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PURPOSE FOR BUDGETING – LITERATURE REVIEW

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ABSTRACT

This paper studies the literature regarding budgets and their importance within a company. In the current economic climate, companies are starting to pay more attention to efficient management of resources and, for this purpose, use budgets as tools for financial management at company's level and at the level of the main types of company's activities. So, the budget is the most important tool in conducting any activity successfully. A budget is the tool by which a company's management translates into action the corporate strategies and quantitative mission statements.

Keywords: budgets, budgeting, performance.

I. INTRODUCTION

The existence, development and environmental adaptation of an economic entity generate a complex network of financial flows that define the general assembly of financial economics at both microeconomic and macroeconomic level, nationally and internationally. Developing a company must be based on knowledge of its capabilities, weaknesses and strengths as well as external macroeconomic environment. From these results it is absolutely necessary to develop an appropriate policy to ensure not only the maintenance of the business to a certain level but also for development in accordance with the changing economic environment in which it exists and operates.

For this policy to be as accurate and useful to executive bodies of the economic entity it must set clear financial goals to be achieved and to accurately scale capital needs that can be used cost-effectively. Also, such a policy must be geared towards the future and try to predict optimal financing possibilities depending on existing costs on raw materials, capital and finished goods markets in which the company operates.

To ensure a dynamic balance on both short and long term, the company's management is obliged to pay attention to how they are planned and carried out all financial processes within the company:

- capital needs assessment;
- finding funding opportunities;
- organization of raised capital using in the most efficient manner possible.

In the context of a competitive market economy, business activity should be conducted profitably according to a balanced relationship between revenues and expenditures. To conduct a profitable business the management of any economic entity has to predict expenses, receipts and payments for a certain period of time. This is why budgets have grown to be a primary tool for financial forecasting within economic entities.

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In the current economic climate, companies are starting to pay more attention to efficient management of resources and use, for this purpose, budgets as tools for financial management at company's level and at the level of the main types of company's activities. So, the budget is the most important tool in conducting any activity successfully.

II. DEFINING BUDGETS

"Rigorous planning …of any economic activity is an essential element for the success of those activities. Without planning the activity of any economic entity would detach from surrounding reality ...the capacity for provision and planning of any activities in a market economy conditions assures the survival and development of these activities"(Achim, 2009, p.33).

In general the term budget is seen as representing a list (a document) in which are placed face to face predictable revenues and expenditures of a particular economic entity, for a specified period. This approach corresponds to reality, but at a more detailed analysis, this expression reflects a methodological category specific to finance, seen as a scientific discipline. Under this, budget can be interpreted as a general finance specific methodological process through which, it highlights how formation and sizing of financial resources it is done in particular economic entities, on the one hand, and the distribution to various destinations of resources for the fulfillment of predetermined targets, on the other hand.

The budget is a planning document which contains a number of financial and / or nonfinancial information that refers to the activities that will take place in the future. Budgeting is the activity of recording financial and / or non-financial elements into the budget (Achim, 2009a). Blumentritt defines budgeting as "the process of allocating an organization's financial resources to its units, activities and investments" (Blumentritt, 2006), while Horngren et al. sees budget as the quantitative expression of a proposed plan of action by management for a specified period and an aid to coordinating what needs to be done to implement that plan (Horngren et al., 2004).

The income budget represents the financial estimation for sales of company's products and services and the expenditure budget is the financial estimation of resource consumption necessary to achieve company's objectives. So, the budget is a financial or quantitative statement, containing the plans and policies to be pursued during a specific time period (typically a year).

All decisions made at the company's level (technical, economic, organizational and others) result in affecting the existing financial balance and determine the need for a new balance, employing for this purpose changes in the level and structure of funds and resources needed to finance them. The new financial balance requires reliance on a higher level of financial indicators by budgeting. The income and expenditure budget is therefore the company's financial program with which it predicts revenues, expenditures and financial results of its activities, own funds and the loan, businesses relationships, payments to the budget and others.

Planning finances of a company is achieved through the process of budgeting the business activity. This is an operational plan on a given time horizon, usually one year, which includes forecasting revenues and expenditures of a company, additional capital needs and how to finance them and the main indicators characterizing the hoped efficiency. Even if the budget is a financial plan regarding future revenues and costs of

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a business, it is about much more than just financial numbers. Budgeting process involves choosing specific objectives of future activities and company policies, programs and procedures designed to ensure the necessary conditions for achieving these objectives.

The purpose of the budgeting process is to ensure that the financial resources available for a company are used efficiently, for both new attracted resources to finance its activities and excess of capital flows from previous business activities. "At the annual financial budgeting stands a strategy for business development in a predictable timeframe for achieving an acceptable probability. Spearheading of this strategy is the marketing studies that may reveal possible future market size and the market slice that the company could count on" (Giurgiu, 2000).

III. BUDGETS' PURPOSES

Budgets have always played a key role in managing an institution, both private and public, being an important control system in many companies (Ekholm and Wallin, 2000, Merchant and Van der Stede, 2003). Otley sees the budget as the central stage of most organizations' systems of management control (Otley,1978). The overall objective of the budget is to keep control of the activity done in the company by providing a roadmap for future activities and to set a series of goals to be achieved and the means by which to achieve those goals (Achim, 2009a). Therefore the management efficiency can be appreciated by the achievement of predefined objectives and the means used to their achievement. There are several empirical studies that demonstrate that budgets are one of the most used planning and control tool for companies (Abdel-Kader and Luther, 2006, Uyar,2009).

Managers are responsible for the realization of the indicators within their budgets and for any variance from the estimated values, cases in which they are required to take remedial action. Budgets are used by management for different uses (Riley, 2012):

- control income and expenditure (the traditional use);
- establish priorities and set targets in numerical terms;
- provide direction and co-ordination, so that business objectives can be turned into practical reality;
- assign responsibilities to budget holders (managers) and allocate resources;
- communicate targets from management to employees;
- motivate staff;
- improve efficiency;
- monitor performance.

According to Romanian authors (Achim, 2009a) budgeting purposes (budget functions) are the following:

1. Planning operations that ensure the companies' strategic objectives realization.

   Budgeting process stimulates managers to predict all the problems before their appearance and thereby avoid making hasty decisions in the event of certain undesirable situations in the future. We can say that budgeting "guarantees" that they will plan future operations depending on how it was accomplished the previous budget, taking into account all the factors that have influenced changes regarding previous budget indicators.

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2. Coordinating various activities of different types of subdivisions. Coordination of each employee and groups interests.

   Each subdivision of an economic entity has its own objectives and this can lead to situations in which these goals are contradictory in relation to other responsibility centers. So, the budget has the role to reconcile and regulate these contradictions in favor of the economic entity so that these situations can be prevented.

3. Stimulation of managers from all business levels to achieve predetermined goals of each responsibility center. This budget feature strongly manifests in case of participative budgeting when responsibility center managers can propose various quantitative indicators. Therefore the budget indicators are indicators not forced to realize from the center but settled by mutual agreement with the management of each responsibility center.

4. Control of current activity, ensuring discipline according to the business plan.

   Careful drafting of budgets ensures the optimum standard to compare undertaken activity achievements, to determine deviations and to take measures to eliminate them.

5. Evaluation of plans fulfillment by each responsibility center and their managers.

   Management performance can be appreciated by comparing the results with those expected to be achieved.

6. Training managers and other employees from financial services of a company.

   Budgets are considered to be highly beneficial to companies (Wijewardena and Zoysa, 1999) The usage of budgets has a number of advantages (Epuran, 1999, Achim, 2009a):

- requires the use of planning in business management;
- represents the framework for assessing performance due to indicated parameters that the company needs to realize in order to achieve her objectives;
- promotes communication and coordination for engagement and balancing all departments and functions of the company in order to achieve its set objectives;
- undertakes responsibility center managers to foresee the consequences of decisions made or to be taken, budgets representing a landmark in decision making;
- allows the existence of an efficient accounting information system that provides all kinds of information necessary for users (especially internal ones);
- provides leadership through exception because if the budget is well-designed, management needs to intervene only in situations where there are deviations from budgeted indicators;
- ensures participation in the planning activity of both management and performers that drives involvement in achieving or exceeding budgeted indicators.

There was conducted a lot of research regarding the role and the importance of budgets within a company. Different authors evidence the fact that budgets are the most used tool for planning and controlling within companies in both developed and developing countries (Dugdale and Lyne, Ahmad et al., 2003, Joshi et al., 2003, Wijewardena and Zoysa, 1999,Ghosh and Chan, 1997). In the studies conducted by Jones the results obtained showed that there are three major reasons for which companies use budgets: evaluate performance, aid control and planning (Joshi et al., 2003). Other authors evidence others benefits of budgeting such as preventing information asymmetry between top managers and lower-level managers, enhancing employees' work attitudes, providing motivation to department and committee heads and resulting in a greater level of goal commitment by lower-level managers (Oak and Schmidgall, 2009, Joshi and Com, 1997). According to Turkish authors Ali Uyar and Necdet Bilgin, the reasons for budgeting, in the order of their importance are: control expenses, profitability, aid long-term planning, co-ordinate the operation, aid short-term planning, evaluate performance, motivate managers, motivate employees and communicate plans with employees (Uyar and Bilgin, 2011). There are numerous authors that consider budgets as intended strategy operationalization through resource allocation and assessment of strategy (Hansen and Van der Stede, Anthony and Govindarjan, 2003, Merchant and Van der Stede, 2003). Shields and Young consider that budgets contribute in creating a culture of democracy within a company (Shields and Young, 1993) or at least an appearance of democracy that brings the legitimization of a company (Covaleski et al., 2003).

All the mentioned objectives and functions of budgets are achievable due to budgetary control. Budget execution control is the process of determining and analyzing the deviations of effective values of indicators from the predetermined values (Achim, 2009a). The most important advantages of budget execution control are (Achim, 2009a):

- it is useful to managers at different hierarchical levels because it is a daily guide for their activity;
- allows senior management to achieve a synthesis analysis of the business' activity which allows it to objectively assess low-level managers work;
- allows the knowledge of the meaning and importance of deviations in comparison with forecasts, that leads to increased efficiency in key areas of economic management of the entity;
- enhances coordination of activities carried out in different functions of the company, allowing decentralization of responsibilities;
- leads to technical and economical updating where necessary.

But, we should also consider the criticism mentioned by different authors regarding the process of budgeting. The most mentioned "black ball" of the budgets is about the time consumed with this activity (Otley, 1978, Neely et al., 2003, Wu et al., 2007, Hope and Fraser,2003b). Another criticism discussed is the fact that budgets can be affected by corporate politics and gaming (Otley,1978). Some authors consider as a problem for budgeting the way budgets are used (Horngren at al., 2006) while others sustain the idea that budgeting processes are fundamentally flawed (Hope and Fraser, 2003a). To sustain all this, there are authors that named budgets as being an "unnecessary evil" (Wijewardena and Zoysa, 1999), "a thing of the past" (Gurton,1999) or even "broken" (Jones, 2008). All the criticism brought to the use of budgets is called the "beyond budgeting" approach.

With all this criticism the majority of economic entities continue to use budgets in order to control the realization of establish objectives. This means that budgets, if they are used appropriately and adapted to a company's needs can be a tool for obtaining value-added. The key for this is to implement practices that generate commitment to budgets, adopting clear procedures to prepare budgets, creating linkages to connect the budget with the company's strategy and analyzing budget variances and taking corrective action (Uyar and

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Bilgin, 2011). To this we can add the clear definition of managerial responsibilities, drawing up a plan of action for each individual budget and continuous monitoring of performance.

The response to all criticism of budgets is found in the multiple roles of budgets that combined can enhance performance (Uyar and Bilgin,2011).

There are different reasons for which companies use budgets. The key purposes of budgets can be translated into planning the use of resource, forecasting the future, assistance in performance evaluation and maximization, assuring the means of communication for the management, controlling the activities of various groups within the firm, motivating employees to achieve performance, controlling performance by investigating variances, resolving conflicts of interest between groups with the organization, pricing decisions and control (Riley, 2012, Oak and Schmidgall, 2009, Cruz, 2007, Ahmad and Suleiman, 2003, Joshi and Com, 1997, Joshi et al., 2003).

IV. PURPOSE OF BUDGETING

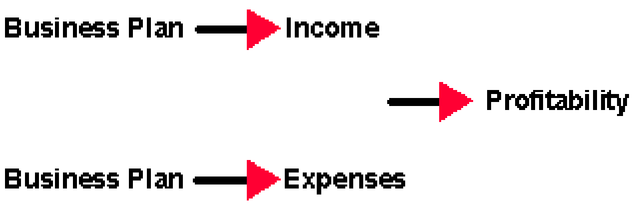
In the context of business management, the purpose of budgeting includes the following three aspects:

- A forecast of income and expenditure (and thereby profitability)
- A tool for decision making
- A means to monitor business performance

V. FORECAST OF INCOME AND EXPENDITURE

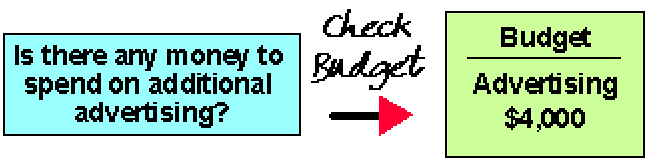
Budgeting is a critically important part of the business planning process. Business owners and managers need to be able to predict whether a business will make aprofit or not. The purpose of budgeting is basically to provide a model of how the business might perform, financially speaking, if certain strategies, events, plans are carried out.

In constructing a Business Plan, the manager attempts to forecast Income and Expenditure, and thereby profitability.



VI. TOOL FOR DECISION MAKING

The purpose of budgeting is to provide a financial framework for the decision making process i.e. is the proposed course action something we have planned for or not.



the purpose of budgets and know how to manage them. In managing a business responsibly, expenditure must be tightly controlled. When the budget for advertising has been fully expended, the decision on "can we spend money on advertising" is likely to be "no".

VII. MONITORING BUSINESS PERFORMANCE

The purpose of budgeting is to enable the actual business performance to be measured against the forecast business performance i.e. is the business living up to our expectations.

In the figure opposite, "variance" is the difference between budgeted expenditure and actual expenditure.

	A	E	F	G	H
1		*Budget 30 Apr 07*	*Actual 30 Apr 07*	*Variance $*	*Variance %*
2	**Expenditure**				
3	Advertising & Promotion	$ 1,466.67	$ 200.00	$ 1,266.67	86%
4	Bank Charges	$ 166.67	$ 395.50	-$ 228.83	-137%
5	Photocopying & Printing	$ 433.33	$ 566.30	-$ 132.97	-31%
6	Postage	$ 666.67	$ 1,153.40	-$ 486.73	-73%
7	Rent	$ 1,333.33	$ 1,000.00	$ 333.33	25%
8	Repairs & Renewals	$ 333.33	$ 225.00	$ 108.33	33%
9	Salaries	$ 18,333.33	$ 18,333.30	$ 0.03	0%
10	Stationery & Computer	$ 500.00	$ 628.90	-$ 128.90	-26%
11	Telephone	$ 1,000.00	$ 1,665.00	-$ 665.00	-67%
12	**Total**	**$ 24,233.33**	**$ 24,167.40**	**$ 65.93**	**0%**
13					

many issues when it comes to budgeting. Budgeting is dealing with money, the organisation / company's money, sponsor's money, other private funder's money, depending on how the organisation / company functions, but in every scenario, you are dealing with money.

You may have so much going on, complaints from customers, problems with suppliers, service providers may have shut down; you may be thinking of adding that little bit extra money on top of last year's budget, just in case! Handover the developed budget on to an accountant and then relax! Or planning to spend everything allocated on a budget! Or having thoughts that remaining within a budget will prove you to be an efficient employee / budget manager! No, the answer is NO. You need to take responsibility for each action and part of the budget, understand

Budgeting is not a simple process that is developed and left as such, but it is an ongoing system that needs monitoring, controlling, recording, reporting and many more while following the organisation's legal and regulatory requirements. This in itself is self explanatory, telling us that the budgeting procedure does not stop with developing and agreeing budgets, but involves the huge responsibility of managing budgets; that is what businesses are all about; you can never say that you have nothing left to do, there is always some work or the other.

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VIII. UNDERSTAND THE PURPOSE OF BUDGETS

the purpose and benefits of managing financial resources effectively and efficiently.

Managing financial resources effectively and efficiently is a standard for financial and performance management and this means, reasonable value for money. Efficiency in managing financial resources means that the business is achieving maximum performance with minimum input and with very little waste. Effectiveness in managing financial resources means that the business is able to provide / deliver services and products successfully by meeting all its goals and objectives.

"Managing financial resources means using funds effectively, efficiently and economically."

IX. THE PURPOSE AND BENEFITS OF MANAGING FINANCIAL RESOURCES EFFECTIVELY AND EFFICIENTLY ARE

- You have a short term plan for the company's expenses; usually for a period of one year.
- You will have a good idea of allocation of financial resources, the goals or objectives for which each financial resource will be allocated and be ready to look for alternatives in case of any issues; in other words, cash flow will be adequate and perfect
- You get maximum benefits for money that you spend.
- You can look at the costs and the benefits of each objective or goal and prioritise accordingly
- You get a chance to assess different objectives and fund the most cost effective one
- You can specify goals and objectives for the budgeting period.
- When an objective/goal/task does not go by the normal flow but has deviations from the actual plan, you are able to evaluate the reasons for the deviations and take necessary actions to correct them.

X. BUSINESS BUDGETS ARE ESSENTIAL MANAGEMENT TOOLS

- You can avoid over expenditure, under expenditure and also cover unexpected expenses
- You are able to plan and control the money or finances and this is done by constant monitoring, evaluation and reviews.
- You are able to make any required changes only if proper management of financial resources is in place
- It improves the overall operation of the company / organization

XI. IDENTIFY LEGAL, REGULATORY AND ORGANISATIONAL REQUIREMENTS FOR MANAGING A BUDGET.

For organisations depending on their mode of operation and dependence on government and other systems, the management of budget needs to adhere to legal, regulatory and organisational requirements. Budgeting is a complex process and must be integrated with the organisation's strategies, services, values, aims, etc.

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XII. SOME OF THE LEGAL, REGULATORY AND ORGANISATIONAL REQUIREMENTS FOR MANAGING A BUDGET ARE:

- Performance monitoring against the organisation's budget
- Consistency in budgeting
- Accuracy and transparency in budgeting
- Be wise and avoid mistakes in managing budgets
- Strong and firm estimations for the budget
- Adequate (minimum level of) resources to fund various services that are necessary for the functioning of the organisation
- Report on any shortfalls well in advance to the organisation
- Monitor budget and control thereby improving performance
- Take necessary actions in case of shortfalls or over spending
- The financial planning system needs to be accurate and spot on.
- Any changes in services need to be forecast, changes in policies need to be replaced with alternate ones and forecast the costs for the future
- Meet demands, resources should match expenses
- Review performance against budgets, prioritise items on budget depending on importance of service deliveries
- Always have records of estimates for the future
- Have long term plans in hand
- Have detailed guidelines on various spending with reasons
- Refer to previous year's budget and use it as a base, look for service changes, cost changes, etc
- Decisions are made by a board or committee who are involved with finances and budgeting
- Involve people who will be directly dealing with budgets
- Look at the implications of each item on the budget, the organisation's objectives, goals set, practical facts about the budget, etc.
- Plans and reserves need to be ready in times of deficit
- Have proper monitoring, controlling and reporting + reviewing procedures for budgeting

XIII. DESCRIBE DIFFERENT TYPES OF BUDGETARY SYSTEMS AND THEIR FEATURES.

Budgetary systems are part of the planning and controlling process of a business. When planning businesses, it could be a short-term plan (*less than a year*), a long-term plan or a medium-term plan. Depending on the plan, the type of organisation and taking into account various facts involved, you should be able to choose the right type of budgetary system. There are various types of budgetary systems. We will look through a few among those and their features.

XIV. TYPES OF BUDGET

Traditional budgeting

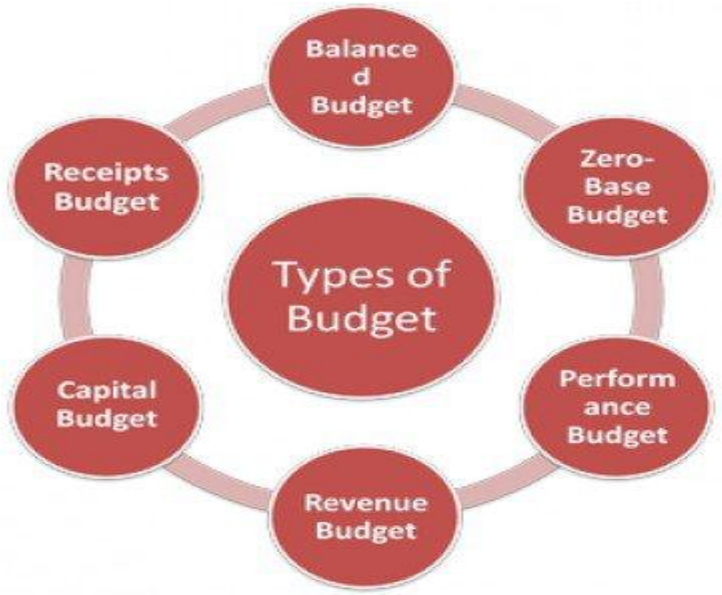
In this type of budgeting, the information and figures from the previous year are taken into account and the budget is created for the following year with minor variations wherever necessary. These budgeting systems are easy to develop and implement. They are cost and time effective too. However there are some drawbacks in using this system as they follow the top-down budgeting process where budget is imposed by higher management. They are also not very flexible and cannot be used for long term budgeting systems.

Activity based budgeting (ABB)

Budgeting here is based on the activities that caused an expense. Based on the activity, and how it benefits, resources are allocated. These are highly accurate in the sense, tracking of costs for each service / objective is easier. It consumes lot of time, is complex and costs more.

Rolling budget:

These are short-term budgets where budgets are added for each rolling period. For example, a budget could have been developed for just 3 months and when this period expires, new budget will be added taking into account the facts and figures from the previous rolling period. As this budget looks at short term plans, the budgets are always up to date and realistic. It requires more time as budget has to be prepared quite often (*every few months*) rather than once a year



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XV. TOP-DOWN BUDGETING

The budget is prepared by the top management and is passed on with authority to the employees in the organisation. These are common in small organisations or new businesses. Sometimes managers who lack budgeting skills, not aware of the positive outcomes of other budgeting systems, impose budgets on employees using this process. However this may not be the case always and sometimes not all employees will agree to the budget. This budgeting procedure is less time consuming and may need motivation for agreement.

XVI. BOTTOM-UP BUDGETING

Managers come together for discussions and make decisions on budgets. This is exactly the opposite of top-down budgeting. Skills and ideas from various people are brought together when developing the budget and hence the quality of the budgeting process is good. These systems are used in big organisations / businesses that are well established. The managers involved will have good budgeting skills and ideas are gathered from experienced staff in each department. This type of budgeting is time consuming.

XVII. ZERO-BASED BUDGETING (ZBB)

Budgets in this case are prepared from base level, that is, from zero base. In the process of zero based budgeting, all tasks / services are prepared which will help with achieving the organisation's objectives. Managers decide on the priority of each service based on how the organisation will benefit. Based on this priority, resources are allocated. Some areas in which ZBB can be used are, training, R&D, not for profit services, etc. This is a very effective form of budgeting system, but consumes lot of time. Managers need to be highly skilled in order to develop a ZBB system.

XVIII. INCREMENTAL BUDGETING

This is a type of budgeting system where any anticipation in increase or decrease in income for the business is taken into account while developing the budget. This type of budgeting is straight forward and effective cost wise, but will not include any other expenses like one-off expenses, emergency expenses, etc. This is a very easy and quick form of budgeting and can sometimes lead to errors in allocation of resources.

XIX. PROFIT-MOTIVE BASED BUDGETING

This type of budgeting is based on profit achievements; that is, based on the amount of income or profit expected for a particular financial year. Most businesses use this type of budgeting as a common method of budgeting, but cannot be considered a formal method of budgeting. As this budget is based on profit motive, if sales are affected, it will affect the budget too.

XX. CONCLUSIONS

We consider that Pyhrr words reflect the importance of budgets for a company's management. About budgets Pyhrr said that "with it, managers can reassess their operations from the ground up and justify every dollar spent in terms of current corporate goals" (Schields and Young, 1993).

The budgeting process has some features that are particularly important for any economic entity. First, it is oriented towards a specific well established purpose of the company that provides management a good reference

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for the assessment of predetermined objectives. Secondly, favors the introduction of a system of control over the management of all types of resources used within a company and thirdly, but not least, it coordinates the efforts of all organizational structures of the company in achieving the objectives set, as all are engaged and involved in the budgeting process.

This is why an efficient budgetary systems has a positive impact on the ability of the management to anticipate and respond with articulated measures to opportunities and pressures from the environment in which the company operates, this being a critical aspect for a company' survival in a changing business environment such as the present one, due to the fact that budgets are an interactive tool between different levels of management, assuring an open dialogue within a company.

At the question "Why budgeting?" we surprised in the paper a lot of opinions consisting in lists of reasons for budgeting and we found hard to choose the best list, but we can choose from all the lists the most mentioned ones: organizational planning, performance evaluation, organizational control, communication of goals and strategy formation. Different contexts determine organizations to have different potential reasons for budgeting. The idea of multiple uses for budgets isn't new in the specific literature, as we could see, but the continuous change in the business environment determines the change over time of the budget's uses within a company.

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