Task 12 Budgeting control and behavioral aspects

Controllable vs Uncontrollable costs

A controllable cost is a cost which can be influenced by the budget holder. There may well be costs which cannot be changed by the budget holder or by management within a given time period. These are uncontrollable costs. Responsibility accounting associates costs and revenues with the managers that can control them. It therefore distinguishes between controllable and uncontrollable costs.

Task 12 Budgeting control and behavioral aspects

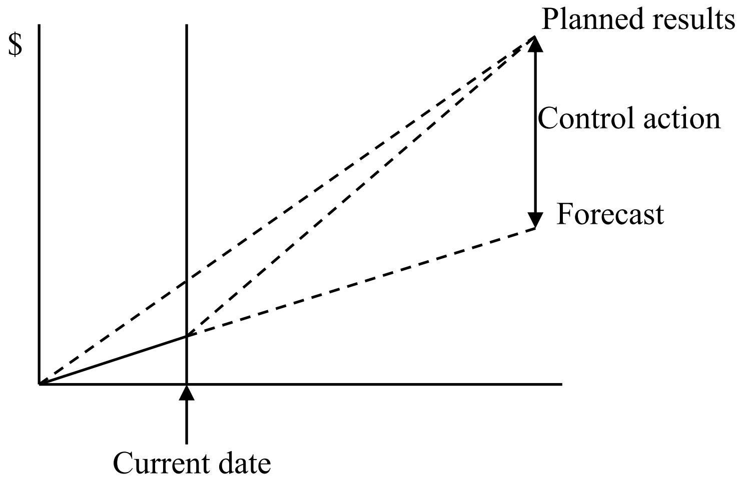
Control cycle-Feedback control

This flow of information through a system is known as the ‘feedback loop’.
A feedback system operates by comparing actual (historical) results against a standard or plan, and taking control action where differences between actual and plan have occurred.
Events in the past are used to take corrective action for the future.
Positive feedback indicates that results were better than planned. Control action may be taken to encourage the deviation from what was originally expected.
Negative feedback indicates worse results than planned. Control action aims to get back to the original plan.
Single loop feedback – for example if sales targets are not reached, control action will be taken to ensure the targets will be reached soon. But the plan is not changed.
Double loop feedback – for example if sales targets are not reached, the company may need to change the plan.

Task 12 Budgeting control and behavioral aspects

Control cycle-Feedforward control

Feed-forward control system is to compare budgeted results against a forecast. Control action is triggered by the differences between budgeted and forecasted results. It is different from a feedback system which compares the actual historical results with the budgeted results.



Task 12 Budgeting control and behavioral aspects

Conflicting objectives

✓ **Company versus division**

- Company objective is normally to maximize shareholders wealth. This usually involves the use of NPV but divisions are assessed on accounting targets. Eg, profit.
- Corporate objectives are looking at long term but division objectives are relatively short term targets.
- Division managers could reject a project that dilutes divisional performance.

✓ **Division versus division**

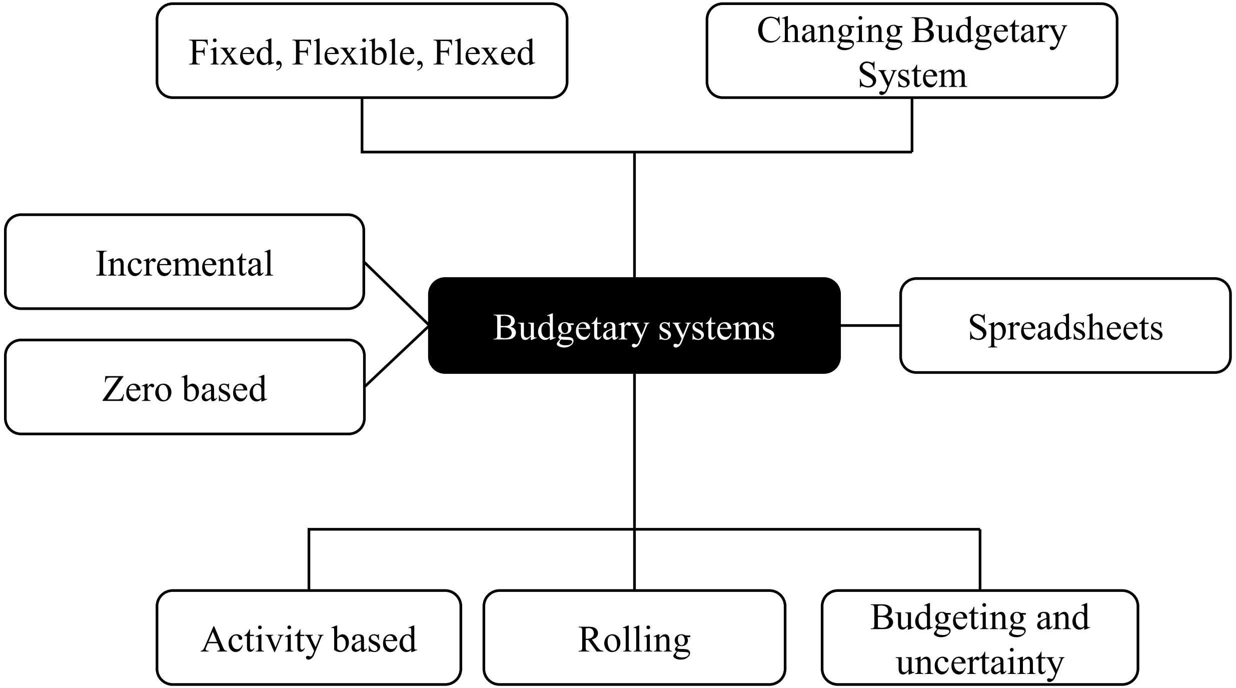
Divisions may compete for limited company financial resources when setting budgets.

✓ **Shortermism**

Managers may meet the short term targets by cutting R&D expenses.

Managers may reject projects purely because they are ‘slow starters’ even they have positive NPV.

Task 13 Budgeting systems



Task 13 Budgeting systems

Top down and bottom up budgeting

- **Top down budgeting approach** is a budget that is set by the top management without allowing the operating personnel to participate in the process.

- **Bottom up budgeting approach** is a budget that is set by the lower-level managers who then submit the budgets to their superiors. This approach provides the lower-level managers to participate in setting their own budgets.

Task 13 Budgeting systems

Advantage of bottom up	Disadvantage of bottom up
Increased motivation due to participation of the budget.	Senior managers may lose control.
Increased commitment from managers.	Dysfunctional behaviour occur when budgets are not in line with corporate objectives.
More detailed information used in budget setting process.	Process is slow.
	Managers may set easy targets for themselves.