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1926

## Mystery of budgeting

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### Recommended Citation

Haskins & Sells Bulletin, Vol. 09, no. 02 (1926 February), p. 10-14

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## The Mystery of Budgeting

THE term "budget" until recently has been used almost exclusively in connection with governments and institutions. A leading dictionary of a few years ago defines a budget as a financial statement prepared for submission to a legislative body. In this connection the term has come to signify a statement of the estimated probable revenue from all sources for an ensuing fiscal period, balanced against the proposed expenditures for the same period—in short, a plan of activities for the period, prepared in advance for the guidance of the legislative body in fixing taxes, fees, and assessments, and approving the expenditures, and of the executive branch in carrying out the program decided upon.

The use of the budget for governmental purposes is exemplified in Great Britain, where it has been highly developed and perfected. There it constitutes the basis of all financial measures, and apparently is an effective means of controlling expenditures. The savings effected as a result of the budget system inaugurated by our own Federal government a few years ago are a matter of common knowledge. Some form of budget is employed by states and municipalities generally in arranging their financial programs.

Societies and clubs and similar organizations in the social, civic, and philanthropic group also have taken largely to its use. In most of these cases some estimate of proposed expenditures is necessary in order to fix the amount of revenue required to be obtained, and to apportion the burden among the individual members. Further, it usually is desirable to plan the expenditures in advance in order that they may be gauged so as not to exceed the total revenue available. These ends are accomplished by the preparation of a budget, which is at once the basis for au-

thorizing and controlling the activities of the organization.

Budget-making in business is of comparatively recent origin. However, the principles underlying the use of the budget are those which always have been recognized informally by business men in the conduct of their affairs.

The country store-keeper "stops to figure" before he adds a new line to the stock of his emporium. He considers the probable demand on the part of his customers, in the light of his past experience; the additional storage space and shelf room required; his ability to finance the additional purchases; etc.

The city merchant makes his plans for a certain period in advance, at least in his own mind. He estimates the sales he will make during the Christmas season, and makes his purchases, arranges for his loans from the bank, and plans his newspaper advertising accordingly.

The officials of the large corporation distributing its products over the whole nation plan their activities in advance for the coming period. Sales and production are estimated on the basis of market analysis. Advertising campaigns frequently are laid out a considerable length of time ahead. Estimates are made of cash receipts and disbursements, and bank loans arranged for.

Although planning and estimating of this nature are done as an incident to every business enterprise, they oftentimes do not comprehend all of the functions of the business simultaneously, with the object of pointing the enterprise as a whole towards a definite objective. Further, adequate provision is not always made for subsequent control over the operations, in order to assure realization of the plans and estimates.

These are the purposes of a budget. As

the term is applied in business, it contemplates simply the orderly and intelligent planning in advance of all of the activities of an enterprise for a certain period of time, on the basis of past experience and present trends, thereby setting up a definite goal towards which to work; together with sufficiently frequent comparison of actual results with the estimate to detect deficiencies and aid in carrying out the program laid down.

The initial step in the preparation of a budget in any business is an estimate of the sales that are deemed possible and desirable during the budget period, which usually is a fiscal year. All of the activities of a business enterprise are concerned with profitable sales. Consequently, an estimate of the sales is the first step in planning future operations.

In fixing sales quotas, in order to arrive at a reasonable sales expectancy, it is necessary to give consideration to past experience, and to present and prospective market conditions. It is not enough that the total volume of sales only be forecast. In order to plan the manufacturing and purchasing activities, the proposed sales must be set forth by commodities, lines, or what-not. Information regarding the months of the year in which shipments or deliveries probably will be made also is necessary.

The general buying power of the clientele served by the enterprise in question should be taken into account. Recognition should be given to trends or tendencies to diminished consumption of some lines and increased consumption of others. For example, a shoe manufacturer would consider, in planning his sales, the tendency of low shoes to replace high shoes, and would make up his sales estimate accordingly.

Any contemplated changes in prices, discounts, etc., should be considered in the light of their probable effect on sales.

Likewise, the results of proposed advertising campaigns, invasion of new territory, and the like, should be estimated. An important factor is the capacity of existing facilities to handle the volume of sales it may be deemed feasible to secure.

The completed sales budget is a statement of the sales it is expected to make throughout the budget period, in terms of units and dollars, prepared on the basis of past experience, present trends in the market, and proposed changes in policy.

Using the sales budget as a basis, it then is possible to plan production, in the case of a manufacturing concern, or purchases, in the case of a mercantile establishment, to meet its demands. The production department of a factory plans its operations in order to make deliveries at the proper times. Those in charge of the purchasing for a trading concern plan their buying so as to have goods on hand when needed.

In a manufacturing concern the quantities of units of various kinds required to be made during the budget period are estimated from the inventory on hand at the beginning of the period, the number called for by the sales budget, and the quantity it is deemed desirable or safe to have on hand at the end of the period. In planning its activities the production department should consider the equipment available, or to be made available, during the period. Obviously, it is desirable to provide whenever possible for an even flow of production through the factory to the consumer over the entire period. In seasonal businesses, however, sales are high in certain months and low in others. The production department must recognize this, and make the goods available when needed by the sales department. It must plan its activities in order to realize the utmost from the various productive factors, and still keep at a minimum the capital tied up in large inventories during

the slack season. The production budget involves the preparation of a statement showing estimated material, labor, and manufacturing expenses, by months, and showing also unit costs. Obviously, purchase commitments, additions to the payroll, etc., should conform to the proposed production.

The purchases budget for a trading concern involves timing the purchases of various commodities to make them available for the proposed sales. Factors to be considered are such as the probable status of the market during the budget period, storage facilities, unnecessary tie-up of capital in large inventories, etc.

The expense budget requires careful consideration. An estimate should be prepared showing, in detail, the selling, administrative, and general expenses to be incurred during the period under review. The estimate should be made in the light of past experience and the program called for by the sales budget. It should be made by months. Some expenses, such as administrative salaries, are relatively fixed, while others, such as salesmen's commissions, fluctuate with the volume of business.

The preparation of the expense budget offers rich possibilities for the control of these items. By planning the expenditures in advance, it is possible to consider the need for each particular item in its relation to the whole proposed program, before making any commitments. Loading the camel's back up to the proverbial last straw is avoided.

One of the first steps in preparing the expense budget is an intelligent classification of expenses, in order that it may be ascertained that the total of a given kind of proposed expenditures is not out of proportion, as well as that the individual items are necessary.

If any capital additions to plant and equipment are contemplated during the

budget period, an estimate should be made thereof. A number of important considerations are involved in planning new construction or the purchase of new equipment. First is the need for additions. It should be ascertained definitely, on the one hand, that sufficient sales are assured to justify the additions; and, on the other hand, that the proposed additions are adequate for the program of sales planned.

Careful consideration should be given to the funds available for construction, and to the financing that may be required. It is necessary to consider also the probable return on the additional investment, and the effect of increased charges for maintenance, depreciation, interest, insurance, etc., on the future income statements. Frequently these latter points are overlooked.

A statement should be prepared, showing the changes in plant and equipment decided upon, the capital required, and the dates of payments.

After the budgets of sales, production and purchases, expenses, and capital additions have been prepared, the next step in an orderly planning of the year's activities is the preparation of a cash budget, to aid in arranging for the financing necessary to carry out the plans shown in these statements.

The cash receipts for each month of the budget period are estimated on the basis of proposed sales and past experience in realizing on accounts receivable. The terms of sale and the experienced turnover of accounts receivable are taken into consideration. The cash disbursements for materials, labor, and expenses are estimated on the basis of the production and purchases and expense budgets.

The difference between the estimated cash receipts and cash disbursements for each month of the budget period represents the increase or decrease in the cash

position for the month because of operations. This difference is applied to the cash balance at the beginning of the month, together with estimated cash receipts from proposed bank loans, cash requirements for liquidation of bank loans, and cash outlays on account of additions to plant and equipment. The final result is an indication of the estimated cash position at the end of the month.

An estimated balance sheet and profit and loss statement frequently are prepared, showing the probable effects of the plans proposed for the period. Such statements are an aid in determining the soundness of the plans. Further, they constitute a goal towards which to work.

The channels through which data should be secured for the preparation of a budget differ with various schemes of business organization. Regardless of the method pursued, the data should be co-ordinated. Too much stress cannot be placed upon this point. All of the departments and functions of a business enterprise are inter-related. No intelligent plan of operations can be made without full co-operation from all. For example, an advertising campaign cannot be planned without a knowledge of sales expectancy, and of the capacity of the plant to produce goods for sale. Hence, the master budget should be a statement of plans which embraces at once all departments, as working together towards a common end.

After the completion of the co-ordinated budget, comprising the plans for the ensuing period, comparisons should be made at intervals during the period—usually monthly—to see how nearly actual results conform to the estimates. These comparisons are for the purposes of detecting deficiencies in carrying out the proposed program, and of revising the plans if necessary. The data as to actual performance may be obtained from the accounting and statistical records.

Only when a frequent check-up is had is the fullest measure of control realized.

As outlined in the foregoing, a budget system in business is simply a means of planning intelligently a year's operations in advance, by estimating as scientifically as possible the proposed sales, production, expenses, capital additions, and financial requirements, together with provision for controlling the program during the period.

The preparation of a budget involves a study of the business as a whole, in its relations to the outside world, and frequently is the means of disclosing ways of enlarging and strengthening the enterprise. The assembly of the plans of all departments results in a well-considered and profitable program of operations, and makes for closer co-ordination of all the activities. The estimate of expenses for the period enables an effective control to be established. This control is maintained by frequent comparisons between the actual and the estimate.

A budget system may be made as elaborate as desired, and may involve a large corps of employees. The principle is applicable as well to the smallest business.

A simple plan for utilizing operating budget data embraces a form which is an adaptation of the ordinary statement of income and profit and loss. The income and expense classification usually employed by a given organization constitutes the basis for the budget statement, although any items may be subdivided or elaborated as far as desirable. To the right of the account classification appear the following columns: total budget, total actual, January budget, January actual, and so on through the months of the year; as may be made clearer by the sketch which follows at the head of the next page:

	Total		January		February	
	Budget	Actual	Budget	Actual	Budget	Actual
Sales . . . . .						
Cost of goods sold . . . . .						
Gross profit . . . . .						
Selling expenses . . . . .						
Administrative expenses . . . . .						
Total . . . . .						
Net profit . . . . .						

Budget figures are entered in advance; actual figures as they become available. In the absence of complete actual monthly figures, certain items only may be used, or the form may be contracted to a quarterly, semi-annual, or even an annual basis. However, as departure from the monthly basis becomes greater, the value of the scheme becomes lessened.

A budget plan of this character may or may not be all that any organization needs. It provides for a statement of operating plans for the year and for monthly comparisons between actual and estimated figures. At least the plan illustrates the whole principle of budget control which quite frequently has been made so much of a mystery.

### Fraud Affecting the Assets

**F**RAUD in accounts is no new subject. Practicing accountants have been coping with the appropriative inclinations of abnormal individuals in business for years. Book-writers have discussed the subject at great length and from many angles. However, the frequency with which fraud cases now are appearing, and the relation which the matter has to the practicing accountant and his clients, seem to justify some further consideration of the subject.

Fraud relating to the assets usually results in either overstatement or understatement thereof. The motive for overstatement is to inflate values, thereby increasing the surplus for the purpose of gaining favorable credit consideration, or deriving illegitimate gain on the refinancing of a business enterprise or on the sale of the assets pertaining thereto. The benefit in

cases of the latter kind accrues to one or more principals involved as individuals in the capital transaction.

The motive for understatement is to conceal misappropriations of assets. The benefit in instances of this character is derived as a rule by some subordinate employe, occasionally in collusion with other employes or with confederates outside of the organization.

The officers of a certain corporation overvalued the inventories, thereby swelling the surplus, improving the current position, and inducing the banks to extend credit which otherwise probably would not have been extended. An officer of another corporation caused the quantities in the inventory to be increased without warrant, thereby inflating the inventories, and as a result received more new shares in a refinancing and exchange scheme than he was