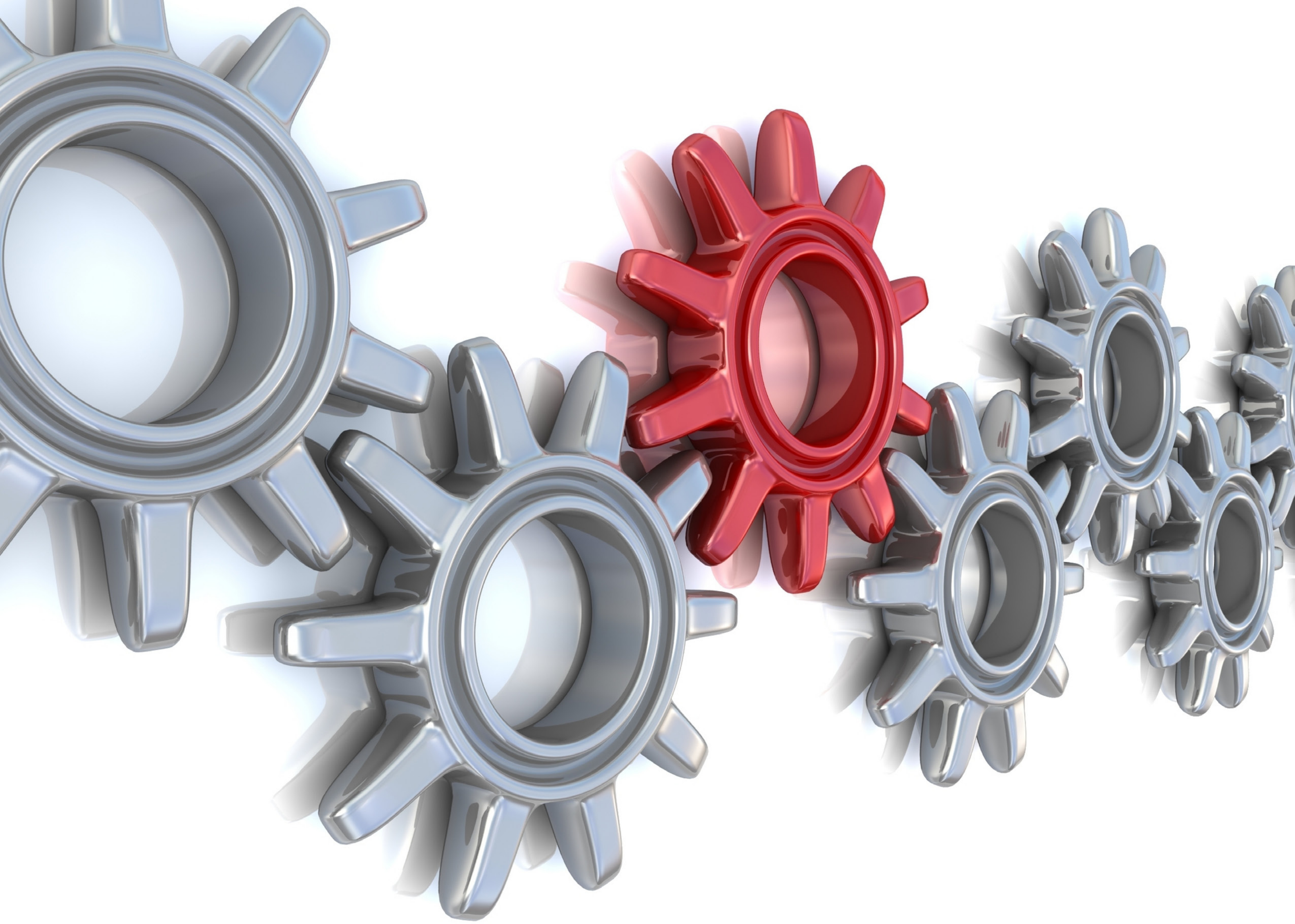
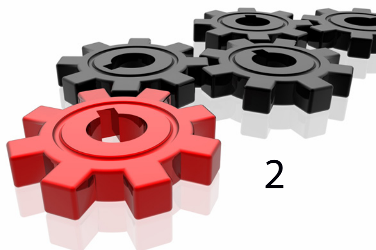


Budgeting for mid-market companies

A Prophix white paper

Contents



Overview/Purpose of this document

Prophix develops software that is used by finance professionals to manage financial processes such as budgeting, financial reporting and financial consolidation. This white paper is an overview of one of those processes – preparing the annual budget. Prophix software is used by finance professionals worldwide and this white paper is intended to share with the reader some of our wide experience in this area.

This document is intended to be an educational document for finance professionals. It is for an audience that may not know anything about the software developed by Prophix or have any detailed technological knowledge. However, it is assumed that the reader has experience with spreadsheets and a basic understanding of accounting.

What is budgeting?

Why companies prepare a budget

Preparing the annual budget is an exercise embarked upon by most mid-sized companies. However, companies produce budgets for many different reasons and it is important to understand why you need to go through the annual budgeting **process.** For example:

> Budgeting is a form of **management reporting and control**. In some countries, financial reporting is regarded as much more important than management reporting and so detailed budgeting is not viewed as essential; its place is taken by higher level corporate planning. However, budgeting at the departmental level is very useful in managing an enterprise and controlling how the company is run and is common in most English-speaking countries.
>
> Budgeting can be an **approval process**. In some companies, budgeting is a very formal process with precise milestones and a well-defined approval process by the Board with possible reworking of the plans if approval is not immediately forthcoming. In others, this is not the case; sometimes the budgets are finalized only after the start of a company's financial year. Most companies are in between these extremes, with senior management approval of the budget towards the end of the previous fiscal year.
>
> The annual budget is often a means of **communication** of forward looking plans to external stakeholders such as banks or potential investors. A well-developed plan gives company management credibility and justifies financing transactions, provided the budget is realistic and validated. Moreover, communicating an annual budget when you are half way through the year is often not enough – in these circumstances, having a regular reforecast for external audiences can be invaluable.

Sometimes, the budget is presented to departmental management as an **approval to spend**. This is usually not a good idea since it can give rise to a 'use it or lose it' culture where money is spent unnecessarily in order to validate having asked for it in the first place and to justify including it in subsequent plans.

This last issue raises an interesting point – how elastic is the plan? If an expense is not in the plan, does a departmental manager have to wait an entire year before getting approval to spend outside the budget? If so, managing a company based on an annual planning cycle can create a sluggish corporate culture that discourages innovation and change. Slavishly working to the budget if your company is sinking can even speed up the downward spiral. This is especially true as technology and rapid changes in consumer preferences speed up business cycles; a year is becoming a long time in the life of an enterprise. However, as we shall see, establishing a well-defined budget can be a first step towards more regular forecasting and planning.

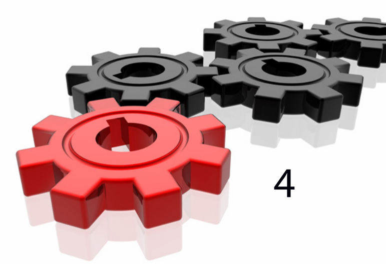
Other types of planning

Besides preparing the annual budget, there are other types of planning that companies commonly implement such as:

Corporate planning. This usually means planning for a company at a relatively high level for multiple years with either annual or quarterly periodicity (i.e. with less detail, or granularity, than a budget). It is associated with strategic planning, which involves not just numerical information but often commentary and long term assumptions about extraneous economic variables. Ideally the budget and the corporate plan are aligned, but one common practise is, after finalizing the budget (which is much more granular and hence, ideally, more accurate), to revamp the corporate plan using the budgeted values for the first year.

Mid-year forecasts. These are similar to budgets in terms of granularity and periodicity but the plan is only for the balance of the year. Some companies go through this exercise every quarter, others every month and others only when business conditions change dramatically (e.g. if the price of an important raw material changes or another company is acquired). Many companies that use spreadsheets for planning find it very difficult to do effective forecasting since they simply don't have the available bandwidth.

Rolling forecasts. This is a way of planning that formally means producing a new plan every month that looks forward for a full year. In practise, many people who use this term really mean that they produce a new plan every month, but not necessarily for a full twelve month horizon. One of the difficulties of true rolling forecasts is that managers are being asked to continually plan for the new month in the forecast. Depending on the industry and the company's growth, this can be very difficult.



Concertina planning. This is a compromise between monthly forecasting for the current year and rolling forecasts. Companies produce mid-year forecasts up until a specified date (usually in the third quarter of the fiscal year) and then expand the forecast to include the whole of the following year. Going forward, monthly forecasting then includes a full plan for the following year, so at budget time the budget for the following year is almost complete.

Operational planning. Most of the planning mentioned above does not delve below the level of detail in the General Ledger. However, more granular planning is often used, to produce a more accurate budget or a timelier forecast. Examples are personnel planning at the level of each individual employee, capital acquisition planning for each capital item, or weekly sales planning.

Budgeting differs from all the above (though operational plans can feed into a budget and mid-year forecasts can be derived from a budget) and is usually recognized as a process that takes place each year (towards the end of the fiscal year) and produces a plan for the following year that is used to determine where to allocate a company's resources. This the 'traditional' type of planning that parallels the General Ledger in terms of the detail or granularity of the plan.

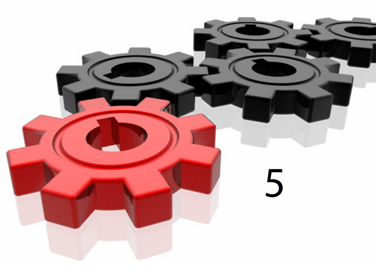
Budgeting calculations

The most basic budgeting usually involves producing a forecast for every combination of department and income statement account in a company's general ledger and aggregating this to company and income statement totals. This can be a simple aggregation of revenues and expenses that are entered manually and reports can easily be produced from the General Ledger. One drawback is that most accounting software, although great for producing Accounts Receivable aging statements, is not great at reporting from the G/L.

Budgeting usually goes beyond a simple aggregation of data. Budgeting can include complex calculations to create a simulation of how the general ledger accounts are related based on certain assumptions. For example, a simple assumption might be that, for every product sales dollar, customers will spend two dollars on associated services. Because of the importance of these types of calculations in budgeting, companies generally build a business model to produce the budget, the output of which is an analog of the General Ledger. The model will contain calculations that define the relationships between accounts in the G/L and this can be developed using spreadsheets or software like that developed by Prophix.

Budgeting can also go beyond the Income Statement to the Balance Sheet and when planning the Balance Sheet it is necessary to perform even more complex calculations. One standard example is how to forecast Accounts Receivable. There is no one correct method. As examples, the A/R balance can be forecast based on days of sales or as percentages of historical monthly billings, but both methods require more than trivial calculations.

Because budgeting is so calculation intensive, it is important that the software you use is extremely flexible. Most people in finance are acquainted with how spreadsheets perform calculations, but there are many types of calculation that are commonly needed in budgeting and that are not easily accomplished in spreadsheets without a lot of manual work.



For example, one common requirement is to plan the budget based on actual data for the previous year. If next year's budget is being prepared in October then one way of forecasting telephone costs is to take the average spend for each of the prior nine months and add factors for inflation and increased staffing levels to give a budget for the next year. This can be refined if the business has significant seasonality. For example, every year sales in Q4 may be higher than in Q3. This calculation methodology may need to be repeated for many combinations of account and department. Doing this in spreadsheets can involve a lot of copying and pasting of both data and formulas.

As well as providing spreadsheet style calculations, Prophix has other calculation options. For example, users can define calculations that will automatically apply to all departments and scenarios – even to new ones that are added later – the calculation results are available with no extra work required. Users can also create new scenarios with adjusted data, perform allocations, and easily make changes to existing data by entering annual figures and having them automatically spread to individual months without the need to enter formulas.

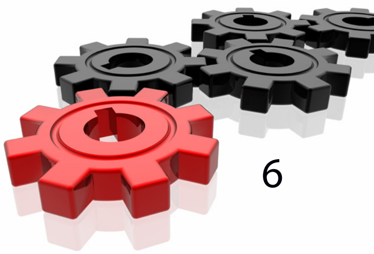
Budgeting processes

Unlike, say, corporate planning, budgeting in most companies is not an exercise performed by a single person. It is highly collaborative and consists of a series of processes performed primarily by the Finance department but also touching other parts of the company. The processes used in budgeting include:

1) Importing historical data (so budgeted values can be validated, or as a basis for the budget).
2) Finance entering or calculating some budget items.
3) Requesting data input from users outside of Finance.
4) Checking in data supplied by users and consolidating it.
5) Calculating metrics, validating and analyzing data.
6) Requesting approval for budgeted data from senior management.
7) Copying data between budget versions for scenario analysis.
8) Distributing reports containing the final budget to users outside of Finance and to senior management.

Not every company performs all of these processes when they produce a budget. In fact, when using spreadsheets for planning, they simply may not have the time.

However, accepting that budgeting is a process gives us a different understanding. At Prophix, when we describe what our software does, we think less in terms of "performing calculations like a spreadsheet" and more in terms of "automating the processes in the Finance department".



The accounting or transactional processes (such as invoicing or paying bills) have been automated for many years by accounting software. Prophix automates the non-transactional processes in finance, such as annual budgeting and monthly financial reporting; these are tasks for which almost every finance department is responsible. The value Prophix adds is that we enable our customers to perform these processes quicker, easier and more accurately.

For example, it is not uncommon for companies' finance staffs to spend months in the annual budget process; this includes designing and preparing spreadsheets, sending them to departmental managers, reminding them when the budget figures are due, receiving the spreadsheets back, copying data between spreadsheets, validating the aggregated numbers, formatting spreadsheets for submission to senior management, and potentially repeating many of these tasks for different scenarios. In many cases, by the time the budget is finalized, there has been no time available to get a handle on whether the plans are credible.

Many companies that use Prophix have gone from a 3 month budget process to one of just 3 weeks. Quite apart from the quantifiable benefits of saving everyone's time, there are other 'soft' benefits such as a more accurate budget that ties in with the company's strategic objectives, better validation of the numbers by understanding whether they are realistic, and plans where excess costs have been trimmed.

Who is involved in budgeting?

Most of the work that is needed to prepare a budget is performed in the Finance department. But other people are involved and it is important to understand where they fit in. It is useful to identify:

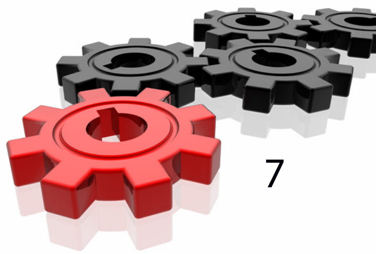
The **timeframes** for the budgeting process; the dates for users to submit their plans and by which the budget needs to be finalized.

The steps in the budgeting **process** - who contributes which data and in what order. The degree of authority that finance has to involve other staff in the process and to adjust data they submit.

The person or persons who have final **approval** of the budget.

The purpose of preparing the budget; it might be used for management reporting to departmental users, as an approval for spending or as a method for communicating the company's plans to external stakeholders.

In some companies, all of the work is performed by finance staff and departmental users have little input; this is sometimes called a 'top-down budget'. In others, any numbers contributed by departments outside of finance is sacrosanct and cannot be changed (a 'bottom-up' budget); the finance staff are merely collectors of data. Most companies do something in between.



Departments outside of Finance generally contribute some budget data, whether sales forecasts or expense requirements. Budgeting is a collaborative process. As well as submitting data, users also need to be kept informed; the ability to produce meaningful reports and analysis (both during the budgeting process and after) is essential. Managers need to see what they are expected to produce in the coming year and senior management need to understand what they have approved.

In most budgeting processes there is the role of an approver or approvers; there is no point in preparing a collaborative plan if there is no agreement. This can be informal, perhaps with a CFO discussing the budget with a single senior executive, or a formal presentation to a board of directors. The two important parts of these interactions are, firstly, to ensure that reports are accurate and contain sufficient analysis and detail and, secondly, to accept that changes will be made and therefore there will be a need to rapidly produce alternative scenarios.

Budgeting challenges

Most people don't like budgeting. In many companies it is regarded as an unpleasant once-a-year chore that has to be done, sometimes reluctantly, often at the last possible time.

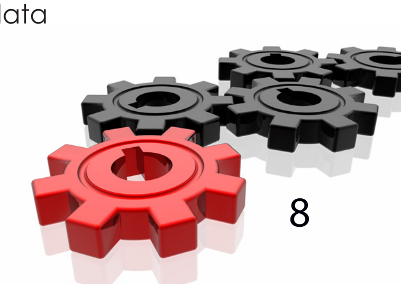
Finance professionals usually don't like budgeting because it is extra work involving major time spent copying and pasting data and formats in spreadsheets. Budgeting with spreadsheets is incredibly labor intensive. In many companies the annual budget cycle takes up to three months of late nights and disrupted weekends. More than one finance professional refers to the budgeting time of the year as 'Spreadsheet Hell'.

This is compounded by the fact that senior management is always asking for more. They want to change the assumptions, add more scenarios ('what-if analysis'), or they may need reports that require the organizational structure or the Chart of Accounts to be modified. Because spreadsheets are not very flexible, all this can take a lot of manual labour and a lot of time.

Departmental users usually don't like budgeting. They often see it as an emotional time when they are expected to justify their expenses and commit to plans for the coming year. The reality is that most people don't like making decisions, especially decisions for which they will be held accountable.

Quite apart from their likes and dislikes, users don't think budgeting is important if it has no value to them. Therefore it is in the interest of the finance department to make budgeting not only relevant but also as easy as possible for people who contribute data in the budgeting process; budget contributors should be expected to expend as little effort as possible and derive the maximum benefit.

The former is accomplished by an easy-to-use system that allows them to enter data how they want, when they want. The latter might appear more difficult, but, if you provide value to end users with relevant, useful reporting and analytics, they are much more likely to accept their involvement in and become closer to the budgeting process. They will feel more involved, with a sense of ownership of the numbers, and hence be more accountable.



The two most important components of a budget

No two companies have the same planning requirements. For example, oil and gas companies can predict quite accurately the volumes of products they will sell from existing wells, but these products are commodities, so they have little control over market prices. In other industries, how products are sold (e.g. directly or through partners) or priced can be very important.

Notwithstanding the above, most companies have two main areas where accurate planning is extremely important. These are **revenues** and **personnel costs**.

If a company could accurately predict sales for a full year in advance then planning would be easy; such a company would never need to overspend and could always be profitable. In reality, revenue planning is one of the most difficult parts of formulating a budget.

How this works varies from industry to industry. Manufacturing industries, for example, may include details of unit costs for multiple cost types such as labor costs or material costs (for companies that have an MRP system it is important to point out that MRP planning usually has a shorter time frame than one year and so differs from budgeting). Wholesalers and retailers may include inventory forecasts as well as sales. For both of the above, revenue planning is regarded as being different from budgeting and the main difference is that preparing a revenue plan often requires a level of detail that is deeper than the accounts in the General Ledger.

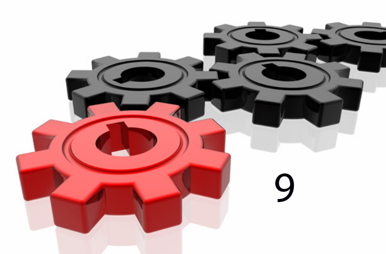
Revenue planning for a manufacturer can involve planning by product, salesperson or channel; for a retailer, planning can be by product and store location. This type of planning is often very difficult using spreadsheets because of the large data volumes. It usually requires a completely separate business model from that used for the budget and the results from such a model will be loaded into the revenue accounts for the budget.

For other industries, revenue planning is different. For example, in a service business like a law firm, revenues can be planned for each revenue-generating staff member based on utilization rates and billing rates. Planning revenues this way naturally leads into a discussion of personnel planning.
Personnel planning is important because up to 90% of a company's costs (depending on industry) are staff related. However, it is difficult to plan staff costs for two main reasons:

- Labor costs in most companies are not totally elastic; it costs money to hire and train staff and employees cannot be laid off without cost implications if demand is lower than expected.

- Personnel costs are not continuous, but discrete; it is difficult to hire one third of a marketing executive.

Because of the above, the timing of staff acquisitions can be tough to plan, especially if a company is growing and is constrained by cash flow considerations Therefore, personnel planning frequently entails a lot of what-if analysis with multiple options that describe alternative hiring scenarios.



In addition, a business model that relates non-payroll costs to salaries and wages is essential when planning personnel costs; a simple example is to forecast benefits as a percentage of salaries and wages. Personnel planning can also go beyond this; for example, automobile expenses, mobile phone costs, and incentive compensation can also be modelled.

Like revenue planning, personnel planning generally requires greater granularity than the General Ledger. In many countries personnel costs are typically modelled by job function; forecasting the cost of employing programmers is accomplished by multiplying the number of programmers by the average cost of employing a single programmer. However, because payroll taxes and benefits in North America are so complex, many companies in the US and Canada plan staff costs in greater detail. A separate detailed model, where the costs are forecast for each employee, becomes important.

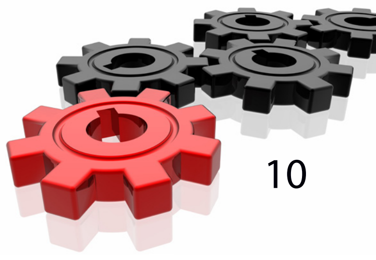
Revenues and personnel costs are two examples of how companies plan at greater detail than the General Ledger and use the aggregated costs in the budget. The benefits of planning at a more granular level of detail include the ability to quickly calculate different scenarios accurately and to have a better understanding of the budgeted data by being able to drill down in greater detail. For example, if planned personnel costs in a department for the following year are dramatically increased, then it is helpful to know exactly why this is.

Planning revenues and personnel costs are examples of 'operational planning', which is becoming more common as companies realize the related benefits. Management of the amounts of data needed for these types of detailed planning requires software that is not only more flexible but also more sophisticated than spreadsheets. Moreover, these more detailed plans must be seamlessly integrated into the budget. This is so the data can be used, in an aggregated form, as the budgeted figures and also as a source for more detailed reporting and analysis.

Analyzing and validating the budget

This is often ignored because of time constraints; when using spreadsheets for budgeting, so much time can be taken up with copying and pasting that there is no time available for finance staff to understand the numbers. Yet analyzing and validating the budget is an extremely valuable exercise that can save a company a lot of money by identifying where costs can be cut. In order to properly budget you need proper analysis and/or calculation of meaningful metrics.

An important part of budgeting is preparing scenarios or 'what-if analysis'. The benefits of being able to input several assumptions and to create numerous scenarios is often overlooked due to the misconception that more time and effort is required – this may be true when using spreadsheets but not when using budgeting software like Prophix. Companies are able to gain more insight on multiple variables, allowing for better decision making. Trends are easier to spot when data is up-to-date, thorough and readily available.



Perhaps the most common mistake made in planning is to produce a budget that is simply not realistic. For example, if during the current year an average salesperson sells $1MM, it may not be realistic to assume that they will all sell $1.5MM next year, especially if there are no changes in the sales force or in marketing programs. If these figures are submitted by the sales department, finance should send the plans back for reworking, or at least ask for an explanation. Unfortunately, in such circumstances, the finance department can be seen as unduly pessimistic or even as being the 'revenue reduction' department. Having accurate figures makes the finance department's job much easier.

Calculating a ratio or a metric such as sales per salesperson (measuring sales force capacity) is an obvious example of identifying what appears to be an unrealistic (or wildly optimistic) plan.

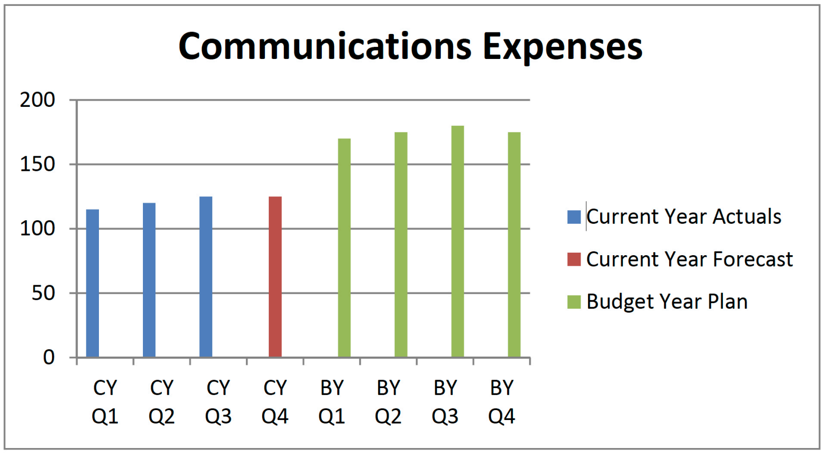
Which ratios you use depends on your business. For example, overhead as a percentage of revenues, operating costs per employee or ratios that relate marketing costs to sales performance can all be used.

Part of the process of calculating metrics can involve performing allocations. For example, planned direct costs can be allocated to products for the purpose of calculating forecast standard costs. These can then be analyzed to make sure they are in line with historical values.

As well as metrics, there are other ways of spotting questionable numbers. The most obvious way is to simply look at the plan over time to get a feel for its validity.

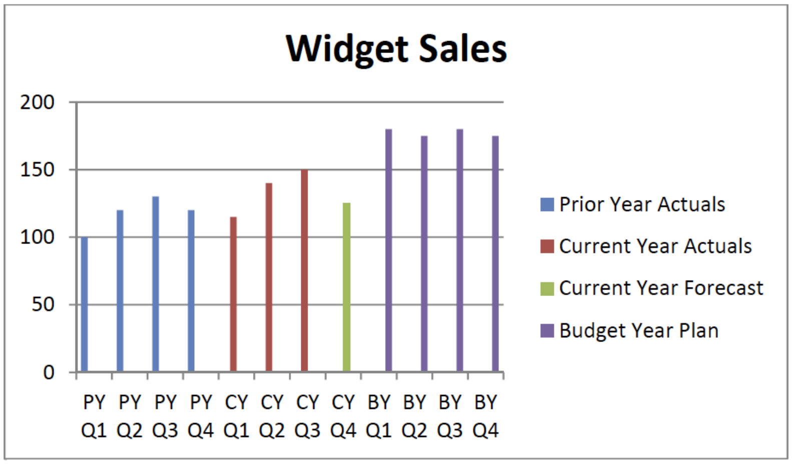
The easiest way to do this, assuming there have been no major changes to the structure of the company, is to compare the budget with the previous year. Previous year figures should be a combination of the historical actual data and a forecast for the last months of the current year.

For example, this chart of projected communications expenses should ring some alarm bells. Costs are planned to magically increase in the new year. This may be realistic – maybe new call center staff are being hired or sales reps are all being given mobile phones – but it behooves the finance department to make sure that this is the case.



Another potential pitfall is when data has seasonality. Revenue and/or expense data is seasonal in most businesses. Retail is an obvious industry where this is the case, but it is true even in the CPM software business, where the first calendar quarter is slow because many finance people are too busy closing the previous year's books to spend much time purchasing software. There is seasonality not only in revenues but also on the expense side of the income statement. For example, in North America payroll taxes are heavily weighted towards the beginning of the calendar year.

This chart of Widget Sales clearly indicates that the budget might have some problems with seasonality.



Unrealistic plans can simply be mistakes. However, in most companies there are individuals who are content to take advantage of the rules. This is especially true when an individual's variable compensation is tied to performance. For example, a manager whose compensation is based on saving money by spending less than plan will be motivated to maximise the planned costs in his or her department.

Perhaps the most difficult validity check is whether or not the budget ties in with the company's strategic goals. If senior management expect the company to grow by 20% next year, but the budget is only for 10% growth, then you have a problem. In such circumstances it is imperative that the people who prepare the budget can produce the numbers and assumptions to back up the various scenarios.

Validating and analyzing the budget requires the finance department to:

- Calculate meaningful and useful metrics.
- Produce multiple scenarios for management discussion.
- Quickly produce understandable reports that communicate their concerns to other areas of the company.

Performing all of this is much easier when a company goes beyond spreadsheets and uses state-of-the-art budgeting software.

Budgeting software alternatives

Budgeting with spreadsheets

Most companies start budgeting using spreadsheets and software like Prophix is usually acquired to replace what was previously done in spreadsheets. There are many reasons why companies change, but recent phenomena have made the spreadsheet unattractive as a platform for planning and budgeting. Reasons include:

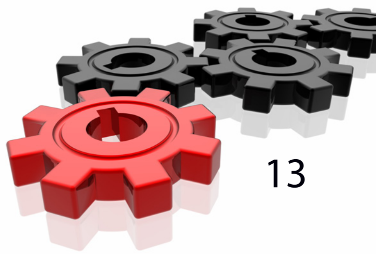
Historically, the **data volumes** and data structure of the General Ledger remained fairly simple. However in recent years, as ERP and accounting software has become more sophisticated, accountants can now plan for more accounts in more cost centers. An integral part of this job is the consolidation of data from many (often hundreds) of departments or cost centers. But management of all this information has become a major issue since spreadsheets are not good at managing large amounts of data.

A second factor is the increased **participation** of departmental managers in the planning process. In the past, their involvement in many companies has been quite minimal, with most of the work being done by finance staff. However, the downsizing trend in the mid-1990s meant that top-heavy centralized finance departments became unfashionable – in many companies, the onus of budget preparation has increasingly fallen on departmental management. The finance department is less the source of the numbers in the budget and instead has become the orchestrator of the budget, responsible for managing workflow in a multi-user environment. Therefore a need has arisen for multi-user budgeting software.

Another reason has been the increased **frequency** of planning. Years ago, the budget was produced annually and, once approved by the board, was 'cast in stone'. All managers had to run their departments based on plans that, by year end, might have been formulated as much as 18 months previously. Events like 9/11 changed economic expectations worldwide and every company needed to be more nimble in its planning. Today, mid-year forecasts, rolling forecasts and concertina planning are becoming more common; planning is becoming an ongoing process. Because of this, the finance department needs software that is more flexible than spreadsheets and enables it to quickly and easily create new plans and multiple versions of plans for management approval.

These are the 'macro' reasons for dissatisfaction with spreadsheets. These apply pressure on finance departments to produce more detailed plans more often with more collaboration. This pressure gives rise to the more direct problems encountered when spreadsheets are used for budgeting:

• The **manual labor** required to manage large numbers of spreadsheets is enormous. This includes copying data between spreadsheets, formatting spreadsheets, copying formulas, and applying security on individual cells. A major time-consuming task is maintaining spreadsheets when structures change – for example, just adding an extra account to the Chart of Accounts can require hundreds of spreadsheets to be edited.



• Spreadsheets do not enable **collaboration**. They are personal productivity tools and were never designed for multiple users. Attempts have been made to address this, but collaboration involves a whole lot more than just sharing data on a server. Workflow involves scheduling when and in what order users need to plan, reminding users when they have to submit their budgets and keeping track of which users are late. More sophisticated users also want to access data in many different ways – not just in pre-defined spreadsheets.

• **Accuracy** can be a major problem when budgeting with spreadsheets. It is impossible to effectively document and validate all the thousands of spreadsheet formulas required for even a modest budgeting exercise. For scenario analysis it is necessary to maintain multiple versions of spreadsheets, ensuring that revenues and expenses from different versions are not mixed up incorrectly for reporting. There is also a need to constantly check numbers to ensure that all formulas have been copied correctly and not edited by users.

The real problem is that there is often no time for analysis. Maintaining spreadsheets is not a good use of finance staffs' time. It is more valuable for finance professionals to be engaged in annualizing and validating the numbers.

Budgeting in the General Ledger

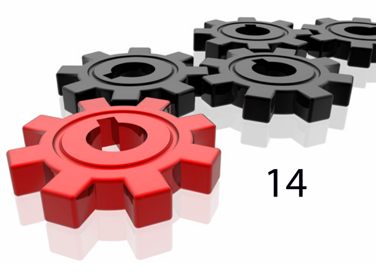
When surveys ask companies how they do their budgeting, one common answer is that they "use their General Ledger". What this usually means is that they are using the G/L as a mechanism for storing budgets and producing variance reports, because most ERP systems allow for plan data to be stored in the General Ledger for reporting purposes.

But budgeting consists of a lot more than simply coming up with a number in a bucket; analyzing and validating these numbers are important parts of the process. In addition, most General Ledgers have limited, or complicated, relational reporting. In many cases, reporting is so difficult that IT staff or consultants have to be brought in to make even minor changes. Moreover, the cost of adding additional users to an ERP licence can be prohibitively expensive, so all reports have to be generated by the finance department and then distributed to other staff.

Because of these limitations, software products have been developed to make it easy to move data from a General Ledger into spreadsheets for reporting. These products also allow users to design spreadsheets for planning purposes and copy the plans into the General Ledger. However, they don't solve the problems mentioned above that make spreadsheets less than ideal for budgeting; simply providing a better way of transferring data between spreadsheets and the General Ledger does not eliminate 'Spreadsheet Hell'.

Budgeting with Performance Management Software

Performance Management Software occupies a unique niche between accounting systems (or ERP systems) and spreadsheets. To budget effectively requires not only the multi-user data management, collaboration, data security and consolidation features of a general ledger but also the calculation and ease-of-use features of a spreadsheet.



As well as basic income statement calculations, best-of-breed budgeting software will include functionality to perform much more complex calculations. It should be able to address balance sheet and cash flow forecasting as well as consolidating multiple currencies, depreciation on capital additions, revenue planning, and personnel planning.

At the outset, finance and accounting professionals usually budget using spreadsheets, and acquire Performance Management Software to replace complex spreadsheet models. Software like Prophix is nearly always acquired by companies that want to perform multi-departmental, multi-user planning more effectively than they can with spreadsheets.
Whereas in a spreadsheet all calculations are defined and performed using a cell-based calculation paradigm, Prophix performs calculations in different ways. This makes budgeting easier because a single calculation definition can apply to a large number of entities – for example across all months and all cost centers. This means a maintenance task such as adding an extra account to the budget is done in seconds instead of editing hundreds of spreadsheets. This is one of the many ways that Prophix saves time for finance professionals.

It is not unusual for Prophix to reduce the effort required for the annual budgeting process (in, say, person-days) by factors of two, three or four when compared with spreadsheets. This means that financial professionals will be able to spend more time understanding and analyzing the company's plans instead of copying data between worksheets or maintaining complicated spreadsheet-based systems.

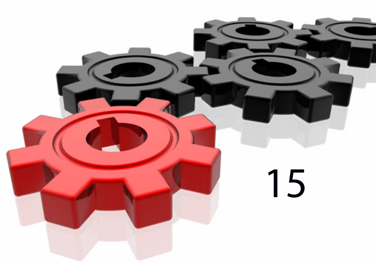
Using Performance Management Software for budgeting will do more than just reduce the time that is spent managing spreadsheets. Software like Prophix has collaboration built in, handling multiple users, workflow, task scheduling, and end-user data access security. OLAP technology, used in Prophix, ensures data integrity; one calculation replaces thousands of formulas. Scenarios are handled automatically and data accuracy is considerably enhanced.

Budgeting software, by automating budgeting processes, will speed them up, save time, and increase productivity. These are quantifiable benefits. But there are other benefits associated with a budgeting system, such as helping financial professionals to understand and validate the numbers, and make better, timelier decisions with increased planning flexibility.
These benefits are more qualitative, but they are just as valuable. A finance department that contributes more insight into business performance empowers the entire organization.

CPM and budgeting

Some companies that are looking for budgeting software are daunted when they see terms such as "Corporate Performance Management". However, this is just a name that has been invented by the software industry. Prophix develops software that manages financial processes such as budgeting, which is considered a component of Corporate Performance Management (CPM).

There are many other acronyms such as Business Performance Management (BPM), Enterprise Performance Management (EPM), and Organizational Performance Management (OPM) that essentially have the same meaning;



these terms have been used to differentiate them from the human resources use of the term 'Performance Management'. Historically, the most popular term when this type of software has been marketed to large companies is 'Corporate Performance Management', but we often call it just 'Performance Management' Software. The 'formal' definition of CPM software is that it consists of the following five types of software application:

CPM Component	Functionality
Planning and Forecasting	Budgeting; rolling forecasts; multi-year plans
Financial and Management Reporting variance analysis	Monthly report books; statutory reporting;
Financial Consolidations	Inter-company eliminations; journal entries; multi-currency
Profitability Modelling and Optimization	Cost analysis; product/customer profitability; allocations
Strategy Management	Scorecarding; KPIs; data visualization

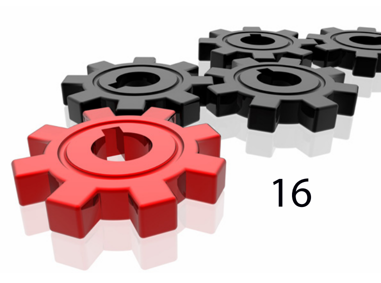
These applications have been grouped together under the CPM umbrella and the conventional wisdom in the software industry is that CPM is a useful and well-defined category of software.

This does not mean that every midsize company that uses this type of software will be implementing all of the above applications; very few do. However, Budgeting is the core of CPM and over 65% of the companies that buy Prophix start by implementing Budgeting; the experience they have with budgeting enables them to automate other processes. In many cases, using Prophix to automate the budgeting process opens the eyes of our customers and creates a vision for how the finance department can be managed better and more effectively.

In 1995, Prophix Software Inc. became a developer of budgeting software. Since then, we have enhanced our products so they address nearly all the functionality of CPM, but Prophix specializes in the planning needs of the mid-market and budgeting is one of our core competencies.

Software called CPM was originally sold into the 'Enterprise' market (i.e. companies with revenues in excess of one billion dollars) but, as with many other software categories (e.g. accounting software) it is now being adopted by mid-market companies (i.e. companies with revenues from $25 million up to the Enterprise level).

It is also important to realize that, whereas large organizations can spend a lot on a CPM solution, the same is not true of the mid-market. We are talking not only about software license costs but also the costs of implementations; most high end Enterprise CPM solutions, by their very nature, require a fair amount of detailed customization to be useful to a customer; they are essentially 'tool kits' with very little functionality available 'out of the box'.



Because of this, Enterprise solutions are usually not appropriate for mid-market companies; they simply don't deliver sufficient value. Enterprise CPM vendors often attempt to address the mid-market by partnering with resellers that are mainly consulting companies. In many cases the resellers will make major discounts to the software license costs because they benefit from selling the large amount of professional services required, but they still don't have the affordability of a true mid-market solution.

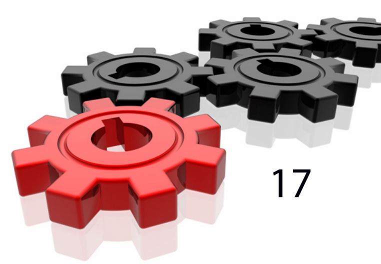
The mid-market requires a different type of product that has a lot of the functionality built in. Prophix calls this 'productizing'; we seek to understand how our customers use our software so we can build in the most frequently used functionality. Our customers don't need to employ IT staff or highly paid consultants to customise everything (by repeating what they have done for other customers, a bit like 're-inventing the wheel'). Instead, our professional services people, most of whom have business degrees, quickly configure the software to meet our customers' needs. Prophix delivers excellent value because our customers can have a usable solution within a relatively short time and at a reasonable cost.

Conclusion

Budgeting with Performance Management Software like Prophix brings major benefits for a mid-sized company, such as automating budgeting processes, enabling better inter-departmental collaboration, and increasing the accuracy of the finished budget. Because of this, finance professionals spend more time on high-value tasks such as validating the budget and gaining greater insight into business performance.

Although preparing the annual budgets might be the justification for the initial acquisition of Prophix, most of our customers use it also for other financial applications. A relatively modest initial investment for better budgeting will pay dividends almost immediately by reducing costs and enhancing the planning process. Once a Finance department has used Prophix for budgeting they will realize the benefits of applying it to other financial processes, such as monthly reporting or regular mid-year planning. Prophix will transform the way a company plans, reports and analyzes not only financial but also operational data.

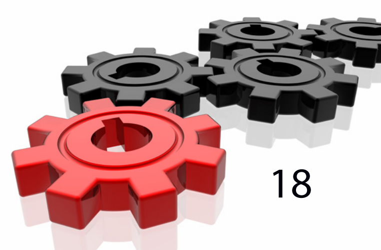
The Prophix software can be applied in many ways; some of these may be part of the initial budgeting process, while others go beyond annual budgeting. This is a summary of the more popular applications of Prophix:



Applications used in the Annual Budget Process	Applications used in Other Processes
Planning the Income Statement.	Financial Reporting.
Planning the Balance Sheet and Cash Flow Statements.	Monthly Budget/Actual Variance Reporting.
Budget Validation Reporting.	Mid-year Forecasting.
Depreciation of Planned Capital Additions.	Monthly, Weekly, or Daily Sales Reporting and Demand Planning.
Multi-currency Planning.	Financial Consolidation.
Personnel Planning.	Multi-Year Planning.
Revenue Planning.	Profitability Analysis.
Ad Hoc Analysis of Financial Data.	Scorecards and Dashboards.

Personnel planning, revenue planning and demand planning are examples of operational planning; this involves planning at a greater level of detail than the General Ledger. These plans will need to be seamlessly incorporated with the budget; this is easy with Prophix because it is a completely integrated budgeting and planning system.

Whatever the size of your company, using Prophix is a start on the road to better management of the finance department. This empowers finance professionals to enhance the management standards of the company and to contribute more to the leadership of the entire organization.



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