The zero based budgeting accounting essay

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Zero-based budgeting avails a better approach to dealing with the drawbacks associated with incremental budgeting. Unlike in incremental budgeting, zero-based approach does not necessarily start from the previous year's budget level; instead, the existing operations are evaluated and continuance of the operation or activity ought to be justified on the basis of its utility and its need to the company. Zero-based budgeting pursues to justify resource allocation within individual budget scheme, irrespective of prior period budgets. The budget in this case is initially allocated as zero unless the manager responsible makes the case for resource allocation. Every plan in this case is justified as per the total cost and the total benefits and past performance is not in any way referred as a building block. The goal of zero-based budgeting is to re-evaluate and re-examine all programs and expenditures for each budgeting cycle by computing workload and effectiveness appraisals so as to verify substitute levels of financing for each program or expenditure.

Zero-based budgeting approach avails some distinctive advantages compared to traditional incremental budgeting such as: it allocates financial resources based on planning requirements and results; and, in order to attain efficiency, zero-based approach encourages managers to search for alternative operation plans. However, despite the outlined advantages, zero-based approach also manifest some disadvantages; first, since the budgeting process is sophisticated, the process can consume a lot of managerial time and may appear to be " too drastic a solution for the task at hand"; second, short-term benefits may take precedence and obscure long-term planning as the latter is less dominant within the planning process; and, third, since the

new budget is launched every year, there may be annual conflicts over budget allocation.

In order to circumvent these drawbacks, especially concerning the managerial time required, one alternative may be to conduct a rolling budget every year and carry out zero-based budgeting perhaps three to five years, or in cases where a considerable modification that occurs within operations. This compromise may aid to weed out waste and inefficiency, especially within a period of intense competition and reengineering that is characteristic of the mobile phone industry. Indeed, zero-based budgeting is an effective means of controlling for unnecessary costs since the departments and divisions in Pear Ltd do not automatically receive a distinctive sum every year, each amount of money apportioned to each unit bear a purpose, which keeps waste and discretionary spending to a minimum. Zero-based budgeting minimizes the " entitlement mentality" with respect to cost increases, and bears the potential to render budget discussions to be more meaningful.

Activity Based Budgeting

Activity-based budgeting awards financial resources to activities that see the highest return in the form of enhanced revenues for the company. Thus, the organization can be able to translate its vision into a strategy with definable objectives so as to create value. The benefit of adoption of activity-based budgeting is that Pear Ltd can be to accurately link revenues to strategic objectives, which, in turn, may enhance revenue moving forward. Nevertheless, the implementation of an activity-based model demands

investment of substantial time and resources, which may not be immediately feasible for Pear Ltd. The most effective performance budgets manifest how the invested resources fund day-to-day tasks and activities, and how the activities are anticipated to generate certain outputs and the outcomes that should be the result. If Pear Ltd adopts a performance-based budget, the company will have a good idea of how money is anticipated to translate into results. One of the drawbacks to this approach is that the budget process must incorporate the review of performance measures and time for discussions of performance against expectations.

Performance-based budgeting

Performance-based budgeting (PBB) process is a continuum that incorporates the accessibility and utilization of performance grounded in information at each of the varied phases of the budget process. Performance budgets mainly seek to contain information of a number of elements, namely: inputs, outputs, efficiency, and effectiveness. PBB mainly start at begin policy level in which the organization develop goals and explicit policy objectives. Decisions are mainly taken to link budget allocations to the set goals, objectives, and measures.

Priority-based budgeting

This approach represents an adjustment of zero-based budgeting method whose focal point centers on highlighting corporate priorities and apportioning growth accordingly. This demands a thorough ongoing review of departmental services. Based on the analysis for every unit the elements of spending could be classified as highly desirable or beneficial. Such

decisions are supplied to the decision makers. Priority-driven-budgeting is a powerful tool that aids entities to: better manage the expectations of constituents; address present or anticipated fiscal constraints; highlight on the revenues at hand and utilize them in the most productive ways possible; spend within the entities means; and, attain the best results for the invested resources.

Flexible budgeting can be employed by Pear Ltd management in planning by indicating what costs will be at diverse levels of activity. In so doing, flexible budgeting can be employed to solve the problem that emanate from employing static budgets for performance evaluation. Whereas the traditional incremental budgeting may not be necessarily flawed, the adoption of flexible budgets can award managers some feel for the impact of both fixed and variable costs. Pear Ltd’s management could shift from traditional incremental budgeting to zero-based budgeting. The adoption of zero-based budgeting suits the Pear Ltd, especially since in the mobile phone industry competition is rife. This is informed by the fact that it allows every managerial activity to be properly identified and then assessed by analyzing alternative levels of operation for a particular activity. The highlighted alternatives may be ranked and relative priorities laid for attaining effectiveness and efficiency. Alternatives to traditional incremental budgeting offer Pear Ltd’s management the most ideal characteristics of a budgeting system such as flexibility, responsiveness, and coordination. A move towards a decentralized structure can be critical to easing the drawbacks associated with traditional budgeting process.

Critically evaluate alternative methods of product costing and the role of such methods in supporting such areas as the evaluation of strategy and cost control.

Costing systems differ along three dimensions, namely: the components being measured; what is included in product cost; and, the manner in which the cost are accumulated. The differences in costs emanate from the urge to incorporate or exclude certain forms of information in product costs. The differentials manifested between the approaches stem from the timing of the cost recognition whereby the core issue centres on when the fixed production costs become expenses. Eventually, both methods produce the same merged appraisal of total profit; nevertheless, there may be differences in short-term phase profit measures and stock valuations.

Basic approach to product costing normally incorporates assigning direct costs to products and allocating manufacturing overhead costs to products. The core product costing methods in this category include job costing and process costing. Job costing encompasses the transfer of outlays to a certain manufacturing job and may include contract costing and batch costing. Overhead is allocated to jobs and the approach is utilized when individual lots of products are distinctive, especially when the entities are billed directly to customers. Process costing infers the accumulation of labor, material, and overheads outlays across whole divisions or entities whereby the entire production cost being allocated to individual units. Process costing incorporates aspects such as operation costing, unit costing/output costing, service costing, and multiple/composite costing.

Alternative Product Costing

There is an overall concurrence as to the accounting treatment of key aspects such as product costs and of period costs; however, there is constantly a debate centering on what item costs should be billed as product costs. This is largely a case of designation of absorption costing (AC) and variable costing (VC)/ marginal costing) that embodies diverse approaches to product cost description and dimension, and consequently profit measurement. Absorption costing embodies the traditional approach that deems all production costs to be product costs. The accounting treatment of fixed production costs varies as per each approach. Hence, all the approaches deliver varied periodic stock valuation whereby in absorption costing, stocks remain valued at full cost of production while under VC; the stocks remain valued at variable production cost. Similarly, the methods may also yield to diverse periodic profit measurements.

Variable costing system incorporate direct material, direct labour, and the variable constituent of overhead within product cost. Fixed overhead, in this case, is treated as a period cost. Absorption costing system incorporates direct material, direct labour, and both the inconsistent and rigid elements of overhead in product cost. Factory overhead, in this case, is absorbed into the product cost.

Job order costing

Job order costing explores and establishes the outlay of individual jobs/batches. The direct material employed and the direct labour hours are accumulated for each job whereby manufacturing overhead is mainly applied

as per the direct labour hours. One of the advantages of employing this approach is that the outlays of every job can be independently analyzed. If the actual cost was extremely high, the manager is at liberty of reviewing the actual material and labour costs to establish the reason for the surge. While job order costing can be an effective tool for some companies, it can create additional work tracking costs that may not necessarily add value.

Activity-based costing

Activity-based costing represents a managerial accounting method that approximates the outlay of products and services by apportioning overhead costs to direct costs. Activity based costing system represents a modified absorption costing system whereby the indirect outlays are outlined to their cost pools to reflect resource exploitation of indirect reserves by the cost object. Activity-based costing (ABC) represents a two-stage product costing method that first allocates costs to activities and then allots them to products based on the product's consumption of activities. Activity-based costing mainly incorporates four steps: first, identifying the activities that consume resources and assign cost to them; second, outlining the cost drivers connected with every action; third, computing a cost rate per cost driver unit/transaction (each activity should possess multiple cost drivers); fourth, establishment of output metrics and conveying outlays to products in multiplying the outlay driver fee by the quantity of outlay driver units registered in the manufacturing of the product.

Since product mix has grown more diverse, activity based costing has evolved to become a useful tool. Activity-based costing allows managers to

arrive at decisions by employing product outlay constituent that only covers those actions that add to the manufacturing of the product. Nevertheless, ABC demands more detailed analysis of the activities within the plant that require additional resources from the company. The key benefit of this approach is the potential to approximate the outlay of entity products and services precisely. ABC helps to underline wasteful or non-profitable ventures that impact on the productivity of the production processes.

Marginal costing

Marginal costing is an approach that employs variable costs. Variable costs, in this case, embody those outlays that stay the identical per unit, but vary in sum as per the overall quantity of units manufactured. Fixed costs essentially remain the same in total irrespective of the number of units produced. Since variable costs are mainly controlled costs, marginal costing enables mangers to make decisions devoid of being swayed by uninhibited statistics such as fixed outlays. Marginal costing also embodies a valuable device to utilize when the entity business environment is extremely competitive. The product pricing can be engineered to recover the changeable outlays of the products. However, disregarding fixed outlays may modify the proceeds to recover overall outlays of the business.

The Role of Alternative Methods of Product Costing in Supporting Evaluation of Strategy and Cost Control

Alternative methods of product costing are critical to the evaluation of company strategy and overall cost control. In the contemporary competitive business environment accurate product costing is essential to a business

survival. Such methods are critical in supporting such areas as the evaluation of strategy and cost control. The approaches are critical in shaping precise divisional and product outlays as a foundation for estimating the cost effectiveness of divisions and the productivity of diverse products. Cost allocation plays a strategic role in shaping competitiveness, especially in informing the effectiveness of the decision-making.

Alternative methods of transfer pricing

The rapid advances in technology, communication, and transportation have yielded to a large number of multinational enterprises that bear the flexibility to place their enterprises and activities anywhere in the world. The main rationale of transfer pricing is to render most favourable decision making within a decentralized organization so as to maximize the profit of the organization. A transfer price integrates the cost one sub-entity of a corporation charges for a given product or service supplied to the next sub-entity within the same corporation. The sub-entities may be profit centres, cost centres, or investment centres.

Pear Ltd central management’s adoption of alternative transfer prices may possess significant impact on aspects such as motivation, performance indication and autonomy across the range of Pear Ltd’s responsibility centres. Motivation in this case combines goal congruence and effort and includes the aspiration to achieve a given goal outlined by the management merged with the search of those goals. Ideally, alternative transfer prices should possess properties such as promoting goal congruence, motivating

management effort, useful in evaluating subunit performance, and preserving an enhanced level of subunit autonomy in decision making.

The advantages of transfer pricing across Pear Ltd's range of responsibility centres include better, timely decisions owing to the manager's proximity to local conditions; the managers are not diverted by regular, restricted decision difficulties; managers' motivation increases since they have better control over results; and enhanced decision making that avails better training for mangers for enhanced level positions within the future. Some of the disadvantages that can be cited include lack of goal congruence among mangers within diverse parts of the organization; inadequate information available to top management; and, lack of coordination among managers in diverse parts of the organization.

Alternative methods of transfer pricing

Market-based transfer pricing

Market-based transfer pricing details when the outside market for the product is well-defined, competitive, and stable, organizations frequently tend to institute the market price as a benchmark for the transfer price. This approach, however, attracts some concerns, especially when the outside company is neither competitive nor stable. This may distort internal decision making for relying on market-based transfer prices that mirror distress prices or a variety of " special" pricing strategies. Market-based pricing overall leads to finest decisions, especially when: a) the marketplace is perfectly competitive; b) there is low interdependencies of sub-divisions; and, c) there is lack of extra costs or gains to the association in its entirety from buying or

selling within the external market rather than transacting internally. Using market prices for transfers in certain conditions leads to goal congruence. Division managers will be acting in their own best interests to arrive at decisions that may be within the best interests of the organization as a whole. Nevertheless, one can argue that computing transfer prices grounded in cost will most probably make Pear Ltd to pay little attention to mitigating outlays since all expenditures incurred amid production will be recovered.

Negotiated transfer pricing

This approach features a firm identifying regulations for the computation of transfer prices. Divisional managers, in this case, are persuaded to settle or jointly agreeable transfer prices. The exact transfer price in this case hinges on the negotiating powers of the divisions. The bargained transfer price manifests a number of properties: attainment of goal congruence; critical for evaluating division performance since the transfer derives from express bargaining between the set divisions; motivating administration endeavour given that once bargained, the transfer price is autonomous of real costs of the subunit (the subunits in this case manifest every reason to direct the organization resourcefully to increase profits; and, safeguarding subunit independence since the transfer pricing flows from express negotiations between the two subunits.

Cost-based transfer pricing

In the lack of perfectly developed market-price, majority of the companies base their pricing on the manufacturing cost of the supplying sub-entity. The most prominent methods employed include: full cost, cost-plus, variable cost

plus lump sum charge, dual transfer prices, variable cost plus opportunity cost. One possible restraint of full-cost-based transfer prices derives from the fact that they can yield to suboptimal conclusions for the organization as a whole. Transferring products internally at incremental cost possess the following properties: attains goal congruence; not useful for evaluating subunit performance since transfer price fails to exceed full costs.

Transferring products internally at incremental cost fails to preserve subunit autonomy since it is rule-based and some divisions have no say in and, thus, no capability to set the transfer price. However, transferring products internally at incremental cost will motivate management effort if based on budgeted costs (actual costs are comparable to budgeted costs). If, however, the transfers are grounded are based on actual costs, Pear Ltd possess little incentive to control costs. Although, neither approach can be cited to be perfect, negotiated transfer pricing possesses more favourable properties compared to the cost-based transfer pricing. Both transfer-pricing approaches attain goal congruence; however, bargained transfer pricing assists in the estimation of subunit performance, stimulates management action, and conserves subunit autonomy, while the transfer price remain based on incremental costs fails to attain these objectives.

The benefits of utilization of alternative methods of transfer pricing between responsibility centres is that the operating managers possess the incentives to closely weigh and conduct cost-benefit analysis prior to requesting group’s services or products. Similarly, the operating managers possess an inducement to pursue the job and the development undertaken by the responsibility centres. Decentralization would encourage plant managers to

enhance output so as to achieve the highest profitability, and inspire plant managers to track cost cutting measures that would increase margins. Manufacturing managers would be equally motivated to design their operations as per the criteria that satisfy the marketing manager’s approval, hence enhancing cooperation between the responsibility centres.

The problem that emanate from adoption of alternative transfer pricing by Pear Ltd’s central management is that the contract may necessitate extensive internal negotiations with regard to cost, time, and technical specification. Similarly, Pear Ltd’s divisions need to consistently “ sell” their services or products to the operating division and this could possibly result in loss of morale. To the degree that the focal point of the responsibility centres is on short-term schemes stipulated by the operating divisions, the current arrangement would lead to goal congruence and motivation. Goal congruence is attained since both the central management (operating divisions) and the responsibility centres are motivated to work the organizational goals such as enhancing the environment. The operating divisions would be highly motivated to utilize the services of the responsibility centres so as to attain the objectives outlined for them by the administration.