What is budget system in an organisation

In this high competition market place today, every company need a planning and control tool to act faster to increase competitive advantage. Budget is the tool to plan, monitor and control daily activities to meet organisation goal with effectively and efficiently.

The toolkit will help you plan, develop and use budgets effectively in your organisation. If you have a sound understanding of the principles of budgeting, you will be well on the way to sound financial management. If you use this toolkit in conjunction with other toolkits, as indicated, you will increase the capacity of your organisation to manage its finances effectively. You will also increase its ability to survive through foresight and planning.

In this assignment is to discuss what is budget system in an organisation, how the organisation uses it as tool to plan and control company expenses and expected revenue. We have chosen to make a case study about the budget process in London Biscuits Sdn Berhad. We will discuss budgeting system in this company and how to improve effectiveness of existing system.

London Biscuits Sdn Berhad is a home grown Malaysian company. Main products are corn base snacks and layer cake. London Biscuits product can be found in Malaysia and 65 markets, worldwide. Its main oversea markets are China, Hong Kong, Macau, Vietnam and Middle East country. As a pioneer in the cake products segment locally, London Biscuits has fine-tuned the process of making cakes with long shelf life, of 8-12 months, without refrigeration.

Budget

What is budget; according to business dictionary define as estimate of cost, revenue and resources over a specified period, reflecting a management's reading of future financial condition. The CIMA definition of budget is a quantitative statement, for a defined period of time, which may include planned revenues, expenses, asset, liabilities and cash flows (Dyson, 1997).

In other words, budgeting is the process of " translating financial resources into human purposes" (Wildavsky, 1986). Budgeting is also viewed as a process of identifying, gathering, summarising and communicating financial information of an

Organization's future activities. Blumentritt (2006) further explained that budgeting processes include a review and study of the prior period's financial results, projections for sales, operating expenses (fixed, variable, and semi-variable) and

Financing expenses, examination of proposals for capital expenditures, and means of rolling up and rationalizing figures from different functional departments to ensure they meet company-wide profit expectations.

Hence, budget is a statement of financial position that an organisation would like to achieve. A well planned budget can lead company to achieve company goal successfully. It is managerial control tool to plan and control future expenses, profit and resources allocation in a certain period normally in 1 year advance.

In order to have a realistic and good budget, there are few factor need to be considered before we draw up:

Assign right person to draw up the budget. The person in change need to heavily involve in the entire exercise. Predictive ability is the must. He or she need to clear about organisation activities as well as the possible income and expenditure.

Clear channel of communicate, authority and responsibity

Objective and procedure or guidelines of budget must be clear can be implemented in the budget.

Accounting generated accurate, reliable and timely information

Compatibility and understandility of information

Support at all levels of the organisation, upper, middle and lower

Budgets consider external factors, such as market trends, economic conditions, and the like.

allow for changing circumstances

History of budget

The budget only is used for governmental setting during agriculture ware. In industrial wave, budget had been use in large company as management control tool to plan and control their business. In 1960, budget is recognized as effective way to centralize company operation under top management.

When come into information wave, high expectation from customer, competitors not only from own country but is worldwide comparison, decentralise the business is one of solution in order for company can react faster. When business management style change from centralize to decentralise, company need to change budget system to meet company objective. Hence, traditional budgeting like incremental budget be replace to zero base budgeting and other modern budgeting is begin implement to follow company direction. Method of budget also change from top down (centralise) to bottom up budgeting (decentralise).

The order new budgeting system like rolling budget, balance score card, activity base budgeting and beyond budgeting are start implement in some company to improve effective and efficiency of organisation.

Purpose of budget

As planning tool

Budgeting plan and allocate fund to achieve company goal. Manager need to formulate business strategies to achieve company goal with arrange resource allocation e. g machinery, fund, staff changes, scheduling production and operating company in advance. Mean that budget use as tool to link company objective with company resource to allow for thinking how to make operations and resource more productive and efficiently. Budget is a plan to provide the overall picture to manager for status of company resource, expected income and expenses. It is a better money management skill by creating structured plan. Thurs, manager can prevent problem before they arise. All financial statements should be written in terms of the budget so that it is easier to be transparent and accountable and to ensure that no money is spent on costs that you have not budgeted for. So manager have not establishes guidelines in the form of a road map to proceed in the right direction.

Communication tool

Budgeting process is involving every departments in a organisation. Team work is required to completed a budget. In other word, budget as aids coordination between departments to attain efficiency and productivity. Indirectly budgeting process can improves working realationships. It as coordination of top management with media and lower lever at organisation.

Delegation tool

Improves managerial decision making because emphasis is on future events

and associated opportunities

Encourages delegation of responsibility and enables managers to focus more on

the specifics of their plans and how realistic the plans are, and how such plans

Monitor and control

Budget is allows management to monitor, control, and direct activities within the company. Manager can compare budget plan with actual result and points out deviations. Investigation and corrective action will be taken. Therefore, management can aware of problem faced by lower levels. action can be taken earlier before result worse.

Motivation

Employees participate in the budgeting process able to motivating them to perform in line with the company goal. The feeling in involvement in the process able to enhance motivation. Additionally, expected profit or cost reduction planned in the budget may motivate manager to achive. And those meeting budget target, incentive will given as motivational device.

The budget planning and control process

The budget process used by a company should suit its needs, be consistent with its organisation structure and take into account human resource. The budgetary process establishes goal ad policies, formulate, limits, enumerate resource need, examines specific requirements provide flexibit, incoparates and consider constraints. ( ) Hence, budget process is start from the company goal with determines the overall or strategic goals and strategic of business, which are then translated into specific long term goals, annual budgets, and operation plans. Setting financial goals is the starting point in the budgeting process. Examples: earnings growth, cost minimization, sales, prod volume, return investment and quality.

Once short term goal of company had been set, manager need analysing available resources, forecasting profit and expected cost …….. manager can base on history or past experience to estimate cost like capital cost, staffing cost, operation cost and organisation cost. And estimate revenue like usually is generate from sales income. Therefore, sales budget is first budget to be plan then following with cost budget. Those estimate figure will be put in the budget format according to company needed. Finally compare revenue and expense projections.

First draf of budget will sudmit to top management to obtain approval. Top manager will evaluate the budget with company objective. If budget is realistic and meet the company goal or target. It will be implemented, distributed and coordinated among different functional department. If budget is rejected, necessary adjustments to the budget, check your calculations once again and resubmit for approval again.

The budget is the most important tool you have for monitoring the finances of your organisation, project or department. You use the budget to monitor income and expenditure to see whether or not you are on target; report how you are doing financially to your staff, board and donors; do cash flow projections and make financial decisions.() Comparisons of actual income and expenditure against the budgeted income and expenditure need to be done regularly. Variance report need to be prepare if any. There are 2 variance result: Interpreting the result:

Favourable = actual is better than planned then it is a positive variance

Adverse= actual is worse than planned then it is a negative variance

Investigate and corrective action need to be taken.

Budget process in London Biscuit (LB)

London Biscuit top management group will start to plan the next year budget on every year end. That top management group include CEO, COO and head of department. They will have the pre budget meeting to set the next year target or short term objective need to meet by next year. Target and short term objective are link to company goal. For example, LB plans to open new market at USA. So short term objective will be develop new product and survey the USA market. Therefore, company may decide to spend more money to invest at R&D and having market survey for USA food market.

They will only set the target to organisation, and let staffs collect relevant information will influence next year target. Therefore, method of budget in LB is bottom up budgeting. Finance department is department to lead and compile budget to master budget.

Same with common company, budget will start from sales budget. Sales team start with constructing prognoses and environment analysis. They need to include the objective or target had been set by top management. For example they may need to achieve 10% of total sales growth on next year. Sales department at LB is delegate base on area sales. Account dept will help to provide sales history for past few years to predict future sales performance. Statistical analysis will be performed by each area sales managers. Simple calculation Statistical analysis can be averages based on past sales to identify trends that can be extrapolated into the future. This is call incremental budgeting. In this case, top management is set yearly target for sales dept is 10% of inscreasment of total sales. Hence, managers will base on past year record and forecasting 10% increase sales figure.

After sales budget be approved by sales director, it will be distribute to related department to continue plan the expenses will be incur to procure estimate sales figure. There are 2 type of main organisation expense;

operation cost and administration cost. In LB there are few dept in charge of operation cost: Production, engineering, QA and QC and supply chain departments.

Production budget included unit of product need to be produced to meet sales target qty. Example: budgeted sales volume on Jan 2011 is 10, 000 carton of pie cake, production manager need to base on this figure to estimate how many direct labour, machinery cost, utilises cost and so on.

QA & QC need budgeting how many instruments to support production output checking before pass the output to shipment. Common instrument include in the LB's QA & QC is pass sticker, scale and manpower needed as well.

Supply Chain manager budgeting direct material cost base on budgeted sales target. The required raw materials are computed to meet the production schedule which planned base on the sales target. According to policy of LB, less than 5 % of raw material inventory can be planned. SCM manager is considering the material pricing increase factor during budgeting.

Administration cost

are non-operational costs and will include things such as marketing, human resources, rents and vehicle costs as well as general administration

HR & admin manager in LB prepare the indirect labour budgeting. It includes training cost estimation, general overhead, office maintenance cost ….

Account manager budgeting the general office cost like

IT is one of supported dept in the LB. IT manage handle all the IT intructment. He need to budget those equipment like computer, printer or other related need.

After all the departmental budget and sales budget is done, finance dept as accountable to compile these budgets into master budget. Finance controller will compare revenue and expense projections and verify budgeted result in line with the LB short term objective.

In case finance controller found that any contingency budgeted result, department manager is request to revise and submit budget again. Else, master budget will submit to CEO and COO for final approval. Once Master budget is approved, it will distribute, communicate and implemented in LB. Each department manager need to explain detail to subordinates and monitor the result from time to time.

Budget control in LB

Finance department and department managers take important role in controlling parts. Each department managers are assigning as budget committee. Quarterly management meeting will be held in LB for follow up and monitor budgeting purpose. Finance controller need to liaising between the budget committee and managers responsible for budget preparation. Finance controller is core person in the budgeting control as he have to provide training to budget committee, ensure budget dateline is meet and dealing with budget problem.

According to finance controller at LB the reason why budget meeting only held quarterly is some department manager like sales manager will be outstation and seldom in the office to join the meeting. But department managers need to submit monthly report every early of the month to finance department. Account department also will provide history of income and expenses to finance department for verify purpose.

Master budget in Lb is break into monthly report. They call it as Monthly Budget value report. This report includes all budgeted and actual income and expenses in a month. Comparison of actual and budgeted figure need to be shown in the standard format which fix by finance controller. This shows you, month by month, where you are over-spending, under-spending or on target.

For that variance more than RM5000, explanation and variance report needed. This report outline the cause of significant variance, propose remedial action and any other significant matter. An analysing report provided finance controller base on variance report to analysing and foresee what impact for master budgets is.

Current financial status

Analysis of budget changes

Financial position to date

In month financial position

Trend analysis by month

Main cause of variance

Estimate end of year position

Suggestion action or corrective action

In some cases that prove the budgeted figure is unrealistic, budget is request to revise.

First month

Year-to-date

Budget

Actual

Budget

Actual

Revenue

Sales

Cost recovery

Interest from investment

Total income

Expenditure

Project 1

Project 2

Directorate

Operational costs

Organisational costs

Staffing costs

Total expenditure

That department budget with significant deviation will be issue short cause letter and variance report from finance depart. They need to follow the action plan and act accordingly. Audit will be held from time to time from finance dept to ensure they are complying accordingly.

Budget system

Types of budget

Marketing Budget – The marketing budget is an estimate of the funds needed for promotion, advertising, and public relations in order to market the product or service.

Project Budget – The project budget is a prediction of the costs associated with a particular company project. These costs include labor, materials, and other related expenses. The project budget is often broken down into specific tasks, with task budgets assigned to each.

Budgets can be classified according to Time, Function, and Flexibility.

ACCORDING TO TIME:

1. Long Term Budget

2. Short Term Budget

3. Current Budget

4. Rolling budget

ACCORDING TO FUNCTION:

1. Sales Budget

2. Production Budget

3. Cost of Production Budget

4. Purchase Budget

5. Personnel budget

6. R & D Budget

7. Capital Expenditure Budget

8. Cash Budget

9. Master Budget

ACCORDING TO FLEXIBILITY:

1. Fixed Budget

2. Flexible Budget

Cotrolling A budget

Budgetary control is defined by CIMA as " the establishment of budgets relating the

responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results, either to secure by individual action the

objective of that policy, or to provide a basis for its revision". Budgetary control is a

system of controlling costs and resources which includes comparing actual

performance with the budgeted performance and subsequently acting upon the actual

results to minimise variance and achieve maximum returns. In essence, budgetary

control is purported to ensure that the activities carried out are providing the desired

results.

Monitored using variance analysis

Good

Writing a budget require target to be set- every1 know what need to achive, concentrates wokers mind on what gas to be done

Depart have to communicate

Problem can be identifiend before it is too late unacceptable

By comparing a bugest wuth the actually happened a bunisess can identify weak area.

Useful tools in allocting resoures e. g machinery, employee, makinf staff changes, scheduling prod and operating business

Their creation can also be used as a motivational tool. The plan can be used as a means of evaluation and control as well as a resource for information and decision-making.

A

Bad

Inaccurate & unrealistic budgets will be ingoned

It can restrict business activity which may lose the firm business

If budgets are impose upon people there is little incentive for them to stick to target

If 1 of dept not focus to B, whole master b will be effected.

Lack of training

Long lead to plan

The signs of budget weaknesses must be spotted so that corrective action may be

taken. Such signs include:

Managerial goals are off target or unrealistic.

There is management indecisiveness.

The budget takes too long to prepare.

Budget preparers are unfamiliar with the operations being budgeted and do

not seek such information. Budget preparers should visit the actual operations

firsthand.

Budget preparers do not keep current.

The budget is prepared using different methods each year.

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Exhibit 1. 3

XYZ Company

Divisional Performance Evaluation

Net Income Net Sales

There is a lack of raw information going into the budgeting process.

There is a lack of communication between those involved in budgeting and operating

personnel.

The budget is formulated without input from those affected by it. This will

likely result in budgeting errors. Further, budget preparers do not go into the

operations field.

Managers do not know how their budget allowances have been assigned or

what the components of their charges are. If managers do not understand the information,

they will not perform their functions properly.

The budget document is excessively long, confusing, or filled with unnecessary

information. There may be inadequate narrative data to explain the numbers.

Managers are ignoring their budgets because they appear unusable and unrealistic.

Managers feel they are not getting anything out of the budget process. Changes

are made to the budget too frequently.

Significant unfavorable variances are not investigated and corrected. These

variances may also not be considered in deriving budgeted figures for next period.

Further, a large variance between actual and budgeted figures, either positive

or negative, that repeatedly occurs is an indicator of poor budgeting.

Perhaps the budgeted figures were unrealistic. Another problem is that after variances are identified, it is too late to correct their causes. Further, variance

reporting may be too infrequent.

There is a mismatching of products or services.

A budget can be disadvantageous because:

A budget promotes gamesmanship in that those managers who significantly inflate

requests, knowing they will be reduced, are in effect rewarded by getting

what they probably really wanted.

A budget may reward managers who set modest goals and penalize those who

set ambitious goals that are missed.

There is judgment and subjectivity in the budgeting process.

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Managers may consider that budgets redirect their flexibility to adjust to changing

conditions.

A budget does not consider quality and customer service.

Conclusion

Activity Duration

Future-proof the council 10 days

Define the required outcomes

and their relationships

15 days

Define measures and set bases

and targets

20 days

Assess risks and allocate rewards

at the corporate level

10 days

Total 55 days

Recommends

Understandable and attainable. Flexibility and innovation is needed to allow for unexpected contingencies.

Provide more opportunities for staff to join.

Sometimes it is necessary to have two different budgets for your organisation. One as the ideal budget that you would like to have and a second one as a minimum budget of the money that is absolutely necessary for your organisation to survive. Often when your draw up the ideal budget, your are not yet sure that your will get all the money your need and a minimum budget will help you to decide which costs can be cut, if your don't manage to raise the necessary funds.

A computer should be used to make quick and accurate calculations, keep track of projects instantly, and make proper comparisons.

Shortened planning and budgeting cycles. Ä…Ä…

Enabled better decision making. Ä…Ä…

Reduced total cost of the processes. Ä…Ä…

Improved credibility and quality of outputs. Ä…Ä…

Planned and relocated budgets based on material events. Ä…Ä…

Increased user participation with frequent real-time updates. Ä…Ä…

Raised ownership and accountabilityÄ…Ä…

Aligned individual, department and business unit plans with company ojb.

There are a number of advantages to budgeting and budgetary control:

· Compels management to think about the future, which is probably the most important feature of a budgetary planning and control system. Forces management to look ahead, to set out detailed plans for achieving the targets for each department, operation and (ideally) each manager, to anticipate and give the organisation purpose and direction.

· Promotes coordination and communication.

· Clearly defines areas of responsibility. Requires managers of budget centres to be made responsible for the achievement of budget targets for the operations under their personal control.

· Provides a basis for performance appraisal (variance analysis). A budget is basically a yardstick against which actual performance is measured and assessed. Control is provided by comparisons of actual results against budget plan. Departures from budget can then be investigated and the reasons for the differences can be divided into controllable and non-controllable factors.

· Enables remedial action to be taken as variances emerge.

· Motivates employees by participating in the setting of budgets.

· Improves the allocation of scarce resources.

· Economises management time by using the management by exception principle.

Problems in budgeting

Whilst budgets may be an essential part of any marketing activity they do have a number of disadvantages, particularly in perception terms.

· Budgets can be seen as pressure devices imposed by management, thus resulting in:

a) bad labour relations

b) inaccurate record-keeping.

· Departmental conflict arises due to:

a) disputes over resource allocation

b) departments blaming each other if targets are not attained.

· It is difficult to reconcile personal/individual and corporate goals.

· Waste may arise as managers adopt the view, " we had better spend it or we will lose it". This is often coupled with " empire building" in order to enhance the prestige of a department.

Responsibility versus controlling, i. e. some costs are under the influence of more than one person, e. g. power costs.

· Managers may overestimate costs so that they will not be blamed in the future should they overspend.

Conclusion

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Dyson, J. R., 1997. Accounting for Non-Accounting Students. 4th ed. London: Pearson Professional Limited.