UNIT 9: MANAGEMENT ACCOUNTING: COSTING AND BUDGETING

- LEARNING OBJECTIVE 3: BE ABLE TO PREPARE FORECASTS AND BUDGETS FOR A BUSINESS
THE BASIC SYLLABUS

1. Be able to analyse cost information within a business.

2. Be able to propose methods to reduce costs and enhance value within a business.

3. Be able to prepare forecasts and budgets for a business.

4. Be able to monitor performance against budgets within a business.
LEARNING OUTCOMES

- Be able to propose methods to reduce costs and enhance value within a business

- At the end of the class the students should be able to:
  - 3.1 Explain the purpose and nature of the budgeting process
OVERVIEW

- The budgeting process is an essential component of management control systems, as it provides a system of planning, coordination and control for management. It is often an arduous process, however, and often strikes dread in the hearts of those involved in budget preparation.
CIMA’s Official Terminology of Management Accounting defines a budget as: ‘a quantitative statement for a defined period of time, which may include planned revenues, assets, liabilities and cash flows. A budget provides a focus for the organisation, aids the co-ordination of activities and facilitates control.'
A budget is a key management tool for planning, monitoring, and controlling the Finances of a project or organization. It estimates the income and expenditures for a set period of time for your project or organization. Your budget can serve a number of important purposes, including:

- Monitoring the income and expenditures over the course of a year (or a specific project time frame)
- Helping to determine if adjustments need to be made in programs and goals
- Forecasting income and expenses for projects, including the timing and the availability of income (such as additional grant funds)
- Providing a basis for accountability and transparency
BENEFITS

• Budgets don’t guarantee success, but they certainly help to avoid failure. The budget is an essential tool to translate general plans into specific, action-oriented goals and objectives. By adhering to the budgetary guidelines, the expectation is that the identified goals and objectives can be fulfilled.

• It is crucial to remember that a large organization consists of many people and parts. These components need to be orchestrated to work together in a cohesive fashion. The budget is the tool that communicates the expected outcome and provides a detailed script to coordinate all of the individual parts to work in concert.
**BENEFITS**

- When things don’t go as planned, the budget is the tool that provides a mechanism for identifying and focusing on departures from the plan. The budget provides the benchmarks against which to judge success or failure in reaching goals and facilitates timely corrective measures.

- Operations and responsibilities are normally divided among different segments and managers. This introduces the concept of “responsibility accounting.” Under this concept, units and their managers are held accountable for transactions and events under their direct influence and control.
Benefits

- Budgets should provide sufficient detail to reflect anticipated revenues and costs for each unit. This philosophy pushes the budget down to a personal level, and mitigates attempts to pass blame to others. Without the harsh reality of an enforced system of responsibility, an organization will quickly become less efficient. Deviations do not always suggest the need for imposition of penalties. Poor management and bad execution are not the only reasons things don’t always go according to plan. But, deviations should be examined and unit managers need to explain/justify them.
Within most organizations it becomes very common for managers to argue and compete for allocations of limited resources. Each business unit likely has employees deserving of compensation adjustments, projects needing to be funded, equipment needing to be replaced, and so forth. This naturally creates strain within an organization, as the sum of the individual resource requests will usually be greater than the available pool of funds. Successful managers will learn to make a strong case for the resources needed by their units.
But, successful managers also understand that their individual needs are subservient to the larger organizational goals. Once the plan for resource allocation is determined, a good manager will support the overall plan and move ahead to maximize results for the overall entity. Personal managerial ethics demands loyalty to an ethical organization, and success requires teamwork. Here, the budget process is the device by which the greater goals are mutually agreed upon, and the budget reflects the specific strategy that is to be followed in striving to reach those goals. Without a budget, an organization can be destroyed by constant bickering about case-by-case resource allocation decisions.
Another advantage of budgets is that they can be instrumental in identifying constraints and bottlenecks. The earlier example of the power plant well illustrated this point. Efficient operation of the power plant was limited by the supply of natural gas. A carefully developed budget will always consider capacity constraints. Managers can learn well in advance of looming production and distribution bottlenecks. Knowledge of these sorts of potential problems is the first step to resolving or avoiding them.
The overall concepts of planning and control are illustrated in ABKY Exhibit 11-1 and summarized in a similar exhibit below. After the organization's objectives, goals and strategy has been identified, the master budget is developed to express the plans in monetary terms. The master budget serves as a tool for communication and coordination recognizing the interrelationships within the organization. The control elements of the cycle involve calculating differences (variances) between the actual results and the budget estimates to help monitor performance.
LINKS WITH ORGANISATIONAL OBJECTIVES/STRATEGY

Planning and Control Cycle

1. Identify Organization Goals and Objectives
2. Develop Long term Strategy and Short term Plans
3. Measure Performance against the Budget
4. Reevaluate Objectives, Goals, Strategy and Plans
5. Develop Master Budget
A budget manual is a written set of instruction that serve as a rulebook and reference book for your company's budget. This manual is going to be used for information in writing your budget. So when creating a budget manual you are going to want to know the basics of your budget so that you can write down how you are going to want budget plans submitted. Your budget manual can also be your budget process, basically the steps you are going to take to plan your budget.
BUDGETS AS PLANNING

• The organization should react to such shocks and surprises in some systematic manner. Management must have advance information on possible deficits. For this reason it has to plan and prepare budgets. Planning may also help the organization to establish concrete goals for motivating people to perform better, and provide standards for measuring performance.
BUDGETS AS PLANNING

Without planning, the organization is like a black box: not knowing how things are happening and how interrelationships and interdependencies work. Planning alerts management to potential problems, and the result is better management of resources.
BUDGETS AS PLANNING

- Figure 1 Consequences of inadequate planning

1. Deficit not known
2. Ad hoc requests
3. Arbitrary approvals and cuts
4. Impact on services
BUDGETS AS PLANNING

- Analysis of deficits helps management to identify reasons and take corrective actions. Sometimes it is argued that all non-profit organizations will have deficits. This may be true, but then how much? All organizations incur certain costs in order to perform their activities. To meet these costs, the organization gets funds from government or other agencies. Whatever activity the organization is performing, it has cost implications (Figure 2). Deficits arise because of a number of reasons, including those considered below.
The development of a budgetary control system is an activity which requires coordinated efforts from different departments and at various levels. To ensure that staff become involved and participate in a useful and meaningful manner, all efforts need to be coordinated. Since different departments are involved, conflicts are likely to arise. The organization should develop mechanisms to resolve such conflicts without affecting the basic objectives. Management must also ensure that people actively participate in the budgeting process. It is only through active participation that staff feel committed, motivated and encouraged to work towards the common goals and objectives.
Motivation

- Budgets provide a target at which group members can aim. They provide a focus for each individual’s efforts. When participation is allowed during budget setting those involved in the discussion are more receptive to the decisions made and are more likely to cooperate in achieving the budget.
Planning is a process of stating what we want to achieve, and trying to achieve what has been planned. Future outcomes are controlled on the basis of what has been achieved in past. Control is possible only if we have established criteria against which the actual accomplishments can be compared. The indices developed for the purpose of evaluating planned tasks and actual accomplishments (Session 1 of this module) provide important insights into achievement efficiency of planning. However, a detailed investigation of the outcome of these indices is required. The ultimate objective would be:

- to ensure that plans are achieved; or
- to lay emphasis on what can be achieved.
To ensure that plans are achieved requires that activities and operations of the organization are coordinated in such a manner that the achievement of plans is given more emphasis. Any departure from the planned figure is treated as serious, and a detailed examination of factors causing such deviation is undertaken. Emphasizing what can be achieved can be an outcome of changed circumstances which have made such achievements possible now.


Bibliography

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