

Evaluate Budgeting Solutions Separately From GL and Other Finance Systems

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Many finance evaluations make the mistake of including budgeting, planning and forecasting (BP&F) functionality as part of their evaluation of core financial management applications. IT professionals and finance users must understand why this is the wrong approach, and how to correctly conduct these evaluations.

Key Findings

- General ledger (GL) applications can manage budgetary control procedures, but their data structure means they cannot support sophisticated BP&F functionality (like top-down spreading, scenario creation and forecasting). Also, they cannot support driver-based planning.
- Corporate performance management (CPM) applications have matured; they offer powerful BP&F functionality.
- BP&F applications are “loosely coupled” to underlying ERP applications, rather than “tightly integrated.”

Recommendations

- Evaluations of core financial management applications and BP&F systems that are conducted concurrently need to be managed as two separate, but linked, work streams.
- Do not give excessive weight to BP&F integration with underlying core financial management applications in evaluations.
- A need to replace BP&F systems may be an indicator that a broader CPM solution is required. Finance teams, therefore, need to consider their broader CPM strategy, rather than thinking of BP&F as an “extension” of the GL.

WHAT YOU NEED TO KNOW

Budgeting is a key finance process, and many finance teams are planning to replace outdated or Excel-based systems. However, for several reasons, BP&F systems do not form part of an integrated suite of core financial management applications. These applications hold data differently from the core financial management applications (which have data structures optimized for high-volume transaction processing), and provide forecasting and simulation capabilities that cannot be delivered by a GL application. Yet, many finance teams do not understand this and assume that only an administrative ERP suite vendor can provide these

capabilities. This limits their evaluation options, plays into the hands of the larger vendors and may result in suboptimal product selections. CFOs and finance teams evaluating finance systems need to understand the difference between core financial management applications and CPM applications, and structure their evaluation activities accordingly. IT professionals supporting business applications should work with business users to ensure that they do not restrict evaluations only to vendors that appear to offer a combination of core financial management applications and BP&F functionality. BP&F is, and will remain, separate from core financial management applications, and should be evaluated as such.

ANALYSIS

Context

Finance teams evaluating finance systems typically look for a combination of core financial management application functionality along with “budgeting.” Many CFOs and finance users are unfamiliar with developments in CPM in the past five to 10 years; therefore, they (wrongly) assume that BP&F will be part of the core financial applications. This means their evaluations are wrongly slanted toward vendors that appear to offer a complete solution.

Analysis

Most of Gartner’s discussions with clients evaluating core financial management applications focus on the applications needed to support their finance processes. Users list the application modules they require, which typically include the core financial management applications, GL, accounts payable (AP), accounts receivable (AR), fixed assets (FA) and possibly other functionality, such as project accounting and treasury management. Invariably, the word “budgeting” gets added to the list. This is an immediate warning signal that indicates the finance team has a limited knowledge of the technology required to support effective BP&F. This is not surprising, because most finance users do not have much experience with the latest generation of CPM applications, as too many finance users still believe that Excel spreadsheets are an appropriate BP&F solution. However, by creating an evaluation project that combines core financial management applications with BP&F, organizations face two potential issues:

- The choice of vendors will be restricted to only those that appear to offer a complete solution, ignoring some potentially strong CPM vendors which may lead to suboptimal choices and potentially weaken an organizations negotiating position.
- The BP&F project will underdeliver on potential benefits, because it will be focused on the current spreadsheet-oriented processes and will fail to take into account the needs of budget managers and business users.

BP&F Functionality: More Than “Budgeting”

The major challenge for most finance users is that their perception of BP&F is either based on manual, spreadsheet-based processes or outdated, first-generation BP&F applications. Very few users have experience with current-generation CPM applications and BP&F best practices. Their tendency is to focus on simple budgeting functionality, such as budget entry via spreadsheet-like templates, workflow to control the budget submission process, and budget models that are built using GL codes and financial classifications. These are requirements that all the current CPM suite vendors can satisfy with their BP&F applications, but the capabilities of the current BP&F solutions are far more sophisticated. These include:

- A financial modeling engine that has an integrated profit-and-loss, balance sheet and cash flow forecasting capability.
- Support for short-term financial budgeting, usually with a one-year time horizon and longer-term planning, commonly with a three- to five-year time horizon for more-strategic financial and corporate planning.
- Support for other aspects of strategic planning, such as initiative management, and should provide links to strategy maps in scorecard applications.
- Detailed budgeting capabilities, such as salary or head count planning, revenue planning, capital planning, or expense planning.
- Sophisticated forecasting and modeling capabilities, which involve extrapolating new versions of plans and budgets based on the analysis of historical data and trends. These also include top-down spreading of budgetary targets across multiple dimensions (such as products, budget centers and projects).
- Support for driver-based planning. This enables users to model financial outcomes by varying the business driver assumptions, shifting the focus from planning by the numbers to planning for business activities. This approach provides a coherent and structured way of linking financial budgets with operational plans.
- Ability to export budget data to ERP applications, and the ability to import actual data and business driver data from ERP and other systems.

By leveraging these capabilities, organizations can deliver significant improvements to current budgeting and planning processes, while building a financial planning system that is more closely linked with business operations. Also, this creates an opportunity to leverage other aspects of CPM to increase the overall strategic value of the finance function.

Why the GL Cannot Support Effective BP&F

Finance teams need to understand that delivering BP&F capabilities is not possible in core financial management applications. Many finance users assume BP&F is an “extension” of the functionality in a GL, primarily because some vendors delivered rudimentary budgeting capabilities as part of their GL in the 1990s. However, even the most sophisticated GL will be incapable of delivering this functionality for several reasons:

- Data structures.** The underlying data structures of GL systems are optimized for high-volume transaction processing. They must be able to deal with large volumes of journal postings and interfaces from subsidiary systems, and the current generation of ERP systems all use highly normalized data structures held in relational tables to do this. BP&F systems, on the other hand, do very little (if any) transaction processing. They need to be able to aggregate and manipulate large volumes of data on complex models to produce forecasts and scenarios. This requires a data structure very different from a GL, and all BP&F applications have a different database design structure, while many utilize online analytical processing (OLAP) databases to support the complex modeling and aggregation functionality that is required.
- GL code orientation.** The core of any finance application is the GL chart of accounts and code block. This is used by finance personnel to organize all financial transactions for corporate and management reporting. Any budgeting system built in a GL will use the same elements to drive BP&F processes. While this may make sense to finance users, it makes no sense to business managers. To them, GL codes are a necessary evil in BP&F processes. Unlike finance users, business users do not live and breathe GL codes. Planning is performed by using business drivers, such as sales volumes, prices and average deal size. BP&F applications in CPM suites allow users to create planning models based on business drivers, and to map the results to GL codes. The current architecture of GL systems cannot support this capability, which is vital for linking financial budgets more closely to business operations.
- Processing loads.** The primary goal of a GL is to support a rapid close of the books at period end. This means the typical monthly transaction processing loads for GL systems peak significantly in the few days around the period close. This is the same time that most budget center managers will want to run reports against their budgets, update forecasts and complete other complex tasks. Attempting to perform these activities in the GL at the same time as the transaction processing peak will place pressure on hardware resources, slow down the monthly close and create the provision of unused capacity for the rest of the month. For these reasons, it is better to keep the BP&F data in a separate

database from the GL data. This enables the BP&F system to manage the peak loads of budget users, which, in some organizations, can be thousands of users, without impacting GL processing. Actual data can be extracted from the GL and passed to the BP&F system, while approved budgets can be passed back to the GL for budgetary control purposes.

There is, however, an important aspect of BP&F for which the GL is ideally suited – budgetary control. This involves tracking approved budgets in the GL against AP invoices and purchase orders for commitment and encumbrance accounting, along with enforcing commitment limits against approved budget levels. Many public-sector organizations reallocate approved budgets between departments or services by using GL journals to create an audit trail of how the funds were moved. These activities are best-performed in the GL once the approved budgets have been passed back from the BP&F application.

Adopting the Right Evaluation Approach

The differences between BP&F systems and core financial management applications mean that the vendors of BP&F systems differ from the vendors of core financial management applications. There is some overlap, because some vendors offer both core financial management applications (as part of their ERP offerings) and BP&F applications (as part of their CPM suites). However, it is important that evaluations are not restricted to vendors that only offer both solutions, because this will exclude some ERP vendors (which do not have BP&F solutions) and some BP&F vendors (which do not have ERP applications). Finance teams and IT professionals evaluating finance systems should, therefore, adopt the following evaluation approach:

- Conduct core financial management application and BP&F evaluations as separate, but linked, work streams within the same project.
- Understand that it is not necessary to select a GL before making the choice of a BP&F solution. BP&F applications can be linked to any GL, and the integration tasks are not complex (and can typically be maintained by finance users with the appropriate training).
- Do not exclude any CPM vendor from consideration because it does not offer core financial management applications, and do not exclude any ERP vendor because it does not offer BP&F.
- Evaluate the integration provided by an ERP vendor with its BP&F system against the integration capabilities of specialist BP&F vendors. In some cases, they may offer prepackaged connectors for specific ERP systems.

If there is little difference (in evaluation terms) between shortlisted BP&F solutions, then give preference to the solution from your preferred ERP vendor (if there is one). However, do not delay the BP&F decision until the core financial applications decision has been made, unless doing so does not compromise your project time scales.

Potential vendors of both core financial management applications and BP&F solutions can be found in “MarketScope for Core Financial Management Applications, 2008” and “Magic Quadrant for Corporate Performance Management Suites.”

One final consideration for IT professionals: Any requirement from finance users for a BP&F solution is usually an indication of a wider need for a broader CPM solution. This means IT must be prepared to engage finance in a discussion of how the BP&F solution will fit into the wider CPM landscape, and also how it may relate to business intelligence initiatives.

The Illusion of Integration

Vendors that offer both core financial management applications and BP&F will sell the benefits of their integrated solutions. While it is true that these vendors will generally offer out-of-the-box integration with their GL and/or underlying data repositories, users should not give excessive weight to this integration in their evaluations. All CPM suites have been designed to work with any back-end GL and finance system, and the integration requirements are relatively straightforward. Master data from the GL (like chart of accounts values and code block elements) needs to be transferred to the BP&F applications, and to aggregate actual data on a periodic basis. All CPM vendors offer integration tools to manage this integration (in some cases, as predefined connectors) and have experience working with most of the common ERP systems. In most cases, the integration tools can be managed by appropriately trained finance users and do not require a high degree of specialized IT skills. Vendors like SAP and Oracle have actually dropped their in-house-developed BP&F applications in favor of acquired products

(from OutlookSoft and Hyperion, respectively). Although they offer integration with their ERP systems, these applications are designed to work as stand-alone solutions, and are still sold on that basis.

Key Facts

- A GL and other core financial management applications can support basic budgetary control procedures, but their data structure means they cannot support sophisticated BP&F functionality (such as top-down spreading, scenario creation and forecasting). Also, they cannot support driver-based planning.
- CPM applications have matured and now offer powerful BP&F functionality. However, these applications are not tightly coupled to the underlying core financial management applications. Several ERP vendors have abandoned their original tightly coupled BP&F solutions and, instead, purchased or built loosely coupled solutions that not only work with their core financial management applications but also can be sold as stand-alone solutions.
- A need to replace BP&F systems may be an indicator that a broader CPM solution is required. Finance teams, therefore, need to consider their broader CPM strategy, rather than thinking of BP&F as an “extension” of the GL.
- Evaluations of core financial management applications and BP&F systems that are conducted concurrently need to be managed as two separate, but linked, work streams.