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“Ye Olde Budget”

BY ANDREW S. MIHALIK

“Hear ye, hear ye, make way for the barons of the exchequer who are now assembling to audit the accounts of the sheriffs.” The chancellor solemnly continued his mythical announcement. “The semi-annual audit of the sheriffs’ accounts will now begin so that all loyal subjects of His Majesty, King Henry I, may enjoy full justice of person and equal justice of monies.”

This quaint announcement was quite common in England at the turn of the twelfth century. At that time England was having what has been named in the twentieth century a “new deal.” As if to match the alphabetical style of the twentieth century, King Henry consulted his aides and produced the CR and the CE. It was up to the CR (*curia regis* or king’s court) to see that justice was done in the realm according to the new liberal decrees of the king. The CE (*chancellery of the exchequer*) which was composed of a picked group of barons headed by a chancellor, saw that all taxes and fees of the sheriffs, the official tax collectors, were properly checked and approved.

HOW OLD IS OLDE?

King Henry I, whose reign lasted from 1100 to 1135, differed from all his predecessors. His counsellors (*jurists of curia regis*) were all highly educated men, trained at the school of Laon, in France. Thus his administrative advisors curiously resembled the twentieth-century brain-trusters. With his characteristic native brilliance the king established order and a high degree of organization throughout his realm. He introduced a regular system of finance and justice. He championed the cause of the forgotten peasant and thus unconsciously instituted one of the first “new deals” in history. The people were thus given for the first time a voice in the affairs of government, which, with negligible interruptions, was to stand a test of eight centuries. Here, as history shows, the modern budget had its birth.

The word “budget,” however, really goes back to early mediæval France and to the days of the troubadours. These strolling players assigned to one of their members the task of handling

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funds of the company which were kept in a leather bag (*bougette*). In time, the custodian was known as the budgeter. And, just as in the twentieth century, his popularity was uncertain.

In subsequent centuries it became the practice of the king's chancellor in England to appear before parliament with a document of proposed governmental finances, tucked away in a leather bag. It was probably from this association of the leather bag with the government's control program that the latter began to be known as the "budget," from the French "*bougette*."

While the term dates back to mediæval times, the idea of control by budgeting probably goes back to the beginning of history. We find that the Babylonians and Egyptians employed elaborate systems of control over their grains and money. The Romans used estimates of income and outgo to lay an "ability to pay" tax.

Nevertheless, the modern budget idea, as instituted by Henry I of England, differs fundamentally from any system of fiscal control employed by the ancients. Nowhere in Babylonian, Egyptian, Grecian or Roman history is any evidence found tending to show where the common man had a voice in affairs of the state—particularly in financial matters. We must, therefore, give the credit to that far-sighted monarch of the twelfth century for breaking with the past and allowing his subjects some degree of freedom to consider their prospective burdens.

The encouragement given by Henry I to democracy was not in vain. A century later the people's demands from King John at Runnimeade established for all time that freedom of legislative procedure which later expressed itself in the modern budget. Parliamentary life became centered around an annual budget message from the executive. Approval or disapproval of that message developed into the essence of modern democracy. Indeed, this concurrent development of the budget idea and of democracy became so commonplace that we have Gladstone in the nineteenth century exclaiming: "Budgets are not merely affairs of arithmetic, but in a thousand ways go to the roots of prosperity of individuals, the relation of classes and strength of kingdoms."

As if taking a cue from Gladstone, the modern budget experienced a magnificent development. In public life, the attention of scholars and legislators was focused upon estimates of the government's fiscal program in advance. This was based upon its

expected receipts and expenditures. As the result, the science of governmental budgeting developed so remarkably that every leading country in the world employs it today. In the United States, each state in the union has fiscal budgetary control. This plan has also spread widely into municipal control.

A characteristic development of the budget idea is found in the present-day family. Attention was first focused upon a plan of expending family or individual income mainly by two people: A Prussian, named Ernest Engel, who in 1857 laid down four laws of family expenditure, may have been the first to lay foundations for modern family budgets. Later, in 1899, Ellen H. Richards of the United States published *The Cost of Living*, the first attempt in this country at household budgeting. Today, educational institutions, banks, insurance companies and social agencies have issued many "model" or "ideal" budgets for given incomes. These are used by far-sighted persons as a basis for planning their living standards in advance.

Finally, the theory of budgeting invaded and conquered the business world. It is essentially a post-war development—nevertheless it goes back to Frederick W. Taylor, who developed his time and motion studies about 1911. These studies enabled manufacturers and others to determine scientifically and beforehand what their estimated cost per article ought to be.

However, it was not until 1922, when J. O. McKinsey published his *Budgetary Control*, that industrial budgeting really received its start. In 1931, according to a survey of budgetary control in manufacturing industry published by the National Industrial Conference Board, slightly more than half of the largest American industries employed such control. I venture to say that since 1931 the desire of business to keep itself solvent, and a desire to assure itself a profit, have boosted considerably the interest in budgeting.

Industrial budgeting is based upon premises radically different from governmental budgeting. For one thing, revenue is not as certain and controllable in business as it is in government programs. Then again the degree of expenditure of funds in business may determine future income. As an example, consider promotional work and advertising. This is not the case with governmental expenditure, where, as a rule, there is no possible relationship between expenses and income.

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What is the meaning of the budget? Why is it so important as a measure of executive and management control? A reference to a few definitions will make that clear.

In private industry the essential idea of the budget is to plan to coördinate the balancing of expenditures with income, while at the same time forecasting the expected business operations for a definite period of time. These are expressed in “numerical terms in accordance with accounting forms employed to record the operations of the business” (National Industrial Conference Board, 1931). The primary purpose of every business organization is profit making. A budget, expressed in simple terms, is a scientific instrument designed to assure a profit to a well-managed business. It is the result of research applied to the profit factor. A further definition of the budget appropriates generously the scientific method by saying that “Budgeting may be described as an attempt to coördinate the principles and procedures of cost accounting, industrial and management engineering and statistics for the purpose of measuring, recording and reporting currently all the operations of a business enterprise.” (Edwin L. Theiss, “Accounting and Budgeting,” *Accounting Review*, June, 1935.) The latter definition states more precisely what a modern industrial budget should do.

In government, René Stowrm expresses an early conception of a public budget when he calls it a “document containing a preliminary approved plan of public revenues and expenditures.” However, a little reflection on the ramifications of such a plan fails to reveal the real significance of the budget system, which is to provide an orderly administration of the financial affairs of the government. In actual practice, it involves an estimate of revenue and expenditure needs for a definite fiscal period, the appropriation acts, the accounts and, finally, a report. Furthermore, with this plan is also included certain information about the past, present and even future operations of the government. It may even include whatever bills are required for legislative authorization of the budget.

Thus the modern governmental budget is a comprehensive coördinating instrument of fiscal control. It is the means whereby the chief executive carries out the purpose of his office and the will of his superiors. It is also a report and a record of performance for the benefit of the fund-raising body and the people. The approved budget program thus controls the chief

executive to the extent that the executive exercises control over the details of his administration.

IN EUROPE

The modern conception of the budget as a central comprehensive means of control is a fairly recent one. In England, the original and simpler idea developed with the right of the governed to authorize any burdens about to be placed upon them, this to be done through a representative body. Such a right in part was granted by Henry I, but extracted by force from Edward I and King John. History shows that every time the executive violated that right, serious trouble ensued. Such was the case during the reign of the Stuart kings and also at the time of the civil war of 1642 to 1649. The revolution of 1688 furnishes still another conspicuous example. However, the most important and tragic violation of that right occurred under King George III, bringing on that tremendous historical event, the American Revolution. And it is particularly significant that one of the first things the newly constituted American authorities did was to designate Alexander Hamilton as a creator of a report which set forth the new financial program as the people wanted it.

Notwithstanding the set-backs of despotic government, the budget idea gained prominence as the centuries rolled on. France fought and bled during the French revolution before securing it for the first time. Today the minister of finance assembles the departmental estimates with the revenue requirements and submits them to the chamber of deputies. The senate approval follows. This power of popular approval of the budget is so important in France that if the bill fails to pass, the ministry resigns and a new one is formed in order to obtain majority approval.

In Germany we find that a complete budget came into existence during the nineteenth century. We find Prussia adopting it in 1821. A *staatshaushatt-etat* was instituted in Prussia with the constitution in 1850. However, we see that as late as 1862 Bismarck still had his way when he needed money.

Austria adopted the budget in 1766, but the legislature of that country secured control of it only after the fall of the Hapsburgs in 1919.

During the early struggles for the adoption of the budget, attention was primarily focused on questions of revenue. It was not

until 1688 that England first began to control expenditures. A glimpse at the present English system reveals that the idea of executive responsibility in the preparation of the budget, as preliminary to parliamentary approval, has become fairly fixed. The treasury, through the chancellor of the exchequer, has complete control of estimates of future needs of all the departments. These are balanced with the necessary revenues and submitted to the cabinet for its approval. They are then presented by the chancellor to the house of commons. Since the powers of the house are limited to a reduction of appropriations and a general discussion of the budget, hardly any changes are made. The house of lords is required merely to give a formal assent to the measure, according to the parliament act of 1911.

The government is held strictly accountable both for the efficiency and economy of its service and the regularity of its accounts. This control is accomplished through the audit of an independent officer appointed by the crown. Any irregularities in the accounts or practices are quickly revealed to the house, which immediately institutes proceedings. Normally this audit expressed in a report is the basis of recommendations by the house to the treasury.

It is noteworthy and remarkable that many of the budget features of the home government were adopted in the budget systems of Canada, Australia, New Zealand, South Africa and India long before they reached our capital. Even continental Europe saw widespread adoption before our government finally decided to act.

IN AMERICA

The year 1921 is a notable landmark in the development of government budgeting on American shores. It was in that year that the government of the United States of America formally adopted a budget system. Prior to that time the financial plan of the government merely consisted of a collection of individual requests rather than a well-coördinated and thought-out plan of action.

Although the United States as a democracy required legislative approval for all governmental expenditures, the various types of administrative units lacked the benefits of modern budget practice. It was not until 1899 that the first step in this country was taken toward better administrative control. Following a demand

to place the municipalities on a budget basis, the National Municipal League drafted a model municipal corporation act in that year. The model contained the following section:

“It shall be the duty of the mayor . . . in each year to submit to the council the annual budget of current expenses of the city, any item of which may be omitted or reduced by the council but the council shall not increase any item in, nor the total of, said budget.”

This section, although admittedly deficient, nevertheless marks the beginning of the budget system in municipal governments in the United States.

While many studious souls were considering municipal conditions and seriously laying plans for reform, some of our largest cities had not yet recovered from the havoc wrought by political gangs. The Tweed gang in New York had been broken up, but no practical measures of reform supplanted the earlier conditions. However, since agitation for sound administration continued, special “bureaus of municipal research were organized to study the financial procedure, organization and management of city governments” (A. S. Buck, *Public Budgeting*, page 13). The most noted of these, the New York Bureau of Municipal Research organized in 1906, immediately inaugurated a study of local budget needs. One of its first reports, entitled *Making a Municipal Budget*, which was released in 1907, formed the basis of the New York budget a short time later. The idea spread from the New York laboratory to municipalities throughout the country. Many states have established uniform budget procedure for city, county and district governments. The procedure may vary according to the size of the municipality—nevertheless, the idea of budgetary control is ever present. There have even been legal provisions relative to budgets in the United States dependencies, Philippine Islands, Hawaii, Alaska and Porto Rico.

The second move in the United States was instigated by President Taft’s commission on economy and efficiency in 1910. After an exhaustive study covering two years, this commission published a report, *The Need for a National Budget*, which President Taft sent to congress with a message of approval in 1912. But congress felt indisposed to part with the power of asking and receiving unchecked sums of money and spending them without control. In 1914 it rejected a bill designed for that purpose.

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The work of the Taft commission, however, had far-reaching effects among the American states. Within a short time almost half the states had established commissions to study ways to effect economy and means to achieve efficiency. Among the first recommendations which these commissions made was the adoption of state budgets. Although political capital was made of the budget, it did arouse the people to an interest in finances of state governments to such an extent that six states adopted budgets in 1913. California and Wisconsin had adopted them in 1911. Since 1913 seven states have made the budget a part of their constitutions, while practically all the rest have adopted the budget as a fiscal means of control.

The types of budgets adopted by the states may be summarized as follows:

- I. The executive type of control.
 1. By the governor alone.
(A few states having this type are Ohio, Illinois, New Jersey, New York.)
- II. Legislative type of control.
 1. By legislature.
 - (a) Committee.
 - (b) Agents.
(In use in Arkansas.)
- III. Commission or multiple type of control.
 1. By executive or administrative officers.
 2. Appointees of the governor or legislature.
(In use in Connecticut, Missouri, West Virginia, Georgia, Maine, Florida.)

The movement has spread recently into county government administrative methods. Indeed many states have made adoption of a budget a part of their constitutions.

So widespread did the interest in budgets become that in 1916 an institute for governmental research was created. Its object was to carry on the work of the Taft commission and to prepare for adoption by the United States government a budget system second to none. Its labors aided in the adoption of a bill which brought into harmony the divergent practices of both houses. The signature upon the budget and accounting act of 1921 constituted

the third forward movement of the budget in the United States, at that time possibly the most complete system of control in the whole world.

The sad but true fact is that, since 1921, other nations and organized bodies have adopted far better systems than ours. It is unfortunate that while they have secured the benefits of modern research in accounting science, the United States has consistently refrained from making advantageous changes in its budget system.

The law gave the president the sole responsibility for submitting in regular session a complete budget involving the condition of the treasury, estimates of revenues, estimates of expenditures, etc. It also established the necessary administrative machinery in the form of the bureau of budget in the treasury department. Charles G. Dawes was appointed our first director of the budget.

The results of the federal budget have been fairly gratifying. It has aided in abolishing obsolete methods of appropriating funds in both houses, and it established one committee in each house. The national administration was thus modified, centering more political power in the president and making his budget report comparable to the report by the general manager of an industrial concern to his board of directors. Furthermore, states have been stimulated still more to adopt budget measures of their own and have since surpassed the federal government. The most recent development has been to give the executive more power in establishing business systems and executing budgets. In view of this, it seems quite probable that as the executive in the future gets more and more power (both in political and economic spheres) this concentration of power will be coincident with the development and the refinement of the budget idea. It is a truism that "he who controls the finances of a state controls the nation's policy."

In comparison with the British budget system, the American system is at least technically far superior. In England the upper house can not revise the budget except with permission of the lower house. Neither house may make additions to the proposals submitted by the ministry. In the United States, both houses have the power to modify the budget, the differences being adjusted by a joint committee. Thus both the executive and the legislature consider requests, while in England only the treasury has that power.

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In France each minister prepares his own budget which is summarized by the finance minister, who himself has no other authority.

The opposite is found in Germany, with the supreme authority vested in the executive and the upper house.

Attention has been called earlier to the household budget. After Ellen H. Richards' introduction of the idea into this country, it was eventually adopted as one of the major objects of study by the bureau of home economics of the department of agriculture. The bureau is engaged in studies of several standards and costs of living to provide the basis for home budgets. It often works with the budget committee of the national conference of social work to draw up suggested budgets. The result has been that today with the help of the family budget an increasingly large portion of the population is enabled to enjoy an intelligently happier life than was possible without the aid of such a plan.

Coincident with the interest in governmental, institutional and personal budgets was the desire of business men to apply this new tool to business problems. It was in the industrial field that the budget idea performed one of its greatest accomplishments. While it is true that informal estimates were made of sales, advertising, purchases, and production prior to 1911, it was not until that year that any progress was made in rescuing industry from some of the uncertainty of planning for the future. At about the same time new interest in control gave a strong impetus to management, which resulted in planning details of operation, setting standards of industry and making use of extensive cost and accounting systems. The world war gave a further stimulus to this trend with its emphasis upon efficiency. J. O. McKinsey's work in the early twenties crystallized all experimentation into complete budget programs for industry. These budgets in their simplest terms are merely estimates of future needs for money, labor, materials, production, advertising, sales or any other item of income or expense. And budgetary control is merely the coordination of these income and expense accounts into a unified, predetermined plan, the main object of which is to assure success in efforts to earn money.

A summary of the leading definitions of a budget usually reveals that the modern industrial budget program contains the following:

1. Detailed estimates of action for each department of a business.

2. Coördination of these estimates into a program as a whole.
3. Estimated balance-sheet.
4. Estimated profit-and-loss statement.
5. Estimated manufacturing and financial statements.
6. Preparation of progress reports.
7. Preparation of estimated comparative statements.
8. Employment of supplementary devices like the budget manual, budget analysis and profit charts.

It is quite readily seen that budgeting seriously involves the policies and the very organization of a business itself. It constitutes one of the first tools which modern management has created to control and check production costs. The vehicle has been standard predetermined costs. Because mere control of production costs proved insufficient during the past five years, many wide-awake firms are beginning to establish standards in distribution, thereby attempting to control sales and overhead costs through budgets.

Tom Grisell (*Budgetary Control of Distribution*) was one of the pioneers in applying budgetary control to distribution and sales. He aided many firms to eliminate waste, discover new undeveloped markets and otherwise achieve results through efficiency. E. Stewart Freeman also contributed to this phase of business planning. He devised a unique method of apportioning "order-filling" and "order-getting" costs to the individual orders. However, the application of standards to distribution is difficult because there seem to be more variables than in the case of production. Cost accounting for distribution is yet in its infancy as compared with production-cost accounting.

Budgeting in industry further developed from the need for some sort of check upon management. Bankers are laying stress upon a better appraisal of management rather than property. Thus it can be seen that control of sales and production must be tied up with control of the executive in order to achieve greater managerial efficiency.

The need for some sort of financial program was still another factor that influenced the budget's growth. It is evident that if a firm is planning to continue in business for years to come, it is compelled to create a long-range financial program which becomes more specific as the end of the fiscal year approaches.

The needs of a business may be specifically calculated for the first year. They are less specifically calculated for the following

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two or three years; and for the remainder of, say, a five-year period, they are projected in a general but, nevertheless, intelligent way. Unfortunately, most firms today have merely short-term budgets.

The principal benefit of a budget system to an enterprise is the assurance of an intelligent, efficient and well defined effort to conduct business. With a greater degree of both managerial control and managerial coöperation, not only greater sales (which in a large degree are predetermined) but also an assurance of profits may result. The main disadvantage of the modern business budget, however, is found in the attitude of management in executing it.

“WITHIN THIS PRESENT”

To review briefly, we have seen that the budget idea had its birth in England at the turn of the twelfth century and during one of the earliest “new deal” administrations on record. And, as democracy developed, the budget became an indispensable part of that development. When that development became mature enough to achieve greater efficiency and control than had been possible, the budget was carried into the household and into private business. Budgeting of activities in industry followed. The exigencies of the war, post-war and the recent five-year depression gave a further impetus to the development of the scientific budget. Cost finding and control became a necessity. “Standard costs” in production have recently been expanded to include distribution and office expense. In coördinating the machinery of management, the budget has been an invaluable aid. Full executive support, however, is absolutely needed if the plan and the principle are to succeed. Finally, those who are to execute the plan must have an active and definite part in its making.

The result of adoption of the budget idea has been to place it high in the realm of human coöperative endeavor. By it the destinies of whole peoples are calculated beforehand. In the United States, many of the important industries now employ budget systems as part of their formal policies. Finally, social and humane organizations are making the assistance of the finest economic intelligence available to heads of families, thereby enabling every citizen to enjoy more of this limited life. Certainly the budget idea rules the world today as never before.