Exercise

# Financial Reserves

Consider each of these scenarios and determine how you would approach the answer with respect to financial budget reserves.

1. You are the manager of an IT data center department. While preparing your budget for next year, you have identified three accounts that are potentially reserve accounts. These three accounts are 1) disaster recovery from massive facility issue, 2) patches to existing code for compatibility issues from upgraded/modified commercial software that is used by customers to generate data used in our databases, 3) Education and training costs for new employees, (varies based upon frequency of staff turnover).

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| --- | --- | --- | --- |
| Account | Year | Frequency | $$ Spent |
| Disaster Recovery | 2015 | 0 | 0 |
|  | 2014 | 2 | $34,282 |
|  | 2013 | 1 | $23,759 |
| Software Patches | 2015 | 36 | $58,325 |
|  | 2014 | 41 | $88,227 |
|  | 2013 | 34 | $48,482 |
| Education & Training | 2015 | 4 hires | $8,755 |
|  | 2014 | 11 hires | $29,209 |
|  | 2013 | 5 hires | $17,311 |

The table shows the spending in each of these three areas over the past year. There is nothing occurring in the coming year that would make you think that the frequency of any of these will increase or decrease. Decide how much reserve to allocate in the annual budget for each account and the timing (estimated transaction date) for that reserve.

1. You are a project manager for a new product development project. This project is a derivative product of a well-documented product line that currently has no significant problems. The project estimate is 11 months and a budget of $1,755,200 based upon the bottom up estimate from your team members. You have done a risk analysis and three significant risks were identified.

* Loss of a key team member during the project would delay the project by three weeks with an impact of $10,000 extra cost and $75,000 lost sales revenue this year. (Probability is high, impact is moderate)
* Test failure of the product during final systems testing will require a redesign to correct design flaw. The impact is 3 month delay, an extra $400,000 in cost and a loss of $300,000 in sales revenue during this year and next. (Probability low, impact high)
* New manufacturing tooling and test equipment has flaws that must be corrected and a new pilot run conducted. The impact is a four week delay, an extra $150,000 in cost if both tooling and test equipment require corrections ($75,000 each), and a loss of $100,000 in sales revenue this year. (moderate probability, moderate impact)

You identify risk mitigation strategies:

* Incentivizing your team members to stay with the project; which if adopted would add $10,000 to the project and no schedule impact.
* Add prototype and bench testing before system test; which if adopted would add $30,000 to the project with no schedule impact, since these test would be done in parallel with currently planned activities.
* Add compatibility tests and analysis to tooling and test equipment design; which if adopted would add $30,000 and three weeks to the schedule.

Your management team decides to approve the risk mitigation approach for the failed system test (the second risk) which you incorporate into the project. This lowers the risk probability from “low” to “very low.” The new project cost is $1,785,200. There is no change in the end date of the project. Decide how much reserve to place into the project and whether to allocate it to a set of tasks or maintain it at the project level.