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NATIONAL ASSOCIATION
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Official Publications

Vol. VI December 15, 1924 No. 8

**The Administration of
the Budget**

**BUSH TERMINAL BUILDING
130 WEST 42nd STREET, NEW YORK**

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The Administration of the Budget

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Cleveland, Ohio.**

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NATIONAL ASSOCIATION OF
COST ACCOUNTANTS

DECEMBER 15, 1924

National Association of Cost Accountants

PUBLICATION DEPARTMENT NOTE

Because of an innate tendency toward industry, the author, even at the early age of fourteen adopted the plan of working in shops during his summer vacations. He consistently pursued this course during his high school and college life, each year selecting a different industry for study.

Contrary to his natural desires he spent three years in the educational field as a teacher and principal of a high school. This diversion was the result of two causes (1) being born in Indiana he was duty bound to show some regard for literary and educational interests, and (2) a parental desire to have the offspring follow in the footsteps of the father.

Resuming the vocation of his choice, the author came to Cleveland in 1905, and for the past twenty years has been engaged in industrial accounting. Prior to his present connection he was a manufacturing accountant, first with the United States Steel Corporation and later with The General Electric Company.

For the past eleven years he has been associated with Nau, Rusk & Swearingen, Certified Public Accountants and at present is a junior partner and manager of the factory system department of this firm. He is a Certified Public Accountant of the State of Ohio, member of the American Institute of Accountants, member of the National Association of Cost Accountants and Vice-President of the Cleveland Chapter of the latter organization.

THE ADMINISTRATION OF THE BUDGET

Every progressive idea that has ever been advanced in the history of society has encountered opposition. Sometimes this opposition has manifested itself in a bitter, militant antagonism, but more often the progress of improvement has been retarded, if not stifled, by a spirit of apathy.

The idea of budgetary control of business has been no exception. It has never been opposed with any degree of combativeness, neither has it been received with jubilant enthusiasm. In an endeavor to diagnose the cause for the reception which has been accorded the principle of budgetary control, we find several contributing factors. Among these, two stand out prominently; first and foremost is the apparently unconvincing pleading by its advocates and, second, is the natural antipathy for attempting the new and little tried.

The responsibility for overcoming the first obstacle is ours as the advocates of better methods through scientific management. We, who are eternally preaching the gospel of improved business methods, have not always manifested sufficient enthusiasm for our convictions. Too often have we been prone to consider the principle of the budget as a cloak that may be donned or doffed as the exigencies of the occasion seemed to indicate. This condition has largely been the result of a lack of self-conviction that

budgeting is the wonder-working panacea that it has been represented to be.

Those of us who have not yet given the subject that analysis and study which will enable us to form definite conclusions as to its feasibility, must, in justice to our calling, set ourselves to the task. This is a prerequisite. With but few exceptions, the proper understanding of the theory of the budget, followed by an actual test of its application, has demonstrated its practicability. Most of us are disciples of this belief. Perhaps, our greatest need is a rededication of ourselves to the purpose of effecting the general acceptance of the principle of budgetary control as a necessary factor in management. It would seem that such a determination on our part will eliminate the second obstacle which is more apparent than real.

Let us examine some of the "straw-men" which have been set up in opposition to the acceptance of the budget as a workable instrument. How many times have we heard the expression, "yes, a budget is probably a good thing for most businesses, but mine is different." We used to hear the same harangue about cost systems, but happily such expressions are rarely made in this connection now. Again, many business men are of the opinion that the operation of a budget entails untold detail in which they do not care to become entangled. Some look upon it as a veritable straight-jacket which will restrict their activities. Others think of it solely in connection with affairs of state but have never considered it as being applicable to business. They do not see the replica of the famous "pork barrel" in their own organizations. These are some of the misunderstandings which have created this spirit of apathy toward the budget.

Most business men who have considered the merits of budgetary control have accepted the theory as sound, but have displayed a reluctance to put it into practice because of an uncertainty as to its administration. May we therefore direct our attention to a consideration of the machinery which is required in the operation of a budget. Parenthetically, it may be stated that the uninitiated will be agreeably surprised at the simplicity of the mechanism.

Consideration will first be given to the kind of an organization required for the operation of budgetary control. Is any special form of organization necessary? Every business is engaged in the buying and selling of things for profit. In every organization some individual is responsible for each of these functions and both of these activities must have the general supervision of a directing head. True, you will be able to cite instances in which this alignment is not readily apparent, but a little thought will verify this assertion. In some businesses these functions may be performed by one individual. At the other extreme it may be found that the responsibility for each of these activities is lightened through the delegation of authority to hundreds of subordinates. But no

matter how complicated some modern organizations may appear to be, and irrespective of the ramifications of authority, a brief analysis will reveal the simple fundamental skeleton standing out in bold relief. And so the conclusion is reached that no special form or type of organization is necessary to the adoption of budget methods.

I like to think of a budget as a coordinator. In fact, the need for the correlation of the functional activities of the departments of a business is the one real purpose of budgetary control. Each of us can call to mind instances in which the business ship has hit the rocks of bankruptcy simply because of a lack of coordination of activities. These shipwrecks have not been the result of mutiny on board. Perhaps the engineer suddenly decides to experiment with the great engines of the ship, forgetting for the moment his duty to furnish sufficient power to bring the ship into port. The steward may have inadvertently provided food that has incapacitated the sailors, or the pilot may have decided to try an uncharted course, in order to shorten the voyage. The captain is a seasoned mariner in whom all on board have implicit confidence and the crew is composed of individuals who have a high regard for each other and for their captain. But the distractions caused by the failure of his subordinates to function properly finally cause the captain to be taken with a fit of insanity and the good ship goes to the bottom with all on board.

Most department heads are sincere in their desire to so function that the business will achieve the purpose for which it exists. With but few exceptions, these executives are proficient in their particular fields of endeavor. Wherein, then, lies the cause for the absolute failure of such a large percentage of business undertakings and the instability of many others? Is not the condition largely attributable to a lack of coordination of activities? The sales manager is apt to become so engrossed in his endeavors to market the product that he soon forgets that raw material must be purchased, that labor must be employed to handle or fabricate the product and that the production or merchandising departments have problems and difficulties in satisfying the sales requirements, especially when they have not been acquainted with these requirements. Likewise, the production or merchandising executives are inclined to become so enmeshed in their particular fields of activity that they forget that any other department is in existence.

Most of us can recall the old village band in which each member apparently played a different selection or at least a different key, entirely oblivious of the other members of the band but intent upon going through to the end. The effect upon the unfortunate listener gave him no concern. So it is with many business organizations. Each of the several departments may function proficiently within itself but their failure to synchronize precludes the attainment of the ultimate objective.

If the budget is to serve as a coordinator of these otherwise

uncorrelated forces, how is it to function? First of all some one individual must be responsible for its operation. By this is not meant that the entire responsibility for its working is to rest upon the shoulders of one individual, but rather that this person is to act as a clearing house for matters relative to the operation of the budget. This person, whether styled the chief budget officer or what not, must act as the representative of and be responsible only to the president or general manager. Because a complete budget program involves the activities of all departments it will not prove expedient to delegate the responsibility or its execution to any one of the departments.

While the organization for the operation of budgetary control must necessarily include the heads of all departments, it is, nevertheless, essential that the budget organization have a central executive who is independent of and superior to the department executives. We are all familiar with the shortcomings of the original McCormick bill which established a federal budget system under the control of the Treasury Department. The fallacy of making the budget officer responsible to any one department is apparent when we try to conceive of this budget officer attempting to make any radical revisions of the estimates of his superior.

The president or general manager of the business should have direct control over all matters relating to the operation of the budget plan. It will, of course, be necessary for him to delegate most of the actual work to subordinates, but these assistants will act as his agents and will be directly responsible to him for the performance of the work so delegated.

With this arrangement the president is in a position to emphasize the importance of the budgetary program upon some department heads who might otherwise be inclined to underappraise its value. Again, differences of opinion and disagreements are sure to develop in the process of coordinating the programs of the several departments. Manifestly the president is the one and only executive who will be in a position to make the final decisions relative to controversies between department heads of equal rank. As another reason for making the chief budget officer directly responsible to the president, it might be mentioned that he will have more prestige in his relations with the other departments than if he is a member of some subordinate department.

The establishment of a budget committee or bureau has proven to be an excellent expedient to facilitate the successful operation of a budget program. This committee should consist of the principal executives of the business, with the president or general manager acting as chairman. In an industrial organization, the president, sales manager, factory manager, treasurer and chief accounting officer will constitute an ideal committee. In a mercantile enterprise, the president, sales manager, merchandise manager, treasurer and chief accounting officer will usually form the budget committee. The chief budget officer, as a direct representative of

the president, will act as secretary and will attend all committee meetings.

All budget estimates will originate in the departments. Experience has shown that the best results are obtained when the original estimates are prepared by the persons who are later to be held responsible for their execution. The estimates of all other departments are necessarily dependent upon the forecast of the sales department. With the estimate of the sales department as a basis, each department head will be in a position to proceed with an outline of his requirements to meet the sales quota. The preliminary departmental estimates are then submitted for the approval of the budget committee. The chief budget officer should receive these estimates, check them against each other and forward them, together with his suggestions and recommendations, to the budget committee. He will also see that the committee is furnished with all available related data which will enable it to give the proper consideration to the departmental estimates.

The budget committee then reviews all of the departmental estimates. Consideration is given to the merits of each estimate in itself but, more particularly, as to the degree with which it harmonizes with the complete program. It will make such changes and revisions as is deemed to be necessary. In the event that the members of the committee disagree upon any estimate the matter is referred to the president for decision. It is entirely possible that the president may stand alone in his opinions upon certain phases of the estimates, but nevertheless, he has the power to overrule the majority because, in the last analysis, his is the responsibility for the ultimate success of the business. However, this prerogative will seldom be exercised, inasmuch as the chief executive will recognize that the successful operation of a budget program is dependent upon the cooperation of the department heads.

After sufficient consideration has been given to the departmental estimates and the necessary revisions have been made, the committee formally adopts the estimates. The chief budget officer then forwards the approved estimates to the various department heads and these budgets become the working program for the departments.

Periodically, and according to a definite program, reports showing the actual results in comparison with the budget estimates will be submitted to the committee. Too much stress cannot be placed upon the importance of having a definite program for the preparation of both the estimates and the reports of actual performance. Some attempts at budgetary control have failed because the necessity of checking the execution of the program against the forecast was not fully realized. The character of these reports must necessarily vary, but they will usually show the actual sales against the estimated sales; the actual production or actual purchases set off against the anticipated production or purchases; the actual expenses against the estimated expenses. The respective

information should be shown by departments and in the same detail in which the budget was set up.

Once the budget has been established, the chief function of the committee is the receiving of these reports of actual performance, the correcting of the inefficiencies indicated thereby and the revision of the budget program for the remainder of the budget period. From their very nature, budgets cannot be made to forecast with absolute accuracy, because they are concerned with futures. From these periodic reports inaccuracies in the budget will be discovered. Often such discrepancies will be caused by changed conditions which could not possibly have been foreseen at the time of the preparation of the estimates. However, the committee will take advantage of these periodic reports to correct these inaccuracies at the earliest possible moment.

The mere reference to the budget period suggests the question as to what is the proper length of these periods. Manifestly, an arbitrary, all-inclusive answer to this question cannot be given. I know of budgets which are operated on a daily basis while at the other extreme the period has been set at five years. In justice to the latter, which is exceptional, it must be added that the five-year budget is supplemented by estimates prepared annually. This company is engaged in an industry which has shown a steady expansion and it is one in which several years preparation for the increase is required in the way of construction. It is evident that a number of factors enter into the determination of the proper length of the budget period for any particular business. Among these might be mentioned the nature of the business, its rate of turnover, current market conditions, its financing policy, and the completeness with which the information of its past history has been recorded.

In a seasonal business, in which the entire production of the year is sold within a brief period during the year, the year should represent the budget period. In businesses having a short turnover period the budget will not exceed three or four months. Some concerns require considerable borrowings at some time in the year in order to carry the peak load. In this case the forecast needs be made several months in advance. During times of rapid fluctuations in general market conditions it is desirable to make the budget period as short as possible so as to make the necessary adjustments and revisions in the program with the least inconvenience. Any forecast of the future must necessarily be based, to a large extent, upon results of the past. The length of the budget period must therefore be somewhat dependent upon the degree of completeness with which the records of past have been kept.

In general, we might say that where all of the conditions are conducive, the year makes an ideal budget period. By this is meant that the yearly budget will be a broad outline of the year's program and an attempt to furnish a comprehensive view of the

business which is anticipated, the cost of handling this volume of business and the approximate result of the year's operations. It will consist of few details. Supplementing this yearly budget, and controlled by it, there should be monthly budgets which will be in the detail required by the nature of the business. These monthly budgets will give effect to the seasonal fluctuations which are inherent in most businesses, and they can be checked against the actual performances and revised as seems to be indicated. Some budgets have been operated upon a continuous basis by adopting twelve months as the basic period, always dropping the expired month and adding the twelfth month in advance.

A difference of opinion has existed among executives as to the degree of publicity that should be accorded budget performances. Some insist that the actual results, showing the extent to which the forecast has been fulfilled, are to be considered as confidential information, to be handled in the utmost secrecy and available only to the eyes of the holy of holies. Others insist upon scattering the information broadcast so that everyone, from the president down to the janitor, can be fully advised as to all angles of the results. It would seem that each of these represents an extreme attitude and that some middle course is preferable. A department foreman cannot possibly have a wholesome interest in the amount expended by salesmen for traveling. Neither should the office boy be deeply concerned with the cash receipts and disbursements handled by the treasurer's department.

On the other hand it is advisable to apprise each interested person of the actual performance in respect to those features of which he has had a part in the preparation of the forecast. In fact, many executives have obtained excellent returns by adopting a policy of giving each individual just a little more information than he thought he had a right to expect. The subordinates seem to take pride in the fact that the management has taken them into its confidence. I am not a psychologist but I am firmly of the opinion that, in the degree that the man at the bench is made familiar with the vicissitudes of management, in that same degree are we to approach that much desired ideal of a mutual understanding between employer and employee.

When adjustments in schedules, quotas and allowances are to be made, the budget committee will effect such changes after it has reviewed all of the facts which necessitate the revision. All interested persons should be advised of these adjustments and the information should be handled with the same formality which characterized the preparation of the original program.

We have stated that the successful operation of a budget plan is contingent upon adequate records of past and current operations. What function, then, does the accounting office perform in the making and operation of a budget? To what extent can the actual accounting records be utilized? The records of past performances, when tempered with an intelligent appraisal of present conditions

and a careful analysis of things in prospect, must form the backbone of the budget program. Then, the accounting records must be of such a nature that the budget control will coincide with the program. It must be geared to reflect the actual in the detail in which the anticipated results have been set forth.

It is rather generally agreed that the dividends of the future must be the result of small margins of profit on a large volume of business. If this condition is to prevail, it requires no great stretch of the imagination to understand the necessity for watchfulness over the little things. Nor will a great lapse in this diligence be required to cause a serious hole in the profits. Much of the information relative to the budget control needs to be furnished daily and before it can be obtained from the usual accounting routine. As one writer has so aptly expressed it, the vital information must be served hot. This demand will give rise to a scheme of obtaining the desired statistical information before it has progressed to the stage of becoming a part of the formal accounting records. It may be that the results of such procedure will vary a fraction of a per cent from the actual accounting records when compiled. This is not serious, but the fact that undesirable tendencies may be killed aborning is all important.

The impression may have been gained that the monthly operating statements have no relation to a budget scheme. On the contrary they perform an important function. The statements of income and profit and loss furnish the gauge by which the extent to which the goal has been attained is measured. It is comparable to the yard lines of the football field. Schedules displaying the necessary detail and telling the story of wherein we have succeeded or have failed in accomplishing our anticipation should accompany the master statement.

The charge has been made that budgeting complicates the accounting work. If the accounting system is functioning as it should and furnishing the management with the information that it should, prior to adoption of a scheme of budgetary control, then this charge must be challenged. Of course, we are all familiar with those so-called simple, vest-pocket accounting schemes which so closely approach the superlative of simplicity that the word "simple" can appropriately be used to describe their creators. I have in mind the kind of a scheme by which you can readily ascertain the amount of cash in the bank, the total of the receivables and payables, the total sales, expenses, and profits and one in which the bookkeeper submits his monthly reports in the shape of a neatly typed trial balance on the second day of the month. The injection of a budget into a system of that description would truly tend to complicate the bookkeeping work.

The accounting requirements under a scheme of budgetary control are modest and in no way exceed what should be demanded of the system without a budget. It is true that the chief budget officer may require statistical data in advance of the actual record-

ing thereof upon the books of account. There may be some apparent duplication of effort as between the budget officer and the accounting department, but whatever slight duplication occurs will be more than offset by the results obtained. Budgeting never complicates a real accounting scheme and many systems have actually been simplified by the introduction of budgetary control.

The successful administration of a business is largely dependent upon the degree of control exercised by the management. Certain resources are placed at its disposal by the stockholders and management must account for its stewardship. If it is to maintain adequate control over these resources it must be fortified with comprehensive information and be able to place the proper interpretation upon the facts as they are revealed. In many businesses, the amount of capital tied up in inventories constitutes a large portion of the total available resources. Too often this item is many times greater than it need be. Numerous instances might be cited of large enterprises that have met with disaster simply because the management lost control of the inventory. If budgetary control did nothing more than to harmonize the sales, purchasing and production efforts into a force bent upon the maintenance of proper inventories, this function alone would justify its adoption.

There is no particular touch of secrecy or suggestion of legerdemain in connection with budgets. One simply needs to arrange the facts of past experience, temper them as needs be to serve as a guide to future expectancies and accurately record the business history as it transpires.

In these days of bitter cynicism and social unrest, when faith and harmony seem to have given way to doubt and misunderstanding among men, business must seek and discover some stabilizer which will coordinate society's efforts. As a worth while factor in our endeavors to add to the sum total of human happiness let us give serious consideration to the possibilities of budgetary control.

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