

Traditional budgeting and its criticisms accounting essay



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Traditional Budgeting is a value-adding subject and has played a crucial role in management control in organizations. Budgeting has been seen as a considerable approach as well as a tool for evaluation and regulation of specific activities in a firm. It is recognized as “ annual budgeting” by front-line managers. This type of budgeting process was used by companies to control demand of consumers/customers, adopt organization design and strategy of past years and how to fix errors in co-ordinating managerial process in the future years. Traditional budgeting also gives business organizations and companies’ guidance regarding the direction in which they are supposed to be going. This accounting methodology was developed to take the centre stage when competitors come to play.

In the yet, not-so-predictable environment, traditional budgeting has been proved to have limitations; A budget being a financial plan of all expenses and revenues of a business organization can sometimes be found to be unrealistic and unreliable and difficult to allocate these revenues and expenses especially in a business organization. They also proved to be time-consuming and monotonous, it didn’t focus on strategy, it tended to possess constrained flexibility and it also focused on cost reduction rather than value-creation. There has also been researches that traditional budgets enables superiors to be fraudulent in order to achieve positive results. There is also a challenge of accomplishing targets, simply because, when one part of the organization freezes up, or is engaged in a management or financial decline, it shifts its focus on adjusting and fixing errors. It is a case of fitting a square peg in a round hole. In a bid to enforce stronger measure of performance, “ Beyond Budgeting” was introduced.

This essay takes on analytical approach to highlight the key issues and trends underlying this factor. The strong concerns and limiting factors would also be stressed, yielding anticipations as to whether beyond budgeting should be in full force and why traditional budgeting should still be considered ruling out the benefits that can be drawn from it.

History of Budgeting

It has been found out that over 50% of small UK companies don't undergo the budgeting process. Budgeting plays a powerful role in most organizations' system of management control process. The history of traditional budgeting can be traced to as far back as the 1920s. When the world began to recognize the concept of buying and selling, there was a need to account for the predominant financial production and distribution of goods and services. In the mid-eighteenth and nineteenth centuries, there was a widespread mobilization of business cycles. This extended and developed in the twentieth century as an industrial revolution and contributed to the enormous growth of government tax incomes. Naomi Caiden (1994)[1] suggests that these developments conformed into the model of the modern budgetary system and plays a vital role in this transformation.

Overview Of Beyond Budgeting

This part of this essay provides an insight of the Beyond Budgeting approach, emphasizing on its potentials based on how it measures performance for managers. Beyond Budgeting is an attempt to deal with the problems of traditional budgeting. Traditional budgeting has had its time and business organizations need new tools today to determine managements' <https://assignbuster.com/traditional-budgeting-and-its-criticisms-accounting-essay/>

performance as well as its objectives and obligations. The control system in organizations could be quite controversial especially when targets and limits are set. Beyond Budgeting does not only describe management performance and controlling performance to management but also creates room for more principles and performance routines. Beyond Budgeting is driven by rolling forecasts, balanced scorecards; this system prepares the organization for profitability improvement, and gears its structure towards a more flexible strategy. Jürgen H. Daum (2002)[2]denotes that the two fundamental elements of Beyond Budgeting model are new leadership principles based on the principle of the empowerment of managers and employees, and new more adaptive management processes. This stresses the point that this new process follows a radical approach that defines the focus of clear information between management and employees, and also unlocks the risks and regrets of competition.

Beyond Budgeting assumes a concise decentralized decision-making structure. It seeks to encourage self-responsibility in an organization hierarchy drawing the line between bureaucracy exercised in the organization and the culture in which it operates on. Over the years, there have been really few companies that abandoned the traditional budgeting process and still retain its position, this is not to say that traditional budgeting process is not feasible, but it depends on the management philosophy. Classic examples are IKEA, Boots (The UK Pharmaceutical Retailer), and of course, the Swedish company-Svenska Handelsbank, who had no budgets for more than three decades and had an outstanding profitability capability.

J. Hope and R. Fraser supported the argument that Beyond Budgeting process should be practised. They argue that rolling forecasts sets the underlying structure for which value-creating decision making will be made, and unforeseen circumstances can be predicted and dealt with before it becomes a stumbling road block to achieving success.

A further analysis embraces the consortium of the BBRT (Beyond Budgeting Round Table) which supports the agreement that annual budgeting should be a one-off elimination action. On the other hand, T. Libby and R. Murray (2007) counterargues, denoting that it might be universally unacceptable to presume that budgeting processes cannot be considered for command and control purposes. This is because successful firms that implemented these annual budgets have reportedly seen it as conventional. It is with no doubt that this holistic approach of accounting concept breeds reliance on the totality and control mechanism in the firms. In the light of these criticisms, Aaron Wildosky (1978) didn't accept the unfavourable judgement as well of traditional budgeting; he strongly presumes that the design of budgetary processes can be used to fit any circumstance. He also pinpoints that companies that still practice annual budgets perceive it as a device for stability in the provision of economical and managerial purposes, that is, to check inflation and to improve mechanisms of employment status in a particular economy.

Alnoor Bhimani (2006) suggests different approaches to the diagnostic process. The first process was based on management principles which reflect the reinforcement of benchmarking targets against evaluation of performance standards. This is done in a bid to conform forecasting to a <https://assignbuster.com/traditional-budgeting-and-its-criticisms-accounting-essay/>

precise standard. The second process creates an insight to measuring customers' satisfaction with the profitability of the company's potentials. To buttress Bhimani (2006) view. Hansen, Otley and Van der Stede(2003) also embraced benchmarking against performance evaluation, indicating that benchmarking could either be internal or external (i. e. within the organization or amongst competitors)Hope and Fraser, R. (2003) brings forward the emphasis of KPIs (Key Performance Indicators); they stressed that KPIs is a standard of comparison for measuring long-term goals. These authors set an example of a Danish petrochemical engineering company that lost 30 percent of its fixed costs due to its poorly infected plants; the management of this company regained its profit over the years because it empathetically had a strong base of reward performance measurement. Suffice to say, this extensively shows that if the cost structure of an organization.

Beyond Budgeting rejuvenates the implementation of transparency of forecasting and resource allocation. Companies, in this modern age, might want to incorporate and monitor co-ordination of skills of their employees as well as incorporate training and development of staff and employees to manage finances in the company. This is advised to be practised in order to ensure efficiency and effectiveness throughout all levels of hierarchy in the firm, in addition, to achieving goals without little or no supervision. In addition, style of leadership can be related to whether managers would refocus on this style of budgeting, this ensures the grasp and stronghold of the company's strategic plans.

Russ Banham (2012) discovered in their budgeting research for Holt CAT and Group Health co-operative, their Chief Finance Officers acknowledge that in as much as the beyond budget process has been accepted and fully proficient in their firms, they advise that newer approaches should be discovered and acquired in order to make their systems easily accessible, open to challenges and to suffice financial risks.

On a last note, placing emphasis on the beyond budgeting consortium, i. e the BBRT(Beyond Budgeting Round Table)that was mentioned earlier with the aim to technical design, develop, understand organization's design, empowerment and devolution. J. Hope & R. Fraser (2000) depicts exemplary cases of firms that have emerged with confident outcomes as well as sustained financial performance over the years. These authors, who are also founders of the BBRT, argue that not only do firms require effective strategic management; they also need to redesign their organizations to devolve authority more effectively to the frontline.[3]

I don't think traditional budgeting should be abolished reasons being that, although the widespread accounting methodology might seem obsolete, its advantages cannot be overemphasized. Even though, it demonstrates behavioural weakness, organizations still find means of improving their systems by using zero-base budgeting and/or activity-based budgeting. Also, Aaron Wildosky (1978) also admits that traditional budgeting fosters planning in the sense that it possesses the consistency of measuring budgets in volume. Also, traditional budgeting makes calculation less difficult and not broad in scope unlike the other methods. Lastly, the annual budgeting

process doesn't pose as a challenge for an in-depth epitome of plans of action or contracts.

Conclusion

Drawing from the work above, it can be seen that beyond budgeting is a considerable approach as well as well as an asset-oriented method. It gathers resources, performance and motivational factors that breed outcomes of positive values. It also adapts a decentralizations approach that makes resources available when managers are in dire need of them. I believe that managers can use it as a form of collecting knowledgeable information from low-level employees and allow the organization to gain a powerful view about their organization structure. Rolling forecasts, balanced scorecards and KPIs are the measurement criteria used in this type of budgeting. Nevertheless, traditional budgeting is not be to left outside the scene because some companies still make use of its advantages and practitioners would rather demonstrate virtually its level of compatibility in this modern day environment. This figures the reasons why it isn't and should not be completely dysfunctional.

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