



UniSA

BUSINESS
ENTERPRISE

Accounting For Decision Making

Topic 8

Budgeting and Control

Goals for this session...

- Explain the importance of **budgeting** and **control** processes in achieving the organisation's goals, including the role of the planning and control cycle;
- Identify the **strategic** and **operational purposes** for budgeting;
- Describe **budgeting process**;
- Outline the **behavioural issues** associated with budgeting;
- Describe the major **features of budgets and control systems**;
- Explain how the balanced scorecard can be used for measuring **performance** (and strategic management).

The planning and control cycle

Strategic Plan



Strategic Goals



Strategies



Budget



Actions



Performance Reports

Strategic Planning

- ... a long-term planning process through which an organisation formulates a set of strategies it intends to implement to achieve its objectives
- Involves three types of strategic decisions:
 - *Corporate Strategy* ("What business should we be in?")
 - *Competitive Strategy* ("How should we compete?")
 - *Operational Strategy* ("How should we organise our resources internally to achieve the goals of the organisation?")

The Budget

- ... a **quantitative expression** of a short-term plan of action
- Specifies how **resources** are **used** and **acquired** during a specified period of time (12 months)
- Identifies the **financial implications** of the activities planned for the coming year.

*How do
budgets link
with strategy ?*



Strategic Planning and Budgeting

- The budget **must** tie in with the long-term strategic plan of the organisation
- Many organisations will have particular programmes or **strategic emphases** for which resources must be provided in the budget.

Budgeting - a pivot for change

"the fundamental purpose of new management systems is to *link market values and strategy* more directly with *enterprise competencies and operations*. ... an important pivot point occurs within the process of planning and budgeting. This is where a resolution between strategy and operations finally takes place and resource allocation is decided."

"Advanced budgeting : a journey to advanced management systems"
Bunce, P., R. Fraser and L. Woodcock, MAR 1995

The Budget ~ A Means to an End or an End in itself?

- To *plan how to implement* strategies over the short term
- To *allocate* resources and coordinate actions
- To *communicate* the plans to managers at all levels
- To *control actual* performance (of managers and their units) *against planned* performance
- To *motivate* managers to achieve the plans

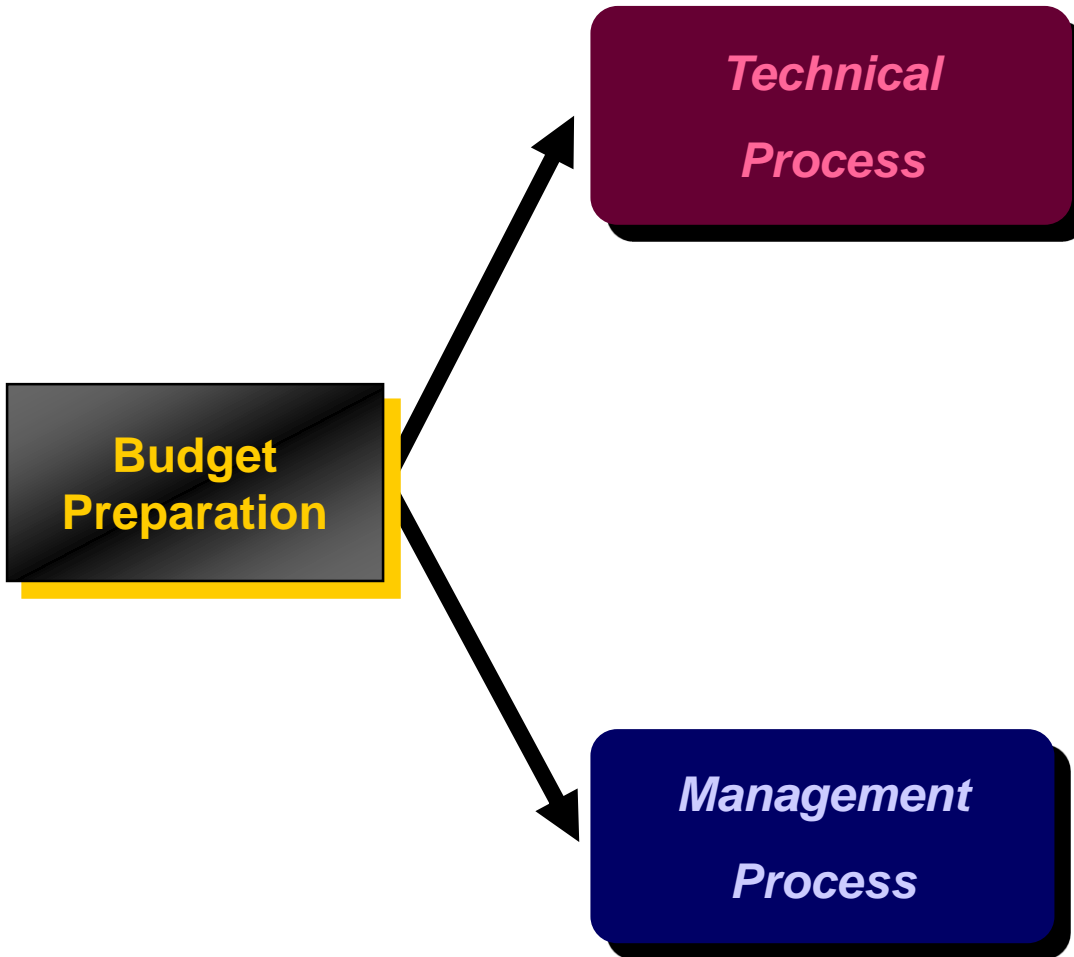
Strategic reasons for Budgeting...

- *Translating* strategy into a detailed action plan
- Assessing whether there are *sufficient resources* to implement defined strategies
- *Linking* economic goals with leading indicators/measures of strategic performance.

Budget variances

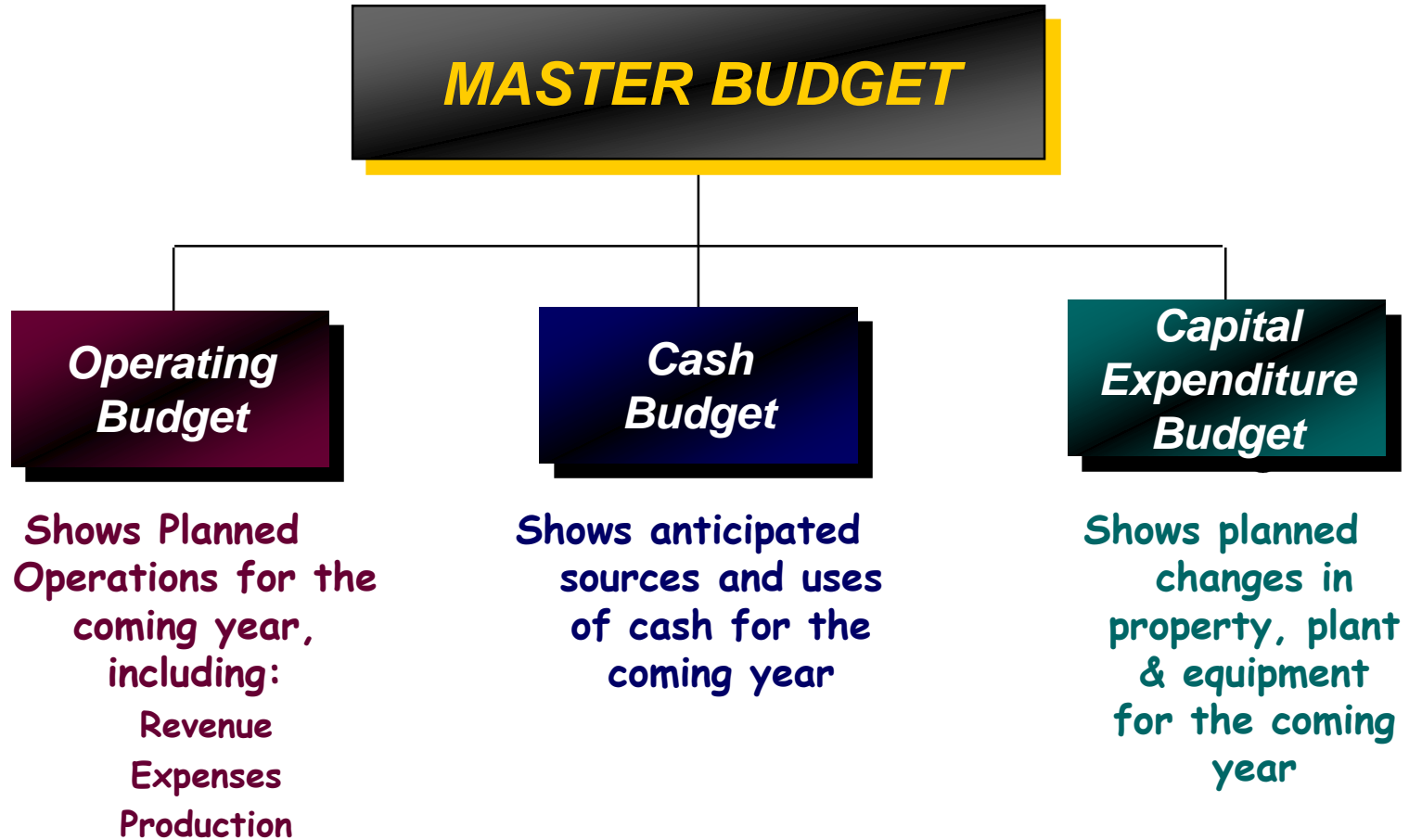
- ❑ Budgets are based on forecasts about the future, so **complete accuracy is impossible** and variances will occur:
- ❑ A **favourable variance** ('f') will occur when actual revenues > budgeted, or actual costs < budgeted.
- ❑ An **unfavourable variance** ('u') will arise when the actual revenue < budgeted, or actual costs > budgeted.
- ❑ Determining the underlying reasons for a budget variance is not a straightforward exercise.

Preparing the Budget



- Mechanics of the system
- Procedures for assembling budget data
- Budget Formats
- Procedure & format similar to preparation of Financial Statements
- Reflects future expectations rather than historical events
- Our focus!

Budget Components...



The Operating Budget

- *Revenue Budget:*
 - Summary of estimated revenues
- *Cost Budgets:*
 - Summary of estimated cost of operations
 - Can include:
 - Production budgets
 - Materials budgets
 - Labour budgets
 - Overhead budgets

The Cash Budget...

- Shows detailed *expected* cash receipts and planned cash payments
- Includes large cash *inflows & outflows*
 - Eg: borrowings, sale of assets
- Considers *timing* of cash inflows & outflows, therefore reveals *when shortages & surpluses are expected to occur*.

Example of a Cash Budget

Ainsworth Enterprises has provided the following estimates relating to the first quarter of 2014:

Cash sales	\$46 000
Credit sales	92 400
Receipts from debtors	71 500
Cash payments:	
Wages	54 000
Office furniture	12 600
Utilities expenses	3 800
Administrative expenses	14 100
Depreciation on office furniture	315
Receipt of loan	15 000
Credit purchases	65 600
Payments to creditors	52 900

The cash balance at 1 January 2014 was \$11 250.

Prepare a cash budget for the quarter ending 31 March 2014.

Example of a Cash Budget

AINSWORTH ENTERPRISES

Cash budget

for first quarter ending 31 March 2014

Cash receipts

Cash sales	46 000	
Receipts from debtors	71 500	
Receipt of loan	<u>15 000</u>	132 500

Cash payments

Wages	54 000	
Office furniture	12 600	
Utilities	3 800	
Administrative expenses	14 100	
Payments to creditors	<u>52 900</u>	<u>137 400</u>

Net cash flow **\$(4 900)**

Bank balance at 1 January 2014 11 250

Bank balance 31 March 2014 6 350

The Capital Expenditure Budget...

- Plan for the **acquisition and disposal** of fixed assets (buildings, plant & equipment)
- Shows the **estimated cost** of each project and the **timing** of the related expenditures
- Evaluation of Capital Projects to be covered in our Finance course.



Budgeting terminology...

- Static budgets
 - *Annual budget is a static budget*
 - *Static budgets provide a **poor basis** for control*
- Flexible budgets
 - *Flexible budgets are budgets that reflect **a range** of different **activity levels***
 - *Flexible budgets provide **a better basis** for control.*

More budgeting terminology

- Zero base budgeting
 - *Works from a base of zero, in setting budgeted amounts for the coming year*
 - *Managers must justify every activity they want funded*
- Program budgeting
 - *Budget allocations made by program*
 - *Control achieved through the identification and monitoring of program objectives*

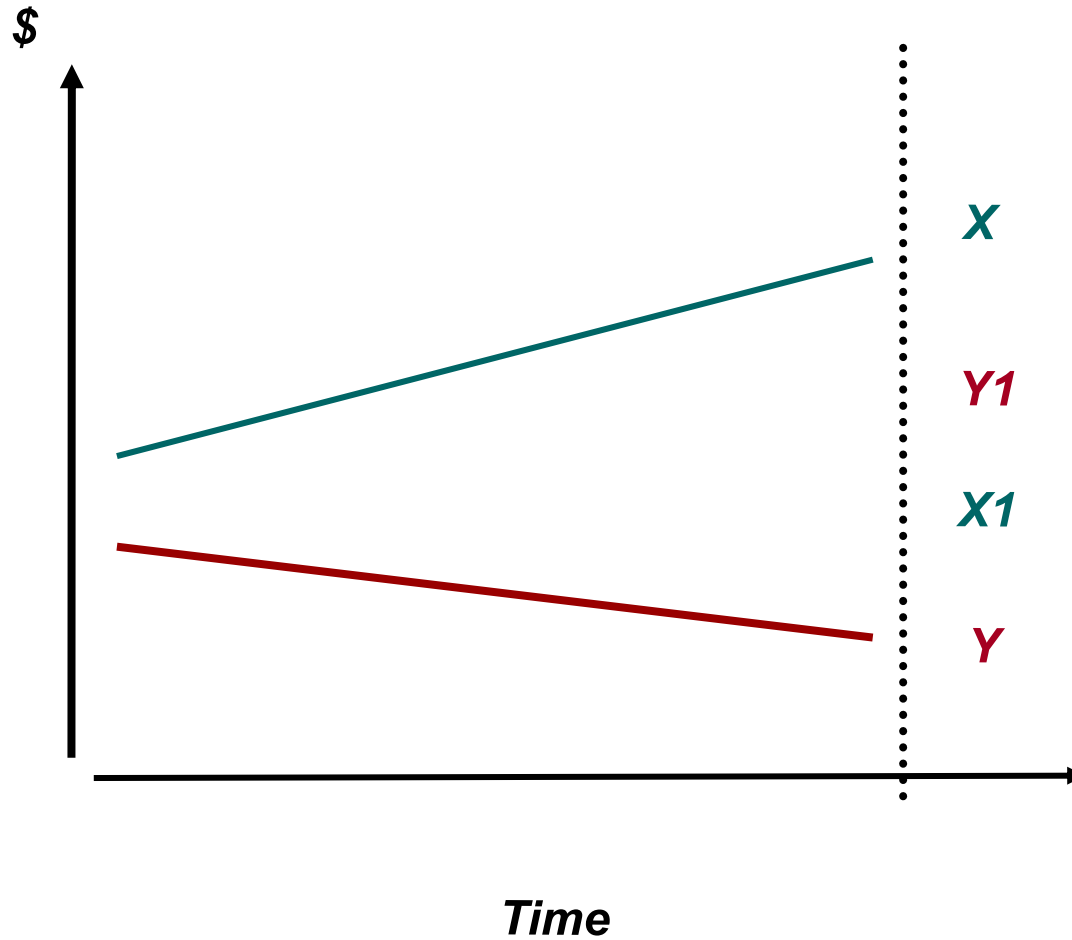
Managing the budgeting process...

- Administrative structure
 - budget committee and budget director
 - budget manual
 - budget timetable
 - annual v rolling budget
- The iterative nature of the budgeting process
- Political considerations

Behavioural issues in budgeting

- Participation
 - “bottom up” as opposed to “top down” approach
 - increases motivation
 - plans need to be tight but attainable
 - *Is a participative budgeting process preferable to an autocratic budgeting process?*
 - *Why?*
 - budgetary slack
 - Understating revenue/Overstating costs
 - *Why do Managers “Pad the Budget”???*
 - *How might we solve the problems of budgetary slack???*

GAMES PEOPLE PLAY...



Budgeting in action...

- ❑ Evaluating the feasibility of introducing a lithotripsy service within the private hospital system

Consider:

- ❑ *Demand of lithotripsy (Demographics)*
- ❑ *Revenue.*
- ❑ *Existing supply (in public sector hospitals) nationally)*
- ❑ *Attitudes of Urologists*
- ❑ *Availability of lithotripsy equipment/substitutes*
- ❑ *Purchase price*
- ❑ *Installation costs*
- ❑ *Maintenance costs*
- ❑ *Opportunity costs*
- ❑ *Staff costs*

*A question without notice ~
your top 3 movies, or, your best ever World XI...?*

1.

2.

3.

Something that really matters...



1.  Banks
2.  Schnellinger
3.  Riijard
4.  Ronaldinho
5.  Beckenbauer
6.  Moore
7.  Best
8.  Maradona
9.  Charlton, R.
10.  Pele
11.  Cruyff

Subs:

12.  *Van Basten*
13.  *Socrates*
14.  *Eusebio*
15.  *Gullit*

Some observations...

- ❖ *There is no "right answer"*
 - Probably about 200+ players/movies who could quite reasonably be selected
- ❖ *Selection is dependent upon personal experience.*
 - Movie selection confined to those you have actually seen
 - 73% of players from Europe & 25% from GB
- ❖ *Selection of reflects a personal view of what constitutes "best"*
 - Acting, story, music, ...???
 - Few players > 6'; Where are the ball winners?
- ❖ *What criteria is used to select the "best"?*
 - Who sets the standards? On what basis? How will it change over time?
 - Is this the best "team", or a collection of the best individuals?

Performance - conceptually...

- ✧ A complex area
- ✧ Difficult to gain consensus
- ✧ Different criteria is used
- ✧ Criteria is rated differently



Performance Measurement...

"What gets measured gets done has never been so powerful a truth"

Tom Peters

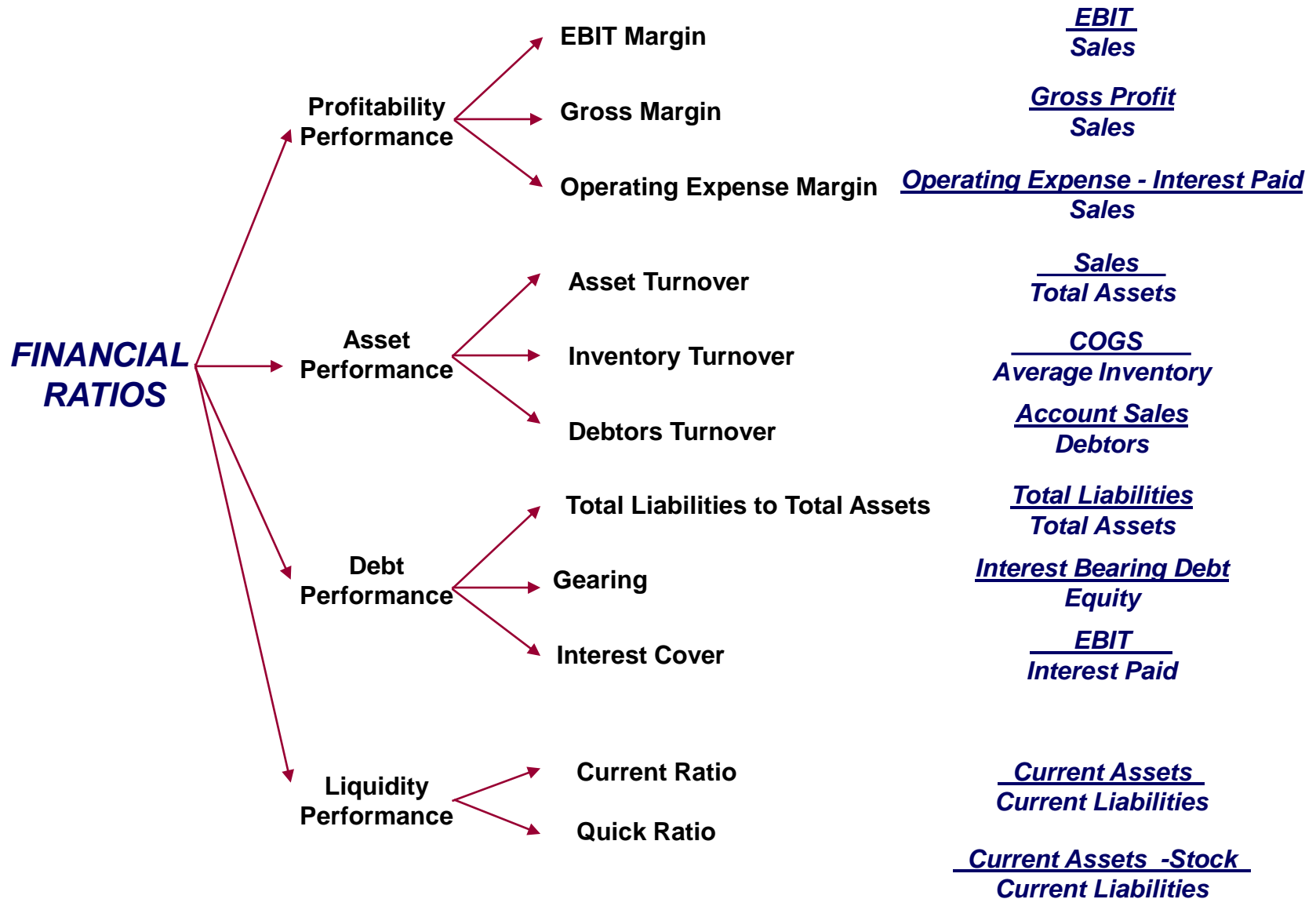
Performance Measures:

- Motivate
- Direct
- Reward
- Provide Feedback

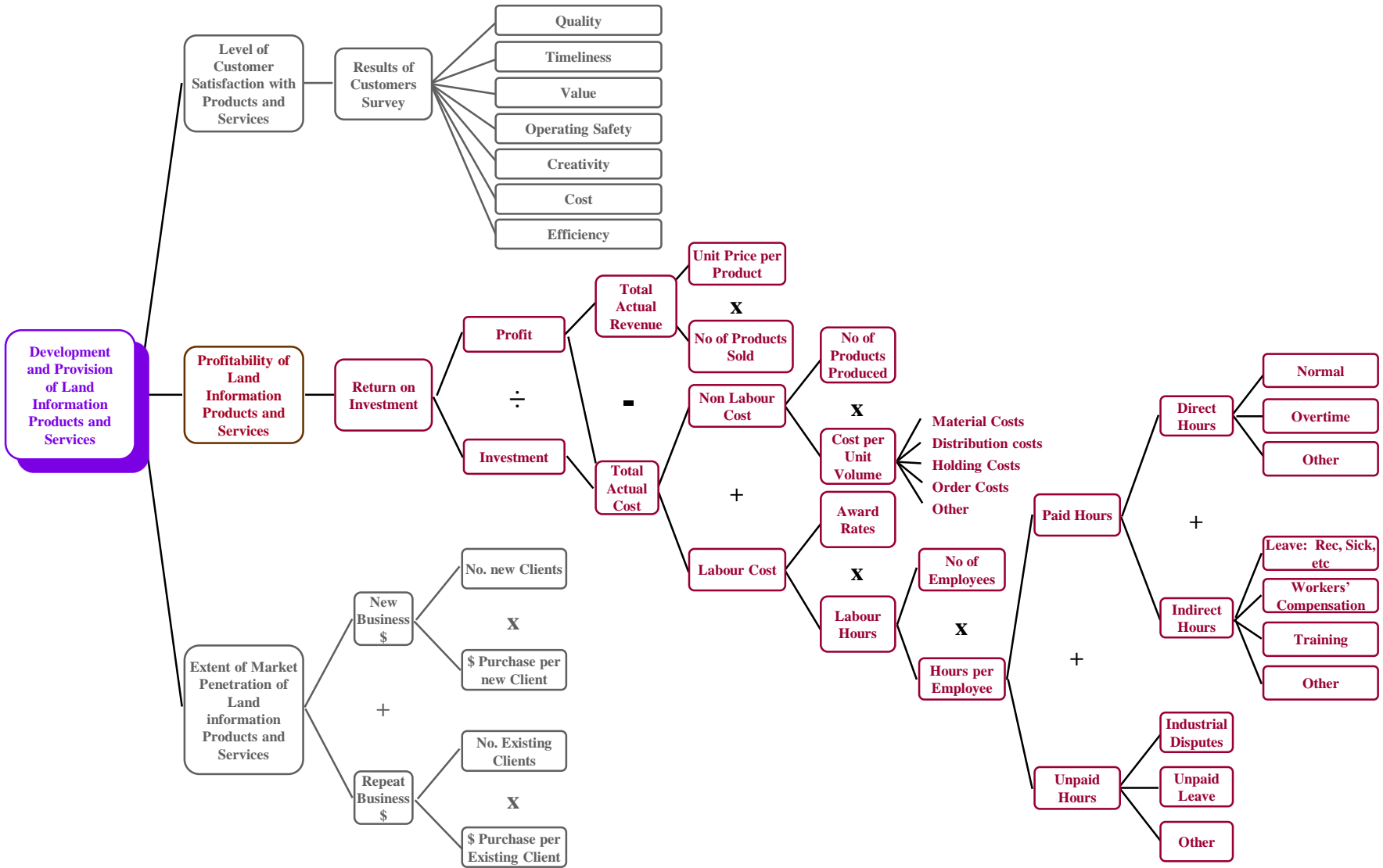
Traditional Approaches...

- mainly **financial** measures at the top of the organisation - ROI, profit, Return on Sales
- comparison of **actual** results **with budget** - individual revenue and expense
- **operational** measures

Financial Ratios...



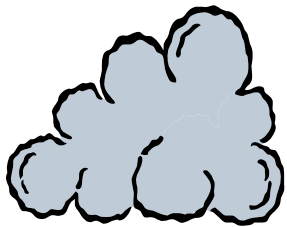
A Practical Example...



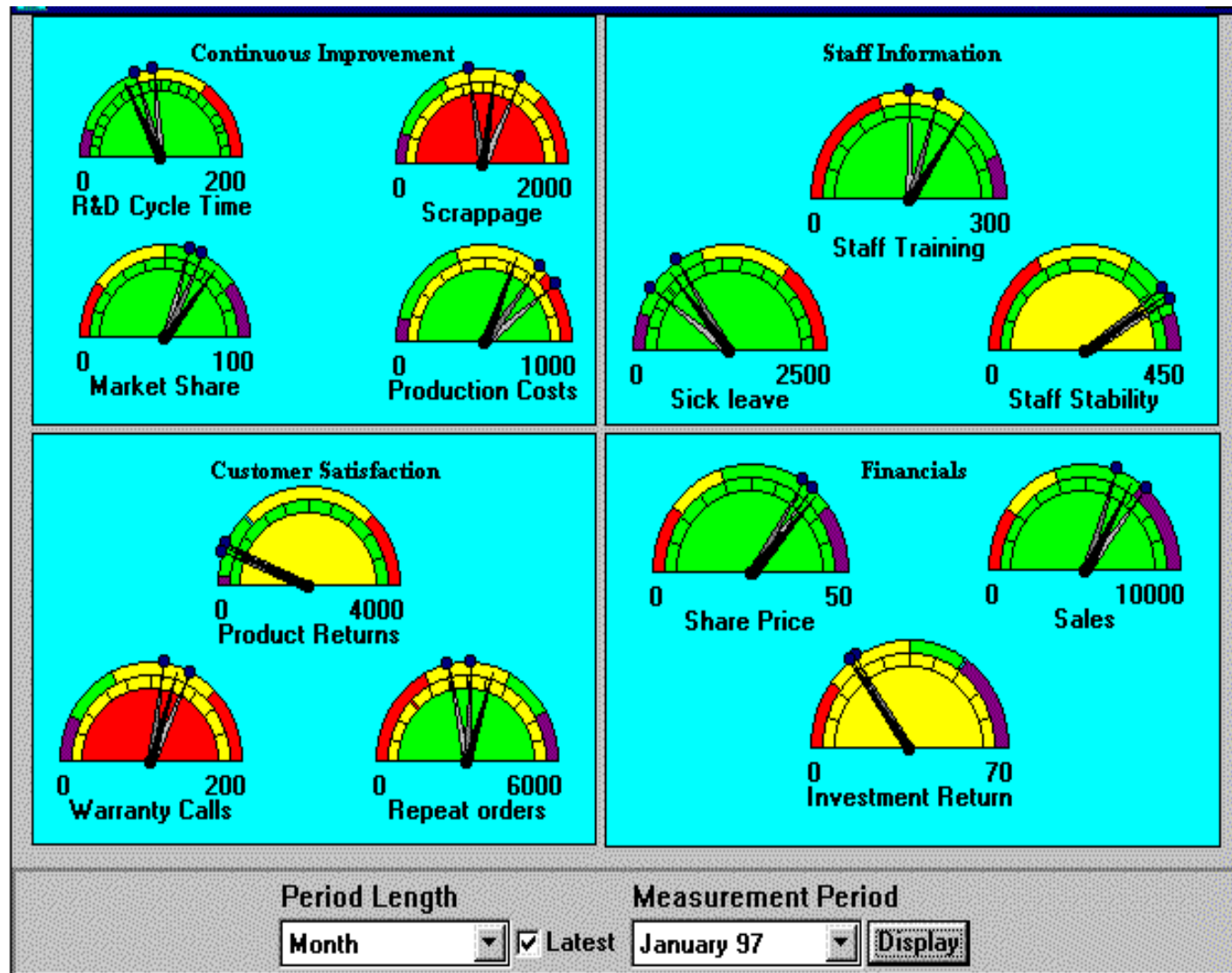
Limitations of Financial Ratios...

- Not readily **actionable**
- Focus on **consequences** not causes
- Emphasise only **one dimension**
- **Lagging** rather than leading.

**“This is the Captain. We’ve got the airspeed
under control, now I’ll work on the altitude.
We appreciate your understanding.”**

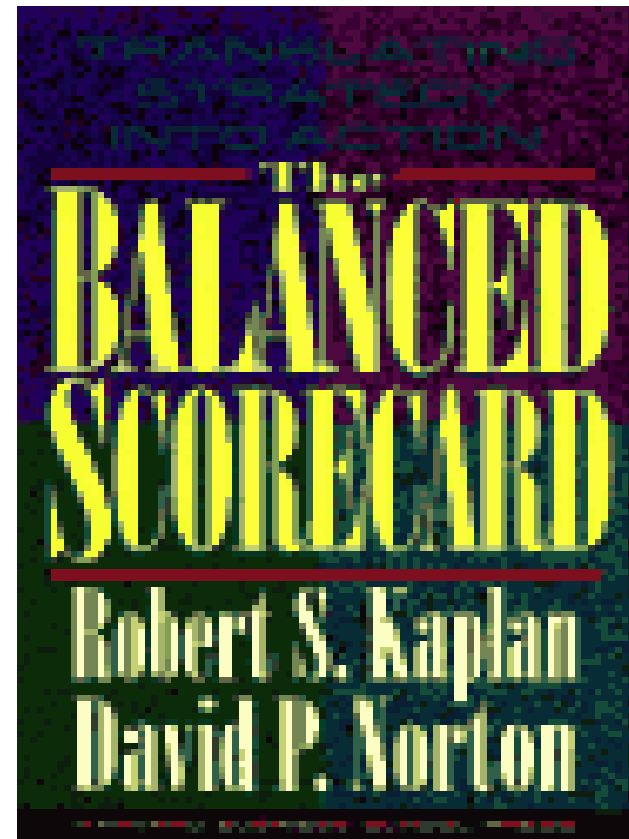


Accuracy, in real-time, ... and not too many...



Towards a more integrated approach...

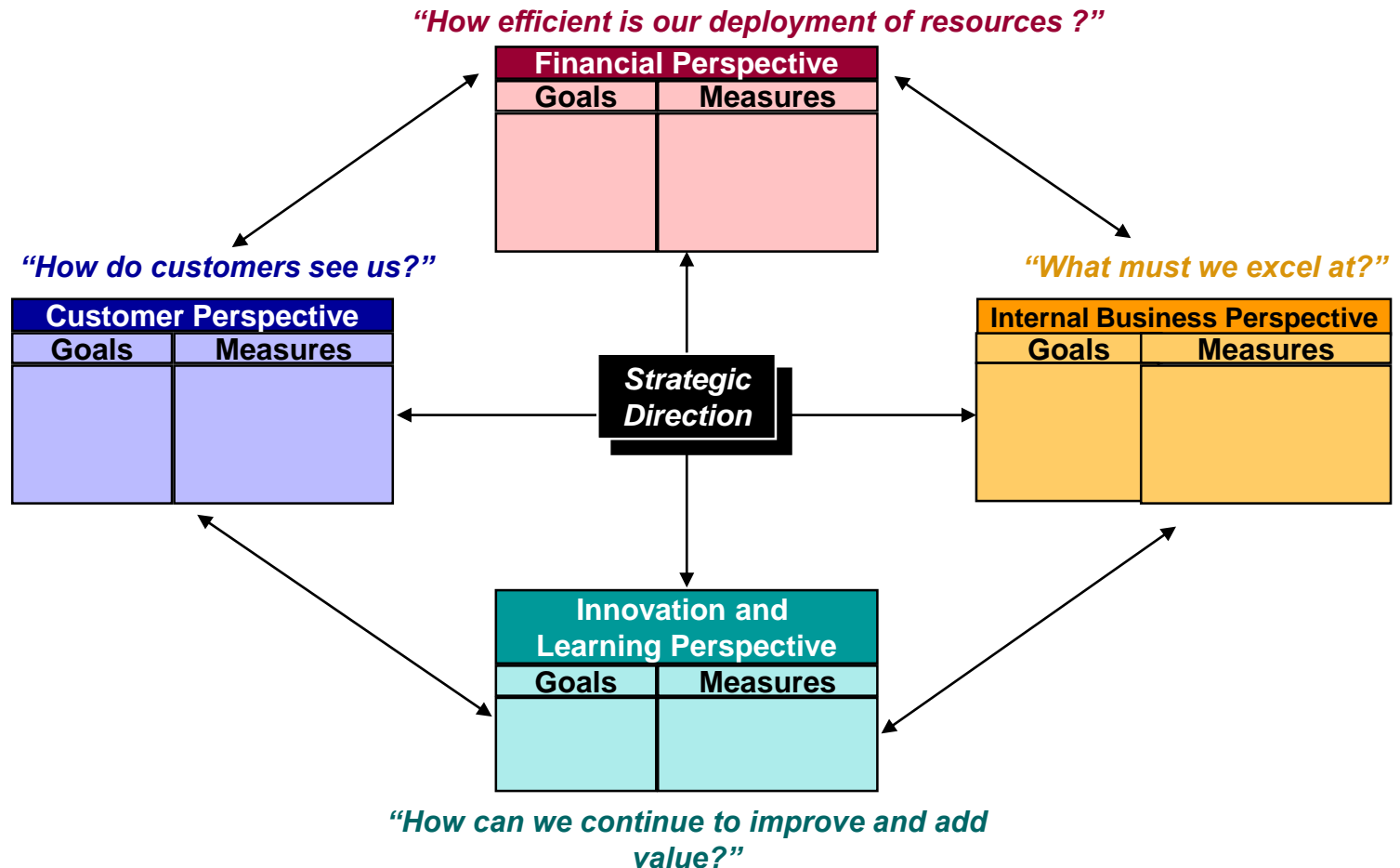
The Key Book...



Four Perspectives...

- Financial *(how do we look to shareholders?)*
- Customers *(how are we viewed by customers?)*
- Internal *(what must we excel at?)*
- Innovation and learning *(how do we continue to improve and create value?)*

The Balanced Scorecard framework...



Value of the Balanced Scorecard...

- Brings together in **one report** all the key success factors
- Balances **short-run** against **long-run**
- Can help organisations break out from a mindless **obsession with short-run profit**
- Connects critical factors through **causal linkages**.

and its limitations...

- Failure to account for the role of motivated **employees**
- Little detail of how to **select** specific measures
- Limited guidance on **how** means & ends should be **linked** analytically
- **Reward structures** are largely ignored
- Role of **feedback** is paid little attention

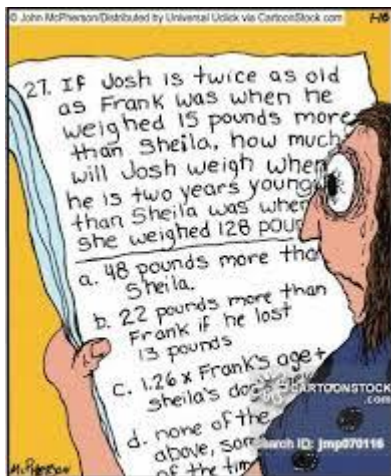
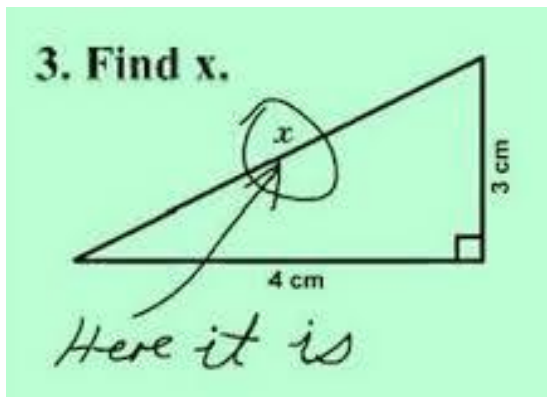
***Congratulations...
....we made it!***



(ALMOST...)

THE EXAM...

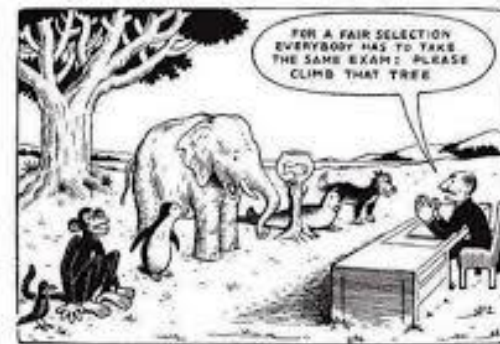




Gretchen encounters the mother of all SAT questions.

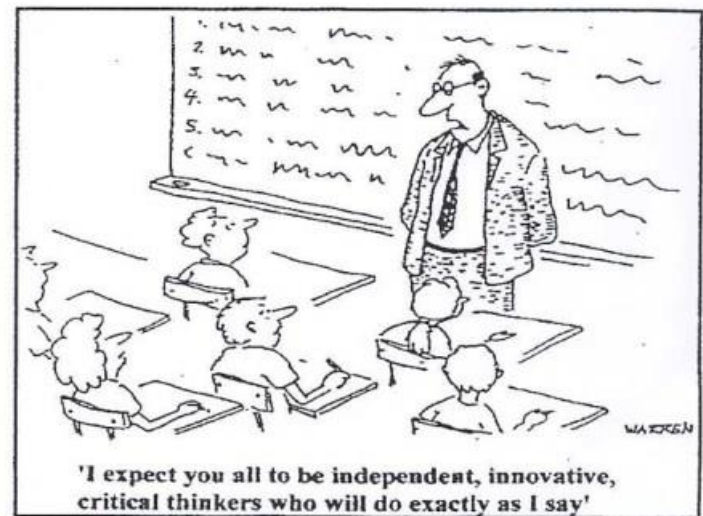
Teacher:
You failed the test.

Me:
You failed to educate me.



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• OPEN BOOK EXAM

Length:

- 3 hours + 10 minutes
- Be on time!!!

• *Structure:*

(4 questions ~ all questions compulsory)

- ALL topics Examinable!
- A mix of *both* qualitative as well as quantitative questions
- First question based on a financial analysis of Red Cross (downloadable from the course website)

Revision strategy....

- Exam is *not* a test of memory, but of our ability to apply the concepts covered in the course
- REMEMBER - the integrated nature of the course:
 - Lectures + Cases + Textbook
- Essential reading - Textbook & Case Studies
- Revisit Case Discussions
- Study consistently up to the Exam.

Revision strategy....

- Make use of reading time
- Plan time strategically (Minutes/Mark)
- Read the questions very carefully
- Do the easy questions first
- REMEMBER - plan the use of your reading time

*CONTACT ME FOR ASSISTANCE IF NECESSARY
(Before & After the Exam!!!)*