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Planning and Budgeting: Past, Present, and Future

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The author traces the historical development of planning and budgeting with particular emphasis on program budgeting by municipalities. The article is adapted from a speech given to members of the American Society of Women Accountants in Oakbrook, Illinois.



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To budget, according to the dictionary, is "to plan in detail, schedule."¹ In this very simple sense, it can be said that the first budgeting venture took place about fifteen thousand years ago.² People, for all the prior time of their existence, had lived off the land. If game was plentiful and the hunters were successful, times were good. If grain was available, they ate. If neither game nor grain appeared before them, they starved. Then people realized that from the same grain they ate they could grow more grain if they planted what they did not need at the moment and they could control their food supply.

This was the first simple budgeting, or planning (or planting) for the future. People saw that by planning their present resources, they could place in store a better future. This is the substance of a budget even in today's sophisticated systems. Hence, it is not the substance of budgets and planning which has undergone transformations, but rather the theory and methodology.

The Traditional School

In the modern history of business, there was a strong development of scientific management theories. The traditional management theorist advocated effectiveness and efficiency in business above all else. This approach naturally made the budget an important tool.³ For the budget, as it was then defined, was a formal plan for coordinating operations, used for measurement and control of the productive process. It is this view that most people have been educated in.

There are different types of budgets; e.g., fixed or flexible. A flexible budget can be a formula budget or a step budget.

Fixed budgets are "one-column" plans based on a certain set of assumptions with no variation allowed for in those assumptions. Variable budgets are actually a series of fixed budgets based on differing assumptions, such as varying sales volumes. The formula budget allows development of a complete budget based on any actual value (e.g., actual sales) to

which the remainder of the budget is related by formulas. The step budget is actually a series of pre-determined fixed budgets for different levels or ranges of activity.

Budgets can be applied to different areas — by company or division or department. And they even have different uses. They can be capital expenditure budgets or operating budgets and they can be used for forecasting or control. The control can be of costs or of revenues.

There are also certain recognized procedures in budgeting. For example, in capital budgeting the popular format is the following:

- Searching — for projects
- Screening — for unwanted projects
- Coordinating — The remaining possibilities must fit into the company's goals.
- Formulating — Exactly what does the project involve?
- Evaluating — Which (of the remaining projects) is best?

Budgeting — Putting the figures on paper (in detail).

Requesting authority for the expenditure

Process controlling — During the project, how is it progressing as compared to expectations, i.e., the budget?

Follow-up or post-completion audit — What went right and what went wrong and what should be changed next time?

In establishing operating budgets some of these steps are eliminated or combined, but the important ones remain, if under different names:

Establishing objectives — This is not necessarily a profit figure.

Formalizing — Again, getting the figures on paper.

Measuring — Making comparisons during the period under control.

Correcting — What is right, wrong, or what will be changed next time.

This is all very basic to budgeting and is presented as a very brief refresher in the subject. Now let us look at the transformations that have taken place.

One thing that is changing is terminology. Today there is a difference between budgeting and planning. Budgeting is normally used in the context of the short-range detailed statement. Of course, exactly how detailed depends on the level of the company being dealt with. But down on the bottom of that stack of budgets there will usually be a very detailed departmental budget. Planning has taken on the connotation of the long-range budget; the less detailed, more flexible "where do we want to be in five years" type of approach.

The Behavioral School

In the early 1950's the behavioral (or human relations) school of management theory came to the forefront. The behavioralists viewed the organization as a social system and saw the entity as the individual actions of the members. In this theory the responsibility of management was to choose the resource arrangements that would evoke a system of cooperative relationships. Goals could be obtained only when an internal social equilibrium was reached, unproductive conflict was eliminated and cooperation reigned supreme.⁴ Obviously, this was in direct conflict with the traditionalists' work-orientated view.

The budgetary process naturally was

foreign to this school since it failed to consider personalities and imposed a thing-oriented restraint on human activity. Partly because of the incompleteness of its "body of knowledge" and partly because of a short-sightedness in its perspective, this school died within its own decade.

The Quantitative School

But since this is the scientific approach to management — and scientists know that nature abhors a vacuum — it is easy to see that another school of thought would rise quickly in its place. And that was the quantitative school.

The speed of the computer set the stage for management theorists influenced strongly by mathematics, statistics and econometrics. And therewith the budget became the primary tool of management. Attention is directed toward selecting a strategy that will permit the firm to achieve its goals within an industry characterized by competition. The manager identifies courses of action, considers the probabilities and develops the strategy. Management has become "gamesmanship."⁵

Financial Models

Among the innovations is the financial model — or a representation of a company based on a set of assumed conditions. The model is used to perform computations and make projections. It transfers the routine clerical aspects of planning from the planner to the computer. This frees the planner to concentrate on the more creative aspects of planning. The use of a model makes it possible, even in long-range planning, to:

- a) Recognize significant interrelationships;
- b) Consider all reasonable alternatives; and
- c) Determine the full financial effect of each alternative; —all with the speed of a computer.

This has also led to the "what if" approach to budgeting. The annual plan is satisfactory in terms of the company's long-range outlook, but what can be done to improve it? What if a second shift is added? What if there is a wage rate increase? These questions are much narrower in scope than those suggested in long-range or less detailed budgeting or planning. But with the sophistication of the computer model the implications can be evaluated.

PPBS

This period has also seen the develop-

ment of PPBS — the planning, programming, and budgeting system.

Already, the theoreticians are looking ahead to the next school while many accountants are still learning about PPBS. But it is a commonly held belief by those familiar with this system that the real day of PPBS is yet to come.

But what is it really? And why are the management people getting excited about it? Strangely, this relatively new theory has found a home in a highly bureaucratic area — that of municipal finance. The little town (or for that matter the big city) normally so slow to change has adopted PPBS. Since municipal budgets affect everybody and since the financial plight of cities and towns is making the headlines every day, it makes sense to take a closer look at the working process of planning, programming and budgeting systems.

Each department in a local government exists either to produce a service that meets a community need or to assist other departments to provide that service. For example, the water department supplies water for a town's residents. The controller's office, by producing the monthly bills, supports this function.

Program budgeting operates on the premise that, because departments operate to achieve certain purposes, by clearly establishing these purposes an operating unit can improve both the use of resources and a program's effectiveness. At the same time, it will provide the community with a clearer understanding of the departmental program and the financial resources needed for its support.

The program budgeting process begins by requiring a department to identify each program or activity that it conducts and the community need that it serves. Typically, this process may reveal a program without a purpose, an area of need without a program, and areas served by several programs. Next, the department, assisted by community feedback, develops budget guidelines which establish areas of priority in the coming year. They will also highlight any important external assumptions or constraints. The department then examines its programs in terms of how well they are achieving the purposes while remaining within the specified guidelines. If improvements are indicated, an assessment of the benefits to the community from making these changes, as well as short and long-range cost implications, is made.

Finally an estimate of the resources needed to operate each program over the next several years is developed. The department then compiles these data into a

program budget format which includes the purpose of each program, a description of the services performed, the benefits and costs of any program changes requested, and the multiyear costs.

From this stage forward, the budget process itself remains unchanged, but the content has clearly changed. Boards and budget review committees can concentrate their efforts on evaluating the total benefit of a department's services versus the cost required to provide these services. Moreover, if faced with a requirement to contain costs, the departments are able to assess for a committee the impact of such an action on the level of services offered.⁶

Of course this is not a "cure-all" that will result in all governmental units running more effectively. Like any other system, the controls still have to be in force. And it won't completely replace the line-item budget either, if only because (for now at least) most state statutes require this method of budgeting. But it does have definite benefits.

First, for the government units that must monitor and review operating departments, program budgeting provides a better understanding of what each department is trying to do. Moreover, because it lays out the purposes, anticipated costs, and outputs of each program within the department, it makes it possible to compare the costs and the benefits of the various activities. Such information facilitates the tasks of choosing priorities, assessing the impact of required budget cuts, and developing overall budget recommendations.

Decision-making is further improved by providing, through the multiyear financial plans, an estimate of the longterm implications of new programs or program changes.

At the operating level, the process redirects administrative attention toward program output and the control and quality of services. Because traditional budget methods emphasize the control of expenditures and the use of inputs, the purposes of activities were easily lost sight of. Finally, the program budgeting process helps managers identify areas where needs are not being met, where services are duplicated, or where services are available but not recognized by the community. Because the departments are required to state their objectives, a basis for departmental accountability is created.

For the citizens, who ultimately bear the cost burden for the services, program budgeting offers a clearer picture of what the tax dollar is buying, and it provides

opportunity for the community to express its needs and desires to the various departments prior to and during the budget process. Only too often does the traditional system of budgeting entail simply adding a "reasonable" increase to last year's budget in order to arrive at this year's budget request, thus usually failing to determine in any formal way whether the services are still needed or whether improvements are required.

Those who have worked with PPBS say that they have found only one disadvantage — it is hard work! They also offer three suggestions to those who want to adopt PPBS:

1. Start small with a few departments at a time. Since the line-item budget still has to be prepared (though it is relatively easy to derive from the PPBS figures), the town would find itself preparing two complete budgets. And in that first year of "Does anybody here know what is happening?" the methodology of the new system is bound to suffer. And if that happens, it won't work; and if it doesn't work, it will probably be discarded without being given adequate opportunity to prove itself.
2. Be sure the departments do their own budgeting. Part of the purpose is to make them more aware of the services they are providing as well as to inform the city managers and the citizens as to what the department is actually doing — as opposed to what it thinks it is doing — or as opposed to what it is supposed to be doing!
3. Expect results in the first year. This may seem rather like asking for trouble; but if there are no results, something isn't being done right. Expect programs, outlays and the quality and reasonability of services to be questioned. And expect to make changes in the following year. If the system was perfect now, there would be no need for PPBS.

The Structural School

While practicing accountants are contemplating new approaches to municipal budgeting, what are the theorists doing? They are predicting the demise of the quantitative school and looking forward to the new breed of manager — the structuralist.

The structuralists assume an eclectic posture regarding the role of the administrator. They aim to integrate the previous schools into a coherent body of management theory. They recognize the dilemma between the needs of the entity and those

of the individual but, at the same time, they accept the conflict for its contribution to the viability of the entity (and don't try to serve one need to the entire exclusion of the others, as do the traditionalists or the behavioralists).

The structuralists believe that, since the task of the administrator is to build an organization that will have the capacity to respond to the changing environment, the administrator must combine the physical and human resources of a firm into a viable unit capable of reacting to the pressures of change.⁷

Where does the budget fit into this theory? It doesn't (yet), at least not as previously defined. But the plan does.

The financial plan is now a strategic course of action. It is charted by top management and has (preferably) survived a rigorous screening process of computerized simulation models and it maximizes resource allocation. It is not expected to reflect change, but is considered an aggressive charter that forces change.

Though it will probably be some eight to ten years before the main body of structural theory is adopted by management in general, it has a good chance of seeing fulfillment. One reason is the increase in younger managers who have been exposed to it and are now in policy-influencing if not policy-making positions. Another reason is the increased emphasis on continuing education which will certainly bring the theory home to accountants past college age.

The above synopsis of planning and budgeting has shown that the theory and methodology of budgeting have changed, are changing, and will continue to change. In the present economic situation it is especially important that resources be used as effectively and efficiently as possible. Budgeting and planning can help to attain these objectives, and accountants have a very important role to play in this process.

NOTES

¹Webster's *New World Dictionary of the American Language*. New York: The World Publishing Company, 1970.

²P. A. May. "The Budgeting Process." *Management Accounting*, January, 1973.

³D. A. Drinkwater. "Management Theory and the Budgeting Process." *Management Accounting*, June, 1973.

⁴Ibid.

⁵Ibid.

⁶H. I. Steinberg and J. D. Carney. "Program Budgeting for Towns and Villages". *Management Controls*, May, 1973.

⁷Drinkwater, *op. cit.*