EVALUATION OF BUDGETARY PRACTICES IN THE PRIVATE SECTOR BANK OF BANGLADESH

By

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A Research Project

Submitted in Partial Fulfillment

For the degree of

Master of Philosophy (M.Phil.)

At

Department of Accounting & Information Systems

University of Dhaka

Date: November, 2014

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DECLARATION

I hereby fervently declare that this dissertation is my own work and that, to the best of my knowledge, it contains no material previously authored and published by another person or material which has been accepted for the award of any other degree, except in the cases where due acknowledgements have been made in the text.

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This is to certify that this dissertation by Ms. Rumana Nasrin under the title "Evaluation of Budgetary Practices in the Private Sector Bank of Bangladesh" has been written under my supervision and is hereby approved for submission to obtain the degree of Master of Philosophy (M. Phil), under the university of Dhaka.

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ACKNOWLEDGEMENT

I am grateful to Almighty ALLAH for giving me the opportunity to conduct and complete this research study.

I would also like to take this opportunity to express my thanks and gratitude to all whose helps and assistances contributed to the completion of this dissertation.

First of all, I am indebted to the department of Accounting and Information Systems (AIS), Faculty of Business Studies, University of Dhaka for accepting me to conduct and carry out this research study.

My heartfelt thanks and gratitude to my supervisor, Professor Md. Maksudur Rahman Sarker whose tireless efforts, unending supports and valuable guidance during the entire research period made it possible to complete this study.

I am greatly indebted to all the related officials of the twenty eight private commercial banks for their kind cooperation for collection of necessary data and information during the field survey. This study could not be finished without their cooperation and assistances.

Lastly, my warm regards and blessings go to all those who have made a positive contribution in my life.

Abstract

Budgeting is no more the act of 'matching' the figures of income and expenditures as had been in the past. It has come out of age. As a major tool of management control, budget does not only set performance standards for measurement and control; it is a better tool for future planning. Besides, budget recognizes the impacts of external standards through cognizance of business trends and competitors' performance. Modern budgetary practices also recognize the human behavioral aspects of budget through participatory approach model of budgeting.

The prime objectives of this research study were to determine how far the practices of budget are prevalent in the private commercial banks in Bangladesh and the attitudes of the management towards its effectiveness. A qualitative research method was followed. Questionnaire was designed to extract data and information as were considered necessary in the circumstances. Secondary data source was also used. Extracted data and information were duly interpreted and analyzed. The analysis of the findings indicates that managements of all the sample banks, in general, are positive in their attitudes towards budget; budget is prepared and implemented in all the banks. But at the same time, procedural lacks and lapses were also abundant in budgetary practices in some of the sample banks. In other words, budget is partly used and full benefits of budgetary practices are not reaped by these banks.

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LIST OF ABBREVIATIONS

ALCO	Asset Liability Committee
BB	Bangladesh Bank
CAPEX	Capital expenditures
CAR	Capital adequacy ratio
DFI	Development Financial Institution
FCB	Foreign Commercial Bank
IMF	International Monetary Fund
MCR	Minimum Capital Requirement
MD	Market Discipline
MANCOM	Management committee
NPL	Non- performing loan
OECD	The Organization for Economic Co-operation and Development
PCB	Private Commercial Bank
ROI	Return on investment
SCB	State-owned Commercial Bank
SME	Small and Medium Enterprises
SRP	Supervisory Review Process
TMDM	Total Measurement Development Method
ZBB	Zero - based budgeting

CHAPTER-1: INTRODUCTION

1.1 An Overview:

Budget is a basic and essential process that assists businesses to attain many goals in the course of its operations. A business may have many goals to achieve to be successful. These goals include control and evaluation, planning, communication, and motivation (Lucey, 2004). Budgeting is a process of planning the financial operations of a business (Kariuki, 2010). It is a financial tool and is useful for both evaluation and control of future actions. Budget as management tools can greatly influence the performance of a company (Larson, 1999).

Budget is a set of guidelines for those who perform and tools of control for those who supervise. In other words, budget is a link, combining goal- setting and goal-achieving machines (Dunbar1971).

There is another aspect of budgetary control which is rather psychological. Festinger (1957), Brehem and Cohen (1962) observed that- goals must not only be set but also achieved. The critical step between the setting of a goal and its achievement is the acceptance of the goal by the goal- achieving machine, that is, the budgeted individual. So, it is assumed that if the budgeted individual can be persuaded to accept the budget goals, it can be expected that the goals will be reached or to bring performance as close to it as the environment will allow.

The functionality, usefulness, effectiveness and benefits of budget cannot be over emphasized. Financial institutions such as- banks, insurance companies, leasing companies, and development financing institutions can reap these benefits from budgeting. Relevance of budget for commercial banks to help proper planning, performance measurement and exercising of control with a view to achieving the goal of maximizing profit is indisputably accepted.

With the private banks and financial institutions operating in the complex economy of the present days, the urge for growth, competitiveness and profitability grew faster. In a growing and competitive market, the needs for proper planning, right goal setting, exercising control, facing rivals and increasing profitability demand the use of budget and thus, its importance is undeniable.

In Bangladesh, the practice of budget is both traditional and formal. Government prepares and declares budget every year. Government's financial policies are shaped and designed in line with budgetary allocations. All the foreign companies and most of the local big companies prepare budgets and undergo all the required budgetary processes in order to ensure proper control.

Private sector banks have significant contributions to the national economy. Success of these Banks largely depends on efficient management of the affairs of the banks in the existing competitive environment. No doubt, proper budgetary practices can, to a large extent, help to achieve smooth and effective operations. The present study has been initiated and designed to assess the state of budgetary practices in this sector. Accordingly, attempts were made to ascertain the attitudes of the management towards budgetary practices in general. It was also aimed to focus on budget preparation process, its effective implementation, proper monitoring and feed-back process, performance measurement, variance analysis and cost control effectiveness.

1.2 Background of the study:

Private commercial banks in Bangladesh are operating in a challenging environment. Steep competition and intensified rivalry from foreign banks are well known. Operating in an environment of competition and constrain requires strict compliance of rules and procedures essential for healthy survival. Budget as a management tool for proper planning, control and performance measurement is very much essential to ensure smooth operations.

Manufacturing companies in general, prepare and implement budgets of different segments of its operation such as, procurement, production, stock retention, sales and distribution, cash-flow etc. with details. This facilitates pin-pointing areas of operational weakness, inefficiencies, and inadequate efforts. Through performance analysis on a regular basis, the deficient areas could be located before irreparable damages are done. Abundant publications and research reports are also available on these areas.

Efforts were given to locate and find previous publications, research papers and write-ups on practices of budget in private banking sector. But the efforts were not fruitful. Articles or write-ups on practice of budget by private banks in Bangladesh could not be located and it seems that no such studies were carried out previously on this topic. Most of the articles available focused on performance measurement of banking sector, managerial performance, financial performance of banks, risk management, customer service relationship (CSR), credit facility and loan recovery system etc.

From different articles, news reports and statements of different authorities of banking and financial sectors, it clearly appears that control procedures, good governance, necessary corrective measures are not working well in banking sector. It is apprehended that in case budgetary practices were perfectly exercised in banking sector like manufacturing companies, the recent exposure of various irregularities in banking sector could have been prevented and/or restricted and the focus on point of responsibility would not escape.

1.3 Research problem and justification:

Statement of the problem:

In case of manufacturing companies the production units are limited in number and in case of most of the industries productions and distributions are generally centralized. Although sales and distribution centers may be at different places but these are controlled from the head office. Due to this, it is easy for manufacturing company to plan and forecast its entire operations of different segments accurately for incorporation in the budget. A budget prepared based on accurate plans and forecasts can be properly monitored. Exercising effective control, locating variations and taking remedial steps become easy and timely.

On the other hand, the operational bases of commercial banks are their branches spread over the country. It is normal that some of the branches are situated at economically advantageous places but others may be located at places where economic activities, trade and commerce are not of significant volume. For the banks, the operational units, that is, the branches are separate cost centers and income generating unit. Thus, it is rather difficult for a bank to accurately forecast income and expenses of individual branch to incorporate into the total bank budget. This is one of the reasons that while preparing budget, banks normally opt for expediency and the average balance - average rate approach. In this case budget inputs are based on what the managers believe their volume and rates will be, with no regards to what the current volumes existing in their favor.

Furthermore, demand for products can be ascertained from market survey with adequate accuracy but economic strength of people of particular area is really difficult to ascertain. Thus, it may be fairly apprehended that commercials banks budget may not be prepared on accurate plans and forecasts and as such, subsequent control and monitoring processes may not as effectively and timely as expected.

Justification of the study:

Considering the vital roles played by the commercials banks on the economy of the country, accurate forecasts and preparation of a budget with highly dependable data and achievable goals, is imperative. Through a budget, accountability of the responsible employee is assigned. Without assigning responsibility and authority, good governance becomes impossible.

Delegation of authority and responsibility of performance ensures proper control. As main sources of the income of banks are from loans and advances, timely recovery of those required strict rules and control. A properly drawn, rightly implemented and strictly monitored budget can ensure all the above factors and can contribute positive results in growth and profitability. From this point of view, good practice of budget and study to ensure that proper budgetary practices are followed by such important organization like banks is undeniable. Keeping this in view, the subject research topic was considered to be timely and result oriented.

1.4 Research objectives:

Given the background of the present study and the review of the research problems and justifications, it seems that the need to understand the use of effective budgetary practices in private commercial bank is very important. To ascertain and ensure whether the commercial banks follow budgetary practices in consistence with banking industry standard and requirements, and whether the banks are well equipped with trained employees and supporting manuals and guidelines is also essential.

The specific objectives with which this research program has been designed are as follows:

a. To determine the present state of budget practices in private commercial banks in the country and attitudes of the banks' managements towards the effectiveness of this management tools.

b. To find out whether proper procedures are followed in preparing the budget and whether supporting guidelines and manuals such as, budget manual, fixed asset manual, central bank guidelines are followed or not. Also to ascertain, whether budget is prepared by independent department with trained staffs and prescribed budget forms are used or not. Further, to find out that budgets are prepared in details with narrative accounts head and are classified into categories such as–revenue budgets, capital budgets, man-power and recruitment budgets etc.

c. To find out whether participation of all concerned departments/ branches/ staffs were ensured and budgetary responsibilities of respective employees were established duly. Also to observe the responsibilities for budget preparation, budget adoption, execution and reporting are separated and are not done by the same set of people.

d. Whether best estimates are made for deposits on income center basis or source basis and whether any incentive plans are in action for deposits in addition to prescribed interest rate. Also to ascertain whether the banks outline a fixed recovery schedule for loans and advances and other related matters and to find out whether an efficient risk management team and a legal department are actively engaged in recovery process.

e. To ensure whether the process of implementation and adoption of budget is supplemented by official circulars with definite responsibility and whether punitive actions are enforced for failure.

f. To find out whether budget estimates are compared with the actual results periodically and variations are duly brought to the notice of the proper authorities for necessary and timely actions.

g. To find out whether necessary remedial actions are taken to fix up the negative results and adverse course of actions, if any, to reverse the undesirable events.

h. To outline suggestions and recommendations necessary for the lacking areas.

1.5 Scope of the study:

The subject research topic is 'Evaluation of Budgetary Practices in the Private Sector Bank of Bangladesh'. Obviously, the field of the study was restricted within the private sector banks. In Bangladesh, there are total 56 scheduled banks operating now. Bangladesh has a mixed banking system comprising of: 4 State- owned Commercial Banks (SCBs), 4 Development Financial Institutions (DFIs) or Specialized Commercial Banks (SBs), 39 private commercial banks (PCBs) and 9 foreign commercial banks (FCBs) and 4 non schedule banks in Bangladesh. Bangladesh Commerce Bank Limited (BCBL) is also excluded from this study because the government owns more than 50 % of its share. As a result, the ultimate sample size is confined with the remaining 29 PCBs in the country.

For the purpose of this study only private commercial banks are selected as sample in line with the selected Topic. For this reason, all nationalized, specialized and foreign banks are excluded from the study. Out of 39 private commercial banks, 9 private commercial banks are excluded from this study because all of those were established in the year 2013 or after that and most of these newly established banks are not yet fully in operation.

1.6 Significance of the study:

Banks operate with large numbers of branches. Besides, for such vast operations huge number of employee are engaged. It is not easy to control and monitor activities of such huge numbers without proper monitoring and control system in force. Budgetary Practices to a large extent can ensure effective operational control and policy compliance.

Lack of previous research works on budgetary practices in private banking sector of Bangladesh was a constraint. Views and ideas could not be formed about the present state of practices of budget in this sector without in-depth study. This has inspired and instigated to take up the present topic for study.

This study aims to critically examine the practical situation that is prevalent in private commercial banks regarding use and effectiveness of budgetary practices. The study can open a window to have insight views as to how far the banks are successful in using budget to strengthen their control system.

A research study of this nature and magnitude may easily identify the weak areas of the budget implementation, monitoring and the adverse effects of lapses, if any. Recommendations and suggestions can be drawn out for future research and implications.

1.7 Research Methods and Analysis:

Primarily, a qualitative research method was followed to collect information through a close-ended structured questionnaire. The qualitative data were supplemented by quantitative data while analyzing, in order to measure performances and growth. Both primary and secondary data were used in this study.

Research design was made to reach at the research objectives as set in the preceding section. Sample design and sample size was chosen to cover all conventional commercial banks up to 3rd generation. Collected data were analyzed in chapter six and the findings are stated therein in details.

1.8 Limitations of the study:

While conducting this research project certain constraints were faced. Those can be summarized as:

1. Lack of published works- while quite a good number of published articles or works were available on different aspects of operation such as: performance, profitability and growth etc. But research works and publications on the topic of budgetary practices in private commercial banks were not available.

2. Time constrains – the time obtained for the project was very limited compared to the total number of 29 banks taken into consideration.

3. Sample selection- there are 39 private commercial banks in Bangladesh. Only 29 were selected for this study ignoring the rest as those belong to the 4th generation banks, established during 2012/2013.

4. Tendency to maintain secrecy- while dealing with the concerned employees of the selected banks it was observed that in respect of giving information and

data, most of them acted conservatively. Tendency to maintain secrecy in disclosing internal information was widely observed.

1.9 Thesis outline:

The study proceeds with briefing the importance of budgetary practices in banking sector. The overall outline as well as the approach of the study is discussed in this section. This thesis comprises of total seven chapters and these chapters contain the following -

Chapter -one: Introduction:

The chapter discusses the concept of budget, research background, research problem and justification, objectives of the research, scope and significance, brief methodology and limitations of the study.

Chapter - two: Review of Literature:

Literature review focuses on views and opinions of the experts and authors related to this research Topic. This includes research works, articles from published journals, other publications on budget and allied subjects. This chapter additionally discusses the literature related to the purpose of the budget, classification of budget, standard setting, time duration to establish a budget, forecasting, preparation/ basis, budget –committee/ department responsibilities, centralization / decentralization, variance analysis, internal control, cost control, performance measurement, feedback analysis, and revision or revised budget.

Chapter-three: Methodology and Research Plan:

Methodology of the study covers both qualitative and quantitative research approaches as far as required for this study. This chapter includes sample design, research design, questionnaire design, data collection, and data analysis.

Chapter- four: Budget and Budgetary Control:

The chapter proceeds by outlining the broad view of budget and budgetary control system. Budgetary control system includes budget centralization, budget coordination, monitoring the budget, feedback analysis and internal Control. It discusses the concepts of budget as a tool of performance measurement which includes setting of goals, obtaining periodical reports of performance, finding of variances and reasons thereof and corrective measures and actions. It also broadly discussed the budgetary practices in Bangladesh.

Chapter- five: Banking Sector in Bangladesh:

This chapter deals with the history of banks in Bangladesh, evaluation of public sector and private sector banks. It discussed the contemporary development of private commercial banks. A comparative study of public and private sector banks in Bangladesh was also done. It also broadly discussed the budgetary practices in banking sector.

Chapter- six: Budgetary Practices in Private Sector Banks:

This chapter deals with an overall review of budgeting in private banks. The preparation of budget, budget responsibility, planning for deposits, credit facilities and recoveries are also discussed in this chapter. It also focuses on implementation of budget, evaluation and performance measurement and monitoring and feedback.

The chapter also deals with data analysis and interpretation of the study. The obtained data are classified according the consistent nature of each section. Feedback of the selected banks are analyzed and interpreted. The findings of the study have been summarized in this chapter.

Chapter-seven: Conclusion and Recommendation:

This chapter provides review of objectives, implications of results, limitations of study, future research direction and recommendations.

1.10 Summary:

To initiate the discussions, this chapter started with an overview of budgetary practices- its definition, importance and implications. A background of this research was outlined for selecting the particular topic. Problems anticipated for the study and justification to conduct the research was discussed in the next. Detailed objectives and significance of this research were narrated at length. This study was not without constraints and limitations; these were pointed out followed by thesis outline and research frameworks. The succeeding chapter discusses the methodology and research plans followed in this study.

CHAPTER-2: METHODOLOGY AND RESEARCH PLAN

2.1 Introduction:

This chapter provides justifications of the methodology used in this study. The research design and program should have a specific methodological direction based on the research objective and framework. The aims and objectives of this study are to obtain a vivid picture of the present state of use of budgetary practices in private commercial banks. From the preparation of budget up to monitoring and feedback, whether uniform and standard practice is followed or not is also another objective. Furthermore, whether effective control and monitoring system are in practice or not and whether drawbacks are identified and subsequent remedial actions are taken or not are also a purpose of the study. It emphasizes to identify well practices with a view to providing some insights on the budgeting approaches applied and developed in the private sector commercial banks in Bangladesh.

It is assumed that different banks operate in different environment with different attitudes of management and follow different approaches to obtain their goals and objectives. Therefore, a uniform budgetary practice may not exist in the entire banking sector.

In order to effectively conduct this research, both qualitative and quantitative approaches have been used. The report is prepared based on a critical review of both primary and secondary data. Primary data are obtained through discussion with the concerned officials, who are involved with the organization's budgetary practices. Primary data were also obtained through a structured close-ended questionnaire. The questionnaire was classified into seven different sections covering areas from preparation of budget up to the steps and action taken for favorable and unfavorable performance.

Secondary data were also collected from publications of Bangladesh Bank and other publications, such as books, research papers, relevant articles, magazines, newspapers, periodicals, websites of the banks and different authentic web publications.

In this section, the sample design, research design, questionnaire design, data collection procedures, data analysis and limitations of the study are presented.

2.2 Sample Design:

In Bangladesh, there are 56 scheduled banks operating now. Bangladesh has a mixed banking system comprising 4 State- owned Commercial Banks (SCBs), 4 Development Financial Institutions (DFIs) or Specialized Commercial Banks (SBs), 39 Private Commercial Banks (PCBs) and 9 Foreign Commercial Banks (FCBs). Moreover there are 4 non-schedule banks in Bangladesh which were established with specific purposes and do not perform basic commercial banking functions. 39 Private Commercial Banks (PCBs) in Bangladesh can be categorized into two groups. There are 31 conventional PCBs are now operating in the industry. They perform the banking functions in conventional fashion i.e. interest based operations. There are 8 Islami Shariah based PCBs in Bangladesh. (Source: Bangladesh bank)

From the four types of banks only private commercial banks are selected as sample for this study. This study is conducted on budgetary practices in the private commercial banks of Bangladesh. For this reason, all nationalized, specialized and foreign banks are excluded from this study. Out of 39 private commercial banks (31 conventional PCBs and 8 Islami Shariah based PCBs), 9 private commercial banks are excluded for sample from this study because most of those are established in the year 2013 or after that. Only a few of these 9 banks started operation at a very limited scale and with a very limited number of branches up to now. And as such, preparation of a total budget package and application of performance measurement techniques are not still in practice. For this reason they are excluded from the study.

Then again, from the remaining 30 PCBs, Bangladesh Commerce Bank Limited is excluded from this study. This bank was excluded because the capital structure of this bank consists of 33.94% of the share are directly held by the Government itself. Furthermore another 16.47% of the capitals are held by state-owned banks and Government owned corporate bodies. This totals 50.41% ownership of the Government itself. As such this bank was also excluded for the purpose of this study. Therefore the rest of the 29 private commercial banks are selected as sample. A structured questionnaire was developed and distributed to all 29 sample banks. Out of 29 private commercial banks, a satisfactory 28 questionnaires were duly completed and received. A simple percentage of response rates are 97%. And non response rate is insignificant 3% only.

This study covers all the private commercial banks which fall within the category of 1st generation to 3rd generation banks of the country established within the period from 1982 up to 2010. The 4th generation banks were ignored with due reasons. Collected qualitative data were related to the present state of budgetary practices in the private bank without reference to previous practices.

2.3 Research design:

'Research design is the plan and structure of investigation so conceived as to obtain answer to research questions. The plan is the overall scheme or program of the research. It includes an outline of what the investigator will do from writing hypothesis and their operational implication to the final analysis of data.' -Cooper and Schindler, (2008).

The present research study is basically of qualitative and descriptive nature. As Riley, et al. (2000) states, 'there are many occasions in which we want not to "count", or quantify some social phenomenon. Riley, et al (2000) also states, 'This is the type of method of research we label qualitative, describing explanations based on non-numerical data'.

The prime aims and objectives of this study are to find out present state of use of budgetary practices in the private sector banks in Bangladesh, its effectiveness and loopholes, if any. Efforts were also made to explore the scope, relevance and significance of this dissertation. Research problems, justifications and limitation of the study were also taken into consideration.

In order to get a concrete idea about budget and its practices in general, extant literature by experts were extensively reviewed. Areas such as, preparation and uses of budgets, its implementations, internal control and monitoring system of budgets, budget as tool of control mechanism were covered. Furthermore, literatures on budget to measure performance were also taken into account to form a theoretical idea about the effectiveness of budget and its advantages for an organization.

Qualitative research approach was followed as suitable in the circumstances. Both primary and secondary sources of data were used in this study. A sample size of 29 PCBs have been selected for the study and were approached with a close-ended structured questionnaire for data and information. Completed replies were received from 28 respondents which is 97% of the total sample.

Further discussions proceeded on history of budget, use of budget in the light of practices in Bangladesh with special emphasis on banking sector. The impact of budget on exercising control in the financial sector was critically examined from a theoretical point of view. The control system can function properly only in a well-structured organization where full cooperation and coordination are ensured. Desired benefits of budget can only be achieved if actual performance is measured with the set standards. Here begins the process of variance analysis and performance measurement.

A gradual development of the entire banking sector of Bangladesh was given in succeeding section. History of banking industry in Bangladesh, its divergence, impact on national economy and its successes and pitfalls are enumerated. The policy of nationalization, partly privatization of the banking sector was discussed. Emergence of private commercial banks and their roles on the economy were reviewed.

In keeping with the title of the present research topic, all out efforts were exerted to get a vivid picture of the present situation of budgetary practices in the PCBs. This was done through a field survey by questionnaire. The survey data portraits a clear picture of the processes of practices of budget in private banks of Bangladesh. From preparation, implementation and subsequent follow up, monitoring and feed-back all aspects of budgeting processes were covered.

The collected available data from the survey were analyzed by using percentage method, ranking method and comparative analysis method.

2.4 Questionnaire Design:

In this study, questionnaire functions as a preliminary data collection technique. The questionnaire aims to describe the general pattern of budgeting practice in the private sector Banks of Bangladesh.

Saunders et al. (2003), state that the validity and the reliability of the data you collect, as well as the response rate you achieve, depend, to a large extent, on the design and the structure of your questionnaire.

In order to collect necessary data and information for this research report, a structured questionnaire was prepared and used as primary source of data. In the questionnaire, only closed ended options have been considered. After pre-testing the same was distributed amongst the respondents. While designing the questionnaire consideration was given to cover all the aspects of budget and budgetary practices as deemed to be applicable to the banking sector.

Keeping this in mind, total questionnaire was divided into seven segments. Each segment has a set number of questions depending on nature of the segment. The first segment, ‘Use of budget’ outlines questions as to the types of budget used by banks, use of budget manual and other guidelines and the composite of budget authority as prevailing in the banks. This segment has fifteen questions.

In the second segment emphasis was laid on the mode of ‘Preparation of budget’ in respective banks and it has five questions. This segment focuses on two aspects such as, factors to be considered in preparation of budget and the basis of preparation of budget.

'Budget responsibility' is dealt in segment three outlining the participation of the concern employees and responsibility distribution. This section has five questions. It also emphasizes on finding out whether the budget is drawn from the operational unit level or from the corporate level. Questions are also designed to find out whether periodic review of the responsibility is in force.

The main strength of bank lies in 'Planning for deposits and investments'. Accordingly, questions were designed to cover all these aspects in segment four with five questions. The questions cover basis of deposit target, basis of investment or credit facility target and target for loan recoveries. Furthermore, efforts were made to gather information as to provision for classified loans and provision for necessary actions for loan defaulters.

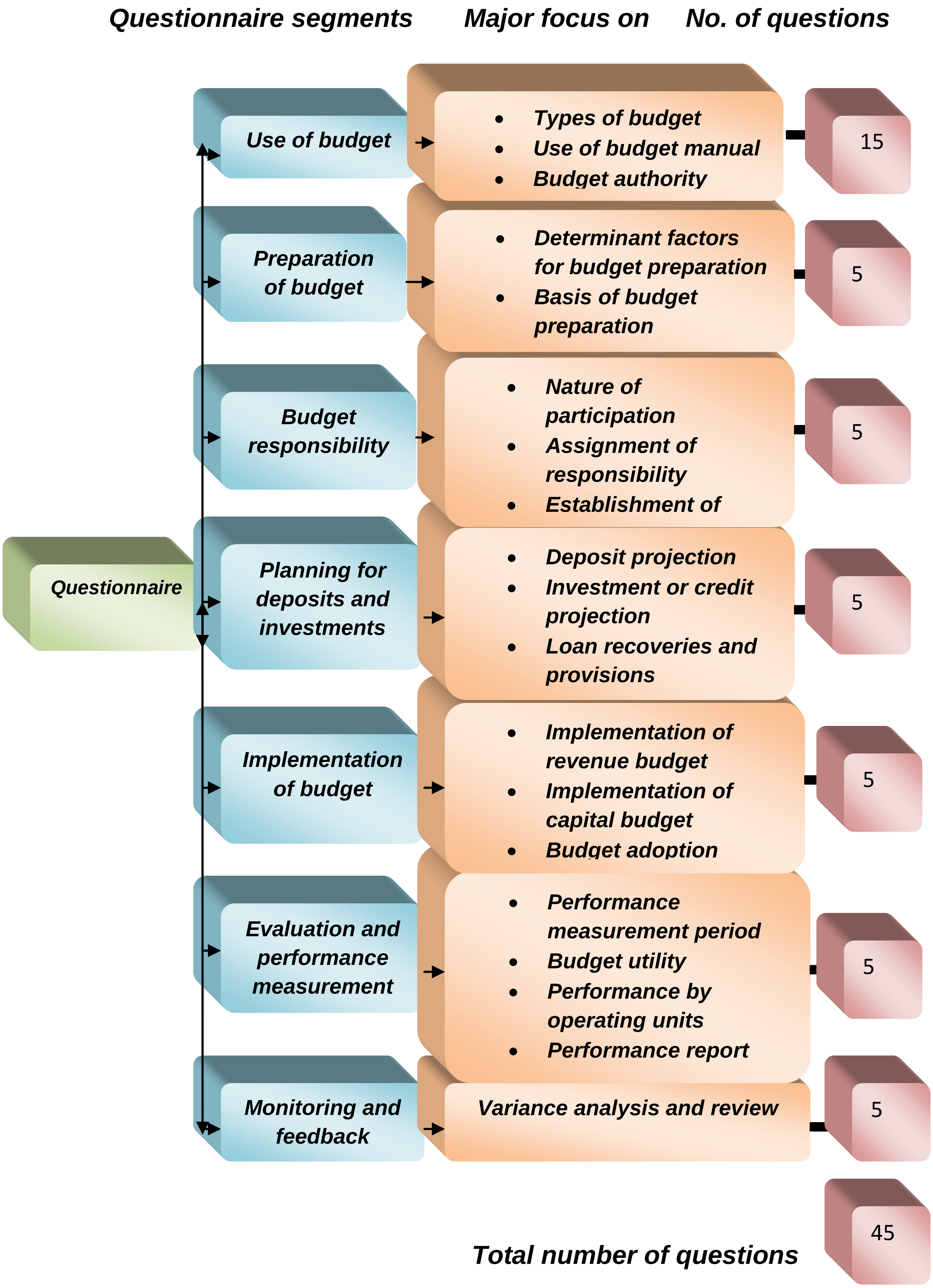
'Implementation of budget' is the most important activity of the budgeting process. In segment five, there are five questions designed to find out whether both revenue and capital budgets are implemented at the base branch level or corporate level. It was also designed to reveal whether implementation is a time bound activity or not.

'Evaluation and performance measurement' was dealt in segment six of the questionnaire. It has five questions. It was designed to find out whether budget is used as performance measurement tool or not. It also tried to find out the performance measurement period and operational unit base of performance measurement.

The ultimate advantages and benefits of budget lie in 'Monitoring and feedback' process. Segment seven of this questionnaire dealt these aspects. Five questions were designed to extract information as to whether budget estimates are recorded in accounting system and variances are analyzed regularly. It was also tried to reveal whether corrective measures based on variance analysis are taken or not.

A pictorial view of the design of the questionnaire as discussed above is shown in the next page.

Figure: 2.4 Questionnaire design



The analysis and interpretations drawn in this dissertation are based on survey data received from the respondents of this Questionnaire.

2.5 Data Collection:

Data were collected from both primary and secondary sources. Primary sources include personal interviews and questionnaire. The secondary source included publications of central and other banks and other publications on allied topics. In fact, main source of qualitative data was the questionnaire. To cover all the aspects of budgets including usefulness and effectiveness, all questions considered to be relevant were incorporated into the questionnaire in order to enable to support the hypothesis of the research. The questionnaire form was used because large amounts of information to be obtained at low cost and more accurate responses are expected as interviewer bias is avoided.

2.6 Data Analysis:

The data extracted from the respondent banks through a questionnaire of seven segments are analyzed and interpreted. While analyzing the data percentage method, and comparative analysis method were followed based on the nature of the collected data. Graphical presentations of the results of analysis are also shown in the form of column, line and pie charts.

2.7 Limitation:

Despite exertion of reasonable efforts to collect information and create a perfect data base there might have been some pitfalls. The following limitations of this study are apparent-

i. The respondents are limited in term of size as only one designated executive of a bank supplied the completed questionnaire.
ii. The depth of analysis of collected data has been limited to the extent of information made available by the respondents.

2.8 Summary:

All the 29 private commercial banks are taken as sample for this study. A questionnaire was submitted to each bank and feedbacks were obtained from a single source of the banks with a few exceptions. A qualitative research approach was followed in keeping with the objectives. The collected data were analyzed and interpreted to draw inferences. Secondary data were also collected through related publications. In this chapter the research methodology was discussed and following chapter is planned to deal with literature review.

CHAPTER-3: LITERATURE REVIEW:

3.1 Introduction:

In the previous chapter research methodology as followed for this study was discussed in details. This chapter is designed to review and discuss theoretical research literature done by scholars on different aspects of budget and budgetary practices. The main areas which are covered for review comprise the extant literature on budget and its purposes, budget types, standard setting, forecasting, budget timing, budget committee, budget manual, centralization/ decentralization of budget. Furthermore, the relationship between budget and internal control, budget and cost control, variance analysis and performance measurement are also explored in this chapter. This chapter was planned to help review the supportive views and opinions that may provide more insights for this study and to form a theoretical idea as to preparation and use of budget in general. Moreover, it is expected that expert's views and opinions about implementing and monitoring systems of budget could be reviewed. The chapter also aimed to get a theoretical base as to use of budget as an effective management tool and the attitudes of management towards those ends. Efforts were made through this review to form an idea about suggestions and recommendations of the academics and experts on lacking areas.

The theoretical literature taken into consideration for this review discuss budget and budgetary practices in general term as there is a scarcity of the literature directly related to the research topic of this study.

3.2 Budget- An overview:

This section consists of three sub-sections- budget, its definitions, purposes and classifications. Each of these points is discussed in details below.

3.2.1 Budget - introduction:

Extant literature on budget in general is abundant and varied, defining budget and other aspects of budgetary practices from different angles and perspectives.

Bruns and Waterhouse (1975) define budget as financial plans that provide the basis for directing and evaluating the performance of individuals or segments of organizations.

Needles, Powers and Crosson, (2002) refer to budgeting as the process of identifying, gathering, summarizing, and communicating financial and non-financial information about an organization's future activities. They add that a budget is a plan of action that forecasts future transactions, activities, and events in financial and non-financial terms.

Abdullah (1980) outlined budget as- a plan based on a classification of costs and their variability, and it can serve as a control over future operations. He further explained that in its flexible form, the monthly budgets can be adjusted to current volume. Unless these adjustments are made promptly, costs may not be kept into line with changes in volume.

Merchant (1981) defines budgeting system as a combination of information flows and administrative processes and procedures that are usually integral part of the short-range planning and control system of an organization.

Frederick (2001) defines budget as plan that is measurable and timely. Elaborating the areas and scopes of budget, Arthur Anderson (2000) defined budget as a systematic method of allocating financial, physical, and human resources to achieve strategic goals. Companies develop budgets in order to monitor progress towards their goals; helps control spending and cash flow and profit.

According to the CIMA-(UK) (2005), definition of budget is – ‘A budget is a quantitative expression of a plan for a defined period of time. It may include planned sales volumes and revenues, resource quantities, costs and expenses, assets, liabilities and cash-flows’.

From functional point of view, budget has been defined as a set of interlinked plans that quantitatively describe an entity's projected future operations. A budget is used as a yardstick against which to measure actual operating results, for the allocation of funding, and as a plan for future operations.

In the context of the advantages of budget, the entire budget process is defined as- the key benefit of business planning, budgeting and forecasting for a company is that it will give the opportunity to stand back and review business performance and other factors affecting the business.

From the expert views defining budget, its merits and objectives as outlined above, it may seem that budget has all the positive and beneficial impacts on organization. Pierce and O’Dea (1998), also subscribe to the view that budgets are still relevant to today’s business environment. Clarke and Toal (1999) too are of the opinion that budgets are still essential and can for example, be incorporated as part of the financial component of the balanced scorecard.

But on the other hand, some critics argued differently. In an article, Anderson (2000) stated that- “The central challenge that budget developers face in mapping out the future, is something that can never be done with perfect precision. The fast pace of technological change and the complexities of global competition make developing effective budgets both more difficult and more important".

Some critics stepped further on the limitations and obstacles of budget. The research paper on Budget by Libby and Lindsay, part 1, (2003) criticized budget by saying that drawback associated with the budget is that annual financial budget targets encourage short time perspective and cost savings in order to meet the objectives.

Again, Hope and Fraser, (2003) said- "Short term goals prevent organizations to emphasize on long term value adding strategies, which can be harmful in the long run. Employee's fear of not meeting the objectives encourages bad behavior such as manipulating and gaming with numbers."

In another article by Hansen et al. (2003) it was said that according to a survey of France companies, organizations that operate under unpredictable circumstances are most dissatisfied with budgets. Although budgets can be a useful control tool for companies operating in stable environments, Hansen et al (2003) stated that for most business budgets are not useful.

In another survey conducted by (Libby and Lindsay, 2010) it was opined that the budget does not facilitate adapting to changes in unpredictable environment. Hence, spending time on forecasting and planning the future can be completely useless.

Opinions, views, depictions and analysis of the majority of authors clearly favor practices of budget in business organizations with a few limitations and negative views. And as such, budget is widely used in both commercial and public organizations all over the world and its limitations are surpassed by its benefits and advantages.

3.2.2 Budget- purposes:

Budget can serve many purposes if it is prepared properly and used rightly. Major views on purposes of budget center on improving profitability, operational efficiency, right and timely decision making and fixing responsibility and accountability. As contented by Heckart and Wilson (1955), the purpose of the budget as simply - finding the most profitable cause for an Enterprise.

Like Heckart and Wilson, Stedry (1960:2) concentrated primarily on increasing profit as the main purpose of budget. According to Stedry, the primary objective of budgeting is to increase long run profit at the fastest possible rate.

In firms the budget has historically had a control function (Libby &Lindsay, part-1, 2003) but with the change of time other objectives and purposes have come out which vary among organizations. Drury (2004) summarized eight purposes of budget as- planning, coordination, communication, resource allocation, performance evaluation, responsibility distribution, establishing objectives and motivation. These purposes are correlated with each other and realization of these purposes largely depends on a collaborative action of all levels of employees of the organization.

Ax et. al. (2009), complemented the above eight purposes with further two purposes such as- awareness and incitement. According to him budget creates awareness about the organization’s goals to make worker understand the overall picture of the organization. Staffs can understand how their individual work is contributing to the organization as a whole instead of just seeing their own unit. Budget is an incitement for the employees. The budget becomes a benchmark for what is sufficient level to reach. By comparing the budget with the actual outcome, a reward for the accountable can be made.

Hansen and Stede (2004) examine the purposes of budget from a practical point of view and found four purposes corresponding to the traditional reasons. The authors concluded that four main purposes of budgeting are – operational planning, performance evaluation, communication of goals, and strategy formation.

Besides profitability and efficiency improvement, budget can also serve its purpose through psychological motivations and bearings of the budgeted individual. This aspect of purpose of budget was very nicely stated by Festinger, (1957); Brehm and Cohen (1962).They assumed that if the budgeted individual can be persuaded to accept the budget goal, his homeostatic nature can be relied upon to achieve it, or to bring performance as close to it as the environment will allow.

Budgetary control is a hierarchically linked combination of efforts of goal setters and goal achievers. It is thus, a control tool for legislatures over executive, for the chief executive over subordinates, and a means of specifying authorization and limitation for the executive (Okoye and Ani, 2004).

These reviews establish a reasonable supportive ground on the purpose of budgeting. It would not be unreasonable to say that operating a business organization without a budget is like a pilot navigating in the dark without instruments. No doubt, this remark provides a genuine and authentic view on the purposes of budget and budgetary practices.

3.2.3 Budget- classifications:

Different writers and authors classified budget in their own different ways. But in summing up, almost all types of budgets are covered by each of them under different names and terms.

Budget types:

Gregory (2005) identifies two main types of budget. These are traditional budget and The Medium-Term Expenditure Framework (MTEF) budget. MTEF budget is used in the public sector and particularly by the Government and as such, concentration will be on traditional budget only.

The traditional budget is a tool which is used by business to achieve certain goals predetermined for a future period. Gregory (2005) reclassified traditional budget into four categories namely: Fixed Budget, Flexible Budget, Capital Budget and Sales Budget.

a. Fixed budget:

Fixed budgets are often used by organizations which rely on their forecasts. Hofstede (1968) observed that frequently discussed issue in the accounting literature is whether a budget should be fixed or variable with respect to volume, sales or other inputs. The fixed budget is therefore, a budget which once made and accepted cannot be changed. Changes in sales volume does not affect in other elements of costs.

b. Flexible budget:

According to Garrison (2000), a flexible budget reflects the effect of changes in the budgeting environment which affect the performance of the budget, it does not confine itself to only one level of activity and actual results do not have to be compared against budgeted costs at the original activity level.

Flexible budget is a technique that adjusts the budget for various level of business activity. In developing the flexible budget, expected or budgeted costs relationships are quantified so that the budget can be easily adjusted to any level of business activity (Cherrington, Hubbard and Luthy, 1988). Maher and Deakin (1994) agreed that a flexible budget indicate revenues, costs, and profits for virtually all feasible levels of activities.

c. Capital budget:

Pandy (1999) defines capital budgeting as the firm's decision to invest organization's current funds most efficiently in long-term activities in anticipation of an expected flow of the future benefits over a series of years.

d. Sales budget:

The key factors in planning a sales budget are assessing the market demand and the ability to meet that demand on the part of the organization. Stanton (1971) mentions that the cornerstone of successful marketing planning in a firm is the measurement and forecasting of market demand. The key figure needed is the sales forecasts because it is the basis for all budgeting and all operation in the firm.

Adams et. al. (2003), identifies five different classes of budget; activity based budgeting, zero-based budgeting, value based budgeting, profit planning and rolling budget and forecast.

a. Activity Based Budgeting (ABB):

Wilhelmi and Kleiner (1995), subscribe to the views that ABB can be applied in all industries and in all functions, including service industries and overhead functions. It also can be used in manufacturing industries alike. It is a management process, operating at the activity level, for continuous improvement of performance and costs.

b. Zero-Based Budgeting:

Lucey (1993), argued that, zero-base budgeting is a cost benefit approach. Thus, it is assumed that the cost allowance for an item is zero and will remain so until the responsible personnel justifies the existence of the cost item and the benefit the expenditure brings in.

Appiah-Mensah (1993), viewed that ZBB are prepared without reference to the budget of the preceding period. A fresh look is made at the activities of the organization and based on the new circumstances and entirely new budget is prepared.

c. Value-Based Budgeting:

This is a formal and systematic approach for managing the creation of shareholders value over time (Adams et al. 2003). All expenditure plans are evaluated as project appraisals and assessed in terms of the shareholder value they will create. This helps to link strategy and shareholder value to planning and budgeting.

d. Profit planning budget:

According to Adams et al. (2003), profit planning budget is about planning the future financial cash flows of profit centers (profit wheel), it gives the possibility to assess whether an organization or unit generates sufficient cash flows, creates economic value and attracts sufficient financial resources for investment. It also ensures consideration of an organization's short-and and long term prospects when preparing its financial plans.

e. Rolling budgets and forecast:

Rolling Budgets and Forecast appear to have the most potential as the better regular budgeting approach. It enables firm improve their forecast accuracy and overcome the traditional budgeting time lag problem. (Adams et al, 2003).

Brook and Palmer (1984), classified budget into seven categories such as – sales budget, production budget, direct material budget, direct labor budget, manufacturing overhead budget, operating expenses budget and cash budget. Each category, in brief, is described below:

a. Sales budget:

Sales budget is the sales department's objectives for the budgetary period. It is the key to the overall industry budget, because the projected sales volume is used as a basis to determine amount of goods to be produced, the labor, equipment and capital required and the natural and amount of various selling, administrative and financial expenses needed. Sales estimates are based on past performances and on the forecast of business conditions for the coming period.

b. Production budget:

Once the sales budget has been determined, a production budget can be made to meet requirements of sale budget. The actual number of units to be completed is computed from the units to be sold, desired size of ending inventory and units in the beginning inventory.

c. Direct materials budget:

Material budget is developed to determine the material to be purchased based on the usages and inventory to be maintained for the period. It is usually prepared to show the quantity and value of materials required for the estimated production. The material budget is a determining factor for future cash requirements.

d. Direct labor budget:

The direct labor budget is an estimate of the total direct labor hours and direct labor costs required to complete the projected production for the budgeted period. Appiah-Mensah (1993), also explained that, it may show wages of direct workers and direct labor utilization needed to complete the production schedule for the budget period.

e. Manufacturing overhead budget:

The manufacturing overhead budget is more difficult to estimate than direct materials and direct labor. It show the amount expected to be spent as cost of running production units. Manufacturing overheads include both variable and fixed elements of costs.

f. Operating expenses budget:

Budgets for operating expenses are prepared covering all selling and administrative expenses estimated to be incurred to achieve estimated sales and production operations.

g. Cash budget:

Cash budget is the estimated cash in-flows and cash out-flows expected to occur during the budget period. The cash budget shows the effect of budgeted activities selling, buying, paying wages, and investing in capital equipment and so on. Cash budgets are prepared to ensure that there will be sufficient cash available matching with budgeted activities.

3.3 Budget- forecasting:

Discussions on standard setting, budget time/ period and forecasting are dealt with in the section. Chronological detailed narratives are as follows.

3.3.1 Budget- standard setting:

Forecasting for the future, of business performance or of any planned actions, invariably requires some standards to prop on. It is difficult to predict future, even roughly, without enough experiences and reasonably correct estimates based on specified goals or objectives. It is also true in case of budgeting. Setting standards is like mapping the path of the journey.

According to Drury (2004), these performance standards embracing all the activities of an organization together, form a plan or a budget, which gives the direction and indication for future management. This at the same time provides the standard by which actual result can be measured (Hanson, 1966). While elaborating features of budget standard, Johnson (1998) and Drucker (1954) advocated the use of setting clear, tangible, verifiable, measurable goals in order to motivate, rather than to ‘control’ people.

Hirst (1987) identifies two characteristics of budget targets namely, the specificity and difficulty level of budget goals. Specific targets are those that are expressed in quantitative terms and non-specific or general goals are expressed in non-quantitative terms.

Budget target setting consists of establishing specific, measurable time targeted objectives. Goals provide a sense of direction and purpose (Locke & Schweiger, 1979). Hofstede (1967) hypothesized that while up to a certain level of difficulty, higher goals would be accepted with resulting improved performance, beyond that, the goal would be rejected and performance would decline.

Hirst (1987) defines goal difficulty as the level of performance required to achieve a goal. In general, goals are moderately difficult where they are set at the average level of performance for a given task.

In a study conducted by Stedry and Kay (1966), it was observed that difficult goals were associated with either very good or very bad performance -good performance resulted when the performers thought the goals challenging, but bad performance resulted when they thought them impossible.

However, when budget targets are established at management level and thereafter solely laid down, employee motivation with regard to achieving these targets is rather suppressed (Lock and Latham, 2002).

Participation of goal achievers in setting goal or standard enhances performance. Vroom (1964), after a number of studies concluded that as subordinates were given a larger participation in target fixing decisions their performance improved. From the budget point of view, this may mean a greater willingness to honor their self-commitment. Lawrence and Smith (1955), found that production increase very significantly where objectives had been set after participation and discussion with the budgeted individuals.

Hofstede (1967), after his intensive studies on ‘participatory budget’, expressed an expectation that participation helps to ensure a perception among budgeted individuals that goals were fair and therefore budget would be more relevant to them.

Further, on the issue of flexibility for setting up a budget standard, Andersen (2000) viewed that best practice companies develop budgets, (setting standard) that accommodate changes, require managers to create scenarios based on a variety of assumptions about business conditions. That flexibility allows the companies to take quick and immediate actions when actual activities follow a particular flexible direction.

In fine, setting up standard for preparing budget may take any of the forms such as: a) a fixed budget based on data of previous period with certain percentage of variation in line with future estimation; b) a flexible budget with different levels of activity; c) a variable budget with different levels of activity and with cushions for alternative opportunities; d) Incremental budget with figures based on those of actual for the previous year with a percentage added for an inflationary increase for the year under budget; e) a budget set on zero bases and the budgeting process starts from scratch with the estimation of anticipated activities for the period under projection.

3.3.2 Budget-period/ time duration:

The period which is covered by a set of budgets is budget period. Period of budget may vary from organization to organization based on the nature of business or nature of expenditure. Generally revenue budgets are prepared for a period of one year with monthly or quarterly split ups. As acquisition of Capital Assets may take longer period to execute, Capital Budget may be, say, for one year, two years, and five years or even, for ten years. Brown and Howard (1982), observed that there is no “right” period for any budget; budget periods vary between short term and long term.

According to Jones and Pendlebury (1984), the budget period is of one year's duration, and will be designed to coincide with an organization's or government’s financial, or fiscal, year. There is no reason why a budget period has to be one year, but typically it is made so.

Cherrington, Hubbard and Luthy (1988) explained that, companies may have both long term and short term goals and objectives. Long term goals indicate companies strategic planning for couple of years whereas, immediate or short term goals specify the immediate steps to accomplishing the long term goals. The short-term plan is called a budget.

Izhar (1990) endorsed the views of Cherrington et al (1988) that the long-term budget is a financial translation of long term future plans and when these plans are split over a shorter period say, a month, a quarter or a year, it is a budget.

3.3.3 Budget- forecasting:

Sometimes it appears that the terms budget and forecast are used interchangeably- but it is not. Forecast is an estimation of some future events generally generated by cost centers or departments which have effects on the budget. Further, forecasting can be made by business organization for use of the Management other than incorporating into the budgets. While describing features of forecasts, Hope & Fraser, (2003) stated that traditional forecasts are rigid and do not change with changing business conditions.

Wallander (1999) observed that while preparing a budget data from the past are collected and these data are used to frame a forecast for the future. Wallander further observed that there is a limit of variables that can be considered when making a budget and thus, assumptions and forecasts must be made.

Correct forecasting of future operation is a key part of generating reliable budget. Forecasting may not be a science but if based on past results and proper assumption for the future, it will produce dependable performance. Wallin & Ekholm (2000) and Bergstrand (2003) said that forecasts are, in most firms, used in combination with the budget.

Reasonable forecast ensures that strategies and goals are based on solid ground and in case of risk or responsibilities it outlines how to handle those. Anderson (2000) distinguished between the budget and forecast in the manner that some companies rely on “rolling” or “continuous” forecasts rather than on traditional annual budgets. Difference between such forecasts and traditional budget is that the forecast is updated with actual results as the company moves through the year.

3.4 Budget- preparation:

Different basis of budget preparation, budget authorities and centralization and decentralization of practices of budget was discussed in this section.

3.4.1 Budget- preparation/ basis:

Initialization of preparation of budget starts with selection of a budget committee which will have the ultimate responsibility of preparing the budget and other related works. The next step will be to prepare a budget manual or budget guidelines in case a budget manual is not in use. Before starting draft of the budget, another significant factor is to be considered seriously, that is, determining ‘limiting factor or key factor’.

Maitland (2001) mentions that the process of preparing and agreeing on a budget is a means of translating the overall objectives of the organization into detailed, feasible plan of action.

Cherrington, Hubbard and Luthy (1988) and Izar (1990) share the same opinion on the process of preparing a budget. A number of stages can be identified in the preparation of a budget.

<u>Stage one:</u> Identification of the key aims for the budget year and major expected changes affecting the business for the same period.

<u>Stage two:</u> Determination of the key or limiting factors. Most of the businesses face some limiting factors hindering its growth. Generally it is the Sales or demand. It can be lack of skilled labor or anything else. However, the limiting factor(s) and its effect must be carefully identified.

<u>Stage three:</u> Preparation of the sales budget considering ‘limiting factors’ which is the most difficult budget to prepare.

Stage four: Initiation for preparation of the subsidiary budgets that is, production budget, direct labor budget, production overhead budget, selling and distribution budget, administration budget, capital expenditure budget and the cash budget.

Stage five: Involves review and co-ordination of the subsidiary budgets by the budget officer/ budget committee.

Stage six: The individual subsidiary budgets are to be consolidated in a master budget.

Stage seven: At this stage, the budget to be presented to the board of directions for approval.

Scott (1970) enumerates budgeting procedure to include: preparation of a statement of basic assumptions underlying the individual budget in the organization and preparation of a forecast of general economic conditions and condition of the particular enterprise. Budget preparation is usually characterized by uncertainties. This means it is based on probabilities with the use of assumed data. Factor not anticipated could adversely affect the budget and even when the factors are anticipated, some are intractable.

One of the most important areas of budget preparation is to allocate limited resources according to the organization’s priorities. On resources allocation, Andersen (2000) stated that every function and business unit needs funding for both capital and operating expenses- usually in excess of the actual resources available. This makes it critically important for companies to design procedures so that resources are allocated to support key strategies.

In fine, it may be said that in most of the Organizations, small or large, resources are limited whereas demand for the same is almost always beyond that limit. Here lies the importance of prudent allocations, so that the broader objectives of the Management to effectively run the Organization with maximum profit earning capacity are achieved.

3.4.2 Budget - committee/department responsibilities:

A budget committee is a delegated authority to prepare, implement the budgets and monitor subsequent performance reports. It is generally comprised of a few members of the top management

Henry (1969) noted, in general terms, the areas of functions of the budget committee that should include: to provide guideline on budget preparation, extend technical advice, review details of budget, suggest changes if required, reconcile various budget activities, finally approve budget in the acceptable forms and review budget reports during operational time. In fact, budget committee is management committee which supervises and coordinates the activities of the entire department in an effective manner.

With broader views on composites, functions, and responsibilities of the budget committee, Jawahar Lal (2002) viewed that- responsibility for the budget direction and execution is usually placed in the hands of a Budget Committee. The committee reports directly to top management. Budget committee comprise of managers of major functional areas such as, sales manager, personnel manager, finance manager, the production manager and engineer, the treasurer and the Chief Financial Officer (CFO). No doubt, budget committee plays a very important role in keeping the organizational budgets on right track and thereby ensures smooth operations and financial solvency.

3.4.3 Budget-centralization/decentralization:

Budget is a control device for an organization. There are different models of control approaches and as such, different models or methods of budgets exist in business. The budget models may include a centralized or 'top-down' approaches or a decentralized or 'bottom-up' approach. Companies can select which method they believe works best for their operating environment.

Top-down budget settings are situations when employees are not participating in the budget process. The top management sets the budget, without any participation of the employees. The budgets and goals are being imposed and employees have little influence (Drury, 2004). Centralized budgets are a top-to-down approach.

Child (1973) states the nature of centralization as a strategy for control. Maintaining control by the centralizing decision making reduces the need for organization, systems, procedures and specialized personnel to operate administrative systems. Owners and managers are responsible for creating the budget and "pushing" it down to each department in the organization.

Cherrington & Cherington (1973), pointed to a positive impact of top-down approach. Top-down imposition of budget target can lead to higher performance among the real performers as opposed to the managers who sometimes set their own targets.

The top-down approach works as front-line workers can do little to change the budget. Slack is also not present in this budget as executives restrict added money in the budget.

Making employees participative in budget process is called bottom-up (decentralized) budget setting, (Ax.et al., 2009). Decentralized budgeting approach is also known as 'participative budgeting'.

Decentralized budgets involve more input from individuals outside of the upper management team. Child (1972-p-163) observed the nature of control under de-centralization with structuring and states - the locus of decision making authority on operational matters de-centralized down to the incumbents of official roles, these roles are structured by virtue of their specialized prescribed duties and particularly by a system of procedure and documentation designed to limit areas of directions as well as provide information on role performance.

Participative budgeting has been defined as a means of communicating and influencing managers in the budgetary process, and as the extent of subordinate influence over setting budgetary targets (Brownell, 1982; Lau & Lim, 2002; Covaleski et al., 2003; and Mah'd, 2010).

Drury (1998) thinks that implementing budget participation implies that the budget should originate at the lowest levels of management and that managers should submit their budget to their superiors.

Vroom (1964), after citing a number of studies, concluded that as subordinates were given a larger influence in decisions, their performance improved, partly because of ego involvement which participation generated. Hofstede (1967) also expected participation to help ensure a perception among budgeted individual that goals were fair, and therefore the budget would be more relevant to them.

Participative approach creates a sense like ‘this is our budget’ and enhances responsibility among the performers to accomplish the goals or targets. Hilton et al (2000) endorsed the same idea. According to him participative approach may be effective and the performers may be inclined to attempt to achieve budgetary goals as a part of their commitments.

But Fisher et al. (2000) opined differently. Accordingly to their opinion, participative budget may give an opportunity on the part of the performing managers to create undue budget slacks. Johnson (1992), supported participative budget; according to him, this approach would result in a bottom-up employees’ empowerment.

From a different dimension, Denton et al, (1999), observed that participative approach can ensure that the staff to be more receptive of decisions and objectives if the management is able to create an environment of mutual trust and a sense of employee ownership.

Companies may also use participative budgeting in conjunction with another budget model. That may gain wider acceptance towards budgets from all concerned.

3.5 Budget- implementation:

A broader discussion on implementation of budget was done in the section. Moreover, variance analysis, its implications, performance measurement etc. were also dealt with here. Point-wise detailed narratives are in the following sub-sections.

3.5.1 Budget- implementation:

Implementation process of budget just begins with the completion of budget package. Good budget implementation just doesn't happen automatically. Rather a sound budget implementation system is needed. While explaining the process of implementation of budget, Khaleda (1981), suggested that four steps are required in the process of implementation of a budget which are: organizing and coordinating, staffing, directing and motivating.

In the same manner and with more details Professor Jawahar Lal (2002) elaborated the implementation process in the following order-a) once the budget plans have been approved in the light of organizational goals and availability of resources, the budgets should be communicated to departments and responsible managers; b) changes and modifications incorporated in the final budget should be made known to managers to obtain their cooperation and support for the budgets; c) the final budget is presented to the managers concerned and adopted as the plan of operation for the coming budget period.

Proper implementation and smooth running of budget require some supportive favorable conditions prevailing in an organization such as, dynamic organizational structure, professional staffs, proper integration etc. Evans et al (2001) noted some common drawbacks faced in implementing budgetary planning and control system which are: lack of dynamic structure; disconnection between compensation and financial measures; lack of integration; finance function not a strategic partner; poorly trained financial professional.

Seldin (1981) observed that proper budgetary planning and control are preconditions for implementation of budget.

To sum up, the implementation process involves the following steps and actions:

- An executive order circularizing the budget to the users particularly to the cost center managers and their related staffs.
- Approving and distributing reporting formats for feedback.
- Receiving feedback reports of compliance and monitoring results.
- Motivating the responsible managers /staffs with incentives and timely action for non compliance or adverse result.

3.5.2 Budget-variance analysis:

Variance analysis is a simple process of comparing the actual performances with the budgeted ones to find out the variations and the reasons thereof. A variance is caused by the difference between actual and budget figures which can either be positive/ favorable or negative/ unfavorable.

Variance analysis establishes whether over expenditure is caused by deliberate actions or inadequate controls by management (Arora, 1995). Once a budget is drawn up, it can be used as an instrument of control by continually comparing actual with budget performance that is, calculating the deviations and finding the factors causing such deviations, Lockyer, K (1983). Alesina and Perotti, (1996) observed that variance analysis reports and finding reasons thereof, constitute a control frame for the management.

Budgetary control is the process of comparing the actual results with the planned results and reporting on the variations called variance. This sets a control framework to keep the costs and expenses to the standard limit. Deviations are noted continually suggesting corrective actions, Lucey (2008). Glautier, (1997) and Fang, (1998) emphasized on analyzing, investigating and correcting the budget variances. Analyzing requires splitting up the variances into two components of standard costs i.e. quality standard and cost standard in order to pin-point the unfavorable or weak areas. In the view of Appiah-Mensah (1993), if actual performance is not controlled it will differ from planned performance and the business will not achieve its objectives. That control can only be exercised if the differences and the factors causing those are known through analysis and interpretations.

Continuous comparison is made between the actual and budgeted result, which is intended to either secure, through action of mangers, the objectives of policy or to even provide a basis for policy revision (Evans, et al 2001)

In addition to serving as a tool of control measure, perhaps the most important use of budget variances is the fact that the managers learn from their past mistakes and future performance may be improved using these lessons, Parker, Ferris & Otley (1989).

3.5.3 Budget-performance measurement:

If multiple questions are asked about where lies the uses and effectiveness of budgeting practices, a single but appropriate answer probably would be- in performance measurement for control. It becomes difficult to manage and control an activity unless and until the extent of its positive or negative achievement can be rightly measured. Researchers defined organizational performance from different angles, ranging from social performance or contribution to charity (Casio, 1998) to company profits (Huselid, 1995), and organizational effectiveness Zahra and Pearce, 1989), input efficiency, output efficiency, and in some cases, transactions efficiency (Heffernan and Flood, 2000). However, this study concentrates on measuring performances of business organizations for control purposes.

Organizational performance has been defined as the measure of how well the organization does its job (Stoner, 1995). Pettigrew (1979), says, it is the extent to which an organization achieves its intended outcomes.

Budgeting is simply making the estimations and then to compare these estimates with the actual results and do the performance measurement (Ottey, 1999). A majority of organizations today use the budget targets for evaluation of performance, (Libby & Lindsay, 2007).

Hilton (1997), pointed to three basic elements of budgetary control system such as: standard performance level, a measure of actual performance and a comparison between stand and actual performance. Setting budgets provides target against which actual performance can be measured thus, providing a management control system.

Arnold (1987) emphasized on performance measurement through the comparison of variables besides profit and cash. According to him, the assessment of the performance of individual management blocks is to depend on clearly defined objectives. Further, performance measurement may indicate both the weak and strong areas of operations of an organization.

Merchant and Stede (2003), put importance on not only the quantitative aspect of results of performance but also on qualitative aspect of the results which, according to them, can help shape the fortunes of an organization.

Budgets set the targets that ultimately provide the basis for motivation and performance evaluation and employee involvement. (Banovic, 2005).

Drury (2002), is more specific on the role of performance evaluation in identifying performance responsibility. According to him, performance of a particular department is the responsibility of the manager of that department and as such, it is his or her performance which will be questioned if the budget is not met. When employees of an organization do not know the results of their efforts, they have no indication of success or failure and no incentive for higher performance (Henderson, 1997).

Neely et al. (1995) has defined performance measurement system as the set of metrics used to quantify both the efficiency and effectiveness of actions.

Performance evaluation is sometimes linked with employees' bonuses for meeting targets and for promotion. Buckley and McKenna (1995), endorse the ideas with comments that when the budget management is successful, bonuses are awarded on the basis of an employee's ability to achieve the targets, or promotion may be partly dependent upon a successful budget records.

Performance measurement has various purposes, including taking directions and indications as to future course of actions. Evaluating performance against budgeted standards and performance targets has a particular intension of taking corrective action (Emmanuel and Otley, 1985) Hansen et al (2003) and Samuelsson (1999) are critical of using budget for performance evaluation. In their view, to do that the conditions and circumstances must be stable in order to be capable to set realistic targets.

But the role of performance measurements in budgeting cannot be ignored as its exclusion may greatly reduce its control potentials (Grifel, 1993; Millians, 1947; Robinson & Brumby, 2005).

However, performance measurement is simply a method for assessing progress towards stated goals. Generally, it is not intended to act as a reward or punishment mechanism, rather as a communication and management tool.

3.6 Budgetary Control:

This section consists of four sub-sections- internal control, cost control, feedback analysis and revised budget. Each of these points is discussed in details below.

3.6.1 Budget – internal control:

One of the main purposes of budget is to exercise and ensure both financial and strategic control. In fact, budget can play a significant role in realizing the purposes and objectives of internal control of an organization. Budgetary control involves the steps taken by management to increase the likelihood that the objectives set down at the planning stage are attained and that all parts of the organization are working together toward that goal (Garrison, Noreen, Bewer, 2006). Budgetary control cannot be effective and useful without the existence of an adequate Internal Control System in force. Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives in reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations (Whittington & Pany.2001).

Hayes et al., (2005) viewed internal control from a different perspective. According to their views, internal control comprises of five components; the control environment, the entity's risk assessment process, the information and communication systems, control activities and the monitoring of controls.

A close look on the aims and objectives of budget reveals that, among others, it aims to create an environment of control, to establish necessary communication and cooperation among the budgeted individuals to monitor the activities and to take timely remedial actions, if necessary. According to Batty (1970), budgetary control aims at the performance of three primary functions of planning, cooperation and control aided by feedback and corrective action. These objectives, to some extent, match with the internal control components. A critical element of any comprehensive Internal Control System is regular monitoring of the effectiveness of internal controls to determine whether they are well designed and functioning properly, Treba (2003). Similarly, to ensure budgetary control, performance is compared with actual to determine the effectiveness of the system to reach targets.

There are two types of major internal controls namely, strategic control and financial control, associated with the management of large firms, which have an important effect (Hitt, Hoskisson, Johnson, and Moesel 1996). A properly drawn and rightly implemented budget can ensure that both strategic and financial control objectives, to a large extent, be achieved if operated in an environment of adequate internal control system.

The definition of internal control system reveals that it is not fundamentally different from management control, which has an essential component of control such as planning, organizing, staffing and directing (Chambers et al., 1987).

Effective control is a key management task which ensures that efforts produced at all levels are commensurate with those required to ensure the long-term future effectiveness and success of the organization (Stewart, 1997).

Budget and internal control are not two different devices of controlling means. In a broader sense, budget is a tool of internal control and budget works as a supplement to the entire setup of internal control. As such, it fits well in an environment of well-formulated and designed internal control system. Other way around, budgetary control can also be achieved through enforcement of internal control system in its different forms.

3.6.2 Budget – cost control:

Budget is an effective management tool for control mechanism. But a rational question always may creep up like: to control what? Budget has the potential to exercise control on multiple aspects of an organization. Arora (1995) stressed on the cost control role of budget by saying that budgetary control is the system of controlling costs through budgets. Cost control is not a very simple process. It involves, according to Liebers (1998), four functions which are: cost estimation, production monitoring, cost calculation & evaluation and cost modeling. Cost control is a process to hold expenditures within the budget by monitoring and appraisal of the cost performance (Clark and Lorenzoni, 1997). Budgeted profit of an organization is determined only after costs and expenses are standardized and estimated at certain rates. Any increases in those costs and expenses shall, obviously, result in reduction of profit. On the other hand, reduction in costs and expenses through exercise of control may result in increase in profit.

Costs are best controlled at the point at which they are incurred (J. Batty, 1970). Budget clearly identifies cost centers and thus defines responsibility. For cost control, the employee who has the authority to incur a cost should be held responsible for that cost. Organizational plans are carried out by people, thus, control is exercised not over operations, revenue, costs, but over the persons responsible for those operations and the related revenue and expenses (Otley, 1978). Budgeting provides management with opportunities to control the costs and resources sacrificed by identifying the point at which these are incurred.

A budget provides a detailed plan of action for an organization over a specified period of time. By planning, problems are anticipated and solutions thought. This helps to reduce on costs and achievement of goals is enhanced (Mathis, 1996).

Controlling and managing costs involves estimating, scheduling, accumulating and analyzing cost data, and implementing measures, if needed, to correct a cost problem. Current cost control techniques tend to focus on variances in line items once the cost overrun has been discovered (Fleming and Hoppelman ,1996). According to Merchant (1982), a budget is a result and future-oriented management control instrument. However, it is not the budget that can reach the objective, but rather the behavior of the manager. A budget is only a tool, what is essential to control costs is to implement an effective cost control methodology in combination with perfect budgetary practices in an organization.

3.6.3 Budget-feedback analysis:

Where performance evaluation ends feedback process starts. From the results of performance evaluation, feedback is sent to the controlling authorities for appropriate measure. Reversely, constructive feedback from the management to the performing employees follows when they make any mistakes.

According to Batty (1970), budgetary control aims at the performance of three primary functions of planning, co-operation and control aided by feedback and corrective action. Cook (1968) opined that feedback is positively associated with budget performance. Feedback focuses on the extent the employees have achieved expected levels of work for a specified period. The reports should be accurate and prompt in order to take timely actions. However, according to him, accuracy should not be at the cost of promptness.

Budgetary control would not be effective without continuous flow of budget reports. These reports should be prepared at regular intervals comparing the actual performance with the budgeted ones, showing favorable or unfavorable variances. The budget center-head should explain these variances to the top management so that necessary corrective action may be taken (Arora, 1995; Foster, 1987). In order to reap an effective control from the use of budgets, the addition of the operating phase and the feedback phase needs to be done and that should be supported by corrective action where necessary (Baggott, 1979).

Henderson (1997) emphasized on the role of feedback process in enhancing performance. According to him, the outcome of budget feedback indicates success or failure and as such, it works as a catalyst for higher performance. Feedback reports can suggest necessary changes in future course of actions by pointing to the weakness in the operations. Modifications in the weak areas become easy and timely in order to achieve the required results (Drury, 2000).

Feedback process offers learning opportunities to both the management and the employees. Management needs to learn to install confidence in the employees, and back them up when they make mistakes by providing constructive feedback. Mistakes drive people and organizations to learn (Heifetz & Laurie 1994).

3.6.4 Budget-revision/revised budget:

Generally, companies don’t feel egger to change budgeted goals during the budget operation period as it involves lots of paper works, and renewed decisions. But sometimes situations demand revision of budget when the actual performances vary to a great extent due to some abnormal situations.

Budget revision is necessary to bridge the gap between the budget and the actual performance to ensure that corrective actions are taken where necessary (S. Modetola Odelaye, 1991).

Business environment is both competitive and perpetually changing. Re-examining the future plans in line with expected future changes sometimes become necessary. This will normally mean that the budget plans should be adjusted (Benlo, 1990). This revision then represents a revised statement of formal operating plans for the remaining portion of the budget period. This is to reflect the changes in the environment (Hansen et al., 2003; Frederick 2001).

Morgan (1997) opines that budget is not only a financial tool but also a perfect managerial tool. It is the best tool for making sure that key resources are assigned to priorities and to results. He further emphasized that budget empowers the manager to know when to review and revise plans, for reasons that the results are different from budget estimates or due to environmental, economic conditions, market conditions or technologies change, not corresponding to the assumptions of the budget.

Generally, periodical reviews of budgets are carried out to report on changes of business conditions to enable the managers to adopt new tactics to meet the targets for the budget period. It is important that budget should not be revised to cover up poor performance or poor planning. Yet, best practice companies choose to revise budget rather than adhere to budgets that do not reflect current conditions (Andersen, 2000).

Revision of budget allows flexibility to incorporate changes in required situation. Though undesirable, but revision of budget becomes a must in order to make reasonable comparison in changing circumstances.

3.7 Summary:

The above literature review gave a picture of Budget, its purposes, benefits, limitations, implementation and uses very clearly. But the review could not focus light on the research topic of ‘Budgetary practices in the private sector banks of Bangladesh’ because of limitation of previous research on this particular topic.

Besides, manufacturing companies prepare budget in details and stretch importance on budget and its implementation which is not the case of banking sector. Similarly, research studies on budgetary practices in general and the same in public sector were available to some extent. Although there is a scarcity of research on budget practices of private commercial banks in Bangladesh, certain research works were done on banking sector covering different aspects of banking operations. A few of those are reviewed.

Samina (2013) conducted a research study on performance analysis of private conventional banks of Bangladesh. The findings of the study were that the performances of banks are dependent more on the management's ability in formulating strategic plans and the efficient implementation of its strategies.

Another research work was done by Jahangir et al. (2007) on the profitability of Bangladeshi banking industry. It was found that there is a strong and significant relationship between market size and bank's return on equity. It seemed that capital adequacy is an important factor for a bank to be profitable.

A study for Evaluation of internal control structures of six private commercial banks was done by Sultana and Haque (2011) to determine the capacity of those banks to ensure that the organization's activities are carried out in accordance with established goals and procedures. The study concentrated on five components of internal control such as- Control Environment Component, Risk Assessment Component, Control Activities Component, Information and Communication Component and Monitoring component. The findings were encouraging in the sense that more or less the current internal control structure is effective for all the sample banks used in the study.

Mihir and Sazzad (2013), took a research venture to investigate the effect of bank's overall service quality, product quality and corporate social performance on bank reputation within the context of 10 private commercial banks of Bangladesh. The independent variables that is, overall service quality; overall product quality and corporate social performance statistically and significantly were found co-related with banks' reputation. As such, it was inferred that there is no alternatives but to improve the quality of both products and services.

To critically examine the risk management practices of Bangladeshi banks, Alam and Jaman (2011) carried out a research study covering five commercial banks. The study intended to find out types of risk facing a bank, procedure and techniques used to minimize the risk etc. and also to examine how far the banks follow the guidelines of Bangladesh Bank regarding risk management. It was found that credit risk, market risk and operational risk are the major risks to the bankers which are managed through three layers of management system such as: Board of Director, Executive Committee and the Audit Committee. In this context, internal rating system and risk adjusted rate of return on capital are relatively more important techniques used by banks.

It can be observed from the above literature review that literature on practice of budget on PCBs was scarce. That means, no previous research study was done on this specific area. The importance of the PCBs in the economy of the country is undeniable. The role budget can play to augment PCBs efficiency, internal control and smooth operations cannot be overemphasized. In this context, the present research study is very significant and timely. This study can also contribute and enrich the existing literature on banking sector.

While this chapter dealt with literature review, the succeeding chapter is planned to discuss in details budget and budgetary control.

CHAPTER-4: BUDGET AND BUDGETARY CONTROL

4.1 Introduction:

The previous chapter was on literature review on budget and budgetary practices. The present chapter is designed to discuss budget and budgetary control in details. Budgeting is an age-old practice. It is neither merely forecasting nor a simple estimation or baseless prediction. It is a well conceived plan of the future actions translated into figures. 'Budgets are essentially forward looking; they provide yardsticks for purposes of comparison. They are concerned with people, in that they delegate responsibilities to one person, whether he is head of a Government department, a company or a small budget center. A budget is a means to an end, not an end in itself'. (Brown and Howard, 1982)

Budget aims, among others, to outline control devices. By control it is generally meant control of costs. In the present competitive business world, survival of business largely depends on controlling costs to maximize profits. Budgets establish definite responsibility by setting cost centre's goals. It also set standards whereby the achievements can be measured. Managers are responsible for controllable costs within their budget areas and are responsible to explain major deviations, particularly excessive negative ones. In fact, when budgets are set and coordinated for all activities of an enterprise, the benefits of budget can be reaped at the fullest. In the successive sections attempts are made to define and to discuss in details the relevance, implications and benefits of budget and budgetary control.

4.2 Budget and budgetary control:

Budget:

How the word 'budget' in English was transformed into its present form is both funny and interesting. Oxford English Dictionary (1989) traced its origin as: from the word Latin bulga (to bulge), came bouge in Middle French, meaning a bag; or bougette, the diminutive. This term crossed the Channel sometime between 1400 and 1450 and "bougett" became a standard part of the late Middle English vocabulary, usually referring to a leather bag or satchel. During early 18th century, the Ministers of the British Crown used to carry the plans of expenditure to the parliament. These plans were called the statements or schedules of accounts. The large leather bag, in which these plans of expenditure were carried, was called the ‘budget’. It is said that in 1733, the then British Prime Minister Mr. Robert Walpole referred to the inauguration of the discussions of the proposed expenditure as ‘opening of the budget’. The fashion continued and over years, the term budget started to mean the contents of the box rather than the box itself.

No doubt, the practice of budget was initiated by Government. Over years, practice of budget got its ground in private companies in consideration of the positive roles it can play in business for future planning and controlling purposes. In this study the term budget is used to mean budget of commercial organizations alone.

However, budget has been defined by different writers in different ways. Some of them emphasized on the preparation and implementation while others on the objectives and purposes of budget. A few of them focused attentions on the controlling aspect while some others gave more importance on planning, goals setting, performance measurement areas.

The CIMA- U.K defines budget as -a financial and /or quantitative statement prepared and approved prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective. It may include income, expenditure and the employment of capital.

Bergstrand and Olve (1996), considered budgeting system as a traditional way of managing and controlling companies. Arwidi (1991) emphasized on the budget period and thus stated that- organizations use the budget to plan and coordinate the following year. Libby & Lindsay part-1 (2003), focused on the role of budget to motivate employees, allocate resources, coordinate operations within an organization, to facilitate responsibility distribution and to evaluate performance.

Omolehinwa (1991) emphasized on the choosing of organizational priorities in future planning with the foreseeable constraints and allocation of resources according to such priorities to achieve the goals.

Budget is also defined as: (a) the quantitative expression of a proposed plan of action by management for a specific period and (b) an aid to coordinate what needs to be done to implement that plan. A budget generally includes both financial and non-financial aspects of the plan and serves as blueprint for the company to follow in an upcoming period (Horngren, et al. 2009).

Appiah-Mensah (1993) explain that, budgeting is the ways and means of preparing budgets and that a budgets is a plan of action which has been prepared and approved prior to the period when it will be used, detailing monetary, quantitative or other descriptive terms, the event to be accomplished in the budget period. A budget is different from a mere forecast, in that it is a formal management of events which are desired by management to take place in an organization within a defined period of time.

According to Brook and Palmer (1984), budget is a business's financial control system. Budgeting is about making plans for the future, implementing those plans and monitoring activities to see to it that they conform to plan.

Budget is also defined as a 'roadmap' of an organization and is essential to understand the course of actions. Brown and Howard (1982) compared budget with the Routine of a ship's Captain. The Voyage is planned well ahead, the routes are chosen, tides and adverse weather forecasts are taken care of and hazards are noted. After the voyage, the encountered conditions are compared with those expected and the next voyage is planned based on those experiences.

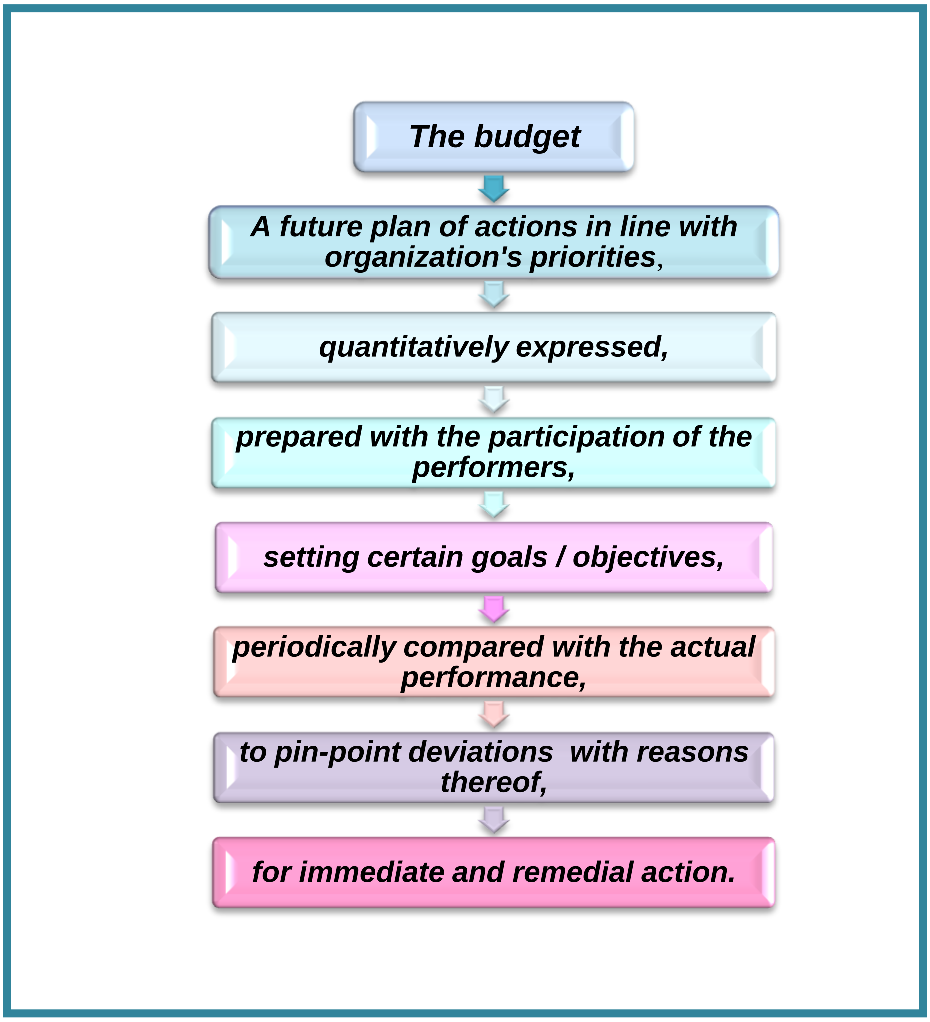
Drury (2006) defines budget as a plan expressed in quantitative, usually monetary term covering a specific period of time usually one year in other words a budget is a systematic plan for the utilization of manpower and materials resources. In a business organization a budget represents an estimate of future costs and revenues.

Lucey (1996) defines budget as a plan expressed in monetary terms. It is prepared and approved prior to the budget and may show income, expenditure and the capital to be employed. It may be drawn up showing incremental effects of former budgeted or actual figure, or be compiled by zero -based budgeting.

'A budget is a quantitative expression of a plan of action prepared in advance of the period to which it relates. It is a plan expressed in terms of money prepared and approved prior to the budget period which shows income, expenditure and capital to be employed.' (Lucey 1993)

The above views and opinions clearly discuss all aspects of budget and budgeting. If the entire processes are put chronologically, it will appear as shown in the following figure:

Figure: 4.2 The Budget



(Developed by: Rumana, 2014)

Budgetary Control:

Exercising control is one of the most important objectives of a budget. When the activities of a business organization are controlled by the use of budget as a tool, it is known as 'budgetary control'.

Budgets perform the function of control, which is the art of comparing where you are (actual performance) to where you are supposed to be (Budgeted) so that corrective action can be taken. It is necessary to ensure that plans as laid down in the budgets are being achieved. Through control, organizational activities are monitored and performance is evaluated (Sebbi, 1994; Lewis, 1996).

Budgetary Control is the process of comparing actual results with planned results and reporting on the variations (Lucy, 1996). According to Briston (1981), financial control and monitoring ensures efficient and cost-effective program implementation within a system of accountability.

By means of budgetary control that is, comparing actual results with planned results and reporting on the variations, a control frame is set for management. It helps expenditure to be kept within the planned limits (Alesina and Perotti, 1996).

In this control process, at least two methods are followed:

a. Pre-authorization of expenditure – the performers are restricted of the authority of expenses up to certain level. This control is applicable only for expenses.
b. By setting predetermined goals –it may be used to set specific organizational goals such as: increase of sales, profit or reduction of costs. In this case, actual performance results are compared with the standard set, variations are analyzed, weak areas are identified and necessary remedial actions are taken.

In fact, the budget starts functioning as a tool of control at three stages of the process. Firstly, the forecasts are made from the performing department justifying their ability to perform up to certain level and their needs to support that performance- a control process of 'commitment' starts here. Secondly, with the approval of the budget, the targets are set, which the performers are committed and at the same time, is expected to maintain. That sets the responsibility. Finally, with the comparison of the actual with the target or goal, the area of weakness or otherwise is revealed. With that the process of remedial actions begins to reverse the negative impact. That is the final aspect of the control.

Another way of control which can be achieved through budget is 'motivational control'. When the goals and targets are set in participation of the employees, they are motivated to do the best to meet that goal. By setting own goals, the employees understand better as to what is expected from them and where they stand with their commitments. Control basically provides the ex-ante motivation to achieving the budget and the ex-post reinforcements necessary to ensure future motivation (Kerr, 1979).

4.3 Budgetary control system:

Control cannot be exercised without a system in force and system does not work without a hierarchically linked organizational structure. The same views apply to budgetary control system. A system is a collection of interconnected elements. In budgetary system, a combination of a goal-setting and a goal achieving machine work together to achieve the goal. The control system is applied through a well structured organization. In order to organize a system, full cooperation of all concerned members of the organization is very much needed. Furthermore, an efficient organizational structure, procedural framework and supporting techniques are required to be in place to make the system workable. These can be as follows: a) the cost center or budget center, b) a budget committee, c) budget manual, d) uniform techniques, e) sufficient records maintenance, f) a budget period, g) normal and achievable activity level. Another essential element of an efficient control system is the presence of coordination amongst different departments or cost centers.

The design of budgetary control system is dependent on several factors. These factors determine how easy to exercise controls in an organization. Hoftsede G.H (1968) argues that budgetary controls are easiest in organizations where: a) the objectives are clear and unambiguous; b) outputs are measurable; c) the effects of interventions are known; d) the activities are repetitive.

4.3.1 Budget centralization:

In order for the budgetary control system to work efficiently, it is desirable that the affairs of the budgetary control system should be under a centralized authority. Generally, the budget committee is that authority. It is usually entrusted with the tasks of formulating plans to prepare budgets and to coordinate amongst the all concerned. The committee is normally headed by the CFO/CEO of the company and routine affairs are conducted by the secretary of the committee. Post budget feed-back, variance analysis etc are done by this committee. Remedial actions, if any, are recommended by this committee but actions are subject to approval of the Board.

4.3.2 Budget coordination:

Business organizations generally have different operating units. These units work, to some extent, independently but under the same management. All operating units within an organization are dependent on each other. Each of the units is engaged in different segments of operations. Through the use of budgets, these operating units have to compromise and cooperate when it concerns use of limited resources. The budget is meant to consider the organization as a whole entity. Thus budget tries to solve resource conflict on priority lines. Departments may have different ways of doing things. But budget makes the departments to compromise and work together with the common goals.

Preparation of a budget assumes the inclusion and coordination of the activities of the various segments within an organization. The budgeting process demonstrates the managers the interconnectedness of their activities.

This integration is impossible without laying effective coordinated relation between all the performing units. In case of 'Top Down' approach, that is, centralized authority, the significance of interdepartmental relation is of less importance. But this 'Top-Down' approach is not very much in common now-a-days. The alternative is 'Bottom-up' approach that is, decentralized but structured approach. In this case, the focus of decision making on operational matters is decentralized down to the incumbents of official roles. These roles are structured by virtue of their specialized prescribed duties and particularly by a system of procedures and documentation designed to limit areas of discretion as well as provide information on role performance, (Child, 1972). It is important for an organization that people engaged at different segments of operation should be aware of the objectives, policies, programs that are working in the organization.

Budgeting serves functions of financial and management control. Financial control results to the control of financial resources while management control ensures that the activities of the parts of the organization are co-coordinated (Otley, 1987). Budgets coordinate the activities of the parts of the organization; through this the objectives of the organization are harmonized with the objectives of the parts or departments. Budgets facilitate coordination through communication of information about plans to managers and employees (Nassolo, 1997).

Inter-departmental relation can be established through the exercise of the following approaches-

a. Making planning and budgeting is a collaborative process: A collaborative process offers greater accountability and a better execution of corporate strategy. This can be done by regular managerial meetings, meetings of the feedback forums etc. The top executives need to decide on business strategy, the mid-management or the departments need to implement the plan; the performers need to perform to reach the goals.

b. Aligning operating tasks with strategic planning: The day to day operations need to support high level corporate plan to ensure that there is an understanding of the planning objectives at all levels of operations. Successful companies support this practice by extending this corporate strategic plan from top management to the rest of the organization. It happens in a way that upper management sets strategic goals, the finance department translates the goals in to specific departmental plans and the departmental managers use the specifics to operate the business. With the alignment of operating tasks and the strategic plan the detections and adjustments phase becomes more efficient and the organizations gain the competitive advantages of achieving clear corporate objectives.

c. Aligning resource allocations with objectives and strategy: In every business organization, each function requires resources. To avoid wastage resources and misinformed decisions, it is important to identify, prioritize and invest in operations that align well with corporate strategy.

4.3.3 Monitoring the Budget:

The budget monitoring device is generally used to measure how closely an organization is meeting its objectives in finance terms. Commitment regarding implementation of budget must be specific and measureable within specific timeframe. Effective monitoring includes evaluating the progress of the plans, the impacts and lessons learned.

According to Drury (2000), budgetary monitoring and control process is a systematic and continuous one and is characterized by the steps as follows:

a) Establishing level of activity for each department of the organization by way of setting targets to be achieved enhances the monitoring of the performances.
b) Communicating details of the budgetary policy to all the stakeholders for easy appreciation of the set targets and objectives and the results achieved at end of the day.
c) Monitoring actual revenue or cost data by way of continuous comparison of actual performance with the budgeted performance and regular reporting of variances to the responsible officers.

The process helps in determining the reasons for the differences between actual and budgeted performance and in deciding the required corrective actions. Through this process of monitoring, analysis and control, the problem of "ratcheting" is generally avoided (Kelly, 2003).

A monitoring system assumes that expenditure must agree with the budgeted plans. Financial control is also one of the most important aspects of budgeting. By means of monitoring, which means comparing actual results with planned results and reporting on the variations, a control frame is set for management.

This frame points to managers to track flow of resources accurately and consistently. According to Briston (1981), financial control and monitoring ensures efficient and cost-effective program implementation within a system of accountability. It was further noted that the existing financial control arrangements must be complemented by further improvements in the overall monitoring system for better implementation.

The process needs comprehensive planning and approved framework, consistent with processes for constructing budgets, both Capital and Revenue. Proper assessing the financial impact of proposed expenditures, compatibility with other management and performance data and a system of control that set clear responsibilities and gives accurate and timely monitoring information on performance against budgets is important.

4.3.4 Feedback analysis:

The budgetary control report is very important in the feedback and analysis process to ensure maximum effectiveness. It is important that report's design should be useful and timing should be proper to enable to take timely measures, if necessary.

In order to monitor the budget performances, the monitoring authority needs data and information which should come from the respective performing unit or cost centers. One of the objectives of budgeting is to provide a base against which the actual performance can be measured. Actual performance must be properly recorded on a regular basis in all the cost centers and those should be sent in report form for further analysis and interpretation. But this is only worth of doing if actions are taken as a result. Actions can be taken only after finding the variations and reasons thereof and as such, variance reports are prepared for the top management to decide on remedial actions.

The key items which should be shown in these reports are the budgeted level of costs and revenue for the period and year to date, the actual level of cost and revenue for the period and year to date. The report should also show the 0variances between the above two points stated together with the trends in variances along with the indications of what variances are significant. Analysis and comments which can be used to bring the variances under control should also be stated in these reports.

4.3.5 Internal Control:

The term internal control is defined as a system of organizational control which coordinates a department's policies and procedures to safeguard its assets, check accuracy and reliability of data, promote operational efficiency, and encourage adherence to sound management practices.

Internal controls are basically following four types: Preventive, Detective, Corrective and Compensating.

Adequate internal controls allow managers to delegate responsibilities with reasonable assurance that what they expect to happen, actually does.

Managers must develop internal controls for each activity for which they are responsible.

From the definition, nature and purpose of internal control it is evident that practice of budget is one of the internal control devices. Budget sets the organizational plans and policies, fixes operational target and goals, review performances etc. The purposes of budget is like the purpose of the internal control, to monitor compliance or otherwise of the organizational policies. Budget may not be an alternative to internal Control System but a supplement to it.

4.4 Budget as a tool of Performance measurement:

For business organizations measurement of performance, somehow or other, is an age old practice. Several performance measurement systems are in use today and each has its own group of supporters. As an example, the Balanced Score-card system was developed by Kaplan and Norton (1993, 1996, 2001), Performance Prism by Neely (2002), the Cambridge Performance Measurement Process by Neely (1996), Total Measurement Development Method (TMDM) by Tarkenton Productivity Group. Over time and with further research, more advanced techniques will emerge. However, performances are commonly measured by three main types of indicators namely- a) indicator of output quantity, b) indicator of output quality and c) indicator of efficiency. It is fundamental building block of Total Quality Management. However, performance measurement has been defined in many different ways by different writers and experts. Neely et al. (1995) has defined performance measurement system as the set of metrics used to quantify both the efficiency and effectiveness of actions.

The usual argument for performance measurement tends to rely on a statement: What cannot be measured cannot be managed (Drucker, 1993).

Well-rehearsed adages such as 'what gets measured gets done' and ` `you get what you measure' suggest that implementing an appropriate performance measurement system will ensure that actions are aligned to strategies and objectives (Lynch and Cross, 1991). Increasingly, research evidence is demonstrating that companies that are managed using integrated balanced performance measurement systems outperform (Lingle and Schiemann,1996) and have superior stock prices (Gates, 1999) to those that are not 'measure managed'.

The literature in the field of performance measurement emphasizes the importance of maintaining relevant measures that continue to reflect the issues of importance to the business (Lynch and Cross, 1991).

A simple performance measurement framework includes more than just measuring performance but also defining and understanding matrix, collecting and analyzing data, then prioritizing and taking improvement action.

Budget has all the yardsticks required to measure performance. Performances are measured against set standard or goals. Budget sets standards to define-'what to reach' (target), 'when to reach' (timeframe), 'at what costs' (value) and 'by whom' (responsibility). Budget provides management with established criteria for quick and easy performance evaluation and as such, budget is considered a perfect tool of control for the management through which the managerial policies and goals are periodically evaluated and established as guidelines for the entire organization. Performance measurement processes begin with setting of goals and followed by other devices which are chronologically outlined below:

4.4.1 Goal setting:

Performance is measured with standards or goals, set in keeping with the objectives and priorities of the organization. The goal setting process may not be as easy as it may appear. A common norm is – goals should not only be set but be achieved.

Goal fixation is better to be participatory that is, the goal achieving machine should have a say in deciding goals. Goal should not be imposed rather be accepted. Vroom (1964), concluded that as subordinates were given a larger influence in decisions their performance improved, partly because of the ego involvement which their participation generated. In another way, participation may enhance the sense of responsibilities of the budgeted individuals and thus achievement becomes a matter of self-esteem.

The process of setting goals should be a collaborative effort between the goal setting and goal achieving machines. Whether deciding long or short-term goals, the most widely-used framework is the abbreviation S-M-A-R-T which stands for: Specific, Measurable, Attainable, Relevant and Time-bound.

<u>Specific:</u> The goal should be specific and clearly defined. Employees responsible to perform should know exactly what is expected of them, when, and how much. Specific goals are easily and perfectly measurable.

<u>Measurable:</u> The norm 'you cannot manage what you cannot measure' is quite correct in this case. Measurability provides milestones to track progress and motivate employees towards achievement.

<u>Attainable:</u> The goal/ target should be attainable with reasonable efforts and should not be beyond reach. It should not be too high or too low.

Hofstede (1967), hypothesized that while up to a certain level of difficulty, higher goals would be accepted with resulting improved performance, beyond that, the goal would be rejected and performance would decline.

Relevant: The goal should be in keeping with overall company strategy and priorities.

Time-bound: Keeping enough time to achieve the goal, but not too much time to undermine performance. Goals without deadlines tend to be with loose-end.

Setting financial goals and creating a budget are tools which can help in making better financial decisions. Setting goals will show where to go financially and creating a budget will provide a map of how to get there. Another step of goal setting is goal alignment. It is process by which all the concerned employees can see the directions for the entire business and can know their individual place in the total scenario. In fact, goal alignment strengthens leadership and creates organizational agility.

4.4.2 Performance reports:

Budget enables the management to evaluate performances of each operating unit against a set standards or goals. Without budgeted goals/ standards, performances can be measured only with past actual. But that is neither desirable nor result-oriented because of the facts that past actual may be influenced by miscues or substandard performances. Here raises the question as to how the present running operational performance result can be obtained in the form of performance reports.

Maggie Kennedy (1995-96) rightly noted that while preparing a performance report at least three questions to be asked; a) Are we presenting the right information? b) Are we presenting the information in the right way? c) Are we reporting information at the right time?

There are no hard and fast rules concerning the format for performance report. The format will be chosen in line with the requirements for information. It is desirable that the formats and grouping of the performance data should to be in keeping with the formats and grouping of the budget of that specific segment. In this case, the task of re-grouping and adjustment can be avoided and comparison with the budgeted standards or goals will be easy and error free.

Performance report format of a manufacturing company will, certainly, be different from that of a service company as the nature of business is different. But a performance report of any organization should comprise of the results of each and every operating unit or cost centre with detailed brake-ups of every distinct head of cost and revenue. Usually, the budget details are drawn in the same manner the details of accounts heads are maintained in accounts and finance department. To be useful, the performances reports should also be in the same pattern and design with detailed data.

Performance report period is an important issue. It is the management's decision how frequently they desire to compare the actual with the budgeted set goals. The frequency may be weekly, fortnightly, monthly, or anything else. Whatever the frequency be, the operating units must furnish required data in prescribed formats to the management for timely comparison and follow up actions.

4.4.3 Variances analysis:

Once the standards or goals are set through the budgets and actual performances are obtained through performance reports, the task remains is to compare the actual with the projected ones, that is, calculating the variances and analyzing those to find out the reasons.

Variance analysis has been defined as- a variance is the difference between the actual results and expected performance. The expected performance is also called budgeted performance, which is a point of reference for making comparisons, (Horngren et al, 2009).

In addition to finding performance deviations, variance analysis sometimes used to study cost of one company compared with industry average. But in this study emphasis is on the first use that is, variance analysis as a basis for performance appraisal.

The technique of comparing actual with budget is very simple one. Statements are prepared of detailed heads of all elements of costs, expenses, revenue etc. and actual results are placed side by side with budgeted ones and the differences, both negative/ positive, are calculated.

There is a common notion that all negative variances are not 'negative'. Apparent negative variances in an element may have been caused due to other related elements which can only be detected by proper analysis.

Variances need to be analyzed by sub- dividing the total variance into smaller parts in such a way that management can assign responsibility for any negative performance. Another aspect of variance analysis is to separate controllable from uncontrollable variances. Analysis of controllable variances will help the management to identify persons responsible for its occurrence. Through variance analysis it is established whether over expenditure is caused by deliberate actions or inadequate controls by management (Arora, 1995).

According to Glautier, (1997) and Fang, (1998), a budget variance requires analysis, investigation and correction. The analysis of the budget variance necessitates splitting up the variance into two components of standard costs i.e. quality standard and the price standard.

Variance analysis is the act of determining the drivers for those variations. Variances are noted and accounted for. This technique greatly reduces the need for comprehensive review cycles. Performance analysis in particular can be an eye opener for the management. When performances fall short of set standard/ budget, an in-depth analysis pinpoints the weak areas for corrective actions.

4.4.4 Corrective measures and actions:

When performances are analyzed periodically and deviations are detected in time and the reasons for the same in details are known, taking appropriate corrective or punitive actions become easy and prompt. In case of controllable adverse variance, lapse of time in finding those would cause more losses financially. Besides, detection of causes may induce to change course of actions in due time, resulting in saving money and reducing losses.

Alternatively, positive budget variance generally is linked with Incentives/ Performance Bonuses. Major positive variances may be due to deliberate unreasonable conservative forecasts incorporated into the budget by greedy and dishonest Managers to reap undue benefits with clever practices. In such cases, budget targets can be revised to match with the actual performance.

Moreover, it is administratively prudent that staff should be aware of the consequence of controllable adverse variances and the facts that unjustified expenditure will not pass without punishment. In case, a performance analysis process is in practice in an organization, it serves as an indirect warning to all concerned employees. This will render the staffs to be more cautious and careful while using resources in performance of tasks. As a result the costs may reduce and proper utilization of resources will be ensured with a sort of moral control.

4.5 Budgetary Practices in Bangladesh:

Budget is a very familiar word in Bangladesh even to the common people, in particular of the government annual budget. In the business arena, the practice of budget is, if not wide and massive, quite prevalent in Bangladesh. All major business houses-trading, manufacturing, real estate or others, prepare their periodic (generally yearly) budgets as a tool and technique of planning the future course of action and as a means of controlling costs and undesirable events of the operation. The practices of budget are strictly followed by the multi-national companies operating in Bangladesh, if not that strictly by all local companies.

Like other countries, annual government budgets in Bangladesh are prepared based on the requirements and guidelines as prescribed by concerned Ministries. In addition, Lenders and Donors prescribed guidelines, if any, are generally followed in compliance to their requirements. The IMF (International Monetary Fund) has some budget guidelines for the Grant and loans receiving countries prescribed in IMF Manual on Fiscal Transparency under the title-Code of Good Practices on Fiscal Transparency. These are as follows:

a) On Clarity of Roles and Responsibilities:

Commitment or expenditure of public funds should be governed by comprehensive budget laws and open administrative rules.

b) On Public Availability of Information:

The budget documentation, final accounts, and other fiscal reports should cover all budgetary and extra budgetary activities and the consolidated fiscal position should be published. Comparative figures to that in the annual budget should be provided for two preceding fiscal years, together with forecasts of the main budget aggregates for two succeeding years following the budget.

c) Open Budget Preparation, Execution, and Reporting

i) The budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.

ii) A statement of fiscal policy objectives and an assessment of fiscal sustainability should provide the framework for the annual budget.

iii) Any fiscal rules that have been adopted (e.g., a balanced budget requirement or borrowing limits for sub national levels of government) should be clearly specified.

iv) The annual budget should be prepared and presented within a comprehensive and consistent quantitative macroeconomic framework, and the main assumptions underlying the budget should be provided.

v) New policies being introduced in the annual budget should be clearly described.

vi) Budget information should be presented in a way that facilitates policy analysis and promotes accountability.

vii) Budget data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category. Data on extra budgetary activities should be reported on the same basis.

viii) A statement of objectives to be achieved by major budget programs (e.g., improvement in relevant social indicators) should be provided.

d) On Assurances of Integrity

i) Budget data should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.

ii) The annual budget and final accounts should indicate the accounting basis (e.g., cash or accrual) and standards used in the compilation and presentation of budget data.

In addition to IMF guidelines, OECD (The Organization for Economic Co-operation and Development) also formulated a series of guidelines on budget, emphasizing on the fiscal transparency.

These were designed as a reference tool for Member and nonmember countries to use in order to increase the degree of budget transparency in their respective countries and are based on different Member countries' experiences in each area. It should be stressed that the guidelines are not meant to constitute a formal "standard" for budget transparency. But Developing Countries which receive and accept Loans and Grants from OECD countries have to observe certain provisions of OECD guidelines on budget in order to comply with their requirement.

International Monetary Fund, World Bank and OECD are all interested in encouraging developing and underdeveloped nations to improve their budget practice. This shows the importance attached to budget as a management process.

As for the business organizations, the forms, contents and objectives are different to some extent from that of the Government Budget. Best practice budget in business organization is developed on organization's experience and based on the nature of the business. Business in any country like Bangladesh has to operate within the regulatory supervision of the Government. In Bangladesh, any type of business organization needs to comply with some rules or guidelines formulated by the Government. For example, Partnership firms are regulated by Partnership Act 1932, Limited Companies are formed according to the provisions of Companies Act, 1994; banking companies are regulated by Bank Companies Act 1991 and so on. These Acts provide rules for proper recording of financial transactions including assets, liabilities, incomes and expenses etc. in order to ensure financial transparency. Sections 149 – 153 of Companies Act, 1994 provide rules as to Books of Accounts, Financial Statements, Auditors Reports etc and Section 35 of Income Tax Ordinance, 1984 also provides rules and procedure of Accounts. But neither the Companies Act, 1994 nor the Income Tax Ordinance 1984, which are very much related to business organizations, provide any rules on requirement of budget or proper budgetary practices.

In spite of facts that the practice of budget for Commercial organizations is not legally mandatory, the budgetary practice as a control tool is widely in use in the country. There are not enough research works on the extent of practice of budget in Commercial organization in Bangladesh. So, research papers on allied topics with references of budget and budgetary practices were relied upon for this study and their findings are noted here.

Khanam (1981) found in her research survey that Jute Mills of the country practice budget to supplement their control procedure. According to her findings the Jute Mills used to apply 'Top-down' approach and participation of the Mill-Managers and other related officials were almost absent. In another research on evaluation of accounting practices in jute Industries in Bangladesh, Muinuddin (1977) also found that budget used to be prepared but without participation of the budget users and without any objective, targets, allocations, sales forecasts, standards for costs etc. at the disposal of the budget users. So these budgets were nothing but guess-work, whimsical, unrealistic and nothing but some sort of scribbling. These two research papers on budgetary practices in Jute Industries were conducted during early eighties. Situations may have changed by this time.

Couples of research studies were done during recent years on management accounting practices, its significances and applications in the Industrial enterprises in Bangladesh. Among other techniques, practice of budget was found to be of common uses in almost all the selected samples. Findings, in brief, are furnished below of a few of those researches.

James and Farjana (2005) have conducted a study on application of responsibility accounting as one of the management accounting techniques in 30 organization. This study has also revealed that budget is the most common technique used to evaluate the performance.

Another research study by Bidhan (2007), on Application of management accounting Techniques on 35 manufacturing companies, of which 15 in the public sector, 15 in private sector and the rest 5 in MNC, revealed that 100% of the sample selected used budget as a control device. But the report indicated that this technique is not rigorously followed and thereby the enterprises are deprived of its full benefits.

Farjana and Sumon (2009) have conducted a study on financial institutions in Bangladesh. It revealed that managers of the financial institutions are very much satisfied in application of budgetary control and variance analysis to measure their performance among the fourteen management accounting techniques.

Yeshmin and Fowzia (2010) have made a comparative analysis in a study where the result has focused on the variability of management accounting practice in 74 manufacturing and 77 service industries. The study has revealed that budgetary control is frequently used in managerial functions along with other quantitative techniques of management accounting.

In conclusion it may said that in Bangladesh, practices of budget is not uncommon rather most familiar. But among the various management control tools, Bangladeshi Business organizations, either manufacturing or service company, use the traditional quantitative techniques frequently over advanced and qualitative techniques.

4.6 Summary:

Budget is better defined by its functions that is, to control under a system. It works better collaboratively with goal-setting and goal- achieving machines. The tasks of goal setting simultaneously assign responsibility and collaborative participation ensures commitment to perform, resulting in higher efficiency, better performance and increased profits.

Practice of budget is wide in Bangladesh and is not restricted within the public sector alone. Private sector enterprises use this effective tool of management for internal control and to measure performances. Like any Business organizations, Private Commercial Banks of the country also practice budgetary system. Budgeting is not a regulatory obligation on the banks. But the commercial banks practice this effective device as a control mechanism. This chapter discussed budget and budgetary control. The following chapter is planned to discuss banking sector in Bangladesh.

CHAPTER-5: BANKING SECTOR IN BANGLADESH:

5.1 Introduction:

In the previous chapter budget and budgetary control was dealt with. This chapter is initiated to review the state of banking sector in Bangladesh. Banks play an important role in the economic development of a country. Bangladesh, as a developing country, is no exception to this. In Bangladesh, the banking sector dominates the financial sector and the macroeconomic management largely depends on the performance of the banks. The country's banking sector comprises of Bangladesh Bank (the Central Bank), State-owned Commercial Banks (SCBs), Private Commercial Banks (PCBs), Foreign Commercial Banks(FCBs), Development Banks and other Financial Institutions(DFIs).

Bangladesh started its journey with 6 nationalized commercial banks, 2 State owned specialized banks and 3 Foreign Banks in 1971 after independence. From 1982 when private commercial banking was officially granted to face the rising demand of banking services in the country, banking industry achieved significant expansion with the entrance of private banks. Presently, banks in Bangladesh are primarily of two types - scheduled banks and non-scheduled banks.

The banks which get license to operate under Banking Companies Act, 1991 (Amended in 2003) are termed as Scheduled Banks.

There are 56 scheduled banks in Bangladesh operating under full control and supervision of Bangladesh Bank. Under Bangladesh Bank Order, 1972 and Bank Company Act, 1991 Bangladesh Bank is empowered to exercise such authority. Scheduled Banks are classified into following types:

1. State Owned Commercial Banks (SCBs): There are 4 SCBs which are fully or majorly owned by the Government of Bangladesh.

2. Development Financial Institutions or Specialized Banks (DFIs): 4 specialized banks are now operating which were established for specific objectives like agricultural or industrial development. These banks are also fully or majorly owned by the Government of Bangladesh.

3. Private Commercial Banks (PCBs): There are 39 private commercial banks which are majorly owned by the private entities. PCBs can be categorized into two groups:

a. Conventional PCBs: 31 conventional PCBs are now operating in the industry. They perform the banking functions in conventional fashion i.e. interest based operations.

b. Islami Shariah based PCBs: There are 8 Islami Shariah based PCBs in Bangladesh and they execute banking activities according to Islami Shariah based principles i.e. Profit-Loss Sharing (PLS) mode.

4. Foreign Commercial Banks (FCBs): 9 FCBs are operating in Bangladesh as the branches of the banks which are incorporated in abroad.

The banks which are established for special and definite purposes and operates under the acts that are formed for meeting up those objectives, are called Non-Scheduled Banks. These banks cannot perform all functions of scheduled banks. There are now 4 non-scheduled banks in Bangladesh which are: Ansar VDP Unnayan Bank, Karmashangosthan Bank, Probashi Kollyan Bank and Jubilee Bank. The Bank Company Act 1991 has been revised and the banks are functioning as per guidelines contained therein.

Bank is a financial intermediary institution which primarily deals in loans and advances. In common parlance, Bank means Commercial Bank and its functions, except in the case that it is formed with different objectives and specialized functions. The development of a country depends, largely on the efficient functioning of its banking system. It helps mobilizing resources and allocating funds (Hafiz-2001). There is a consensus regarding the positive role played by the financial sector in promoting economic development (Gerschenkron, 1962, Patric, 1966: Goldsmith, 1969, Galbis, 1977 to mention a few). The efficiency of financial intermediation can effect economic growth (Levine, 1997).

The basic features of commercial banks lie in its nature of business, functions and objectives. A primary feature of Commercial Banks is to run for profit. Their service charges and interest rates are designed with the intention of making surplus money over costs. This characteristic of commercial banks contrasts with the primary function of cooperative banks/ societies which are nonprofit institutions that help individuals and businesses to manage their money. Commercial banks make money by charging clients who use their services and borrow their funds. In addition to taking deposits and lending money, commercial banks earn profits by rendering other secondary services to the customers by charging fees for such services. Such services include clearing of checks, transfer of money, providing Letter of credit (L/C), purchase and sale of shares, bonds and securities etc. on behalf of customers, acting as Trustee of clients, safe custodians of Valuables etc.

Generally, commercial banks are owned by private individuals or collections of private individuals known as shareholders. They are regulated by government institutions such as the Central bank, ministry of Finance etc. and must follow all applicable laws formulated by the central bank and concerned Ministries of the Government. In Bangladesh, exception as to private ownership prevailed from 1972 to 1982 during which period all the commercial banks of the country were owned by the government due nationalization policy.

Commercial banks are primarily interested in working with Business organizations rather than individual customers. Of course, Commercial banks generally offer products and services to individuals under the Retail Banking Services. But their primary interest is in working with businesses and that is one of the reasons Commercial banks are also sometimes known as "business banks”. Business accounts generally involve larger amounts for longer periods than individual customers and as such, the income from interest and fees are bigger in amount.

The basic features of Commercial Banks’ services have changed a lot over times. At present time, Commercial Banks of Bangladesh offer extended services to customers such as: Development Financing, Project Financing, ATM Services, Online Banking, Money transfer (both local and foreign), SME Financing etc. in addition to their normal and conventional banking services.

5.2 History of banks:

Opinions and views of writers and authorities differ on the origin of the word bank. Some writers and experts believe that the word ‘bank’ was derived from

'Banco', 'Bancus', 'Banque'or 'banc' all of which mean a bench upon which the mediaeval European money lenders and money changers used to display their coins. Another opinion is that a long stool or bench was said to be replaced by 'bank', 'Bangke' etc. in the Scandinavian and middle European countries and Dutch and French words 'Banque', 'Bangko' have the same meaning of stool or bench and in course of time the word 'Bank' came into effect.

It is also further suggested that 'banco' in Italy and 'banke' in German and Australia used to mean 'public debt' or issue of paper money. During middle of twelfth century, Italian government were in political turmoil and in Eleventh fifty (B.C.) the government introduced public debt/ collective credit/ forced subscribed loan at 5 % compulsorily on the public to meet economic crisis. At that time this loan was called 'banke', 'banco', 'compara', 'monte', and the word 'banke' and 'banco' have been transformed into English word 'Bank'.

Who, when and where the word bank was introduced is of academic interest only. But the reality of banking history is that, with the industrialization of Europe, vast expansion of business both at home and abroad, demanded the extensive services of financing institutions such as banks. Expansion of business and trade played a vital role for the advancement of banking. From 1700th century on words in Europe, bank progressed tremendously and banking services improved a lot in Europe followed by middle-east and Indian subcontinent. The word bank in Bengali has the same meaning of the word Bank in English.

A close review of the history of commercial banking system shows that it was entirely short-term, only providing working capital and trade finance but over years commercial banking services have been expanded and commercials banks have been an important source of investment finance. Also in U.S.A the strict difference between commercial banking system and investment banking is now an event of the past. Even in 1990, U.S.A Senate passed a historic legislation to modify US banking laws allowing the commercial banks to carry on Securities and Insurance business. The same legislation repealed some parts of the 1933 Glass-Steagall Act and 1956 Bank Holding Company Act to level the domestic playing field for US banking companies.

Not only for the developed economies but the growing and developing countries of the world demanded the commercial banking services through expansion of branch network in particular to rural and semi-urban areas. The purpose of such expansion was to mobilize domestic resources, to encourage generation of savings and to assist productive sectors with capitals both for running and further development.

In fact, a proper organized commercial banking system is of vital importance in the economic growth of a country. In this regard an important view was expressed by Athanasoglou, Brissimisand Delis, 2005 saying – 'Banks are the most crucial financial intermediaries in the most economies that render a bundle of different services. Economies that have a profitable banking sector are better able to withstand negative shocks and contribute to the stability of the financial system'.

The tough process of economic development of any country needs, first of all, capital formation in addition to improvement of human resources, better organizational skills and a sound health and education system. Capital formation comes first in order of importance for economic development which comes in the sequence of – savings, financing and investment. Commercial banks constitute an important source of mobilization of savings intermediation between savers and investors and granting of credits to productive sectors. In short, banking system is one of the key agents in the whole process of development, the other one is of course, entrepreneurship.

5.3 History of banks in Bangladesh:

Modern banking evolved in Bengal during the British period. The Hindustan Bank was established in Calcutta in 1700. But the Bengal Bank, established in 1784, is considered to be the first British-patronized modern bank in India to start trading in credit and money. Also, there were loan offices in major towns in the East Bengal. Although the British rules established and ran the Bank of Bengal with the local revenue, it did not lend to the business and the people of the Bengal. (Dr. Chittabrata Palit, professor “emeritus” of history at Jadavpur University in Kolkata) (Source: the daily star, February 19, 2010).

With the separation of India in 1947, Pakistan started its banking services with 639 branches of 44 banks and financial institutions. In 1948 State Bank of

Pakistan was established with branch at Dhaka, (then East Pakistan). In the whole Pakistan, there were 36 commercial banks in operation until 1971. Most of these commercial banks were owned by West Pakistanis and till 1949 only 3 commercial banks had their branches in East Pakistan (now Bangladesh). During 1950-58, more 3 other Pakistani- owned banks (namely, Premier Bank Limited, Muslim Commercial Bank and Bank of Bhawalpur Limited) had opened their branches in East Pakistan. Further, during 1959-65 another 4 banks (namely The United Bank Limited, Union Bank Limited, Standard Bank Limited and the Commerce Bank Limited) also started their operation in the then East Pakistan. All these banks had their head office in West Pakistan. There were only 2 commercial banks in Pakistan owned by East Pakistani owner namely, Eastern Mercantile Bank limited (presently Pubali Bank) and Eastern Banking Corporation Limited (presently Uttara Bank Limited) established in 1959 with head offices in Dhaka.

With the independence in 1971, Bangladesh inherited Dhaka branch of the State Bank of Pakistan which was later declared as Central Bank of the Country and named as Bangladesh Bank. This was done through the Presidential order no: 127 of 1972. Also there were 1130 Branches of 12 Commercial banks in existence at that time, in addition to three foreign banks. The then pro-socialistic Government nationalized the banking sector and all the existing commercial banks were merged and grouped into six state owned commercial banks pursuant to Presidents' Order 26, 1972.

After nationalization the banks were renamed as under:

1. The National Bank of Pakistan, The Bank of Bahawalpur Limited, and The Premier Bank Limited were renamed as Sonali Bank (Sonali Bank Limited).
2. The United Bank Limited and The Union Bank Limited were renamed as Janata Bank (Janata Bank Limited).
3. The Habib Bank Limited and Commerce Bank Limited were renamed as Agrani Bank (Agrani Bank Limited).
4. The Muslim Commercial Bank Limited, the Standard Bank Limited and The Australasia Bank Limited were renamed as Rupali Bank (Rupali Bank Limited).
5. The Eastern Mercantile Bank Limited was renamed as Pubali Bank Limited.

6. The Eastern Banking Corporation Limited was renamed as Uttara Bank Limited.

The aims and purposes of the government for nationalization of commercial banking sector were to channel funds, to prioritize credit to war-affected industries and agricultural and transport sectors to revitalize damaged sectors. Funds available from local sources and grants loans and credit facilities received from foreign sources were channeled through these 6 nationalized banks. Unfortunately, these banks were unable to operate well because of government control and lack of efficient Management. Another cause of partial failure of these commercial banks was the fact that loans and advances were provided to public sectors, in line with the government policies, without commercial viability, lack of proper recovery process, abnormal delay in taking proper and timely actions etc. The concepts of profitability, maintenance of liquidity and adequacy of capital were almost absent in the policies of the Bank Management.

From 1971 up to early 1982, only the nationalized banks were operating in the country. In 1982, Arab Bangladesh Bank Limited (currently AB Bank Limited) started its operation as a private Commercial Bank, the first of its kind in Bangladesh. Denationalization process of banks started after that time by handing over Pubali and Uttara bank to the private sector. In 1983, five (5) new licenses of private commercial banks were issued and by 1983 end, a total number of six (6) private commercial banks were established. The successive government followed the trend in response to increase demands of the banking services. By 2011, the total private commercial banks counted to 30, fully operational with huge number of branches. In addition to that, another 9 new banks were approved after 2011 most of those are under the process of starting operation or partly in operation.

In addition to Commercial banks as mentioned above, there were two Government owned specialized Banks in the country These two banks were renamed as to Bangladesh Krishi Bank and Bangladesh Shilpa Bank (BSB). In March 1987 Bangladesh Krishi Bank was bifurcated and another specialized bank as Rajshahi Krishi Unnayan Bank (RAKUB) was formed for Rajshahi Division. Bank of Small Industries &

Commerce Bangladesh Ltd. (BASIC) started its operation as Private Bank from 1988. Later on, BASIC was brought under direct control of the Government and was categorized as a specialized bank with effect from 1993. From July 1995 again the BASIC was categorized as a private bank. In 1997 for the second time, the Government decided to treat this bank as a specialized bank. BSB & BSRS were merged and renamed as BDBL from early 2010.

Besides private Commercial Banks and Specialized Banks as mentioned above, there are other categories of banks rendering various banking and financial services in Bangladesh. These are a 4 state –owned commercial banks, 9 foreign commercial banks and 4 non-schedule commercial banks. In keeping with the topic of the research, this study is restricted only to the private Commercial Banks.

Appended below is a table showing growth in numbers of all 4 types of commercial banks in Bangladesh from 1975 up to 2010:

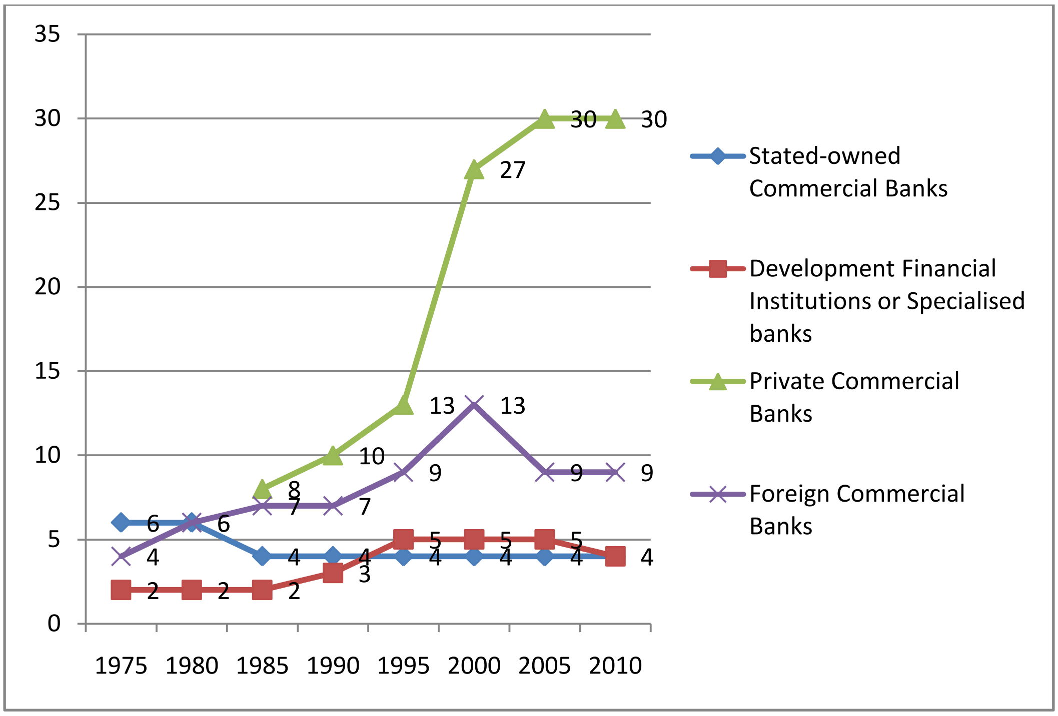
Table: 5.3 Banks in Bangladesh:

	1975	**1980**	**1985**	**1990**	**1995**	**2000**	**2005**	**2010**
Total number of Commercial banks	12	14	21	24	31	49	48	47
State-owned Commercial banks	6	6	4	4	4	4	4	4
Specialized Commercial banks	2	2	2	3	5	5	5	4
Private Commercial Banks			8	10	13	27	30	30
Foreign Commercial banks	4	6	7	7	9	13	9	9

Source: Annual Reports and Monthly Economic Trends of Bangladesh Bank for several years.

If the above figures are presented graphically, the picture will be as follows:

Figure: 5.3 Banks in Bangladesh:



From the figures and the graph, it appears that the number of SCBs and DFIs remained almost same with little variations due to merging together of some SCBs and privatization of two banks. FCBs grew up by the year 2000 and reached the number 13 but again declined to 9 by the year 2005. The PCBs grew steadily during 1995-2000. Then again, with the approval of 14 new PCBs, the figure jumped to 27 by the year 2000. Further approval of 3 more PCBs were given and the total number of PCBs reached 30 by the year 2005. The same figure remained unchanged up to the year 2010.

5.3.1 Public Sector Banks in Bangladesh:

In 1972, the government of Bangladesh nationalized the banking sector. A total of 6 state-owned commercial banks (SCBs) were formed absorbing the then existing 12 private commercial banks. The 6 SCBs were: Sonali Bank, Janata Bank, Agrani Bank, Rupali Bank, Pubali Bank Limited, Uttara Bank Limited. On nationalization, it was expected that these public sector banks would be playing a vital role for social benefits and in the economic development process. The aims and objectives of the nationalization were-

a. Expansion of branch network to the both semi-urban and rural areas with special emphasis for providing services to rural people.

b. Mobilizing and utilizing at the best possible way, domestic savings with special emphasis on rural savings.

c. To provide credit facilities to the priority sectors such as – agriculture, fisheries, small and cottage industries etc. to achieve balanced reasonable development, removal of control of the banking sector by a few vested interested individual/ groups.

Unfortunately, these objectives were only partly achieved, priority sector credit was very low and quality of customer services has been deteriorated and efficiency of performance, safety of investment and profitability were sacrificed in favor of so called social benefits.

In order to overcome the problems accumulated on the SCBs, the Government formed a committee on "money, banking and credit" by mid 1980s. The committee was headed by the then Finance Minister. The committees' objectives were to recommend ways and means for improvement of the operational efficiency of the banking system. In the year 1990, a reformation initiative under the title 'financial sector reform project - FSRP' was taken based on the recommendations of the Committee. FSRP outlined some regulatory and legal measures. Besides, FSRP introduced some manual for operation and guidance of reporting system. These were: lending risk analysis, financial spreadsheet, performance planning system, large loan deposit system and new loan ledger card.

Before FSRP termed was expired the government again formed one Banking Restructuring Committee-(BRC), to recommend to the Government, necessary financial discipline and for improving efficiency of SCBs. In 1997, a Commercial Bank Restructuring Project (CBRP) was taken which was funded by the World Bank. It was intended to assess the progress on key issues and to identify urgent actions that were needed to be taken for the development of commercial banks in Bangladesh. The aims of all these steps to make SCBs more efficient and disciplined were not materialized duly.

The sole role and dominance of SCBs on the economy continued up to early 1982 that is, until private commercial banks were approved to operate.

In January 1985, Pubali Bank and Uttara Bank were denationalized and subsequent to that (in 2007) all the 4 remaining SCBs were converted into state owned limited Banking Companies with independent Board of Directors to take care of both the operational and policy matters, of course, under direct supervision of Ministry of Finance and under control of Bangladesh Bank. It was intended that under independent board of directors to run their business autonomously, these banks would become competitive, profitable and more efficient. Bangladesh bank has issued licenses under article 31(1) and 31(2) of banking Companies Act 1991 in favor of Agrani Bank Limited, Janata Bank Limited and Sonali Bank Limited on 30 May, 31 May and 5 June 2007 respectively to operate banking business. In order to complete the process of corporatization, a vendors agreement was signed with each of the newly licensed banks as per clause (1) of article 27 a of Bangladesh Banks (Nationalization) Order 1972, to transfer /vest entire assets, liabilities and capital of the SCBs to the new banks. (Source: Bangladesh Bank Annual Report 2012-13).

The state-owned Commercial Banks had their structural limitations that is, short term sources of fund, lack of enough skilled manpower etc. in making an entry into term financing of industrial projects and agro based industries. To fill the vacuum, specialized financial institutions were established. These institutions were known as Development Financial Institutions (DFIs). At present four DFIs are operating in the Country, namely: Bangladesh Krishi Bank. Rajshahi Krishi Unnayan Bank, BASIC Bank and BDBL (Bangladesh Development Bank Limited.

5.3.2 Private Sector Banks in Bangladesh:

It is apparent from the discussions in the above section that up to 1982, there were no Private Commercial Banks (PCBs) in Bangladesh. The journey towards private banking services in the country started with the approval of Arab Bangladesh Bank Ltd. in 1982 and it was followed by establishment 5 more PCBs in 1983. In 1985 Pubali Bank and Uttara banks were denationalized and were handed over to the Private Sector. The Privatization process went on and by the year 2010, the number of PCBs in Bangladesh reached up to 30. Other 9 PCBs were approved during 2012/13, which are not yet fully operating.

The modern concept of commercial banking rests on quality services and products. Julian and Ramashen (1994) rightfully observed-"delivering quality services and products to customers is essential for success and survival of today's competitive banking environment".

It may not be unjustified to say, that the SCBs did not operate with viable objective of profitability and only partly rendered quality services and products. Rather, SCBs operated with some sort of 'society oriented service perception', giving importance to some specific sectors of the economy. Due to this and some irregularities of management, the SCBs faced increasing bad debts, huge pile of overdue loans etc.

Moniruzzaman and Rahman (1998) conducted an important study to evaluate the profitability performance of denationalized banks both before and after denationalization. It was found that the profit for 1984 that is, after denationalization was 36.43 % higher than that of 1983. They also observed that profitability performance of Uttara Bank Limited, Pubali Bank Limited and Rupali Bank Limited has been recording a downward trend after nationalization and their profits have been showing a wide fluctuating position after denationalization period as compared to pre-denationalization period.

Besides, disinvestment of some public sector enterprises and growth of private sector industries during eighties demanded more funds and wide range of banking services to meet their needs. Further, to invigorate the economy and to face the competitions thrown by the foreign commercial banks, there were no alternatives but to allow private commercial banks to operate in order to inject more money into the economy, to be competitive to the clients and to render desired services to the customers which the SCBs partly failed to render.

The aims and objectives with which the Private Commercial Banks (PCBs) were approved can be summarized as follows:

- **a.** To ensure enough flow of credit to economic sectors at large.
- **b.** To increase competition in banking sector.
- **c.** To reduce government deficits due to subsidies provided to the public enterprise to recover the losses.
- **d.** To revitalize operating efficiency of banking sectors.

e. To improve quality of services and products to customers.
f. To expedite capital investment to industry, trade and business.

It may not be that the PCBs attained, at full length, all these objectives in the country. But if analysises and interpretations are made of the growth and market share the PCBs from eighties up to 2010, it can be said without doubt that the PCBs successes are commendable and remarkable.

Since 2002 the domination of the banking system by the SCBs has been declining while PCBs and FCBs have been gaining larger market share in both deposits and bank loans and advances (Bhattachariya & Chowdhury-2003). This reflects an increase competition in the banking sector.

The PCBs' growth was not only in number but also in total assets and total deposits as compared to other 3 types of banks in Bangladesh as of the year 2010. In 1990, the SCBs market share was 54.4% which declined to 28.06% in the year 2010. Whereas, in 1990 the PCBs market share was only 22.6% but jumped to 59.34% by the year 2010. Similarly FCBs have also shown slight increase in holding total industry assets of 6.59% and DFIs holding of 6.01% by the year 2010. The following table shows PCBs total number of branches, total assets and total deposits in comparison with other 3 types of commercial banks in Bangladesh as of the year 2010:

Table: 5.3.2 Comparative positions of commercial banks in Bangladesh:

Bank types	**Number of Banks**	**Number of Branches**	**% of Branches**	**Total assets (Crore tk)**	**% of industry assets**	**Deposits (Crore tk)**	**% of Deposit**
SCBs	**4**	**3,447**	**44.60%**	**135,929.28**	**28.06%**	**101,357.14**	**27.80%**
DFIs	**4**	**1,382**	**17.88%**	**29,091.57**	**6.01%**	**18,408.22**	**5.05%**
PCBs	**30**	**2,828**	**36.59%**	**287,416.75**	**59.34%**	**222,182.25**	**60.93%**
FCBs	**9**	**72**	**0.93%**	**31,942.40**	**6.59%**	**22,677.42**	**6.22%**
Total	**47**	**7,729**	**100%**	**484,380.00**	**100%**	**364,625.03**	**100%**

Source: Bangladesh Bank

Although SCBs have the highest number of branches but as to total assets and total deposits, SCBs ranked only second. The PCBs with 2,828 (SCBs

3,447) branches and 59.34% of industry assets attained 60.93% of the total industry deposits which indicates that the PCBs are playing a leading role in the banking sector of Bangladesh.

5.3.3 Comparison of Public and Private Sector Banks of Bangladesh:

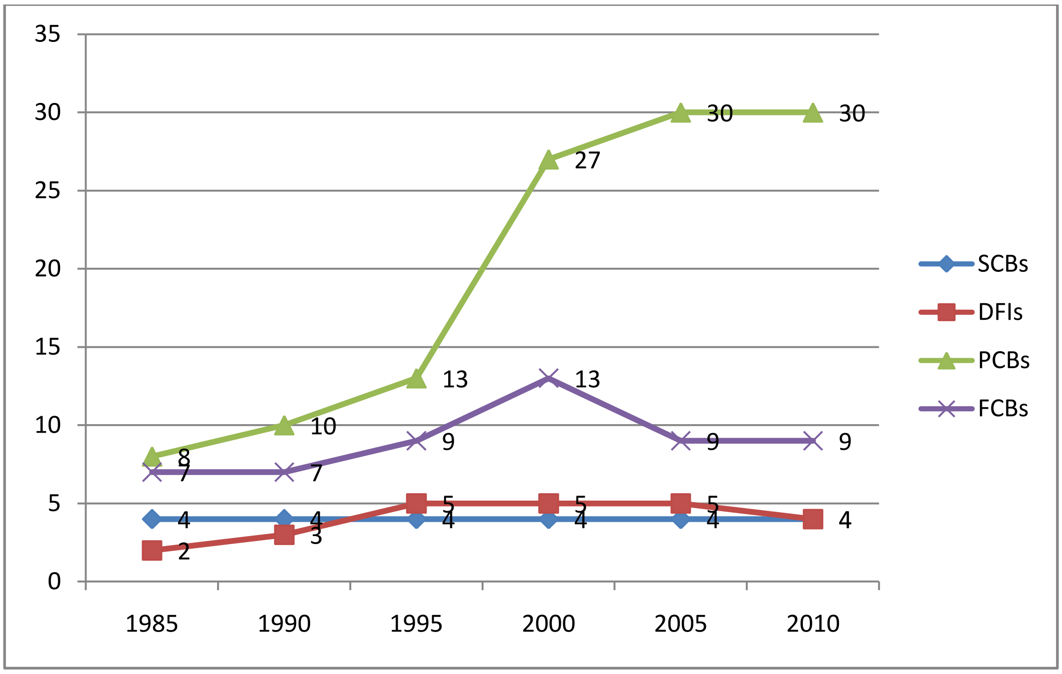
After emergence of Bangladesh the commercial banking sector was dominated by SCBs in line with the then Government's nationalization policy. The situations remained unchanged till 1982. The SCBs could not perfectly face the challenges of the market demands and with the expansions of national economy especially in the Private Sector, the needs for PCBs could not be denied. On the other hand, the competitions thrown by the FCBs and the shortcomings of the DFIs financing operations further augmented the needs for more competitive and efficient Private Banking Services. The demand of the time was duly met with the approval of PCBs to operate in the country. Gradually, more and more PCBs came into the banking sector.

At present the Commercial Banking System of Bangladesh is comprised of 4 types of banking institutions namely- SCBs, PCBs, DFIs and FCBs. Total number of each type as on Dec 2010 were – 4 SCBs, 30 PCBs, 4 DFIs, 9FCBs. To make a comparative evaluation of the performance of PCBs with SCBs and other banks some factors are considered necessary and relevant. These factors are expansion of bank and its branches, market share of industry assets, deposits, advances and growth in profit.

5.3.3.1 Number of banks:

The following graph shows that the total numbers of SCBs have remained the same (4 Nos.) throughout the years from 1985 up to 2010 whereas, the total number of PCBs have increased from mere 8 in 1985 to 30 in 2010. Numbers of PCBs are continuously increasing and during the years 2011 through 2013 more 9 PCBs were approved. In case of FCBs and DFIs, the increase in number was negligible that is, from 7 FCBs were operating in 1985 the number rose to only 9 in 2010 and from 2 DFIs the number rose to 4 by 2010. It is apparent from these facts that the PCBs are growing rapidly and have firm grip on the market over the SCBs.

Figure: 5.3.3.1 Number of banks:

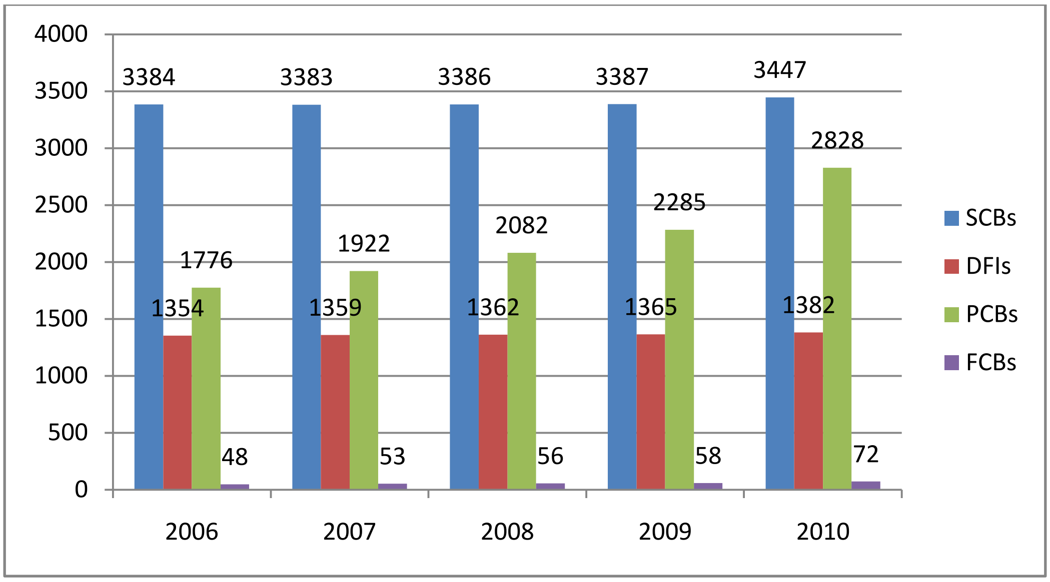


Source: Bangladesh Bank Annual Report and Monthly Economic Trends of Bangladesh Bank

5.3.3.2 Number of branches:

SCBs had 3,384 Nos. of branches in 2006 which was increased to 3,447 branches by 2010. Growth of only 103 branches in 5 years is not remarkable. The PCBs had 1,776 branches in the year 2006 which increased to 2,828 by 2010. The PCBs posted a record growth of 12% annually. The DFIs opened new 28 more branches in five years from 2006 to 2010 and FCBs opened 24 more branches during the same five years. It is clear from these facts that the positions of PCBS in the Banking Sector have been gaining grounds. In respect of branches, the SCBs enjoy advantageous position with the highest numbers of branches all over the country from the early years but their further growth is very much limited as compared to that of PCBs.

Figure: 5.3.3.2 Number of branches:

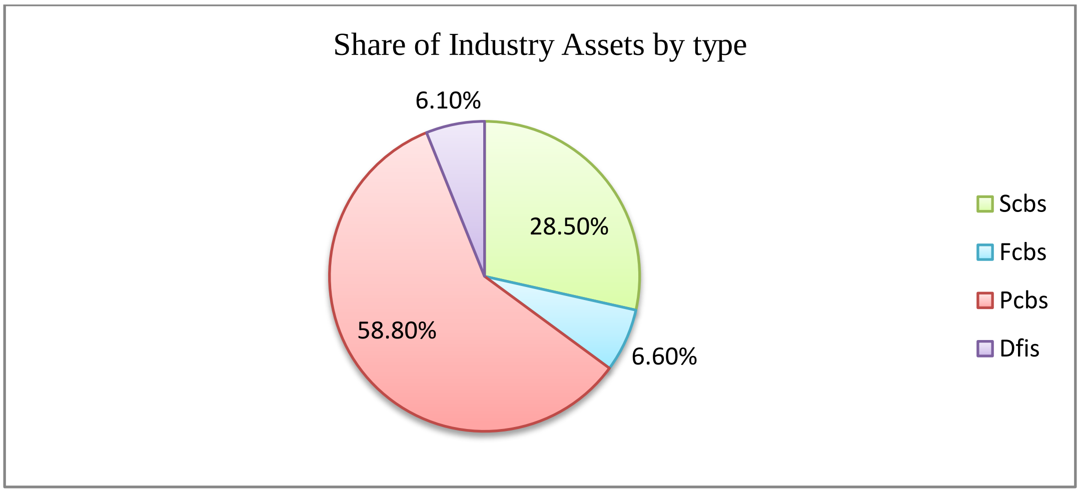


Source: Bangladesh Bank Annual Report

5.3.3.3 Share of industry assets by type:

Market share of Industry Assets is another very important factor determining comparative positions. In this respect, the PCBs enjoy a dominating status over SCBs and other two types of Commercial Banks. The chart below shows that at the end of 2010, PCBs had 58.8% hold on total Industry Assets as compared to 28.5% of SCBs, 6.10% of DFIs and 6.60% of FCBs. In 2006 the positions were: PCBs 47.70%, SCBs 32.70%, DFIs 7.80% and FCBs 11.80%. The chart vividly exhibits that when the market share of SCBs, along with that of DFIs and FCBs have fallen down, the PCBs were able to enhance the same at a remarkable pace.

Figure: 5.3.3.3 Share of industry assets:

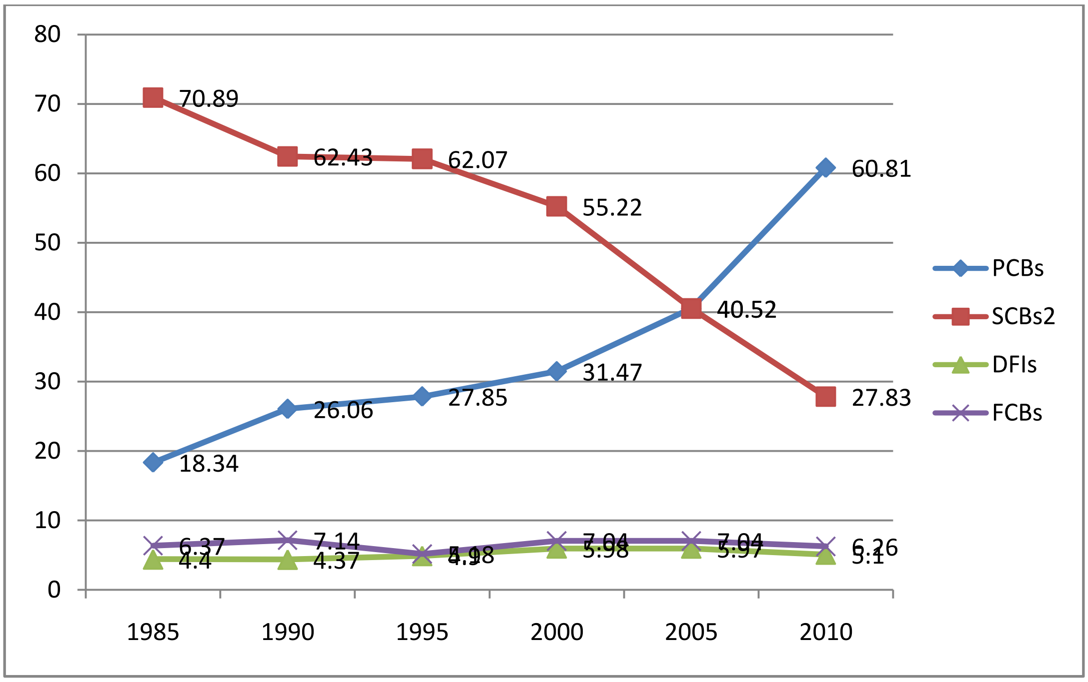


Source: Bangladesh Bank Annual Report of 2009-10

5.3.3.4 Share of deposits:

In 1985 SCBs occupied 70.89% of the total deposit of banking industry. Since then a sharp fall in SCBs share recorded resulting in 27.83% market share of deposits by the year 2010. The recorded fall is about 60% over a period of 25 years giving a negative sign towards the market position of SCBs. But in case of PCBs deposit market share in the year 1985 was 18.34% which increased up to 60.81% by the year 2010. The resulting growth is 231% over a period of 25 years which is quite remarkable in a competitive market. Both DFIs and FCBs retained their market share of little over 6% and around 5% respectively during these 25 years. It is mentionable that the market share of PCBs was tremendously higher between the years 2000 to 2010 snatching the share of SCBs.

Figure: 5.3.3.4 Share of deposits:

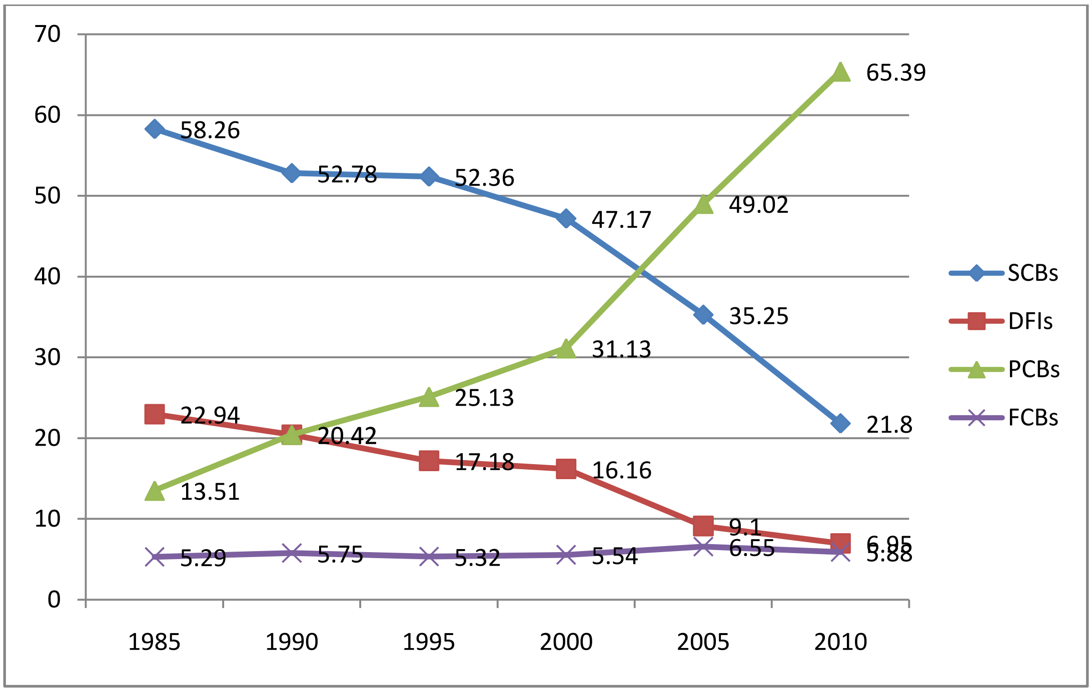


Source: Bangladesh Bank Annual Report and Statistics Department Bangladesh bank

5.3.3.5 Loans, advances and credits of commercial banks by type:

The scenario of market share of advances and credits ran in the same direction of market share of Deposits. From the graph below, it can be observed that where the market-share of SCBs in the year 1985 was 58.26%, it fell down to 21.80% by the year 2010. On the other hand, the PCBs had a market share of 13.51% in advances in the year 1985 which grew up to 65.39% by the year 2010. SCBs recorded a fall down of about 63% from 1985 to 2010 where PCBs recorded a growth of 384% during the same period. The market share in Advances of DFIs was 13.51% in the year 1985 which fall down to 6.95% in the year 2010. The same of FCBs did not record any major changes rather remained 5% to 6% from 1985 to 2010. It is not only the fact that PCBs grabbed market share from SCBs and DFIs rather it acquired new customers and expanded its area of operations hugely.

Figure: 5.3.3.5 Loans, advances and credits of commercial banks:



Source: Bangladesh Bank Annual Report and Statistics Department Bangladesh bank

5.3.3.6 Profitability trend of commercial banks:

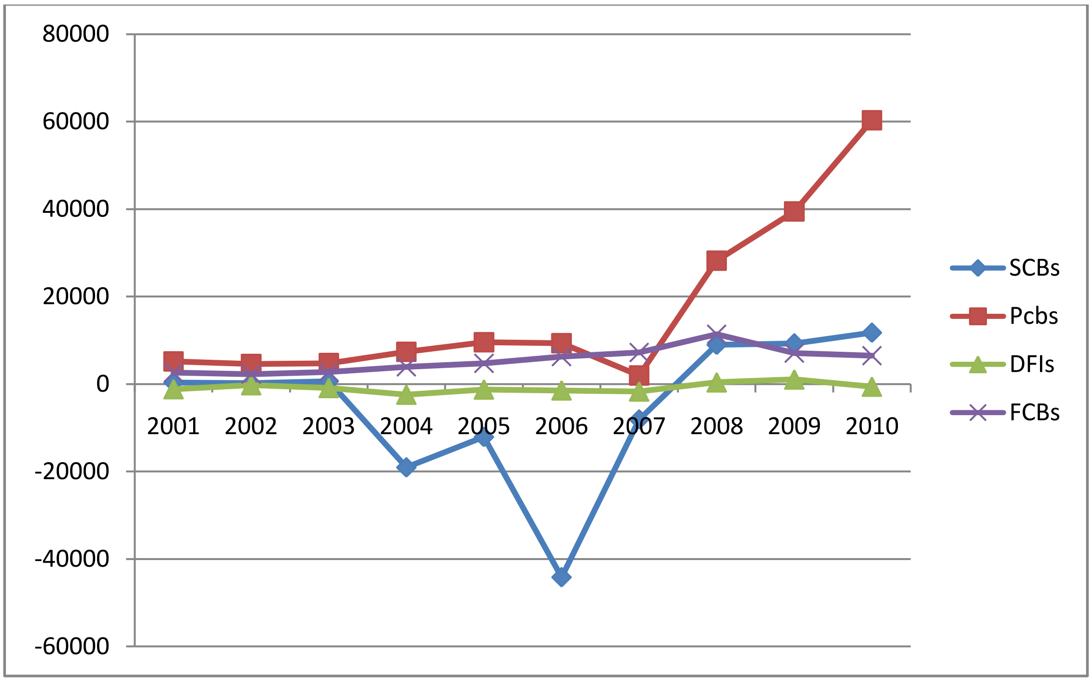
The following table and the graph show the trend of net profit/loss of all four types of Commercial Banks in Bangladesh for 10 years from 2000-2010. FCB's and PCB's net profit trend were in the positive direction and were rising over the entire period. For PCBs net profit of 5,144.80 million taka for the year 2001 reached its pick at taka 60,320.30 million in the year 2010. Similarly, FCBs also posted rising trend and from 2,598.10 million profits for the year 2001 it went up to 11,384.20 million in the year 2008. Profit for the year 2008, were the highest for FCBs and same for the year 2009 and 2010 partially declined. But it was able to generate a handsome profit. As for SCBs, the scenarios were not encouraging. Although during the years 2001 to 2003, it earned a profit but from the year 2004 a big loss of taka 19,047.20 million was incurred. The situations alarmingly worsened in the year 2006 when SCBs incurred 44,159.20 million loss which was the highest ever loss since early1990s. A positive look signaled in the year 2008 when SCBs earned a profit of 8,976.80 million reversing their negative trends from 2004 up to 2007. Unfortunately, the DFIs could never earn a profit from 2001 up to 2007. The position improved a bit in 2008 and 2009 with a profit figure of 401.6 and 1,057.6 million respectively.

Table: 5.3.3.6 Profitability trend of Commercial Banks: (Taka in millions)

Period	***SCBs***	***FCBs***	***PCBs***	***DFIs***
2001	382.40	2598.10	5144.80	-1146.40
2002	198.80	2240.80	4587.90	-243.20
2003	682.10	2764.40	4755.90	-878.90
2004	-19047.20	3920.10	7364.90	-2406.80
2005	-12094.10	4701.80	9547.10	-1230.00
2006	-44159.20	6241.20	9315.40	-1436.20
2007	-8091.00	7233.30	19957.50	-1671.70
2008	8976.80	11384.20	28186.60	401.60
2009	9313.5	7087.8	39477.2	1057.60
2010	11762.6	6456.2	60320.3	-584.10

Source: Bangladesh Bank Annual Report and Statistics Department Bangladesh bank

Figure: 5.3.3.6 Profitability trend of Commercial Banks:



Source: Bangladesh Bank's Monthly Economic Trend, Feb, 2014

All these six factors, which are taken into consideration to make a comparative study of the positions of PCBs as against other 3 types of Commercial Banks of the country, clearly indicate a stronger, dominating and brighter position of the PCBs.

5.4 Private Sector Banks: Contemporary Development:

The banking sector of Bangladesh is usually classified into four generations. Banks incorporated from the period of 1971 - 1990 are classified as first generation banks. Second generation banks were licensed in the period of 1991- 2000. All banks licensed since 2000 are classified as third generation banks. Among all fourth generation Scheduled Banks have started their operation from the quarter April-June, 2013.

Table 5.4: PCBs in Bangladesh:

Sl. No.	***Name of PCB***	***Year of Foundation/ Denationalization ****	***Generation of Banking Sector***
1	***Arab Bangladesh bank limited***	1982	First Generation Bank
2	***IFIC Bank***	1983	First Generation Bank
3	***National Bank Limited***	1983	First Generation Bank
4	***Islami Bank Bangladesh Limited***	1983	First Generation Bank
5	***The City Ban k Limited***	1983	First Generation Bank
6	***United Commercial Bank Limited***	1983	First Generation Bank
7	***Uttara Bank Limited***	1985*	First Generation Bank
8	***Pubali Ban k Limited***	1985*	First Generation Bank
9	***ICB Islami Bank Limited***	1987	First Generation Bank
10	***Eastern Bank Limited***	1992	Second Generation Bank
11	***NCC Bank Limited***	1993	Second Generation Bank
12	***Prime Bank Limited***	1995	Second Generation Bank
13	***Dhaka Bank Limited***	1995	Second Generation Bank
14	***Al-Arafah Islami Bank Limited***	1995	Second Generation Bank
15	***Southeast Bank Limited***	1995	Second Generation Bank
16	***Social Islami Ban k Ltd***	1995	Second Generation Bank
17	***Dutch-Bangla Bank Limited***	1996	Second Generation

			Bank
18	***Trust Bank Limited***	1999	Second Generation Bank
19	***Bank Asia Limited***	1999	Second Generation Bank
20	***EXIM Ban k Limited***	1999	Second Generation Bank
21	***First Security Islami Bank***	1999	Second Generation Bank
22	***Mutual Trust Bank***	1999	Second Generation Bank
23	***Mercantile Bank Limited***	1999	Second Generation Bank
24	***ONE Bank Limited***	1999	Second Generation Bank
25	***The Premier Bank Limited***	1999	Second Generation Bank
26	***Standard Bank Limited***	1999	Second Generation Bank
27	***Bangladesh Commerce Bank***	1999	Second Generation Bank
28	***BRAC Bank Limited***	2001	Third Generation Bank
29	***Jamuna Bank Limited***	2001	Third Generation Bank
30	***Shahjalal Islami Bank Limited***	2001	Third Generation Bank
31	***NRB Commercial Bank Limited***	2013	Fourth Generation Bank
32	***South Bangla Agriculture And Commerce Bank Limited***	2013	Fourth Generation Bank
33	***Meghna Bank Limited***	2013	Fourth Generation Bank
34	***The Farmers Bank Limited***	2013	Fourth Generation Bank
35	***Union Bank Limited***	2013	Fourth Generation Bank
36	***Modhumoti Bank Limited***	2013	Fourth Generation Bank
37	***Midland Bank Limited***	2013	Fourth Generation Bank
38	***NRB Bank Limited***	2013	Fourth Generation Bank
39	***NRB Global Bank Limited***	2013	Fourth Generation Bank

Source: Bangladesh Bank

This categorization of the PCBs is based only on the year of establishment and there was no thumb rule.

5.5 Budgetary Practices in the Banking Sector:

The preceding section above clearly indicates that budget is widely used as a control mechanism in almost every types of business organization in the country. It can be assumed that the banking sector is not an exception in this regard. The basic rules governing the banks' affairs are the Bank Company Act 1991. At the same time, Bangladesh Bank, the central bank of the country, is a supervisory authority outlining operational procedures parallel with the Ministry of Finance- banking division to some extent. The banking companies Act prescribed rules for different kinds of check and control including maintenance of account, preparation of financial statement and reports, audit of the Accounts of banks etc. Section: 38-40 prescribe rules and procedures in this regard.

The Bangladesh Bank, from time to time issue directives on procedures to be followed on different operational issues. In such a guideline, titled as 'Guideline on Assets Liabilities Management guideline' the Central Bank instructed the schedule banks to prepare Balance Sheet variances that is, variances of Assets and Liabilities against the targets of the banks, under supervision of the Asset Liability Committee (ALCO). In another guideline titled as 'Bank Internal Control Policy Guideline' the Central Bank emphasized on the introduction and use of Finance and Accounting Manual. But the Bank Companies Act and the Central Bank Guidelines do not specifically mention any rules or directives as to the compulsory practice of budget by Commercial Banks. On the other hand, Bangladesh bank adopted Basel II and Basel III framework which is followed by all commercial banks in Bangladesh. Basel II principle has three pillars. These are- pillar-1: Minimum Capital Requirement (MCR), pillar-2: Supervisory Review Process (SRP), pillar-3: Market Discipline (MD).

In a policy guideline, under the title 'Managing Core Risks in Banking: Internal Control & Compliance' issued by Bangladesh Bank, reference was made of IMF's observations on the role of internal control to improve performance of Commercials Banks in the following text.

'In Bangladesh analysis on the performances of the banks has pointed out that an effective internal control system could have contributed significantly in improving the performance of the commercial banks if the control culture is brought in through policy guidelines and structural changes at these banks'.

5.5.1 Budgetary practices in public sector banks:

As an internal control device SCBs prepare and implement budgets in their banks. As SCBs are 100% owned by the government, their policies and procedures are largely influenced by finance ministry and the central bank. Even their members of the board are also selected by the government. SCBs also enjoy certain advantages from the government. Development funds, particularly in the rural areas, are channeled through SCBs. In addition, mobilization of funds and conducting major transactions of the government controlled corporations are done through SCBs. Further, in case of needs and necessities, government injects additional capital in SCBs. In spite of all these advantages, SCBs performances are not ranked as satisfactory. As per Basel II requirement, CAR should be 10% whereas, as on June- 2013, SCBs could maintain only 1.2% CAR which is too low as compared to other types of banks. As regards to other efficiency measurement criteria SCBs positions are not satisfactory also. The positions are NPL (26.4 %- highest in the banking sector), bad debt provision adequacy (97.4 %- seems to be near to Basel II requirement), profitability (-11.9 % as of 2012) and liquidity ratio (29.2 % as of 2012). It is alarming that the profitability situation of SCBs were -11.9 % that is negative. It is apparent from these facts that the internal control systems of these SCBs are not effective and strong enough. Formally budgets are prepared by SCBs both at corporate and branch level but implementation, monitoring and feedback systems in SCBs do not seem to be effective and strong.

5.5.2 Budgetary practices in private sector banks:

During the field survey on questionnaire, the issue was raised with the concerned executives of some banks. They opined that there is no compulsory provision of rules for budget. However, PCBs follow the provisions of Basel II for maintaining capital adequacy. Basel II is also followed in classifying capital structure into different tier.

Budgeting is an internal policy of the banks and it is used as a control measure in consideration of the benefits the practices offer as a management control technique. The filled-in survey questionnaires collected from the respondents indicate that all the sampled banks prepare and use budget.

Analysis of performances of PCBs in the recent years shows positive results. As per Basel II requirement, CAR should be 10% whereas, as on June- 2013, PCBs could maintain 11.4% CAR which is reasonable. The positions are NPL (6.6 % as of June, 2013), bad debt provision adequacy (98.9 %- seems to be near to Basel II requirement), profitability (10.2 % as of 2012, which seems to be reasonably good) and liquidity ratio (26.3 % as of 2012). Replies on the questionnaires indicated that budget is extensively practiced in PCBs. Thus, internal control system functions efficiently resulting in improvement of performance and profit.

However, most of the private commercial banks have their internal budget policy guidelines with necessary modifications. These guidelines are sent to branches for preparation of budget of any particular area. To some extent these guidelines differ from bank to bank based on their policies and strategies. Some guidelines on common issues cover the following areas:

1. Deposit mobilization:

Branches are advised to mobilize maximum deposits with optimal mix for the budget projection. List of top depositors with risk involved, if any, should be mentioned alone with budget format.

2. Loans and Advances:

As per Bangladesh bank policy guidelines, loans and advances are grouped into four categories as: continuous loan, demand loan, fixed- term loan and short-term agricultural credit. PCBs also follow BB guidelines to classify overdue loan / installments.

Generally, branches are advised by the head office to analyze respective loan mix (corporate, SME, retail etc.). Analysis of sector wise credit portfolio, with risk and prospects are required to be submitted with the budget. Segregation of performing and non-performing sectors for loans and credit are required to be done with further credit preferences to performing sectors in the budget projections. A credit deposit ratio is always advised to be maintained which vary according to availability of liquidity.

3. Non-interest business:

Guidelines as to non-interest fee/commission structures are generally given for budget projection with emphasis on import and export business.

4. Inter- branch interest (pool rate):

The branches are generally given guideline as to inter branch transfer pricing that is, charges for inter-bank lending and borrowing.

5. Guideline as to growth projection:

Banks generally categorize their Deposits, Loans and import business according to volume and quality. Guidelines are usually given to the branches as to the projection of growth rates for different categories for incorporation into the budget.

6. Projection of over dues and default loans:

As per BB guidelines overdue loan/ unpaid installments are required to be classified into four categories namely: special mention account, sub-standard, doubtful and bad/loss depending on the types of loan and period of overdue.

Branches are required to classify loans and advances into 'not yet due' and 'overdue' with the separate lists of both the types for incorporation in the budget. Braches are also required to enclose with budget a list of 'written off' loans and plans to recover those.

7. Capital expenditure:

Branches are advised to furnished capital expenditure requirement if any, for the budget year with details of costs and timing.

8. Income projection:

For income projection in the budget the branches are always advised to consider the latest schedule of charges.

9. Idea for new business:

Branches are always advised to give ideas about prospective business based on local existing and future demands.

These are only some common guidelines have been observed being given to branches by some private commercials bank. In fact, budget guidelines to branches differ from bank to bank in some respects in line with their policies and planning.

The answers to the question that whether all the banks properly implement budget and conduct due process of feed-back and follow up procedure or not, can only be found once these questionnaires are analyzed, interpreted and the findings are drawn. That will be done in the succeeding Chapter seven.

5.5.3 Budgetary practices in foreign banks:

Nine foreign banks are presently in operation in Bangladesh. These are branches of the multinational banks with head offices situated in different countries. In order to exercise operational control and to operate at a profitable level the head offices put extra emphasis on preparation of budget and its compliance. The role of budgeting in ensuring complete and effective internal control is undisputed. Proper internal control results in higher efficiency and greater profit. Besides, FCBs, as a matter of regular practices have to submit operational reports to their head offices frequently. These reports enable the head office to compare the performance with the set-targets. FCBs have been maintaining highest positions in the country in respect of profitability, CAR, NPL, liquidity ratio etc. continuously. This proves that they have proven internal control system in operation due to their proper implementation and compliance of budgetary practices.

Operational profit-wise, FCBs are at the highest position at least for last ten years. In addition, FCBs maintain the highest capital adequacy ratio as compared to other types of banks. FCBs maintained CAR at 20.3% as on June 2013, as against Basel- II standard of 10 % CAR which is the highest of all types of operating banks in Bangladesh. Further, as to non- performing loans, (NPL) FCBs are the lowest at 4.7 % and in regard to bad debt provision adequacy FCBs maintained at 98.2%. (June, 2013). FCBs maintained 17.3 % profitability ratio as of 2012 and also maintained 37.5 % liquidity ratio as of 2012, which is the highest in the country.

It is evident from the above facts that FCBs achievements are the result of efficient internal control system, which is intern, is the positive effect of budgetary practices.

5.6 Summary:

Banking industry as a whole has come out of age globally. But this did not happen over- night. From lending small amount of money sitting on a bench, banking industry are now operating from skyscrapers situated at the most posh areas of all the cities in the world. Indisputably, banking industry is the major contributor to the national economy both in developed and developing countries.

Bangladesh is not an exception to these facts. Bangladesh had a very modest start of its banking industry after the independence. With only 4 state-owned Commercial Banks, a few foreign and specialized Banks, Commercial Banks started its journey in Bangladesh. During 1980 some private Commercial Banks were allowed to operate in the country. With their satisfactory performances, more private Commercial Banks are allowed to operate in the country and at the present, private Commercial Banks are dominant in market share, profitability and growth. But the role of SCBs cannot be denied considering their large number of branches operating in both rural and urban areas. Furthermore, to face competitions from FCBs and PCBs, the SCBs are on the way to modernize their overall operations. The SCBs are converted into limited companies with independent Board of Directors to effectively run the banks. Still the SCBs will need more time and efforts to be profitable and financially sound. In competition with the PCBs, the FCBs are more ahead specially in doing business in the international trade finance and foreign exchange. The FCBs profitability is remarkably higher. DFIs in Bangladesh are far behind as to profitability and financial soundness. But their role in fulfilling Government programs of financing priority Sectors of the economy are praiseworthy.

In this chapter efforts were made to depict a clear picture of the banking sector as functioning in Bangladesh. Different types of banks with different functional areas were looked into. The internal control system of the banks as supplemented by budgetary practices and the effects on their performance are outlined. In the following chapter budgetary practices in PCB will be critically examined through the analysis and interpretations of the replies to the questionnaires.

CHAPTER-6: BUDGETARY PRACTICES IN PRIVATE SECTOR BANKS: DATA ANALYSIS AND INTERPRETATION

6.1 Introduction:

Since inception, the private commercial banks (PCBs) have been facing steep competition from the then existing government owned commercial banks (SCBs). The SCBs were solely in operation since independence of Bangladesh up to 1982 when first private commercial bank was granted permission. During almost 12 years the SCBs had enjoyed complete monopoly in the banking sector and during that time the SCBs extended their operations throughout the country through branches and other net works. The SCBs also enjoyed the preferential treatment from the government with regards to mobilization of government funds. That no doubt, helped generating temporary liquidity. Even some branches of a particular SCB conduct government treasury functions. All these facilities certainly placed the SCBs at an advantageous position over other banks. Initially the PCBs had to start from scratch to compete with well established SCBs with branches spread all over the country. Moreover, there had been foreign commercial (FCBs) banks operating in the country. The FCBs are local branches of multinational banks operating with efficiency, solid financial backgrounds, quality products and services. The PCBs also have been facing competitions from these FCBs. On the top of this, the number PCBs raised to 30 with huge number of branches within 2010. That renders the PCBs to face steep competitions from all these commercial banks.

In the recent years economic growth of the country has slowed down and imports dropped significantly. Economic expansion has failed to keep pace with growth of number of banks. In order to be able to face such situations, the PCBs need to plan carefully, to operate efficiently and to exercise extreme internal control to survive. Proper internal control may help saving cost; operate efficiently and thereby generating more profits. Practices of Budget can certainly ensure a proper internal control system, and compliance of it.

Like any other business organizations budget is widely practiced in the banking sector of Bangladesh. It is more so in the case of private banking sector. The prime purpose of the private banking sector is to be more efficient in order to maximize profit. The private investors of the banking sector, like any other private investors, expect maximum operational efficiency with the objective of handsome returns on their investments. The top management of the private commercial banks is more accountable to all investors. It is because, if the investors fail to earn reasonable return on the investments, the top management will be at a shaky position. Besides, PCBs, to a great extent, are guided and monitored by the central bank by providing regulations and guidelines. Among any other purposes of these regulations and guidelines the prime objective of the central bank is to safeguard the interest of the investors. If the interests of the investors are not protected properly, growth in the banking sector will be hampered. Central bank regulations also aim to bring discipline and order in the operational affairs of the banks. Because, an efficient private sector can ensure economic growth and can also play vital role on the overall economy of the country. The Bangladesh bank adopted provisions of Basel I, Basel II and Basel III over time for practice in the banking sector both as regulatory and disciplinary devices. The regulatory policies, procedures and guidelines are designed to bring operational efficiency and effective control to maximize profit and to protect the interest of the investors.

Among other control devices of the management, budgeting is considered to be of prime importance and significance to ensure both operational and financial controls to achieve desired goals. In consideration of the importance of budgeting for internal control, this study was planned to explore state of existing budgetary practices in the PCBs. To ensure that how effectively budget is practiced by the PCBs, data and information related to total budgetary practices were needed to be collected. There are different devices in practice to extract data and information for a research study. As this is a qualitative research study, questionnaire was considered to be the most relevant source of primary data. Questionnaire has some advantages over other devices of collecting data. It is a simple way of data collection. Large number of information can be collected from a large number of respondents in short time in a cost effective way. Due to direct communication between researcher and respondents, validity and reliability of data can be ensured. Responses on the questionnaire are more direct and unambiguous. So it is easy to analyze more objectively.

The close ended structured questionnaire was used for this survey. It was designed to cover all the relevant aspects of budget within seven sections. It contains total 45 questions. Most of the questions have more than one alternatives. The first section having fifteen questions on types of budget, use of budget manual/guidelines and budget authority. Questions were asked on revenue budget, capital budget, fixed and flexible budget, the practice of zero based budgeting etc. Through relevant questions, efforts were made to find out whether the basic supporting documents such as, budget manual and other budget guidelines are used or not by the PCBs. Further, in this section questions were there to find out the existence of proper set- up of budget authority and its functionality.

The second section is on the preparation of budget. This section focuses on determinant factors of preparation of budget and the basis of budget preparation. It has five questions with numerous alternatives. It was aimed to shed light on the factors PCBs consider while preparing budget. This section also focuses on the use of budget format, budget period, sources of data for preparation of budget. Questions were also there to determine basis of budget preparation that is, whether budget is branch based, regional based or corporate based.

Budget responsibility is covered by the third section of the questionnaire with five questions. The questions covered assignment, segregation and establishment of budget responsibility and also whether responsibilities are regularly reviewed or not in the PCBs.

Section four is on planning for deposits and investments having five questions in total with alternatives. This section has three sub-sections namely, deposit projection, investment projection and loan recoveries. Major questions were designed in this section as to whether deposits and credits are projected on branch basis, regional basis or corporate basis. This section also focuses on the procedures of loan recovery.

Implementation of budget is covered by section five having five questions with alternatives. This section is divided into three sub-sections viz., implementation of revenue budget, capital budget and budget adaption. There were questions as to whether revenue and capital budgets are implemented on branch basis, region basis or corporate basis. Also there were questions on procedures of budget adoption and on authoritative actions for failure to adopt budget properly.

Section six covers evaluation and performance measurement. This section has five questions with alternatives and is divided into four sub-sections. Questions on this section emphasize on performance measurement period, performance report format, performance by operating unit and uses of performance reports by management.

Section seven, the last one, contains five questions on monitoring and feedback. It deals with questions on variance analysis, review process and provision for corrective measures.

It is reasonably hoped that replies of the questionnaire will give a clear picture of the state of budgetary practices in PCBs.

6.2 Use of budget:

The first section of the questionnaire is a general introduction on budgeting in PCBs. This section comprises of fifteen questions. It has three sub-sections covering types of budget, use of budget manual /guidelines and budget authority.

6.2.1 Types of budget:

In line with the title of this study the initial question was intended to determine the existence of budgetary practices in the PCBs. In reply to the question as to whether budget is prepared by all the subject banks, the answer was totally positive. All twenty eight banks (100 %) confirmed preparation budget in their organization. Though preparation of budget is not legally obligatory on the part of the PCBs, budget is commonly practiced by all the banks to augment internal control and efficiency. As a matter of management policy, different budget models are applied in the PCBs which indicates positive attitude of the management towards budgetary system.

There are different types of budgets in practice in banks. Each of these types of budgets has its own advantages and a combination of two or more types may drive greater benefits. For example, if a bank prepares only revenue budgets without capital budget, its capital expenditures may not be based on prudence and expected return on investment may not be achieved. Besides, un-budgeted and un-planned capital outlays may cause constraints on liquidity. Again, if budget is prepared on fixed or static basis, abrupt changes in business will give misguiding comparative results. Accordingly, through this questionnaire, it was intended to find out what is the specific type of budget used by each of the responding banks. Also it was aimed to find out how effective the practice of budget is in the PCBs.

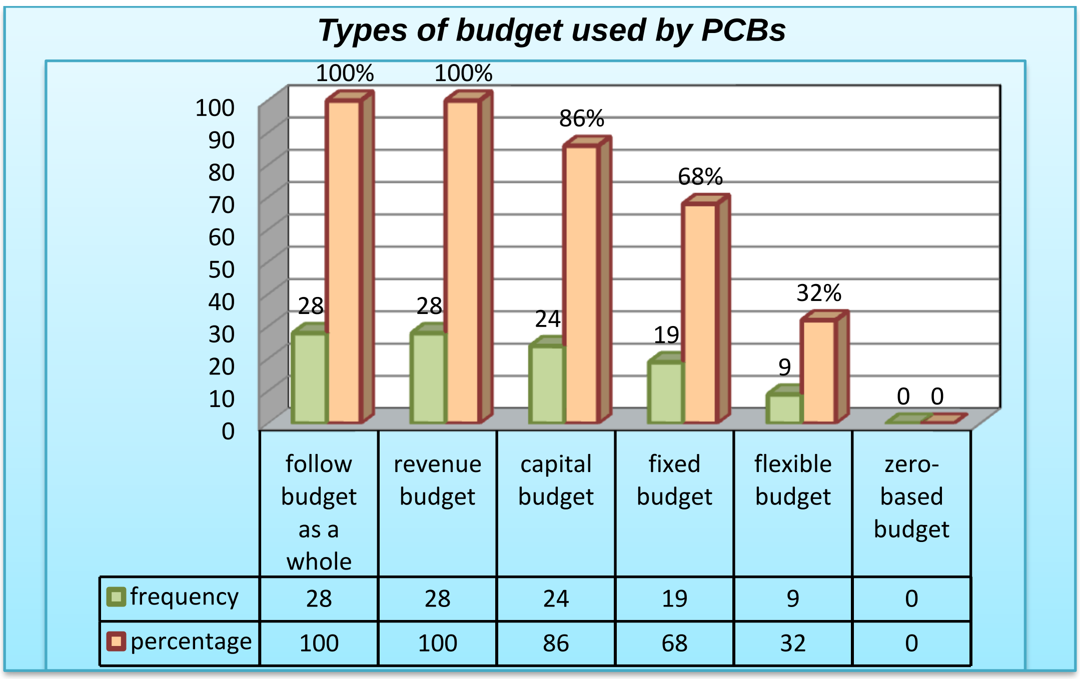
It is revealed from the replies of the respondents that all the banks under this study follow budget as a whole. All the PCBs prepare a complete budget package for the entire bank at their corporate office. The corporate budget packages are not similar in all the banks. A few banks prepare budget only for the entire bank as a whole without splitting the budgeted figures into zone or branch levels. But most of the banks follow ‘operational unit based’ approach. That means the expected operational target of each individual branch are estimated first and they are included in the corporate budget. Some banks also project in their budgets estimated operational results on the basis of zone or region.

Further, all the twenty eight banks (100%) prepare revenue budget. Emphasis on revenue budget is reasonable. The revenue budget estimates banks’ income and expenses from different sources for the budget period. The overall operational efficiency is generally judged by the surplus of revenues over expenses that is, profit. Banks’ major revenues or incomes are generated from interest, commission, exchange gain and brokerage. Minor income or revenue may be generated from other than main operations. A detailed revenue budget is important for the banks to pin-point its strongest and weakest areas of operations. In order to exercise control on expenses, banks generally prepare detailed budget of expenses such as: interest payment, salaries, rent, taxes, insurance, advertisement and other heads of expenses. Reduction of costs and control of expenses becomes easy if budget is prepared in details. Provisions for loans and advances as per Basel-II requirements are also shown in the revenue budgets. It is observed that all the respondent banks give emphasis on preparation of revenue budgets without exception.

Whereas, only 24 banks that is, 86 % of the respondents prepare capital budget. Clear indication is here that 14 % of the respondents do not prepare capital budget. Certainly institutions like banks undertake capital expenditure each year in keeping with its growth and expansion. Banks' capital expenditure may be for acquisition of land, building, office-equipment including computer hardware and software, office furniture, transport vehicles etc. Acquisition of most of these items involves large sums of money and completion of acquisition may require longer period. As such, capital outlay without proper budget may result in lack of control both on time and money. Decisions for capital expenditure in these banks are taken by the top management on need basis. Financially speaking, this is not an appropriate way of capital investment. However, in banks where capital expenditure budget is not prepared such investments are decided and supervised by the Asset Liability Committee (ALCO) and Management Committee (MANCOM) in keeping with the policy guidelines of the central bank.

Following is a figure containing replies of the respondents on the questions on types of budget used in PCBs.

Figure-6.2.1 Types of budget used by PCBs:



Source: Survey result/data

It may be observed that most of the banks (19 banks that is, 68%) prepare budget on fixed target basis. On further question as to why most of the banks prefer fixed target budget, it was find out that fixed budgeting practice is considered to be easy, less time consuming, less laborious and less costly. The current trend of growth in the private banking sector is such progressive that budget on fixed target basis may not be suitable for comparison purposes. Fixed targets based budget generally decide future projections on past actual or past budget with additions or deletions for expected changes. It ignores the impacts of major changes in the future operations both positive and negative.

Nine banks (32%) prepare budget on flexible basis. In the continuously growing banking sector these banks better accommodate growth in the budgets for reasonable comparison. In flexible budget a series of fixed budgets is set for each budget centre and whatever the level of output is reached it can be compared with an appropriate budged target. It seems that these banks are in better position in keeping pace with time and progress.

It is interesting to note that none of the 28 banks under study uses Zero-based budgeting (ZBB) concept for preparation of the entire budget. But eight banks confirmed that they apply ZBB concept only for new branches or for new types of products.

6.2.2 Use of budget manual and guidelines:

A budget manual is a guidebook outlining how to prepare, implement and monitor budgetary process. It sets out instructions concerning responsibilities of person and the procedures, forms and records relating to the presentation and use of budget. It defines budgeting system, its objectives, budget responsibilities and duties, reports and statements to be prepared at prescribed interval. It cannot be expected of all the employees related to the budget practice that they are all equally expert. So, use of a prescribed guidebook may ensure proper preparation and smooth operating of budgeting process. Budget manual provides procedures for coordinated plan of future actions and internal control to the management. As the manual defines responsibilities of all concerned, nobody can escape his part of the budget responsibility as a flop in one spot will hamper the entire budget process. Problems and difficulties faced in the process of budgeting can be easily solved as the manual highlights actions on each and every step for the budgeting process. A budget manual is a common book used by the entire organization. Thus, the methods and procedures of budgeting are standardized and uniform practices in the process of budgeting in different cost centers are ensured. It provides all levels of management the idea that budgetary control is worthwhile and essential.

In absence of budget manual prescribed budget guidelines from the higher authorities for the budget related staffs are alternatives. As budget is an internal policy matter of the banks, it is management's responsibility to guide the staffs as to how to prepare budget and implement it. Bangladesh bank's guidelines on financial management of banks require an annual budget to be prepared and approved by the board of directors. To comply with this requirement the bank management issues necessary guidelines on budgeting process to be adopted. The guidelines give a view of the banks' general strategy to be followed in the ensuing budget period. Besides, instructions as to presentation of deposits, loans and advances, major interest and non-interest income are given for inclusion in the budget. Such guidelines also require the banks to classify loans which are considered to be doubtful of recovery and to make necessary provisions for such classified loans. The guidelines may also require to present banks' income in the budget at higher rate over previous actual to match with the corporate annual growth plans, if any. Instructions for discloser of capital expenditures (CAPEX), if required for the budgeted unit, are generally included in the guidelines. It is management responsibility to guide the staffs as to how to prepare budget.

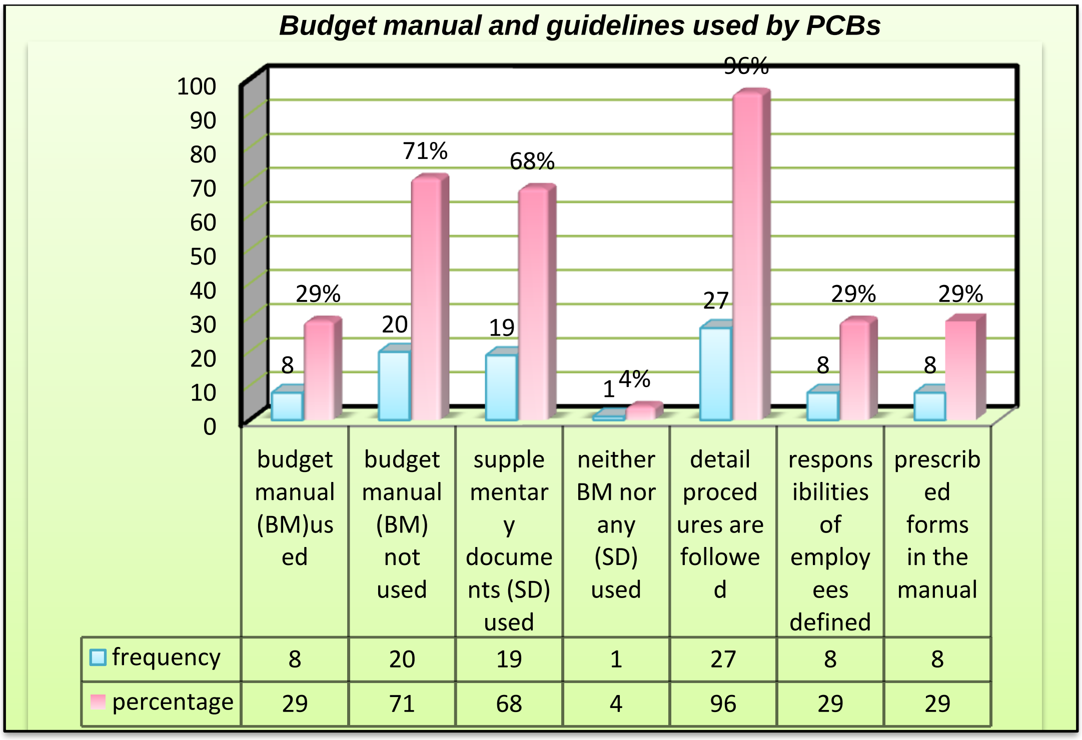
Considering the importance of budget manual and budget guidelines, this sub-section of the questionnaire was designed under the title 'use of budget manual and guidelines'.

An analysis of the replies on use of budget manual and guidelines shows that only 8 banks (29%) have and use budget manual. This means that 20 banks (71%) do not have and follow any budget manuals at all. This is not at all a positive sign. Out of the rest 20 banks 19 (68%) banks use guidelines and supplementary documents issued by the higher management instead of budget manual. These guidelines and instructions are issued by the management at different times as and when it is considered necessary. Usually, budget guidelines such issued are used at corporate level and down to the regional and branch level as and where applicable. There remains a question how earnestly these guidelines in the form of circulars and memos are preserved to be followed. A close scrutiny reveals that budget guidelines generally instruct regional offices and branches to maintain certain percentages of growth of advances and deposits. Besides, these guidelines also instruct to limit revenue expenses and capital outlays within certain percentages of previous year's actual. In fact, budget guidelines and supplementary documents are not enough to replace budget manual as a budget manual is a complete instruction book on the entire budgeting process. Budget manual is a permanent instructions book in loose-leaf form. In case of modification of any instruction, the page is replaced by new one with modified instructions. Only one bank, out of total sample of 28, neither uses budget manual nor any supplementary guidelines. In fact, this bank does not prepare conventional budgets. Rather, they use the latest concept of 'Beyond Budgeting' for future estimates of expected operations.

Excepting one bank as mentioned above all the rest twenty seven banks (96 %) follow a detailed procedure particularly in preparation of revenue budget. Budget estimates for each and every heads of account for income and expenses are shown separately to facilitate easy comparison and to exercise control. This seems to be a positive and encouraging sign.

Following is a figure with frequency and percentage of replies on this subsection.

Figure: 6.2.2 Budget manual and guidelines used by PCBs:



Source: Survey result/data

On the issue of defined responsibilities of employees as to total budgeting process, the outcome of the replies is not very satisfactory. Only 8 banks (29%) confirmed positively that budget responsibilities of the employees are well defined and are properly assigned. In case of rest of the 71% of the banks, neither there is separate budget department nor a definite set of employees who are assigned budget responsibilities. In these cases, budget responsibilities are assigned on the decision of the management and on the availability of the staffs for such jobs. This is a major lacking area. Without a budget department or a definite set of employees to prepare budget it cannot be expected that budget responsibility will be properly done. Defined responsibilities for a definite job can only ensure proper performance. In case of 71 % of the sample banks there is absence of definite set of people to do budget jobs. There is a common norm that 'everybody's job is nobody's job'. About these twenty banks (71 %) it will be reasonable to ask questions whether budgets are prepared properly, implemented rightly and followed up timely or not.

As to use of prescribed forms for preparation of budget, performance measurement and variance analysis reports the replies were not satisfactory enough. Only eight banks that is, 29 % of the respondents confirmed use of the prescribed forms. Twenty banks that is, 71% replied negatively that they do not have complete prescribed forms duly authorized by the higher management for use in the budget process. As these twenty banks do not have budget manual, they replied negatively to the question of having budget prescribed forms in the manual. In these banks each concerned department uses forms of their own design and preference. It clearly indicates that there is no standard use of forms in majority of the banks. This is not favorable for generating uniform reports within the bank.

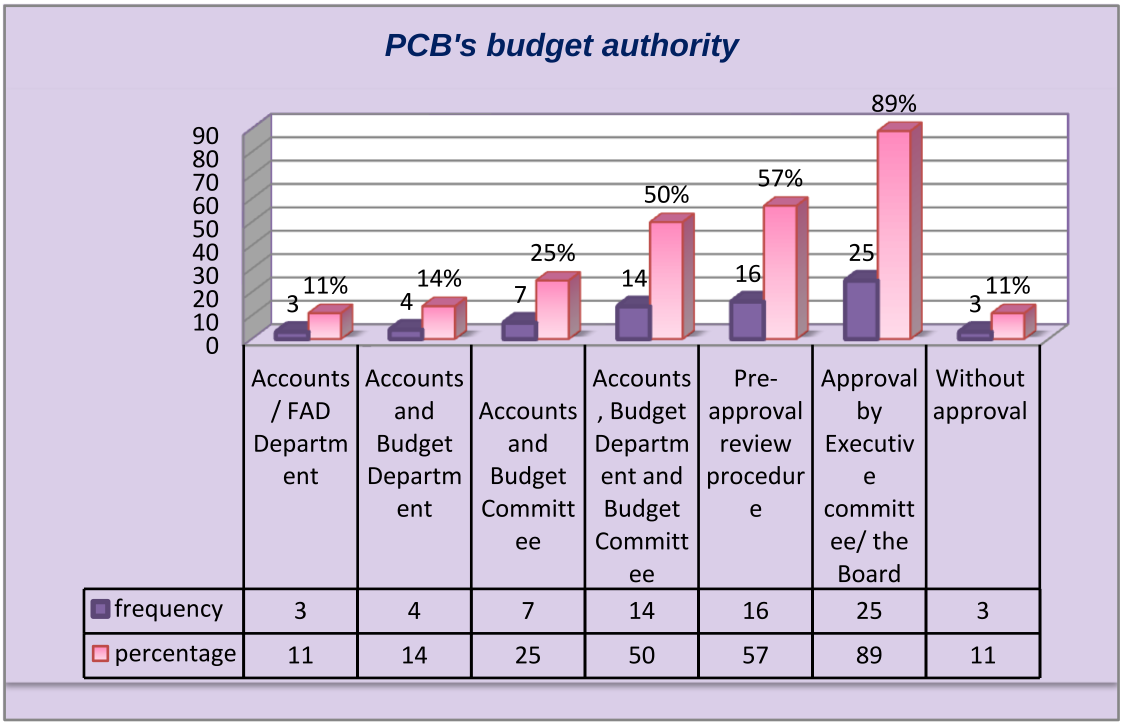
6.2.3 Budget authority:

Another aspect of this section of questionnaire is related with the budget authority. Simply, budget authority here refers to the department responsible for preparation of budget, budget supervising authority and budget approval authority. Replies of the questionnaire on this area are varied and mixed ones. For preparation of budget only four banks (14%) have separate budget department. Preparation of budget and monitoring thereof, are the sole responsibility of this budget department under the supervision and guidance of the budget committee and the top management. It can be fairly assumed that due importance is given to budgetary practices by the management of these banks. Only 25 % of PCBs are having separate budget committee responsible for preparation and implementation of budget in collaboration with accounts departments. In these cases budget committee is solely responsible for supervising the affairs of budget preparation but the physical compilation of budget is conducted by the accounts department. The committee also takes accounts department as a source of information and data. The budget committee provides necessary instructions and guidelines. Again, in another fourteen banks (50 %) preparation of budget is participated by three departments which are budget department, accounts department and budget committee. In this case the budget committee is in the supervisory position; budget department is the real preparers assisted by accounts departments. Here accounts department is the providers of data and information, both historical and future estimates. In these banks budget responsibilities are well defined and segregated. In this case the possibilities of preparation, proper implementation timely monitoring of the budget will be brighter. This seems to be an optimum situation. In rest of the three banks (11 %) budget is prepared by accounts/ FAD department. They do not have either a budget department or a budget committee. The entire affairs of conducting the budget rest upon the accounts/FAD department. Here is a clear indication lack of supervision and guidance.

Private commercial banks in Bangladesh have reasonable size of operations and volume of transactions is huge. Considering the roles budget can play in ensuring control procedures of banks, it is desirable that every bank should have its own budget department duly supervised by a budget committee or a higher authority. The responsibilities to prepare, implement and monitor budget may lie with different departments as can be seen above. But the final authority to approve the budget rests on the board of directors. This is as per Bangladesh bank guidelines.

Questions designed to cover budget authorities as described above and replies received against those questions are illustrated in the following figure.

Figure-6.2.3 PCBs’ budget authority:



Source: Survey result/data

Usually, after compilation of budgets by different departments and before final approval is accorded to it, a pre-approval review is essential. In this review representatives from all related departments verify that respective department’s projections are properly reflected in the proposed budget. In the budget preparation process, the forecasts, data and estimates are provided by each operating unit/ cost centre. These data and information are compiled in the budget by another department. So, it is very important that before final approval, there should be a forum where each department can verify their forecasts. Pre-approval review meeting functions as forum where such verification is done. Furthermore, it is also reviewed that the budget is in line with organizations future plans, policies and strategies. In fact, pre-approval review is a coordinated effort to ensure optimum and balanced projections of total operational activities of an organization for the budgeted period. Generally, modifications if required are done in this pre-approval review.

In their reply to the question of pre-approval review procedures, sixteen that is, 57 % of the banks affirmed positively. These banks arrange pre-approval review meetings to discuss their forecasts with other related departments to ensure balanced projections in the budget. Besides, human errors in presentation of data, if any, can also be detected in this review. This is, no doubt, is a coordinated effort and commendable. Twelve banks, that is, 43 % of the respondents do not have pre-approval review system of budget in force. In these cases, data and information as provided by each operating unit/ cost center are incorporated directly in to the budget without verifications or review. The possibilities of unbalanced budgets and human errors in data and information remain. Pre-approval review can play very important role in presenting well-balanced and error-free budgets. Lack of it in 43 % of respondents may cast doubts whether budget in these cases are results of coordinated efforts of the organizations or not.

To ensure authenticity it is desirable that budget should be approved by an executive committee and preferably by a bank's Board. According to Bangladesh bank's guidelines on the functions and responsibilities of the board of directors, approving annual budget is mentioned as a responsibility of the board. The replies received on this final approval issue it is quite satisfactory and encouraging. Twenty five banks (89%) confirmed that their budget is approved by the executive committee or by the Board and in some cases by both.

On the other hand, three banks, that is, 11% stated that neither budget is pre-reviewed nor is placed for final approval to executive committee or the Board. No doubt, there are big procedural lapses in these cases. Further, there are possibilities that budgets in these banks are nothing more than compiling some figure as a matter of mere formalities. Budget projections are not properly supervised, reviewed and discussed by competent authorities. The responsibilities to accomplish budget targets loose grounds. Besides, it can be reasonably doubted that budgets in these organizations gain little ground and importance among the employees related with budgets and its achievement.

6.3 Preparation of budget:

Preparation of budget needs some initial planning. The first and foremost job is assigning budget responsibility. These responsibilities can be assigned to a budget committee, to a budget department or to accounts and finance department. It may also be that budget responsibilities will not be given to a single committee or department rather be vested on more than one department. In this case, a committee or department will supervise the job; another department will provide information and final compilation of budget will remain with a third department. This type of assignment of budget responsibilities can better ensure proper supervisions and a perfect compilation of the budget. Again, when the process of budget preparation is participated by more than one department, the check and balance system function properly.

The next step is to decide genuine and correct sources of data to ensure reasonable estimates for budget projection. The data and information supplied should generate accurate estimates of income/ revenues, expense and other relevant information for the budget. This is not an easy process and needs cautious and careful selection of genuine and accurate data. Figures driven from mere guess will worth nothing but jumble of figures. Data and information as to market trends and competitive analysis are important to make best projections. Market trends give indications of future directions and which can help deciding future courses of actions. Operations of commercial banks are greatly influenced by the government fiscal and monetary policies. It is very important that due considerations are given of the impacts of such policies before budget projections are done.

Accurate determination of cost center is another important aspect required to be considered before start of the budget preparation. A cost center is a grouping of activities that make a coherent financial unit. Cost center determines the categories under which each of the head of income and expense can be classified. Besides, determination of cost center helps assigning of budget performance responsibilities.

Determining details head of accounts under each of the categories of income and expenses is an important task. A budgetary account identifies a specific source of revenue or a particular type of expenditure by using budgetary account number.

One of the most important tasks for the management in compiling a budget is allocation of resources with optimum application. Each function of an organization requires resources. But resources are always limited. To avoid wasting resources and misinformed decisions it is necessary to identify, priorities and invest in projects or departments that better align with corporate strategy. By clearly defining strategies, risk, and opportunities organizations can better allocate resources that will produce desired outcomes. In most of the organizations and even in banks resources are limited whereas, demand for the same is almost always beyond the available limit. Here, lies the importance of prudent allocations of resources. It should be allocated in a way so that the broader objectives of the management to efficiently run the organization with maximum profit are achieved.

For this analysis and interpretation, preparation of budget has been segregated into two different segments. The first segment covers the determinant factors for budget preparation. Some determinant factors are external having undeniable impacts on budget projections. There are also some internal determinant factors needed to be considered while making budget projections. The second segment is the basis of budget preparation. Here four different bases are taken into consideration. These are budget detail basis, operational unit basis, budget time basis and budget data source basis.

6.3.1 Determinant factors for budget preparation:

It is a general practice that budget projections are made depending on certain determinant factors. To certain extent the exception is, though partly, in case of Zero-based budgeting. Otherwise, some dependable variables or standards are taken as factors for preparation of budget. In Bangladesh, the major determinant factor of preparing the budget for PCBs is historical information. The historical information mentioned here refers to either previous actual or previous projections and in some cases both. Taking previous actual as a basis for future estimates may be, to some extent, reasonable where there will no chances of major fluctuations in the future business. In case major growth or fluctuations can be foreseen, considering previous actual as a determinant factor for budget projection will be misleading one. In this case, the budget projections will not reflect the reality of future operations. Of course, using previous experience does not imply that it is an unacceptable procedure for preparation of budget. But such additions or deletion of certain percentage with the previous actual must be justified. Again if new products or services are expected to be introduced in the market, budget based on historical data will suffer from major shortcomings.

In addition to that, and particularly in case of banks and financial institutions, specific Government fiscal and monetary policies are major determinant factors for budget projections. It is well known that the performance of the financial sector as a whole and that of commercial banks in particular, may greatly be influenced by the Government's fiscal and monetary policies. On the other hand, Government's development and financial policies may greatly influence operational activities of commercial banks. For example, in case of major development activities planned by the government, huge funds are mobilized. Certainly a portion is channeled through the PCBs. That may help growth of liquidity position and lending capacity. Further interest rate, both on deposits and investments, are controlled by the government through the central bank. In case government financial policies outline major changes in rate of interest, both income and expenses of the PCBs will be affected. In case interest rate is raised that will increase both interest income and interest expense. Depositors may be encouraged by the higher interest rate but at the same time, borrowers will suffer and bank's loans, advances and investments will decline. Adversely, deposits in the bank will increase and there will be pileup of idle funds. Central bank's policies such as: changes in liquidity reserve requirement, changes in LC margin, and changes in bank verses borrowers investment ratio may greatly influence PCBs business. All these factors exert undeniable impacts on budget estimates of the PCBs. Standard rules or procedures prescribed by the central bank as a supervisory authority may also be some external determinant factors. Fortunately or otherwise, no such procedures or factors are prescribed by Bangladesh Central bank which can influence budget projections at large.

Trends of businesses of banking and financial sector, as a whole, can largely influence the budget estimates and projections. In an expanding and growing market, it is reasonable to be optimistic while making budget projection for future operations. Whereas, declining and shrinking market tendencies dictate the planners to be conservative in budget projections of future operations. Trends of demand for new products and services is also influencing factor for budget preparation. The present trends of e-banking and mobile banking are examples. This e-banking system is gradually replacing the conventional transfer of funds. How far a PCB can adopt with these new trends and systems largely determine the future business it can obtain. These are external determinant factors.

In addition to these external factors, there are some internal determinant factors which greatly influence budget estimates and projections. These internal factors are so relevant for the smooth operation, growth and satisfaction of the investors that these demand due consideration while drawing budget. The internal determinant factors are future profitability, capital adequacy ratio, exchange rate risk factors and return on investment. Sustainability and growth of profit are given due consideration while drawing budget. Like any other commercial enterprises earning reasonable profit is one of the prime motives of the PCBs. Earning profit and its gradual growth is important not only from investors point of view but also for bank's reputation and standing. Cautious planning of income and expenses segment of the budget is very important in this respect. The budget should reflect plans and programs for increase of income and reduction of expenses at reasonable level.

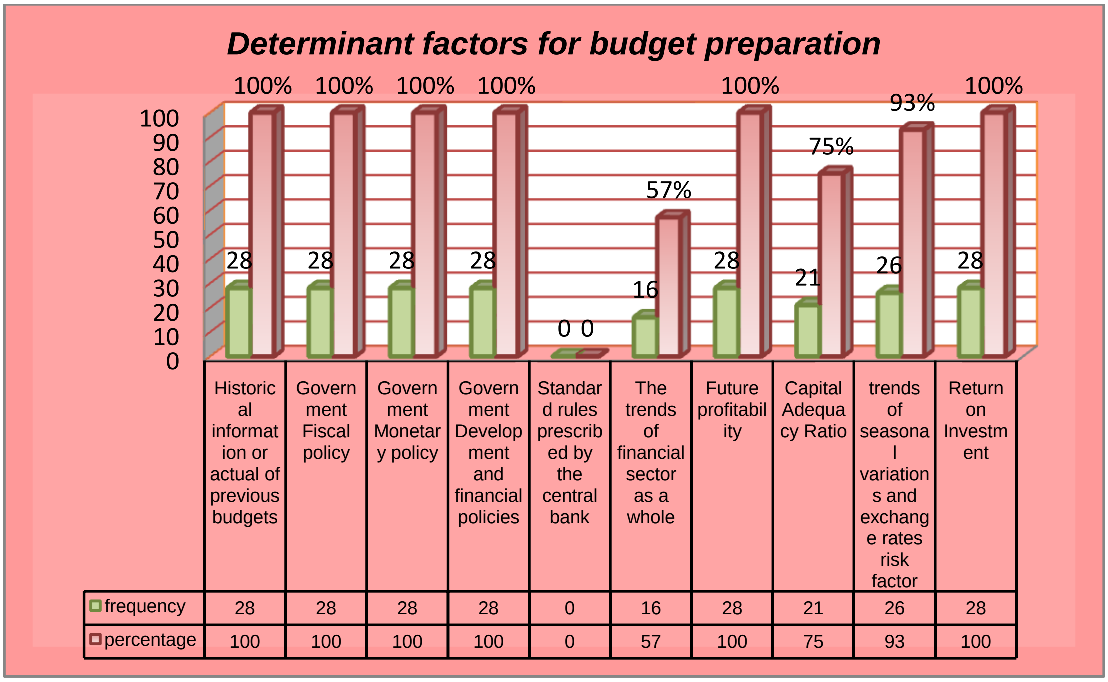
Another important internal determinant factor of budget is maintaining capital adequacy ratio. Maintaining certain percentage of capital adequacy is the central bank's requirement in keeping with the provision of Basel II. While planning loans, advances, credit and investment for budget projections, PCBs should exercise care and caution to restrict possibility of risks of recovery. Credits and investments with loose-ends result in increase of risk factor and thus, maintaining CAR becomes difficult. Budget should reflect the measures taken to maintain CAR.

Exchange rate risk is another determining factor. Due to unstable world economy, international currency market has become volatile in recent years. Both upward and downward trends of major currencies' exchange rates have become regular feature in the international money market. Due to this factor, banks of least developed countries become easy prey of currency risks. Bangladesh is not an exception. Abrupt fall of exchange rates and continuity of that may result in huge losses for commercial banks. PCBs should take necessary measures to restrict exchange risk factor and those measures should be reflected in the budget.

Return on investment (ROI) can greatly influence budget planning and preparation. ROI is a yardstick to show the efficiency of a business as a whole. Investors also expect satisfactory returns on their investment in the forms of dividend and or, of bonus shares. These are paid out of profit. Possibility of reasonable return on investment only can persuade the investors for further investment. In planning and drawing budget, sufficient scope for reasonable return on investment becomes a determining factor to fix up sales/revenues and expenses. Further, to enhance profit to be able to provide reasonable return on investment, it may be necessary to plan new lines of business or growth in the existing lines. Not only that but also plans to reduce expenses to enhance profit may become necessary in budget preparation through cost control and internal control devices. In sum, planning ROI can affect each and every stages of a budget preparation. Accordingly, due considerations are usually given to retain reasonable ROI through different exercises as referred above.

In this part of the questionnaire questions were drawn on these determinant factors influencing preparation of budget. Replies received on these questions are shown in the following figure:

Figure: 6.3.1 PCB's budget determinant factors:



Source: Survey result/data

All the 28 (100 %) respondents confirmed that historical information or actual performance data are always considered as major determinant factor for preparation of budget. It is obvious because the most dependable and easily available data and information are the historical ones which had happened and are being recorded. But dependence on historical data may not always be perfect especially in situations where major changes may occur in the future budget period. It is better and perfect not to depend on the historical data alone but to take into consideration actual scenarios expected to happen for the budget period. Otherwise, comparison of actual with the budgeted data will be misguiding incase, major market changes happen during the budget period. Despite its qualifications, all the PCBS use historical data for a base of budget preparation.

The operations of PCBs can largely be influenced by Government's fiscal and monetary policies. Questions were given to determine whether banks give importance to Government fiscal and monetary policies as major determinant factors while planning budget projections. All the 28 banks (100 %) replied in positive. That means private commercial banks take into consideration the impacts and results of both fiscal and monetary policies of the Government in preparation of budget.

In response to the question as to- do the PCBs consider government development policies while drawing budget targets, 28 (100 %) replied in positive. In a developing country like Bangladesh Government's development programs play an important role in fund mobilization and growth of business for banks. Government development spending is mobilized not only through the nationalized banks but also through PCBs. Private Entrepreneurs including private banks to some extent become indirect beneficiary of development program. Obviously, fixing budget targets to some extent is influenced by this factor.

All the 28 (100%) respondents replied negatively to the question whether there are standard rules or procedure as to practices of budget by the central bank. In case of PCBs there are no hard and fast rules laid down by the Central Bank for budgeting. Budget is considered as an internal policy and control device of the banks and it usually framed on some standard and suitable formats designed by the users.

A question was given to ascertain whether PCBs do analysis trends of business of the financial sector as a determinant factor for preparation of budget. Sixteen banks that is, 57 % replied that they do analyze trend of financial sector as a whole. Twelve banks that is, 43 % do not consider trends of the financial sector as a determinant factor for their budget. Trend analysis can give directions as to what had happened in the past and can be expected from the market during a future budget period. How these 12 banks do projects their revenues and income for the budget period without trend analysis of the banking sector's business remains a question.

Another important determinant factors came out from the replies of the respondents is the consideration for future profitability. All 28 banks (100%) affirmed that future profitability is a major determinant factor they consider for budget preparation. This is obviously done by drawing future plans for increased revenue and income and at the same time, plans to reduce expenses. This results in surplus of profit. Furthermore, reputation of a bank and confidence of the depositors depend to a great extent on the profitability of the organization.

While replying on the capital adequacy ratio (CAR), 21 banks (that is, 75%) replied that they consider CAR as a major determinant factor for budget preparation. Capital Adequacy Ratio is a measure of a bank's ability to absorb losses by calculating the ratio of capital to risk related assets. In other words, it is the ratio between the total capital and risk weighted exposures. Maintaining reasonable capital adequacy ratio is a device to protect depositors and other creditors from the potential shocks of losses that a bank might incur. Reasonable Capital Adequacy Ratio as prescribed by the banking supervisory body is intended to help absorb all possible financial risks like credit risk, market risk, operational risk, residual risk, core risks, credit concentration risk, interest rate risk, liquidity risk, reputation risk, settlement risk, strategic risk, environmental and climate change risk etc. At present, commercial banks need to maintain 10% CAR as per Bangladesh Bank's requirements. The budget should reflect plans and devices how to maintain prescribed CAR.

Whether the PCBs consider exchange rate risk as a major factor of budget projection or not was a question. It is encouraging to note that 26 banks (93 %) of the respondents affirmed that they do consider exchange rate risk factor as a major determinant for budget preparation. Exchange risk factor is a very important determinant for budget preparation of banks. It has been observed that in the recent years some very strong foreign currencies abruptly fall down where some other currencies got very strong grounds. PCBs of Bangladesh may be hard-hit by the effects of this volatile foreign currency rates in case of export-import financing. Commercial banks may suffer or gain in an unpredictable way due to this volatile foreign currency market. Due to this exchange rate risk factor has to be dealt with prudently and should be reflected in the budget projection. Other 2 banks (7 %) replied in negative. On further inquiry it was found that the foreign currency transactions of these two banks are not significant enough and profit contribution of foreign currency trade is negligible.

Another important determinant factor for budget preparation for PCBs is the return on investment (ROI). Positive finding is that all the 28 banks (100%) give due consideration and weight on ROI factor while setting budget projections. In consideration of the significance of ROI especially for an organization's reputation and standing and its ability to attract investors, this factor deserves due emphasis. It is encouraging that all the banks give due attention to this factor while preparing their budget.

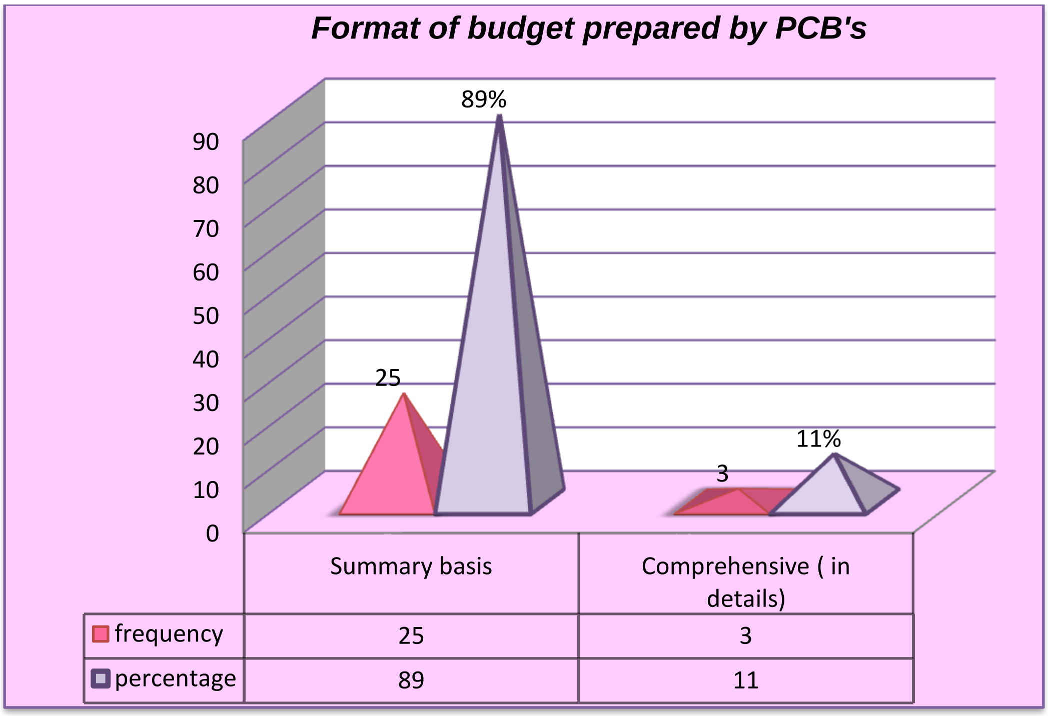
6.3.2 Basis of budget preparation:

In the second part of the preparation of budget, questions were designed to find out the basis of budget preparation. For this questionnaire four bases were considered. These are: budget format/detail basis, operational unit basis, budget period basis and source of data basis.

6.3.2.1 Budget format/details:

A budget can be prepared either on a summary basis where projections are done only for the major accounts of assets liabilities, income and expenses. Generally these are done on the format of financial statement. On the other hand, a detailed budget can also be prepared were each and every item of assets and liabilities and income and expenses are segregated and projections are made for all the items. For organizations like banks with numerous sources of income and expenses a detailed budget is voluminous. In the questionnaire, questions were set to find out whether the banks prepare budget in details or summary basis. Following is the figure of questions is replies for budget formats/ details.

Figure: 6.3.2.1 Format of budget prepared by PCBs:



Source: Survey result/data

Twenty five banks that is, 89 % replied that they prepare budget on summary basis. Their budget formats cover major heads of income and expenses and budget projections are only done for these major heads avoiding details. Majority of the PCBs have huge number of branches spread all over the country with varied income/revenue sources and various types of expenses. From a summary budget how can they pin point week and strong areas of operation remains a question. Besides, comparison of actual with budget targets needs uniform heads of income, expenses, assets and liabilities both in books of accounts and in the budget. That renders the work easy, less time consuming and less complicated. But that is not the case in respect of twenty five banks. Budget in summary form has also some other shortcomings. It becomes difficult to trace and locate the person or persons responsible for negative variances and to undertake timely remedial actions.

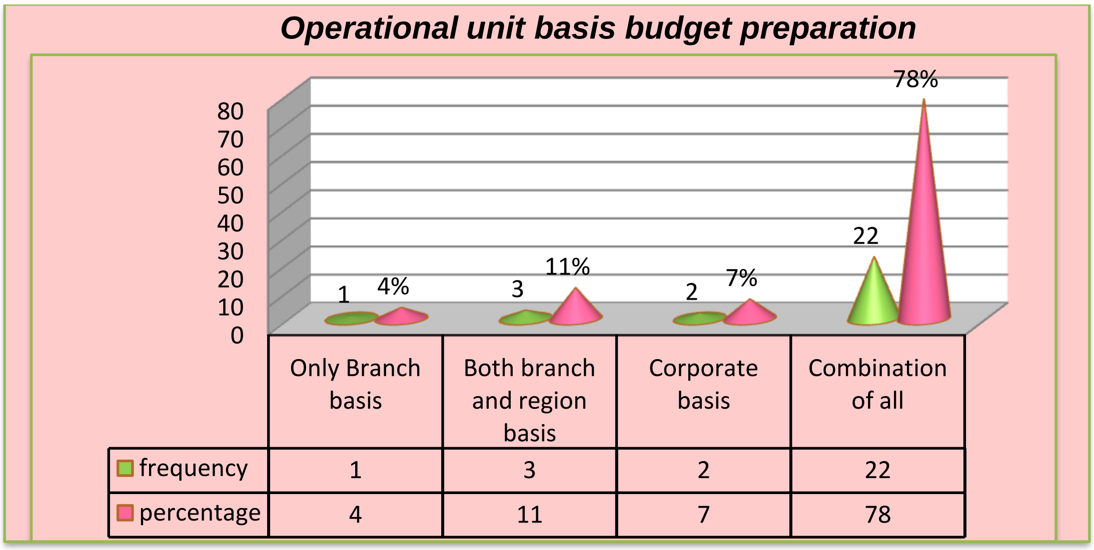
Three banks that is, 11 % of the respondents confirmed that they prepare budget in details. The budget format covers all the heads of accounts as are in the ledger/chart of accounts for income and expenses and both assets and liabilities. Preparation of detailed budget involves more time, more manpower and more costs. But it is worth of doing so. In this case it is easy to know performance of each and every segment of operations and lacks, lapses and shortcomings are easily identifiable. Taking proper and timely actions to reverse the adverse situations becomes easy and quick.

6.3.2.2 Operational unit basis:

Commercial bank's basic operational units are its branches. Each and every branch of a bank is both income generating and expense incurring unit. Besides branches, some banks divide the total operations into regions or zones. In addition to or side by side with head office budget, bank may prepare budget on branch or zone basis. A mix basis or combined budget that is, budget on corporate, zonal and branch basis are also in practice.

The figure with the questions on this issue and the replies are appended below.

Figure: 6.3.2.2 Operational unit basis budget preparation:



	Only Branch basis	Both branch and region basis	Corporate basis	Combination of all
frequency	1	3	2	22
percentage	4	11	7	78

Source: Survey result/data

From the replies of the questionnaire it is found that 22 banks (78%) use a combined method. This means, these majority of the banks prepare budget for individual branches, for respective zone and a combined budget of the entire bank at corporate level. Using a combined method ensures delegation of responsibility and commitments for achievement of budget from the root level and at the same time to the supervisory level. In this case, estimated operational results of each operating unit (branches) are taken into account for budget projections. This probably gives accurate and reasonable estimates of both income and expenses for the budget period. Again, this way of budget projection ensures participation of all concerned. Variance analysis reports, in this case, clearly indicate point of both efficiencies and deficiencies. Fixing budget targets for each branch and zone creates an atmosphere of challenges among the managers and thus, fair competition and better operational results can be expected.

Two banks (7 %) do not prepare budget either on branch or zonal basis. They prepare a budget package of the entire bank at corporate level that is, at head office. Total operations of all branches are projected together with an estimated amount for the entire bank's income and expenses. Preparing a lump sum budget at the head office with mere guesses may not reflect the operational and market realities in the budget. This method of drawing budget projections also does not involve the real performers at the point of operations with their responsibility and commitment and thus, lacks participation of all concerned. Budget without participation of all concerned creates an atmosphere of indifference and importance of budget fades out. This may cast doubts as to whether the budget projections are rightly estimated and whether the budget reflects market reality at all. Proper and timely implementation of budget may not happen in these situations.

Three banks (11%) prepare budget for branches and for respective zone. But these three banks do not prepare a corporate budget that is, a total budget for the entire bank in a single package. While projecting budget estimates for branches and zones emphasis is given mainly on targets of deposit collections and loans, advances and credits. Branch managers are held responsible to accomplish their set targets. At the same time the regional offices are also jointly responsible to achieve their regional targets. Positive impacts of this practice are that the regional offices offer necessary assistances and exert pressures on the branches to fulfill their targets. But without compiling a corporate budget for the entire bank how these banks get an idea of their operational profitability during the budget period remains a question.

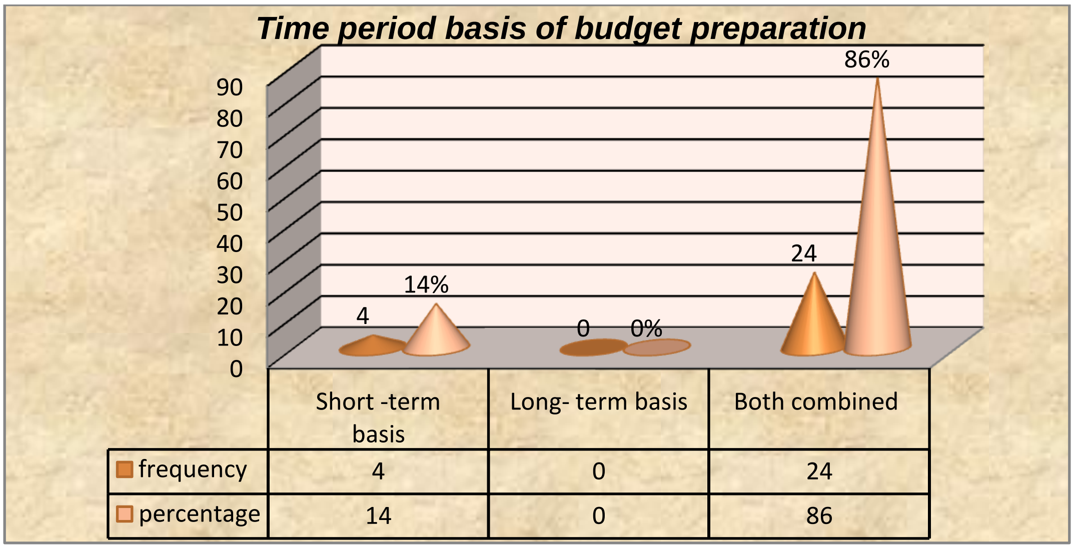
It was interesting to find out through the questionnaire that, one bank (4%) prepare budget only for all individual operating branches. This particular bank does not prepare budget for region or for the entire bank at the corporate level. The respective branch manager is held responsible to achieve the targets and control expenses. This practice does not seem satisfactory as a total picture of the operations of the bank cannot be viewed easily.

6.3.2.3 Time basis:

Budget is usually prepared for a definite period as suitable for the organization. The budget period can vary between short-term and long-term. Generally, revenue budgets such as income, expenses, sales, procurement, production etc. are prepared on short- term basis. The short-term budget usually covers a period of one year with monthly or quarterly split-ups. Long-term budget is usually prepared for capital expenditures and the period may vary depending on the time required for completion of capital project. Long-term budget may cover period from one year to even 10 years or even more due to size of capital project and complex technical involvement. Bank's operational budgets are short-term ones usually covering one year.

Questions and replies on the time basis of preparation of budget are illustrated in the following figure.

Figure: 6.3.2.3 Time period basis of budget preparation:



	Short -term basis	Long- term basis	Both combined
frequency	4	0	24
percentage	14	0	86

Source: Survey result/data

Out of the 28 banks (100 %) covered by this study only 4 banks (14%) replied that they prepare only short-term budgets for different parts of operations that is, they prepare revenue budgets. Their short term budgets cover one year with monthly and quarterly splits. These particular four banks do not prepare capital budget at all. How they allocate and estimate capital expenditures could not be ascertained.

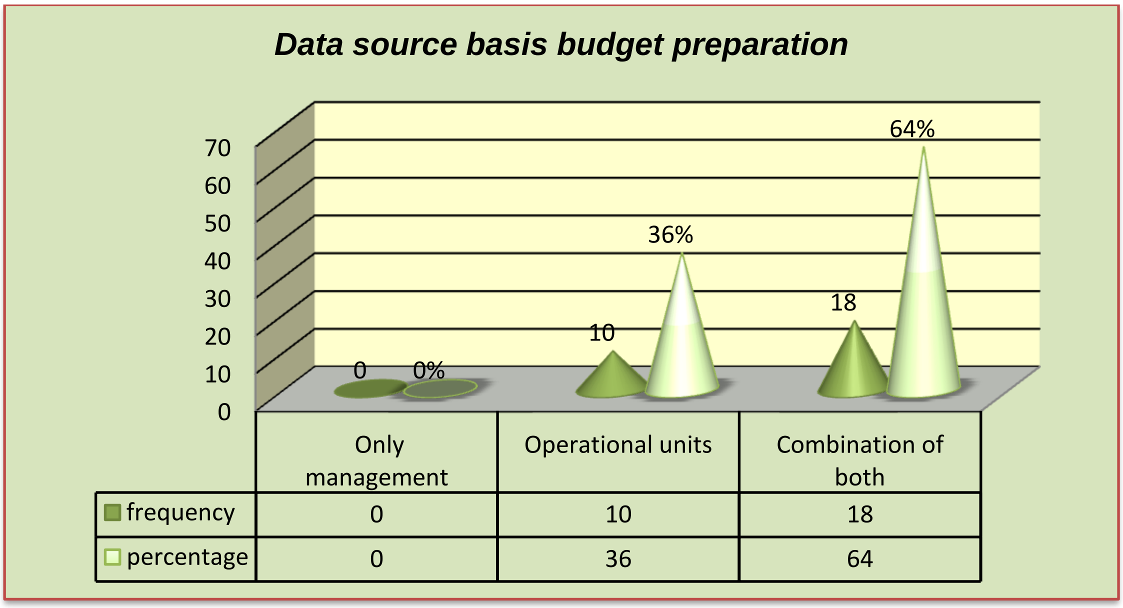
Twenty four banks (86%) replied that they prepare both long-term and short-term budgets. For revenue budgets they apply short-term basis which is commonly for one year in conformity with banks' financial year. For periodic performance measurement within the budget period, yearly budget is split up in to month and quarter. For capital expenditures both short term and long-term basis are adopted after considering capital project completion period. Capital assets where entire acquisition process can be completed with one year are covered by short term capital budget. Similarly, capital projects requiring more than one year for completion, are covered by under long term capital budget. It seems that these banks are on the right track in choosing time basis.

6.3.2.4 Data source basis:

Budget is usually prepared from data and information collected and made available from different sources. The sources of data may be only the management (imposed budget) or data and information may be gathered from forecasts furnished by different operational units (participatory budget). Budget can also be prepared from data gathered through combined sources where data and information are the results of coordinated efforts of all concerned departments including the top management. Budget forecasts are generally fixed after discussions and meeting among officials of different costs centers. Projections in the budget should be in line with the corporate policies and strategies for the budget period as planned by the management. The basic criteria for selection of data sources are reliability, accuracy and relevance. Sources directly related with operations are better placed to furnish accurate data. Without accurate data from reliable sources, preparation of budget would be mere paper works with no desired results.

Questions on the issues of sources of data and information for budget preparation were included in this part of the questionnaire. Replies on sources of data as extracted from the questionnaire are given in the following figure.

Figure: 6.3.2.4 Data source basis budget preparation:



Source: Survey result/data

It is apparent from the replies that none of these banks follows the practice of preparing budget on information and data supplied only by the management. That means the PCBs do not draw budget as prefabricated by the management alone without participation and contribution of the related officials. In other words, contributions and participation of the officials working at different levels of operations are ensured in preparing budget. This is, undoubtedly, a desirable situation. This does not mean that the management has no roles in budget preparation. The management plays a supervisory role and policies and strategies to be followed during the budget period are outlined by them.

Ten banks (36%) replied that data and information are gathered from operational units (branches or zones) for incorporation into the budget. It indicates that the operational units take responsibilities of data and information for budget preparation. As the forecasts are from the operational officials who are also responsible to execute the budget, it is assumed that these forecasts are also their commitments. That implies a sort of responsibility assumption which is needed for accomplishment of budget targets. These ten banks did not specify whether others sources are utilized for budget projection or not. It appears that in these banks management's role in preparation of budget is negligible. This is not a positive sign. The importance of budget fades out and implementation and subsequent follow up process get weaken due to lack of interest on the part of the officials.

The rest 18 banks (64 %) of the samples use data and information from multiple sources that is, a combination of operating unit sources and management sources. Normally, data for operational projections are gathered from operating units or branches. The operational personnel are in the market place and as such, their forecasts should probably be reasonable. Data for fixed or semi-variable expenses are gathered from Accounts/ Finance department from books of records. Modification to these data is done after meetings and discussions for incorporation into the budget if more than usual variations in the operations are expected for the budget period. Data and information related to expansion of business, introduction of new products or services are generally furnished by the top management as these decisions are done at that level.

6.4 Budget responsibility:

Budget may be one time job in a financial year or for a specific period. But it involves massive figure works for compilation of numerous data and information. Besides, after preparation of budget follow up and feedback process are periodic and continual. Budget is, nonetheless, a technical job in a sense that it needs certain level of arithmetical expediency and analytical skills. It also needs coordinated and joint efforts to consolidate projections of different segments of business together. Capital budget further needs great caution, care and keen foresightness. Critical analysis of viability of capital expenditure keeping in mind the return on capital employed and other factors are needed to be taken into account. For all these technical jobs definite staffs with defined responsibilities and adequate knowledge and expertise to be assigned. In this section of the questionnaire questions were designed on nature of budget participation, assignment of budget responsibility and establishment of budget responsibility.

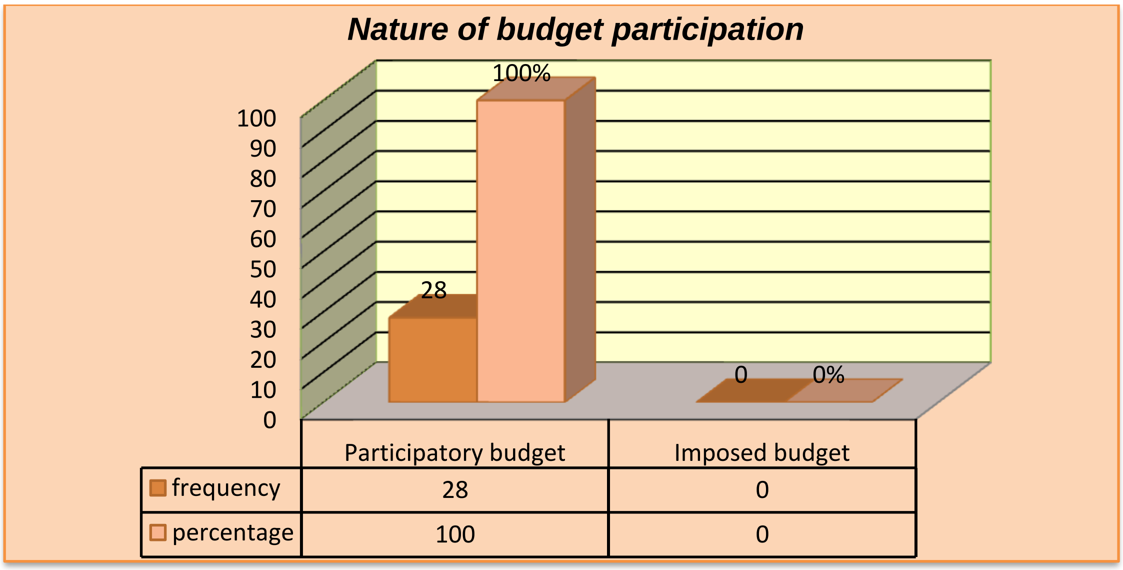
6.4.1 Nature of budget participation:

There are different budget models exists in business. Major two verities are centralized and decentralized ones. Centralized budgets are top-to-down approach. Owners and managers frame the budget in their own way and ‘push’ it down to each department of the organization for implementation. Officials of the organization do not have any ‘say’ in the data and information incorporated in the budget. The top management here is the decision making authority for every operational matters and in this case budget is ‘imposed’ and the performers are just to follow. The approach also results in lack of accountability or involvement of the operating managers.

On the other hand, decentralized or participatory budget model is quite opposite to this approach. Decentralized budgets involve more input from individuals outside the upper management team. Through forecasts, meetings and discussions officials of each cost center or department contribute to the compilation of the budget. This model is also known as ‘bottom-up approach’. In this case decision making involves more employees than just the management team. All managers may have say in the budget process. In this approach the real performers are allowed to project their own future estimated performance. In other words, the performers are committing to their own forecasts and are assuming responsibilities. Participatory budget model is widely appreciated by both academics the management due to the facts that it is more effective from budget achievement point of view and more rational. Participatory approach also serves as a moral boosts for the employees taking part in the budget process. They feel that the targets are fair and are more relevant to them. Due to participation the employees feel that they are a part of the organization.

The following figure illustrates the state of budget participation in the PCBs as revealed from the replies of the related questions:

Figure: 6.4.1 Nature of budget participation:



Source: Survey result/data

From the replies it is clear that 'imposed budget' approach is not in practice in PCBs of Bangladesh. This indication was also received from the replies on questions on source of budget data. It was seen there that none of the banks prepare budget based on data and information supplied only by the management.

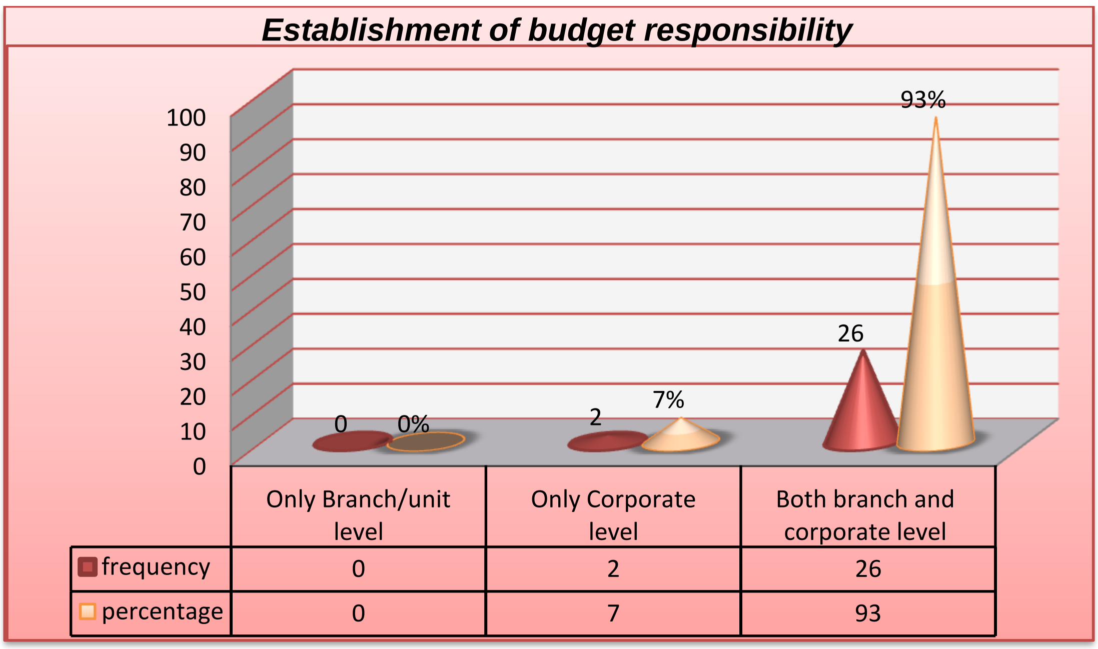
The replies above confirm that the PCBs use 'bottom up' or participatory approach. It is revealed from the questionnaire that all the 28 banks (100%) practice participatory budgetary system where related employees of different levels contribute to the entire process of budgetary practices in some way or other.

6.4.2 Budget responsibility established:

It is the responsibility of the management to decide the stages of operations and control where budget responsibility should be established. Budget responsibilities are not limited within preparation and implementation of the budget alone. Responsibilities also include budget monitoring, feedback analysis, review and corrective actions as and when necessary. Responsibilities for preparation, implementation and performance report may rest with the operating units but monitoring and supervisory responsibilities normally lie with the corporate office. As such, total budget responsibilities may not be established at operating level alone.

In reply to the questions on establishment of budget responsibilities in PCBs, the respondents also confirmed above mentioned views. Following is the figure showing the relevant questions and the answers.

Figure: 6.4.2 Establishment of budget responsibility:



Source: Survey result/data

It is seen from the table that total budget responsibility is not established at branch level alone in any of the sample PCBs. This is quite reasonable. In case of 2 banks (7%) the entire budget responsibilities are established and discharged at the corporate level. This means that, though data and information are gathered from related operational levels but compilation of budget and follow-up process rest at corporate level. This may not be a desirable situation because the officials of all operating levels are kept out of budget functions.

Twenty six banks (93%) confirmed that budget responsibilities are established both at operational unit level (branch) and corporate level. Here the basic tasks of preparation, implementation and performance reports rest with the operating level but monitoring and review tasks are done at corporate level. Establishment of joint responsibilities at both branch and corporate levels is well balanced approach.

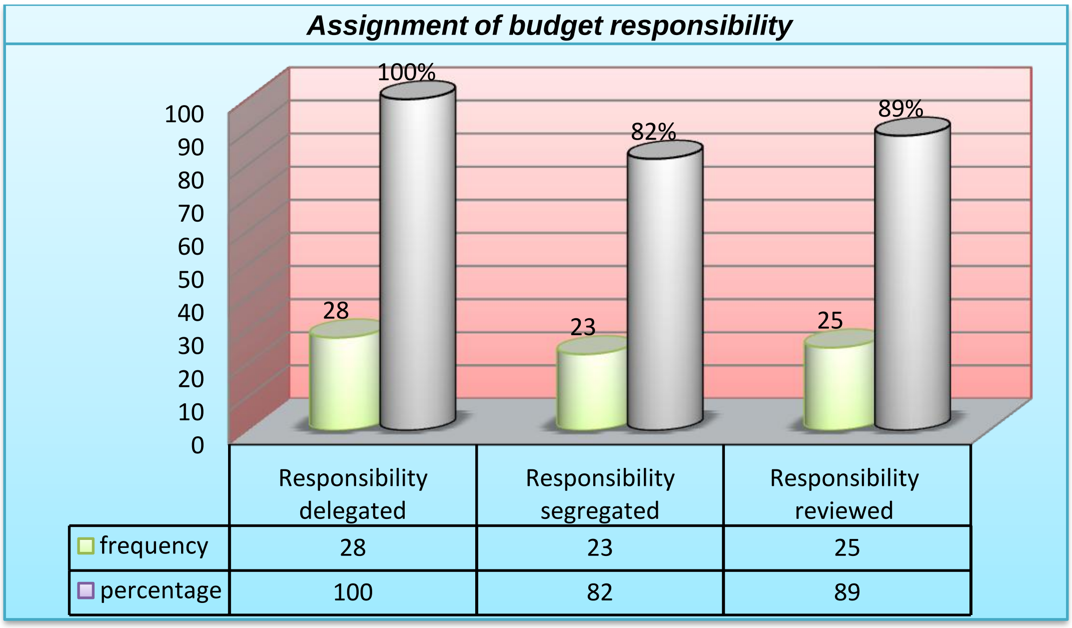
6.4.3 Assignment of budget responsibility:

As stated above, budgeting job is, to some extent, technical and voluminous. The tasks of preparation of budget, up to monitoring and feedback, should be properly assigned to the competent hands. A definite job if performed by a definite person or persons ensure smooth running of the task. Here lies the importance of delegating of authority and responsibility. It is encouraging to note that, all the sample banks confirmed that budget responsibilities, at whatever levels it may be (corporate or unit level) are well defined and properly delegated in their banks.

The entire budget processes are done in different stages chronologically. The processes involve collection of data and information, compilation of those data and information, drafting of the final budget, its implementation, generating a performance report, analyzing variance and taking remedial actions as and when needed. All these jobs should not be performed by a single person or hand. These jobs should be assigned to different people in order to ensure smooth running and proper control. Segregation and delegation of budget responsibility do not function automatically. Whether delegated responsibilities are performed properly or not need to be reviewed. The review process is a check and balance function which can ensure smooth running of the budgetary system. It means someone somewhere should oversee that assigned responsibilities are performed or not.

In the following figure questions and replies on assignment of budget responsibility are shown:

Figure: 6.4.3 Assignment of budget responsibility:



Source: Survey result/data

All twenty eight banks (100%) confirmed that budget responsibility is properly delegated to responsible hands in their banks. Again, 23 banks (82%) also replied that in their banks budget responsibility is properly segregated. This may seem to be very positive. But from the previous replies on questions who prepares the PBCs budget, only 14% (four banks) replied that they have separate budget department to handle budget related jobs. 25% (seven Banks) replied that they have budget committee and the committee handles budget jobs not independently but in collaboration with the accounts department. In cases of all other seventeen banks (61%) budget jobs are handled jointly by staffs of accounts/FAD, budget department and budget committee. From these findings it could be concluded that though delegation and segregation of budget jobs are done but in most of the cases these jobs are not handled by definite staffs selected for only these jobs. Organizations like commercial banks should afford maintaining a separate budget department to take care of budget related jobs.

Twenty five banks (89 %) confirmed that periodic review of budget responsibility is in force in their banks. But only four banks (14%) have their separate budget department. In all other banks basic budget functions are conducted by accounts department in addition to their own department's routine jobs. This additional budget jobs create pressure on them. In this case how far the periodic review practice is effective remains a question. But 3 banks (11 %) replied negatively. That means, in those 3 banks there is no supervisory tasks to ensure that budget responsibilities are performed duly. Situations in those 3 banks demand improvements.

6.5 Planning for deposits and investments:

Customers' decision to select a bank for keeping deposit is influenced by many factors. The first and foremost factor is the assurance of security. The more a bank is considered to be secured to the customers the better will be the prospects for deposits. This is known as the 'safety factor'. Financial soundness and reputation are the basic conditions for a bank to be considered safe. Secondly, the prospect for higher interest on deposits also influences the customers while deciding and selecting a particular bank for deposits. This is known as 'return factor'. These two factors are correlated with deposits. It is neither practical nor feasible that a commercial bank's total fund requirements may be covered by its own capital. In fact, mobilizing public funds as deposits is the main source of commercial bank's working capital which is lent to the borrowers. Depositors are paid at a certain rate of interest or profit on the deposits. The PCBs also need to maintain certain percentage of liquidity to meet depositors' and other creditors' instant demands for cash. In order to be able to maintain their liquidity, PCBs need to exert all round efforts to attract deposits. Estimated deposits as expected should be shown clearly in the budget alone with cost of deposits that is, interest to be incurred. While planning deposits projection in the budget, due considerations and weight should be given to both 'safety factor' and 'return factor'.

Commercial banks invest their funds in the form of loans, advances, credits and others. Returns on these investments generate major income/ revenue for banks. In order to generate maximum possible income and to get rid of idle funds, all feasible investment possibilities are to be explored. But before deciding new investment proposals 'investment risk factors' are to be considered seriously. The prospect of smooth and timely recovery and possibilities of defaults are to be deeply apprised. All investments should be done after execution of legally valid agreements with provisions for timely recovery of investments. Proper projection of planned investments should be in the budget. Broad outlines of investment plans should also be reflected. Both existing investments and prospective investments as planned for the budget are generally shown separately to be able to easily see proposed growth during the budget period.

Extending credits is the main business of commercial banks. But banks' success largely depends on the prospects of recovery of such credits. For timely recovery legally binding agreements should be between the bank and the clients. Such agreements should clearly mention recovery time and period. Favorable liquidity position of commercial banks largely depends on regular recover of loans and credits. Defaults in credit recovery result in liquidity crisis which, in turn, blocks new prospect of credits and investment. In the budget, a clear projection of credit recovery plans should be presented. New investment prospects and recovery plans are correlated. The greater the prospect of credit recovery, the brighter will be the prospect of new investments and credits. If projections of credit recovery and new investments are reflected on the budget a picture about the bank's business plans for the budget period will be vivid from the budget itself.

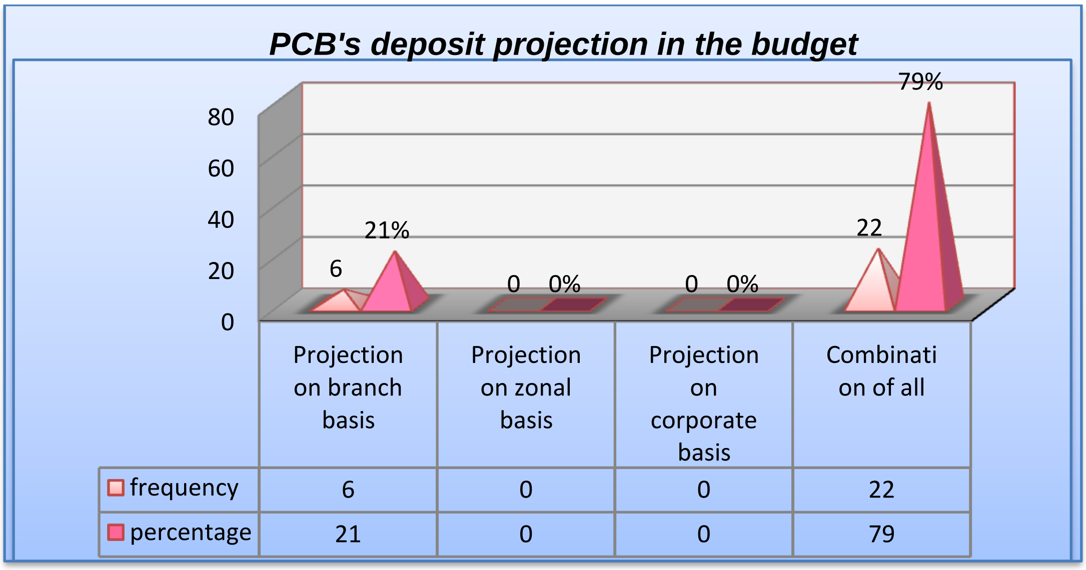
The functions of collecting deposits, extending credit facilities (bank's investments) and timely collection of advances and deposits is a chain of efforts. Success of each function largely depends on the success of others.

6.5.1 Deposit projection:

Deposits are the main financial strength of commercial banks. Careful estimation of deposits for budget projection is very important. PCBs have a wide net work of operations in the country through branches and also have solid deposit base. A reflection of deposit targets in the budget is a must in order to ensure that other inter-related and dependent functions are equally matched. Keeping this in mind, questions were set on the basis of deposit projection, that is, whether deposits are projected in the budget on branch, zone or corporate basis.

The detailed findings of this portion of the questionnaire are given below.

Table: 6.5.1 PCB's deposit projection in the budget:



Source: Survey result/data

Six banks (21%) stated that they project deposit targets on individual branch basis. In other words, expected deposits at each and every branch are estimated and projected in the budget. The total deposit projection in this case of the entire bank is the sum total of estimated expected deposits of all branches together. Branch is operating base of the PCBs. Through branch based deposits projection, the responsibility of the branch officials in general and the branch manager in particular, is ascertained and established.

Measurement of performance and efficiency of the mangers and officials becomes easy. Branch based deposit projections is a participatory model of budget preparation.

Practice of deposit projections in the budget only on zone or corporate basis is totally absent in the PCBs as evident from the replies shown above. Zone or corporate basis projection amounts to top-to-down approach. This approach is not in practice in the PCBs. Replies relating to budget preparation and budget responsibilities also confirmed that top-to-down or imposed budget approach is not followed by the PCBs.

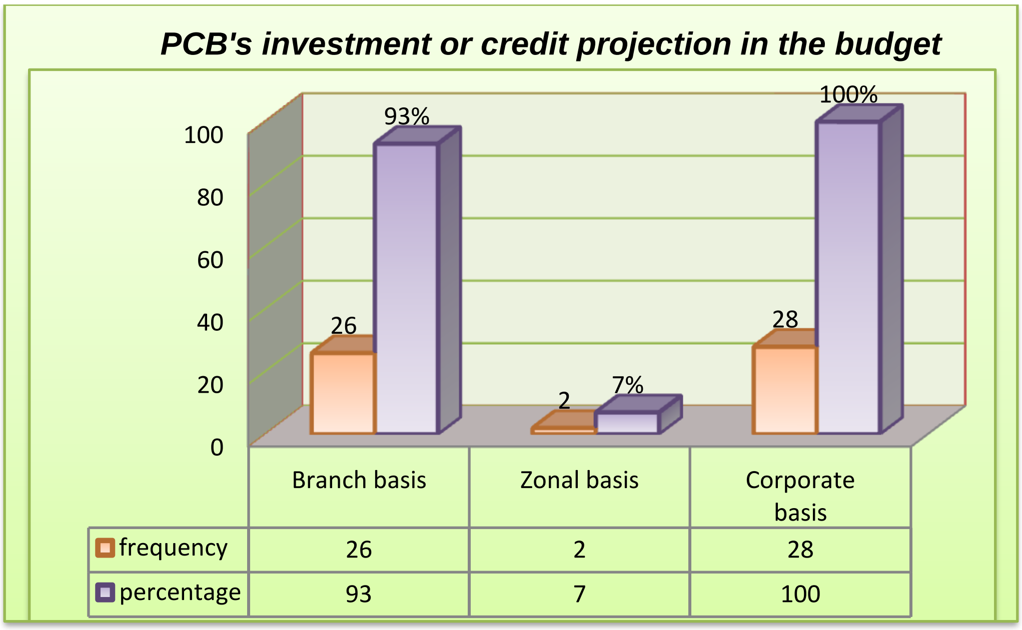
It can be seen from the table above that 22 banks (79%) use a combined basis for projection of deposits. That means, deposit estimates for budget projection are done jointly by branch, zone and corporate officials for all the three levels. Projections done at each level are duly adjusted and modified through discussions, meetings and official memos. This coordinated effort ensures participation of all concerned. This approach is neither a top-to-down or bottom-up one. The result is a 'consensus budget' projection. This way of fixing deposit target has some extra advantages. Here, commitments for deposit mobilization do not rest only on the performing managers. The zonal officials also make some commitments to achieve and maintain a desirable level of deposits for the zone. Besides, due to participation of corporate level officials in deposit projections, policies and strategies of banks get reflected in the budget.

6.5.2 Investment or credit projection:

Investments and credits are main line of business of PCBs. Opportunities of safe and profitable investment only can guarantee utilization of banks' funds and generation of income. Returns on investments and credits granted to the customers in the forms of loans, advances etc. are the major sources of income. Lack of investments or credit facilities to the customers will result in surplus of idle funds which may incur loses to the bank in two ways. Firstly, idle funds do not generate income whereas, depositors must be paid interest or profit on their deposits with the bank. To avoid such situations it is imperative for PCBs to exert best efforts to procure opportunities for secured and profit generating investments and credits. Budget of the bank should reflect a projection of the estimated investments and credits for the budget period. Budget should also clearly state the plans and strategies to be followed during the budget period to enhance and retain investments and credits.

Questions related to the basis of credits and investments projections in the budget were covered in this part of the questionnaire. The replies and findings are given below:

Table: 6.5.2 PCB's investment or credit projection in the budget:



Source: Survey result/data

It appears from the above table that 26 banks (93%) follow 'branch basis' projection approach. That means the estimates of investments and credit facilities to be extended during the budget period to the clients are made by and for each individual branch. Branches are the operational base of banks and branch officials are more aware of the economic situations of that area. They are also familiar with the needs of clients and customers and at the same time customers' financial strength. This approach may provide dependable and accurate budget projections. The branches totals are projected at corporate level as investments and credits for the entire bank. This is a participatory approach of budget preparation. Here the branch managers extend their commitments of business and thereby accept certain responsibilities.

Two PCBs (7%) replied that they follow zonal basis projection of investments and credits instead of 'branch basis' approach. In these two cases estimates are made of investments and credits for a particular zone and the sum total of all zones are incorporated in the budget as bank's total investments and credit facilities at corporate level. In these cases, the branch officials are not at all involved in the credit projection process. But these are the officials responsible to implement the budget. This approach lacks responsibility and commitment of individual branch officials. But by deciding zonal targets the zonal officials to some extent assume responsibility for meeting the targets.

Replies also confirmed that PCBs do not make investment and credit estimates for budget projection at the corporate level alone. This is quite reasonable. The corporate or head office officials are not in touch with the market reality as they are not dealing with the clients spread over the country. Their forecasts and estimate of investments and credit may not be dependable and accurate.

6.5.3 Loan recoveries and provisions:

Loans and credits are granted to the clients with the expectations that principal amounts along with interests and charges will be collected back as per agreement. In case of PCBs, recovery may in one time or scheduled over a period of time in installments based on the nature of the credit. The recovery terms are decided by execution of agreements between the banks and its clients. Timely recovery of loans and credits is essential. If recoveries are not regular and timely, the banks fail to make further investments and advances due to lack of funds; banks suffer from liquidity crisis. The whole operations of banks will become standstill. To get rid of such situations, bank should make definite target for loan recovery in the budget in line with credit agreement.

Despite all out efforts on the part of the banks, recovery of some loans and credits may be delayed or even become doubtful. It is more so in Bangladesh context. In the business world it’s a common practice to make a provision for doubtful of recoveries. The delayed and doubtful loans are to be carefully classified during every financial period. Necessary provisions to cover those are to be made.

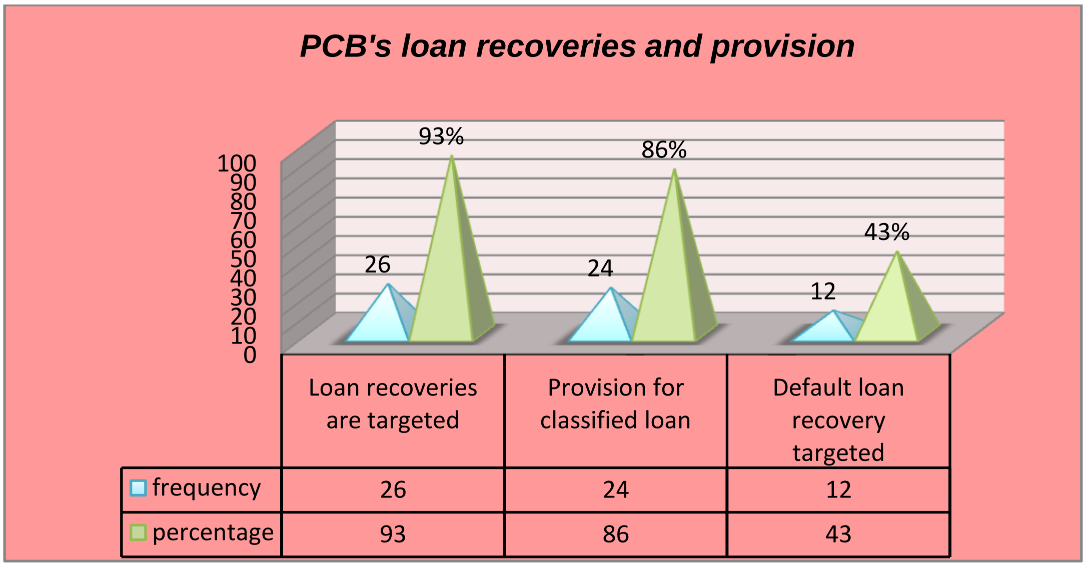
Making provisions for doubtful recoveries is financially prudent. As per Bangladesh Bank regulations (revised till June 2009), provisions are to be made at different rates based on the different classifications of loans and credits. The prescribed rates of provisions are: for substandard loan 20 %, for doubtful 50 %, for bad /loss 100 %. Another provision of the Bangladesh bank regulation as mentioned above requires all commercial banks to make a general provision of 1 % on all unclassified loans. A provision of 5 % is also required on unclassified loans clubbed under ‘special mention account’. In addition, the regulations provided that interest can be calculated on substandard and doubtful debts but that interest should be credited to Interest Suspense Account instead of credit to interest income. Further, once the loan is classified as bad/loss, accrual of interest shall cease. But that should not mean the defaulters should go free. Sufficient arrangements should be there in banks to initiate necessary actions against the defaulters. This is usually done through credit control and legal departments.

Targets of credit recovery, both unclassified and classified should be shown in the budget. That will provide proposed plans for recovery and the amount of fund to be generated during the budget period. On the other hand, recovery targets impose collection responsibility on the respective branch officials.

Budgeted recovery targets can be compared with actual collections and required necessary steps can be taken from that.

On the issues of loan projections, loans classification and provision for classified loans questions were designed in the questionnaire. The replies and findings are as follows:

Figure: 6.5.3 PCBs Loan recoveries and provisions:



Source: Survey result/data

Loan recoveries are targeted by twenty six banks (93 %) and the targets are reflected on the budget. It appears from this discloser that these banks are careful for loan recovery. By fixing recovery targets in the budget the responsibility of the concerned officials are established. Branches giving such loans are held responsible for targeted recoveries. This certainly augments the collection follow up efforts. Rest two banks (7%) do not target loan recoveries. This a major lack. How do they handle loan recovery process remains a question.

As to provision for classified loans, twenty four banks (86%) confirmed that their classified loans are provided for as per requirements and those provisions are shown in the budget. This seems to be a satisfactory course of action. Four banks (14%) do not show provisions for doubtful debts in their budget. Whether they classify doubtful debts and make due provisions could not be ascertained from the replies.

Efforts to recover defaulted loans are usually exercised by banks through their credit control and legal departments. A question was on targeting defaulted loans recovery in the budget. The replies were unsatisfactory. Twelve banks (43 %) replied in the positive, the rest 16 banks (57%) replied in negative. This means that only twelve banks (43%) target recovery of defaulted loans through budget. Targeting default loan recovery in the budget indirectly imposes some sorts of responsibility on respective loan granting branches and officials and as such, the recovery process may become more effective and stronger. How the rest 16 banks (57%) initiate and implement defaulted loan recovery efforts remain a question.

6.6 Implementation of Budget:

Implementation is placing a plan into action. A budget is a plan of future actions translated into figures. Once the budget is drawn, pre-approval review is done and authoritative approval is accorded to it the implementation process starts. Budgets are generally circulated by an executive order to all users. The budget package should contain necessary formats for various reporting for the use of the different cost centers. For effective implementation of budget coordinated efforts and inter-departmental cooperation are essential factors. Implementation of budget requires trained staffs. Without proper staffing the expected benefits of budgetary control cannot be attained. The role of persuasions and motivations cannot be denied. Cost center managers and related staffs may be offered extra incentives for proper implementation and smooth running of the budgeting process. In short, budget implementation requires organizing, coordinating, staffing, directing and motivating.

In most of the private commercial banks, implementation of budget begins from branch level. Branches of the banks are the basic cost centers. And almost all the types of revenues and expenses are generated from that level. Alternatively, budget is implemented at regional level in few PCBs. In this case, budget estimates and sum total of actual performances of all the branches of that particular region are accumulated together for comparison. Again, it happens in some PCBs that budget is prepared at corporate level for the entire bank as a whole and also implemented at that level. In this case, actual performance data are collected from all the operating units and the resultant total is compared with corporate budget. This is applicable for both revenue and capital budgets.

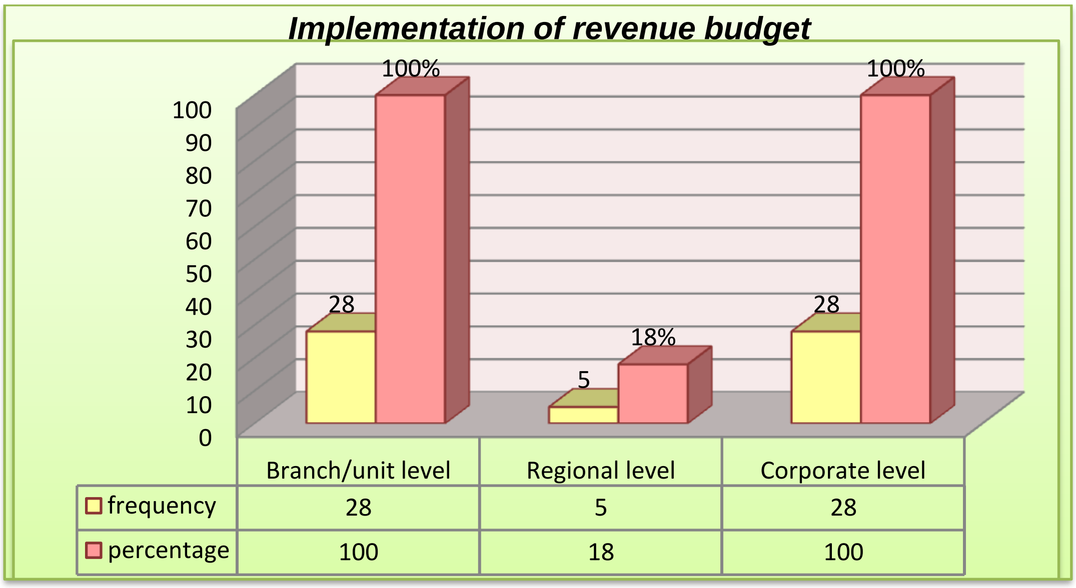
On these issues, questions were framed to form an idea as to at what level PCBs' both revenue and capital budgets are implemented. Besides, questions were also framed as to time limitation of budget implementation, provisions for actions if any, for failure to implement and adopt budget.

6.6.1 Implementation of revenue budget:

Revenue budget is more widely used and implemented in PCBs. Here emphasis is given on revenue budget from branch level to head office level. Achievement of income and revenue targets and exercising control on expenses are monitored through revenue budgets. Revenue budget implementation process begins with executive orders formally circularizing budget to all users and departments. Standard formats are also given to the users for use in preparing performance reports, variance analysis and other reports in majority of the PCBs.

The survey results on revenue budget implementation issues are given in the following figure.

Figure: 6.6.1 Implementation of revenue budget:



Source: Survey result/data

From the replies received, it is evident that revenue budget of PCBs are implemented and adopted at a wider scale. All the twenty eight banks (100 %) replied that revenue budget is implemented at branch/ unit level. Five banks (18 %) further confirmed that, in addition to implementation of revenue budget at branch level they also draw budgets for zones and implement at regional level. Regional level budget is in fact, the sum total of projections of all the branches of that region.

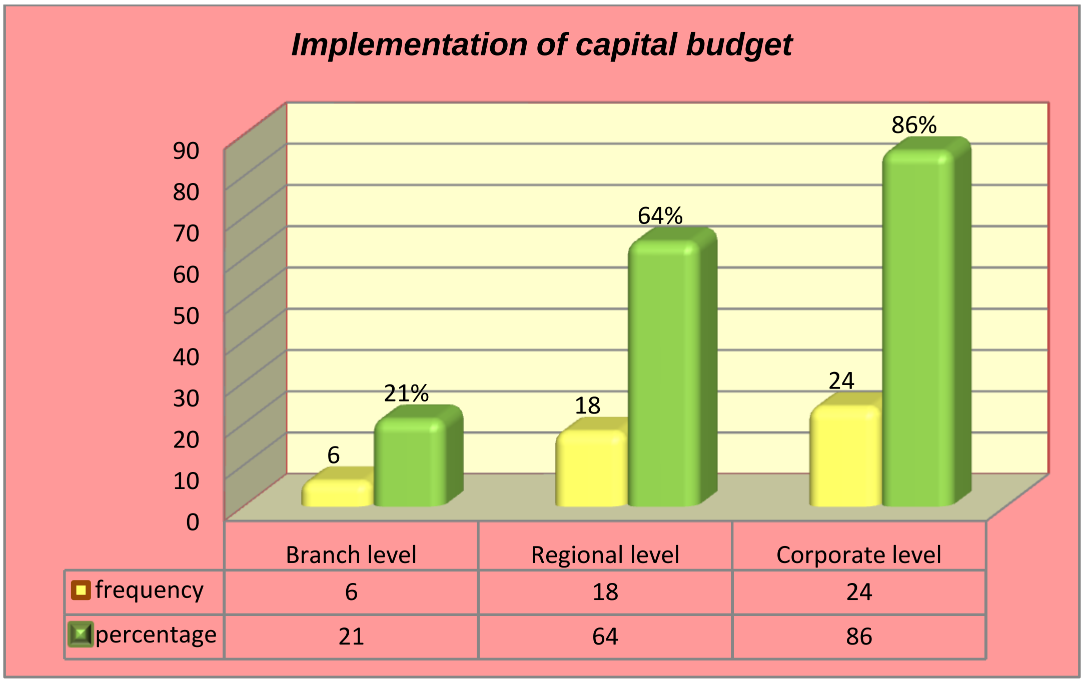
All the twenty eight banks (100 %) also confirmed that in addition to implementation of revenue budget at branch and regional level (wherever applicable), the budget as a whole is implemented at corporate level. Budget implementation at this level is done by budget department, where an independent budget department exists, or accounts/FAD department and budget committee. Reporting on budget performances is also done at corporate level based on the data and feedback received from operating units and in some cases from zones.

6.6.2 Implementation of capital budget:

While use and implementation of revenue budget is wide in PCBs, uses and implementations of capital budgeting system appears to be limited. This is quite usual. Revenues and expenses are the results of every day's continuous operations. Whereas, capital expenditure is an occasional investment related with expansion, development and growth. Major capital expenditure occurs once in a while. It is also true that, the returns and benefits of capital expenditures are usually reaped in the long run. Capital budgeting is more technical job and needs quite reasonable expertise.

On this series of questions on implementation of capital budget, the replies received and the findings are shown in the following figure:

Figure: 6.6.2 Implementation of capital budget:



Source: Survey result/data

From the replies being received on question of implementation of capital budget, only 6 banks (21%) confirmed that if there is capital expenditure at branch level, capital budgeting process is implemented there. Eighteen banks (64%) confirmed that they do not prepare or implement capital budget at branch level. The responsibility of capital expenditures in any zone lies with the zonal office. It is the zonal office which draws and implements budget for capital expenditure of the zone, monitor the progress, prepares reports for head office. It may be that field works are supervised by the branches and the job progress report is submitted by the branch to the regional office.

Whether capital expenditure budget is implemented at branch level or regional level (partly), overall capital budget of the bank, its implementation and monitoring is done at corporate/head office level. Twenty four banks (86%) confirmed that they prepare capital budget at corporate level and split up the corporate budgets into zones and branches for the areas for which the capital expenditure is planned. These banks appear to follow proper budget procedures through coordinated efforts among corporate, zonal and branch offices.

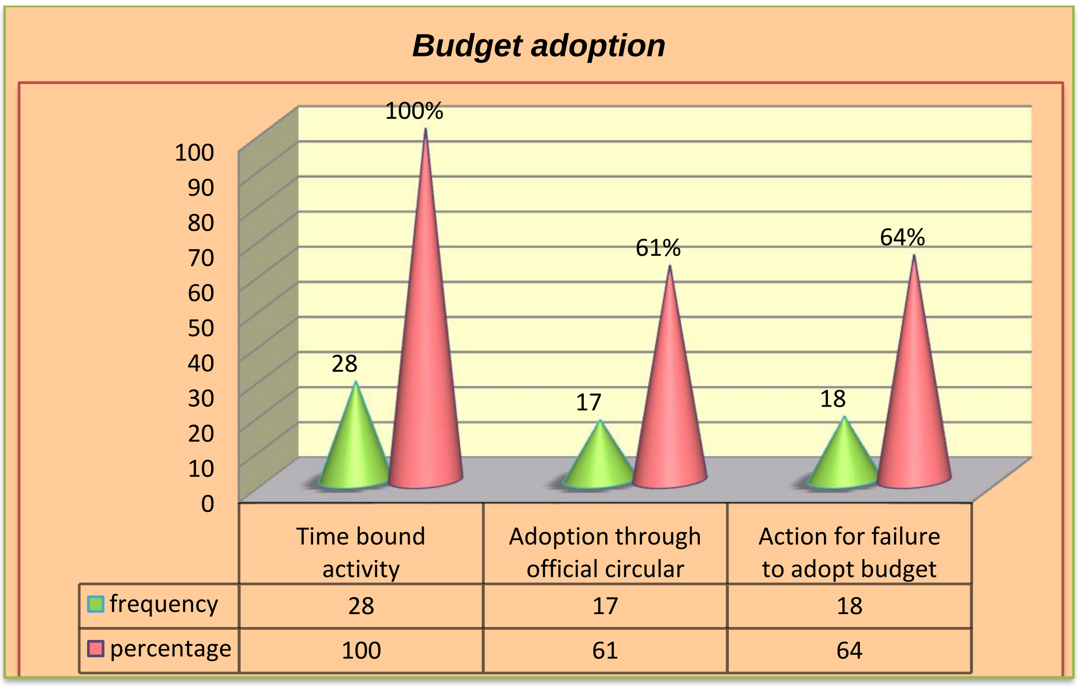
The rest four banks (14%) confirmed that they do not prepare budget for capital expenditure. Decisions for capital expenditures are taken by bank's top management on 'need basis. Funds for expenditures are released with the progress of the capital project. This appears to be old fashioned and does not seem to be satisfactory and desirable. Check and balance on capital expenditures is absent and control appears to be lacking in these cases.

6.6.3 Budget adoption:

Once budget is approved and circularized to the users (cost centers) it is the responsibility of the cost centers to adopt the budget within a certain time. Each and every stage of the budget processes have to be done within certain time limit. Otherwise, the importance and implications fade out. For example, preparation of budget should be finished before the beginning of the budget period/ year, implementation and adoption should be before the first reporting date and so on. Budget, without timely implementation, adoption and reporting is nothing but futile exercise. Therefore, provision for necessary disciplinary and punitive actions is essential in case of failure to comply these requirements.

On time limit of budget adoption, budget circularization and failure to adopt budget, this section of the questionnaire was used. The replies and findings are as follows:

Figure: 6.6.3. Budget adoption:



Source: Survey result/data

All the twenty eight banks (100%) confirmed that budget is a time bound activity and as such, implementation, recording of estimates, collecting feedbacks and preparing budget reports have to be done within definite time as decided by the management. Verification of the validity of this statement was not done as this was beyond the scope of this survey.

Only seventeen banks (61%) confirmed that budgets are circularized through official memo. The rest of the eleven banks (39%) stated that budgets are handed over to the users that is, cost centers through proper channels without any official memo or circular. This does not seem to be a desirable way of budget adoption. This also may reduce the weight and importance of budget to the users.

As to actions for failure to adopt budget, eighteen banks (64%) affirmed that there are provisions for disciplinary actions for such failure. Provision for disciplinary actions has positive moral impacts. Its application is not always required. The sense of embarrassment for failure leads the employees to be abiding and disciplined. Whereas, ten banks (36%) replied that there is no provisions for disciplinary actions for failure to adopt budget. This is a loose situation. It is though fair but not practical to expect that all employees will discharge their part of the job right and proper. So, the provision for disciplinary actions is essential. Preparation of budget entails lengthy and time consuming exercises. It is also costly as preparation needs involvement of many staffs at different levels. All these efforts, exercises and expenses turn in vain in case timely adoption and implementation is failed.

6.7. Evaluation and Performance Measurement:

Performance measurement is an integral part of the management planning and control system. It is done for identifying and tracking progress against organizational goals and opportunities for improvements in lacking areas. It also helps comparing actual performance against both internal and external standards. Budgetary practices aim, among others, to exercise control through performance measurement. Budget sets standards as to what is expected of different levels of operations and cost centers. But setting standard or goal does not alone serve the purposes of control unless and until the set standards are compared with the actual. Control can be exercised when it is known what is expected and what is achieved. Actual performance result is gathered through different performance reports from cost centers or operation department. In other words, performance measurement is a process of quantifying the efficiency and the effectiveness of action. In order to be able to do that it is a normal practice to obtain performance reports to compare the actual performances with the budgeted ones. When performances are compared with the budget targets the results are either to the negative or positive directions.

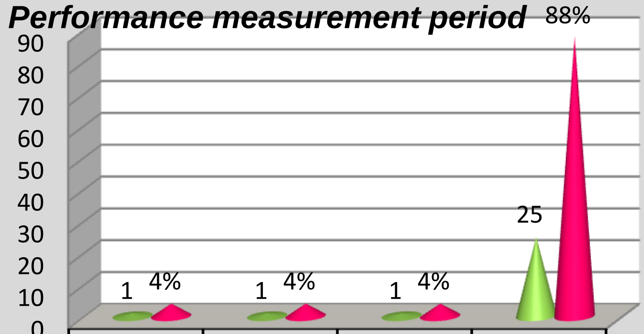
Thus, performance measurement pinpoints areas of strong or weak operations. Performance measurement is sometimes termed as an 'awaking call'. When actual performances fall short of budgeted standard that prompts the senior management to trace the reasons and to take necessary remedial actions to improve the adverse situations. Budget gives the management probing and learning opportunities. With this, the reasons for deficient performance can be traced and those who are responsible for weak performance or negative variances can easily be located. At this same time, the areas of efficient performance are also easily identified. Once the areas of weakness and reasons for negative performance are identified it is easy for the management to take necessary remedial actions before grater damages are done and bigger losses are accumulated. Performance measurements are also used as a determining factor for motivations and incentives. Areas where stronger performances are recorded resulting in positive variations are generally rewarded.

Performances are measured periodically and the frequency of reporting is the choice of the management. But prudence dictates that performance measurement and evaluation should be done as frequently as possible say, monthly, bi-monthly or quarterly. This is done to obtain earlier warning in case of negative variances for taking timely due course of actions. It is considered to be a well practiced norm to use pre-approved and well designed formats for performance measurement reports, variance analysis and evaluation reports. That can ensure uniformity in reporting within the organization. In PCBs, performances are measured at different operational levels such as, branch, zone or corporate level.

6.7.1 Performance measurement period:

Frequency of report that is, period covered by each report, is very important. Lesser the period covered by the report, the quicker the results will be known and taking corrective actions, if needed, will be without unnecessary loss of time and money. In order to form an idea about the frequency of performance reports of PCBs, questions were designed. The replies received along with the results and findings are as follows:

Figure: 6.7.1 Performance measurement period:



	Monthly basis	Monthly and quarterly basis	Quarterly , half yearly and yearly	All combined reports
frequency	1	1	1	25
percentage	4	4	4	88

Source: Survey result/data

Only one bank (4% of the sample) prepares performance measurement report on monthly basis for management's review. This particular bank does not prepare any quarterly, half yearly or yearly performance reports. The reporting frequency here is appreciable. But due to lack of accumulated reports for a longer period, there is a constraint to judge trends of performances that is, whether favorable or unfavorable.

Another one bank (4% of the sample) prepares performance and evaluation report monthly and quarterly basis. This seems to be an improved situation. Similarly, another one bank (4% of the sample) confirmed preparation of reports on quarterly, half yearly and yearly basis but ignoring monthly reporting. In this case, chances are there that unfavorable variances are brought to the notice of the management lately and thus taking remedial action is delayed which is not desirable.

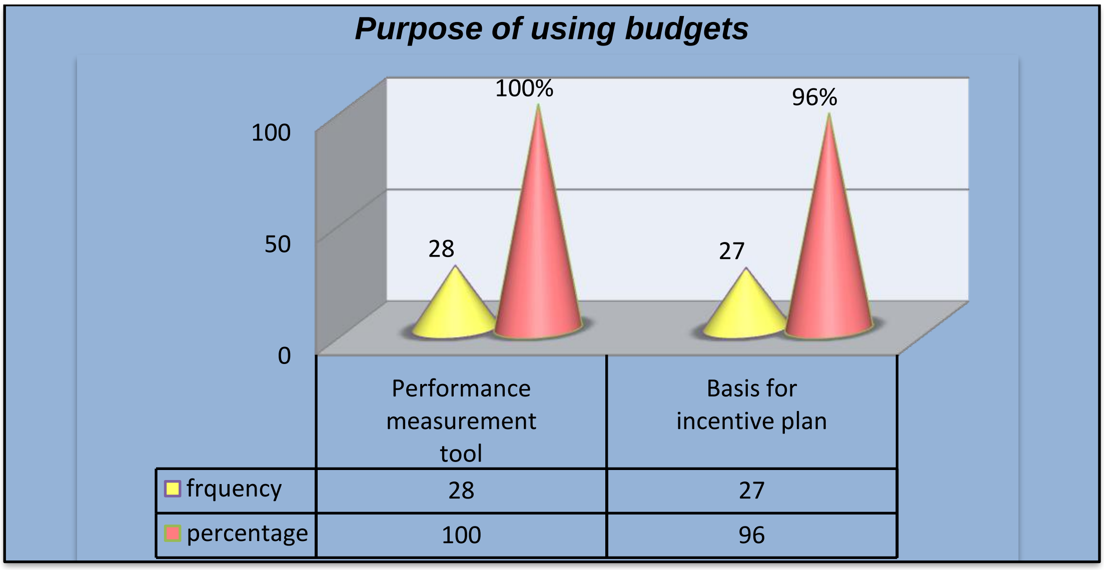
But the encouraging finding is that, rest twenty five banks (88% of the sample) prepare performance and evaluation reports in regular frequency of monthly, quarterly, half yearly and yearly basis. This is the most rational and desirable practice. If these reports are properly reviewed, the management can get a clear picture of the trends and directions the operations are heading to and taking necessary actions will not suffer from loss of time.

6.7.2 Budget utility:

Like any other business organizations PCBs also use and utilize budgets for some common purposes. The first and foremost use of budget is as a tool of performance measurement. A branch based budget opens an opportunity for the PCBs to successfully determine the expansion, growth and otherwise of operations as compared to set targets. Similarly, a region based budget can give a picture of the operations of the entire region in the same manner. On incurring expenses at branch or zonal level, budget imposes certain authorization limits. Comparing budgeted limits with the actual expenses the management can exercise due control on over expenditure.

It is a common practice for PCBs to plan incentives based on positive performance as compared to budgeted goals. In this case, budget functions as a yardstick for incentive plans. In this part of the questionnaire, questions were set to find out how PCBs use budget. The replies and findings are on the following figure.

Figure: 6.7.2 Purposes of using budget:



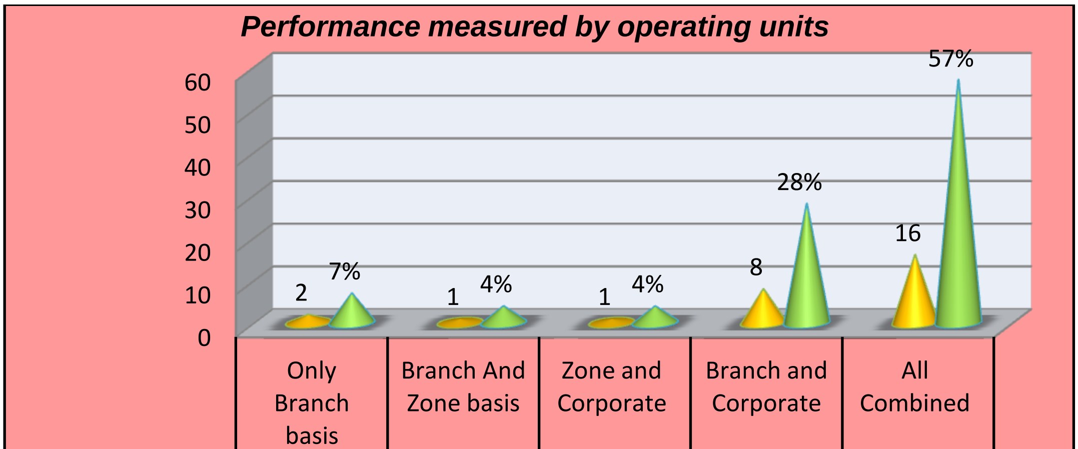
Source: Survey result/data

All the twenty eight banks (100%) use budget as a tool of performance measurement. Through the use of budget PCBs measures performance not only of certain employees but also performances of branches and zones and that of the bank as a whole. Twenty seven banks (96%) confirmed that they use achievement of budget target as a yardstick for incentive plans.

6.7.3 Performance by operating units:

In PCBs performance can be measured on branch basis, zone basis or on corporate basis. In case of corporate basis the performances of entire bank are measured ignoring performances of individual branch or zone. Alternatively, a combined basis can be used. In that case, performances of the branches are measured independently. Performances of a particular zone are measured with the resultant total of the branches of that zone. In some banks, zonal performances are ignored. Performances of individual branches are measured and accumulation of total branch performances constitutes overall performance of the bank or performance on corporate basis. In order to ascertain the basis PCBs use for measurement of performance this part of the questionnaire was designed. Replies and findings are as follows:

Figure: 6.7.3 Performance measured by operating units:



	Only Branch basis	Branch And Zone basis	Zone and Corporate	Branch and Corporate	All Combined
frequency	2	1	1	8	16
percentage	7	4	4	28	57

Source: Survey result/data

Two banks (7%) measure performance on branch basis. In this case, targets for individual branch are fixed in the budget and periodic actual performance is compared. This basis of measurement of performance of banks emphasizes on the performances of each operating unit. This is definitely encouraging for branch staff. They may try hard to grow business for individual achievement. Branch basis measurement of performance focuses light not only for the performance of that particular operating unit but also on the few employees of that unit whose contributions are significant. When bank uses performance measurement as a determining factor for incentive plan, branch basis measurement of performance can give the fairest choices.

Only one bank (4%) confirmed that they measure performance on branch and zone basis. This means that in addition to fixing target for individual branch the particular bank also sets target for each zone for comparison purpose. Here responsibilities for improvement and growth of business do not lie on the branch alone. The officials of the regional office are also partly responsible for that. This dual responsibility and join efforts may contribute positively. This seems to be a better way.

Another one bank (4%) confirmed that they ignore measuring performance at branch level. Preferences are measured only at regional and corporate level. This bank gives more emphasis on zonal office for better business rather than on the branches as the operating units.

Eight banks (28%) confirmed that they measure performance at branch and corporate level ignoring the role of regional office in bank's performance. Here, the importance on branch is emphasized but the role of zonal office is totally ignored.

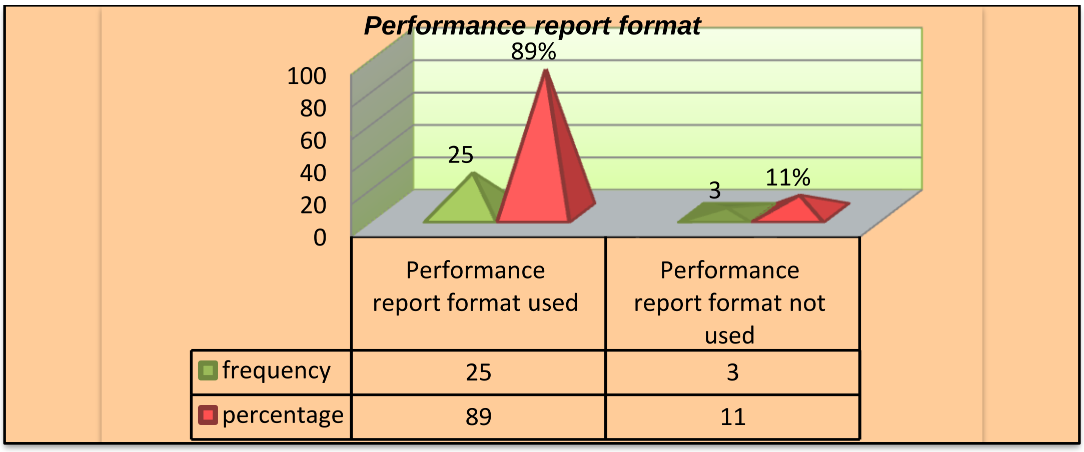
The best ways of measuring performance are adopted by sixteen banks (57%). They use a combined basis. Performances are measured at branch level, zonal level and corporate level. In this case the responsibility to achieve budget targets is shared by the officials at three levels. In fact, if performances are measured in this way, identification of strong and weak areas of operation and potentiality of further business and right course of action to improve it becomes easy. This seems to be the most rational and desirable way of performance measurement for banks.

6.7.4 Performance report format:

In any report certain information are expected in specific order. It is more so for big organizations like commercial banks where same type of reports are usually gathered from numerous branches and cost centers. If these reports are prepared in certain order or form, compilation of subsequent reports becomes easy. For uniform reporting it is always useful to use prescribed forms. Similarly, PCBs have to gather hundreds or even thousands of performance reports from their branches. These reports are further processed to generate a consolidated report for the banks. In this case, if PCBs use prescribed standard form for performance report, the tasks become easy, simple and less time consuming. Further, uniform reporting in prescribed form helps to draw conclusions easily.

Whether a prescribed form for performance report is in use in the PCBs or not was a question in the questionnaire. Replies and findings are as follows:

Figure: 6.7.4 Performance report format:



Source: Survey result/data

As can be seen from the table above, twenty five banks (89%) confirmed use of prescribed formats for performance reports. The head office designs and distributes these formats for common use in branches and zones. For consolidated reports prescribed standard formats are also used. But three banks (11%) replied that they do not use prescribed forms for generation of performance reports. Both at branch and zonal level officials in these banks use formats of their own design and choice. It cannot be expected in these cases that the performance reports so generated are uniform and in the same order. How these reports serve the purposes of generating subsequent consolidated reports remain a question.

6.8 Monitoring and Feedback:

Budget is, no doubt, essential for financial management and control. It sets objectives and directions as to what is to be done, when is to be done and at what costs to be done. But planning alone does not drive the desired result unless it is reviewed that how closely the organization is meeting its objectives as set in the plans. Drawing a budget alone does not guaranty accomplishment of its targets and objects. It needs further monitoring. Effective monitoring involves evaluating the performance and the progress of the plans, the subsequent impacts and the lessons learned. This evaluation process becomes easier if budget estimates are recorded in the accounting system for comparison. In fact, budget monitoring is done through analysis, interpretations and reviewing of certain reports.

Continuous feedback and review process improve accountability and can help increased performance. The performance report, variance analysis reports and in-depth analysis of the variance reports can depict a clear picture of the prevailing operational situations. These reports are also termed as budget feed-backs. Through monitoring and feed-back process the actual results are compared with the planned goals, the variations and reasons thereof are find out and a control frame is set for the management. It is important that the feedback reports' design should be useful and the timing should be proper. The variance reports and the detailed analysis indicate the areas adverse to the set budgeted standards. In addition, analysis and interpretation also indicate the reasons for adversity and deviations. This enables the management to decide in right time to take necessary corrective measures to reverse the adversity.

6.8.1 Variance analysis and review:

Once performance reports are generated it is needed to be seen whether the actual performance conform to the budgeted targets or not. It is the done through variance analysis. Variance analysis is an internal control technique which involves the functions of comparing the actual performance with budgeted targets to find out variations and the reasons thereof. In other words, variance analysis aims to determine the driving forces causing those variations. Determination of these causes is very important to understand what is wrong, to get indications as to what has happened and prompt debate about what can be done to improve.

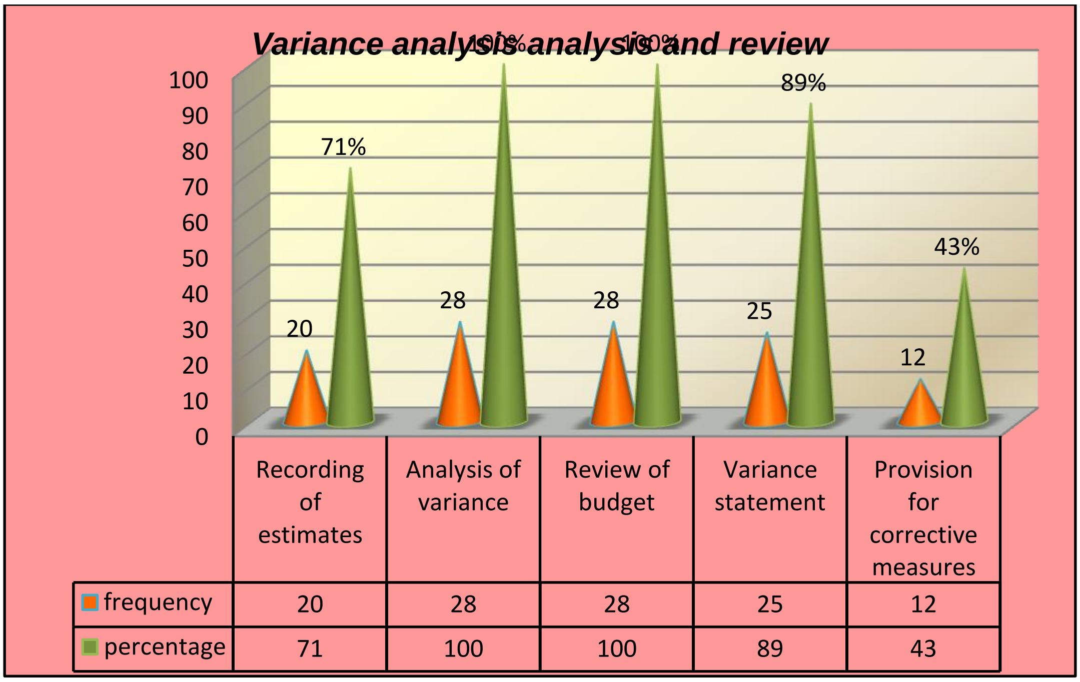
In order to make variance analysis process easy, it is advisable to record budget estimates in the accounting system. In that case drawing figures for variance report becomes easy and less time consuming. Variance analysis should be done frequently and on a timely basis. If negative variances with causes are not detected immediately, taking necessary actions to prevent those will be delayed. That accumulates losses for the organization. Sometimes it happens that the variations and their trends are abnormal as compared to budget targets. Maybe the variances and trends indicate that the standards need amendment. Such situation demands review of budget projections. If it is find that the situations and conditions based on which the budget targets were fixed have changed during the budget period and possibility of reversal is remote, the budgets need to be revised. Revision of budget resets budget standards in line with existing reality. Revision helps reasonable comparison in case of changing circumstances.

It is not correct to assume that negative variances are always caused by changes in the business circumstances. Evidences are there that negative variances may also be caused due to willful negligence, inefficiency, lack of sense of responsibility on the part of the employees which could have been prevented. Provision for disciplinary actions should be there to prevent such deliberate actions.

In consideration of the importance of monitoring, feed-back, variance analysis and budget review, questions were framed to ascertain how the monitoring, feed-back and review system are adopted in PCBs. Whether the banks record budget estimates in accounting system for easy comparison was also another question.

The replies were quite encouraging which are shown below in the following figure:

Figure: 6.8.1 Variance analysis and review:



Source: Survey result/data

As to recording of budget estimates in the accounting system, twenty banks (71%) confirmed that they do record budget estimates in the accounting system for later comparison with the actual. Eight banks (29%) do not adopt this system. They pick-up budget figures manually from the budget sheet for use in the variance report. This is time consuming and chances of mistake are high. This may also lead to inaccurate reporting.

Twenty eight banks (100%) confirmed that they prepare variance analysis report at regular periodic intervals with reasons for variances for management use. This outcome is quite satisfactory. But it could not be ascertained for sure how far the management acts on these reports and to what extent the banks are benefited as that was not within the scope of this survey.

On the question of review of budget, all the twenty eight banks (100%) replied positively that they review budget projections during the budget period. Further inquiries in a few cases revealed that budget review is done only when major negative variances are reported.

Twenty five banks (89%) stated that in addition to periodic variance analysis report they generate variance statement at the end of the year. This statement enables the management to see the deviations for the entire year at a glance. It helps the management to decide future courses of action on the areas of major deviation. Other three banks (11%) of the sample do not prepared year-end variance statement. How the management of these three banks become aware of the annual total variances for their managerial decisions remains a question.

From the above analysis it may appear that regarding overall monitoring and feedback the sample banks are, more or less, doing enough. But the replies received on the question whether there are provisions for corrective measures in case of major negative/adverse variances, were quite frustrating. Only twelve banks (43%) stated that corrective measures are taken for adverse variances. Rest sixteen banks (57%) replied negatively. This simply means that majority of banks do not have provisions for corrective measures in force for even major adverse variances. The obvious question is if provisions for corrective measures are absent what is the use of so many exercises for performance measurement, variance analysis and other feed- back reports.

6.9 Summary:

This chapter is the essence of the whole research report. To form an idea about state of practices of budget in the PCBs in Bangladesh, questionnaire was designed to collect data and information as was considered necessary in the circumstances. In this chapter data and information so extracted from the respondents are analyzed and interpreted. This chapter is designed in line with the design of the questionnaire to keep similarity in the order of presentation. Like the questionnaire, this chapter consists of seven sections. Analysis of the replies was done individual question-wise and frequency and percentage of the replies as compared to the total sample size, are shown in a table in each section of the analysis.

On the types of budget used by PCBs, the analysis reveals that practice of budget is common in all the banks particularly revenue budget. PCBs use fixed budget approach in majority of the cases except three banks who use flexible budget approach. None of the sample banks uses latest concept of zero bases budgeting (ZBB). Only eight banks have budget manual as a budget guide book. Nineteen banks use budget guide lines issued by the top management as guide to preparation of budget. Only in fourteen banks confirmed that budget responsibility is well defined in their banks whereas the other fourteen replied in negative. Only thirteen banks use prescribed forms for preparation of budget, the rest fifteen banks have no prescribed budget forms.

In only four banks a separate department is fully responsible for the entire budget related functions. In rest of the twenty six banks budget jobs are done jointly by the accounts /FAD, budget department and budget committee. Budget of twenty five banks is approved by executive committee or by the board of directors. In three banks budget is implemented without prior approval from the top management.

All the twenty eight banks consider previous actual or historical data, future profitability, ROI, government fiscal, monetary and development policies, as determinant factors for budget preparation. CAR, exchange rate risks and trend of financial sector as a whole are also taken into consideration while determining budget targets. Twenty five banks prepare budget on summary basis and only three banks prepare on detailed basis. Summary basis budget is not suitable for performance measurement and variance analysis. Most of the PCBs use a combined basis for budget projection. That means budget estimates made for branch, zones and the entire as a whole at corporate level.

Data for budget are gathered from the branches as basic operational unit. Data are also collected from zones and if necessary from the management specially relating to future plans and strategies. PCBs follow a participatory budget approach. Budget responsibility is established both at branch and corporate level. Budget responsibility is properly segregated and duly delegated.

Deposits, investments, advances and credits are projected in the budget. Majority of the banks project these items on branch basis. A few banks project on regional and corporate basis. Budget is implemented in majority banks at branch level and corporate level. Only five banks confirmed that budget is also implemented at regional level. Budget is in generally considered a time bound activity. But in twelve banks there are no provisions for disciplinary action for failure to abide by time frame.

All the PCBs prepare and use budget. But in the total budgetary procedures there are weakness and lapses especially in the feedback, follow up and monitoring process. If these weakness and lapses are not rectified full benefits of budgetary practices cannot be reaped. The following chapter will be the concluding on with a brief review of the entire report.

CHAPTER- 7: SUMMARY AND IMPLICATIONS:

7.1 Introduction:

This research study involved exploring the state of budgetary practice in PCBs in Bangladesh. The PCBs play important roles in the economy of the country. The success of PCBs largely depends on smooth operation through effective control mechanism. Budgetary practices can enhance effective internal control system. The basic objective of this study was to bring in light the prevailing state of budgetary practices, the attitude of management towards the budget and development of budgetary system in PCBs. To achieve this research objective a comprehensive review of the extent literature was conducted. Directly related literature on the topic was scare but literature on budget in general and allied topics were reviewed to form a theoretical background of this study in chapter three. Informative discussions on evolution of banking sector in general and that of private commercial banks in particular was done to depict the implications of budgetary practices for business organizations as a management tool of control was also discussed with its relevance to and impacts on PCBs.

To collect required data and information, a qualitative research approach was followed and questionnaire was used as primary source of data collection. Data and information were also collected from some other secondary sources. Question-wise analysis and interpretations were done and the findings were outlined in details in chapter six. In short, it can be said that preparation and implementation of budget is common in all the sample banks. But to make the budgetary practices effective and worthy, other auxiliary factors are weak and insufficient in many of the PCBs. For example, only four banks (14%) have separate budget department and twelve banks (36%) do not have any provisions for disciplinary actions in case of failure to implement and adopt budget within reasonable time.

Efforts are made to review the research problems faced during the study in this part of the report. Also, research objectives and how far these objectives were attained are reviewed here. Major findings of the study and its importance and implications are discussed in the succeeding sections.

This chapter will be concluded with discussions on the future needs of further research and directions thereto.

7.2 Review of Objectives:

This research study did, to a great extent, vindicate the prevailing situations of budgetary practices in PCBs and the attitudes of the management towards budget which were the major objectives of the study. Budget is widely practiced in PCBs but how far the PCBs could reap the positives contributions out of budgetary practices needs to be seen step by step. Budget being a technical and voluminous job, it was intended to get an idea as to how specifically responsibility for budget was established, how these responsibilities were segregated and delegated to avail of the best budget performance. The findings in this regard are not very much encouraging. In most of the cases budget is prepared, implemented and monitored by accounts department and FAD in addition to their own departmental routine jobs. Only four banks have separate budget department and seven banks have budget committee. So, budget responsibilities are well established in most of the banks is not the ground reality.

Replies on budget projections of deposits, investments, loans and credits were mainly positive. Whereas, most of the banks project deposits, investments and credits in their budgets, four banks do not project in their budget provision for classified loans and advances. How adequately these banks provide for classified loans remains a question. Even two banks do not project loan recovery target in their budget. Whether necessary steps are taken or not for timely recovery of installments needs further verification.

It was also intended to see through this research study that performances are measured periodically and remedial actions are taken in due time for adverse variances. The findings were contradictory. All the banks prepare performance reports and analysis variances but only twelve banks said that they have provisions for actions in case of adverse variations. The rest eighteen banks have no provisions for remedial actions for adverse variations. This seems to be the weakest area of budget practices in PCBs.

7.3 Major findings of the study:

Budget as a whole is followed by 100% of the sample banks and all the banks also prepared revenue budget. 86% of the banks prepare capital budget for both short and long term capital expenditures. But 14 % of the banks do not prepare capital budget. They allocate funds for capital expenditure on ‘needs’ basis as and when decided by the management. This is not in keeping with sound financial management policy.

32% banks prepare budget on flexible target basis. That facilitates reasonable comparison especially in case of major variations in performance as compared to standards. 68% banks prepare budget on fixed target basis. In the continuously growing private banking sector fixed budget is not suitable. Performance measurement may render unreasonable results. 71% of the banks do not have budget manual as permanent budget guide book and 68% percent of them use budget guidelines issued from time to time by the management. How far the circulars and memos are properly preserved and followed remains a question.

57% of the banks have pre-approval budget review system in force. It ensures coordinated efforts and balanced budget. Errors in forecasts and presentations would be easily detected. 64% banks have budget department. But in only 14% banks the budget department functions independently. In the rest 50% banks, the budget department functions in collaboration with accounts and other related department. In fact here the budget department is not completely independent. 36% banks do not have a budget department. Here the budget is prepared by accounts/ FAD. Other budget related works are also done by accounts/ FAD in addition to their own jobs. In 89% cases, the budget is formally approved by the Board of Directors and in some cases also by the banks' Executive Committee.

Deposits are duly projected in the budget by all the banks. 21% of them project deposits only on individual branch basis and 79% banks project on branch, zone and corporate basis. But in all cases total projections are reflected in the corporate budget. Investments and credits forecasts are projected in the budget by 93% of the sample banks on individual branch basis and for rest 7% banks on zonal basis. But the total projections are shown in the corporate budget. In case of 7% banks where investment and credit projections are done on zonal basis, branch's performance would not be apparent from the budget. Besides, commitments and responsibilities of the branch officials are absent here for business development.

Loan recovery targets are set in the budget by 93% of the sample banks. This projection indicates management's emphasis on loan recovery and serves as a caution for operational officials. Loan recovery is not projected in the budget in 7% of the banks. This clearly gives an indication that they may not have a concrete recovery plan. This may cause indifference among the officials in the recovery efforts. Provision for classified loans is shown on the budget in 86% of the banks. Provisions for classified loans are not shown in the budget in 14% of the banks. Whether these banks make necessary provisions for classified loans could not be ascertained from these replies. Default loans recoveries are not targeted in the budget in 57% of the banks. This is a serious lack. If recovery is not targeted, serious efforts for such recovery on the part of the loan granting branches would remain at bay. 89% banks prepare budget in summary basis. This is not desirable because actual variances and reasons thereto cannot be pin-pointed easily in these cases.

Budget responsibility is established both at branch and corporate levels in 93% of the banks. That means supervisory responsibility lies with the corporate officials. Responsibility for execution of the budget lies with the operational officials. This ensures coordinated efforts for budget's success.

But budget responsibility is established at only corporate level in 7% of the banks. In these cases the operational officials are kept out of budget preparation process though they are the executors of the budget. This may have negative impacts on performance.

Budget responsibilities are reviewed in 89% of the banks. This is encouraging in the sense that employees become more serious and positive in discharging their jobs. Budget responsibilities are not reviewed in 11% of the sample banks. This is a serious lapse. It is not practical to expect that employees would discharge their duties properly without supervision and monitoring. Here, lies the importance of budget responsibility review.

Disciplinary actions for failure to adopt budget are not taken in 36% of the banks. This is a gross lapse. Absence of actions for failure to implement and adopt budget renders the budget to be a futile exercise. Budget is not officially adopted through circular or memo in 39% of the banks. This is a procedural lapse. Due to this lapse the weight and importance of budget may fade out.

Budget is used as a performance measurement tool in 100 % of the banks. It is a positive sign that performances are measured as compared to budgeted targets for further actions. But prescribed formats for performance reports are used in 89% of the banks. It ensures that a uniform report system is in use in these cases. Prescribed formats for performance reports are not used by 11% of the banks. Each department uses report format of their own design and choice. It is not a uniform report system. Preparation of consolidated performance report for the banks from these multi-designed reports is both difficult and time consuming.

Budget estimates are recorded in accounting system for easy comparison in 71% of the banks. This seems to be quite positive. At the same time, budget estimates are not recorded in accounting system in 29% of the banks. For performance comparison budget targets are picked up manually and chances of human errors are high. This is also wastage of time.

Corrective actions for major variances of budget performance are not taken in 67% of the banks. It is a major procedural lapse. It renders all the budgeting efforts meaningless.

7.4 Implications of results:

From majority of the replies of the questionnaire, it may appear that budget practice is well-oriented in the PCBs and running smoothly and effectively. But a keen review of the objectives parallel with the findings as discussed in the preceding section clearly indicates that there is another side of the coin. It is apparent from the replies that both the management and the concerned staffs have positive attitudes towards budget. At the same time, some factors and conditions essential for efficient and successful budget practice is grossly absent in a good number of PCBs. The deficient areas as discussed broadly in the preceding sections may work as an eye-opener for the banks' managements who are really serious about using budget as an important control device.

It is no denying the fact that there is scarcity of literature on budgetary practices especially in commercial banks in Bangladesh. The present research is one of the first of its kind. It may be reasonably hoped that this study, with its remarkable findings, may make an absolute contribution to the existing literature. This report may also help the future researchers as a guideline. A general view on the research topic is depicted here. The future researchers may easily decide where from to begin for in-depth study.

7.5 Future research direction:

This research study provides some insights into PCBs' practices of budget in general. Scope of further research is abundant. Specific research studies may be conducted in different areas. In-depth studies on impacts of budget on PCBs internal control system, overall performances and improvement of operational efficiency can be carried out. With the negative outcomes of this study, further research may be initiated to determine the causes of such lacks and lapses-whether it is due to indifference of the management, lack of manpower or due to lack of resources or anything else. To form a concrete idea on the research topic, it is better to conduct research on individual bank basis rather than on the sector as a whole. Research may be conducted with comparative studies of bank's several years' performances to determine the benefits of budgetary practices or the adverse effects due to lack of it.

7.6 Recommendations:

The findings of this report pointed out to certain areas where some PCBs are lacking much behind. With those shortcomings, it cannot be expected that these banks may reap full benefits of budgetary system. The situations require improvements. In this context, the following recommendations are suggested.

Independent budget department:

Each and every bank should have a separate budget department functioning under the supervision of a competent budget committee. The staff of the budget department should have proper training and orientation on budgetary system with reasonable technical knowledge and analytical skills. It is fairly assumed that big organization like banks can afford maintaining such a department.

Budget manual:

Budget manual should be introduced in all banks as guidebook with detailed procedures of budgeting system. That will enable all the related staffs to follow a uniform pattern of budget in a systematic order.

Budget details:

Budget should be prepared in detailed form for each cost center so that performance of each and every function can be compared and analyzed.

Capital budget:

All capital expenditures should be pre-budgeted. Release of funds on ‘as and when required’ basis should be avoided. That will ensure timely and cost effective completion of capital project.

Recording budget estimates:

All budget estimates should be recorded in the accounting system once the targets are fixed. That facilitates comparison and performance measurement.

Classified loans provision:

Loans should be duly classified once it is considered doubtful of recovery. Full provision for classified loans should be made in keeping with the provisions of the Bangladesh Bank instructions and guidelines.

Pre-approval review:

Draft budget should be reviewed before it is forwarded for final approval. That gives an opportunity to adjust forecasts through coordinated efforts. Human errors can also be detected through this review.

Board’s approval:

Budget should be duly approved by the Board of Director pursuant to Central Bank’s guidelines. Further, it brings awareness and importance of budget among the employees.

Disciplinary action:

There should be provisions for disciplinary actions in case of failure to implement and adopt budget on time. Otherwise, the importance of budget fades out.

Corrective measures for variance:

Steps and action should be taken in right time to fix up abnormal budget variations. Otherwise, the entire efforts of budget will turn in vain.

7.7 Conclusion:

A brief review of the total report was done in this chapter. Emphasis was given on review of the major objectives parallel with related findings. This study could clearly identify the areas where the PCBs are successful as far as budget is concerned. Also the deficiencies for proper budgetary practices are clearly pointed out. Directions for further research, particularly in the lacking areas, are clearly indicated in this report. The outcome of this research study, both positive and negative, fairly commends worth of it.

Appendix:1:

Questionnaire on: "Budgetary Practices in the Private Sector Bank of Bangladesh"

Name of the Bank : ___________________________________
Address of the Bank : ___________________________________

➔Please note that this closed-end questionnaire has total SEVEN sections and you are kindly requested to fill-up all these sections accordingly. The seven sections are as follows :

1. Budget : Use of budget
2. Preparation of budget
3. Budget responsibility
4. Planning for deposits and investments
5. Implementation of budget
6. Evaluation and performance measurement
7. Monitoring and feedback

➔ **Please put a tick (√) mark around the correct answer:**

A. Budget : Use of budget: ***N/A = Not Applicable***

Questions	Yes	No	N/A	Comments
1. Do you follow budgetary system in your organization?				
2. Do you focus on revenue budget?				
3. Do you focus on capital budget?				
4. Is the budget being focused on fixed target basis?				
5. Is the budget being focused on flexible target basis?				
6. Do you follow the concept of ‘Zero based’ budget?				
7. Do you have any budget manual?				
8. Do you supplement budget manual by circulars, memos and other instructions regularly?				
9. Does the manual clearly define the procedures to be followed in preparation of budget?				
10. Does the manual clearly define instructions as to responsibilities of different level of employees?				
11. Does the manual contain prescribed forms and records relating to the presentation and use of budget?				

Questions	Yes	No	N/A	Comments
12. Is there a separate department responsible for preparation of budget? If your answer is 'yes', please write the name of the department in the comments column.				
13. Is there a separate budget committee in your organization?				
14. Is there any system of 'pre-approval' review of the budget?				
15. Is the budget being approved by the Executive Committee and the Board of Director?				

B. Preparation of Budget:

Questions	Yes	No	N/A	Comments
1.Do you consider the following factors in preparation of budget:				
• Historical information or actual of previous budgets				
• Any standard rules or procedures prescribed by the central bank				
• The trends of financial sector as a whole				
• Government Fiscal policy				
• Government Monetary policy				
• Capital Adequacy Ratio				
• Future profitability				
• Trend of seasonal variations and exchange rates risk factor				
• Government Development and financial policies while setting budget standard				
• Return on Investment				
2. Do you prepare budget on:				
• Summary basis				
• Comprehensive				
• Both				
3.Do you prepare budget on:				
• Branch / unit basis				
• Zonal/ regional basis				
• Corporate basis				
• All combined				
4.Do you prepare budget on:				
• Short- term basis				
• Long term basis				
• Both				
5.Do you prepare budget based on:				
• Data / information supplied by the management				
• Data/ information from operational unit/ zone				
• Both combined				

C. Budget Responsibility:

Questions	Yes	No	N/A	Comments
1.In terms of budget responsibility, do you follow and practice :				
• Participatory budget				
• Imposed budget				
2.Budget responsibilities established in:				
• Branch/unit level				
• Corporate level				
• Both				
3. Are responsibilities reviewed on a periodic basis?				
4. Are the budget responsibilities established and delegated officially?				
5. Are the budget responsibilities are segregated for preparation and adoption?				

D. Planning for deposits and investments:

Questions	Yes	No	N/A	Comments
1.Budget includes target for deposit on:				
• Branch basis				
• Zonal basis				
• Corporate basis				
2.Budget includes target for investment or credit facilities on:				
• Branch basis				
• Zonal basis				
• Corporate basis				
3. Does the budget include a target for loan recoveries?				
4. Does the budget include a provision for classified loans?				
5. Does the budget include a target of loan recovery from loan defaulters?				

E. Implementation of budget:

Questions	Yes	No	N/A	Comments
1.Implementation of revenue budget usually takes place at:				
• Branch/unit level				
• Regional level				
• Corporate level				
2.Implementation of capital budgets usually takes place at :				
• Branch level				
• Regional level				
• Corporate level				
3. Is the budget implementation a time bound activity?				
4. Do you have any punitive action in force in case of failure of implementing the budget?				
5. Does the authority responsible for budget adoption officially circularize the same to all concern?				

F. Evaluation and Performance Measurement:

Questions	Yes	No	N/A	Comments
1. Do you use budget as a tool of performance measurement?				
2. Do you compare the actual with the budget?				
• On a monthly basis				
• On a quarterly basis				
• On a half yearly basis?				
• On a yearly basis?				
3. Do you have any plan for incentives correlated with budget?				
4. Performance measured:				
• At branch level				
• At zonal basis				
• At corporate level				
5. Do you use any prescribed forms for performance report?				

G. Monitoring and Feedback:

Questions	Yes	No	N/A	Comments
1. Do you include budget estimates in the accounting system for later comparison with actual?				
2. Are the actual results compared with budgets and reported with reasonable frequency on a timely basis?				
3. Is there any provision for reviewing the budgets- if needed?				
4. Do you prepare a budget variance statement at the end of the period?				
5. Is there any provision for corrective measures based on variance analysis?				

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Appendix:2:

List of sample banks:

1. Arab Bangla Bank Limited (AB bank limited)
2. Al-Arafah Islami Bank Limited
3. Bank Asia Limited
4. BRAC Bank Limited
5. Dhaka Bank Limited
6. Dutch-Bangla Bank Limited
7. Eastern Bank Limited
8. EXIM Bank Limited
9. ICB Islamic Bank Ltd.
10. IFIC Bank Limited
11. Islami Bank Bangladesh Ltd
12. Jamuna Bank Ltd
13. Mutual Trust Bank Limited
14. Mercantile Bank Limited
15. National Bank Limited
16. National Credit & Commerce Bank Ltd
17. One Bank Limited
18. Premier Bank Limited
19. Prime Bank Ltd
20. Pubali Bank Limited
21. Shahjalal Bank Limited
22. Social Islami Bank Ltd.
23. Southeast Bank Limited
24. Standard Bank Limited
25. The City Bank Ltd.
26. Trust Bank Limited

27. United Commercial Bank Limited

28. Uttara Bank Limited

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