

An analysis of the budgeting in management accounting



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With the fast development of in the area of management accounting, more and more managers are aware of the importance of the budgeting, “ budgeting is an important control system in almost all organizations” (Stephen C. Hansen, Wim A. Van der Stede, 2004, Management Accounting Research, Multiple facets of budgeting: an exploratory analysis,), and it “ provides an expression of the steps which management must take in the current period if it is to fulfil organizational objectives.” (M. W. E. Glautier and B. Underdown. (1997) Accounting Theory and Practice, p531, 6th Edition, Great Britain: PITMAN PUBLISHING).

This paper will discuss that what is budgeting and the budgeting committee, the budgeting purpose and types of budget, the benefits and limitations in the budget, and how to be a successful budgeting.

The budgeting process focuses on the medium term period, normally one year, and it is an expression of plan in monetary terms, which is aim to achieve the organizational objectives, as Colin Drury said “ the budget is a financial plan for implementing the various decisions that management has <https://assignbuster.com/an-analysis-of-the-budgeting-in-management-accounting/>

made.”(Colin Drury. (2008) MANAGEMENT AND COST ACCOUNTING. p10, 7th Edition, China: GENGAGE Learning) The various decisions are covered in cost and revenues, cash flow, assets and liabilities. In additional, the annual budget likely to be sub-divided for reporting periods, such as monthly budget reports, because the risk can be reduced in the monthly budgets and it helps managers easy to find the problems during the operation.

In organizations, “ budgeting is often in the hands of a budgeting committee” (M. W. E. Glautier and B. Underdown. (1997) Accounting Theory and Practice, p533, 6th Edition, Great Britain: PITMAN PUBLISHING), so the members of the budget committee is very important. For example, in the sales budgeting process, marketing department may be deliberately underestimated future sales, thus contributing to their performance evaluation. However, underestimate the quantity of sales will result in a corresponding reduction in production, which means the production will not be able to achieve the most efficient state. Another example, some department may padding the expenses in order to get more budget funds, resulting in a waste of money. Therefore, the budget committee should consist of the various important department managers, and some high-level executives be the leader. Furthermore, it usually has an accountant to be the budget officer in the budget committee, “ the role of the budget officer is to coordinate the individual budgets into a budget for the whole organization, so that the budget committee and the budgetee can see the impact of an individual budget on the organization as a whole.” (Colin Drury. (2008) MANAGEMENT AND COST ACCOUNTING. p357, 7th Edition, China: GENGAGE Learning).

The budgeting purposes and types of budget setting

There are six useful purposes of budgeting, which are planning, coordinating, communicating, motivating, controlling and evaluating. Therefore, the budget will help managers through the planned activities to determine the target of the organisation and allowed managers to consider all possible situations. However, it not only to reflect projected revenue and expenditure budget as of the amount of financial figures, the budget is a kind of resource allocation, input and output of the program content, quantity, and the input-output timing details. Through the budget, so that business managers can have clear objectives. In addition, " the budget serves as a vehicle through which the actions of the different parts of an organization can be brought together and reconciled into a common plan." (Colin Drury. (2008)

MANAGEMENT AND COST ACCOUNTING. P355, 7th Edition, China: GENGAGE Learning) and it is an effective way of the communication in the organization. Managers and staff can be motivated by the budget because of it can help to enhance the predictability and avoid blind behavior and thereby to motivate they to complete the objectives. The Budget is based on quantitative way to show management standards, it can thus be judged according to the budget implementation effectiveness of the work and analyze differences improve their work.

Two types of the budget setting are top down and bottom up. The table of illustration as following

TOP

DOWN

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BOTTOM

UP

OVERALL

BUDGET

FUNCTIONAL

BUDGETS

DEPARTMENTAL

BUDGETS

In the top down way, it typically start with overall budget then broken down into functional budgets and then into departmental. If budget setting is top down, it can be directly link to the organization objectives and reflected to the authority and mandatory of budget. However, it may be limited of the information from lower levels thus that separated from reality and may reduce the effect of budget in planning, coordination and control. On the other hand, in the bottom up way, it typically start with departmental budgets then build up into functional budgets and then into overall budget. Similarly, if budget setting is bottom up, although it can solve the lack of the information from lower levels, but the exchange of information in each department may be not enough thus plans of one department is conflict with others, therefore the lack of coordination will arise.

To solve those problems, the budget setting should be repeated between individuals and the budget committee. Firstly, the objectives proposed by the budget committee, such as the quantity of sales, production costs and target profits. Next, use those indicators to discuss with the various departments in order to reach an agreement, and then the budget committee will be based on the agreement to determine the master budget and give to the departments. After this, the various departments based on the master budget to set out departmental budgets and build up into functional budgets. Finally, the budget committee use those individuals budget to set out the final master budget and gives to each department.

The benefits and limitations

The budget has some benefits to the organization, and it will show in the figure as follow:

Provide a basis for a system of control

Budgets

Provide a system of authorization

Help co-ordinate the various sections of the business

Motivate managers to better performance

Promote forward thinking and identification of short-term

(Perter Atrill. & Eddie McLaney. (2008) Accounting and Finance for Non-specialists. P312. 6th edition. Essex: Prentice Hall Europe.)

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However, the budget has also been found a number of limitations, such as the time lag in the system, which means the results of last month may not be reported in time and be delayed to next month or later. Moreover, there will always be some changes in the organization during the budget period; such as the shortage of funds, labour and materials, and the budget may be impacted thus the objective of organization cannot achieve the optimal state.

To be successful budgeting

As we have discussed in this paper, there are some limitations of the budget, and those limitations may lead to it hard to implement and dissatisfaction may express regarding how budgeting operates in practice. The following is some way to solve those problems and make the budgeting more successful.

Firstly, the budget should be always concerned to achieve the objectives of organization, and need to avoid to only focus on its own target, the reasons of the budget may only focus on its own target and forget the objectives is that it may not properly reflect the requirements of objectives.. In order to prevent the replacement of the budget target, it should enable the budget to more reflect with the organization's objectives.

Secondly, the budgeting should be flexibility, it because of that business conditions are always changing. Although we have planned the business conditions for the situation may occur in the future and make appropriate action to deal with changes, but on the one hand the budget setting cannot cover everything, and on the other hand the situations are always changing that some problems cannot be foresee. Therefore, " it is necessary to view

the budgeting process as a guide to future action, rather than a rigid plan which must be followed irrespective of changing circumstances.”(M. W. E. Glautier and B. Underdown. (1997) Accounting Theory and Practice, p532, 6th Edition, Great Britain: PITMAN PUBLISHING)

Conclusion

In conclusion, budgeting is an important tool for management planning and control, and it has some useful functions for businesses and organizations, but it also has great limitations. The key point in the budgeting is make the benefits of it to be maximum, and reduce the limitations and solve problems during the period, thereby the budgeting can be achieved the most effective level.

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