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Effect of Financial Management on Budget and Budgeting Process

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Abstract: Financial management is same as the objective of a company that is to earn profit. But profit maximization cannot the sole objective of a company. It is a limited objective. If profits are given undue Importance then problems may arise as discussed below. The term profit is vague and it involves much more contradictions. Profit maximization has to be attempted with a realization of risks involved. A positive relationship exists between risk and profits. So both risk and profit objectives should be balanced. A budget is an approved plan of income and expenses for a workplan. A budget shows how much money is needed for each activity and task in the workplan.

Key words: *Financial Management, Budget, Budget Processing*

INTRODUCTION

In spite of years of harsh spending cuts and tax increases, Europe's debt problems are getting worse. Official figures showed that the total debt of the 17 countries that use the single currency at the end of the second quarter was worth 90 per cent of the value of the group's economy – the highest level since the euro was launched in 1999. According to Eurostat, five countries that use the euro are in recession- Greece, Spain, Italy, Portugal and Cyprus. Many analysts expect the eurozone to slip back into recession [1].

If we were to look at Malaysia for instance, there are two counter arguments. The recent 2013 Budget tabled by Prime Minister Datuk Seri Najib Razak on September 28, protests by some, as a budget that has no future because it is still stuck in the 'old framework' [2]. For example, all these years, the budget is more oriented towards awarding mega projects for economic growth and the distribution of resources is not fully emphasized such as increasing income and employment for the people. Therefore, it is not surprising to note that the ministry's 2011 graduate tracking study showed that about 40,000 graduates were unemployed. Twenty-one per cent of those who failed to get jobs were from the public institutions of higher learning, 27 per cent from private instituitions, 28 per cent from polytechnics and 35 per cent from community colleges. One should asks why this population failed to secure a job after spending thousands of dollars to study but should turn into 'entrepreneurs' to create more jobs? Have we solved the problem with an economic structure leading to this phenomenon?

In another argument, the 2013 Budget focus on improving the quality of life of the rakyat, ensuring sustainable economic growth, spending prudently and reducing the fiscal deficit with the overall objective of prioritising the well-being of the rakyat. The Government will ensure that the rakyat enjoys excellent services and obtains maximum benefits from the implementation of development projects and programmes. In combating the phenomenon of graduates who were unemployed, the Malaysian government is planning to introduce a programme and projects in lucrative industries, chaired by the Higher Education Ministry and Economic planning Unit of the Prime Minister's Department to ensure that at least 75 per cent of the 200,000 graduates passing out annually secure jobs within six months of graduation [3]. The 2013 Budget is, indeed designed based on the theme " Prospering the nation, enhancing well-being of the rakyat: a promise fulfilled". This shows that the government has both the ability and responsibility to take care of citizens – or at least a segment of citizens.

It is apparent that some did not understand even the rudiments of public finance and budgets. The above example explains that planning and implementing a budget for a government is not easy. It requires a complete information and expertise. Before we examine the effect of Financial Management on Budget and Budgeting Process, it is best to know what budgets are and what they are suppose to achieve.

2.0 DEFINITION OF A BUDGET

Budget is defined as "a plan of what government intends to do in a budget year and how it proposes

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to raise and use the resources for this purpose" [4]. Budgeting is the process of arriving at this plan. Such plan would include a set of objectives, program structure, revenue expenditure and performance estimates.

Goverments do not hold the answers for all the country's woes. Simply put, budgets are decisions on how to spend a relatively fixed amount of money in a fiscal year. That amount of money is the revenue it will receive in the coming year plus the deficit that it will run and therefore borrow. More of one expenditure item means less of another and it is all a matter of which priority exceeds another. And if the debt burden exceeds what is safe and sustainable, what is spent in one year will have to be taken back in the form of taxes and/ or expenditure cuts in another [5].

For example, several weaknesses were found in the management of public facilities by the Kota Baru Islamic City Municipal Council (MPKB) and Tumpat District Council (MDT). The Auditor-General's Report 2011 stated that state road maintainance works were found to be unsatisfactory despite receiving a yearly grant amounting to RM259.73 million from the Federal Government. A total of 14 out of 36 road resurfacing plans were not implemented and the quality of paving work was found to be unsatisfactory . Damages to the road surface and road shoulders were not repaired and the maintainance of road furniture were not carried out [6].

It captures that insufficient technical expertise and weak financial management as the main reason as to why the Kelantan state government came under fire for the unsatisfactory management that overall, a total of 62. 2 per cent and 47.6 per cent of respondents were not satisfied with the management of public facilities. The lack of understanding of having to make the best use of finite amount of public money from the Federal Government, which is, after all, economics and the effect of financial management is troubling. Budgets cannot solve all the long-standing problems of entrenched poverty and income mis-distribution. Budgetary allocations can help but they cannot solve all the problems of low-investment, efficiency, productivity and quality. Budgets are about decisions to make the best use of the finite amount of public resources in a given year and politics do play a part in these decisions; they are not the sum total in them.

Therefore, all government departments and agencies In Kelantan should learn from weaknesses pointed out by auditors so that incidents of poor financial performance that leads to losses are not repeated. If elements of efficiency, economic and effectiveness were instilled and practised in the management of public finances, the benefits from every sen spent would be tangibled. All heads of departments and agencies must give serious consideration and monitoring in matters involving finance and ensure that all rules and procedures are adhered to so that they are not criticised by the Audit Department [7].

In another argument, despite denials from petroleum royalties, the construction of highways, airports which are not granted international status, the port which has not been developed by the federal government, what is surprising is that the Kelantan government's achievements in terms of poverty reduction, the pace of economic growth and financial strength showed Kelantan state has successfully managed the Kelantan government for a period of 22 years ever since the general election in 1990 [8].

The effect of the financial management of the Kelantan state for instance can be seen in three categories namely Kelantan development theme of its administrative reform, raising the dignity of Islam and the well-being of the people. All can be summed up to 22 development programs which were well received by various parties, including Islamic tourism products. For example, Islamic tourism industry with Islamic products, mosques, Islamic studies in cottages, the opening of the Ramadan parishes each year.especially in the month of Ramadan. Such Programs have proven to be a positive impact on the advancement of the country's tourism industry to attract tourists, particularly Muslims from Arab countries to travel to Malaysia [8].

It is essential for such state to have an accountable stewardship in managing public expenditures, revenues and debts to reduce losses and improve the volume and quality of services in order to increase its revenues. Such benefits are important to a wide range of stakeholders, including taxpayers, recipients of public services, investors, businesses and citizens in general. Public financial accountability contributes to political accountability and transparency, to political legitimacy and even stability. Next the discussion will be focused on the effect of Budgeting Process.

3.0 BUDGETING PROCESS

Budget setting is a process, not a specific formula or technique. Thus, understanding the intricacies and the dynamics of the budgeting process is essential. Budgeting is an iterative cycle which moves between targets of desirable performance and estimates of feasible performance until there is a convergence of plan which is feasible and acceptable [9].

A forecast is a prediction of future events and their quantification is used for the purpose of planning. A forecast relates to events in the environment over which the business has either no control or limited control. Budgeting process also involves the issuance of guidelines by top management, interaction among various departments, strategy analysis, preparation of preliminary budgets, review by departmental/business unit heads, negotiation with top management, finalisation of each budget, preparation of the master budget and lastly, their approval by the top management.

The budget construction process will normally follow the organizational structure. The budgets process provides a system for coordinated planning among different functional areas [10][11]. Some organizations follow a top-down, or mandated approach. Others utilize a bottom-up budget is to be prepared.

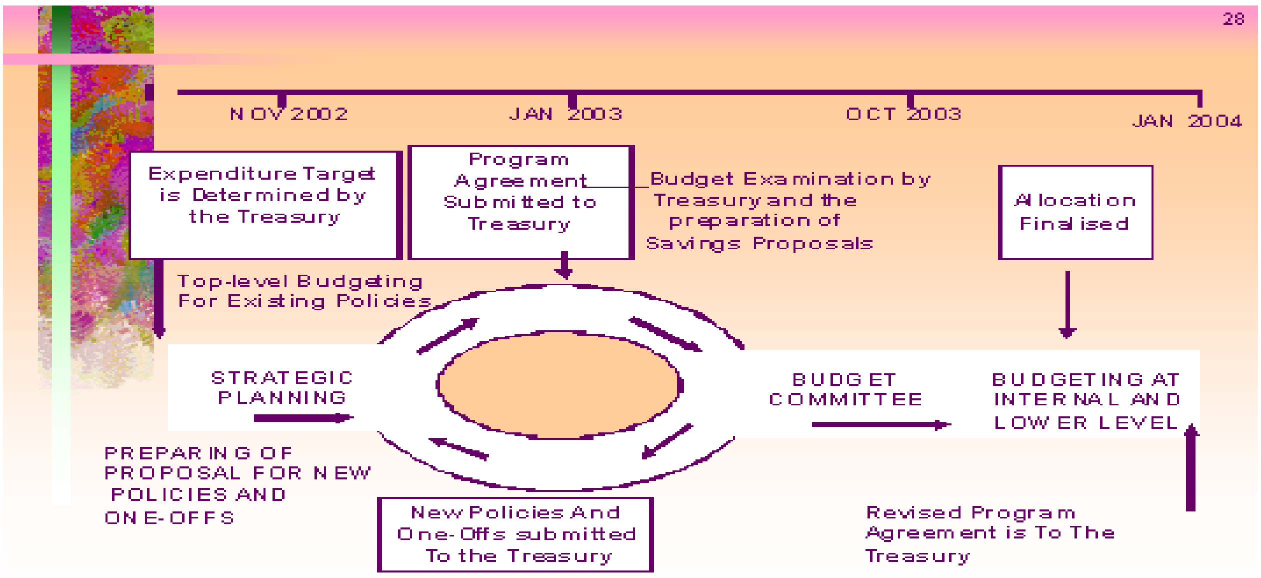
Lower-level managers have very little, if any, input into the determination of the budget amount and setting the overall goals of the organization. The lower-level units involvement in the process are essentially reduced to doing the basic budget calculations and adhering to the directives of top management.

One disadvantage of the top-down approach is that lower-level managers may view the budget as a dictatorial standard. Resentment can be fostered in such an environment. Further, such budgets can sometimes provide ethical challenges, as lower-level managers may find themselves put in a position of ever-reaching to attain unrealistic targets for their units. On the positive side, top-down budgets can set a tone for the organization. Top management can ensure that the budgets are aligned with the strategic plans. The budgeting process can be completed faster as less time is needed for budget administration.

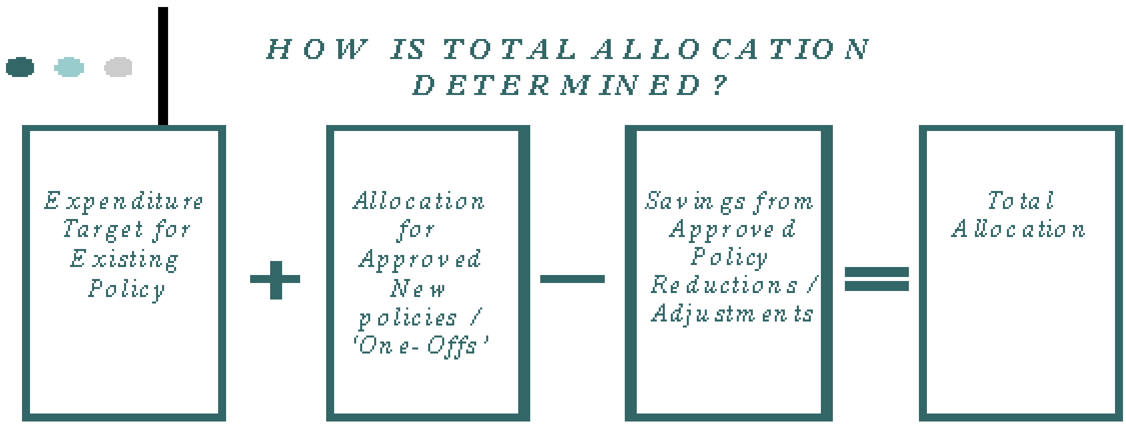
Bottom-up budgeting is also known as "Participatory Budget" mainly due to the nature and degree of lower-level managers' involvement in the formulation of budget. Top management may initiate the budget process with general budget guidelines, but essentially bottom-up budgeting begins at the operational level. The operational units drive the development of budgets for their units. These individual budgets are then grouped and regrouped to form a divisional budget with mid-level executives adding their input along the way. Eventually top management and the budget committee will receive the overall plan. The budget committee reviewed the budget components for consistency and coordination. This type of budgeting requires more time to move through the process and complete the budget, but ensures buy-in and commitment at all levels of the company.

Blended approach is a combination of top-down and bottom-up budget process whereby in this process, top management sets objectives for financial performance and submits these to operating managers, who then develop budgets based on these objectives. The budget is reviewed by top management and either approved, disapproved, or revised. The process may require several iterations of passing the budget back down the ladder for revision by operational units until a final budget is reached.

The blended approach to budgeting is also known as "Negotiated Budget". Negotiation in budgeting process will cause subordinates to behave more cooperatively. Thus, it follows that subordinates' will have less incentive to build slack in their budget target which they are trying to negotiate and are more committed in transforming the plans into actions once approved by the top management. Blended approach is best suited for a company with a certain amount of sophistication in preparing budgets.



4.0 THE EFFECT OF BUDGETING PROCESS



Source: Koshy Thomas Deputy Undersecretary Ministry of Finance, Malaysia

The above chart shows at the very start of the budget process, Treasury provides each Ministry with a single, specific, numerical target for expenditure from the operating budget for existing and minor new policy purposes. Submissions for existing policy proposals cannot exceed the Expenditure Target. A separate submission would be required for any proposed major policy changes and one-off expenditures, if any. Excluded from these targets are charged expenditures, one-offs and major new policy charges. Amongst the benefits derived from the implementation of the Expenditure Target are the explicit and immediate recognition of the Government's fiscal policy position at the operating ministry level and increased financial discipline on ministries by forcing them to decide priorities and trade-offs within an overall budget constraint.

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