

Project Management

ABSOLUTE BEGINNER'S GUIDE

No experience necessary!



Fifth Edition



Gregory M. Horine

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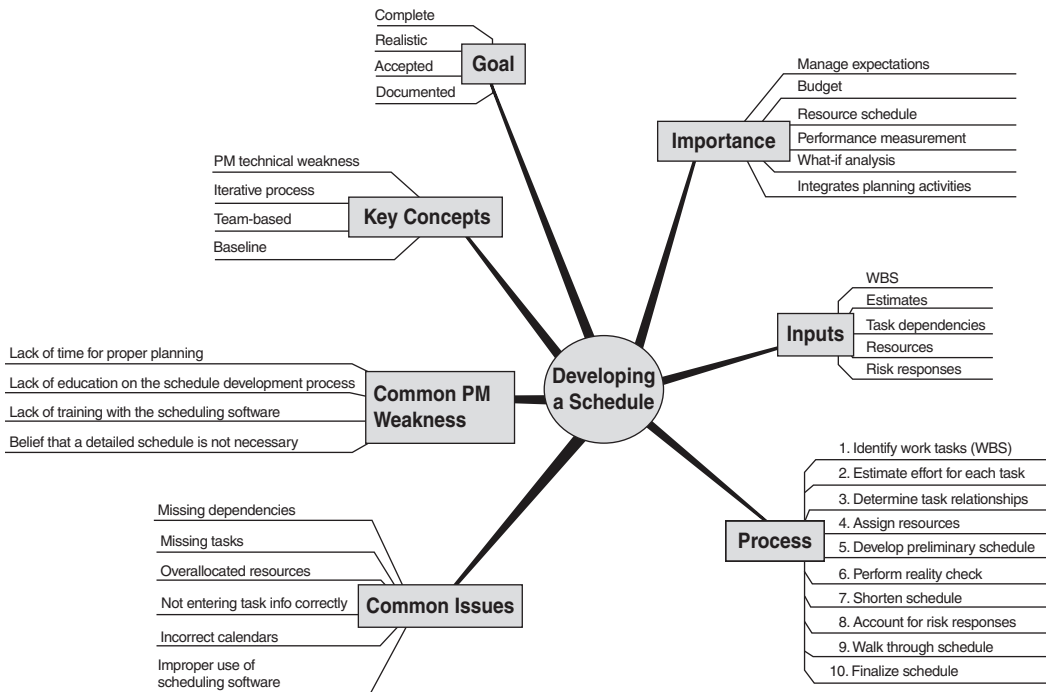


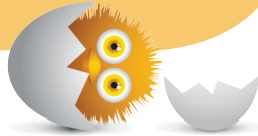
FIGURE 8.6

Overview of developing a schedule.

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IN THIS CHAPTER

- Understand why the project budget is important to project success
- Review the process for figuring a realistic budget
- Learn the key project budgeting principles
- Understand the common mistakes people make when building a project budget



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DETERMINING THE PROJECT BUDGET

It's one of the key success factors for projects—completing the project within budget. Yet, for many project managers, especially those managing internal projects, it's the success factor they have the least awareness about. There are several reasons why this occurs, and it does vary by industry, but most of the reasons have to do with organizational management structures and organizational budgeting and cost-controlling policies.

For our purposes, in this age of increased accountability of project investment decisions, we will assume you need to establish a project budget and need to track costs against it as the project is executed.

Because this is an introductory project management book, we avoid any discussion of advanced financial topics and instead put our focus on the “need-to-know” fundamentals for figuring your project budget. In this chapter, we emphasize the importance of the project budget, review the process and key principles for developing a realistic budget, and highlight the areas where people often go astray. This leads to a budget that has credibility with your stakeholders and provides you with the foundation to effectively track project costs and manage project execution.

The Impact of the Project Budget

Even if you find yourself in an environment where it is not expected that you develop a project budget (instead you are asked to primarily manage schedule and scope), I strongly encourage you to do two things:

- **Do it anyway**—Develop a project budget anyway. This exercise builds your project management skills, enables you to recognize project performance issues sooner, and better prepares you for senior management discussions about your project.
- **Follow the money**—You should have determined this as part of project definition, but just in case you haven’t, make sure you are totally clear on who is financially sponsoring the project and who controls any finance-based decisions to be made about your project. This awareness is key in your efforts to manage expectations and to understand the political aspects of your project.

The project budget estimates all the costs the project will incur, and when they will be incurred. It is a key component of the overall project plan. The project budget is important for the following reasons:

- **Planning validator**—Because the project schedule is a main driver for the project budget, the budget can serve as an excellent cross-reference for the validity of the schedule and vice versa. By looking at the schedule from a cost perspective, you might see resource or budget issues that were not obvious before. Inversely, the schedule input is key for validating the project budget because the budget needs to account for all the time a resource is required on the project.
- **Performance measurement**—By measuring project progress against a cost baseline, you can better measure the true performance of your project along the way, and in most cases, identify issues and risks much sooner. This is the basis for an advanced project controlling technique called earned value management, which we discuss in Chapter 10, “Controlling a Project.”

- **Managing expectations**—The budget impacts stakeholder expectations in several ways. The initial budget sets the expectation of what the total project costs should be. If the budget is not developed properly, then you are bound to have an expectation issue. If the project budget is predefined and serves as a cost ceiling for the project, then it helps you to set stakeholder expectations regarding project schedule and project scope.
- **Cash flow management tool**—Your schedule drives the timing of your resource needs. Especially in organizations where resources are shared across projects or centrally managed, the accuracy of the schedule is key to efficient resource management.
- **Justifying project investment**—With more projects accountable to a project selection process and to financial return on investment expectations, it is increasingly important to establish the cost baseline for the project and monitor closely.



CAUTION Make sure your project budget accounts for all cost factors and for the entire life cycle of the effort.

Principles of an Effective Budget

Before we get into the details of building a project budget, let's review the fundamental principles that guide this process:

- **Iterative process**—Budget development is an iterative process, just like all project planning. The various facets of project planning interrelate and have natural feedback loops. With the project budget, there are strong dependencies on organizational policies and on the schedule development process. As a result, it usually takes several cycles to fully develop the budget and come to an agreement.
- **Total life cycle**—The budget should address the total project life cycle. This is a common oversight, especially for the operational phases of the project.
- **Time-phased**—Not only do we need to budget cost totals, but we need to know when these costs will be incurred for both cash flow management and project control reasons. The goal of the project budgeting process is to establish a cost baseline.
- **Comprehensive**—The budget should account for all project costs. There is a tendency to only account for obvious resources needed for the project (labor or new equipment). As part of our focus on making the budget (like the schedule) complete and realistic, we cover all the costs that need to be considered later in this chapter.

- **Include a buffer**—A buffer, normally referred to as management reserve, should be allocated to the project budget. The management reserve is primarily there to deal with known risks (a risk response), the estimating uncertainty factor, and the overall planning uncertainty factor (hidden work, rework, hidden costs, and change requests). In addition, if you have a long-term project or an international project, you might need a buffer for monetary factors such as inflation and exchange rates. Of course, these should be noted as risks in these situations.
- **Document assumptions**—Budget assumptions are documented like all other project assumptions. Any assumption made as part of the budgeting process should be documented and clearly communicated. As with all assumptions, you can document them within the targeted deliverable (in this case the budget document spreadsheet), or add them to the designated repository for project assumptions (commonly either a separate assumptions document, the project definition document, or project plan).

Creating a Project Budget

The actual process of developing a project budget is straightforward. The general challenges lie more with omissions and the foundation on which the budget is based. In this section, we review the details of the development budget and finalize the budget steps depicted in the general project planning process flow in Figure 9.1.

Sources of Project Costs

The first step in building a project budget is to identify your costs. This sounds easy enough, right? Let's review the cost sources that you need to consider. These cost sources are summarized in Figure 9.2.

- **Labor costs**—One of the key budget cost items. Budget should reflect a line item for each person or role—whichever makes the most sense for your project. Costs are based on resource rates and estimated work durations. When dealing with external labor, these costs are a key component of the business relationship and normally easy to obtain. However, it can be difficult getting rates for internal resources. In most organizations, either the human resources or finance department should have standard labor rates for internal resources based on role.