Budgeting for Managers

With a focus on ethics

What are ethics? What comes to mind?

INTEGRITY

TRUST

ACCOUNTABILITY

TRANSPARENCY

FAIRNESS

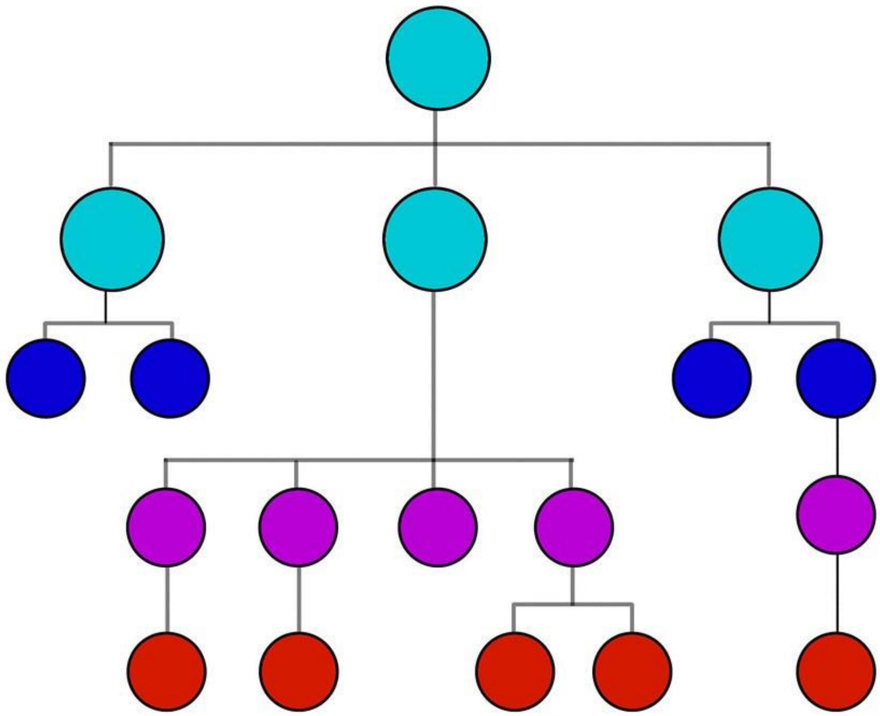
RESPECT

RULE OF LAW

VIABILITY

Precheck. What role do you foresee ethics playing in budget preparation?

What role do budgets play in an organization?



Essential question: Why does management prepare budgets and how do ethics play into the practice?

How does management budget: The planning & controlling cycle

1.) Planning

Goals and objectives are set.

When would this phase happen? What data does management need? Anything else that may influence this phase?

2.) Implementing

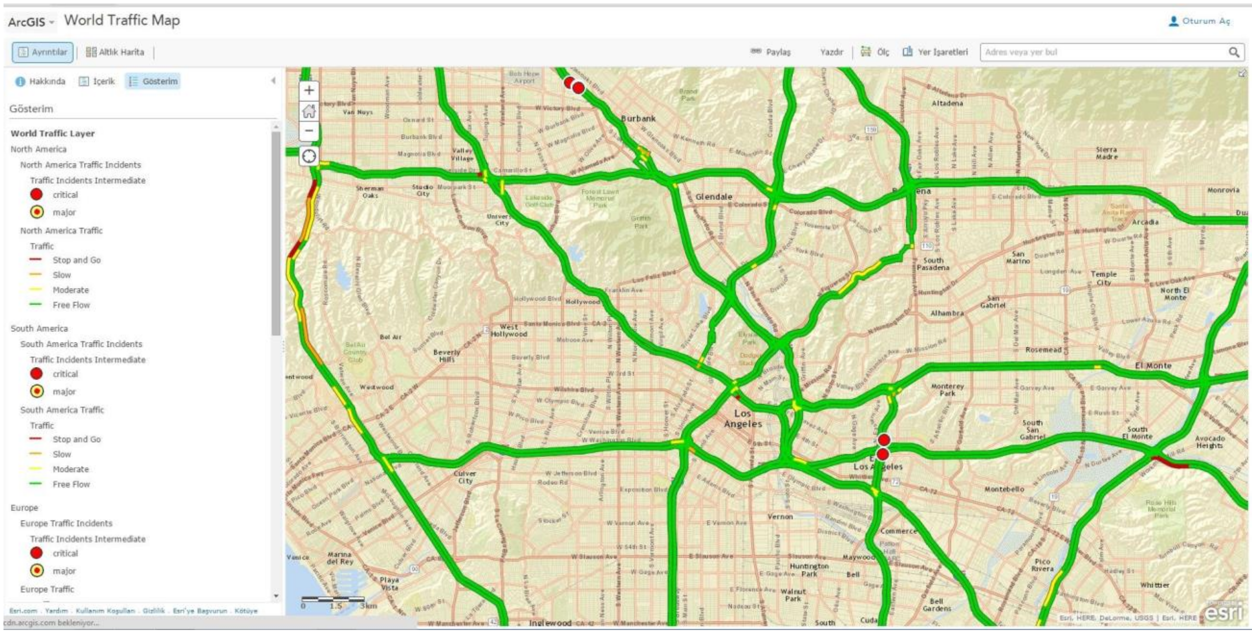
Goals and objectives are put to work.

3.) Controlling

Where the goals and objectives accomplished?

When would this phase happen? What data does management need? Anything else that may influence this phase?

Where it all starts: The planning phase



Recall that planning is the time when management communicates goals and objectives by way of a ***strategic plan****.*

Where does management want to see the organization in the long-term (5 - 10 years)?

How can those long-term goals be broken into short-term objectives (1 year)?

Now we know the planning phase is about translating a long-run strategic plan into bite-sized pieces.

How can this be done effectively? Any ethical implications? Who should be involved?

Let's say lower-level managers and employees are involved. We know that budgeting has a behavioral aspect--whether that's through motivation or response to the budget.

But, managers that are evaluated based on the budget (more on this later) and are incentivized to play games with the budget as a result. If given the opportunity, how can managers be incentivized to not *build in budgetary slack (a little extra cushion) into their budgets?*

What are some ethical implications of incorporating slack into the budget?

In practice: The implementation phase

Budgets help management know how to implement their plan in reality. That means buying materials (from who and how much), equipment, hiring labor (how many, at what rate, who's training them), etc.

*The **implementation phase** suggests management has a lot of work to do. But, think about those tasked with day-to-day actions according to the budget. Such employees like direct and indirect labor and factory foremen, supervisors, and managers. These boots-on-the-ground employees are expected to make management's plan (via the budget) reality.*

As we'll find out, those employees (specifically supervisors and managers) are generally evaluated on their performance against the budget.

That being said, is there involvement "owed" to production employees (e.g., direct/indirect labor, management) in the budgeting process?

Ethically, should managers have a say in how they will be evaluated? How much involvement?

Coch & French (1948)

An old, but interesting, example.

Coch & French (1948) tested employee involvement in production budget preparation at Harwood Manufacturing in Virginia.

Coch & French observed three different "interactions" between top management and production personnel during the drafting of a production budget.

Scheme # 1: Select employees participate with management

Scheme #2: All employees participate with management

Scheme #3: Usual company procedure (i.e., no employee participation) and informing production department of budgeting decisions.

Before getting to the results...

1. Which scheme do you think management would prefer? Why?

2. Which scheme do you think production personnel would prefer? Why?

3. How do ethics play into your answers from 1 and 2?

Scheme # 1 (select employees participate)

Coch & French (1948) observed no resignation in 40 days and slow production improvement.

Scheme #2 (all employees participate)

Coch & French (1948) observed no resignation and greatest productivity improvement.

Scheme #3 (no employee participation--regular procedure)

Coch & French (1948) measured a 17% resignation rate with significant deterioration in productivity.

1 - Are we surprised???

In reflection: The controlling phase

The controlling phase helps management take what did or did not work from the implementation and planning phases and work out the issues.

But, also, in terms of budgeting, the controlling phase help top management demonstrate a type of influence (i.e., control) over the organization. How is this done?

1. *Variance analysis*
2. *Update budgeting assumptions*
3. *Performance evaluation*

Let's talk about performance evaluation.

Performance evaluation & responsibility accounting

In decentralized *organizations, managers are given a segment of the organization to oversee. With this freedom, comes expectation and evaluation of how well the segment performed (either in terms of cost, revenue, or profit--essentially, what the manager can control).*

All of this happens in the controlling phase of budgeting. Remember, budgeting helps management accomplish its goals. So, taking the controlling phase seriously, and using performance evaluation and responsibility accounting, is an efficient way to keep the organization on track.

Segment managers and others should be motivated to accomplish goals set forth in the budget (and strategic plan!). But how?

Cash compensation like raises and bonuses

Stock-based compensation like shares and options

Noncash compensation like autonomy, better job title, better office, expense accounts, and other perks

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There are many things entry to top level managers and gain and lose through performance evaluation.

With that said, what are some steps that can be taken to make sure performance evaluation and the controlling phase are executed as ethically as possible?
