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The Role Of Management Accounting In Budget Control

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ABSTRACT

Most of the books on financial matters use the terms budget and budget control interchangeably. However, these two terms differ in theory and practice. "The term budget refers to the prediction and estimation of future organizational needs according to previous figures and statistical data for a specific period of time whereas budget control refers to the actual comparison of obtained results with the figures and data relating to budget in order to take necessary actions for solving or preventing the recurrence of deviations." In this sense, budget shows the objectives and budgetary control shows the obtained end result. Management can be used for budget control with the help of accounting and, in this way, reduce the waste of financial and human resources in organizations. Needless to say, the task of management accounting is to determine the costs with precision through conducting necessary studies and prevent the waste of resources. Finally, with the proper deployment and utilization of equipment and manpower in the intended direction, management can avoid the occurrence of waste. Budget control can predict the waste of resources that occurs in operations, and management can use budget control to reform the situation and consider such situations to avoid the recurrence of the waste of resources in the provision of future budgets. As a result, budgetary control not only is effective, inclusive and practical for the controlling and direction of activities and the prevention of activities that are carried out on a path other than what was intended, it is also one of the best ways to exert control in organizations.
KEYWORDS: management accounting, budget, budget control, operational budgeting, activity-based costing, balanced scorecard, accountability assessment accounting

INTRODUCTION

Management accounting is a useful and practical branch of accounting and it is necessary for all accountants and auditors to be familiar with its basic concepts. In traditional costing systems, the emphasis is on the output volume of production units and it is assumed that products consume resources. However, the recently developed science of management accounting has produced more jobs in the world of accounting compared to the past. In the past, management accountants were solely active as staff workforce and were often physically separated from managers to whom they submitted their reports. Today, management accountants are considered as intra-organizational business consultants who cooperate hand in hand with the managers of all organizational units in the form of hybrid teams. (International Federation of Accountants, 2009) The role of management accountants in leading companies has changed from "number calculators and financial historians" to business partners and trusted advisors. (Azizi, Gholamreza, 2006)

Management accounting is also responsible for the preparation of financial reports required by groups other than organizational directors such as controllers and tax collectors. Simply stated, management accounting is the accounting for the planning, control, and decision-making activities of an organization. Management accounting is made up of numerous branches one of which is accountability assessment accounting (Institute of Management Accountant, 2008).

The utility of accountability assessment is in preparing and developing a performance report. In summary, accountability assessment is composed of the quantitative assessment of the decisions of managers during a fiscal period and presents the impact of these decisions on a report. Through this report, high-level company executives are able to assess the performance of lower-level managers, determine the responsibility of individuals, and prepare individual and group incentive programs. In summary, the reports prepared in this section should be characterized by the following features:

- It must be in line with organizational performance.
- It must be prepared in time.
- It must be easy to understand.
- It must contain the quantitative number of units in addition to monetary amounts.
- It must present the figures with documents.
- It must report the figures using comparison and analysis.
- We must analyze the performance of a unit by considering its impact on the total organizational performance and not just by itself.
- Etc.

In this study, we attempt to address the topics related to management accounting and budget control with more details.

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Problem Statement and the Necessity of the Study:

Budget is the lifeline of an organization since organizations perform all of their financial activities within the framework of the budget. On the other hand, since the traditional budgeting system ignores important factors such as effectiveness, proficiency, economy and efficiency in relation to resources, the resources are not used correctly and are even wasted. A proposed strategy for the better utilization and management of budget is the use of operational budgeting instead of traditional budgeting. This requires a comprehensive knowledge of the subject and the required data can be extracted from the management accounting source of the organization and be interpreted. (Hassan Abadi, Mohammad. And Najjar Sarraf, Alireza, 2007). The developments and complications of the present age have raised the need for organizations to implement reasonable measures especially including proper planning, scientific decision-making and management, and coordination of matters related to market requirements. The use of new budgeting methods not only prevents the slow working processes of organizational units and the waste of resources and budgets but also is very effective in promoting economic purposes through which organizations can distribute budgets evenly and desirably among their intended goals. Since the traditional budgeting system ignores important factors such as effectiveness, proficiency, economy and efficiency in relation to resources, the resources are not used correctly and are even wasted. However, the increase or decrease of the budget follows the decisions and actions of individuals and their bargaining power whereas the accountability of managers and its measurement do not play a strong role. (Ahmadi, Ali Mohamed, 2003)

In addition, budget issues are associated with economic issues such as economic growth, increase in profitability, reduction in the waste of resources, and economic boom and bust in an organization in general. Considering the advantages of operational budgeting and the defects and shortcomings of traditional budgeting, the need for an operating budget as a new way to replace traditional budgeting is strongly felt. Considering the importance of the subject, this study generally aims to introduce new budgeting techniques using management accounting. To this end, first we present a review of studies conducted in the field. Then, with a review on the evolution of budgeting, we discuss concepts related to operational budgeting. And finally, we present a conceptual model for operational budgeting. (Professional Accountants in Business Committee, 2009)

Defining Budget:

Budget is defined as:

• A financial plan for predicting future operations and, of course, the control of those operations.
• An estimate of future costs
• A systematic plan to make maximum use of human, material, and other resources.

All of the three emphasize the importance of the economic and financial aspects of budget.

Organizations need budgeting for three main reasons:
• Demonstrating the financial purport of plans.
• Identifying the resources required for implementing plans.
• Obtaining assessment measures, and monitoring and controlling the results in comparison with the plan objectives.

Budgetary Principles:

• Principle of annularity: According to this principle, the income and expenditure must be predicted for a year and approved by parliament once for the entire year.

• Principle of universality: It is based on this principle that the budget must be prepared and developed completely for all the systems and subsystems of an organization together as a whole.

• Principle of unity: According to this principle, all government plans, activities and projects, all government revenues and costs, and the budgets of all government organs must be recorded in one place. The benefit of observing the principle of unity is that it determines the balance or imbalance of the costs and revenues.

• Principle of budget allocation: According to this principle, no revenue must be allocated to specific costs and no expenditures must be met from certain sources of income, except under certain conditions.

• Principle of flexibility: This principle is an exception to the principle of allocation and is defined as changes or shifts in the expenditure figures and plans of an administrative organ without any change in the total budget approved.

• Principle of revenue estimation: Principle of estimated revenues: It is possible to receive more revenues than the amount predicted in the budget provided that revenues are received according to the law. Even receiving revenues that are not mentioned in the budget are duly authorized.

• Principle of restrictive costs: The idea is that when 100 units of budget are approved for purchasing an item, it is not possible to pay 110 units for it.

• Principle of equilibrium: This principle refers to the act of maintaining equilibrium between revenues and costs so that an organization is able to pay its financial obligations without resorting to borrowing.

Budget cycle: The budget cycle consists of four steps:

- Preparing, planning, and proposing the budget
- Approval of the budget
- Implementation of the budget.
- Monitoring and controlling the budget

The benefits of implementing budgetary control:
• Controlling activities for being performed in a timely manner and for avoiding possible deviations
• Assessment of tasks and activities required for the achievement of organizational goals
• Identifying the flaws in the previous budget and avoiding them in planning future budgets
• Assisting managers in planning
• Preventing task overlap and duplication and maintaining task equilibrium and coordination.
• Budgetary control reports suggest the extent to which the affairs have developed and can be of great use to equipment, manpower, etc.
• Reducing the waste of financial and human resources of an organization by using budgetary control

Definition of management accounting:

Management accounting is the process of identifying, measuring, collecting, planning, analyzing, and providing financial information to managers for planning and controlling operations, ensuring the optimal use of resources, and monitoring the use of resources. Management accounting is also useful in the preparation and presentation of financial statements for users outside the managerial scope of an organization, such as shareholders, creditors, and legal and government authorities. (Babai, Jamshid, 2006)

Management accounting as a useful tool for controlling the budget:

With increasing advances in science and technology, changes and developments occur simultaneously in production and trade every day. Therefore, we have to think of efficient and effective systems for controlling and monitoring these activities. The ability to control these changes has always been a major concern of managers, management accountants and production engineers. Needless to say, each accounting system has to specify the objectives of planning and controlling to maximize long-term profitability. Many managers' plan and control company operations through personal observation and through systems that include various types of budgets, actual expenditures, and deviations. (Babai, Hassan, 2002)

Tools for planning and control in the field of management accounting include:

• Activity-based costing
• Balanced Scorecard
• Accountability Assessment Accounting
• Etc.

Definition of accounting tools for planning and control

• Definition of Activity-based Management Accounting:

The concept of activity-based management accounting appeared in the 1980s. Many companies managed to adapt to the surrounding environment using this method. (Borzuzadeh, Mohsen, 2011) Activity-based costing is a system of accounting that focuses on activities as key elements in collecting other expenditure criteria such as those of a product. Note that activity-based costing is a general system, that it can be part of a job order costing system or a step down costing system. (Hassan Abadi, 2007)

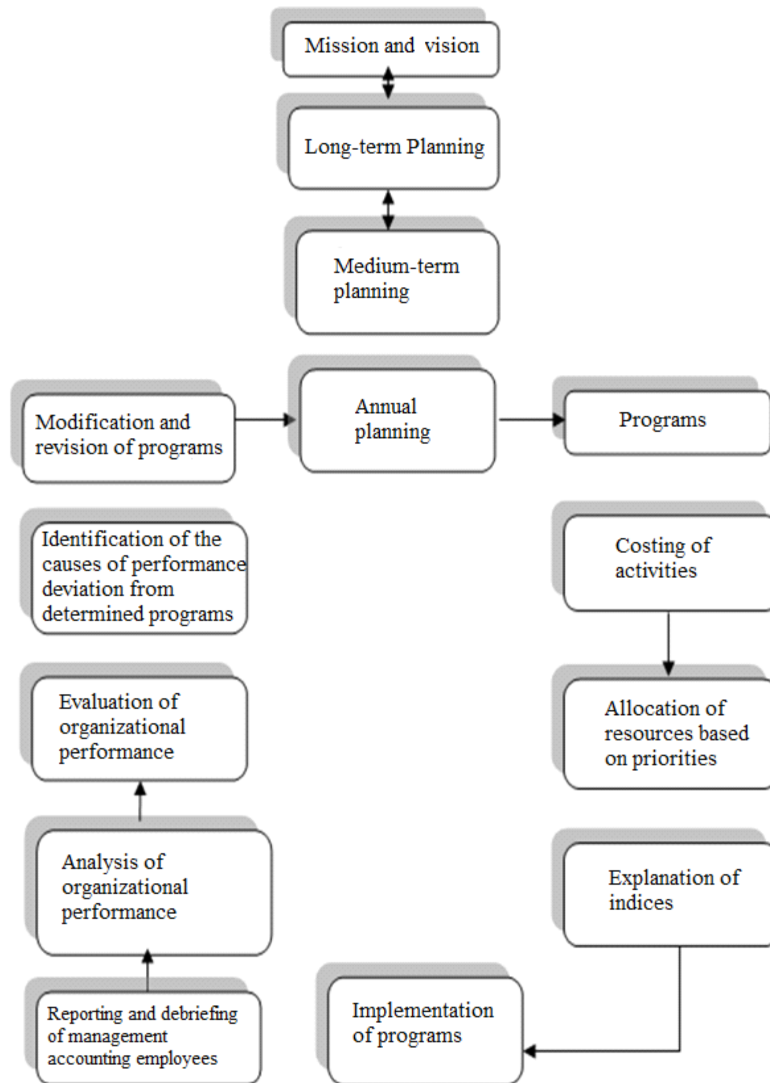

Diagram 1. An example of company operations, units, and activities

Planning and control objectives
A: total operations of the company
Research and development
Product design
Production
Marketing
Distribution
Customer services
Product expenditures for current costing objectives
B: production units only
Forging
Machining
Assembly
Product expenditures for current costing objectives
C: types of activity in production units
Transferring materials
Manual installation
Control
Packaging
Product expenditures for current costing objectives

A real example of the deployment of this system

Consider a manufacturer of electronic products that assembles and tests more than 800 types of products including printed circuit-board 16. Before using this system, the accounting system of this company was like that of other

companies. Its product costing method was based on four categories of production costs, including: direct materials, direct work, a first category of indirect costs of production allocated to products based on the cost rate of direct materials, and a second category of indirect costs of production allocated to products based on the cost rate of direct work. In fact, this costing system was more accurate than most product costing systems that used a unified attribute for absorbing all indirect costs of production. However, as the company was improving and becoming increasingly competitive, managers of the product design, production and marketing units became suspicious of the accuracy of the industrial accounting system. For example, in one meeting, a product designer stated:

Why is it that when I use the $ 0.2 X piece, material overhead changes for $ 0.2, but when I use the $100 Y piece, material overhead changes for $ 100 while piece Y does not consume 500 times the materials used in the production of piece X? Production unit managers came to believe that in some areas of activity, various factors affect costs while the accounting system cannot collect information about them. (Hassan Abadi, Mohammad. andNajjarSarraf, Alireza, 2005). These managers wanted to focus their attention primarily on cost control in activity areas. Marketing managers also found that the accounting system tends to heavily increase the costs of products which are highly competitive. How did this happen? This happened through the allocation of high indirect production costs to high volume products and the allocation of very low expenditures to low volume products. Working as a team, especially in the production and accounting units, is one of the outstanding characteristics of an activity-based costing system. (Arabi, Mahmoud and Saadatmandi, Hashem, 2007)

Formula 1 presented below can be used to calculate indirect cost absorption rates for activities relating to the transference of materials (figures are hypothetical).

Formula 1

Absorption rate= Budget expenditures for the transference of materials/ annual number of budgeted pieces

Absorption rate = $ 300,000

$ 300,000 per piece

2- Balanced Scorecard (BSC):

Balanced Scorecard is a management system which supports an organization for path adjustment and the achievement of key strategic objectives. Balanced Scorecard was created to prepare an organization's management system in order to keep pace with the current rate of trade and make available the data required by the management for making more accurate decisions. (Kurdbacheh, Mohammad, 2005)

Four benefits of Balanced Scorecard (BSC):

- Financial Scorecard is used to identify the financial performance and needs of an organization. These measures tell us that the successful implementation of the goals set in the three previous stages will eventually lead to what financial gains and results.
- Customer Scorecard is used to determine the level of customer satisfaction (through qualitative and quantitative measurements of goods or services)
- Internal Processes Scorecard is used to evaluate the processes required by an organization. In this stage, an organization must identify, and excel in, the processes that allow it to continue to create values for its customers and ultimately for its shareholders.
- Knowledge, Learning and Development Scorecard focuses on the quality of employee training, acquisition of knowledge, and the methods of using knowledge in order to be present and survive in a competitive market.

3- Accountability Assessment Accounting

Definition of Accountability Assessment Accounting

Accountability Assessment Accounting is a system that clearly and accurately determines the financial accountability of managers in performing their assigned duties and responsibilities in a report. It consists of three basic parts: 1. accountability, 2. performance, 3. Report. (Mirzaee, Seyyed Reza, 2006)

Benefits of Accountability Assessment Accounting

- Accountability Assessment Accounting enables management to assess the performance of units and individuals and ensure the consistency of objectives.
- Accountability Assessment Accounting was developed before World War II with the perception that costs are not controlled by the system but rather by people.
- The main argument in Accountability Assessment Accounting is that unit managers must be held accountable for the costs under their control.
- Accountability Assessment Accounting is a management accounting system and its duty is to assess and evaluate the performance of units, managers and other organizational employees.

Implementation Stages of Accountability Assessment Accounting:

- Defining accountability centers: cost center, revenue center, profit center, investment center
- Budgeting and predicting costs and revenues in the form of defined accountability centers

• Preparing an organizational chart and determining the scope of the powers and responsibilities of each accountability center
• Determining controllable and uncontrollable costs
• Preparing reports for each center by its managing director

A Conceptual Model of Budgeting based on Management Accounting Activities and Data

Conclusion:

Based on the results of this study, it should be noted that the main objectives of budgetary control are the timely control of activities, the limiting of possible deviations in case they occur, and the prevention of the recurrence of such deviations in the future. Besides preventing activities from going into wrong or undesirable directions, budgetary control can also be used to evaluate activities undertaken to achieve organizational goals. Budgetary control can help us identify the problems that occurred during previous operations and were ignored in planning previous budgets so as to mark them to be avoided in planning future budgets. Budgetary control also helps managers in organizational planning and making decisions about how, where, and when activities should be carried out in an organization. During budgetary control, managers find an opportunity to identify, stop and prevent deviations on the one hand and conduct more accurate budget planning in the future considering previous deviations on the other. However, for deploying budgetary control, it is necessary first to identify the procedures and policies that initiate and sustain budgetary control and then to follow them for achieving better results. The methods discussed in this study only facilitate budgetary control. The question is: How can we find ways that sustain budgetary control?

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