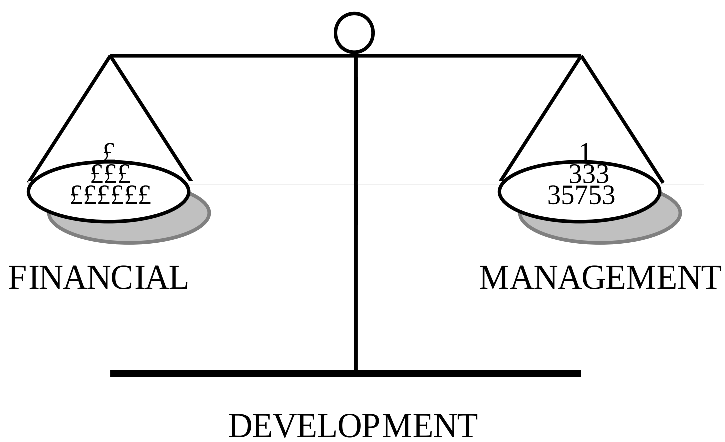
# FINANCIAL MANAGEMENT DEVELOPMENT

## Management Reporting

## Performance Reporting

## NO 222

# TREND ANALYSIS




**ONE OF A SERIES OF GUIDES FOR**

**FINANCIAL MANAGEMENT DEVELOPMENT**

**FROM**

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

# TREND ANALYSIS AND FORECASTING

## OBJECTIVE AND HEALTH WARNING

"The past is not necessarily a good guide to the future, balloons can go up as well as down". **The main purpose of trend analysis and forecasting is to assist present decisions in the light of past events based on realistic estimates of the future.**

Forecasting is an art not a science. It is better to be approximately right than precisely wrong. If there is no better information, it is reasonable to assume that the past will repeat itself with due allowance for inflation and seasonal trends. What is not right is to assume that the budget overrides reality.

For example:-

Budget costs of running a Region are £100,000 per month spread evenly over the months to total £1,200,000 for a year. At the half year the manager has spent £90,000 every month to date totalling £540,000. The manager is asked to send his latest forecast for the full year to Head Office:-

| | |
|---|---|
| Would you report | £1,200,000 |
| | £1,140,000 |
| | £1,080,000 |

In the absence of other information you would assume continuation of £90,000 i.e. £1,080,000. Few managers would report that as their forecast. Most would probably take actual to date and budget for the rest of the year i.e. (£540,000 plus 6 x £1,000,000) £1,140,000. Some older more experienced managers would give a latest estimate of £1,200,000 i.e. on budget for the year but assuming an increase in monthly spend of £20,000 from £90,000 to £110,000. This is common in Government at all levels because if you don't spend your budget they cut your allocation for next year. It is reasonable to guess that part of the difference between Norman Lamont's £3 billion borrowing requirement forecast for 1992/93 made in February 1993 and the outturn of £5 billion was due to him being too honest while the spending departments "spent up to budget" in March. Subsequent Chancellors now know better. Fortunately the private sector is not like that. It does not work in billions, it merely does the same in millions!

Analysis by itself achieves nothing. Review of the past is only useful if it helps future decisions. There are several key questions to ask.

### What has happened?

In particular why is actual different from budget? Is the deviation due to timing, or different treatment of certain items, poor arithmetic or merely that the budget assumptions proved not to be 100% accurate? The answer to why it happened will help with:-

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**Will it happen again?**

If sales are down because there are fewer days in February, then yes it will happen again next February but it will not happen in March. If it is a timing issue it may reverse in the next period. If it won't recur then the forecast can validly be expected to revert to budget. If it is likely to continue then the actual should be used to rebase the projected results. Managers should know. Accounting departments may not.

**If it does, what else might happen?**

If sales continue to be down we will not be able to get into the factory because it will be full of unsold stock. If sales continue to be down we will run out of cash and go bankrupt in September. If the postage costs continue to be double the budget, we will need to buy more stamps. This helps answer the question:-

**If that happens, do I care?**

Do I care enough to take action? Do I lay my bet off? If I lose my job I will have to sell my house so I will pay extra now to insure against redundancy, but if interest rates rise I will keep my house by spending less on other things, so I will not pay the extra for a fixed rate mortgage. Managers need to consider the risk/reward relationship. Thus:-

**If I do care, how do I take action now?**

There is no point in worrying if you have no control. Apart from putting yourself in the happy (or unhappy) position of "I told you so", it is better to spend time on controllable items. This includes those where action consists of warning/telling other people. The important thing is to consider your objective.

How can I increase sale income? If the real problem is cashflow there may be little to gain by decreasing prices to increase sales volumes. The action to be taken needs to consider the problem not deal with the symptoms.

In some cases the action is to reduce the pain. Because we will need more cash, I will go to the bank to arrange the loan in advance. This will cost money, but not as much as if I wait until I am desperate.

Do I need to monitor things more carefully to ensure I know whether I have a big problem or a small problem?

The key is to decide what could go wrong based on priorities and monitor those. One of the benefits of a corporate or divisional budget is that because it is (or should be) self contained, if one item changes you can easily evaluate the impact elsewhere and this helps identify the necessary action to be taken. Without a budget you cannot be sure what the other impacts might be. This does not mean that the budget overrules reality. A forecast is a best estimate, at a point in time, of what will happen. It helps evaluate options. Adherence to an out of date budget will merely delay the inevitable and may even mean that decisions will not be taken until too late for them to be fully effective.

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## Rev. DAVID A. PALMER BA (Financial Control) FCA CTA MCIPD

David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website: **FinancialManagementDevelopment.com** including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

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