THE MANAGEMENT BY EXCEPTION APPLIED TO THE BUDGETARY SYSTEM TO CONTROL PERFORMANCE

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Abstract. *The management by exception represents the simplified management model based on the ascendant flow of information which reflects the deviations from the operational programmers and the key decisions established by the companies' managers. The deviations discovered are distributed on hierarchic levels, except for those deviations representing exceptions, which need to reach the general managers. Management by exception also applies to the budgetary system, combined with a responsibility accounting. To attain the objective of the general budget, the company must coordinate the efforts of all its employees. The method requires the delegation of responsibilities to each manager. The main stages involved in a management by exception are: foreseeing the objectives, defining the allowed deviations, comparing the results with the levels foreseen and making decisions to increase the economic profitability and consequently the firm's performance.*

Keywords: management by exception, budgetary system, responsibility delegation, operational programmers

JEL classification*:* M41

1. Introduction

J.J. Servan-Screiber said about management that "it is the youngest of sciences and oldest of arts". As a science, management means: "the study of the management process in order to systematize and generalize some concepts, laws, principles, rules, conceive new systems, methods and techniques able to contribute to an increased efficiency of the activities carried out to achieve certain objectives" [14], or "the study of the management processes and realities within organizations, to discover laws and principles governing them and to conceive new management systems, methods, techniques and modalities, able to assure the obtaining and the increase of competitiveness [9]. As an art, management is based

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not just on the specialized knowledge but also on the talent of putting knowledge into practice, of establishing objectives, of organizing and of coordinating individuals to reach the objectives proposed.

In other words, management is “the process by which activities carried out in an organization are coordinated, managed, planned and controlled, so that its goals may be attained with maximum efficiency” [1]. A. Mackensie defines management as “the process in which the manager operates with three fundamental elements – ideas, things and people – realizing through others the objectives proposed”. H. Fazol attributes to the term of *management*, the notion of *administration*, mentioning that “to administer is to foresee, organize, command, coordinate and control” [2]. P. Drucker considers that “the main and maybe the only task of management is to mobilize the energies of the economic unit for the accomplishment of its known and defined tasks”.

2. Management systems

Management, about which we could see that, in the beginning, it was an art, and then it became a science, “allows the formulation of some principles ... as well as the identification of some systems, methods, techniques and procedures ... able to assure the increase of the company’s efficiency”[3]. Management systems refer to the essential components of management, being different from management techniques, particularly in point of “scope and complexity” [4]. Both the managerial methods and techniques “are involved in the exercise of different managerial positions that impact certain procedural and structural components” of the economic entity.

The latest management systems are “the management by objectives, which is based on the determination of some rigorous objectives, reaching up to the doers’ level, and on a close relation between rewards (sanctions) and objective achievement; the *management by projects*, which applies when difficult situations occur, for a limited period of time; the *management by product*, characterized by the fact that a manager is directly responsible for the obtaining and the selling of a product; the *management by budgets*, defined as a system assuring the forecast, control and assessment of the activities of an entity; the *management by exception*, based on the identification and communication of situations on certain hierarchic levels; the *management by systems*, based on the modeling of the main activities of the entity; the *management by innovation*, which is a modern, dynamic system, based on an attitude receptive to what is new; the *management by consensus* is that system in which decisions are made based on unanimous agreement” [5].

An economic entity, by the management it promotes, must coordinate the activity of all its employees, to attain its budgetary objectives. “The coordination of the company’s efforts supposes the delegation of certain responsibilities to each manager, who consequently becomes directly responsible for his actions in the planning and control of the human and material resources”[6].

3. Company’s objectives and budgetary administration

The stringent problem that managers have to solve is to find methods allowing them to dimension and control the balance between incomes and expenses, thus “the budget having the possibility to become an instrument of harmonization and particularly of increased efficiency of the relation between expenses and incomes in the company, and cost budgeting representing a systemic economic practice that requires the development of a formal process of financial resource allocation, in order to achieve objectives formulated for the following periods” [7].

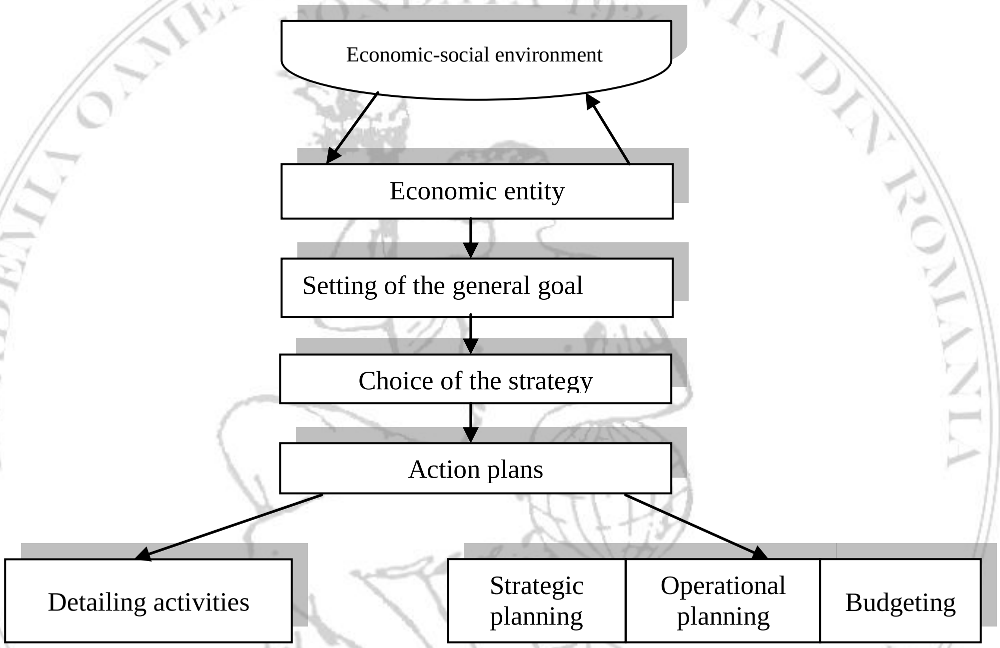
The forecast process focuses on the future, trying to determine “objectives for the future and suitable means to reach these objectives” [8].

Within the forecasting process, the economic entities go through the following stages:

- diagnostic analysis of the organizational activities and capacities to formulate its objectives;
- determination of a strategy to reach the formulated goals;
- coordination of the activities on the level of the economic entity;
- control of the activities carried out in order to reach the objectives established (see Fig. 1.).

Medium-term strategic orientations, once turned into strategic plans, represent a good approach in order to reach the objectives of the economic entity for the future. To have a clear vision of what has to be done in the medium and long term, this approach begins with the preliminary diagnosis of the company, which aims to assess the activity of the company, identifying, on the one hand, the opportunities, and, on the other hand, the company’s strengths and weaknesses. Next, the strategy is chosen, measuring its financial effects, as well. The strategic plan “establishes the great orientations, respectively the track the allocated means need to follow in order to have a decisive advantage over the competitors [9]. It is realized, in the short term and in detail, the forecast of the production activities, works or services, called operational plan. All the tactic aspects contained in the strategic plan are detailed in the operational plan, defining at the same time the actions to be realized for each year in turn. As we have mentioned above, the activities contained in the operational plan need to be quantified and put down in the funding plan. Based on the operational plan, the activities to be carried out are transposed into monetary units by means of the budgets. The passage from programmes to budgets is realized based on a hypothesis of an economic-financial nature, the costs forecast relying on the evolution of the prices and of the costs.

Figure. 1. Strategic planning and budgetary administration (source: processed by the authors)



R.M. Anthony defines the budget as "a plan for the next year, usually expressed in monetary terms" [10]. "The budget, by its monetary dimension, is the most practical manner of expressing the size of the estimated inputs and outputs"[1].

Alain Burlaud and Claude Simon define budget as "a set of numerical, realistic and voluntary forecasts" [11]. The budget is a set of forecasts, whose horizon is generally annual. The numbers are given both in physical and financial terms. The budget has to be realistic and take into account all the external and internal constraints. The budget is not only an anticipation of the future; it is rather a voluntary action plan reflecting the company's objectives.

The budget represents an important link in the operation of an economic entity, by which means of which it is possible to provide coherence between local actions and global performance in that economic entity.

4. Management by exception applied to the budgetary system

Budgeting requires setting the responsibilities of each manager who has a budget. The approval of the budget authorizes all the activity plans within it, so that the management by exception can be applied, namely a subordinate is given a well-defined role, having the authority to fulfil the tasks received, and when the activity does not run according to the budgetary forecasts, the situation is reported and analyzed on a higher level.

To delegate prerogatives into the inferiors' hands does not mean that the administration is abandoned by the leadership; on the contrary, this supposes a greater possibility to control the general progress of the company. The systemic delegation of power by the elaboration of a de-centralized structure is a condition of the effectiveness of the budget elaboration process. Yet, this structure is denied by the supporters of reengineering - of the ABM method -, "who blame budgeting on responsibility centres for operating with an excessive partitioning among different managers who actually have complementary functions in the company"[12].

Depending on the way in which the economic entity is organized, it is possible to largely determine the modality in which its efforts are to be coordinated. Thus, the organizational structure of an economic entity represents a hierarchic system including all the responsibility levels within the entity. "A responsibility centre is a section, a segment or a subunit of an organization, whose manager is responsible for a pre-established set of activities. The higher the hierarchic level of one manager, the more extended his responsibility centre is and, in general, the higher the number of inferiors is". The early finding out of some budgetary articles that do not fit into the plan's forecasts allows the adoption of some operative actions. Actually, the careful monitoring of the unfavourable deviations that occur during the execution of budgets is a feature of the *management by exception*.

Management by exception is a simplified management model based on an "ascendant flow of information reflecting the deviations from the preset limits and on the concentration of the best managers and specialists in the key decisional and operational zones related to competitiveness" [13]. By this system, managers can only concentrate on the primary issue – deviations over the allowed limits – of the economic entity. The deviations discovered are distributed on different hierarchic levels and only those that represent exceptions reach the general managers.

Combined with a responsibility accounting, budgets can provide the general managers with a feed-back on the performances obtained by the managers of different responsibility centres, compared to the budget forecasts. To reach the general budget objective, an economic entity has to coordinate the efforts of all its employees – from directors and managers of all levels up to each supervised worker. The coordination of all the efforts requires the delegation of a certain responsibility to each manager, who thus becomes directly responsible for his actions in the planning and control of the human and material resources. The way in which an economic entity structures its own organization largely determines the way in which its efforts are to be coordinated. The organizational structure of an economic entity represents the hierarchic system of responsibility levels within the company. Each manager, irrespective of level, is in charge with the administration of a responsibility centre. A responsibility centre is a section, a segment or a subunit of an organization, whose manager is responsible for a pre-established set of activities. The higher the hierarchic level of a manager, the more extended his responsibility centre and, in general, the higher the number of his inferiors. Used in a proper way, the information regarding the differences between the actual results and the budgetary forecasts – also named deviations – can be useful for the managers in the economic entities, in three directions:

- Timely warning. Deviations warn the managers about the occurrence of events that are not easily or immediately detectable. Thus, managers can take corrective actions or can take advantage of the opportunities occurred.
- Assessment of performances. Deviations inform managers about how successfully the economic entity implements the pre-defined strategies. Have they used efficiently the raw materials and the labour?
- Assessment of strategies. Deviations sometimes signal to the managers the fact that their strategies are inefficient.

Each manager must be able to control costs, incomes and other similar elements that he is in charge of. A controllable cost is any cost that is, to the greatest extent, under the influence of a given cost centre manager, during a given period of time. The implementation stages of the management by exception are [13] (see Fig. 2.):

- Forecasting the objectives and establishing the norms and all the other elements contributing to the realization of the organizational activities;
- Mentioning the limits of variation from the values foreseen;
- The actual application of the management by exception – comparing the achievements with the levels foreseen and transmitting the information to the pre-established hierarchic level;
- Decision making – to deal with deviations.

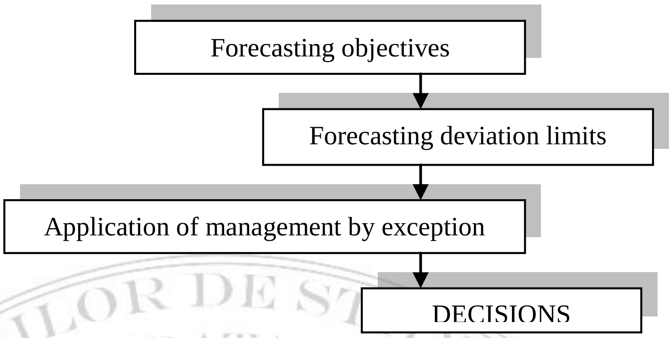


Figure. 2. Implementation of the management by exception (source: processed by the authors)

Conclusions

We can conclude that the budget represents a set of numerical, realistic and voluntary forecasts, translating the organizational objectives. The budget is a planning document elaborated before the running of the anticipated operations, and may consist of financial data, non-financial operational data or a combination between the two. Throughout the year, the real numbers need to be analyzed by comparison with the budget. In this sense, re-forecasts are realized according to new variables or new levels of the existing variables, in order to provide a comparison basis under conditions that are close to the period of analysis of the organizational performance. Forecasts are essential complements of the management system.

The economic entities can apply a management by exception according to their specifics, taking into account the following propositions: the existence of a very well organized information flow system; all the information that need to reach the people in leadership positions shall be progressively selected, on each level, so that decisions may be made by those people possessing adequate skills; if deviations are found, the higher the deviations, the higher the hierarchic level to which the information is to be taken to be processed.

Like any other system, the management by exception has its advantages and disadvantages.

Its most important advantages are:a better use of the management time; a less frequent need to make decisions; the rapid observation of critical situations; the pursuit of what is a priority in the key activities.

Its disadvantages may be: the creation of an impression of stability on the level of the economic entity; it does not give an account of people's behaviors.

The management system is a set of elements assuring the modeling and the exercise of the functions of the management system in order to increase the economic profitability of the organization.

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