

## BUDGETING AND BUDGETARY CONTROL: A MECHANISM FOR MANAGERIAL EFFECTIVENESS

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### ABSTRACT

*The success of every organisation depends on the managers' effectiveness. In recent times, budgeting and budgetary control have become effective management tools in achieving organisations' objectives. Budgeting has stimulated future-oriented perspectives in planning decisions of managers. By looking to the future, managers are able to anticipate and use planning to correct potential problems before they arise. This will enable them to focus on exploiting opportunities instead of managing problems. It is the focus of this study to determine how budgeting and budgetary control help to achieve managerial effectiveness. Survey design was used in the study and data were generated by means of questionnaire to seventy-five management staff of selected manufacturing companies. Two hypotheses were formulated and tested using the Pearson chi-square statistics. The study found that there is relationship between budgetary control and managerial effectiveness. It also established that budgeting and budgetary control mechanisms do assist in achieving managerial objectives for an organisation. It is recommended that effective cost measures should be employed to achieve effectiveness and efficiency of operations.*

**Keywords: Budgeting, Budgetary control, Managerial effectiveness, Nigeria**

### 1. INTRODUCTION

Budgeting is an ancient practice which has been used for virtually all human activities. It has been used prominently in organised economic, social, and political systems, such that the role of budgeting in an organization cannot be ignored (Abogun and Fagbemi, 2011). Recent surveys show just how valuable budgets can be. Business owners and managers for instance need to budget for their resources, which may include everything from raw materials to human resources, in order to ensure adequate and profitable use of such resources. (Hornsgren *et al.*, 2008; Dugdale & Lyne, 2004; Anand *et al.*, 2004).

Budgeting is an effective management tool for business's success. It has transformed managers' perspective in problem solving from current challenges approach to future concern approach. By looking to the future, managers are able to anticipate and use planning to correct potential problems before they arise. This has enabled them to focus on exploiting opportunities instead of managing problems (Drury, 2008). Budgeting is the process of mobilizing, allocating, managing, and controlling resources towards achieving specific goals. If budgeting is not in place, spending would amount to waste of resources (Ariyo, 2015).

The formulation of budget and budgetary control are in response to the growth of world economies and increased trade among nations. The need to develop means of managing this emerging large organisations and industries more effectively necessitated the use of budgeting and budgetary control as management tools (Hornsgren *et al.*, 2008). When budgets are made, they represent the standard the organisation is required to uphold covering both the financial and non-financial aspects. However, most times, the purpose of preparing a budget is not achieved which eventually leads to business failure. They had a plan, they had a budget, but what went wrong? Why has budget and budgetary control failed to achieve its objectives.

In every organisation, controls are necessary to ensure proper planning, communication, feedback and most importantly that the targets set are met. Budgetary control refers to those parameters put in place to ensure that the budget is executed as planned. According to the Chartered Institute of Management Accountants (CIMA), budgetary control is defined as the establishment of budgets relating

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the responsibility of executives to the requirement of a policy and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy, or to provide a basis for its revision. Budgetary control system is part of corporate planning system which coordinates setting the objectives, preparation of plans and budgets, establishment of strategies, policies and monitoring of results and adjustments. Budget control cycle generally consists of five elements, which are budgets, measurement of actual, comparison, feedback and adjustment (Lucey, 2001).

The study is significant to managers and organizations as a whole. It would also serve as a guide to the entire budgeting process and control for achieving set targets. In addition, this study is expected to be of benefit to researchers and students of accounting. It would therefore serve as a reference point for future researchers. Therefore, it is expected that this study would awaken interest in the efficacy of budgeting within the manufacturing sector of the Nigerian economy as this sector often account for a substantial portion of total economic activities of a nation.

The study seeks to achieve the following objectives:

- i. To examine the relationship between budgetary control and managerial effectiveness, and
- ii. To verify if budgeting and budgetary control are mechanisms for achieving managerial objectives for an organisation.

## **II. LITERATURE REVIEW**

In spite of the rich endowment of resources, most countries in Africa have proven that availability of resources is not tantamount to sustainable development (Ariyo, 2017). Budgeting no doubt is a veritable tool for planning, controlling, coordinating, evaluating, directing, communicating and aiding decision making, but the whole process is not perfect altogether. For some years now, there has been movement against budgetary process (Hope and Fraser, 2001). As a result, budgeting has evolved leading to the development of techniques like: Activity based budgeting, performance budgeting; value budgeting, process reengineering; balanced score card, Zero based budgeting, IT based budgetary process, and planning programming budgeting system (PPBS).

Planning is an important tool in achieving set objectives for any organisation. Horngren, Foster and Datar (2002) defined planning as the establishment of objectives and the formulation of the policies, strategies, tactics required to achieve them while a budget is a plan of what the organisation is aiming to achieve and what target it has set. It is based on this premise that budget and budgetary control are seen as necessary tools for organisational planning and decision-making by managers. Budgets and budgetary control go together. Budgetary control is put in place to ensure a budget is effective.

Drury (2008) defined budget as a financial plan for implementing the various decisions that management has made. The budgets for all the various decisions are expressed in terms of cash outflows and inflows; sales revenues and expenses. The business dictionary defines budgetary control as a methodical control of an organisation's operation through established standards and targets regarding income and expenditure and a continuous monitoring and adjustment of performance against them.

CIMA's official terminology of management accounting defines budget as: "Quantitative statement for a defined period of time which may include planned revenues, assets, liabilities and cash flows. A budget provides a focus for the organization aids the coordination of activities and facilitates control."

Budget and budgetary control are therefore continuous processes that help in planning, coordinating and control of business decisions.

The main objectives are:

- i. It operates various cost centres and departments with efficiency and economy.
- ii. It centres on the control system
- iii. It is essential for the planning, control and also acts as the instrument of coordination.
- iv. It helps to eliminate wastes and raises the profitability position of the business enterprise.
- v. It helps in amending deviations from established standards.
- vi.

Babunaku (1998) emphasized that budgets are not primarily all about approving, rejecting, arguing over budget figures and limiting spending but a tool used by most business organizations to focus on company operation and finances. It serves as a control tool for managers for planning and control function and to highlight potential problems, not only for looking forward but also for looking backwards. Wherever the budgets are implemented, it provides the standards for evaluating and scoring the 'company player'.

Therefore, budgetary control coerces management to look into their efforts to outline plans for attaining objectives of department and operation and to predict and grant the company purpose and direction. It is a known fact that managerial performance and organisational performance are linked since the decisions that managers make will influence how well or otherwise the organisation would perform. It is for this reason that performance reports are carried out to spur investigations of exceptional items where actual amounts differ significantly from budgeted amounts for which operations are then made to conform with organisational goals.

Recent surveys show just how valuable budgets can be. Horngren *et al.*, (2008) reported that a study of more than 150 organizations in North America listed budgeting as the most frequently used cost management tools and it was also the tool with the highest value to the organization. Furthermore, they showed that study after study has shown the budget to be one of the most widely used and highest rated cost management tools for cost reduction and control.

Hornrgren *et al.*, (2008) also point out that the result of a survey carried out in the same place (North America) showed most managers still agree that budgeting, correctly used, has significant value to management. They reported that over 92% of the 150 companies in North America use budget and remarked budgeting as the top among the top three cost management tools. In the same view, in a round table discussions organized by CIMA and ICAEW in 2004 on "The traditional role of budgeting in organization", it is stated that budgeting and the accompanying process are indispensable and that, research in organizations seems to suggest that this is commonly held view.

### **Budgeting and Managerial Effectiveness**

Managerial effectiveness has been defined as the management's use of organisational resources and the meeting of the organisational goals (Certo, 2006). In every organisation there are goals set to be achieved and strategies to achieving them. Budget and budgetary control are twin tools in organisational planning. The company cannot run itself but will be run by managers. The question is how these managers can use these tools such that it achieves the set objectives and they (managers) can be seen as effective.

Every manager must therefore have the strategy in the forefront and be a strategic thinker based on a holistic view, focus on intent, thinking in real time, linking past, present and future which should be hypothesis driven and intelligently opportunistic. Tayles (1998) discovered that the most effective planning budget is that which is most probable. The budget level set for this purpose will not necessarily get the performance out of manager but it will rather create optimum motivation. Most times, budgets are generally understood from the cornerstone of management control and management control system. They are the multi purpose management tool supporting planning, control, coordination, communication, performance, evaluation and motivation. He also said that the use of budgets in evaluation and control is also influenced by the way they are used by the manager. Different management styles observed are:

- Budget constrained: placing considerable emphasis on meeting budget targets.
- Profit conscious: where a balanced view is taken between budget targets, long-term goals and general effectiveness.
- Non accounting: where accounting data is seen as relatively unimportant in the evaluation of subordinates.

The style adopted would affect the degree of interdependency between areas of responsibility with reference to responsibility centres. The functions the budget serves are the same as that of the managers; therefore, they are very relevant to every organisation. It therefore follows that participation in the budget process and discussions over how results are measured have benefits in terms of budget attitude and performance on budgets.

The traditional budgetary control is an example of feedback system where actual outcomes are compared to budgets while the budgetary process is the one of feed forward where expected outcomes

are compared with desired outcomes. In most companies these feedback and feed forward systems are not just adopted but are operated on processes which require periodic reforecast of likely outcomes in order to better manage their planning and control activities.

Tayles (1998) concluded by saying it was apparent that budgets serve various purposes and in some cases these purposes may be in conflict and have a consequent effect on management behaviour. These can be tensions and conflicts between budgets used for different purposes. For these conflicts management need to have some strategy and methods of dealing with this.

Also, is the fact that accountants are often criticized of spending more time on controlling rather than understanding the true nature of control in the enterprise. In the dynamic environment currently faced by most businesses, the budget is still an important information source. They should be aware of the cost of maintaining this planning and control system and set this against the benefits obtained, but as yet there is no evidence of wide use of any alternative approach.

### **Managerial Effectiveness in Budgeting**

From the reviewed literature, it can be deduced that the manager plays an important role to the budget process and implementation. The manager makes the decision using the tools at his/her disposal. One of these is the budgeting and budgetary control tool. The whole budget system is seen and understood from the management control system where the manager is able to perform well by effectively and efficiently using budget to achieve set objectives. Where this is achieved, the manager is said to have performed well and will be rewarded based on company policy (Hilton et al., 2006).

The participative style of budget is advocated. However, this would be of relevance where it is done with caution such that it does not create de-motivation and encourage budgetary slack in the bid to meeting targets. By setting controls, either in the feedback or feed forward mode, a better forecast of likely outcomes could be made in order to meet their planning and control activity.

Every organisation should have a budget. According to Tayles (1998), there is no evidence of any wide use of any alternative approach. In the light of this, it is very necessary that the budget is used effectively and appropriate controls put in place, by a strategic thinking manager to achieve targets which are realistic and cover a wide range of computational indices. In carrying out the managerial role, the manager should not just insist on control but also the proper understanding of the nature of control put in place and a good understanding of the dynamics of the work environment.

A system of management by exception is encouraged where there are wide deviations from the tolerance limit set for budgetary control. In other words, a good budget should be participatory, comprehensive, standardized, flexible and have a good feedback of analysis and costs. In conclusion, and in the words of Hopwood the most sophisticated budgetary system may be of little practical consequence if it fails to elicit the achievement and motivations of significant number of managers and employees (Khan and Jain, 1994).

### **III RESEARCH METHODOLOGY**

The survey method research design was adopted. For the purpose of this study, the list of manufacturing companies in Lagos State of Nigeria constitutes the population of the study. The choice of Lagos state was based on the distribution of manufacturing companies in Nigeria. The study was restricted to Lagos State as it harbours 60% of the Federation's total industrial investments and foreign trade and attracts 65% of Nigeria's commercial activities (Academy of Business Strategy, 2011).

According to Ajibolade (2008), over 55% of manufacturing companies had their head offices located in Lagos. Therefore, it is believed that the choice of Lagos is appropriate for this study. The choice of manufacturing sector for this study was based on the fact that, budgeting is most widely practiced in the manufacturing sector compared to other sectors.

Moreso, Wickramasinghe & Alawattage (2007), posited that the development of standard costing technique and budgeting is traceable to the manufacturing industries.

Few samples were selected from the population for the purpose of this study. This was as a result of the difficulties encountered by the researcher in obtaining an up to date list of manufacturing companies in Nigeria. Consequently, a convenience sampling technique was used. The adoption of this sampling method was based on the fact that the study did not use any sampling frame from which a random sample could be drawn.

The instrument used for data collection was the questionnaire. The use of questionnaire was considered appropriate since the data were generated from primary source. A five point Likert-scale was used in designing the questionnaire where respondents were asked to rate their opinion from two extremes, “Strongly disagree and strongly agree”. This was to give the respondents the latitude or wide ranging options from which to choose the one that best reflects their opinion. The nature of the data needed requires respondents to have the requisite knowledge and experience about the subject matter. Therefore, the target respondents for this study were management staff in each of the sampled companies. One hundred (100) copies of questionnaire were administered across the companies sampled but only seventy five (75) were retrieved constituting about 75% response rate. To test the research hypotheses, the pearson chi-square method of statistical analysis was used.

**IV DATA ANALYSIS**

The hypotheses formulated for this study were tested with the use of statistical package for social sciences. The statistical method employed was the pearson chi-square. It was tested with 5% level of significance.

**Hypothesis 1**

**H<sub>0</sub>:** There is no relationship between budgetary control and managerial effectiveness.

**H<sub>1</sub>:** There is relationship between budgetary control and managerial effectiveness.

**Table 4.1: TEST STATISTICS**

	RELATIONSHIP BETWEEN BUDGETARY CONTROL AND MANAGERIAL EFFECTIVENESS
Chi-Square	28.172 <sup>a</sup>
Df	16
Asymp. Sig.	.000

**Source:** Researcher’s fieldwork, 2017

The chi-square value is 28.172. Using the asymptomatic value of 0.000 which is lower than the 0.05 level of significance, the alternate hypothesis (H<sub>1</sub>) was accepted while the null hypothesis (H<sub>0</sub>) was rejected. It was concluded that there is relationship between budgetary control and managerial effectiveness.

**Hypothesis 2**

**H<sub>0</sub>:** Budgeting and budgetary control mechanisms do not assist in achieving managerial objectives for an organisation.

**H<sub>1</sub>:** Budgeting and budgetary control mechanisms do assist in achieving managerial objectives for an organisation.

**Table 4.2: TEST STATISTICS**

	BUDGETING AND BUDGETARY CONTROL MECHANISMS DO ASSIST IN ACHIEVING MANAGERIAL OBJECTIVES FOR AN ORGANISATION
Chi-Square	38.950 <sup>a</sup>
Df	16
Asymp. Sig.	0.01

**Source:** Researcher’s fieldwork, 2017

The chi-square value is 38.950. Using the asymptomatic value of 0.01 which is lower than the 0.05 level of significance, the alternate hypothesis (H<sub>1</sub>) was accepted while the null hypothesis (H<sub>0</sub>) was rejected. It was concluded that budgeting and budgetary control mechanisms do assist in achieving managerial objectives for an organisation.

## V. CONCLUSION

Budgets play a very important role in every organisation; budgetary control helps to ensure continuous monitoring and adjustment of performance against them. However, they should only serve as a guide or standard in organisational planning and not the main focus. Managers should be able to act more efficiently and effectively and ensure goal congruence by subordination of individual interest to organisational objectives for the benefits of all stakeholders. Every organisation should ensure good communication system exists within the organisational structure, encourage staff participation in strategy formulation, and have periodic performance evaluation and rewards without basically focusing on the figures being achieved but on other non-qualitative factors.

The following recommendations are suggested to enable managerial effectiveness for budgeting:

- i. Effective cost measures should be employed to achieve effectiveness and efficiency of operations.
- ii. Budgeting and budgetary control mechanisms should be constantly reviewed and updated in order to achieve managerial effectiveness.

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