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Budget Preparation

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The goal of modern business is to operate "in the black"—to make profits. With the activities of management directed primarily to this one purpose, the assets of equipment, inventories and talent of personnel must be utilized to the fullest extent. This means the company should have one pre-requisite for good management—proper organization. Well-defined outlines of responsibility avoid overlapping in allocating responsibility. As a guide to define the areas of responsibility, the company should have a formal organization chart for the company as a whole supported by auxiliary charts for each division. These charts are supplemented with written directives specifying definite and exact areas of authority and responsibility, relationships, policies and methods of measuring performance. These charts and written supplementals may be reproduced and distributed in the form of an organization manual to those responsible for the various divisions.

Budgeting is essentially a managerial process. Generally speaking, it is a formal statement of managerial plans and policies for a given period to be used as a guide or blueprint in that period. A budget program can be effective only if each management member knows the exact scope of his responsibility and authority. A successful budget program decentralizes the responsibility so that each division head stands on his own, more or less, and is responsible for the fulfillment of the budget program in his departmental operation.

In addition to a carefully outlined organization structure and defined duties, there must be adequate accounting records. Budget programs are guided by past experience applied to reasonable future expectations. The budget department and others preparing estimates depend heavily on the accounting department for reliable historical data to use as the basis for many estimates. The accounting records must be sufficiently complete to reveal past operations as to the relations of sales, costs and detailed components of costs and departmentalized profit. It must be possible to determine from the records the relationships of costs and results and the efficiency of individual, divisional and functional performances. Current trends must be apparent both in operating and financial relationships. Also, prior to any attempt to adopt budget procedures, there should be a complete study of

the chart of accounts and related classifications. In the preparation of any part of the budget, the same chart of accounts and classifications of accounts must be used to facilitate future comparisons between the actual and related budget figures of the same period. In addition supplemental to the chart of accounts there should be accounting instructions as to the components of each type of account.

On the basis of past performance and the expected future, objectives or goals are determined as a guide for the divisional managers in preparing their budget estimates. These goals should be the "expected actual" assuming efficient operations and satisfactory performance under the conditions expected to prevail during the budget period. They—the goals—should be reasonably attainable and yet present a challenge. Objectives set so high as to be, for all practical purposes, impossible to attain tend to discourage any serious efforts to reach them. On the other hand, goals set so low that they call for no special effort will have no meaning or incentive for supervisors.

No effective budgeting can be accomplished without the full support of the chief executive. If he is not willing to study the problems at hand and make the necessary decisions, the enforcement of the budget will be nil and the formality of preparing a budget will have been fruitless.

The chief executive does not generally have the responsibility for the preparation of the budget. The controller or chief accounting officer is the logical person to have this assignment as his knowledge extends to all departments of the business and there is no bias resulting from other functional responsibilities. Some companies of a larger size have a budget committee responsible for the budget program. The person or committee in charge of the budget has the responsibility for the design of the budget program and provides the technical assistance and supervision in bringing the estimates together in final form after they have been prepared by the respective operating department heads. If the decentralization philosophy is to be practiced, the individual members of the management team should be given authority and be held accountable for the results. Therefore, the one to whom an activity has been assigned ought

to be the one who prepares the budget for that activity. If he is to be held accountable for accomplishing specified results, he should have something to say about what he has to spend to get them. All managerial or supervisory personnel, starting at the first level of the organization structure, should be participants in the preparation of this budget program. It is not meant that each manager or divisional supervisor be given a blank check to carry out all the programs he considers to be desirable. The department heads set up their own budget estimates, and the budget director or committee makes the final decision after a careful analysis and study of estimates. Any changes of the department head's estimates by the budget director are reviewed with the department head for a mutual agreement on the final estimates. Experience shows that operating supervisors view with extreme doubt a budget prepared without their active participation. Generally, little effort is shown to follow the budget and there may be indications of trying indirectly to make the budget unworkable. Active participation on all managerial levels in shaping goals has a healthy effect, what we can call "togetherness." Each member of management becomes aware how his individual responsibility fits to make the whole picture. Junior members, having participated in planning, are aware of and adequately prepared as to the future with respect to objective problems and other considerations.

The next question—What period should the budget cover? In general, any budget should be prepared only so far ahead as it is possible to make reasonable predictions. There can be no general rule, but the usual period is the accounting period whether it be a calendar year or fiscal year. It is a better policy to base the budget program on an accounting period as a general outline, but to have more detailed and definite budget figures and outlines for a shorter period—for example, on a monthly or quarterly basis. The shorter period can be used as a basis for immediate action whereas the former, the one year plan, can be used as a basis for future planning. The length of the budget period of the more specific schedules might also be governed by such factors as length of the merchandise turnover period, length of the production period, method of financing employed, general market conditions and the adequacy and completeness of data of past operations.

In reviewing the steps to be taken towards the preparation of the budget, we find:

1. The responsibility of the individuals of

the management team must be clearly outlined and defined;

2. The accounting records and data should be adequate and in sufficient detail to be used as a basis for future projections;

3. Department heads should be responsible for submitting the goals represented by their budgets to the budget director for review, approval and consolidation into the budgetary program of the company.

We also considered the basis for the appointment of the budget director, the period to be covered, and the relationship of the budget to the accounting records.

Since sales are the key factor in profit making so they are also in budgeting. The deviations from all other budgets will be influenced as to the direction and degree by deviations from the sales budget. It follows then that the sales budget should reflect the most realistic estimate of what will be sold. In budgeting sales, the estimates should be based on actual experience and planned changes, such as the addition of a new product, correlated with some index of business activity. The usable indexes available to small companies are less numerous than that for a large national company. However, data such as population trends, bank deposits, personal income and employment statistics are published in local areas. The trend of these can be used as a guide for budgeting. While a budget of total sales is of more value to management than no budget, the greater the detail as to products, point of sale and distribution outlets the greater value of the budget for planning and control. This goes back to the need of adequate accounting records in detail as budgets are based on past performance adapted to future "expected actual." However, if this information is not available in detail, budget may be based on total sales. Don't wait for the detail!

With this sales budget established, the next step is to plan production and inventories. The investment in, reduction of or retaining same inventory level determines the requirements for raw material, direct labor and related manufacturing expenses for the budget period. In the development stages of budgeting, this step may be ignored on the assumption that what will be produced will be sold. If the procedure is simplified to this extent, the budget cost of production will also be the budget cost of sales. If standard costs are being used, the raw material and direct labor standards, adjusted for anticipated price level and wage rate changes, can be applied to the budgeted sales units to arrive at budgeted material and direct labor costs. Where standards are not available, these costs can be

budgeted with reasonable accuracy by determination of experience ratios of those cost elements to sales dollars. These ratios should be modified to reflect anticipated changes in sales prices, raw material costs and wage rates.

The expense budgets are the final step in building the profit budget. For these, factory expenses must be separated from selling, general and administrative expenses. Expense budgets should be flexible rather than fixed. If adjustments cannot be made to budget allowances as activity varies from month to month, the measurement of actual expenses is distorted. In preparing a budget of selling, general and administrative expense it must be remembered that these are generally fixed type expenses, which can be budgeted on the basis of past experience, modified by expected changes in cost levels and any management plans for expanding or contracting specific items.

The operating and financial budgets are best prepared during the last quarter of the accounting period for the coming period. This procedure assures sufficient time for consideration of the important policies and plans involved and assures completion and distribution of the approved plan on or before the first day of the period covered by the budget program. Nothing detracts more from the effectiveness of budgeting than completion and distribution of budget several months after the period has started. When planning begins in ample time on a regular schedule there is full opportunity to enlist the assistance of supervisors, foremen, salesmen, department heads and all operating personnel—major and minor.

The plan which the final budget is purported to represent should evolve from careful consideration and evaluation of alternative courses of action. The planning underlying any industrial budget is predicated on sets of assumptions with respect to such factors as economic climate, competitive strategy, markets, changes in price and cost levels, probability of technical or manufacturing difficulties, introduction of new products, expenditure levels for new plant and equipment, major rearrangement programs and product research and development activities. Obviously plans based on one set of assumptions versus another set can yield radically different results. The planning process in part consists of weighing the various alternatives and arriving at an educated judgment as to what is most appropriate under the circumstances. Analyzing and pricing alternate plans in this orderly fashion and documenting the assumptions in specific terms are of value in that

the very process of weighing alternatives tends to result in a more thoughtful and realistic plan. If the analysis is done properly, alternative plans are available to be put into effect quickly in the event that conditions assumed under the primary plan do not materialize. In other words, the planning is done in advance in an atmosphere of reason, rather than on a crash basis in an atmosphere of crisis.

Once the budget procedure is fully developed and the responsibilities carefully and clearly defined, it should be reduced to standard instructions. These should take the form of a manual which will maintain the uniformity of budget practice and the enforcement of the budget program. This manual should also clearly define the manner of preparation of various estimates and schedules for future study. Let me outline what this manual should include. First, in regards to the budget preparation it will outline the instructions and illustrate the forms to be used. Information as to the responsibility of the operational executives, budget director and/or budget committee is defined. Also part of the manual is a budget calendar specifying the definite dates for completion of each part of the budget and the submission of reports for analyzing the effectiveness of the budget. The manual will also outline the distribution of the various budget schedules. In addition, it should specify the responsibility for the preparation of reports for management of actual figures and their analysis as pertaining to the budgetary figures, the form and content of these reports and their distribution.

The preparation of budgets can be summarized by answering three questions phrased in three words. What? Who? When?

What are prerequisites to preparation?

- Proper organization,
- Adequate accounting records,
- Determination of realistic goals and period to be covered,
- Support of chief executive.

Who prepares the budget?

Chief accounting officer, controller or budget committee who bring together in the final form the approved estimates of the operational division heads.

When is the budget prepared?

In the accounting period (perhaps the last quarter) preceding the budgeted period and in sufficient time to have the approved budget program reproduced and furnished

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3. If any part of the lump sum payable remains unpaid after all payments have been made as described above, the remainder will be paid to any person or persons equitably entitled thereto to the extent and in the proportions he or they paid other expenses in connection with burial in following priority:
 - a. expenses of opening and closing of grave;
 - b. expenses of providing the burial plot;
 - c. any remaining expenses in connection with the burial.

The payment requirement becomes effective for deaths occurring on or after 9/13/60 and where death occurred prior to enactment date unless a lump-sum application was filed prior to December, 1960.

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in a tax dispute—not favor one side and deny justice to the other.

Sometimes a client may suggest a deliberate income omission on the theory that the omission will never be discovered. The taxpayer might say to his tax practitioner "Why do we have to include that? Let's omit it—we will never get caught—nobody will ever know." The tax practitioner says "Let me tell you something about a clergyman who had a daughter. The clergyman's wife was very eager that the daughter should marry—she was very much worried because they couldn't afford the things that the mother thought they needed for the daughter. On a certain occasion the clergyman came in possession of a substantial amount of money, not his own, which he was to hold for a certain length of time. His wife saw an opportunity to use the money for the benefit of the daughter, in the hope that some day they would restore it. The clergyman remonstrated—kept repeating "We cannot do this." "This is not our money." And when the wife said "But no one will ever know" he answered gently and affectionately, "Darling, *we* will know." And so the tax practitioner would say to the taxpayer, "But *we* will know."

The tax practitioner comes into any tax matter solely at the request of the client and has an obligation to serve the tax interests of the client so far as is consistent with existing laws and rulings. The tax practitioner should endeavor to find any legally correct way in which the client's tax is kept to a minimum. This may be by suggesting possible interpretations of the law applicable to the facts involved.

The tax practitioner must assemble facts and figures as he finds them and not create

them to please his client or to mislead the taxing authorities. The tax practitioner's mirror must be clear, pure and flat to reflect conditions as they are. The mirror must not be curved to reflect a more favorable image for the sake of tax savings. He should emerge from every transaction with enhanced prestige and merited respect.

Ours is essentially an involved, complex and perhaps to the layman an esoteric profession. Even to us, the accountants working in the field of books and records, as practitioners in the field of taxation there are times when we wonder if we can extricate ourselves from the maze of laws, rules, regulations and directives without marks and bruises, from stumbling over obstacles that impede our progress towards accomplishing the purposes of the taxing agencies, the client, and the bewildered public. Can all the purposes be accomplished? Can they be accomplished ethically? Can we strive to practice impersonally, unselfishly, honestly—all really interested in our government—our freedom—and our own safety. Of course we can! and when we do, we won't hear so much about conduct and articles like this won't be written.

The purposes can be accomplished by adopting a single standard of ethical conduct for the taxing agency, the client, the tax practitioner and the public. The real test is: How do I feel about all this? what is my reaction to all this? No one could say it better than Shakespeare:

"This above all:

To thine own self be true;

And it must follow, as the night the day,
Thou canst not then be false to any man."

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to the responsible department heads prior to the beginning of the budget period.

This discussion on the preparation of budgets only scratches the surface of the subject. The most important thing to remember about budgets is that to prepare one but not pay any attention to it in attaining the desired goals is a waste of time and time is priceless and not replaceable.

This is the second of a series of three articles based on papers presented at the joint annual meeting of the American Woman's Society of Certified Public Accountants and the American Society of Women Accountants, held in Philadelphia, Pa., September, 1960.