

Management Accountancy

Unit 8

Budgeting for Profit Planning

Lecturer: Dr. Jeetendra Dangol

Contents

- Concept and Features of Budget
- Objectives, Advantages, Limitation of Budgeting
- Demand of Effective Budgeting
- Length of the Budget Period
- Budgeting and Management
- Zero Based Budgeting
- Advantages of Zero Based Budgeting
- Limitations of Zero Based Budgeting

Learning Objectives

- Understand the Concept and Features of Budget
- Describe Objectives, Advantages, and Limitation of Budgeting
- Understand Length of the Budget Period
- Enumerate Budgeting and Management
- Understand Concept of Zero Based Budgeting
- Explain Advantages and Limitations of Zero Based Budgeting

Profit Planning

(Why)

- Turns a profit
- Healthy Balance Sheet
- Generates goods Cash Flow
- Produces a good Returns on Investment (ROI)

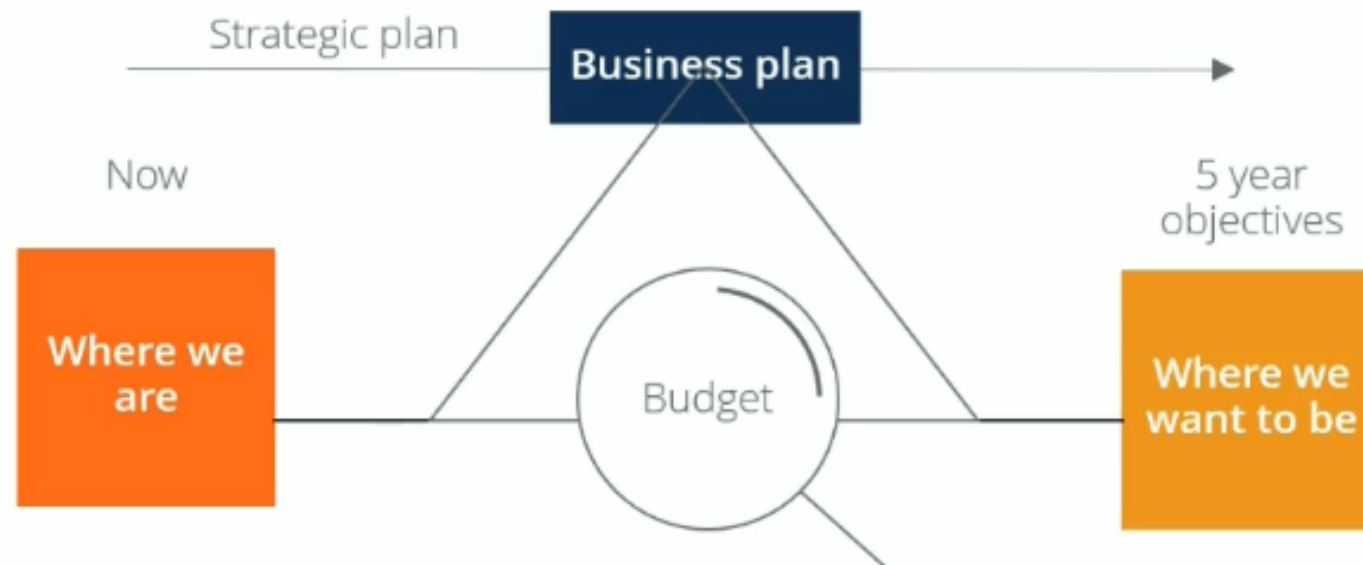
Business Plan

- Technical feasibility
- Market feasibility
- Financial feasibility



Budget

A budget is a detailed financial plan that quantifies future expectations and actions relative to acquiring and using resources



Source: <https://corporatefinanceinstitute.com/resources/knowledge/finance/budgeting/>

Budget (Contd.)

- A financial statement or a quantitative statement prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective.
- Budget is an estimate of future needs arranged according to an ordinary basis covering some or all of the activities of an enterprise for definitive period of time.
- Budget is a pre-determined detailed plan of action developed and distributed as a guide to current operations and as a partial basis for the subsequent evaluation of performance.

Budget (Contd.)

- A pre-determined statement of management policy during a given period which provides a standard for comparison with the results actually achieved.
- Budget denotes a planning for the future. It is a formal business plan for some future period. A budget is both a 'plan' as well as a "Control Tool".
 - Budget is to be referred as a plan because it is a planning for future operation. Similarly, budget can be taken as a basis for subsequent evaluation of performance and can be referred as a control tool.

Budget (Contd.)

- Budget is defined as “the quantitative and financial interpretation of the future plan of operation”, and as the “overall financial plan for future activities”.
- It is a plan for the utilization and co-ordination of various resources available in an organization.

Features of Budget

- A budget may be expressed in terms of quantity or money or both.
- It is related to a defined period in future.
- It pertains to a policy which is to be executed during budget period.
- Some specific objectives are to be achieved through the establishment of budgets.
- It serves as a basis for performance evaluation and control analysis.

Objectives of Budgeting

- To fix the targets and express them in monetary or quantitative terms.
- To state the firm's expectations or goals in clear and formal terms to avoid confusion.
- To communicate expectations to all concerned departments of the firm.
- To determine the policies for achieving the objectives or targets.

Objectives of Budgeting (Contd.)

- To co-ordinate the activities and efforts among different departments.
- To properly guide the execution of works of different departments and set the standard of works.
- To control the performance of different departments in such a way that the use of resources is maximized.
- To measure the efficiency of different departments and supply information on the basis of which the necessary corrective action can be taken.

Advantages of Budgeting

- Budgeting helps the activities of all departments of the business co-ordinate.
- Budgeting develops a sense of responsibility among the employees and assist in assignment of responsibility.
- A budget assists management to attain the given goals.
- It helps to maintain control over the production system. Therefore, it increases production efficiency and reduces waste.
- It contributes in the set up of the standard costing which can act a complimentary to budgeting.

Advantages of Budgeting (Contd.)

- Budgeting provides management with significant knowledge to undertake the remedial action.
- Budgeting compels management to make an early and timely study of its problems and prepare for changing condition.
- With the use of budget, 'Cost consciousness' develops among the staff. Subsequently, the loss decreases and work-efficiency increases among them.
- With the installation of budgeting system, employees of the organization become conscious of the needs to conserve business resources.
- While preparing budget, opinion is sought from all sections of employees.
- Their participation in the preparation and execution of budget increases morale among them, which in turn contributes maximum to the output.

Advantages of Budgeting (Contd.)

- Budgeting helps in determining the policies of the organization.
- Budgeting acts as a control tool for administration.
- Maximization of profit through careful planning and control is possible with the help of budgeting.
- Budget serves as a medium of written communication.
- It ensures better understanding and harmonious relation between top management, managers and workers.
- The amount of capital needed for the budget period can be easily determined and properly managed with the help of budgeting.

Limitation of Budgeting

- Based on estimate
- Danger of rigidity
- Execution is not automatic
- Tool of management
- Expensive technique
- Morale of the employees

Demand of Effective Budgeting

- The participation of both management and workers
- Coordination and cooperation between management and workers
- Sound accounting system
- New trends and inefficiencies are detected at an early stage of the planning/control process
- The delegation of duties/authority, this will mean that job specifications will have to be clear and unambiguous

Demand of Effective Budgeting (Contd.)

- Control by responsibility
- A sound evaluation system for comparing/reporting on budget and actual results.
- The motivation to the work force.
- Good clear communications.
- Corrective action to made by management to remedy adverse situations

Length of the Budget

Short-term Budget

(Control)

Long-term Budget

(Planning)

Length of the Budget (Contd.)

- The types of budget, i.e., sales, production, capital expenditure, cash etc.
- General economic situation and the growth and stability of the product market
- Nature of demand for the products of the undertakings
- Length of the trade cycle of business (seasonal products)
- Production cycle, i.e., the start to finish period required for manufacture of the various products
- Timing of the availability of finances
- Extent of control over the operations
- Probability of changes in products or product mix

Budgeting and Management

- Secure the cooperation and participation of employees, e.g., supervisors, foremen
- Communicate clearly and indicate acceptance of the budget
- Possess negotiation/relationship skills and be able to cope with behavioral problems
- Delegate the authority and responsibility for budgets to subordinates
- Plan well in advance of the forthcoming budget period and the budget preparation process, e.g., timetables for meetings, etc.
- The aim is to ensure that the budget is ready to be implemented before the start of the new budget period

Budgeting and Management (Contd.)

- The appropriate meetings are required to be held for review of the previous budget and discussion of the future budget
- Appoint a person to act as budget controller
- Set up an effective monitoring and reporting system to compare budgeted with actual results at frequent intervals
- Be prepared to take action to put right something, which is going wrong, as indicated by the feedback from comparative statements/reports

Zero-based Budgeting (ZBB)

- Zero-based budgeting (ZBB) is the latest technique of budgeting
 - The conventional budgeting is framed on the basis of previous budget
- ZBB is an approach to making with the base zero
- It does not have any reference to the past and actual happening
- Budget starts at 'Zero' base (scratch or clean state)
 - ZBB refers to a 'nil budget'

Zero-based Budgeting (ZBB) (Contd.)

- The concept and technique of ZBB was developed by Peter A Pyhrr
- ZBB is "a planning budgeting process which requires each manager to justify his entire budget request in detail from scratch (hence Zero Base) and shifts the burden of proof to each manager to justify why (S)he should spend any money at all activities, be analyzed in 'decision packages' which are evaluated by systematic analysis and ranked in order of importance"

Zero-based Budgeting (ZBB) (Contd.)

- According to the ICMA terminology ZBB is a method of budgeting where all activities are evaluated each time a budget is set and each activity is valued and a combination of activities are chosen to match funds available
- ZBB can be also termed as an "expenditure control devise",
 - where each departmental head has to justify the requirement of funds for each and every type of expenditures and prepare the budget without any reference to the past budget or performances
 - In simple word ZBB can be defined as operating, planning and budgeting processes, which require each head of department to justify his entire budget request in detail from zero-base

Zero-based Budgeting (ZBB) (Contd.)

- ZBB begins at ground zero
- It creates without using historical budgets as a baseline
- Every cost area has to evaluate
- It eliminates unnecessary activities

Zero-based Budgeting (ZBB) (Contd.)

- It justifies account for all components of the budget
- ZBB also determine what activities should be performed and how to be performed.
- It rolls out comprehensive planning and execution process
- It communicates clear plans, roles and responsibilities

Advantages of Zero-based Budgeting

- ZBB improves the planning and control activities in the organization by relating cost and benefit.
- It adds psychological impetus to employers to avoid wasteful expenditure.
- This approach increases the communication and co-ordination within the organization about certain decision.
- Inefficient and redundant activity is eliminated and duplicate activities are easily identified.

Advantages of Zero-based Budgeting (Contd.)

- The technique can be used for the introduction and implementation of the system of 'Management by Activities'
- It facilitates better control and maintenance of operating efficiency in the organization
- It develops skills and impersonal relationship for managers at all level
- It is useful more for service department where it can be difficult to identify output
- It leads to increased staff involvement which may lead to improved motivation and greater interest in the job

Limitations of Zero-based Budgeting

- ZBB requires properly trained managerial personnel to do the required job
- It is very time consuming and a large number of paper works are needed
- Manager develop fear feel threatened by ZBB and therefore may oppose new idea and changes
- It is not suitable for all the activities in an organization
- ZBB is indifferent as to whether total budget is increasing or decreasing
- Administration and communication of ZBB process may became critical problems as more managers become involved in ZBB

References

- Anthony, R.N., Hawkins, D.F. & Merchant, K.A. (2012). *Accounting: Text and cases*. The McGraw-Hill Companies
- Atkinson, A. A., Kaplan, R. S., Matsumura, E. M., Young, S. M., & Kumar, G. A. (2104). *Management accounting: Information for decision-making and strategy execution*. Pea\$on Education
- Colin, D. (1995). *Management and cost accounting*. ELBS, London
- Dangol, R. M. & Dangol, J. (2019). *Management accountancy*. Taleju Prakashan, Kathmandu
- Hilton. R. W. & Platt, D. E. (2014). *Managerial accounting: Creating value in a global business environment*. McGraw-Hill Education
- Horngren, C. T., Datar, G. F., Rajan, M. V., & Lttner, C. (2011). *Cost accounting: A managerial emphasis*. Pea\$on Education
- Horngren, C. T., Sundem, G. L., & Stratton, W. O. (1999). *Introduction to management accounting*. Prentice Hall India

Thank You