

Management Accounting
LCBB5002

Budgeting



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Contents

- Introduction
- Function of budgeting
- Advantage of budgeting
- Drawback of budgeting
- Budgeting process
- Balanced scorecard
- Activity based budgeting
- Advantage of Activity based budgeting
- Disadvantage of activity based budgeting
- Conclusion
- References

Introduction

Budgets are written financial statements prepared and permitted in advanced in order to obtain the goals and objectives of the organisation. The preparation of a budget is called 'Budgeting'. The number one goal of the budgeting is measuring the profitability of the business. Simply budgeting is a systematic scheme for utilizing human resources and materials. Budgeting is defined in different ways by different people all over the field of accounting.

"Rigorous planning...of any economic activity is an essential element for the success of those activities. Without planning the activity of any economic entity would detach from surrounding reality..... the capacity for provision and planning of any activities in a market economy conditions assures the survival and development of these activities"(Achim, 2009, p.33).

Blumentritt defines budgeting as "the process of allocating an organization's financial resources to its units, activities and investments" (Blumentritt, 2006)

In other words, budget is a plan how an organisation is going to obtain and uses resources over a specific period of time. Budget plays an important role in managing business in both public and private, as it sees as the core of many organisations. Budgets are the most popular managing and controlling tool for organizations. The basic aim of the budget is controlling the activities in the business by way of offering some ways to achieve its future desires.

There are different types of budgeting methods in use. Some popular ones are Zero-based, Incremental, Traditional, Activity-based and Balanced scorecard. In this report we have provided a detail analysis of Activity based budgeting and Balanced scorecard.

Function of budgeting

Budgeting is required to plan the operations which ensure the organisations' strategic targets recognition and for making strategy to achieve organisational goals. As the Budgeting is being prepared by considering the previous budgets and operations, it is referred as 'beyond budgeting'. Budgeting technique elevates managers to foresee all the problems earlier and as a result of it, keep away from making hasty choices in the future.

Budgeting acts as a framework by indicating the parameters that the organisation has to consider in order to reach the objectives. It does a great role in coordinating and balancing the tasks from different departments and their functions. Researches evidence that the businesses in the developed countries as well as the developing countries use budgets as a tool for controlling and planning processes.

Advantage of Budgeting

The companies use budgets for several reasons. One of the main reasons is planning to use resources efficiently. In addition to that budgeting is used for many other different purposes, such as:

- control expenses and income
- setting targets
- provide the correct path in order to turn dreams into reality
- allocate responsibilities to the managers
- resource allocation
- provide a better understanding about the goals
- employee motivation
- making the best possible use of resources

- monitoring the performance and etc

Drawbacks of budgeting

Some researches and books mention budget as an unnecessary thing and just a waste of time. Because of some reasons. They are listed below:

- It has to be examined and make alteration from time to time so that it costs more expenses in administration.
- Budgets are focused on future but future is not certainty it may not occur in the way expected and the budgets can become pointless.
- Work towards one goal while other weighty tasks are gone worse.
- Unnecessary and additional work within the company which leads to incur costs.
- Chance for misleading as it is prepared on the basis of approximation.
- Managers from each sector wants themselves to have more resource allocation and it may leads to conflicts.
- Employees are demotivated because they will not be eager to engage in work if the tasks are too easy or too hard.
- An employee with specialized skill is needed and it is not possible adequately for a company.

Budgeting process

Every realistic budgets are the outcome of well organized budgeting process. It is the foundation to make the goals into reality. Below are the steps to create a detailed budgeting:

1. Set the objectives of the organisation for future
2. Analyse the available resources within the company. It includes not only the cash but also the outside investment, loans and etc. Further the sales projection has to be considered.
3. Research the available previous year data and competitors' data and information to reach an estimate in order to projecting the needs of future.
4. By keeping the priorities in mind, the available resources have to be allocated to future needs. Even though they are not perfectly matched, the compromising has to be done.
5. After completing the above steps, yes or no decision has to be taken as a final approval from the suitable entity.
6. Distribute the allocated funds to various segments of the business.
7. Observe and Evaluate prepared budget is the final step in this process but, it is more important to hit the desired target.

If these steps are not considered properly, the budgeting will not be realistic and become harder to achieve.

Balanced scorecard (BSC)

The success of a business depends not only in tangible factors but also in intangible factors, It is crucial and hard to define. The balanced scorecard is a management system that measures and coherently expresses these intangibles. It is used to assess an organisation by measuring its performance. All these features are measured with equal importance. Usually for main perspectives are considered in a balanced scorecard.

1. Customer perspective:-

An organisation cannot survive without customers. This perspective deals with the needs and focus of the customers. It identifies the types of customers of a business, their needs and what is the best way to fulfil those needs. It is generally evaluated using surveys. Customers' concerns can be in four categories such as cost, quality, performance and time.

2. Internal business:-

It makes awareness of the processes which are more important such as production, marketing and distribution. It joins up the mission with organisation's daily tactical operations. This perspective is used to identify whether the process of internal business meets customers' expectation.

3. Growth and learn:-

Obviously knowledge is the priceless resource within a company. Unless the business continuously develop and proceed, it will be outdated. This is concerned with training, self-improvement and organisational improvement. Further it develops a better organizational culture which guides the employees with required knowledge to perform efficiently and effectively. The more forward-looking a firm, the greater it will gain related to this perspective of the balanced scorecard.

4. Financial perspective:-

It is the most traditional one in the balanced scorecard which deals with financial data like equity, profit margins, cash flow and assets. Though all are given equal weight, it is given more emphasize compared to other perspectives. A company needs a healthy cash flow for its survival and a revenue growth is important to succeed.

BSC is used by the management prioritise the products and services they should give more important and also to maintain a record and manage every day activities and conveying its target. Apart from the above additional perspectives can be added according to the needs of the companies.

Activity based budgeting (ABB)

Activity based budgeting can be defined as a system that records and analyses the activities of an organisation that give on to costs. Each and every activity that leads to costs are examined in a way to create effectiveness, efficiencies and productivity. The budgets are prepared based on activity based methodology. Further in this concept, the budgets are derived using cost drivers. ABB system gives more attention to the activities, not for the functions because they are activity oriented. Thus the previous budgets are not taken into consideration while preparing the budgets, instead they do a research on the activities that incur the costs before budgeting. Based on the results they allocate the resources for those activities.

In business management, Maintaining the cost to a minimum level is pre-eminent. By eliminating unwanted costs the business can increase its profitability.

Three main steps in Activity based budgeting:

- Identifying the applicable activities that give rise to the expenses of the company.
- Determining the unit number of relevant activities.
- Set out the cost incurred to produce a unit and multiply the figure by the activity level.

Advantage of Activity based budgeting

ABB helps management to control budgeting process by evaluating the cost drivers. They eliminate the irrelevant activities and only the essential ones are taken as parts of business. So that the business can save costs and that can be invested for the production. Apart from that it helps to distinguish the business from its competitors and attract the customers to choose its products.

ABB tool makes the business as one unit not as several departments. The fact is the budget is being prepared viewing the company as a whole, not as any single sectors done in other types of budgeting.

Disadvantage of ABB

As all the systems, Activity-based budgeting too has some disadvantages as well. A clear idea requires to come-up with an accurate budget. If the budget maker is lacking the ability to understand the functional areas, the outcome will not be efficient and accurate to execute. In contrast, it is complex as it needs more and more researches and analysis. Just ordinary staffs can not handle ABB. So well trained employee is needed and the company wants to spend on training such professionals. We need more resources and time to execute and maintain. Instead of this budgeting task, if those resources are used in any other operation, it can produce some better output. When it comes to time period, long term is not focused in ABB management tool.

Conclusion

From the above report, one can conclude that budgeting plays a vital role in financial sector of an organisation. A budget is a framework of a business that analyses the past and forecast the future. An effective budgeting is absolutely necessary for the survival of an organisation. They act as a coherent guide to which way the company should run its business towards success.

In a nutshell, without the support of budgeting achieving the goals and targets of a business is a guessing game.

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