CHALLENGES OF OPERATIONAL BUDGETING AT THE MINISTRY OF FINANCE IN KENYA

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DECLARATION

This research project is my original work and has not been presented for a degree in any other University.

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This research project is submitted for examination with my approval as University of Nairobi Supervisor.

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DEDICATION.

To all Kenyans who live at the bottom of pyramid and who depend on the policies adopted by the Ministry of Finance.

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Many thanks to the Almighty God for seeing me through the entire period; I live for you God.

Special thanks to my family for their encouragement and support during this entire period. My loving parents for setting a strong foundation for education at my early age and whose encouragement has been my source of inspiration.

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ABSTRACT

A budget can act as a motivator and communicator, as well as for functional co-ordination and performance evaluation (Dominiak and Louderback, 1988) of an organization. This study aimed at ' investigating various challenges of operational budget at the Ministry of Finance.

The population of interest of this study was the Ministry of Finance in Kenya. There were twelve(12) departments within the Ministry which includes; budgetary supplies, external resources, accountant general, information technology services, pensions, economic affairs, monopolies and prices commission, debt management, government investment, internal audit, government clearance agency, and administration. Questionnaires were designed to identify the challenges that are faced in the formulation of operational budgets by Ministry of Finance in Kenya. Descriptive statistics were used to summarize the data. This included percentages and frequencies. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis.

The study concludes that members of the different departments and areas were included in the budget committee and these included accounts managers, procurement managers and all heads of departments. In addition, the study also concludes that the Ministry of Finance faces many challenges in the implementation of operational budget .The challenges included lack of technology, inflexibility and political changes.

The study recommends that political leaders should not be allowed to interfere with the operation o operation budgeting at the Ministry of Finance. Political conflicts affect the implementation of ai operating budget. The study recommends that for the Ministry of Finance to overcome operations budgeting challenges, there is a need for proper and efficient technology. Without capable, efficient IT support, implementation of an operating budget concept is infeasible.

CHAPTER ONE

1 0 INTRODUCTION

1.1 Background

Budgets are financial blueprints that quantify a firm's plans for a future period. A budget is a detailed plan outlining the acquisition and use of financial and other resources over some given time period. They require management to specify expected income and expenditure and they provide a mechanism for effective planning and control in organizations (Flamholtz, 1983 **pp.** 153-69; Atkinson, 1993 pp.33-55). The budget is a standard against which the actual performance can be compared and measured. The annual budget is commonly referred to as the "master budget" and it has three principal parts: the operating budget, the cash budget and the capital expenditure budget. It is driven by the sales forecast (Horngren, 1981; Zimmerman, 2003). It has been noted that a sales budget for a company serves as a limit to be observed in establishing production budgets, selling and administrative budgets, cash budgets and budget plans (Moore and Jaedlicke, 1976).

Continuing budget pressure is forcing organizations to re-think their current service delivery models and develop initiatives that reduce cost and increase efficiency. As Atkinson (1993 pp.33-55) notes, "Certainly one of the most visible and highly publicized economic challenges facing the operational budget at this time is the decline in the purchasing power of the acquisitions budget". Many of the reference areas cited (Horngren, 1981,Moore and Jaedlicke, 1976, Atkinson, 1993 pp.33-55) deal with the challenges of advocating for and allocating the funds desperately needed in the face of rising costs and expectations, especially with the new cost-center related to electronic resources. It is, however, important to address the support role that the operational budget can play in meeting the challenge of stretching available resources within the budget constraints once the budget has been determined.

Operational budget is the one that embraces the impacts of operating decisions. It contains forecasts of sales, net income, costs of goods sold, selling and administrative expenses, and other expenses. The cornerstone of an operational budget is forecasted sales. Therefore, the Sales jet is the basic building block for the operational budget. Once the sales budget is prepared, the Production Budget can be formulated.

There are clearly established budgeting rules within the accounting industry. Typically, budgets are used to filter and analyze information throughout the organization, not necessarily to create more information for dissemination. The budgeting process utilizes what information is already available. The focus of budgets and the planning process are often based on the drivers of sales, profits and expenses, relying on historical performance and demand data to forecast future monetary requirements. It is an imprecise activity at best, yet an important action for the successful tactical operation of a business. On a strategic level, budgeting clarifies its competitive priorities, advantages and strategies for the future, employing cost forecasts and demand limits to quantitatively measure the feasibility of capital expansion projects.

For tactical purposes, budgets provide useful information tools and control mechanisms to company leaders, as well as partitioning decision rights with those holding specific knowledge about the operation. The advantages of budgeting (Zimmerman, 2003) include; coordination of sales and production, formulation of a profitable sales and production program, coordination of sales and production with finances, proper control of expenditures, formulation of investment and financing programs and coordination of all operations within the business.

Thus, a budget communicates project expectations to the Project Manager and authorizes the Manager to expend company resources up to the budgeted amount. Control is maintained as the company's owner and project manager reviews the budget report on a certain interval basis. This process serves several purposes: The budget review disseminates specialized knowledge vertically as the owner learns details of each job that he otherwise was not party to; and the review also provides a formal method of communication that is necessary in a company with multiple projects occurring at the same time. The knowledge gained during these reviews allows the business owner to re-allocate company resources where they are best utilized. The owner can also investigate the causes of behind-schedule projects and shift resources to ensure the customer is satisfied and the company continues a valued reputation. This in turn will assist in maximizing the company's overall value (Stroud, 2003).

During budget formulation, officials determine the portion of the organization's resources that **the** manager of each unit will be authorized to spend... budgets often establish performance goals for the unit in terms of costs, revenues, and/or production (Little *et al.*, 2002 pp.209).

1.1.2 The Ministry of Finance in Kenya

The **Ministry** of Finance derives its mandate from the Constitution of Kenya, Cap VII Sections 99-103 which provides for proper budgetary and expenditure management of government **financial** resources. In addition, Parliament, over the years has enacted 49 Acts to which the Ministry of Finance is a custodian thereby adding more responsibilities to the Ministry.
The functions of the Ministry of Finance are strategic in several ways.

As a main function, the Ministry is charged with the responsibility of formulating financial and economic policies. It is also responsible for developing and maintaining sound fiscal and monetary policies that facilitate socio-economic development. This responsibility makes the Ministry strategic and central to the country's economic management, as all sectors of the economy look upon the Ministry to create an enabling environment in which they can operate effectively and efficiently. The Ministry regulates the financial sector which is central to the development of the country and on which all other sectors depend for investment resources.

Another strategic responsibility of the Ministry is the management of revenues, expenditures and borrowing by the government. The Ministry must ensure that it mobilises adequate resources to support government programmes and activities. Consequently, the Ministry has the task of developing sound fiscal policies that ensure sustainable budget deficits. In addition the Ministry must ensure that government expenditure is within the revenue collected to reduce domestic borrowing, which tends to cause negative ripples in economic management. The Ministry is also strategic as far as bilateral and multilateral development financing and technical assistance is concerned. Given the need for support from development partners to enhance the country's economic recovery and poverty reduction efforts, the performance of the Ministry in effectively coordinating this support cannot be underscored. The Ministry must therefore, provide direction in the identification, planning and management of donor support to ensure that it is targeted to those areas of the economy that need it most. The Ministry coordinates government jninistries/departments in the preparation of the annual national budget. It is the responsibility of **the Ministry** to initiate and guide all ministries/departments to prepare their ministerial budgets.

fcudget $uppiy Department is one of the key departments of Treasury. It is headed by a Director of **Budget** with technical officers of Finance cadre, Economists Accountants and Administrators. **The** Department has evolved from a small unit of the Ministry of Finance at independence to a full **pledged** Department in the late 1970s.The department is mandated with the preparation of **annual** estimates of revenues and expenditures that are laid before Parliament every year for approval. It does also prepare supplementary estimates as the need arises.

The main long-term aim of the Ministry of Finance is the achievement of a sustainable, performance of the available government resources for the better living of its citizens. However, the operation of the budget has been faced by a number of challenges which hinder sustainable provision of its services to the republic. Therefore, management processes that help to "add value" or "constrain costs" should form a fundamental part of an operational budget.

1.2 Statement of the Problem

The budget is a standard against which the actual performance can be compared and measured. Budgets are used to communicate top management's expectations to managers and employees. The budgets process provides for coordinated planning among different functional areas (Ramsey and Ramsey, 1985; Bremser, 1988). Budgets are financial blueprints that quantify a firm's plans for a future period. Budgets require management to specify expected sales, cash inflows and outflows, and costs; and they provide a mechanism for effective planning and control in organizations (Flamholtz, 1983 pp. 153-69).

The divergent views on budgeting as a management control tool have provided the major motivation for the present study. Furthermore, there is also a dearth of research involving surveys of budgetary practices in developing countries. Most of the research in this area has focused on the USA, the UK and Australia.

Studies in operational budget practices have also been done in Kenya. Ndiritu, (2007) studied the effectiveness of cash budgeting in public institutions, Kadondi, (2002) did a survey of capital

budgeting techniques used by companies listed at the NSE, Muleri ,(2001) carried out a survey **of budgeting** practices among the major British non governmental organizations in kenya, while **Biwott** (1987) did a study on the budgetary allocation process in public sector institutions.

The literature on budget practices focuses on the relevance and applications of budgets to large, complex and manufacturing organizations and less on government organizations. Additionally, most of the studies on budgeting mainly focus on profit making firms and not on non-profit making organizations. There is therefore a need to close this research gap that exists. This survey is aimed at achieving this goal by establishing the challenges of operational budget at the Ministry of Finance in Kenya.

1.3 Objectives of the Study

The study was guided by the following objective:

i. To investigate the challenges of operational budget at the Ministry of Finance.

1.4 Significance of the Study

The study is invaluable to the following:

To the Ministry of Finance: the study is invaluable to the Ministry of Finance management in that it has provided an insight into the various approaches towards operational budgeting and challenges of operational budgets to ensure efficient utilization of resources.

To the Government: the study is useful to the government in policymaking regarding taxation and other regulatory requirements of the Ministry of Finance.

To the Academicians: the study has provided a useful basis upon which further studies on 3udgeting in the public sector could be conducted.

This research will make a contribution to the academic literature on the field of operational budgets in Kenya where very little is known about its structure and application.

The findings of the study will provide some insights to the regulatory body (Ministry of Finance) and the government at large on the challeges facing the operational budget within the Ministry of Finance and hence enable making of timely and appropriate interventions to mitigate the risks.

CHAPTER TWO

2 0 LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are budgeting budget planning and control budget participation and rewards operational budget tools and performance evaluation

2.1.1 Budgeting

Budgeting plays a key role in an organization. It moves the organization from an informal reaction method of management to a formal controlled method of management (Morse et al., 1984). A budget can act as a motivator and communicator, as well as for functional co-ordination and performance evaluation (Dominiak and Louderback, 1988) of an organization.

Anthony et al (1992) list four uses of a budget. First, to fine tune the strategic plan; second, to help co-ordinate the activities of the several parts of the organization; third, to assign responsibilities to managers; and last, to obtain a commitment that is a basis for evaluating a manager's actual performance.

According to Garrison (1988) there are four major advantages of budgeting. First, it gives planning top priority; second, it provides managers with a way to finalize their planning efforts; third, it overcomes potential bottlenecks before they occur; and last, it co-ordinates the activities of the entire organization by integrating the plans and objectives of the various parts.

In summary, there are four main aspects to budget: the motivations aspect; the co-ordination of resources for their best use; setting benchmarks for performance; and as a cost control mechanism (Sheridan, 1987 pp.26-7).

Review of literature on operational budgeting (Amey, 1979; Bremser, 1988; Douglas, 1994 pp $9-63) reveals that operational budgets serve dual purposes of planning and control. Flamholtz (1983 pp. 153-69) developed a mechanism for effective planning and control aspects of budgets. The study by Ezzamel and Hart (1987) also supported this dual role of budgeting. Moreover, Hopwood (1972), and Abernethy and Stoelwinder, (1991 pp. 105-20) argue that budgets can be used as a control mechanism to regulate the behavior by specifying the means to produce a unit of output.

Budgeting systems are universal and have been considered an essential tool for financial planning. These systems are meant to organize and encourage the performance of organisations (Abernethy and Brownell, 1999 pp. 189-205). Traditionally, budgets were seen as the primary planning document (Alam and Lawrence, 1994 pp.41-51; Johnston, 1998 pp.352-68). Guthrie (1999) states that corporatisation and the application of the National Competition Policy (NCP) meant that finance ministry should operate under some commercial principles so as to become more economic, efficient and effective.

Budgets are used to communicate organisation's expectations to its clients. The budgets process provides for coordinated planning among different functional areas (Ramsey and Ramsey, 1985; Bremser, 1988). Bruns and Waterhouse (1975 pp. 177-203) concluded that when production processes were relatively routine repetitive, budgets could be used effectively to achieve organizational coordination.

2.1.2 Budget Planning and Control

Most studies on budget practices have been conducted in the advanced countries. The study by Cheung (1986) into the Hong Kong situation of 35 managers revealed that operating budgets were widely used. Pike's (1982) longitudinal survey of 150 manufacturing companies from UK, reports on broad trends in the use of budgets. Lyne's (1988 pp.195, 1992 pp.357-69) surveys of 13 UK companies covered the issues relating to the managerial uses of budgetary information, the extent of participation by managers in setting their budgetary targets, and the sources of pressure to meet these budgetary targets.

Chun U996 PP-71-84) replicated Lyne's study, with a larger sample of companies from Malaysia- He reported Malaysian user-groups views on the role of budgets, budget pressure and participation, which were similar to Lyne's findings. Srinivasan's (1988) survey of 402 US companies, which included manufacturing, and service companies revealed multiple roles and **uses** of budgets, especially in successful firms. Skinner's (1990 pp.21-33) telephone survey of 114 Australian and New Zealand companies was concerned with the managerial uses of budgetary information particularly profit data. Drury et al. (1993) studied management accounting practices in UK, and they reported the various uses of budgets by management. Armstrong et al. (1996) conducted a survey of budgetary control used in large manufacturing UK companies, and they concluded that budgetary controls are intimately linked with considerations of labor controls.

There has been some evidence that companies have been showing considerable interest in preparing long-range plans. In a survey of Fortune 500 companies in the USA, Sinha (1990) concluded that formal strategic planning contributed to decisions that were important, risky, global, and involved divestments. Similarly, in another study, Capon et al. (1994) found that a majority of firms employed sophisticated corporate planning and corporate financial plans in their budgeting system. Powell (1992) found that strategic planning was important in the US companies but depended on the type of industry. A study by Wijewardena and Zoysa (1999) found that 95 percent of the Japanese companies and 83 percent of the Australian companies do prepare long-range plans. Furthermore, Chenhall and Smith (1998 pp. 1-19) found that more than 90 percent of the respondent companies adopted long range planning and long range forecasting in Australia. Joshi (2001) and Anderson and Lanen (1999) found that Indian companies were using strategic formal planning and long range forecasting techniques in budget planning. Other studies in Europe found extensive use of long range planning (for example, Germany: Scherrer (1996); Greece: Ballas and Venieris (1996); Italy, Barbato et al. (1996)).

2.1.3 Budget Participation and Rewards

Participation of employees in the process of budget preparation also motivates them to achieve budget goals. Srinivasan (1987) posits that budgets should be used to motivate subordinates to increase their output and efficiency by encouraging their participation during budget preparation.

Hopwood's (1972 pp. 156-82) study contains ample evidence that the association of extrinsic rewards with budgetary achievement is a powerful means to motivate managers. Bails and Asada (1991 pp-131-41) in their study found that bonus and promotion or new assignments are positively correlated with budget performance, while salary is not.

The topic of operational budget participation has always received a considerable interest among researchers. There are conflicting findings on the significance of budgetary participation. Stedry (I960) and Cherrington and Cherrington (1973 pp.225-53) reported negative relationship between operational budget participation and performance as a challenge. On the other hand, Merchant (1987) and Brownell (1982 pp. 12-17) reported a positive relationship between them. Furthermore, Cress and Pettijohn (1985) found a good percent of the companies have a significant role in both the initial and revision stages of operational budget preparation.

Shields and Young (1993 pp.265-80) found that participative budgeting is used more frequently when lower level management and senior management within an organisation are linked to budget preparation and implementation.

2.1.4 Operational Budget Tools

Weisenfeld and Tyson (1990 pp. 19-20.) found that budgeting and variance analysis can be positive tools, if the accounting information/communication process is functioning appropriately. It's assumed that a large portion of the researchers indicate that variances is a good way to measure their performance. They, however, pose lack of or poor technology as a challenge of operational budget in many governmental organisations and the Ministry of Finance in particular.

Auditing management and benchmarking managements can be viewed to be other tools that determine the operation of a budget in any firm. Auditing management procedures identifies the strengths and weaknesses of a company's current performance compared to corporate standards (Hoyle, 1997) while benchmarking management procedures enables comparisons of corporate standards to be made against industry best practice (Zairi and Leonard, 1996).

When auditing or benchmarking highlights, a gap in management performance, a strategy should be developed and targets defined, within an improvement plan, in order to attain the higher standards identified. However, the application of the highest standards available, per se, does not ensure success because a company operating to the highest standards but failing to make a profit will not remain in business for very long. Therefore, the desire to raise standards must be put into the context of overall business performance and profitability. Although benchmarking can provide short-term solutions to some problems, by identifying how other companies address the same issues, the main benefit of benchmarking is more related to changing business culture in the medium and long term. To achieve this, managers need an understanding of the underlying principles, strengths and limitations of the benchmarking process and an appreciation of the impact that economic constraints have on achievable performance standards. Benchmarking should therefore be supported by management models, which describe the issues and predict how changes in management strategy affect company performance.

Current strengths and weaknesses in company performance can then be compared with industry best practices and potential options for improving management performance can be assessed through logical and robust criteria. Descriptive models for implementing benchmarking assessments have been described (Zairi and Leonard, 1996; Bogan and English, 1994) but fundamental models, which explain the theory of benchmarking, have not been developed. Benchmarking can utilise competitive, functional, internal and generic approaches (Zairi and Leonard, 1996) in order to identify successful management strategies.

Zairi and Leonard (1996) have described the basis of benchmarking as "Understanding how better results are achieved and adapting the 'how' into one's own organization so as to overtake the competition in terms of results". The benchmarking process is therefore based on the premiss that searching out the best of the management systems in market leading companies will identify the key to superior business performance. The principles of benchmarking are equally valid for large, medium or small companies, whether they compete in local, national or international markets. However, the aims and achievable objectives of the benchmarking process may be significantly different in each situation. For example, one company may benchmark in order to improve profitability by identifying the most cost-effective way of maintaining their current standards, while another company may benchmark to identify industry best practice.

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L t .

For companies aiming to achieve recognition for world-class performance, it may be necessary **to move** away from a purely reactive approach to benchmarking, which identifies what other **groups or** companies have already achieved, and move on to essentially a proactive approach by identifying and defining the highest standards achievable. In this way they will be recognised as market leaders operating through innovative example.

2.1.5 Performance Evaluation

Feedback is an important role of budgeting for attaining the expected quality and standards in planning, control and leadership. According to Cook (1968), feedback is generally positively **associated** with budget performance. Feedback focuses on the extent to which employees have achieved expected levels of work during a specified time period. Budgets being a standard for performance are also used to evaluate ministerial performance (Srinivasan, 1987). Similarly, Douglas (1994) used a case study approach and found that budgeting places a high importance on the budget-to-actual comparison for performance evaluation purposes both at the corporate and the subsidiary levels. Anderson (1993) also supported this view, stating that in most US companies the development of budget is still used as the main performance measurement system.

There is need to coordinate the ministerial strategies and operational budget in a single, integrated process, characterized by continuous feedback and organizational learning (Kopp and Leyk, 2004.

2.1.6 Activity-Based Budgeting

ABB is a full-absorption budgeting method that has gained ground on conventional methods, Brinker (1994), due to both more correct cost assessments and superb tracing of costs. Conventional costing systems, on the other hand, cannot trace - overhead costs are simply distributed as butter on bread (Hardy and Hubbard, 1992 pp.24-8) as it were without estimating the effect of all the complexities, see Eiler and Ball (1997 pp.B2.1-B2.33), and identifying the root causes of costs. ABB systems imply a new way of thinking (Kaplan and Cooper, 1999 PP-408). They carry with them a set of questions completely different from conventional costing systems, such as "what activities would be performed within the organization, how much it would cost in order to carry out such activities, why the organization would needs to organize enterprise activities and processes, and what would be the starting part or amount required from each activity-products, services and customers?" An ABB system provides companies with an economic map of their operations that highlights the existing and anticipated costs of the enterprise activities and processes. This leads to a deeper knowledge of the cost and the **profitability** of products, services, customers and productive units.

Compared to conventional costing systems, ABB differs in two major points (Cooper, 1990 pp.86-8): In an ABB system, it is assumed that a cost object (products, services and so forth) consume activities, while a conventional system assumes that a cost object consume resources. There are several implications of this difference, but the most important is that ABB acknowledges that one cannot manage costs, one can only manage what is being done, i.e. the activities. With respect to cost management this point also indicates that sound cost management practices should focus on process management and not virtually solely on structure and organization as today. An ABB system utilizes drivers on several levels (for example unit-, batch-, product- and factory level), while a conventional system uses only unit-level characterizations called allocation bases. Roughly speaking, an allocation base is an arbitrary, unit-level driver. In this sense, from the point of view of the allocation, cost-drivers try to establish precise causal relations between products and consumption of activities. The problem is to choose the most suitable cost driver to undertake the allocation process. In general, this problem could be solved choosing between the following requirements: to represent the existing cause and effect relations between costs, activities and products as well as possible and to be the most cost effective to measure and to observe, see Fernandez Fernandez and Munoz Rodriguez (1997 pp.192).

According to the discussion above, when discussing ABB we should remember the points highlighted by Maher (2005): Different cost allocation methods result in different estimates of a product's cost. ABB provides more detailed measures of cost than do plant-wide and departmental allocation methods. ABB can help marketing people select and price products by Providing more accurate product cost numbers. ABB also benefits production because it provides better information about how much each activity cost. It helps identify cost drivers that managers did not previously recognize. ABB provides more information about product cost but requires

more recordkeeping. Thus, managers must decide whether the benefits of improved decisions **justify the** additional cost of ABB compared to departmental or plant-wide allocation. Finally, **implementing** ABB requires teamwork among accounting, production, marketing, management and others.

Hence, ABB is much more accurate and driven by cause and effect relations and not the latest **percentage** add-on from management. In fact, O'Guin (1990 pp.36-41) reports that product cost **estimates** from a conventional costing system can differ by several hundreds per cent compared **to an** ABB system.

2.2 Challenges of Operational Budget

Since proper planning as well as the efficiency and effectiveness of time-honored budgeting methods (Leyk et al., 2006) must be implemented, empirical results from different surveys discuss the challenges of operational budget as effects of mainly technology, competition, inflexibility and political changes. According to Modell (2002 pp.653-79), the myth that organisational change in parts of any organization may be accomplished by more forceful implementation of financial and efficiency-based control methods. Contemporary research suggests that history, power and evolution must also be considered (Boyns et al., 1999 pp.85-108). Van Helden et al. (2001) for the importance of one organisation in understanding the change in system and its linkages with other organisational structures.

Horvath & Partners' 2006 survey of larger firms yielded results broadly comparable to the ones obtained in the aforementioned survey of SMEs. As explained, budget preparation in bigger companies is a long process. More than half the enterprises represented on the panel need between four and six months for their operational planning and budgeting. Indeed, several firms said they required more than 31 calendar weeks for these processes! Taken together, results from the two surveys suggest that traditional planning and budgeting indeed have evolved into costly, time-consuming processes, offering little opportunity to react quickly and flexibly to changes in a company's environment. Accordingly, panel members find the available time and resources insufficient to control their operations optimally.

Not only are plans and budgets no longer appropriate for the conditions currently prevailing at the time of their execution, often enough they already are obsolete before their approval. This obsolescence arises from long duration of the bargaining and negotiations typically involved in planning and budgeting. In larger enterprises, the high degree of detail in budget planning also is an important influence. Decomposing the overall budget problem down to the lowest hierarchical level requisite for detailed analysis consumes large quantities of human and monetary resources. Moreover, wasteful resource consumption occurs every time negotiating partners loop through the planning cycle until they finally approve the annual operating budget. Large firms usually **commit** 75 per cent to 95 per cent of their total controlling capacity to operational planning during the time they are engaged in budget preparation (Kopp and Leyk, 2004). Unfortunately, top management seldom considers the high cost involved relative to the meager benefit derived from such detailed instruments. It then is no wonder that cost, product, and strategic controlling often get little attention in the process.

2.2.1 Information Technology and operational budget

It appears that resistance is a result of the attempt to introduce new practices and technologies without considering the existing institutions or the political, social and ethical ethos of organisational functioning (Burns and Scapens, 2000).

Without capable, efficient IT-support, implementation of an operating budget concept is infeasible. With such support, though, one can improve the quality of the planning and controlling information delivered as well as markedly facilitates implementation of an advanced budgeting concept (Horvath, 2003).

In practice, few firms link strategic and operational planning with one another. Even having a balanced scorecard does not appear to help much in this regard. Only 15 per cent of the companies responding to a Business Finance questionnaire said that they had integrated their balanced scorecard and budgeting (Oehler, 2006).

Risk management also is an insular system in most enterprises. Furthermore, besides the isolated Pillars of strategic planning, operational planning, and risk management, firms currently are

seating another new, isolated pillar with its own internal controlling system, namely, "corporate governance".

Qver and above these problems, consolidating corporate financial accounting information for external reporting and management accounting data for internal reporting often are completely separate processes too.

2 2.2 Competition and Operational Budget

Budget literature indicates that budgets serve multiple objectives and functions (Joshi, 1999; Drury et al., 1993). Without a procedure to review and challenge the budgetary allocations of prior years, there is little impetus to change. However, no business operates in a competitive environment that does not change, so firms relying on budgets for decision making risk becoming out of sync with their marketplaces. Heyer and Van Lee (1992) state that there is no connection between how a company is organized and how it actually works.

There could thus be uncoordinated actions, with the finance department setting budgets and the marketing department doing marketing audits and developing marketing plans. There is normally very little overlap between the functional areas of finance and marketing departments in a business. Departmental barriers could hinder employees who ought to co-operate to accomplish a task.

2.2.3 Inflexibility and Operational Budget

The Ministry of Finance spends a good per cent of its total controlling capacity to operational budgeting during the time it engages in budget preparation (Kopp and Leyk, 2004).

In these circumstances, the ministry's budget will have a moderating effect on any organizational change prescribed by the ministry's strategies. According to McDonald (1992), the one of the challenge facing most of the financial institutions is the design of a dynamic system for budget setting. For instance, a situation in which the ministry recognize a need for a strategic shift and location new resources to that developmental effort. However, if the remaining aspects of the Ministry's budgetary allocations are not reorganized in conjunction with the strategic shift, it is likely that over time the special effort will get marginalized within the ministry's initial business plan. Unforeseen challenges in their running of the country that require rapid and perhaps dramatic supply of without the ability to pay for those shifts may simply call for reallocations of funds, but this may cause unexpected results hence a challenge and need to retain flexible budgets.

2.2.4 Politics and Operational Budget

Political conflicts affect the implementation of an operating budget. (Eccles, 1985). Perara et al. (2003 pp. 140-64) argue the importance of focusing on the subjective values, norms and past experiences and the organisational and social systems - that is, the institutions within which the plan will operate. Furthermore, Boyns et al. (1999 pp.85-108), advises that an increase in power plays and political interplays can occur when there is a misalignment between budgeting priorities and the organisational and social context.

Within the context of the public sector and its reforms, it is possible that the aims of an operational budget be found not so much in its ability to model economic phenomena with any effect, but in its institutional impact, in its ability to construct a competitive environment and thus provide evidence to external constituencies of a seemingly commercial adaptation. It may also be a result of the plausible argument that increases the power of competitive pressures as such, acting as an incentive to reduce budget allocations. This is a familiar piece of rhetoric supporting the advancement of particular reform issues.

CHAPTER THREE

3 0 RESEARCH METHODOLOGY

3.1 Research Design

T^js was a descriptive survey study aimed at establishing the challenges of operational budgeting **process** in the Ministry of Finance in Kenya. According to Mugenda and Mugenda, (1999), a descriptive study is concerned with finding out the what, where and how of a phenomenon.

3.2 Population

The population of interest of this study was the Ministry of Finance in Kenya. There were twelve(12) departments within the Ministry which includes; budgetary supplies, external resources, accountant general, information technology services, pensions, economic affairs, monopolies and prices commission, debt management, government investment, internal audit, government clearance agency, and administration.

3.3 Data Collection

The study was a survey where data was collected from all the departments in the Ministry of Finance. This therefore means that census method was used.

In order to identify the challenges faced in operational budgeting in the Ministry of Finance in Kenya, self-administered drop and pick questionnaires were distributed among sampled employees currently employed by the Ministry of Finance in Kenya. Questionnaires were designed to identify the challenges that are faced in the formulation of operational budgets by Ministry of Finance in Kenya.

In order to maximize on the views aimed at establishing the challenges of operational budget at the Ministry of Finance, five (5) employees were selected from each of the available departments and administered with the questionnaire. The staff in the Ministry of Finance included directors and other staff in the ranks of management. This will make it easier to get adequate and accurate information necessary for the research.

I^e researcher used structured questionnaires as the main data collection instrument. The **questionnaires** will have both open and close-ended questions. The close-ended questions provided more structured responses to facilitate tangible recommendations. The open-ended **questions** provided additional information that may not be captured in the close-ended questions.

Secondary data sources were employed through the use of previous documents or materials to supplement the data received from questionnaires and information from interviews.

3.4 Data Analysis

Before processing the responses, the completed questionnaires were edited for completeness and consistency. A content analysis and descriptive analysis was employed. The content analysis was used to analyze the respondents' views about the challenges in the operational budgeting process. The data was then be coded to enable the responses to be grouped into various categories. Descriptive statistics were used to summarize the data. This will include percentages and frequencies. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis.

CHAPTER FOUR

4 0 DATA ANALYSIS AND INTERPRETATIONS

4 1 Production

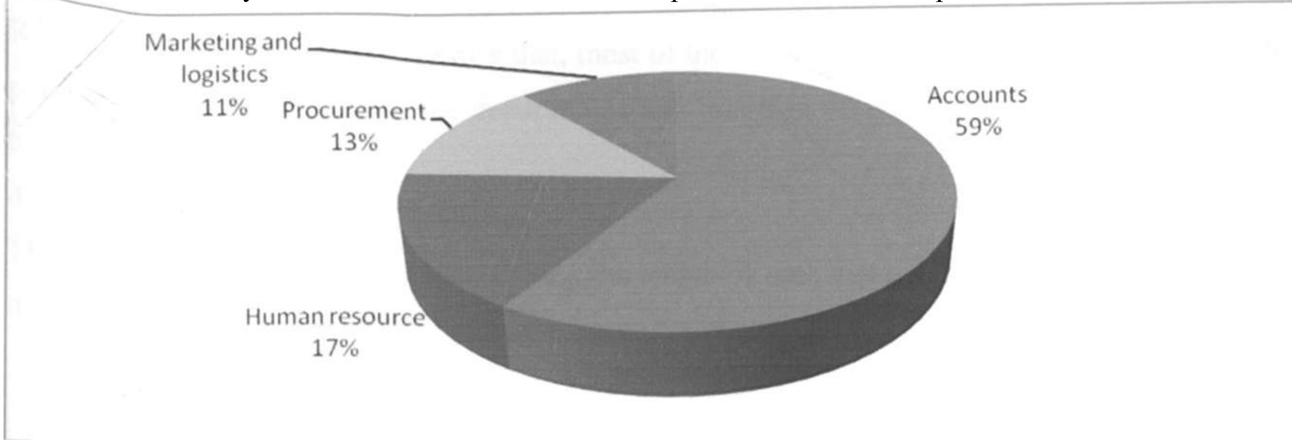
This chapter presents the data analysis and interpretations of the findings. Data from the field was analyzed using Statistical Package for Social Sciences and summarized using tables, charts, fluencies and percentages. From the study, a population of 60 respondents filled and returned the Questionnaires correctly.

4 2 u

ackground information

' **Department**

In this area of study the aim was to establish the department that the respondents worked



FlSUre 4.i Department

Data Presented above shows that most of the respondents were in accounts department (59 Percent) while 17 percent were in human resource department. 13 percent were in the department 0t Procurement while only 11 percent were in marketing and logistics departments.

4.2.2 Number of employees in department

This section aimed at establishing the number of employees th&t worked in each department. The results are as shown in the figure below.

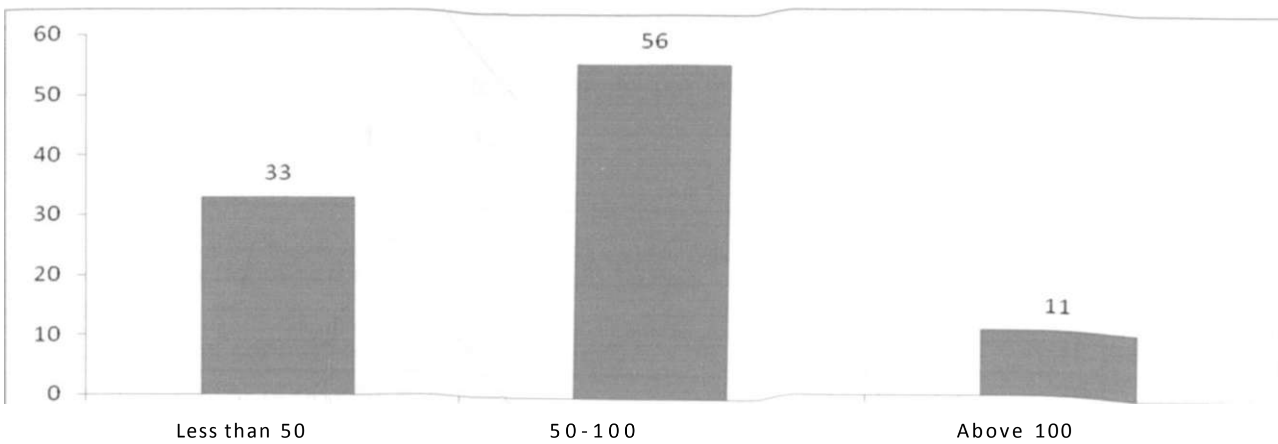


Figure 4.2 Number of employees in department

Results from the figure above shows that, most of the departments had 50 to 100 employees (56 percent), while 33 percent of the departments had less thaT* 50 employees. 11 percent had 100 and above employees.

4.2.3 Length of time in the Ministry

This section of study aimed at indentifying the length of tim^ that the respondents had worked at the Ministry. The results are shown in the figure below.

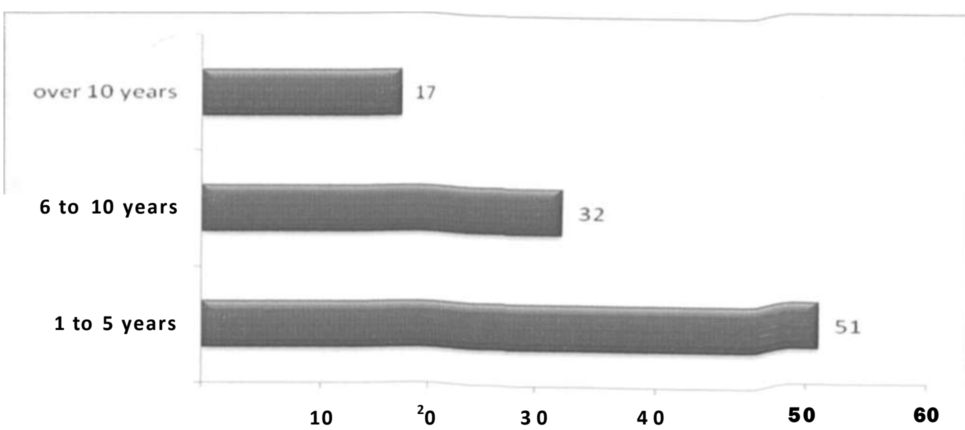


Figure 4.3 Length of time in the Ministry

Data presented in the table above shows that most of the respondents had worked for the Ministry for a period of 1 to 5 years (51 percent) while 32 percent had worked for a period of 6 to 10 years. 17 percent of the respondents had worked for a period of over 10 years.

4.3 **Views on budget planning**

In this area of study, the aim was to determine the views from the respondents on budget planning. This was shown in the table below.

	Agree	Disagree
Does your department participate in operational budget planning	88	12
Is there a budget committee in your department?	54	48
Does your department prepare fixed budgets	71	29
Does your department prepare variable budgets	56	44

Table 4.1 Views on budget planning

From the data presented in the table above, most respondents agreed that their departments were involved in operational budget planning (88 percent) while 54 percent also agreed that there was a budget committee at their departments. However, 71 percent disagreed that their department prepared fixed budgets.

4.3.2 Members of budget committee

Respondents who agreed that their department s were involved in budget planning were asked to state the members of the committees. The respondents cited accounts managers, procurement managers and all heads of departments.

4.4 Basis of break down of operational budgets

The aim of this study was to establish the basis of breakdown of operational budgets at the Ministry of Finance.

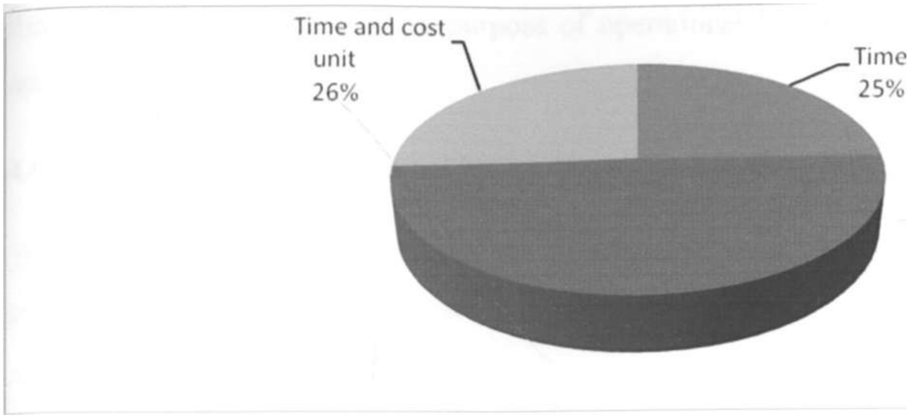


Figure 4.4 Basis of break down of operational budgets

In the above figure, majority of the respondents cited cost unit as the major breakdown of finance consisting of 49 percent while 25 percent cited time. 26 percent cited both time and cost as the basis of breakdown of operational budgets.

4.5 Purposes of operational budget

In this area, the aim was to indentify the various purposes of operational budget. This information is as shown in the table below.

Purpose	SA	A	N	D	SD	Mean	Std Devia
To motivate employees to do better	31	13	27	17	10	2.4156	0.902
As a means by which management communicates to other levels of department	35	48	9	6	3	2.6542	0.945
As a means of performance appraisal	40	29	13	1	7	3.3054	1.992:
To forecast the future	50	27	13	10	0	4.0124	0.903'
Assist in control	57	20	22	1	0	4.1254	0.914'

Table 4.2 Purposes of operational budget

Data portrayed in the table above shows that most of the respondents strongly agreed that the purpose of budgeting was to assist in control (57 percent) while 50 percent cited to forecast the future .40 percent cited as a the purpose of operational budgeting as a means of performance appraisal.

4.6 View on whether operational budgeting process took appropriate time duration

The study proceeded to determine the respondents view on whether operational budgeting process took appropriate time duration.

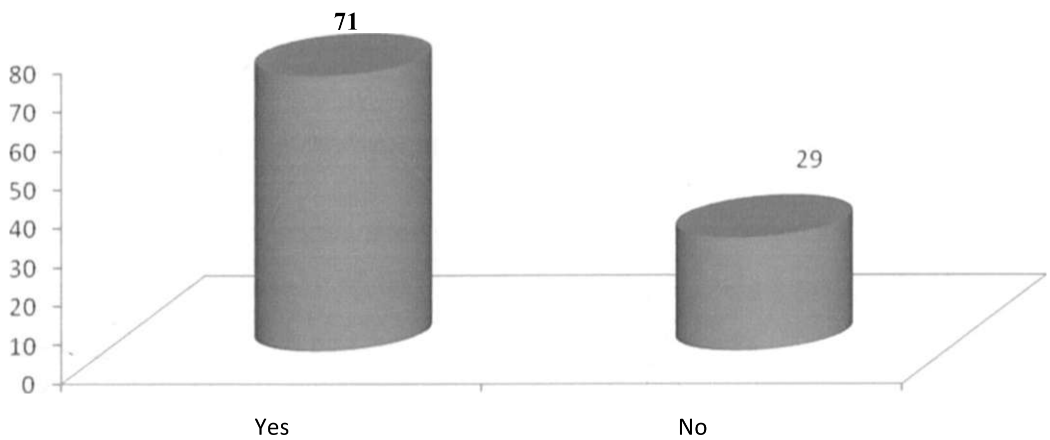


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Figure 4.5 View on whether operational budgeting process took appropriate time duration

Data presented above shows that majority of the respondents agreed that operational budgeting process took appropriate time duration. Most of the respondents agreed (71 percent) agreed while 29 percent disagreed.

4.7 Final decision on the operational budget proposals.

In this section of study, the aim was to establish the person who was responsible for making the final decision on the final decision on the operational budget proposals.

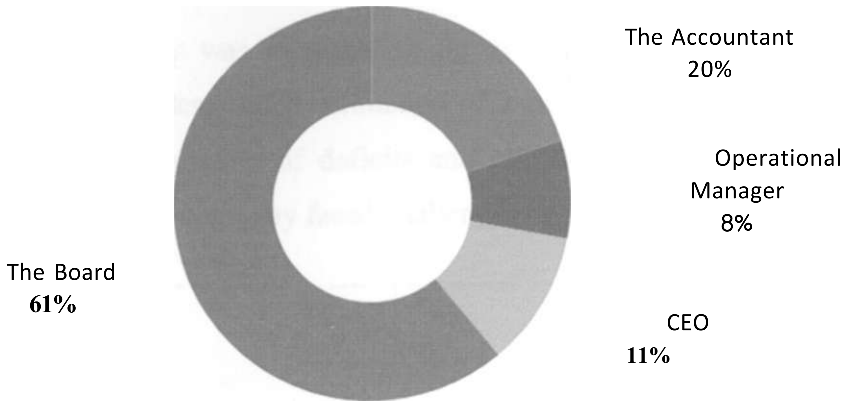


Figure 4.6 Final decisions on the operational budget proposals.

Data presented in the figure above shows that most of the respondents cited the board as being responsible for making the final decision on the operational budget proposals (50 percent) with 20 percent citing accountants.8 percent cited operational managers.

4.8 Effectiveness of the budgeting process

The study proceeded to inquire respondents view on effectiveness of the budgeting process .The respondents were asked whether prepared operational budgets served their purpose and majority (68 percent) agreed while 32 did not agree. When asked on whether modifications were allowed after the operational budget has been drawn, most of the respondents agreed (70 percent) while 30 percent disagreed.

View	Agree	Disagree
Do the prepared operational budgets serve their purpose	68	32
Are modifications allowed after the operational budget has been drawn	70	30

Table 4.3 Effectiveness of the budgeting process

4.9 Stages of operational budgeting process

In this area, the aim of the study was to establish the respondents view on the stages of operational budgeting. The respondents cited estimation of expenditure, the drafting of budget, the estimation of deficits, the narrowing of deficits and aliquetation of finances. The study proceeded to determine whether the company faced challenges of operational budgeting.

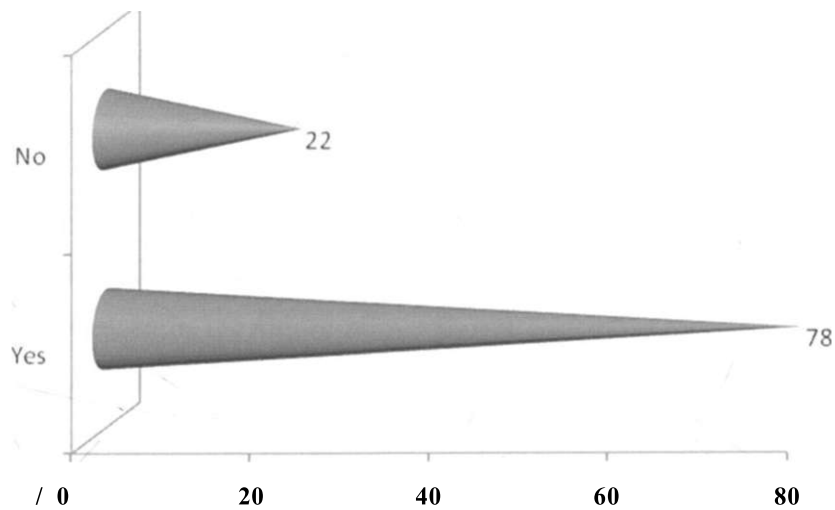


Figure 4.9 Challenges of operational budgeting.

Data presented in the figure above shows that most of the respondents agreed that there were challenges that faced the institution (78 percent) while 22 percent disagreed.

4.10 Challenges facing operational budgeting

The study proceeded to determine whether there were any challenges that faced operational budgeting. The data was presented in the figure below.

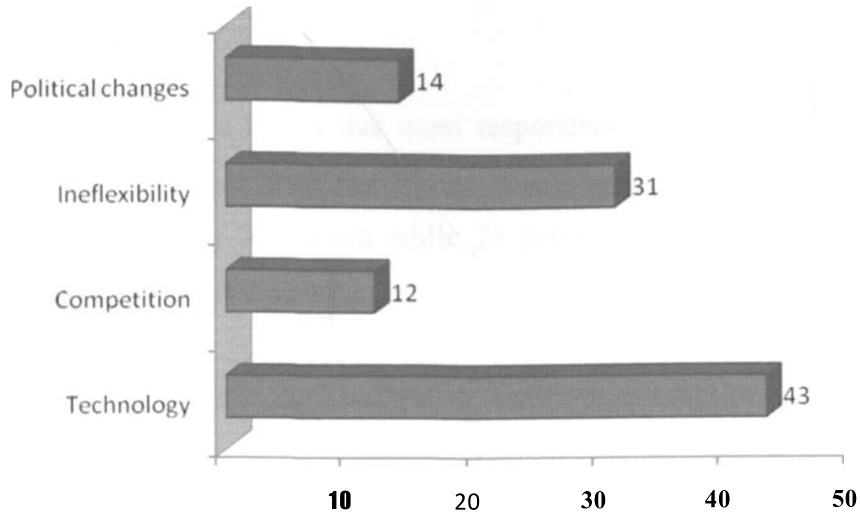
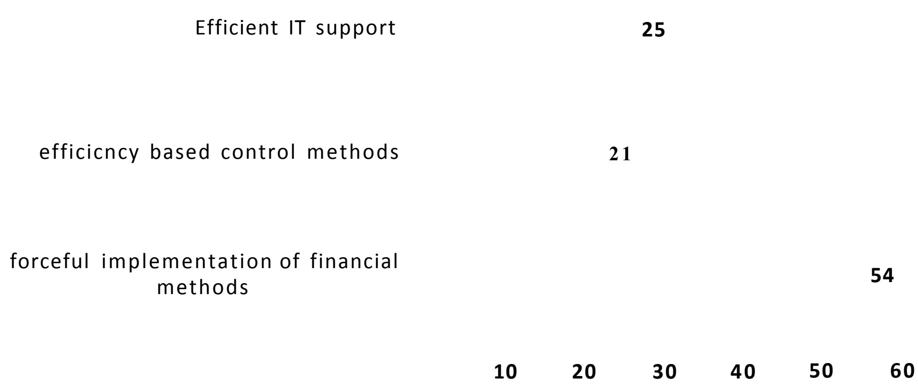


Figure 4.10 Challenges facing operational budgeting

Data presented in the figure above shows that most respondents cited technology as the main challenge that faced operational budgeting (43 percent), with 31 percent citing inflexibility. 14 percent cited political changes while 12 percent cited competition.

4.11 Possible solutions to the major operational budgeting challenges facing your company

The study proceeded to ask the respondents their view on whether there were any solutions to the major operational budgeting challenges facing your company. The respondents cited forceful implementation of financial methods, efficiency based control methods



pigure 4.11 Possible solutions to the major operational budgeting challenges facing your company

Data presented above shows that most respondents cited forceful implementation of financial **methods** as the major solutions to the major operational budgeting challenges facing your company comprising 54 percent while 25 percent cited efficient IT support. 21 percent cited efficiency based control method.

CHAPTER FIVE

5.0 SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings from chapter four, conclusions and **recommendations** of the study based on the objectives of the study.

5.2 Summary of the Findings and Conclusions

From the study, most of the respondents were in accounts department (59 percent) while 17 percent were in human resource department. 13 percent were in the department of procurement while only 11 percent were in marketing and logistics departments. The study also found that most of the departments had 50 to 100 employees (56 percent), while 33 percent of the departments had less than 50 employees. 11 percent had 100 and above employees.

On the number of years that the respondent had worked, the study found that most of the respondents had worked for the company for a period of 1 to 5 years (51 percent) while 32 percent had worked for a period of 6 to 10 years. 17 percent of the respondents had worked for a period of over 10 years.

The study also found that most respondents agreed that their departments were involved in operational budget planning (88 percent) while 54 percent also agreed that there was a budget committee at their departments.

On the issue of members of the budget committee the study found that accounts managers, procurement managers and all heads of departments were the members of the committee. On the issue of breakdown of operational budgeting, the study found that cost unit was the major breakdown of finance consisting of 49 percent while 25 percent cited time. 26 percent cited both time and cost as the basis of breakdown of operational budgets.

On purpose of budgeting, the study found that most of the respondents strongly agreed that the purpose of budgeting was to assist in control (57 percent) while 50 percent cited to forecast the future .40 percent cited as a the purpose of operational budgeting as a means of performance appraisal. The study also found that majority of the respondents agreed that operational budgeting process took appropriate time duration. Most of the respondents agreed (71 percent) agreed while 29 percent disagreed.

On the issue of person responsible for making the final decision on the operational budget, the study revealed that most of the respondents cited the board as being responsible for making the final decision on the operational budget proposals (50 percent) with 20 percent citing accountants.8 percent cited operational managers.

The study also proceeded to determine the stages of operational budgeting at Ministry of Finance and found that most respondents cited estimation of expenditure, the drafting of budget, the estimation of deficits, the narrowing of deficits and aliquetation of finances

On challenges that faced operational budgeting, the study found that most respondents cited technology as the main challenge that faced operational budgeting (43 percent), with 31 percent citing inflexibility. 14 percent cited political changes while 12 percent cited competition.

On the issue of solutions to the operational budgeting challenges, the study found that most respondents cited forceful implementation of financial methods as the major solutions to the operational budgeting challenges facing the comprising 54 percent while 25 percent cited efficient IT support.

The study concludes that all members of the different departments and areas were included in the budget committee and these included accounts managers, procurement managers and all heads of departments

From the findings, the study also concludes that the Ministry of Finance faces many challenges in the implementation of operational budget .The challenges included lack of technology, inflexibility and political changes.

The study recommends that for the Ministry of Finance to overcome operational budgeting challenges there is a need for proper and efficient technology. Without capable, efficient IT-support, implementation of an operating budget concept is infeasible. With such support, though, one can improve the quality of the planning and controlling information delivered as well as markedly facilitates implementation of an advanced budgeting concept

The study also recommends that political leaders should not be allowed to interfere with the operation of operation budgeting at the Ministry of Finance. Political conflicts affect the implementation of an operating budget. An increase in power plays and political interplays can occur when there is a misalignment between budgeting priorities and the organizational and social context.

5.3 Limitations of Study

The author encountered various challenges and limitations while carrying out this research. Some of the limitations included: time constraint as the study required more time especially on the data collection process in order to collect questionnaires.

In addition the author was encountered by a selection bias since the study focussed on 12 departments in the Ministry of Finance. There are other government institutions which work hand in hand with the Ministry of Finance in preparation of the budget, if there were involved in the study may be there would different findings. In addition, the author did not use any comparative tool in order to get analytical results such as correlations and this may have hindered the correct findings and conclusions.

5.4 Suggestions for further Research

The study suggests that more research should be carried out on all the government ministries in order to bring out the comparative effect. Various departments should also be included in order to gain the various views on budgeting, specifically issues of policymaking regarding taxation and the various challenges of budgeting.

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Appendix I: Letter of Introduction to Respondents

University of Nairobi

School of Business

P.O BOX 30197

Nairobi.

1st September, 2009

Dear Respondent,

RE: COLLECTION OF SURVEY DATA

I am a masters' program student at University of Nairobi, School of Business.

In order to fulfil the master's program requirements, I am undertaking a Finance research project on "challenges of operational budgeting in the Ministry of Finance".

/

Your department has been selected to form part of this study. Therefore, I kindly request you to assist me to collect data by filling out the accompanying questionnaire

The information provided will be used exclusively for academic purposes and will be held in strict confidence. Thank you.

Yours faithfully,

GEOFFREY KIRINGA **WINNE NYAMUTE**

Appendix II: Questionnaire

Kindly answer the following questions by ticking in the appropriate box or filling the spaces provided.

Part A: General information

1. Department:_

2. What is your designation?_

3. What is your length of time in the Company?

4. What is the total number of employees in your department: Please tick appropriately

Less than 50 [ ]

50 - 100 [ ]

Above 100 [ ]

Part B: Budget planning

1. Does your department participate in operational budget planning?

[ ] Yes [ ] No

2. Is there a budget committee in your department?

[ ] Yes No [ ]

If yes, who are the members of this committee?

Please specify with office titles:

a)

b)_

c)

d)

e)

5. All senior staff in your department participates in operational budget preparation and discussions. Do you agree to this statement? Please tick appropriate scale.

1. Strongly agree ( )
2. Agree ( )
3. Neutral ( )
4. Disagree ( )
5. Strongly disagree ( )

6. On what basis do you break down your operational budgets?

[ ] Time

[ ] Cost unit

[ ] Time and cost unit

[ ] Others, please specify

7. Does your department prepare the following budgets? (Answer Yes or No)

Fixed budget?

Variable budget?_

Both?_

8. Operational budgets have a number of purposes, indicate how important you think that each of the following purpose is relevant for your department (please indicate the influence of each purpose using a rating scale): -

1. Strongly agree
2. Agree
3. Neutral
4. Disagree
5. Strongly disagree

Factors	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
To forecast the future					
Assist in control					
As a means by which management communicates to other levels of department					
As a means of performance appraisal					
To motivate employees to do better					

9. Do you think operational budgeting process takes appropriate time duration?

Yes [ ] No [ ]

10. Who makes the final decision on the operational budget proposals?

The Accountant [ ]

Operational Manager [ ]

CEO [ ]

The Board [ ]

Any other [ ]

Part C: **Effectiveness of the budgeting process**

11. Do the prepared operational budgets serve their purpose?

Yes [ ] No [ ]

12. Are modifications allowed after the operational budget has been drawn?

Yes [ ] No [ ]

13. Please give the stages of operational budgeting process?

14. Which stage takes the longest time and why?

Part D: Challenges of Operational Budgeting

1. 1. Are there any challenges facing operational budgeting in your company?

   [ ] Yes No [ ]

2. If yes, list the main challenges?

. a)

   b)

   c)

   d)

   e)

3. Which is the challenge that you think greatly affects operational budgeting in your company? (Explain briefly)

4. The management can be able to overcome the operational budgeting challenges in your company. Do you agree to this statement? Please tick appropriate scale.

    a. Strongly agree
    b. Agree
    c. Neutral
    d. Disagree
    e. Strongly disagree

5. What are the possible solutions to the major operational budgeting challenges facing your company?

Thank You.