, consider outsourcing billing and collections)
 - Evaluate how you pay your vendors. If there's a finance charge for using a credit card for payment, write a check or ask if they have ACH options that do not carry a charge.
- Plan for timing of big inflows/outflows

Step 5: Adjust for Slow or No Pays

- Extend grace when you can; when you can't, don't.
- Address habitual slow pays before it becomes an issue
- Allow for bad debt
- Create business policies to deal with late payments

Step 6: Adjust for Seasonality

- Research the demand in the industry if you are establishing a new organization
- Build savings during peak periods to cover the lean months (rainy day funds)
- Flex staffing to meet demand and hire appropriately
- Flex hours to meet demand

Step 7: Factor in Industry and Economics

- The only constant is change; be nimble
- When industry or economic disruptions happen, understand the impact on your organization; watch your KPIs
- Consider the overall economic growth, macro and micro
- Stay current through professional reading and business intelligence to adapt to change

Step 8: When and How to Spend

- Identify and benefit from fixed costs where possible
- Utilize a CapEx plan to determine when it is necessary to replace items like laptops, equipment, and leasehold improvements
- Purchasing vs leasing
- Understand how to determine the ROI on significant expenses, i.e. marketing or advertising

Step 9: Discuss Expenditures with Program Heads

- Ensure buy-in from key management personnel
- Identify unique one-off projects
- Tie targets to performance

Step 10: Prioritize Investing

- What to do with excess profits? Invest back into the organization, but where?
 - Training/development
 - Staff expansion
 - Rainy day funds
- Understand both long- and short-term goals
- Utilizing an investment advisor as part of your overall service provider team (investments, legal, accounting/finance)

Step 11: Budget Reviews

- Review budget-to-actual performance at least quarterly
- Understand the impact of over and underperformance
- Utilize dashboards and other graphical elements to communicate impact
- Consult your accountant prior to any significant purchases

Step 12: Have a Plan B

- Understand your industry risks; be aware of changes, new developments, and impactful legislation
- Plan for underperformance
- Again, have a rainy day fund to help smooth out the rough patches
- The risk of loss of a major supplier, vendor, or class of customer is always a present risk
- Review your insurance coverage at least annually as part of the budgeting process

Forecasting Best Practices

Forecasting: Final Notes

- What is the intended end result?
 - Grow, sell, sustain: These determine your KPIs
- Each end result needs its own forecast
- Goldilocks approach: expect best (or worst)
- Not every variable can be addressed; keep the number of assumptions low
- Time is your enemy
- Roll with the punches



Thank you

QUESTIONS?

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