Using budgets for control

Business, Management

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Budgets provide a means for planning the financial future and play a vital role for planning. Budgets simultaneously make managers construct and implement plans, contribute useful information for improved decision making, provide a standard to administer performance evaluation, and enhance organization andcommunication. An essential component of the budgeting system is control. Control periodically takes actual results and budgeted results and compares the two. It also allows for managers to frequently measure their performance from reports by providing performance evaluations.

The master budget can be separated into operating and financial budgets, each made up of distinctly supporting schedules. Implementing budgets enables managers to create a formulated plan that allows for performance evaluation and improved control. Control involves the process of looking at the past, determining what really occurred and comparing it to previously projected results. Two processes which are significant to adjusting the budget are the control cycle and the planning cycle.

Both are linked through feedback and in their final stage, involve budgets. Participative budgeting gives subordinate managers the opportunity to contribute considerable proposals for establishing budgets. A key factor in implementing participative budgeting is that each manager should only be held responsible for costs they can completely control. Any costs that are outside of their control that are included on their budgets need to be marked as non-controllable, and separated from those costs that can be controlled.

Participative Budgeting also enables the manager with the chance to structure slack into the budget as a way to increase the probability that the manager will achieve the proposed budget and therefore decrease the risk they may incur. This requires upper level management to carefully review budget proposals from subordinate management in order to decrease the amount of slack placed into the budget. Performance evaluation is a vital element in rating the performance of management as well as maintaining control.

When using budgets for performance evaluations it can result in feedback frequency of performance, monetary as well as nonmonetary incentives, participative budgeting, attainable standards, a variety of measures of performance and the possibility of controlling costs. By using frequent feedback on performance it gives managers a means to measure the success of their planning and enforce any corrective action. Monetary and nonmonetary incentives can aid in invoking a positive, goal congruent behavior in whichgoalsat managerial and organizational levels agree.

A simple example of performance evaluation could take place in a pizza restaurant that makes only pizzas. If the owner has an exact amount of toppings that he knows should be put on the pizzas and what that cost is, he can assess the amount of toppings being used. He might find that his workers are inadvertently topping some pizzas with more toppings than others. By encouraging his employees to top all pizzas with a consistent amount of toppings he can improve the consistency of the pizzas delivered to customers and increase savings on costs of toppings.

If this same principle is practiced toward other aspects of the restaurant it could provide significant savings overall. Budgets contribute a valuable role in the success of a company. Implementing control and performance evaluations increases the effectiveness of the budget and provides guidelines for performance improvement in the business. Participative budgeting gives subordinate managers the ability to be involved and invokes a sense ofresponsibilitywhile embracing creativity.

However if not implemented correctly, the results can produce reduced control and padded budgets that can make it difficult to evaluate performance. Although budgets can contribute a valuable measure for managerial performance, they can still be manipulated by managers that are able to increase budgetary performance in the short-run yet cause significant damage to the business. Organizations need to utilize other qualified measures that take into consideration the financial or nonfinancial and short-run and long-run effects in order to avoid any threats of myopic behavior.