

Zdzisław Kes

Wrocław University of Economics

Joanna Dynowska

University of Warmia and Mazury in Olsztyn

MANAGEMENT FUNCTIONS VS. BUDGETING PROCESS

Summary: This paper answers questions regarding how phases of budgeting support management functions. It explores the relationship between phases of budgeting i.e. creating, realizing and controlling budgets and management functions i.e. planning, organizing, incentivizing and controlling. For these four management functions, the research establishes that planning, incentivizing and controlling are directly supported by the budgeting process, whereas organizing is not directly associated with the budgeting process.

Key words: budgeting, management functions, budgeting process.

1. Introduction

Budgeting has supported the planning and controlling functions of economic entities and institutions for many years. Based on numerous published sources, a conclusion can be drawn that knowledge on this issue is both abundant and profound, as verified repeatedly by science and economic experience. This is why the title of this study may (unintentionally) suggest that it was intended to provide theoretical reflections on established, well-known issues. However, based on the published research, the authors have made the assumption that new correlations and relationships between management functions and budgeting processes can be established. These theoretical correlations and relationships represent the focus of the current research.

The analysis of management functions in the context of phases of budgeting enables determination of their common elements, relations among them and, most of all, opportunities to better integrate these processes. Moreover, there are also opportunities to develop new insight regarding stages of the budgeting process.

This elaboration provides an innovative approach to issues regarding the realization of management functions within particular phases of the budgeting process. The authors of this article provide unique insight and a perspective not previously presented in the literature.

Issues in the field of management, as presented in this study, are extensively described in literature. The process of management is presented as a set of four functions: planning and making decisions, organizing, exercising control, and leading (directing, motivating) [Griffin 2000, p. 40]. There may be a viewpoint encountered in some studies that the enumerated functions are “arranged in a certain sequence so that there originates an impression of a process” [Steinmann, Schreyogg 2001, p. 23]. According to Steinmann and Schreyogg, management functions are treated dynamically in the management process, within phases, in the following sequence: planning, organizing, staff assurance, directing and control.

However, the budgeting process, according to many authors of studies in the field of management accounting, consists of three phases: creation of budgets, implementation of budgets, and monitoring of budget execution [Szychta 1998, p. 66].

Consequently, a cursory collation of functions and stages provides Figure 1.

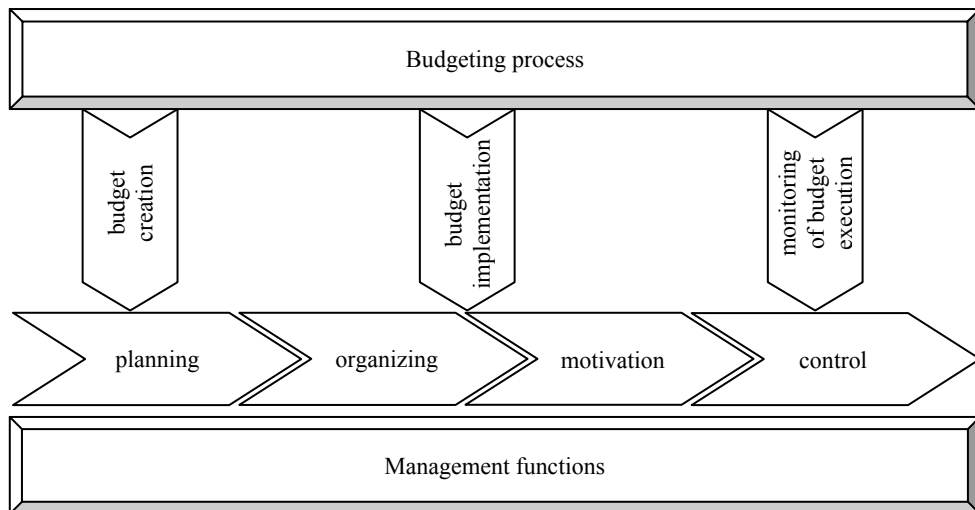


Figure 1. Connection of management functions with budgeting phases

Source: own elaboration.

As shown in Figure 1, those budgeting phases directly related to management functions can easily be identified: budgets creation – planning, and monitoring of budget execution – control. There is no such a clear relationship between budget implementation and organizing or motivation. This is the source of the main research question: What are the relationships between the budgeting phases and the management functions? In order to answer this question, the authors raise the following ancillary questions:

- How does the creation of budgets phase support functions of planning?
- How does the budget implementation phase support the organizing function?
- How does the monitoring phase support the control and motivation functions?

In order to answer these questions, three commonly applied analytical methods have been employed in this study: a critical analysis of subject literature, a comparison of concept scopes, and deductive reasoning.

The main aim of this study is to determine the relationships and intra-dependencies between the phases of the budgeting process and management functions. The findings of this research may influence and shape opinions on the scope and structure of budgeting, both in theory and in practice.

2. Definitions of elementary terms

In the initial phase of the study, an attempt was made to define relations between budgeting and management functions. According to J. Komorowski, “budgeting is a process that simultaneously contains all of the management functions: planning, organizing, motivation and control” [Komorowski 1997, p. 25]. At this point, it should be stressed that his definition of budgeting is not entirely uniform in the literature. According to J. Komorowski, budgeting is a means of managing an enterprise, i.e., determining rules of planning and utilizing financial means in order to perform production tasks efficiently [Komorowski 1997, p. 18]. A consequence of this assertion is acceptance of only two phases of the budgeting process: budget creation and budget implementation. In this context, the former assumption that budgeting is a management method containing all of the management functions needs to be revised. If control is excluded from the definition of budgeting, the former assumption will not be fulfilled. Similar definitions of budgeting, without stressing the control function, have been shared by other authors (compare [Anthony 1997; Drucker 1992; Rayburn 1986; Armstrong 1993] after [Łada-Cieślak 1999, p. 25-26]).

Even those authors who prescribe a broader definition of the budget creation phase, seeing budgeting only from activity-centric perspective, tend to highlight three budgeting phases: creation, implementation and monitoring of budgets (e.g., definition of budgeting in the context of creation of budgets in [*Rachunkowość zarządcza...* 2006, p. 384] and the budgeting phase conjoined with control in [*Rachunkowość zarządcza...* 2006, p. 398-399]).

The view that the monitoring of budget execution takes place in a system separate from budgeting, i.e., within a budget monitoring (budget steering) system, is the view adopted for the purposes of this study.

The International Management Accounting defines budgeting “as the actions necessary for ensuring that aims of budgets, plans, policies and standards are achieved or corrected” [*Management Accounting Glossary* 1990, p. 13].

Concluding this section, it should be noted that budgeting is also perceived as a tool linking planning and control. This perception can be explained by a simple relationship: if budgets are prepared and accepted for implementation, then subsequently using them as a standard for control is a natural result. Further, there is no doubt that linking these functions has a positive influence on the quality and

efficiency of management. For example, establishing a level of particularity for planned items in the budget creation stage, determines the particularity of the data used for control. Conversely, organizational or methodical separation of planning and control can significantly undermine the integrity of these two functions. Elaborations on this approach to budgeting can be found in the literature ([Łada-Cieślak 1999] or [Kes 2002]).

Definitions of budgeting are not uniform or consistent. However, the majority of authors in the field of management accountancy tend to view that the budgeting process contains three phases: creation, implementation, and monitoring of budgets, without explicitly indicating their opinions on the definition itself (compare [Szychta 1998, p. 66; Świdorska 1997, p. 2001]). Using this prevailing view of the budgeting process, this paper examines the relationships and intra-dependencies between these three phases of the budgeting process and the four aforementioned functions of management.

3. Budget creation phases vs. planning

Planning within an enterprise can be examined from many points of view. From the point of view of strategic management, planning may be searching for an answer to the question “What should we do?” From the point of view of operational management, it could be “How are we going to do it?” Regardless of perspective, planning activities share the following six stages:

- 1) Setting basic planning objectives.
- 2) Analyzing circumstances, identifying problems.
- 3) Identifying alternative solutions constituting various strategies.
- 4) Determining tasks needed to achieve objectives.
- 5) Creating a timeline for completion of tasks.
- 6) Accepting the plan; implementing planning decisions [Komorowski 1997, p. 39].

Budget creation, however, includes stages such as:

- 1) Transferring assumptions, guidelines, and restrictions related to the creation of a budget.
- 2) Drafting sales budgets.
- 3) Drafting partial budgets.
- 4) Negotiating budgets.
- 5) Coordinating and verifying partial budgets.
- 6) Accepting and approving budgets [*Budżetowanie...* 2007, p. 41-43].

If the stages of planning and the stages related to the creation of budgets are compared side by side, strong congruencies are apparent between them. There are no doubts regarding the similarities and compatibility between the first and last stages. However, the relationships between the other elements are not as straightforward. For example, the transfer of budget assumptions may be connected to the stage of

setting basic planning objectives as well as to the determination of tasks needed to achieve the desired objectives. During the drafting of partial budgets, a schedule and timeline is made; coordination and verification of partial budgets, however, fosters a search for alternative solutions.

Upon summarizing cogitations relating the planning management function to the budget creation phase, conclusions may be drawn from the discussion on the subject of boundaries between the terms of a budget and a plan. Similarly, extreme outlooks pinpointing similarities and differences may be enumerated here (more on this subject in [Łada-Cieślak 1998, p. 29]). In marginal cases, a budget and a plan may have an identical form and structure. Based on this, a conclusion regarding strong convergence between budgets and plans may be drawn. In practice, there is a prevailing opinion that budgets are a valuable particularization of plans.

A clear result of the reflections presented herein is that the stage of budgeting involving the creation of budgets is very comparable to the planning function in terms of concept and activities. Therefore, a conclusion may be drawn that budgeting supports the planning function and even permeates it.

4. Budget implementation vs. organizing

The budget implementation stage causes many interpretative problems due to undefinable features often connected with this phase. Generally, this phase is considered to start at the time of approval of the budget, i.e., on the first day of a budgeting period, and end on the last day of a budgeting period. However, it is generally difficult to determine what specific tasks and functions related to budgeting are fully realized during this phase. Published literature often equates implementing budgets to conducting economic activity in a way that enables budget assumptions to be accomplished [Bek-Gaik, Łada-Cieślak, Krawczyk 1999, p. 9]. Furthermore, the literature often assigns to this phase corrections that are made to the original budget after the initial budgeting phase [*Budżetowanie...* 2007, p. 34].

However, such a view does not provide a complete picture of budget implementation. In the case of pursuing activities under the guidelines of a budget, it is difficult to identify activities that originate in or are fully realized in the “implementation” time frame. As a practical manner, one could assert that the budget implementation stage should (could) only include activities related to correcting budgets and to monitoring variances of expected values. However, the activities undertaken by people responsible for budget implementation could be classified as managerial activities, which would be performed with or without a formal budgeting process.

It is worth looking at budget implementation from a short-term and a long-term perspective. Let us consider a short time span, e.g., a month. In this time frame, no actions performed by a controller would be anticipated. Any budgeting activities within this short time period would likely be related to budget corrections. Even so,

the corrections would likely take place after the end of the period, not during the course of it. During a long time horizon, such a correction could be implemented, for example, at the end of a month, quarter, or six month period. Such corrections to budgets within longer time horizons are the result of feed-forward, which is a derivative of managing/leading. If we accept that leading is linked to control, then a budget correction could be classified as an action related to the monitoring phase of budget execution as opposed to an activity related to the budget implementation phase.

Alterations to the structures of budgets, e.g., centres of responsibility, planning procedures, etc., may be considered budgeting activities. However, these activities are not necessarily related to the budgeting process, which is characterized with a certain periodicity, but they are related to the overarching budgeting system and are performed on an as-needed basis. They relate more to the organizing management function, which is based on collating resources across the entire organization, than to the budgeting process.

At this point of the discussion the following conclusion can be drawn: the budget implementation phase does not include activities directly connected to budgeting because there are no typical budgeting rules or procedures that would lend themselves to being applied during the “implementation phase.” However, the realization of the control management function, which is aligned with the budget monitoring phase, *does* take place in this “implementation phase,” forcing the utilization of entity’s resources (determined in budgets) and enabling the accomplishment of objectives (settled in budgets).

The scheme of control may be used as an argument for not including an implementation phase in the budgeting process. Control as a model of regulation consists of:

1. Setting a forecasted state.
2. Ascertainment of an actual state.
3. Comparison of actual and forecasted states and settling variances.
4. Deviation analysis.
5. Report [Steinmann, Schreyogg 2001, p. 252].

A similar representation of the budgeting process is presented in the “Budgeting Process,” proposed by J. Brammer and A. Penning, as shown in Figure 2.

Revisiting the issue of relating the stages of budgeting to the functions of management, an opinion from the study [*Budżetowanie... 2007*] is worth noting. To paraphrase M. Nowak, the organizing management function is concerned with integrating partial budgets into the main budget, allocating centres of responsibility in an entity, and dividing/assigning labour within centres of responsibility. Furthermore, according to M. Nowak [*Budżetowanie... 2007*, p. 16] “the basic aspect of organization in an enterprise, directly linked to budgeting, is an integrative role of budgeting based on combining an enterprise’s plans by integrating/merging particular (partial) budgets in an entity budget. Another significant element of organization is allocating centres of responsibility.” Based on this source, one of the elements of

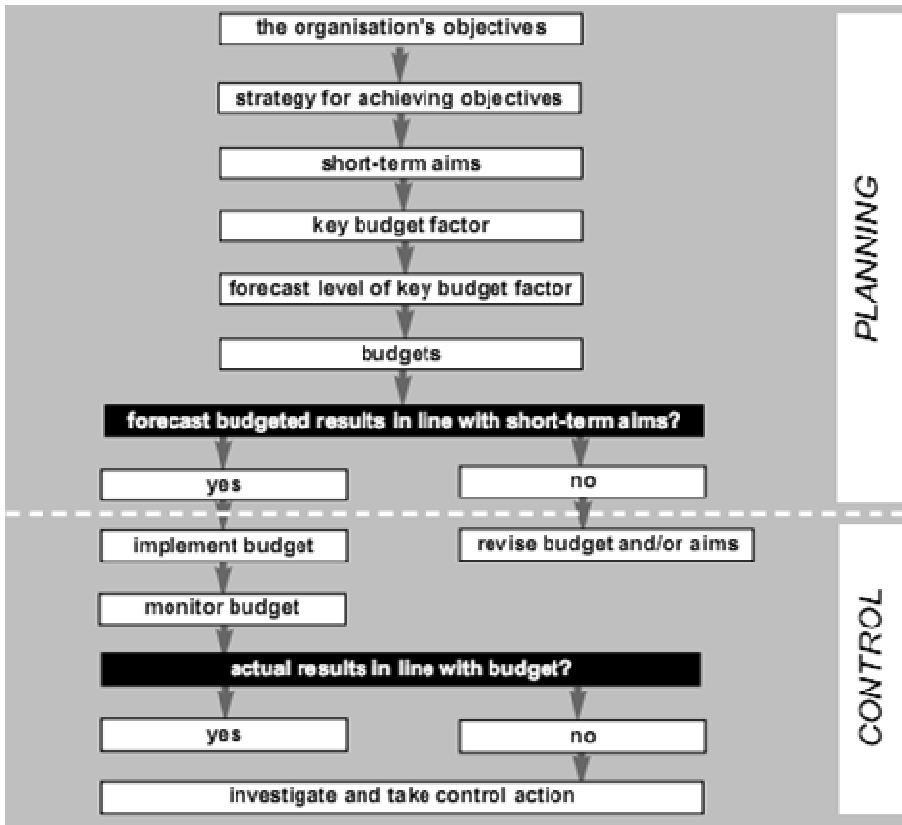


Figure 2. The Budgeting process

Source: J. Brammer, A. Penning, *Managing performance and resources tutorial*, Osborne Books, Worcester 2003, p. 336.

budgeting connected with the organizing management function is allocating centres of responsibility within an enterprise.

This begs the question: “Does allocating centres of responsibility directly support the organizing management function in the budgeting process?” Before trying to answer this question, it is worth discussing the role of decentralization of enterprise management in a budgeting system. The literature did not mention the necessity of decentralization for a budgeting system. The claim that decentralization of an economic entity is a prerequisite for a budgeting system was not encountered in the literature. It is commonly accepted that decentralization within an enterprise and the establishment of centres of responsibility are important, albeit non obligatory, elements of budgeting.

An analysis of the components of “main” budgets was performed to garner insight into the relationship between budgeting and decentralization. However, although many

of the referenced studies related main budgets to “partial budgets,” none of them related main budgets to centres of responsibilities (e.g., [Horngren et al. 2005]).

Due to a lack of premises regarding obligatory utilization of centres of responsibility, there is no basis for asserting that the budgeting function supports the organizing management function, as it relates to decentralization in every case. Budgeting is a frequently used tool that enables the implementation and evaluation of centres of responsibility, which is useful both in theory and in practice. Moreover, assuming that centres of responsibility are methodically connected to budgeting, it should be noted that allocation of centres of responsibility is used in the introductory phase of budgeting or in the course of its functioning, so it cannot constitute a phase of the process.

In concluding this section, there are no premises for stating that the stages of budgeting support the organizing management function in a direct way.

5. Monitoring of budget execution vs. control and motivation

Budgeting offers the broadest range of functional possibilities when used to support the control management function. Control, like planning, may operate at strategic and operational levels. Regardless of the operational level, the process of the control management function includes the following stages: assigning standards, measuring results, comparing results against standards, evaluating results, and reacting (maintaining status quo, variance corrections, alteration of standards) [Griffin 2000, p. 590].

Budgeting supports the last two management functions, especially the control function, along with the entire spectrum and time frame associated with these functions. Assigning standards is performed during the stage of making assumptions, which is a basic step in the creation of budgets. The measurement of results takes place outside of the budgeting system. However, during the measurement of results stage, data used for budget implementation is collected, mainly from the financial and accounting system and from other information systems. Comparison is a fundamental tenant of controlling, based on determination of variances between realization and standards. As highlighted at the beginning of this elaboration, there is no uniform view concerning the inclusion of the control management function into the budgeting process. However, there are monitoring activities, in isolated or non-isolated forms (as one of the phases of budgeting), mentioned in works of authors who advocate the use of budgeting mainly as a utility used for creating budgets. The last stage of the control management function involves analysis and reaction to variances, which is carried out in the control phase of budget execution.

To conclude the comparison, tasks performed in monitoring of budget execution include: settling variances of present or forecasted values in comparison to values set in a budget, identifying areas in which variances occur, identifying the causes of variances, identifying the staff responsible for occurring variances in ex post mode, examining the consequences of variances in various fields of an enterprise’s activities, and proposing actions to correct variances [*Budżetowanie...* 2007, p. 196]. As it can

be seen from this list of tasks, budgeting itself is one of the most important utilities supporting management functions.

Regarding the motivation function of management, it should be noted that the motivation function of budgeting is present not only during the stage of monitoring of the budget execution, but also during the stage of making assumptions for a budget. Managers who are responsible for a certain activities strive to alter performance measures in a way that enables them to achieve these measures with available resources. The stage of monitoring of the budget execution in which, inter alia, variances are calculated, allows the inclusion of motivating stimuli dependent on, inter alia, these variances. Analysing the influence of this phase of budgeting on motivation draws attention to certain features of budgeting that may contribute to the success of the motivation management function. Most of all, budgeting is a formal process that is generally known throughout the organization. Knowledge about the rules and guidelines of the motivating system, which becomes linked to the budgeting process, enables staff to concentrate on achieving objectives in a way that enables benefits to be maximized. This feature may be described as “defining the rules of the game.” Budgeting provides important information regarding the level of success at achieving fixed objectives which, in many cases, enables staff to gauge their own level of success. Moreover, budgeting is a tool that promotes delegation of responsibility, which fosters the use of motivation systems.

6. Conclusion

One objective of this paper is to explore how the budgeting process supports four functions of management. Using the prevailing definition of the budgeting process, with three distinct budgeting phases, it can be stated that:

- the budget creation phase has great importance with regard to the support of the planning management function,
- the monitoring of budget execution phase has great importance with regard to the support of the control management function,
- the budget creation phase and the budget monitoring phase have great importance with regard to the motivation management function.

With regard to the organizing management function, the budgeting process does not include any elements directly related to this management function. Furthermore, the assertion that the budget implementation phase is related to the organizing function, e.g., via allocating centres of responsibility, is not supported. Additionally, it has been conceded in this elaboration that activities in the budget implementation phase may be re-assigned to the monitoring of budget execution phase, due to the ex post nature of activities commonly associated with “implementation.” Furthermore, it seems plausible to condense the budgeting process down to two phases: the budget creation phase and the budget monitoring phase.

In the authors’ opinions, the results presented herein offer debatable conclusions and may constitute a contribution for further research.

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FUNKCJE ZARZĄDZANIA A PROCES BUDŻETOWANIA

Streszczenie: Niniejsze opracowanie porusza problematykę wspierania funkcji zarządzania przez fazy budżetowania. Przedstawia ono relacje faz tworzenia, realizacji oraz kontroli budżetów z funkcjami: planistyczną, organizacyjną, kontrolną i motywacyjną zarządzania. W efekcie rozważań ustalono, że funkcje planistyczna, kontrolna i motywacyjna są wspierane w sposób bezpośredni przez proces budżetowania. Natomiast funkcja organizacyjna nie ma bezpośrednich związków z budżetowaniem.