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Cash Budgetan Imperative Element of Effective Financial Management

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Abstract

A firm's life highly depends on the availability of funds to meet impending obligations as well as efficient employment of excess funds so as to minimize wastages. This paper focuses on cash budgets as a tool that every financial manager should use in ensuring availability as well as effective utilization of cash. Whilst excess liquidity communicates a mangers lack of investment innovativeness, lack of funds to meet short term obligations could also depict a manager's inability to plan on where and when to get adequate funds for business activities at a lower cost in the short term. Another area of interest in the paper is the role of effective financial management in any organization. Nevertheless, the paper concludes that cash budget preparations enable managers to identify possible future liquidity challenges and at the same time creates a platform for addressing such challenges.

Key words: Cash budgets; Effective financial management; Liquidity, Cash flow; Receipts; Payments

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1. INTRODUCTION

A cash budget is a great tool in the hands of financial managers to alert management on future problems due to cash shortages or to the opportunities provided by cash surpluses. ACCA (2012) emphasises that cash budget summarizes a firm's expected cash inflows and outflows over a period of time. By using the expected collection patterns and the planned cash receipts and payments for various expenditures, the cash budget provides the expected cash deficits and surpluses (Marfo-Yiadom, Asante & Darkwa, 2008). On the contrary, even though financial managers recognize the essence of cash budgeting, several organizations underutilize this resourceful management tool especially in not-for-profit making organizations (Hauser, Edwards and Edwards, 1991). Even those who recognize the need for its preparations find it quite difficult in implementing what is on paper (Schmidt, 2013). With regards to its preparations and implementations, Walther (2013, p.1) states that "The process of budget preparation is sometimes seen as painful, and it is not always clear how the effort that is required leads to any productive output". Furthermore, the author explains that budgets can be regarded as imposing barriers that are challenging to manage and establishing goals that are hard to meet. Thus, those smaller firms with fewer sources of revenue and fewer items of expenditure may not experience much challenges. However, as far as multi-national corporations are concerned, it is a hideous task. Schmidt (2013) again explains that this is due to the complexities in the process of making forecast for each source of receipt and payment in the mist of uncertainties surrounding the business environment. Consequently, in spite of these numerous opposing remarks, it is imperative that organizations carefully plan their financial affairs to achieve expected financial targets (Onuoha & Amponsah, 2012). These plans are generally expressed as budgets of which cash budget is rated in this paper as most vital of all and serves as an imperative tool for effective financial management. This is because Olajide and associates (2013) suggests that the cash budget is prepared to incorporate all the functional budgets and the capital expenditure budget.

The impact of how good or bad a cash is managed have disastrous repercussions on operating activities (Olajide & associates, 2013). It therefore doesn't come as a surprise when Roth (2008) summarizes it all by asserting that the most essential thing that organisations can do with their money is to budget for it.

Riley (2012) clarifies that as part of financial management process, it is necessary that management makes available sufficient funding at the appropriate time to meet the needs of their organisations. He further puts it that in the short term, funding may be needed to invest in non-current assets as well as to meet capital requirements of any organizations. As such the cash budget which clearly outlines the sources, timing and value of impending cash flow becomes an indispensable tool in financial management process.

This paper goes a step further beyond the review of how cash budgets are prepared in institutions, and attempts to bring to bear the essence of cash budget implementation as a crucial and indispensable process that fosters the strength of financial management in any organization be it profit or non-profit.

1.1 Significance of the Study

All organizations no matter the type or size need to properly develop a plan for the expected cash intake or expenditure in order to meet their financial goals and objectives. By preparing and implementing a cash budget, an organization is able to determine its short term credit needs as well as ability to meet short term obligations as and when they fall due. Also it predicts likely cash excesses for which management can plan in advance as to how to employ such resources. Since inefficient management of business funds negatively influence shareholders' value, the need to know the expected amounts of cash receipts and payments is critical in enhancing proper financial management. Consequently, the issue of cash budget cannot be overlooked by any financial manager in any organization and this forms the main contribution of this study.

1.2 Objectives of the Study

The overall objective of this paper is to emphasize on the role that cash budget plays in financial management. The general objective could be achieved by the following subservient objectives:

i. To establish cash budget as a superior tool for effective financial management.

ii. To single out cash budgeting as crucial for any financial manager willing to be outstanding.

iii. To recommend best practices that will enhance cash budgeting and its execution by financial managers.

2. RESEARCH METHODOLOGY

The research was both qualitative and descriptive. The study sought to provide in-depth information about cash budget as an effective managerial tool from different angles. Data was collected based on desk research. This involved secondary sources of data comprising of published and unpublished books, World Wide Web, journal articles, Association of Certified Chartered Accountants (ACCA) and Chartered Institute of Management Accountants (CIMA) websites amongst others.

3. LITERATURE REVIEW

This section of the paper concentrates on the definition of cash budget, the role of cash budget in financial management, the concept of effective financial management and finally, the role of cash budget in effective financial management.

3.1 Financial Management Defined

Financial management is an integral part of overall management. It is concerned with the duties of financial managers in the business firm. Interestingly there is no single definition of financial management, b below are some selected definitions of financial management budget:

Brealey (2011, p.1) "Financial management is the process of putting the available funds to the best advantage from the long term point of view of business objectives. It could be argued that the above definitions have short comings since the authors ignore the aspects of financial management that places premium on the acquisition of funds as part of financial management core functions. Therefore, Josheph and Massie (2009, p.1) insist that financial management "is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations. Another author who also considers the acquisition of funds as part of financial management is Maheshwari (2011, p.1). He defines financial management as being "concerned with raising financial resources and their effective utilization towards achieving the organizational goals".

The latter definitions Josheph and Massie, (2009); Maheshwari (2011) suggest that meanings of effective financial management revolve around how effectively and efficiently an organization's funds are utilized to create wealth for investors and cash budget plays a vital role in fulfilling this objective.

3.2 The Role of Financial Effective Management in Organizations

The business goal can be achieved only with the help of effective management of finance. The roles of financial management amongst others according to

Ciuhureanu, Balteş and Brezai, (2009) asserts that financial management carries out the following roles:

i. to ensure efficient usage of funds in all units of an organisation;

ii. to evaluate the financial implications of decisions made by management;

iii. to monitor organizations' financial performance so as to minimize deviations from budgeted performance;

iv.to determine to keep track on items of expenditure for which cash of an organization is used for;

v. to foster and maintain financial stability based on company's cash flow;

vi. to establish optimum capital structure as well as their sources of funding at the lowest cost and at their appropriate time.

3.3 Cash Budget Defined

ACCA (2012) emphasizes that a company needs to produce a cash budget in order to guarantee that there is sufficient cash within the business to achieve the operational levels set by the functional budgets. This makes cash budgets not just an imperative financial management apparatus but supreme to all functional budgets necessary for effective financial management. This is because funds are first and foremost required before any budget can be executed.

CIMA (2008, p.7) officially describes a cash budget as 'A detailed budget of estimated inflows and outflows incorporating both revenue and capital items'. In another definition, Riley (2012, p.1) extends this definition by adding the expected outcome of a cash budget. The author defines Cash budget as "a financial budget prepared to calculate the budgeted cash inflows and outflows during a period and the budgeted cash balance at the end of the period". From the definitions above, it could be inferred that cash budget is a financial plan that summarizes estimated receipts and payments over a given period of time. It is prepared by comparing receipts at the end of each month to payments and the difference being the closing balance for the month in question. This closing balance then is rolled forward to be the opening balance for the month subsequent to the month in question. Walther (2013) concisely puts it that by creating a cash budget you can project your sources and applications of funds for the forthcoming periods.

3.4 The Role of Cash Budget in Effective Financial Management

Critics of cash budget argue that it may not be necessary where a company's immediate and future cash requirement is not in danger, or where bank loan or overdraft facilities are available in case there is a liquidity crisis. The same is true of a situation where a substantial part of a company's business is done on credit basis, or where there are avenues for immediate deployment of cash, profitably. Notwithstanding this, it could be argued cash budgeting may be used for purposes other than those noted above. Free MBA Resources (2008) outlines the significance of cash budget to organizations as follows:

i. Cash budget enables efficient planning and utilization of cash. This is done by identifying in advance deficits and surpluses and providing alternatives as to how to resolve the identified challenges.

ii. Predicting future cash requirement of an organisation. It, thus, helps planning as to how and when to acquire funds at the lowest cost of capital

iii. Cash budget helps to maintain adequate cash balance to meet impending obligations and contingencies.

iv. It serves as a device for controlling cost at departmental levels and units.

v. It is a means by which the performance of departments can be measured. Thus the expected cash flow would be compared with actuals.

vi. It is a platform for measuring the impact of a proposed project of firms' cash flow and its implications on organizational success.

vii. Based on the liquidity level of a firm, cash budget determines the policy firms should adopt with regard to dividend payments.

viii. It co-ordinates the various financial functions of the organization, thereby enhancing financial planning as to how and when funds should be acquired.

Based on the above roles of cash budget, it is obviously direct in line with the functions of financial management. Thus, an organization will identify ahead of time, any cash deficit for the periods in question so as to take corrective actions now to assuage the deficit. This may involve shifting the timing of certain transactions. It may also determine when funds will be borrowed. In situations where borrowing is involved, the amount to be borrowed will also be known as deficit on the cash budget. This constitutes the core mandate of financial management. Consequently, cash budget becomes a paramount tool for financial managers. .

Onuoha and Amponsah (2012) insist that a major function of financial management includes identifying the sources of funds, making the funds available at the right time and in the right quantity, and ensuring that the cost of funds, where borrowing comes in, is reasonable and match the various tenor needs. This implies that as financial managers go about their fund control responsibilities, it is a crucial requirement for taking intelligent decisions so as to ensure that funds that would be needed for future operations would be available as and when the need arises. Effective planning establishes the use of cash projections to identify the areas of challenges and availing provisions for correction before the period is due. Jayeola, Adebayo and Oluwafemi (2011, p.93) emphatically states that "corporate organizations lay strong emphasis on cash management because cash shortage disrupts company's operations and corporate goals, while excess cash remains idle without contributing anything, in terms of returns, to the profitability level of the company". Consequently, they conclude that a primary role of the finance manager is ensuring that there exists parity. This is definitely what cash budget seeks to achieve in financial management thus informing management as to how to employ excess cash for good returns as well as identifying in advance deficits for remedies to be taken.

CONCLUSION

This paper endeavors to highlight on what cash budget is, and tries to establish how cash budget plays a critical role in financial management. The paper emphasises that the starting point for improving financial performance is a budget and should reflect sources and application of funds. Since money is said to be the blood of every business, and it determines the survival or otherwise of an organization, a key challenge of running a business is being able to make sound financial decisions. Without cash budget it is difficult for the finance manager of a business to be proactive and as a consequence may tend to react to financing and investing situations, which is often too late. This often leads to sourcing for funds at a higher cost or hastily investing in not well assessed project which at the end may be unprofitable. A well prepared cash budget ensures the availability of optimum amount of funds to support business activities as well as the employment of excess funds for good returns. Furthermore a cash budget ensures that an organization keeps its expenditure in line with planned cash outflows. The paper emphasises that even though the preparation of cash budget may be quite cumbersome, it is of much benefit to any organization that employs it.

RECOMMENDATIONS

Based on the presentations in this paper, the following recommendations are proposed:

There should be a budget committee who would be responsible for the preparations of the cash budget and other functional budgets. This should comprise of the managing director and all functional managers of the organization with the finance manager as the principal budget officer.

All departments and units of the organization should be involved in the annual preparations and implementations of cash budget no matter the type, size or nature of the organization.

Proper budgetary control should be in place to ensure smooth execution of the cash budget. This can be done by delegating senior officers of the accounts department to continuously monitor and review the implementation process.

There should be well established sources of funds to finance identified cash budget deficits as well as proper laid down investment plans to channel excess funds. This should be continuously reviewed alongside the implementation process.

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