

Management accounting

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INTRODUCTION

Budget refers to a preparation of monetary plan to spend money properly. It is used to determine whether there will be enough money to complete the project or not (Honggowati and et.al., 2017). It mainly focus on allocation of resources, coordination, planning, monitoring and controlling. It is beneficial for management of company to take strategic decisions and forecast business performance, income and expenses. Budgeting process is used to forecast expenses and income of future so that managers are prepared for the uncertainty. There are various types of budgets such as operational budget, sales budget, production, labour, material, fixed overheads and variable overheads. These budgets is beneficial for companies to complete all the business activities within the predetermined budget. Report will contain issues regarding traditional budgeting methods. Traditional budgeting refers to creating a budget by taking previous year's budget as a base. It adjust the expenses like inflation rate, market situation and demand of consumers. There are various drawbacks of traditional methods such as that it is time consuming and there is chance of human error. Managers started to feel that this type of budgeting is ineffective. Traditional budgeting methods has led to new ways of budgeting i.e. activity based budgeting and balanced score card.

MAIN BODY

Budget is prepared by taking the previous year's budget as a base and forecast the future year budget. The main purpose of preparing the budget is to estimate the expenses and income. It is used to make correct decisions and actions whenever needed. It is beneficial for company to evaluate the actual performance with the expected performance. Budget is also referred to as a tool for decision making. It is beneficial for companies to keep their financial statement positives (Klychova, 2015).

Objectives for budgeting

- **Allocation of resources:** One of the main objective of preparing a budget is to allocate all the resources properly. Companies use budgeting as a tool through which resources like funds, technology and market information are allocated to various business activities. Change in the marketing condition changes the preparation of budget. By studying the ups and downs in the cash flow, company is able to decide where to allocate the funds. It helps in determining where to allocate the resources (Abernethy and Wallis, 2018).

- **Estimation of income and expenses:** It is used to forecast expenses and income of the company as it is prepared by taking previous year's budget as a base and estimating present and future years budget. The main objective is to find out whether there is increase in expenses of income. If there is an increase in the expenses then management will take correct actions and decision to decrease the expenses. Unexpected change in the economic condition may affect the budget and it will not be so accurate (Cowton, 2018).
- **Performance evaluation:** Budget benefits companies in measuring their performance. It is one of the most important objective while preparing a budget. By evaluating the actual performance with expected performance variance is identifies. Management of the company measure employees standard performance with the expected one and identify the variance. Through use of variance it is easy for companies to improve the budget so that objectives and goals of the organisation is achieved (Kastberg and Siverbo, 2016).

Process of preparing budget

There are 4 steps in preparing a budget which are as follows:

- **Step 1- Identifying objectives and goals:** Most important step in preparing a budget is to identify the goals and objectives of the business. By identifying the business goals and viewing business plan it will be easy to prepare a budget as a rough structure will be identified. From the business plan, information is collected and which is essential in budget preparation (Strauss, Kristandl and Quinn, 2015).
- **Step 2- Reviewing past documents:** Here all the past documents like income statements, balance sheets, tax returns, outstanding debts, liabilities and cash flow statements are viewed. By reviewing all the documents a trend is identified which is useful in creating a budget. Through income statement estimation of future expenses and income is done, fluctuation in cash flow will help management in allocation of funds properly.
- **Step 3- Fixed cost determination:** In the third step management of the company will define fixed cost associated with the business objectives. In this step each objective is breakdown and specific amount of money is allotted. Past data is used to fill the cost. Research is been done to identify approximate cost (Englund and Gerdin, 2016).
- **Step 4- Budget preparation:** The last step involves analysis of all the information collected in above 3 steps. A trend is identifies which is used in preparing budget. All the

financial; document helps management in allocating funds to different business activities and take decisions to meet the objectives and goals of the business.

Budget is a framework of planning, coordinating and controlling all the business activities. Budget is seen as a road map which guide company in achieving its vision and mission. Budget is prepared on various assumptions, if there us change in market condition then budget need to be reviewed (Nasseri, Yazdifar and Askarany, 2016).

- **Planning:** Budget is a process monetary planning which directs company in spending. Budget planning make sure that company will have enough money to carry out all the activities smoothly. It is importantly to follow the budget unless and until there is no change. Change in the economy such as increase and decrease in the inflation rate, interest rate, foreign exchange rate will affect the budget. As budget was prepared by various assumptions but change in the market condition will help managers in reorganising the budget. It will be beneficial for them in planning.
- **Coordinating:** Budget helps in communicating all the goals and objectives of business to different departments. This helps is coordination between separate activities and makes sure that all the department of the company is balanced. It benefits managers in identifying the strengths and weakness of the company. Coordination among different departments may be affected due to change in market conditions such as introduction of new technologies which will help department in reducing costs (Jansen, 2018).
- **Controlling:** Budget helps in controlling all the activities of business. It helps managers in filling the gap between the actual performance and expected performance. It is beneficial for company to learn from the previous year's performance. It also controls the expenses of the business. Change in market condition will help management in controlling the activities and situation effectively. It helps in achieving objectives of the business.

There are some strengths and weakness of traditional budgeting model because of which new ways of budgeting is proposed.

Strengths

- **Powerful framework:** It provides a powerful framework as it is based on the previous year's budget. It is beneficial for company to manage their financial activities properly

(Honggowati and et.al., 2017). Past year's data helps company in executing the budget plan smoothly. Managers evaluate the performance of the company and improve it.

- **Encourage decentralization:** Everyone in the company is able to look at previous year's data and estimate budget which makes it decentralized. Top management of the company does not need to think budget of future year but only concentrate on high value tasks.
- **Adjustments in expenses:** In traditional budget it is essential to forecast variable expenses such as electricity bill, raw materials etc. if the expenses exceeds than income of company will be reduced. Budget is used to make decisions about what expenses need to be reduced or cut down (Abernethy and Wallis, 2018).

Limitations:

- **Time consuming model:** It is a time consuming system because management of the company need to depend upon the financials which arrive annually. It takes time in sorting and analysing the variance between actual outcome with the expected outcomes. Thus it is time consuming as manager has to wait for the financial report in order to prepare the budget. By considering this academics have proposed activity based budgeting which consumes less times because in this managers does not wait for the financials instead they prepare budget for each activity. This budgeting system does not consider past year data (Kastberg and Siverbo, 2016).
- **Incurs huge cost:** In traditional budgeting cost is incurred because data is collected from past and evaluated to prepare budgets. Cost is incurred in collecting, planning, analysing and estimating the income and expenses. By considering the cost academics proposed balance score card and activity based budgeting where cost is reduced. Managers of the company measure the performance of different departments and make strategies to achieve business goals. It reduces the cost as it does not require past data, funds are allocated to activities after overhead costs (Strauss, Kristandl and Quinn, 2015).

Activity based budgeting:

It is a process of preparing budget using costing methods after taking overhead cost. This type of budgeting does not involve past year's data. Budgets are developed by evaluating the cost incurred by every activity. It is relevant for company to use this budgeting system as it is most trusted and will reduce cost of the company.

Balance score card:

It is used as a performance measuring tool. It is a process which refers to translate objective of business into action plans. It is used to evaluate the performance and find out the variance between actual outcomes and expected outcomes. It is used to achieve vision and mission of company with competitive advantage (Nasseri, Yazdifar and Askarany, 2016).

CONCLUSION

From the above discussion it can be concluded that budgets are used to reach the goals and objectives of the company. Budgeting helps in controlling, planning and coordinating all the business activities. Both the budgeting and other developments like activity based budgeting and balance score card is suitable for company depending on the management settings. Traditional methods has a powerful framework and thus it adjust expenses and is decentralized. It is easy method which is followed by the companies but also it is very time consuming and costly. Managers need to wait for financial report for making budgets but in other two methods there is less time consumed and management does not need to wait for the financials as company can prepare budget by evaluating performance and allotting funds on the basis of each activity.

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