The Role Of Management Accountants, Definition Of Terms Budget And Incremental Budgeting

Management accounting is a profession that involves analysing and organising data to aid with the performance and control functions of an organisation. Highly competitive markets due to the increase in globalisation of the past 20 years has meant that companies have become increasingly more complex meaning current accounting practices have lost relevancy.

Customers have become the main focus for modern day business and easy access of technology has meant management accountants must have faster response times in order to adapt.

Between 1980 and 2000 management accountants primary focus was on budgeting and costs of production. However it was soon realised that this

only painted a one sided picture and in order to be up to date, management accountants began looking at external factors meaning they were better able to serve the customers needs. Management accountants adapted from solely looking at key disciplines such as finance and accounting to marketing, economics and psychology. Management accounting for an organisations is one of if not the most vital department. The ability for Management accountants to adapt to new challenges, from changes in market environment is pivotal to a companies success.

Since management accountants have all the data, rather than being ‘Bean counters” like they once were, they accepted a new role of being the driving force of an organisation. They must be able to critical evaluate the data they have been given in order for managers to make effective decisions. Risk analysis, strategic decision making, and financial forecasting are some of the new roles management accountants must undertake and big role is being placed on their ability to create useful and valuable information. These skills of being a competent Management accountants are becoming increasingly more desirable for modern companies.

Cost of specific products and historic costs are becoming increasingly obsolete but still not irrelevant as they do have uses. They help project future costs and revenues which for a business if done accurately is the difference between success and failure. In order for management accountants to adapt they must evaluate their roles in the company and then see do previous management accounting practices that they have employed are still relevant to the changing business environment.

With increasingly competitive markets due to globalisation, low wage economies such as India and China are setting the standard for lower costs.

The skills of Management accounts has shifted, and now a key skill is to be able to come up with non-financial measures to assess business performance. This new role is due to the introduction of IT. The role of IT has impacted the administration systems, operational systems and the firms competitiveness. It allows the management accountant to obtain information from different sources to gain the upper hand over their competition. In order for management

accountants to keep up with IT they must focus on two areas. Descriptive analysis and predictive analysis. Descriptive analysis requires managers to look at present and historic data such as cost reporting and performance measurement. This data will inform management accountants on certain problems the company is experiencing and they can react accordingly. Predictive analysis requires management accountants to be more future oriented. They look less at historical cost and try to predict consumer trends and forecast the future business environment. This allows management to make better decisions which intern will benefit the future of the company.

Improvements in production and operations has been a big driving force of the changing role of accountants. These include Total quality Management, Just in time and advances in organisational structure. Total quality management has become a big assets for managers as it serves better quality products to its consumers which therefore results in a greater percentage in customer loyalty and increasing the revenue for a business. Just in time is one of the most important accounting tools for businesses. Forty years ago management accountants would record thousand of journal entries which is difficult for a business and time consuming. With JIT, it reduce the amount of journal entries meaning goods are received quicker. It reduces the response time from production systems to suppliers and customers. A strong management accounting system is very important for improving organisational structure. It allows an organisation to improve their decision making and shows a much clearer picture to employees which will only increase the efficacy of the business.

Some tools which Management accountants can use to aid in the decision making process: Budgeting, make-vs-buy analysis, process analysis and customer. Budgeting involves forecasting future demand, sales and costs. By doing this management accountants can better anticipate the future and solve any problems that may come further down the line. Make-vs-buy analysis requires management accountants to investigate if it would be cheaper to make their own products or should they outsource production in order to reduce costs. Due to the impact globalisation has had on the economy, product costs that are too high could mean a loss of competitiveness for a firm. Process analysis requires looking at all the departments in great detail and examining them on their strengths and weaknesses. By doing this, they can then allocate resources accordingly to help increase productivity in the business. Customer analysis is one of the most important tools for management accountants. Management accountants look at then channels in which their products are going through. This means they look at where they are selling their products and if the product could be more profitable being sold a different e.g. online. They analyse which of their products is the least profitable and try to adapt the product to the customers needs. They do this in conjunction with customer feedback. This is very important as it allow the firm to develop their products exactly to the customers needs.

To conclude I feel the role of modern day management accountants has shifted from looking at historic data to now analysing and planning for the future. A constantly changing internal and external environment will mean management accountant must be highly adaptable in order to succeed. Gone are the days of number crunchers and bean counters, todays management accountant must have a greater set of skills including business management, psychology and economics. Descriptive management accounting while it is important is becoming ever more obsolete, meaning in order for businesses to thrive management accountants must look more to the prescriptive side of analysis.

A budget is a financial plan for for a period of time in the future. It estimates future sales,

volumes, revenues, costs and expenses, assets, liabilities and cashflow. The budget is one of the most important tools at the disposal of management accountants. Budgets provide a great baseline in which to measure performance. A budget is very beneficial because it will allow managers make certain decisions based off the data that the budget gives. It allows a business to set future goals, create spending caps and can be shown to future investors to help entice them into purchasing shares in the business.

A budget is the bedrock for most successful businesses. For management accountants to accurately budget is a major skill. If a business has no control over spending or planning then the business has no objectives to achieve. A budgets objective are to: control the finances of a company, ensure the business can fund current projects or any future commitments they may have, allow business managers to make effective decisions and make sure the business has capital to invest in future projects. The dangers for a business not to plan can mean they don't have an idea where funding is coming from and may not be able to take advantage of future investments. Not having financial records may mean the denial of loans or credit and may hamper their ability to bid for government contracts.

For many large organisations a budget is usually done 6 months before the start of the financial year. They analyse on a monthly basis, from the planning stage all the way to the final stage where the budget is implemented. The Framework for a budget is very important and it consists of an operating budget e.g: day-to-day operations, a capital expenditure budget e.g: the purchase of larger assets (property) and a cash budget, which helps a companies managers manage cash flows effectively and aiming to keep liquidity strong.

The process for creating a budget can be done in 12 steps: 1. Analyse budget assumptions: this involves analysing previous sales and cost trends and forecasting the future environment in order to predict future demand. 2. note available funding: when preparing the budget the availability of funding is very important. Attention must be focused on this as it will allow future projects to be feasible. Liquidity is one of the most important factors for a businesses survival. 3. Step costing: the business environment is constantly changing and these challenges affects the costing structure of a business. Factors that may effect future costing must be identified and implemented before the budget creation. 4. create a budget package: A budget package outlines how a budget must be prepared. 5. Forecast revenue: Forecasting sales is critical. It will show a company if they can make enough revenue in order to survive. A lot of a companies resources then must be focused on this in order to create an accurate portrayal of revenue. 6. obtain department budgets: Each department in an organisation should prepare their own budgets in order to reach an overall expenditure.7. validate compensation: Compensation increases annually so it should be prepared with care. Compensation approval comes from managers and once agreed upon it should be put into the budget 8. obtain capital budget requests: Capital expenditure allows a business to grow which is vital for survival. Capital expenditure should be analysed in advance and then added to the budget. 9. Update the budget model: Changes undertaken should be added to the budget and then the first draft should be made. 10. review the budget: Budgets should be reviewed by more than one person and any errors found should be corrected. 11. obtain approval: The budget will be reviewed by the managers in the company and if they are happy with the details then they will approve it. 12. issue the budget: Once approves the budget will be formally issued and future operating decisions should be made according to it.

For a business carrying out a budget is critical and has many benefits. These include funding

planning, cash allocation, bottleneck analysis, performance evaluation and planning orientation. Funding planning allows a managers to calculate how much future projects and operation will cost and by doing this they can allocate funds to these areas. This will help managers see if they can hold onto cash in order to prepare for future investment or to see if they will need funding in the short-term. Businesses only have a limited amount of resources so budgeting allows managers to see which projects will give them the best return on their investment. By analysing a companies bottleneck, managers can formulate solutions to expand the size of the bottleneck or they can come up with new ways to work around it. Performance evaluation between managers and staff will allow managers to create goals for employees and act as a motivation. Managers can compare budgets vs the actual and give bonuses to employees if they exceed the budgeted figures. Planning orientation allows managers to look into the future and set goal for what they want the company to achieve. It will allow a company to become more competitive and make it easier for them to adapt to the constantly changing business environment.

Businesses must not underestimate the important of budgeting. It is possibly the most important tool they have at their disposal and is very beneficial to managers to make effective decisions. It provides vital information about future cash flows and expenditure and offers insight into changing market conditions. The preparation of a quality and useful budget is essential for the survival in modern day business. Globalisation has lead to extreme competition in markets, so a well prepared budget offers companies the ability to have an advantage against competitors.

Incremental budgeting is a process in which a new budget is developed by making marginal changes to the current budget. Incremental budgeted amounts are added or subtracted from the original amounts to form a new budget. Incremental budgeting is a simplistic and conservative approach to budgeting, but however has many flaws. These flaws include that promotes non-essential spending, It discourage R&D and innovation, It doesn’t take into account external factors and it doesn’t allow for a comprehensive review.

Incremental budgeting creates unnecessary spending for a business because it is built on the philosophy that each part of the budget is increased each year. This is exploited by department within a company because in order to be allocated more money in next years budget, departments will not use their resources efficiently and spend more. Even if some departments do not need extra funding they will be allocated it anyway leading to a sub-optimal use of the firms capital.

A major criticism of Incremental budgeting has been that it discourages firms to innovate. This is because new budgets, are based on data from previous years, which therefore means there is lack of funds given to develop new ideas. This is why it's a conservative budgeting process, and will hamper the business growth in the long run. Due to increased competition, a firm that doesn’t constantly develop new products will struggle to grow in the long run. Incremental budgeting does not look at any external factors when preparing a budget. Stability is a key component when it comes to incremental budgeting and this means looking back rather than looking into the future and is therefore slower to react to unforeseen circumstances.

Finally incremental budgeting fails to have a comprehensive review. Incremental budgeting does realise savings which potentially exposes the business to a waste of resources. This in the long run can have drastic effects on a business and may lead to cashflow problems and potentially insolvency in the future. The budgeting process is a key stage in the communication

of managers and different departments within a business. It allow the managers to show different departments future revenues and costs. The budgeting process involves three main stages: 1. The development stage which is the creation of the budget itself, 2. The budget review, this is where the business analysis their budgeted figures with the actual data and 3. Involves the business with an opportunity to gain from their analysis of the budget in the future. The main objective of budgeting is to help managers make better decisions. Arguments in favour of maintaining budgeting include: it gives a business a framework of control, it is an integral part of organisational culture and it assists with the idea for the need to decentralise.

A key objective of budgeting is that it provides a framework of control. This means that a business is better able to coordinate their finances and in the form of a budget this creates a very useful reference point in which managers can use to make effective decisions. It creates an air of stability which in business is a very useful tool to have. The abolishment of the budget would be a lot riskier and result in a greater amount of uncertainty unless other alternative were put in place. Another argument in favour of maintaining the tool of budgeting is that it is an integral part of organisational culture. Budgeting for firms has been around for hundreds of years as it is a key component to any business decisions. Abolishing the budget would be very risky as its a fundamental process in business analysis. However there are arguments for the adaption of the budget which would be less risky and provide firms with more useful information to make decisions. Finally budgeting assists with the idea for businesses to decentralise. Decentralisation is the idea that planning and decision making are distributed or delegated away from a central authoritative location or group. This is especially common in Financial institutions such as banks. Budget cost centres gives managers the freedom to run their departments in anyway in which they see fit as long as they are able to meet their targeted goals.

Although budgeting has its advantages, it isn’t perfect. Budgeting can be improved by a number of different factors. The implantation of rolling forecasts is seen as a better alternative to traditional budgeting. Rolling forecasts involves continuous forecasting over a set time period. This includes a re-forcast for the next twelve months at the end of each quarter. This will allow firms to have more up-to date information and allow them to react quicker to a changing environment whether it is internal or external. This form of budgeting will take much more time and resources to complete, but with the increased introduction of modern accounting IT tools it will be very assessable for businesses in the future.

Another way in which traditional budgeting can be improved is by the use of zero- base budgeting. This involves starting from scratch when budgeting and not looking at the current budget when forming next years one. This is very useful in helping to reduce costs and for avoiding blanket increases or decreases past years budget. This does however have drawbacks. It is much more time consuming then traditional budgeting and may not work in some natures of business which is rapidly changing.

Finally value based management is also an idea that can be implemented to improve the budgeting process. It is the approach that enables businesses to maximise value creation, usually shareholder maximisation. In order for this to be successful it require a deep understanding of the market in which the firm competes. It sets out principles such as recognising that top down command and control structures do not work well. It asks managers to use value-based metrics and involves looking at the income statements, balance sheet and long and short term perspective in order to make decisions.

The budgeting process is in my opinion an integral part for a business in order for managers to make effective decisions. However some see it as a tedious time consuming process which only adds to confusion to managers who aren’t literate in the language of accounting. Managers may be forced to read multiple iterations of budgeted data which can be difficult to understand and lead to confusion. Companies have invested billions of dollars into the development of IT budgeting systems in order for them to be more accessible for managers. The use of budgets has a negative effect on corporate ethics. Managers try to chase down budgeted goals at whatever the cost and don’t acknowledge business ethics or the harm it may be doing to others. Bankruptcy and prison can be the consequence for ignoring ethics and blindly chasing budget goals. I however feel budgets should not be scrapped as they are the foundation to any good business. They allow business to plan for the future and when done correctly lead to very profitable businesses.