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## Why the Budget?

BY WALTER F. VIEH

Most of us think of budgets as having something to do with public finance or with the successful management of a household. We probably get the first impression from the daily press, where we read that this government or that is endeavoring to balance its budget; while the second impression is probably induced by the advertisements of savings banks, which would have us believe that we should spend 25% of our incomes for shelter, 10% for personal advancement, etc., and that we should save 10%. Webster's *New International Dictionary* still informs us that a budget is "the annual financial statement which the British chancellor of the exchequer submits in behalf of the ministers to the house of commons for approval." . . .

But since the first years of the post-war period, when there were so many business calamities,—resulting largely from failure to keep houses in order against emergency—the budget has acquired a new significance, and business has learned something about it, about the practice of looking into the future. Let us not suppose, however, that this modern development has been generally acclaimed. The truth is that there is still stubborn opposition to the use of budgets in a good many quarters. This opposition springs mostly from the knowledge that certain establishments have been eminently successful without them in the past, thus seeming to prove them unnecessary to profitable operation. The remarkable thing is that the objectors fail to let their imaginations include what the same establishments could have accomplished, if they had done some business forecasting. It is interesting to reflect upon what can be done with the assistance of business budgets and, in passing, to study some of the principles of budget making.

Until a few years ago, business was content with a single annual determination of profits, which was undertaken at the close of the fiscal year and rested upon an inventory taken at that date. All can remember the hustle and bustle of inventory time. More recently, however, aggressive executives have demanded more frequent determinations of profits, and we now find semi-annual, quarterly and even monthly calculations of operating results and

statements of financial position. These more frequent statements have been made possible through the use of perpetual inventories of merchandise or of production in its various stages.

But, because of the very nature of the accounting records, even these monthly reports sometimes reach the executive too late to be of any practical value in correcting a down-hill trend or arrive only after much damage has been done. The executive finds it imperative, therefore, to forecast the position of his affairs, and for this purpose he adopts the budget. He looks upon his accounting records largely as a means of preparing for the future, rather than as an historical sketch, for he knows that if he lays his plans carefully for the future, and constantly checks them with the actual accomplishments, the records must eventually prove satisfactory. Sufficient testimony of the value of a budget may be found in the fact that it has been adopted by many of the country's largest, most progressive and successful corporations.

Until we discover practicable means of overcoming the evils of booms and depressions, which are inherent in our present economic structure, years of poor business and even unprofitable years are inevitable. Those concerns are most successful which go into a period either of depression or of boom knowing what to expect and being prepared for the outcome. The budget looks into the future with the hope of averting impending business catastrophe or, at least, of reducing the effects of the storm when it breaks. On the other hand, the budget helps to point out how full advantage can be taken of changing market conditions, which wise plans might turn to profit.

There is perhaps nothing so discouraging as inability to fill orders; and it is disquieting, when business is brisk, to find that if only the market had been anticipated, and purchases made when prices were low, the present profits percentage could have been much improved. On the other hand, it is disastrous to have large stocks which can not be liquidated and tie up working capital when it is sorely needed. In such circumstances, prices are almost invariably on the decline, and the liquidation of stocks, even when accomplished, is attended with serious losses. Means have not yet been devised for controlling the market, but on every hand there are evidences of the trend of important economic influences, and we should make the most of the information.

The adoption and use of a budget means, first, reasonable assurance that a fair gross profit upon sales will be earned and,

### *Why the Budget?*

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second, the assurance that every possible dollar of gross will be carried to net profit, by means of adequate control of expenses. If the gross profit has not been sufficient to warrant continuation of the business the budget will soon disclose that fact.

The accounting department is the source of information concerning past performance, but other departments must be called upon for estimates of future conditions. The success of the budget depends upon the degree of coöperation between the several departments, the spirit in which the task is undertaken, and the patience with which the budget is administered. Past experience plays a large part in the preparation of the budget, and it requires time and patience properly to assimilate and interpret the record of the past. Estimates of the future play another large part; the first estimates may be entirely too sanguine or the contrary. It is only by means of careful comparison of the estimates of the future with the accomplishments, and by the most painstaking analysis of the differences, that the budget can be made successful.

As a result of these comparisons and analyses, it has been demonstrated many times that the tendency of the estimates is to approach ever more closely what will eventually prove to be the accomplishment. Two officers of the Thomas A. Edison Industries, collaborating in an article on business forecasting in their establishment, stated that the forecast of November 30, 1921, which was made thirty days in advance, was so near the actual figures when finally produced, that for all practical purposes it would have been unnecessary to substitute the actual final figures for the estimate. Who can fail to appreciate the value of such advance information? It must be admitted, however, that such results can not be expected immediately. They require development over a considerable period of time.

In laying the plan for a budget a definite period must be contemplated. Furthermore, it must be a period which is ordinarily made the subject of record in the company's accounts, in order that the experience and the estimates may be comparable. At the outset a relatively short period should be embraced—a month, perhaps, being considered the first unit of time. The plans should contemplate, however, an ultimate forecast that will go much farther ahead. The influence of certain economic factors may not be felt for a period of six or eight months; and since the forecast must take these trends into account, the budget,

sooner or later, must be prepared so as to show us our destination six months ahead, or perhaps even a year ahead.

We can not hope to measure these trends exactly, and the budget will be inaccurate to the extent by which the measurements err. Furthermore, as the predictions of the meteorologist sometimes go astray because of unexpected changes in the wind, so the predictions embodied in the budget may prove to miss the mark as new circumstances exert their influences. To avoid being misled in such an event, the executive must see that his budget is revised at frequent intervals, so as to take changed conditions into account.

There may be considerable divergence of thought regarding the probable effect of current influences, but all men are entitled to their opinions on the subject, and capable executives do have opinions. The least that can be done is to synchronize all the operations of the business and to direct them in accordance with the conclusions reached after weighing all the factors.

Budgets have been prepared for a great many purposes. There are budgets of sales, budgets of expenses, manufacturing or production budgets, treasurers' budgets, etc. Perhaps the manufacturing or production budget is met most frequently. All these serve very important purposes and it is encouraging to find them in use; but such departmental budgets are in reality only a beginning. They are a part, rather than the whole, and until the parts are assembled and proper cohesion is established, full benefit can not be obtained from them. The modern development is a coördination of all of the departmental budgets, which results in a finished picture of the business as a whole on a future date. Such a picture renders the utmost assistance. It keeps the business in balance. Moreover, it either lends encouragement when things are already going well, or it gives the danger signal in sufficient time to correct erroneous tendencies before the damage becomes too serious.

The complete budget comprehends a balance-sheet or financial statement as it is expected to appear upon a future date, together with a profit-and-loss account for the period intervening.

The accounting records of almost any business are from ten days to a month and a half behind the date of closing. This condition is unavoidable; it results from the necessity of waiting for information from vendors of materials purchased or services rendered, and for other information relative to production and

### *Why the Budget?*

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sales, prepared at outlying plants or branch offices. The decision required of an executive often depends upon the present position of the company's finances. The complete budget, starting with the last known position and showing the effect of transactions expected to be completed subsequently, bridges the gap and brings the information down to the latest possible date. It follows that the wider the gap, the more urgent is the need for the budget and the longer must be the budget period.

A well organized budget calls upon the sales department for its estimates of the total sales, the sales by classes and the probable shipping dates; upon the production department for the labor and materials required and an estimate of the capacity of the plant to meet the shipping schedule; upon the purchasing department for the estimate of purchases required to supply the necessary material to the production department; upon the credit department for the probable collections from customers; and finally, upon the treasurer's department for financial and administrative requirements. All these estimates must be submitted to a central authority, whose duty it is to coordinate and balance them. The sales estimate in itself would be futile if the production department had not the capacity for turning out goods to meet the shipping schedule. It would likewise be futile if the purchasing department discovered that materials or supplies required could not be purchased in the present market. The purchasing department must give due consideration to the status of the inventory and the additional requirements of material to meet production. Lastly, the treasurer must be prepared to say that he can or can not finance the estimated schedules. To finance them may require going into the market for money, and the treasurer must know whether his credit has been already strained or whether the company can afford to borrow at prevailing rates of interest.

It is the task of the central or coordinating authority to see that all the estimates are sound and that they dovetail. This authority is charged with a very important responsibility. In its consideration of the estimates it must be constantly on its guard against penny-wise-and-pound-foolish principles. On the one hand, it must know not only that it can afford to incur certain expenses, but that such expenses are justifiable. On the other hand, it must know that while certain expenses appear to be out of proportion, yet their curtailment will be at the expense of

service or of the creation and maintenance of goodwill, and therefore can not be afforded.

Having accepted the estimates of the several departments, as revised and coördinated, the authority must submit them to the accounting department. Here a balance-sheet and profit-and-loss account are prepared, which begin with the last known figures and set forth the application of the estimated changes, to produce the probable balance-sheet as at the end of the budget period and the resulting profit-and-loss account. The finished product may disclose a condition which requires immediate attention. For example, the ratio of current assets to current liabilities may appear to be entirely unhealthy; the cash balance may be hopelessly inadequate to finance the operations which can be expected in the succeeding period; or, conversely, large sums of cash may be accumulating which may well be applied in reduction of bank indebtedness, with the consequent reduction of interest charges. In any event, the picture is complete, and it may be studied from any desired angle.

The work of the coördinating authority is of such importance that it demands the assignment to it of some of the most capable members of the organization's staff. They must be familiar with the problems of their own company. They must be in touch with what goes on in the world of affairs. They must be imbued with the spirit of coöperation. The work which they undertake may in itself foster coöperation more effectively than any other single undertaking in the entire range of the company's problems.

The spirit of coöperation must also extend to the department heads, who are responsible for most of the preliminary figures. Many of these subordinates may, at first, consider the budget a useless expense or a contrivance designed to impede the progress of department work, but they will not remain obstructionists after the results of the budget begin to be apparent. Not only must department heads have a voice in the preparation of the budget, but they must be furnished with reports of the operating results. The task of analyzing differences between the estimates and the accomplishments will frequently require the assistance of these men, and their participation can not fail to prove interesting and instructive to them.

When all is said and done, the budget rests primarily upon the sales. Consequently, sales must be given careful consideration, not only in the light of present market conditions, but also in the

### *Why the Budget?*

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light of outside influences which are known to be exerting pressure upon the market. This calls for a high order of talent, but it presents a splendid opportunity to the executive who is well grounded in economics and manages to stay in touch with reports of major movements. He must know his ground well enough to reach his own conclusions, despite conflicting opinions regarding the probable course of business.

The executive who knows his destination and lays careful plans to reach it, can not fail to inspire confidence, and it is almost a foregone conclusion that he will reach his goal.