

## THE GLOBAL DEBATE ON BUDGETING: EMPIRICAL EVIDENCE FROM NIGERIA

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### ABSTRACT

*Empirical evidence from developed economies provides that budgeting is a veritable tool for planning, controlling, coordinating, communicating, evaluating and improving performance and decision making. On the other hand, some experts have mounted wide-ranging criticism of the manner in which budgetary systems are typically implemented. It is claimed that budgeting is not a worthwhile exercise, adds no value to organizations, managers are dissatisfied with it, and therefore it should be abandoned. However, the main focus of this research is to provide empirical evidence from a developing economy on the relevance of the budgetary system. A primary source of data was used and data were collected through the use of a questionnaire. Altogether, a total of one hundred and ten completed questionnaires from nine selected manufacturing companies were analyzed. A Non-Parametric test and descriptive statistics were used for data analysis. This study shows that, though the budgetary system is not perfect, its usefulness cannot be over-emphasized. The study reveals that budgeting is perceived by managers as a worthwhile exercise and a value-creation process. It is recommended therefore that research should be directed towards improving the budgetary system rather than totally abandoning it.*

**Keywords:** Traditional budgeting, Budget criticisms, Empirical evidence from Nigeria

### Introduction

Budgeting is not new in the history of mankind but an age long exercise. It is used for virtually all human activities, and in an organised economic, social, and political system, the role of budgeting cannot be ignored. Business owners and managers, for instance, need to budget their resources, which may include everything from raw materials to human resources and facilities to make the best and most profitable use of what they have to work with (Hornngren *et al.*, 2008).

Budgeting is a veritable tool for effective management (Grifel, 1993; Lucey, 2000; Millar, 1997; Otley, 1978; Schwartz, et al, 2008; Yeung *et al.*, 2006;). Some of the principal roles of budgeting in management are to plan, control, coordinate, evaluate, direct, improve performance, communicate and make decisions (Grifel,

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Business Management Review 13 pp: 1-13 ISSN 0856-2253©January -December 2009, UDBS. All rights of reproduction in any form reserved.

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1993; Zahirul & Peter, 2007). Recent surveys show just how valuable budgets can be (Anand *et al.*, 2004; Dugdale & Lyne, 2006; Horngren *et al.*, 2008). Advocates of budgeting claim that the process of budgeting forces a manager to become a better administrator and puts planning on the forefront of the manager's mind. Many seemingly healthy businesses have died because managers could not identify problems in advance or because they failed to monitor and adjust budgets to changing conditions (Horngren *et al.*, 2008).

On the other hand, it has been argued that, in spite of its widespread use, the budgetary process is not perfect altogether (Hansen *et al.*, 2003). In other words, there are criticisms and debates over the value of budgeting. Recently, a group led by Hope and Fraser in 2001 advocated for what they called "beyond budgeting". In their opinion, managers should look beyond the traditional budgetary system. They identified four key problems with the budgetary process thus:

- i. The process is too time consuming
- ii. The resulting annual operating and financial budgets are not accurate and hence not relevant- especially in industries where market changes are frequent and unpredictable
- iii. Evaluating performance against a budget causes a manager to bias their budgets, resulting in inaccurate planning; and
- iv. A budget target creates incentives for individuals to take action to meet the target even when those actions make the firm as a whole worse off (see for example: Jensen, 2001; Pilkington & Crowther, 2007).

From the foregoing, in spite of its criticism, some hold the opinion that budgeting remains a useful management tool (Horngren *et al.*, 2008; Dugdale & Lyne, 2006; Anand *et al.*, 2004). The argument has generated a lot of heat in the accounting profession in the last few years. It has attracted responses and reactions from various quarters, constituting one of the topmost issues discussed in management accounting literature and conferences. The issue has not been laid to rest as people keep turning in their contributions. The questions are:

1. What is the extent to which companies in Nigeria operate a budget?
2. What is the relevance of budgeting to management and its desirability as perceived by managers/users in Nigeria?

We hypothesised that:

1. Budgeting is not a useful tool for management.
2. Managers are dissatisfied with the budgetary system.

The study observed that most of the research in this area has emanated from the developed world. The researchers are not aware of any empirical study from this part of the world on the debate over the value of budgeting. This study therefore attempts to fill this gap. The remaining part of this study is divided into three sections. The next section reviews the literature. The third section describes the research methods while the last section analyses data and presents the results.

## **Review of Related Literature**

### **Conceptual Framework**

Horngren *et al.* (1999), state that most people misconstrue the use of budgeting as limiting spending and that many people associate the word “budget” with approving, rejecting, or arguing over various estimates. However, Lucey (2000), states that the process of preparing and agreeing a budget is a means of translating the overall objectives of an organization into a detailed, feasible plan of action. (see for detail, Polimeni *et al.*, 1991). This is a major breakthrough as budgets have only been used for cutting costs, restricting spending and allocating scarce resources. Broadly, CIMA’s official terminology of management accounting defines budget as: “Quantitative statement for a defined period of time which may include planned revenue, assets, liabilities and cash flows. A budget provides a focus for the organization, aids the coordination of activities and facilitates control.”

### **Arguments over traditional budgeting**

Budgeting, doubtless is a veritable tool for planning, controlling, coordinating, evaluating, directing, communicating and aiding decision making, but the process is not perfect. For some years now, there has been a movement against budgeting. As a result, it has led to the development of techniques like Activity based budgeting, performance budgeting, value budgeting, process reengineering; balanced score card, Zero-based budgeting, IT-based budgeting, and the planning, programming and budgeting system (PPBS) etc. On the other hand, in spite of all the techniques developed to take care of the shortcomings of traditional budgeting, some are calling for the complete abandonment of budgeting as a whole. For instance, Pilkinton & Crowther, (2007), argue that firms would be better off abandoning budgets altogether.

According to Dugdale & Lyne (2006), there are a series of articles in management accounting, calling for organizations to replace budgets with a range of indicators and techniques. They see the use of budgets as part of a performance contract and a pernicious practice, claiming that it leads to numerous problems, which include the following:

- Meeting only the lowest targets
- Using more resources than necessary
- Making the bonus-whatever it takes
- Competing against other divisions, business units and departments.
- Spending what is in the budget.
- Providing inaccurate forecasts
- Meeting the target, but not beating it
- Avoiding risks

Management accountants recognize these problems, but Hope and Fraser (2001), feel that they are now so serious that they are preventing companies from competing effectively in globalized, deregulated markets. They say that, in order to meet modern challenges, companies must dismantle their rigid command and control structures, which means scrapping their budgets. They should instead adopt a policy of radical decentralization and implement appropriate key performance indicators, scorecards and rolling forecasts (Dugdale & Lyne, 2006). Other criticisms according to Bourne (2004) are as stated below:

- Budgets are time consuming and costly to put together.
- Budgets constrain responsiveness and flexibility and are often a barrier to change.
- Budgets are rarely strategically focused and are often contradictory.
- Budgets add little value, especially given the time required to prepare them.
- Budgets concentrate on cost reduction and not on value creation.
- Budgets strengthen vertical command and control.
- Budgets do not reflect the emerging network structures that organizations are adopting.
- Budgets encourage gaming and perverse behaviours.
- Budgets are developed and updated too infrequently, usually annually,
- Budgets are based on unsupported assumptions and guesswork.
- Budgets reinforce departmental barriers rather than encourage knowledge sharing
- Budgets make people feel undervalued.  
(see for example: Hope & Fraser, 2001)

The above wide-ranging critiques have drawn the attention of scholars, practitioners and academics each reacting differently. These have also birthed and prompted a lot of research. Dugdale & Lyne (2006), in an investigation in response to the critiques by the advocates of beyond budgeting, affirm that the propositions of the critics were based on the banking sector. A proposition for decentralization and the use of only output control for banks may not be recommended for other businesses, especially businesses with all manner of internal complexities. They also find out that budgeting is alive and well. They state:

*All the companies in our survey used budgets and generally, both financial and non-financial managers thought that budgets were important for planning, control performance measuring, coordination and communication (Dugdale & Lyne, 2006).*

On the other hand, consistent with the arguments of the advocates of the “beyond budgeting” concept, Dugdale & Lyne (2006), also pointed out that more than half of the financial managers in their study agree or strongly agree that budgets were problematic because they are too time consuming and managers might be constrained by budgets and delay taking necessary action. However, the shortcomings identified above are not enough reason to abandon budgeting

outright, knowing its importance and usefulness. Jacob (2004), states that there is no alternative to budgeting and budgetary control. Instead of abandoning budgeting, improvements should be sought (see, Dugdale & Lyne, 2006; Horngren *et al.*, 2008; Wickramasinghe & Alawattage, 2007;).

### **Empirical framework**

Horngren *et al.*, (2008) state that recent surveys show just how valuable budgets can be. They assert that a study of more than 150 organizations in North America listed budgeting as the most frequently used cost-management tool and it was also the tool with the highest value to the organization. Furthermore, they show that study after study has shown the budget to be one of the most widely used and highly rated cost management tool for cost reduction and control. Highlighting how useful budgeting is the users maintain that advocates of budgeting claim that the process of budgeting forces managers to become better administrators and puts planning at the forefront of their minds. In the same book, Horngren *et al.*, (2008) also point out that the result of a survey carried out in the same place (North America) shows that most managers still agree that budgeting, correctly used, has significant value to management. They reported that over 92% of the 150 companies in North America use budgets and budgeting is top of the top three cost-management tools. In the same in a round table discussion organized by CIMA and ICAEW in 2004 on “The traditional role of budgeting in organizations”, it is stated that budgeting and the accompanying process are indispensable and that research in organizations seems to suggest that this is a commonly held view. It was further stated that traditional budgeting remains widespread. Some claim that as many as 99% of European companies have a budget in place with no intention of abandoning it (Kennedy & Dugdale 1999, cited in CIMA-ICAEW, 2004). Consistent with this, Anand *et al.*,(2004) in a survey carried out in India found out that the use of budgets as part of the management control system is widespread. Precisely 88.7% of the respondents in their study prepared budgets. They assert that nearly all the companies in Australia, Japan, the UK, and USA prepare budgets (see for detail, Asada *et al.*, 1989, Blayney & Yokoyoma, 1991, Chenhall & Langfield 1998 all cited in Anand *et al.*, 2004).

In addition, research also shows that over 60% of companies claim they are continuously trying to improve the budgeting process to meet the demands set by management for creating sustainable value (Ekholm & Wallin, 2000, cited in CIMA-ICAEW, 2004). According to Bourne (2004), Cranfield University in 2001 teamed up with Accenture’s finance and performance management service line to undertake a large worldwide review of planning and budgeting. They focused on 15 companies in the US and Europe, which had already made adjustments to their budgeting practice. In addition, the researchers reviewed over 100 academic and practitioner books on the subject. The result showed a widespread dissatisfaction with the budgeting process (Bourne, 2004). However, contrary to this conclusion, Dugdale & Lyne (2004) also argue that there is little or no evidence to support the

view mentioned above that there is widespread dissatisfaction with the budgeting process. They affirm that there seems to be no widespread dissatisfaction with traditional budgeting. Instead, managers generally see budgeting as important, especially for planning, control and evaluation. More so, one of the criticisms against traditional budgeting is that budgets are rarely strategically focused, but contrary to this opinion, Anand *et al.*,(2004) in an investigation carried out in India, found out that the respondents as a matter of fact used more than one goal in formulating the master budgets. Empirical evidence from Nigeria on this debate is documented in the later part of this work.

### **Research Methodology**

In this study, since the researcher sought to observe many variables at one point in time (i.e., one-time-only), the cross-sectional survey research design was used; in particular the descriptive research design was used. This design was considered appropriate because all the variables of the study were observed at one point in time, thereby relatively reducing the cost of the investigation.

The population is inferring companies in Lagos State, Nigeria. For the purpose of this study, the list of manufacturing companies in Lagos State constitutes the population of the study. The choice of Lagos state was based on certain reports on the distribution of manufacturing companies in Nigeria. According to Ajibolade (2008), over 55% of manufacturing companies' head offices are in Lagos. Therefore, it is believed that the choice of Lagos is appropriate for this study. The choice of the manufacturing sector for this study was based on the belief that budgeting is more widely practised in the manufacturing sector than in other sectors. Moreso, Wickramasinghe & Alawattage (2007), posit that the development of standard costing techniques and budgeting is traceable to the manufacturing industries.

A few samples were selected from the population for the purpose of this study. This was as a result of the difficulties encountered by the researcher in obtaining an up-to-date list of manufacturing companies in Nigeria. Consequently, the convenience sampling technique was used. The adoption of this sampling method was based on the fact that the study did not use any sampling frame from which a random sample could be drawn. However, because budgeting is widely used by most manufacturing companies, there is no reason to suspect any systematic bias in the findings of this study. The list of companies selected for this study is provided in appendix II.

The instrument used for data collection was a questionnaire, which a considered appropriate since the data were generated from primary sources. A five-point Likert scale was used in the questionnaire, where respondents were asked to rate their opinion from two extremes, "Strongly disagree and strongly agree". This was to give the respondents wide- ranging options from which to choose the one that

best reflects their opinion. The nature of the data needed required respondents to have the requisite knowledge and experience of the subject matter. Therefore, the target respondents for this study were the staff in the accounts section departmental heads and management staff in each of the sampled companies. A total of one hundred and fifty one (151) questionnaires were administered across the companies sampled, but only one hundred and ten (110) were retrieved, constituting about a 73% response rate.

**Table 1: Research Questionnaire (Extract)**

Please indicate the extent to which you agree or disagree with the following statements in respect of each variable stated below. (Ranging from 1 = strongly disagree to 5 = strongly agree).

S/N		1	2	3	4	5
1	My company/department prepares budgets annually.					
2	We prepare annual sales revenue budget in my company/department.					
3	My company/department prepares expenditure budget annually.					
4	My department/company is committed to budget implementation.					
5	We have a system that keeps proper records of actual results.					
6	On a regular basis, budgets are compared with actual results for variance analysis.					
7	Corrective actions are usually taken on below standard performance.					
8	Budgets are usually reviewed to meet environmental changes.					
9	Actual sales revenue is usually in agreement with the budget.					
10	Actual costs incurred are usually in agreement with the budget.					
11	I consider budgeting a useful tool for planning, control, decision making, coordinating, and communicating and value creation.					
12	I value budgeting because it is a worthwhile exercise and it is beneficial to my organization.					

In this study, both descriptive and inferential statistical procedures were used. The descriptive statistics used include mean value, standard deviation, simple percentages and frequency counts. For the inferential statistics, the Chi-square test statistics were used to examine how the actual observed frequency differed from the expected one. The non-parametric test was considered appropriate because the population of this study was distribution free, i.e. it does not assume a normal distribution curve. Also, the summated rating scale used is an ordinal scale, which is appropriate for a non-parametric test (Asika, 1991). For the purpose of this test, alpha = 0.05 i.e. 5% level of significance was selected. Here, if the calculated value is equal or greater than the table value, we reject the null hypothesis and accept the alternative and vice versa.

## Results

Analyses were carried out using the Statistical Package for Social Sciences (SPSS 15.0). For the descriptive analyses, any mean value that is less than 2.0 implies little or no existence of a budgetary exercise and control system. For a mean value of 2.0 and less than 3.0 indicates the existence of a weak budgeting and budgetary control system. A mean value of 3.0 and above shows that companies prepare budgets and have a proper and adequate control system in place. The same principles are applicable for the analyses of other items of the questionnaire.

Table 2 shows that most of the companies prepare budgets annually as supported by a mean value of 3.51. Items four to eight of the questionnaire contained in Table 1 are concerned with budget implementation and control. From table 2, the means are: 3.76, 3.75, 3.39, 3.21 and 3.35 respectively. The implication is that, since the means are above 3.0, the budgets usually implemented and the systems of control put in place by the companies were adequate. More so, for item eleven(11) of the questionnaire, the mean of 3.76 in table 2 shows that budgeting is considered a useful tool for the managerial function of planning, controlling, decision making, coordinating, and communicating. Finally, the mean of 3.84 in table 2 for item twelve of the questionnaire shows that respondents considered budgeting a worthwhile exercise.

**Table 2: Descriptive Statistics**

	Mean	Std Deviation
Sex of Respondents	1.22	.416
Age of respondents	2.87	.803
To which of these management Levels do you belong?	1.52	.604
How long have you been in this Position?	1.43	.677
Are you the head of the department?	1.58	.496
Do you participate in the preparation of budgets?	1.41	.494
Do you work in the Acct/Fin Section?	1.36	.503
Qualification of respondents	2.29	1.177
My Company/Department prepares budgets annually	3.51	1.839
We prepare annual sales revenue budget in my Company/Department	3.57	1.674
My Company/Department prepares expenditure budget annually	3.65	1.573
My Company/Department is committed to budget implementation	3.76	1.545
We have a system that keeps proper records of actual results	3.75	1.617
On a regular basis, budgets are compared with actual results for variance analysis	3.39	1.718
Corrective actions are usually taken on below standard performance	3.21	1.547
Budgets are usually reviewed to meet environmental changes	3.35	1.412
Actual sales revenue is usually in agreement with the budget	2.45	1.212
Actual costs incurred are usually in agreement with the budget	2.79	1.398
I consider budgeting a useful tool for planning, control, decision making, coordination and communication and value creation	3.76	1.780
I value budgeting because it is a worthwhile exercise and it is beneficial to my organisation	3.84	1.556

*Source: Author's computation*

### **Hypotheses Testing**

In this study, two null hypotheses as stated in section one were tested. The test statistics was the chi-square test. To test hypothesis one, item 11 of the questionnaire was used. The item is: "I consider budgeting as a useful tool for planning, control, decision making, coordinating communicating and value creation." However, the hypothesis is stated below as:

H<sub>01</sub>: Budgeting is not useful to managers for carrying out their tasks.

To test this hypothesis, the chi-square test (denoted by X<sup>2</sup>) was used.

Mathematically,  $\chi^2 = \sum \frac{(O - E)^2}{E}$

Where:

O = Observed frequency

E = Expected frequency.

From Table 3, the calculated  $\chi^2$  is equal to 154.075 and is significant at  $p < 0.05$ . As a result, the null hypothesis is rejected, thereby accepting the alternative. By implication, it means budgeting is useful to managers for carrying out their tasks. To test the second hypothesis, item 12 of the questionnaire was used. The hypothesis is stated below as:

H<sub>02</sub>: Managers are dissatisfied with the budgetary system

**Table 3: Chi-Square Test Statistics**

	Policy inconsistency of government inflation, pool infrastructural facilities poor database, corruption, culture and society are some of the factors affecting budget effectiveness in Nigeria	Lack of commitment to budget implementation by management affects budget effectiveness	Lack of participation by all staff in the determination of budgets affects its effectiveness	I consider budgeting's as a useful tool for planning, control decision making coordinating and communicating and value creation	I value budgeting because it is a worthwhile exercise and it is beneficial to my organisation
Chi-Square abc	121.229	22.393	18.057	154.075	100.132
dj	4	4	4	4	4
Asymp Sig	.000	.000	.001	.000	.000

- a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 21.8
- b. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 21.4
- c. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 21.2

Source: Author's computation

The  $\chi^2$  test was also used for this hypothesis. The null hypothesis was rejected because the calculated  $\chi^2$  of 100.132 is also significant at 5% significant level and degree of freedom of 4. This is shown in Table 3. Consequently, the Null hypothesis was rejected. In effect, managers are not dissatisfied with the budgetary system since to them it is valuable, worthwhile and beneficial to their organizations.

### INTERPRETATION OF RESULTS

The first research question was: what is the extent to which companies in Nigeria operate a budget? The findings indicate that most companies in Nigeria prepare budgets annually. This is explained by the mean 3.51 in Table 3.

This finding is consistent with the findings of Sahay *et al.*, (2003). In their study on cost management practices in India, they found that the use of the master budget as a part of the management control system is widespread. Over 88% of the respondents in their study prepare budgets. In the same vein, Asada *et al.* (1989); Blayney & Yokoyama (1991); Chenhall & Langfield – Smith (1998), all cited in Anand (2004), found that nearly all the companies in Australia, Holland, Japan, the UK and USA prepare budgets. This study however contributes to the existing literatures on the widespread use of budgets by corporate organizations. The findings also show that most of the companies: (1) have a system that keeps proper records of actual results; (2) on a regular basis compare budgets with actual results for variance analysis; (3) usually take corrective action on below standard performance; (4) usually review the budget to meet environmental changes. It means therefore that most companies have a control system in place.

The second research question sought to know empirically whether or not budgeting is a useful tool for effective management of corporate organisations. The findings showed that budgeting is considered a useful tool for planning, controlling, decision making, coordinating, and communicating and that it adds value to organizations. In the same vein, the findings reveal that managers still appreciate budgets and are not dissatisfied with them. Respondents claim that budgeting is worthwhile and beneficial to their organizations. This finding is consistent with the finding of Callahan and Waymire (2007), who stated that value was identified in the budgetary process. Also consistent with this are the findings of Dugdale & Lyne (2004), who assert that “There seems to be no widespread dissatisfaction with traditional budgeting. Instead, managers generally see budgets as important, especially for planning, control and evaluation”. In essence, this finding does not support the findings of Bourne (2004); Hope and Fraser, (2001); Bunce, (2004); Jensen, (2001); De Reuck & Holloway (2007).

## **CONCLUSION**

This study achieved its aim of contributing to literature by providing empirical evidence from a country which is not a developed one on the value of budgeting in management. We can conclude that companies in Nigeria operate budgets annually, thereby confirming their widespread use. We can also conclude that besides its widespread use, budgeting is a veritable tool for planning, control, communicating, decision making and value creation. Therefore, it is recommended that efforts through research should be directed towards improving the budgetary system rather than calling for its complete abandonment.

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