Alternatives to Guess Work
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It's the end of August. Second quarter actuals are available. The end of the year is in sight. It's time.

Things have sure changed since your original 1995 budget was prepared. Sales volume is way over your prediction. Some costs are also over budget. Others are far below what you projected. It's time.

At this time of year, managers and owners of small and mid-sized companies need a revised estimate of their 1995 expense budget to make sound business decisions in the second half of the year. One way to improve your budget projections for the second half is to fine-tune how you use expense history to project future expenditures.

The SALT (Same As Last Time) method of estimating expense budgets has limitations. A specific example demonstrates how expense history can be "tweaked" to yield better expense forecasts.

Let's assume that all the costs for keeping your company's production equipment up and running are charged to an account called Equipment Repair & Maintenance. This account accumulates the costs of maintenance contracts, service calls by outside technicians and spare parts for repairs your company does internally. Further assume that $200,000 was budgeted for this account for 1995. Expense history was used to make that estimate. During each of the past two years, about $200,000 was spent for Equipment R&M.

You've just seen 2nd quarter actuals and your company has already spent $125,000 on Equipment R&M. Spending is apparently on a pace to exceed the budget by $50,000 by the end of the year. YIKES! What went wrong with the Same As Last Time estimate?

Further investigation shows that circumstances are not the Same As Last Time. Your inquiries discover that a full half of the $200,000 spent on Equipment R&M during the past two years was spent on keeping an old injection-molding machine up. You got rid of that dinosaur in the first quarter of this year. But wait. If that's all that's changed, you should underrun the Equipment R&M budget. You're not. You keep digging and discover something else not the Same As Last Time. Extensive preventive maintenance was done on your production test equipment in April. You find that your test equipment is on a three year maintenance cycle and the costly year is the third year. History from the past two years didn't predict the third year spike. Armed with this new understanding, developing a new estimate of 1995 Equipment R&M costs is a snap.

Using expense history to estimate future spending is a valid forecasting technique when done cautiously. The key is to understand the causal basis of that history and to adjust it for events and circumstances that may or may not have been included.