

November 18–20, 2010
Arlington, VA



SHRM

SOCIETY FOR HUMAN
RESOURCE MANAGEMENT

HR Budgeting Boot Camp: Overcoming the Prejudice of being an “Overhead” Department

SHRM Leadership Conference

Valerie M. Grubb

Operations Consultant and Trainer

Val Grubb & Associates, Ltd.

www.valgrubbandassociates.com

323.229.2263

Overall Session Goals

- **Create an Effective Departmental Budget**
- **Understand the Fundamental Elements of the 3 Key Financial Statements**
- **Make the Connection btwn your Department's Budget and your Company's Bottom Line**
- **Demonstrate Return on Investment (ROI) for initiatives**



Section



- 1. Basic GAAP Principles**
- 2. Budgeting Effectively**
- 3. Understanding Financial Statements**
- 4. HR's Effect on the Bottom Line**

Basic GAAP Principles

Section 1: Basic GAAP Principles

- **Accounting rules are generated by Financial Accounting Standards Board (FASB).**
- **GAAP is not a legal requirement.**
- **CPA firms are required to disclose deviations to GAAP during an audit.**
- **Deviations from GAAP can jeopardize a firm's financial credibility.**



Basic GAAP Principles

Section 1: Basic GAAP Principles

- **With multinational companies, the accounting rules of the parent company's country are normally used in the consolidated statements.**
- **GAAP rules are NOT tax rules – therefore tax statements will differ from financial statements.**





Cash-Basis vs. Accrual-Basis Accounting

**To conform to GAAP, a business
must use accrual-basis
accounting.**



Accrual Accounting – Matching Principle:

- **Revenues are recognized when they are earned.**
- **Expenses are “matched” with the time period when the services are used up.**
- **The Matching Principle is regardless of when cash changes hands!**



Accrual Accounting – interesting tidbits:

- **Prepaid expenses (i.e., insurance policies) - when initially paid, they are recorded as prepaid expense on the Balance Sheet then are allocated monthly to the dept Operating budget.**
- **Companies carry finished goods in the Inventory account until it's sold, then its transferred to Cost of Goods Sold.**



Final Thoughts

- **Organizations use accrual accounting to determine their profits more accurately.**
- **This is necessary because expenses are often disbursed in a different time period from when revenues are collected.**
- **Accrual accounting does not measure the cash flow of a business. That is done via the Statement of Cash Flow is as important as accounting profit.**

Section



1. **Basic Accounting Principles**
2. **Budgeting Effectively**
3. **Understanding Financial Statements**
4. **HR's Effect on the Bottom Line**

AGENDA

- **The Company's Master Budget**
- **The HR Budget**
- **Tips to Bullet Proof Your Budget**

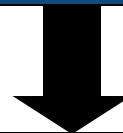
The Company's Master Budget

Section 2: Budgeting Effectively

Sales & Revenue Forecast —

Production & Expense Budgets

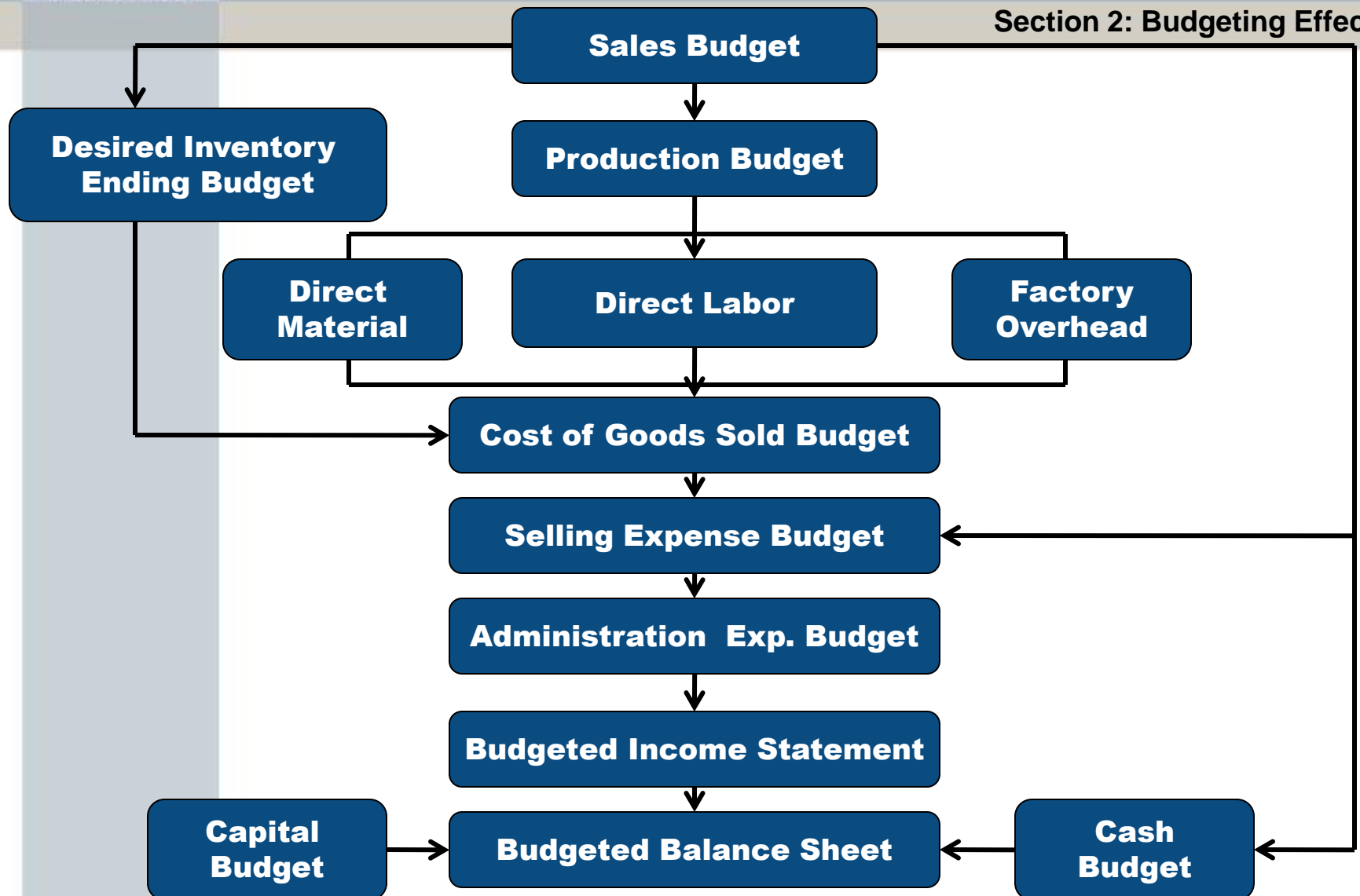
= **Financial Statements**

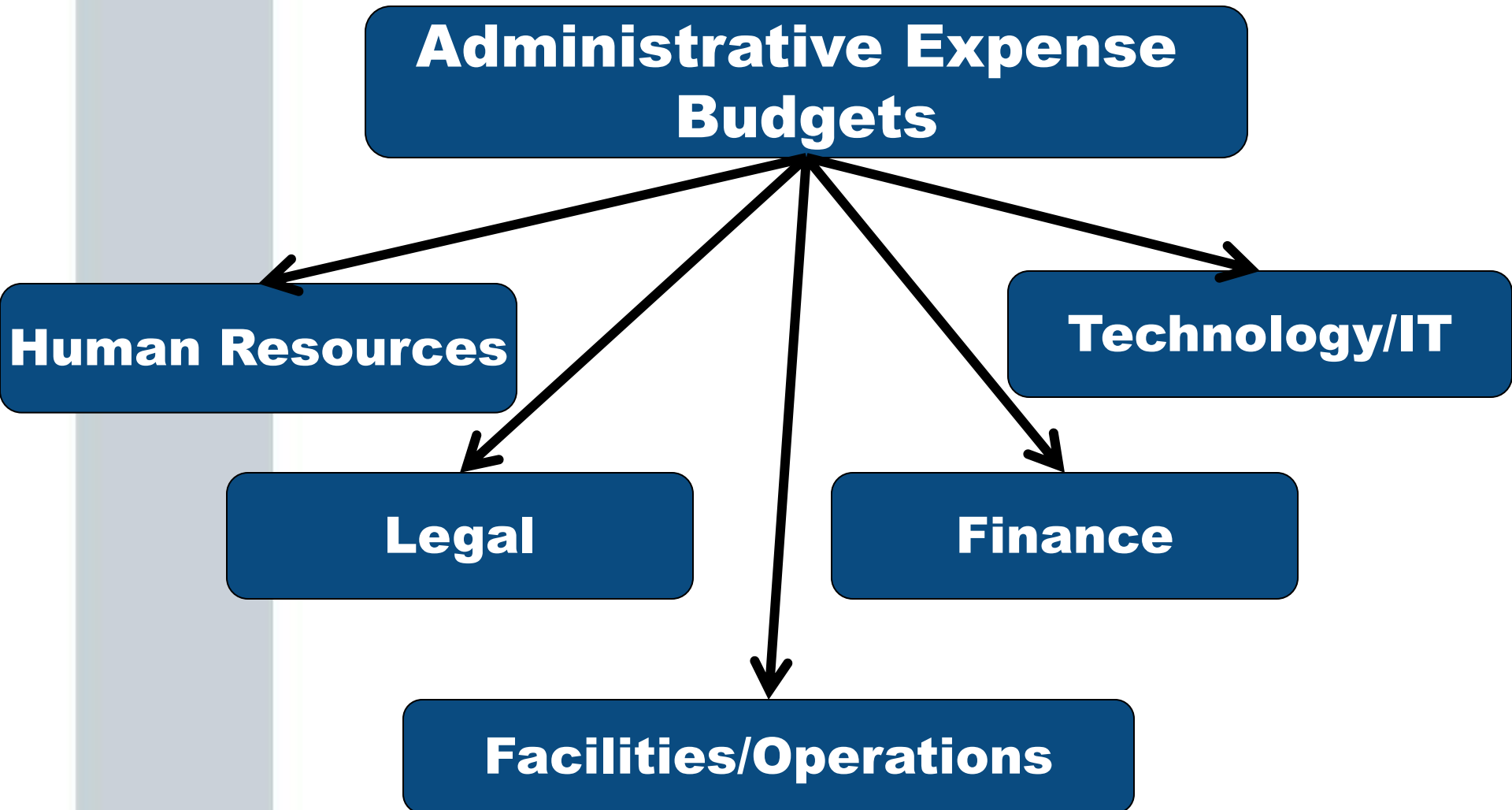


Company's Overall Health

The Company's Master Budget

Section 2: Budgeting Effectively

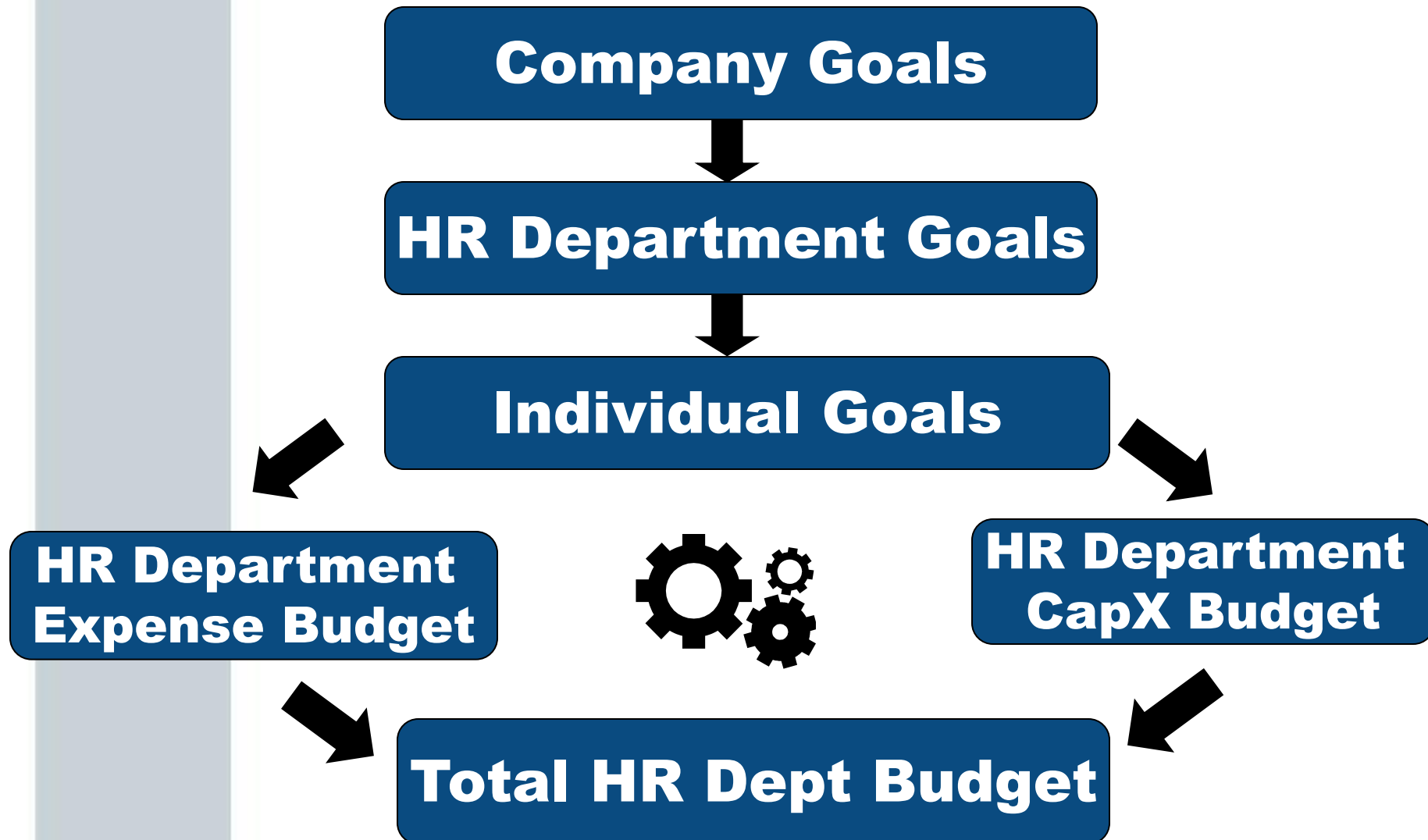




WHERE to START???

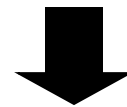






Financial Building Blocks

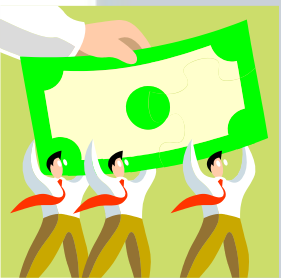
Operating & CapX Budgets



Financial Statements



Company's Overall Health



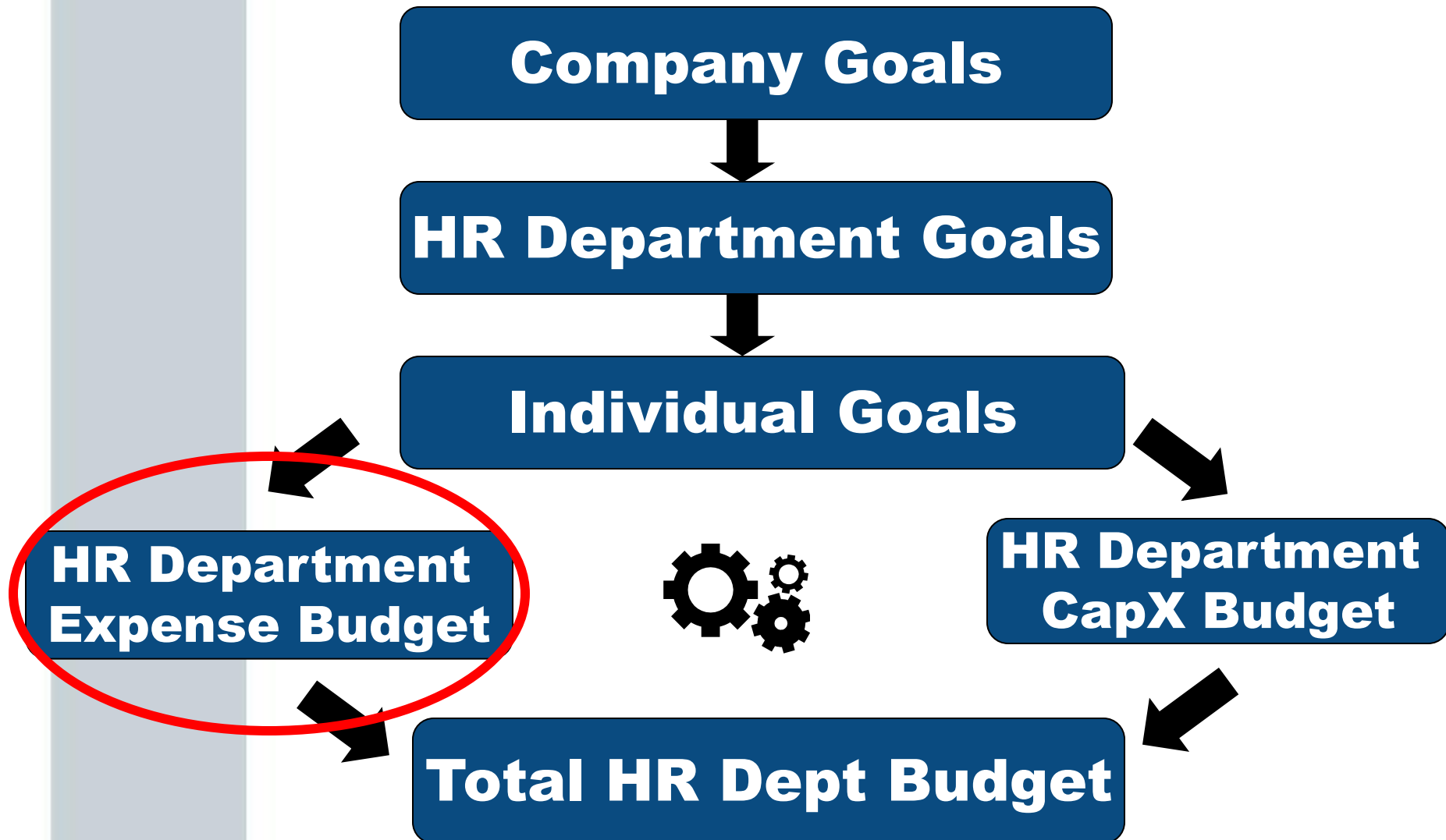
1. Operating Expense Budget

- **Costs which occur during the period (month, quarter or year)**
- **Services that are used up during the specified time period**



2. CapX Budget

- **Short for Capital Expenditure**
- **Asset or project with a useful shelf life of > than a year and over a dollar amount specified by the controller**



Elements of an Operating Budget

Headcount

- Salaries
- Fringe
- Bonuses
- Overtime
- Temp coverage

Expenses

- Recurring
- Non-
Recurring

Discretionary

- Travel
- Supplies
- Training

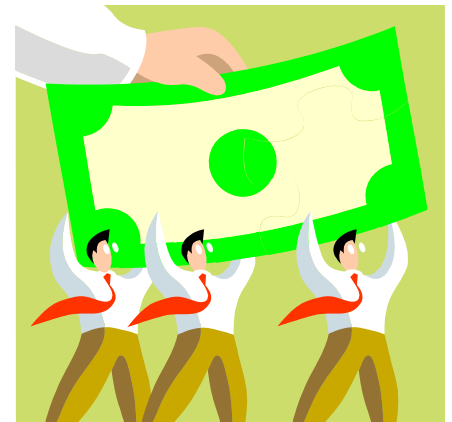
Recurring Expenses

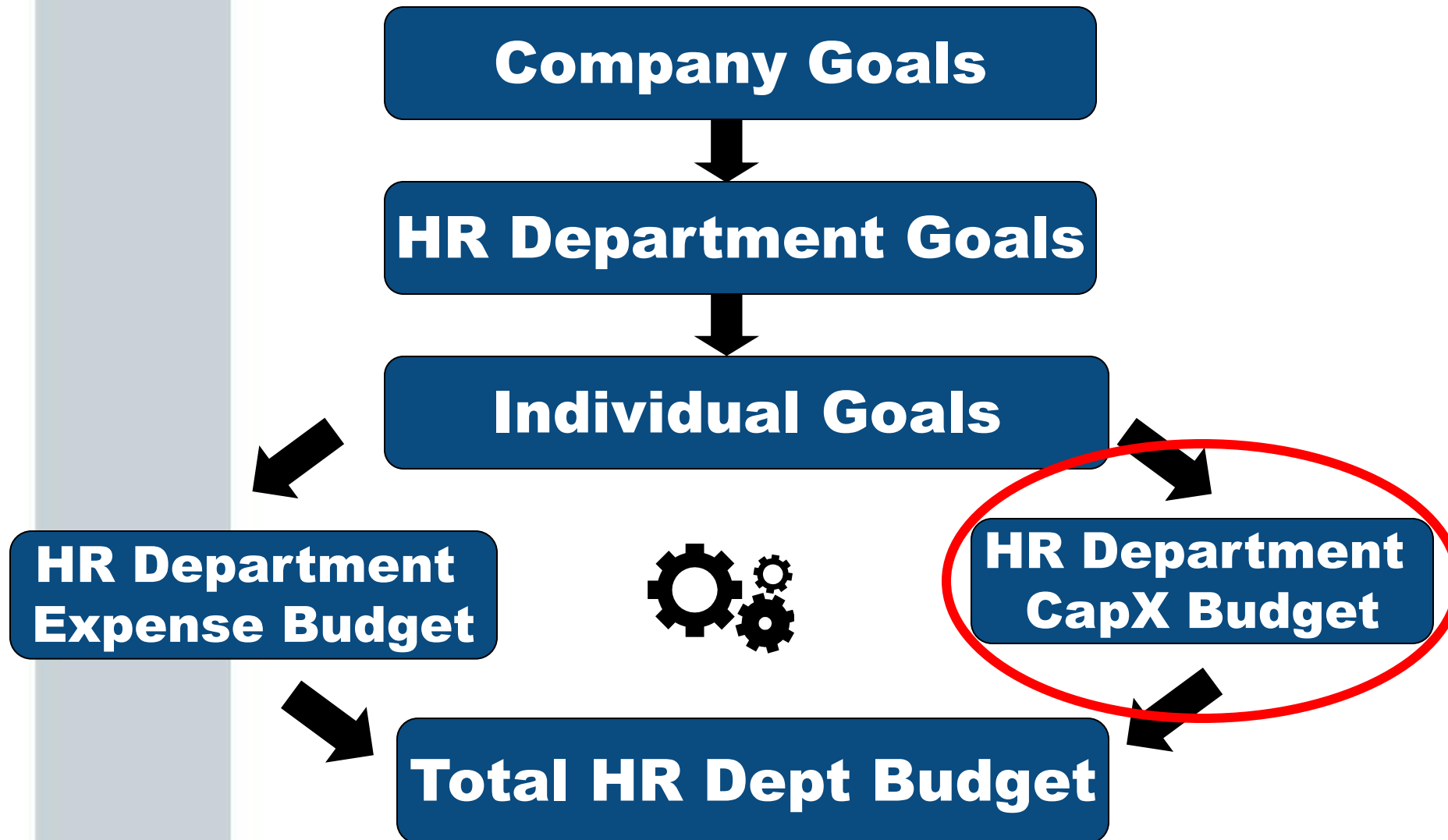
- **Payroll administration**
- **Benefits administration**
- **Other Outsourced contracts**
- **Utilities**



Non-Recurring

- **New computer equipment**
- **Software purchases**
- **Recruiting costs**
- **Diversity efforts**
- **Employee recognition**
- **Consultants**





1) Capital *Equipment* Project:

Purchase of equipment and the services to make it operational.

- **Shelf life of greater than one year**
- **Value over a specified amount (for example, \$2,500 or \$5,000)**



2) Capital *Improvement* Project:

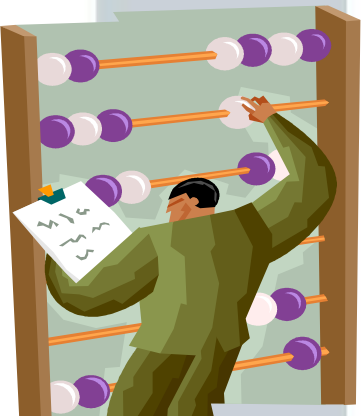
Purchase, construction or renovation of the Building or Facilities used by your Company.

- **Value over a specified amount (typically greater than Capital Equipment project)**
- **Also a shelf life of greater than one year**



Criticality of CapX Budgeting

- Major reason why Companies get into financial difficulty and/or cease to operate is because of poor or nonexistent Capital Budgeting.
- Major CapX expenditures are typically difficult to fund from operating funds.
- Major CapX expenditures may require funding sources such as loans, sell-off of assets, issuing bonds or fundraising campaign.



CapX Examples

- **Big equipment/software purchases**
- **Computers over a certain \$ amount**
- **Major leasehold improvements**
- **Large scale purchases such as a building or another Company**
- **Extended R&D programs**



Sources of Expense

```
graph TD; A[Sources of Expense] --> B[Past Expenditures]; A --> C[Anticipated Future Activities];
```

Past Expenditures

- Previous Years' Budgets
- Past Contractual Commitments
- Purchase Orders
- Notes from Throughout the Year

Anticipated Future Activities

- Company goals
- Interviews with Dept Heads
- Mergers or acquisitions
- Labor Market reports
- SHRM Workplace Trends
- Future Workforce needs

Budgeting for Contingencies

- When the amount budgeted differs from the actual expense, the difference is called a variance.
- Identify factors that might cause changes to the Company's revenue forecast – then determine what changes might be made to the budget.
- Identify ahead of time areas where the budget could be cut with the least possible “damage.”

Final Thoughts

- **Use historical data as a starting point.**
- **Trust your own experience.**
- **Listen to your intuition.**
- **Conduct due diligence.**
- **Talk with and listen to knowledgeable people.**
- **Learn when to take risks and when to be conservative.**
- **Test your assumptions where possible.**



AGENDA

- **The Company's Master Budget**
- **The HR Budget**
- **10 Tips to Bullet Proof Your Budget**



Bullet Proofing your Budget

1. **Couple** spend to company goals.
2. **Calculate** the ROI of projects and rank based on company priorities.
3. **Evaluate** the cash efficiency of initiatives under consideration.
4. **Detail value-added** line items.
5. **Include** one (1) “scapegoat” project.
6. **Interview other Dept Heads** to find out what projects in their departments were cut and model your budget appropriately.

Bullet Proofing your Budget

7. **Document** the latest date your initiatives must be completed or what \$ consequence will incur.
8. **Link** budget to improved profitability.
9. **Garner support** from Dept Heads for initiatives affecting their area.
10. **Garner support** from finance along the way.



Section



- 1. Basic Accounting Principles**
- 2. Budgeting Effectively**
- 3. Understanding Financial Statements**
- 4. HR's Effect on the Bottom Line**

THE BIG THREE:

- **Income Statement**
- **Balance Sheet**
- **Statement of Cash Flows**

Date	Amount	Da
10/20	\$ 738.97	1
10/21	526.82	
10/22	590.53	
10/23	524.21	
10/26	362.24	
10/27	308.42	

Key Financial Statements

Section 3: Understanding Financial Statements

Statement	Purpose	Information Presented
Income Statement (aka Profit & Loss Statement of P&L)	Presents the organization's operating performance during a period of time.	Revenues earned. Expenses incurred. Profit, Income or Loss which is the difference between revenues and expenses.
Balance Sheet	Reports to organization's financial condition at a point in time.	Assets - what the organization owns. Liabilities - what the organization owes. Stockholders' Equity - the difference between Assets and Liabilities (may be called Net Assets for a not-for-profit or government entity).
Statement of Cash Flows	Describes how cash came into the business and how it was used.	Operating Cash Flow - the cash generated by the day-to-day operations of the organization. Investing Cash Flow - the cash reinvested in the business or generated by selling off pieces of the business. Financing Cash Flow - the cash generated by borrowing or selling stock to investors and the cash disbursed to pay off debt, buy back stock or pay dividends.

Income Statement (P&L)

- This is the major device for measuring the profitability of a company over a period of time (from a month to a year).
- It will tell you if a company is making a profit or operating at a loss.

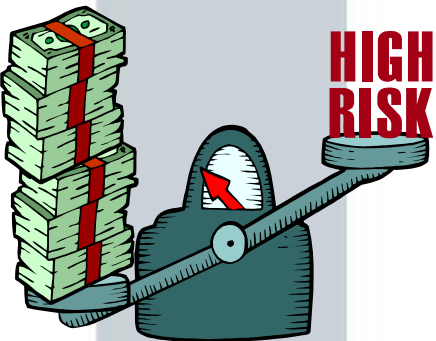
**Revenues – Expenses = Net Income
(or Net Loss)**



Calculating the Income Statement:

$$\begin{aligned} & \text{Total Sales} \\ & - \text{Cost of Goods Sold} \\ \hline & = \text{GROSS PROFIT} \end{aligned}$$

- Gross Profit represents the difference between the cost to purchase or manufacture your goods and what you were able to sell them for.



Cost of Goods Sold (aka Cost of Sales)

- For a manufacturer, this represents the cumulative costs relating to products that were sold to customers during that year.
- It includes:
 - Raw materials
 - Direct Labor
 - Factory overhead – all other costs associated with the manufacturing facility such as indirect labor & supplies, depreciation, supervision, etc.



Cost of Goods Sold (aka Cost of Sales)

- For retailers, wholesalers and distributors: COGS represents what the company paid for those products that were resold to customers that year and the transportation associated with getting the products to the company's premises.
- For services providers: equivalent of COGS is called Cost of Services Provided. This reflects the cost of labor, supplies and other support that was needed to provide service.



Calculating the Income Statement:



Bob & Tom Candy Sales

Retail Sales	\$2,200,000
Corporate Sales	<u>\$1,000,000</u>
Total Sales Revenue	\$3,200,000
Less Cost of Goods Sold	<u>\$1,600,000</u>
Gross Profit:	\$1,600,000

Operating Expense

- Includes all expenses (other than those that are part of Cost of Goods Sold) incurred in the day-to-day operations of the business.
- It includes:
 - Selling, General and Administrative (SG&A)
 - Research and Development
 - Depreciation and amortization of assets not used in a manufacturing process.



Depreciation vs. Amortization:

- **Tangible assets depreciate**
 - **Computers**
 - **Buildings**
- **Intangible assets amortize**
 - **Broadcast rights**
 - **Patents**
 - **Goodwill**



Straight-Line Depreciation of a piece of Equipment:

$$\text{\$100,000/5 years (useful life) = \$20,000/yr}$$

- Annual depreciation expense on the Income Statement is \$20k.
- Depreciation is calculated differently for tax purposes. This is the accounting calculation only.
- Land does not depreciate. Minerals are depleted (aka depreciated).

Calculating the Income Statement:

Total Sales

- Cost of Goods Sold

= GROSS PROFIT

- Less operating expenses (EBITDA)

- Depreciation expense

Earnings before Interest & Taxes (EBIT)





Bob & Tom Candy Sales

Retail Sales	\$2,200,000
Corporate Sales	<u>\$1,000,000</u>
Total Sales Revenue	\$3,200,000
Less Cost of Goods Sold	<u>\$1,600,000</u>
Gross Profit:	\$1,600,000
Less Operating expense	<u>\$ 800,000</u>
EBITDA	\$ 800,000
Depreciation expense	<u>\$ 42,500</u>
Earnings before interest & taxes	\$ 757,500 (EBIT)

THIS IS REFERRED TO AS OPERATING INCOME.

OPERATING PROFIT

- Operating Profit shows if the Operations (i.e., the core business) is operating at a profit or loss.
- It's possible for a company to have a high Gross Profit (25-50%) but have a relatively low operating profit due to marketing the product and/or managing the Company.
- Think of Operating Profit as a measure of how efficient management is at generating revenues and controlling expenses.



Other Income and Expense

- All encompassing category for what's left! These are costs that do not pertain to the continuing operations of the business.
- Subtract or add (as appropriate):
 - Interest income/expense
 - Foreign currency gains/losses
 - One-time events such as major write-offs of assets.
 - One-time gains/losses resulting from the disposal of businesses and facilities.
 - Income Tax



= Net Income



Bob & Tom Candy Sales

Retail Sales	\$2,200,000
Corporate Sales	<u>\$1,000,000</u>
Total Sales Revenue	\$3,200,000
Less Cost of Goods Sold	<u>\$1,600,000</u>
Gross Profit:	\$1,600,000
Less Operating expense	<u>\$ 800,000</u>
EBIDTA	\$ 800,000
Depreciation expense	<u>\$ 42,500</u>
Earnings before interest & taxes	\$ 757,500 (EBIT)
Less Interest expense	<u>\$ 110,000</u>
Earnings before income tax	\$ 647,500
Less income tax	<u>\$ 300,000</u>
Net Income	\$ 347,500

FROM THERE

- From **NET INCOME**, subtract **Preferred Stock Dividend** payments and that is the \$ available to stockholders. Divide \$ available to Stockholders by the Shares Outstanding .
- That equals **EARNINGS PER SHARE.**





FINAL THOUGHTS

- EBIDTA and EBIT are often used as business valuation methods on Wall Street (the value on Wall Street is set as a multiple of EBIT or EBITDA).
- This is what you receive monthly from your Finance Department! Your own monthly P&L or Income Statement for your Department's Budget.

THE BIG THREE:

- Income Statement
- **Balance Sheet**
- Statement of Cash Flows



11/16 Monthly Service

Daily Balance

Date	Amount
	\$ 738.97
10/20	526.82
10/21	590.53
10/22	524.21
10/23	362.24
10/26	308.42
10/27	

Balance Sheet

- Indicates how efficiently a company is utilizing its assets and managing its liabilities at a specific point in time.
- Indicates what a firm owns and how those assets are financed – either through liabilities or ownership interest.



$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

Balance Sheet

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

- **Assets = what is *owned* by the company**
- **Liabilities = what is *owed* by the company**
- **Equity (aka Net Worth) = difference between what the company owns (assets) and what the company owes (liabilities)**

Assets = Liabilities + Owners' Equity

Three Components:

Assets, Liabilities & Stockholders' Equity

CURRENT & LONG-TERM ASSETS

Listed in order of liquidity (ability to convert to cash):

- Cash (current)
- Marketable Securities (current)
- Accounts Receivable including Bad Debt (current)
- Inventory (current)
- Plant, Equipment and Furniture (long-term)
- Goodwill, Patents, Copyrights (long-term)

Assets = Liabilities + Owners' Equity

Three Components:

Assets, Liabilities & Stockholders' Equity

CURRENT & LONG-TERM LIABILITIES

These are the financial obligations of the company broken in to current liabilities (due within one year) or long-term liabilities (1+ year away):

- Accounts or Notes Payable (current)
- Accrued Expenses (current)
- Bonds Payable (long-term)
- Deferred Income Taxes (long-term)
- Litigation Reserves (long-term)



Assets = Liabilities + Owners' Equity

Three Components:

Assets, Liabilities & Stockholders' Equity

TYPES OF STOCKHOLDERS' EQUITY:

- Preferred Stock (paid first in full)
- Common Stock (paid with leftovers)
- Retained Earnings - cumulative earnings reinvested in the business since inception minus dividends and other adjustments (i.e., losses)
- Treasury Stock – what the company paid when it repurchased its own shares previously issued.



Sample Balance Sheet

Assets = Liabilities + Owners' Equity

Section 3: Understanding Financial Statements

Assets

Current Assets

Cash	\$	90,000
Short-term investments		200,000
Accounts receivable		60,800
Inventories		104,000
Prepaid expenses		50,000

Total Current Assets

504,800

Fixed Assets

Property, plant & equipment		2,750,000
Less accumulated depreciation		325,000

Net Property, Plant, & Equipment

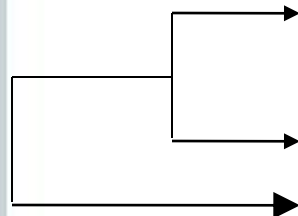
2,425,000

Goodwill Net

62,500

Total Assets

2,992,300



Liabilities & Owners' Equity

Current Liabilities

Accounts payable		127,000
Current maturity of long-term debt		69,000
Accrued payroll		50,000
Income taxes payable		12,000
Other accrued expenses		8,000

Total Current Liabilities

266,000

Long-Term Liabilities

Long-term debt		1,326,000
----------------	--	-----------

Total Liabilities

1,592,000

Owners' Equity

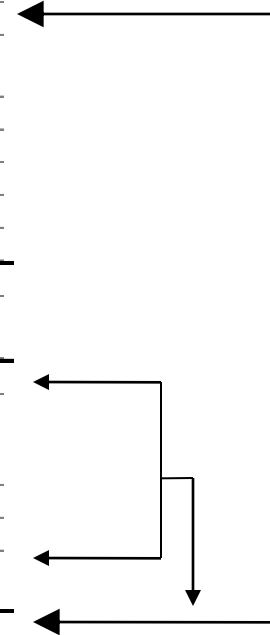
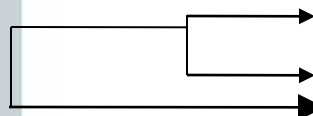
Common stock		1,000
Additional paid-in capital		1,350,000
Retained earnings		49,300

Total Owners' Equity

1,400,300

Total Liabilities & Owners' Equity

\$ 2,992,300



December 31, 2009



Balance Sheet indicates a
Company's NET WORTH

**Stockholders Equity – Preferred Stock =
NET WORTH or BOOK VALUE**

Total Assets

- Total Liabilities

= Stockholders Equity

- Preferred Stock Obligation

= Net worth available for Common Stock

÷ Outstanding Common Shares

= Net worth, or book value, per share

THE BIG THREE:

- **Income Statement**
- **Balance Sheet**
- **Statement of Cash Flows**

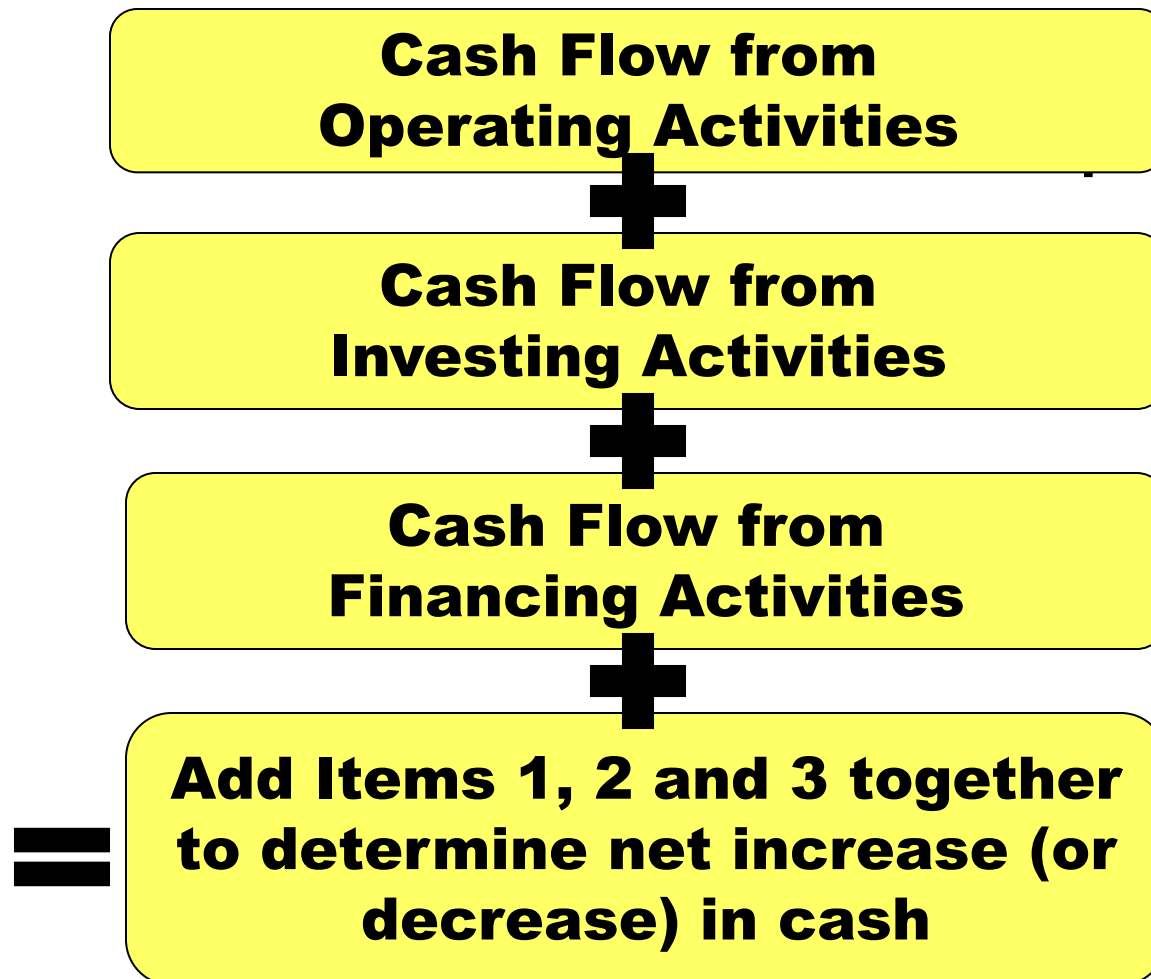


Statement of Cash Flows

- Demonstrates how cash came in and how it was used.
- Indicates if the company's cash flow is increasing or decreasing year-over-year.
- Includes "cash equivalent": an item that can be converted into cash within 90 days (such as a money market fund).
- Translates income statement and balance sheet data into cash flow information.

**Cash Flow (Operating + Other) –
Cash Used = Change in Cash**





Sample Statement of Cash Flows

Cash Flow (Operating + Other) – Cash Used = Change in Cash

Section 3: Understanding Financial Statements

Cash Flows from Operating Activities

	Total
Net income	\$ 148,900
Adjustments:	
Depreciation & amortization	137,500
Changes in assets and liabilities	
Accounts receivable	(25,400)
Inventories	(9,000)
Prepaid expenses	(28,000)
Accounts payable	(49,000)
Income taxes payable	4,000
Accrued payroll	12,000
Other accrued expenses	(7,000)
Net Cash From Operating Activities	184,000

Cash Flows from Investing Activities

Short term investments	(172,000)
Additions to property, plant & equip	(850,000)
Net Cash for Investing Activities	(1,022,000)

Cash Flows from Financing Activities

Capital stock issue	950,000
Short-term debt	6,000
Long-term debt	(63,000)
Net Cash For Financing Activities	893,000

Net (decrease) increase in cash	55,000
Cash, beginning of year	35,000
Cash, end of year	\$ 90,000

For the year ended December 31, 2009

- ✓ **Balance Sheet - Owners Equity Increasing**

GOOD!

- ✓ **Income Statement - Net Income is Positive
(or getting closer to breakeven for start-ups)**

GOOD!


- ✓ **Cash Flow Statement - Cash Flow is Positive**

GOOD!

Section



- 1. Basic Accounting Principles**
- 2. Budgeting Effectively**
- 3. Understanding Financial Statements**
- 4. HR's Effect on the Bottom Line**



PROBLEM: Declining profits as shown by lower Net Income on the P&L Statement (aka Income Statement).

Potential Solutions

- **Reduce operating expenses:**
- **Increase sales revenues:**



**PROBLEM: Your company is
having cash flow problems.**

Potential Solutions:

KEY FORMULAS:

$$\text{Yearly Benefit (\$)} = \text{Total Benefits} - \text{Total Costs}$$

$$\text{Monthly Benefit (\$)} = \text{Yearly Benefit} / 12 \text{ months}$$

$$\text{ROI (months)} = \frac{\text{Total Initiative or Transition Costs}}{\text{Monthly Benefits}}$$

Calculate Return on Investment

Initiative: Outsourcing Benefits Administration

COSTS	
• Cost #1: Total Yearly Consulting fees	\$ 800,000
• Cost #2: Transition fees	<u>\$ 100,000</u>
TOTAL COSTS:	\$ 900,000
BENEFITS (i.e., dollars saved)	
• Benefit #1: Salaries + fringe (benefits, etc.) for the year	\$1,000,000
• Benefit #2: Telephone, temp coverage, floor space, etc.	<u>\$ 200,000</u>
TOTAL BENEFITS:	\$1,200,000
NET YEARLY BENEFIT: Total Benefits – Total Costs = Net Yearly Benefit	\$ 300,000
NET MONTHLY BENEFIT: Net Yearly Benefit/12 months \$300,000/12 months	\$ 33,333
RETURN on INVESTMENT (i.e., ROI of \$100k investment): Transition Costs/Monthly Net Benefit \$100,000/\$33,333	3 months ROI

Calculate Return on Investment

Initiative: Presentation Skills Class for Sales Associates

COSTS	
• Cost #1: Day Rate - \$600/day * 11 associates	\$ 6,600
• Cost #2: Trainer, Room, Other fees	<u>\$ 6,000</u>
TOTAL COSTS:	\$12,600
BENEFITS (i.e., revenue increase)	
• Benefit #1: Est. sales increase (\$5k/mo*12 mos) * I used a flat increase in sales.	\$60,000*
• Costs associated w. Sales aka Cost of Goods Sold (\$2,000/mo*12 mos)	<u>\$24,000</u>
TOTAL BENEFITS:	\$36,000
NET YEARLY BENEFIT: Total Benefits – Total Costs = Net Yearly Benefit	\$23,400
NET MONTHLY BENEFIT: Net Yearly Benefit/12 months \$23,400/12 months	\$1,950
RETURN on INVESTMENT (i.e., ROI of Class Costs): Total Costs/Monthly Net Benefit \$12,600/\$1,950	6.5 months ROI

ANY QUESTIONS?

