

Budget And Budgetary Control

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Introduction

Budget and budgetary control practices are an integral part of an organizational routine as the organizations go about their business activities and day-to-day operations. These help keep the organizations financially alert on how well their actual performance matches the budgeted performance. Budgets are expressed regarding financial or monetary terms. These tools are usually prepared before a fiscal period and reflect incomes and expenditures, as well as the anticipated capital an organization is willing to invest in achieving its set goals. On the other hand, budgetary control can be described as a concept that goes hand in hand with a budget. Budgetary control reflects the different expenses a business can employ and how they can be controlled (Horngren, 2009).

The main aim of budgetary control is checking on the expenditure of all departmental activities in an organization and their adherence to the set budget. In other words, the budget ensures the expenditure patterns are streamlined, assisting the organizations to run smoothly as they carry out their functions. Budgets are prepared for a financial period and clearly show both the income and expenditure as well as the capital an organization employs to achieve the set goals and objectives. Since no business operates without a goal, the successes of those organizations are purely pegged on how well they can predict the future and the actions they would take for the realization of set targets.

Budgetary control pays critical attention to controlling this expenditure and ensuring all departments are on par with the budget allocations, hence running smoothly. In short, the primary function of a budget is to streamline the organization's expenses while assisting in trying to maximize revenues. It is the responsibility of the executives, as per the requirement of a policy, to keep a tab on the budget proceedings and call for revisions when need be (Chenhall, 2003).

Budget Control Cycle

The budget control cycle deals with a budget's life from when it is conceived up to when it is evaluated. Small businesses avoid using the term cycle, but all in all, they employ the same steps that are needed to build a budget. The process of budgeting takes place in stages where planning is the first stage, allocation of funds follows, and eventually, new information leads to revisions should need to be. A budget cycle has four segments, including preparation and submission, approval segment, execution and audit and finally, evaluation. The segments offer a framework for the creation of an important tool that a business requires for success.

Budget cycles are popular with government agencies because, most of the time, they are expected to be transparent about their budgeting process. To them, the cycle contributes to due diligence as well as accountability. This is because past business performance, as well as financial projections, inform the processes and decisions that are well documented at each stage. The cycle begins before the start of a financial period and ends after the period ends (Otley, 2001).

Preparation and submission stage: during this stage, the business considers numbers before making a decision. In the case of diverse departments, each submits their budget projections that must go through several steps before approval. As for a single department, the budget may be a simple one requiring little input from other members. Either way, the budget is presented to the persons who are charged with reviewing and making recommendations and finally approving it. Mostly, this is done by accountants (Horngren et al., 2002).

Approval and execution stage: The length of the approval process depends on the size of the organization, but approval becomes official. Government budgets are approved by high-level managers and officials who are elected by the sitting government. In the case of sole proprietorship, the owner solely approves a budget. While a small business continually keeps altering the budget, massive businesses call for strict adherence to the set budget unless the changes are agreed upon and approved. A company's accounting period marks the execution segment while monitoring and financial activities control happen during execution. Needed changes are then effected, and implementation of the budget occurs (Bruder and Roncalli, 2012).

Audit and evaluation: These two occur at the end of an accounting period. They can be determined by an external or by an internal auditor. He not only examines the accounting activity but also assesses adherence to the set budget by measuring the projection's accuracy that was used to formulate the budget. The auditor then prepares a final report on the budget by making recommendations for the next upcoming budget.

The Budget Cycle

Whereas in practice the budget represents a planned activity spread over a financial period, its primary role is evaluating the comparison of the scheduled acidity to the income it is expected to generate. Upon audit and evaluation, a surplus will indicate an increase in reserves, while a deficit will consequently imply that reserves have dwindled (Bromwich and Bhimani, 2005).

Fixed And Flexible Budgets

While a budget serves to estimate future operations, management accounting prepares two types of budgets. This includes a fixed and flexible budget. Fixed budgets do not vary, irrespective of the kind of activity. They remain constant. That means they are tailored for a production volume that is standard. It simply refers to an estimation of predetermined incomes and expenses that cannot be

altered with the changes in the activity levels realized. This kind of budget can also be referred to as a static budget. It is the type of budget that best fits organizations that rarely fluctuate because it is not affected by internal or external factors.

On the other hand, a flexible budget is created to suit varying production levels. That means it is not constant but instead changes when a level of activity demands. While a fixed budget works at a single production level, a flexible budget consists of many budgets working in a different set of conditions. This kind of budget can be freely re-casted depending on the output produced. When drawing this kind, costs are divided into three major categories, namely: variable, fixed and semi-variable costs. This budget is best suited for organizations with high-degree changes in production and sales or industries easily influenced by external factors (Otley, 2003). In conclusion, a fixed budget is impractical, makes many assumptions and is not very applicable to business concerns. The reason is the way it makes comparisons between the actual and the budgeted differ. On the other hand, flexible budget comparisons between the projected and actual are easy, allowing possible judging of business performance (Burns and Scapens, 2000).

Budget Variance

Budget variance refers to factors that are not predictable and cause a firm to spend slightly more or less than what it has budgeted for. To find the variance, planned labor costs and the cost of materials are separated. The factors occur separately; hence, a company can exceed what was initially planned for. That is, an organization can spend on wages and more on materials or the opposite. Factors that may result in budget variances include;

Labor: Labor costs are influenced by what was budgeted for as well as the number of hours that an employee works. While an organization budgets for labor using the average rate of working hours, if they engage employees who are more experienced to do the job, they may end up spending more money to compensate the workers. Also, the organizations also budget for overtime; hence, employees may end up spending slightly less or more money, which either way results in budget variance (Zimmerman and Yahya-Zadeh, 2011).

Materials: The cost of materials is another factor that results in budget variance. Companies for a given price of raw materials which it expects to use in the creation of the final product. For instance, a company may be using \$30 of raw materials to manufacture products that fetch \$ 70. If the person supplying the product instead charges \$35 for the materials, a budget variance automatically results. However, employees may be wasteful of the materials while some are efficient and end up using lesser materials than what was budgeted for, both scenarios result to budget variance (Stede, and W.A., 2001).

Flexible budget: This is another source of budget variance. A flexible budget is adopted when an organization is trying to escape a variance as a result of excess requisition of products or as a result

of an underestimation of products. According to Oregon State University, a budget that is standard should set costs by considering the number of products the company projects to use, while a flexible budget allows costs based on the capacity the company's production capacity. A flexible budget gets rid of this variance that results when the company makes higher or lower goods than usual. This assists the company in determining its manufacturing process efficiency.

Cost and efficiency: An efficiency variable and a cost variable can be used to separate materials and labor. In the case of labor, the cost per hour of each worker is separated from the amount of **finished product** each worker makes hourly. In the case of materials, the cost is separated from the number of raw materials the employees use to create each product. This way, the organization can regulate how efficient it is, though it cannot control the price it purchases raw materials nor the number of wages each employee demands (Garrison et al., 2010).

Causes Of Cost Variances

Another important tool for business owners to better their understanding of costs is looking at efficiency variances. The latter examines both the cost and use of materials, labor, and overhead costs, helping cite inefficiencies. When attempting to figure out labor variance, one should constantly engage employees in the entire process. Being closest to the problem, they are likely to offer valuable insight regarding possible solutions (Drury, 2013).

Worker pay versus skill level: This factor may greatly affect the variance of labor. The more experienced employees are, the more expensive their skills are. The reverse is true where newer workers are compensated at a lower rate, leading to a favorable variance of labor rate.

Bad scheduling: This is a source of waste operations where too many employees are scheduled during non-peak hours, making the company realize bad labor efficiency variance. Optimal scheduling should be informed by gathering information and forecasting. The more data available regarding previous scheduling, the better an organization can forecast future workflow.

Material quality: Low-quality materials can affect productivity; hence, an organization should consider purchasing materials of high quality rather than purchasing lower-quality ones for a lower price. Most of the time, the lower quality attracts more quantity of materials needed, resulting in materials efficiency variance. There is also a possibility that more time will be consumed while manufacturing a product (Ward, 2012).

Conclusion

Over the last few decades, one term that has become common currency in all managers' day to day lives is budgets. It is the most preferred course of action by managers in running organizations across all sectors. Leaders have employed the tool as their shield or excuse whenever faced with challenges

about any decision. Whereas it is a tool that assists us in resource allocation, it represents a financial counterpart that takes the form of revenue and expenditure. Different types of budgets exist, just as there are many forces controlling the effectiveness of a budget. Some of the budget aspects include variances that occur due to temporary or permanent issues. However, the issues can be fixed through constant revision after the executive advice upon the comparison of actual and projected budget outcomes. Where new information is needed, it is incorporated to reflect current organizational financial status. Also, all organizational policies relating to budgeting and budgetary control should constantly be checked to ensure their relevance. The policy on allocation of resources and budget infrastructure improvement remains the most essential. Budgetary control achievement relies mostly on these two aspects; hence, attention should be paid to them.

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