Advantage and disadvantage of fixed budget accounting essay

However from a bird’s- eye view, budget can be defined as a management tools that put the managers in control of a finical health of the organisation. The objective of the budget is to measure of the financial structure of the organisation and budget is a tool that forces management to be accountable in a structured and objective way. How manager manage the budget is key to their value. Budget facilities the planning and resources allocation and help to estimate, itemised, analysis and examined the entire product and service that organisation offers to customer. (Seer, 2000, p. 187).

Budgeting is a simple process of consolidating budget and adhere them as closely as possible (Maitland, 2000). It is a process turns manager attitudes forward looking to the future and planning; managers are able to anticipate and react accordingly to the potential problem before it arises. Budgeting process allows manager to focus on the opportunities instead of figuratively. The budget system provides sustainability to business process within an organisation. It is an utmost important process to the management. In other word by some researchers “ few business plan to fail but many of those that collapsed failed to plan” (Horngren, C. et al., 2000)

The aim of budgeting is to give management an idea how well the organisation is projecting the income goals and how well the organisation managing the working capital. The budgeting exercise should able to increase the profit, reduce inappropriate expenses and it also helps to expand the markets (Thomsett, 1988, p. 5). To achieve the budgeting aim, the management needs to build a budgeting system (Viscione , J. 1984).

A budget system varies from organisation to organisation and it is not unitary concept. The fundamental concept of budget system involves estimating future performance of the organisation, comparing the actual performance to the budget and analysis the deviation of actual result against the budget. The factors that determining the type or style of an organisation depend on the type of organisation, the leadership style, the method of preparation and desired result (Cherrington & Cherrington, 1973, p. 226)

In general budgeting can be categories into two primary categories (Cohen, J. et al., 1994) which are operational budget and financial budget

Operational budget covers revenues and expenses which involve day to day core business of the organisation which is normal operation activities. The main elements of the organisation operational budget include sales, production, inventory, materials, labours, overheads and R and D budgets.

Financial budget controls the organisation financial aspect of the business. These budgets disclose the influences of the operational budget on the organisation, financial position and potential revenues. Financial budget include cash budget, capital expenditures budget, balance sheet and income statement.

There are many available methods of budgeting are available and it is important for the management to decide the correct methods that suits the organisation. Generally, management choices on how to start preparing budget fall into one of three major approaches (Rasmussen, Eichorn, 2000, p. 19) which are: Top-Down, Bottom- up and Top-down/bottom up. Please refer to figure 1 for Top-down and Bottom-up approaches.

Figure 1: Top-down versus Bottom-up approaches

Source: Rasmussen, Eichorn, 2000, p. 20-25

Main Body

Part A (i)

Budget approaches adapted by United Consultancy

United Consultancy had presently adapted the approach of static budget while preparing the budgeting. Static Budget is also known as fixed budget. Accordingly to Chartered Institute of Management Accountants of England, " a fixed budget is a budget outline to remain unchanged irrespective of level of actual activities attained". A static budget will reflect the expected result or revenues of a budgeting year (Hansen and Mowen, 2011) of a responsibility centre for one level of activities. Normally fixed budget will be prepared in advance before the financial year as the cost classified as fixed and it will not very in direct proportion of the level of activities. Fixed budget approaches are widely adapted by service industry (Reeve and Warren, 2007) and partly by some administrative functions of manufacturing companies such as purchasing, engineering and accounting. Fixed budget is used as an effective tool of cost. If, the level of activities attained are varies from the budgeted activities then fixed budget become ineffective. Comparatively, fixed budget is only suitable for fixed expenses. A fixed budget is appropriate under static condition.

Advantage and disadvantage of Fixed Budget

Small business and service industries needs an overall budget to survive Fixed budget is most widely used by service and small industries as it help to track on control the spending. At the same time fixed budget can cause more problems rather than giving a solution. A fixed budget will capitalised the calculation fixed expenses and help to forecast the bills to be paid by the business. For the variable expenses, fixed budget provides maximise spending limits and it helps to control the finances.

The advantage of fixed budget is to help the business to prioritise the expenses. Fixed budget clearly distinction between the businesses needs and wants by forcing the business to remain consistent, it will also ensure that the bills are paid on time.

The disadvantage of fixed budget as it's operates to one level of activity- the planned activity and it does not account for the business unpredictable activity. The actual always will be captured by a level of activity which is significantly difference from the planned activity. For example, to compare the actual production cost increased at production levels of 1000 units against a standard based on planned activity of 500 units could be misleading. Management will mislead thinking into that the production costs are out of control. An increase in production cost is avoidable as volume increases and it does not means that there is problem on increase cost occurred.

Hiring Consultant for Future budgeting for United Consultancy

A consultant is who has a position to have a certain level of influences over an individual, a group or an organisation but who has no absolute power to make or to adapt changes into the organisation. It is the employee of the organisation has the power to decide whether to accept and implement the changes into the organisation. The consultant brings specialised skills, knowledge, expertises or accessing certain information into the organisation.

Scott & Hascall (2002) had analysed the advantage and disadvantages of consultants and United Consultancy need to consider before hiring consultants for involving in preparation of future budgets.

Advantage of consultants

The consultants are import and hired to fill competency gap in the organisation. According to Drucker (1979) suggested management consultant is an extraordinary and indeed a unique phenomenon as consultancy has the management skills, techniques, knowledge are best learned through exposures to and experiences with many industries as the typical executives lack of this kind of exposure. As Drucker notes, " The executive works with same organisation or most with very few". Executives lack exposure and cannot gain it nor can be stimulate it. Consultant will able to transform the organisation and gain the exposure at the same time will add significant value by reducing the problem resolution cycle time (Hagedorn, 1982). United Consultancy will be hiring consultant for preparation for future budget as it will bring new Idea, proficiency and impartiality objective (Gattiker and Larwood, 1985).

Ifinedo (2011) had surveyed the impacting factor of consultants such as management, support, business, vision and external expertise. The result was found that all these factors influences the business system but the effect of external quality expertise was more important compared to the other factors

Disadvantage of consultants

An organisation hiring a consultant to bring as it will bring the required expertise, knowledge and experience to the organisation. Accordingly to Kelly (1979) hiring external consultant will be expensive as the payment will be based on their specialised skill in the respective field compare to internal consultant. An external consultant will not available at the right time and not easily accessible to the organisation as the internal executives. At the same time, and they are lack knowledge of organisation culture and working environment. Nonetheless consultants have the great level influences the senior management.

A research by Norbck and kerblomMaster (2003) had highlighted that engagement of uncommitted management and inexperienced executives would lead to give an opportunity to consultants to take advantage of the situation and act to their benefit and attaining their own goals. There the experiences and capabilities of management consultants are critical for successful on management of consultants.

One of most important factor to take into account when hiring consultants was mentioned by Luo and Liberatore (2009) which examined consultant's objective and goals. The organisation main objective is to improve the performances while the consultants other goals such as knowledge acquisition and business growth. To overcome the situation, the organisation must well coordinate with consultants to achieve the desired goals.

Part A (ii)

United consultancy using Activity- based costing (ABC) for the allocation cost based fixed and varioable expenses. An effective planning of fixed and variable cost as follows:

Planning to determine the variable overhead activates that add value for customers using the product and service

Effectively planning to use the cost drivers in different level of activities.

At the start of the fiscal year, a substantial percentage of fixed overhead are predetermined compare to variable. When the United Consultancy budget the fixed overhead cost, they should select the appropriate level of activity that will benefit the United Consultancy over long terms. This is a strategic decision.

The key differences are how fixed costs are fixed to level activity and variable costs are allocated to level of activity.

Actual Costing

Standard Costing

Fixed Cost

Actual Prices

Actual inputs are used

Standard Prices

Standard inputs allowed for actual output

Variable Cost

Actual indirect rate

Actual inputs used

Standard variable cost allocation rate.

Standard quality of cost allocation base allowed for actual output.

Activity- based costing has involves the following stage:

Identify the level of activity that resources and cost to be associate.

Identify the cost drivers linked level of activity. A cost driver is any factor that cause on drivers and activity cost.

Calculate a cost rate per cost driver. Each activity should multiple cost drivers

Assign cost to products by multiplying the cost driver rate by volume of cost driver units consumed by the products.

Indentify level of activity that resource is most engaging and challenging which based on activity based costing. A cost advantage rules that companies identify most important activity.

Non Value added activities will be identified and these can be eliminated to improve the efficiency and profitability.

Majority of the cost drivers are related either to the level of activity or the complexity of the production or marketing process.