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The Effect of Budget Padding on the Financial Performance of Management University of Africa

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A B S T R A C T

This research explored the influence of budget padding on the financial performance of the Management University of Africa, a private university in Kenya. The primary objective was to determine the presence and impact of budgetary slack in the university's budget. The study was based on goal-setting theory and supported by agency theory. A descriptive research design was employed to assess the relationship between budget padding and the university's financial performance. The researcher conducted a census of the target population and performed a pilot test to verify the validity and reliability of the questionnaire before collecting primary data. The primary data were analyzed using the Statistical Package for Social Sciences (SPSS), with the results presented in tables and figures. The study's findings revealed that reducing or eliminating budget padding significantly improved the financial performance of the Management University of Africa. To enhance financial performance further, the study suggests involving budget participants in reviewing departmental budgets to prevent any manipulation of the consolidated budget estimates.

Keywords: Budget, participatory budgeting, budget committee, budgetary slack, budget padding, financial performance

1. Introduction

1.1 Background of the Study

There cannot be budget padding without a budget. According to Weygandt et al. (2016), a budget is a formal written declaration of management's plans for a specific future time frame, represented in financial terms. It serves as a quantitative document that outlines expected expenses, cash inflows, assets, and liabilities over a defined period (CPA Australia, 2012). Shim et al. (2012) characterize a budget as a formal representation of management's plans, objectives, and goals that encompasses all operational aspects for a specified time. The Institute of Chartered Accountants in Malawi (2014) explains that a budget translates these plans into monetary terms, detailing both the funds needed for expenditures and the income required to cover these costs. In essence, budgeting is about developing a long-term strategy for the upcoming year (Drury, 2018).Budgets offer significant advantages to organizations. They compel management to articulate future goals in numerical terms, provide benchmarks for evaluating performance, and allow for some delegation of power and responsibility without undermining the management’s need for control information. Through budgeting, organizations can meticulously manage revenues, expenses, cash flow, and capital expenditures, fostering a culture of cost awareness and optimizing returns on investment. The budgeting process comprises six key steps: setting budgetary goals, assessing financial resources, preparing budget estimates, reviewing these estimates, approving the budget, and distributing the sanctioned budget. Departmental estimates are examined to ensure their feasibility before being consolidated into a master budget (Gibson, 2009). The budget committee should scrutinize projections from each department, offer recommendations, adjust the budgeted figures as needed, and decide on budget approval, balancing the interests of budget users and preparers.Budget padding, as defined by Shim et al. (2012), refers to the practice of “underestimating revenue or overestimating costs.” Managers may engage in various "budget games," including budget padding, which can create financial cushions or slush funds (Gibson, 2009). Budgetary slack represents the disparity between forecasted and actual revenues or costs (Weygandt et al., 2016). Participatory budgeting can inadvertently foster such slack. Sheng (2019) posits that budget padding diverges from actual budgetary plans. Managers might include slack in their budget estimates to avoid appearing overspending while essentially not being accountable for overspending in control reports (Institute of Chartered Accountants in Malawi, 2014). Budget padding can lead to excess expenditures, which zero-based budgeting seeks to eliminate. Managers may inflate budgets to exhaust their allocations, fearing reduced allowances in future periods, complicating their ability to meet tighter budgets later. Allowing slack and inefficiency in budgets means that merely meeting targets can indicate that expenditures fall within acceptable limits for wasteful spending. Participants in the budgeting process often have various incentives to inflate their budgets. Aguguom and Ehiogu (2016) note that padding can be useful for unexpected expenses. Managers may inflate costs and lower income estimates to appease superiors (Shim et al., 2012). Weygandt et al. (2016) highlight that budget padding simplifies achieving financial targets. Budget padding tends to occur when there is limited time for budget preparation by participants and review by the budgeting committee. It can also happen if the committee lacks training to identify budget manipulation. To mitigate budgetary slack, senior managers must rigorously evaluate and challenge the budget forecasts submitted by their subordinates (Gibson, 2009). Engaging those who will implement the budget in its creation can enhance performance. Clear communication of the budget's purpose, along with specific goals and performance standards, is crucial. Budget goals should not be set excessively high or low, as unrealistic comparisons with actual outcomes can demotivate individuals. Budget proposals should be closely examined against historical spending trends, and any outlier figures should be scrutinized. Senior managers should avoid situations where there is insufficient time to review submitted budget estimates. The phenomenon of budget padding is not new. Schiff and Lewin (1970) provided an early account of how managers introduce slack into their budgets by understating revenues and overstating costs. It is evident that slack exists and that managers are motivated to function within such a framework. In Africa, Nigeria stands out as a significant example of this issue. Omeje and Ogbu (2019) noted that budget padding was already prevalent before 2016, gaining notoriety due to scandalous allegations among members of the Nigerian House of Representatives. Aguguom and Ehiogu (2016) argue that this practice has been ingrained in Nigeria's budgeting processes for years, representing a clear case of official corruption. Concerns have been raised regarding the impact of budget padding on Nigeria's economic development, as padded budgets lead to misallocation of resources, redirect funding away from viable projects to irrelevant initiatives, and sometimes result in the outright theft of allocated funds (Umoh et al., 2023). Such budgetary practices contribute to poverty, inequality, unemployment, destitution, diseases, illiteracy, and poor living conditions for the citizens of Nigeria (Oloto et al., 2019).

1.2 Statement of the Problem

The phenomenon of budget padding, characterized by the intentional overestimation of expenses or underestimation of revenues, remains a pervasive issue within participatory budgeting (PB) framework. Although PB has gained traction globally since its inception in Porto Alegre, Brazil, in 1989 (Melgar, 2014; Bartocci et al., 2019), challenges such as accountability and transparency continue to hinder its effectiveness, particularly in developing nations (UN-Habitat, 2008). While some studies indicate a positive correlation between PB and financial performance, including improvements in governance and quality of life (Buele et al., 2020; Wagner et al., 2021; Wangari & Muturi, 2017; Nyongesa et al., 2016), others highlight the inadequacies of PB processes, including their tendency to foster budgetary slack and insufficient participation (Fachrizal et al., 2017; Lerner & Secondo, 2020; Knutson, 2016).

In the context of universities, limited empirical research has been conducted to assess the prevalence and implications of budget padding within PB framework (Tang et al., 2022). This lack of research is particularly concerning given the significant role that budgeting plays in the operational success of educational institutions (Iyoha, 2021). Moreover, the discrepancy between the ideal participatory nature of budgeting and the actual practices observed in many organizations suggests a pressing need for further investigation into how budget padding undermines financial control and accountability. Consequently, understanding the dynamics of budget padding within the PB framework in higher education is crucial for improving budgeting practices and enhancing financial performance, addressing the existing knowledge gap in this area.

1.3 Objective of the Study

To establish the effect of budget padding on the financial performance of Management University of Africa.

1.4 Significance of the Study

Investigating the involvement of budget participants in the budgeting process will enhance financial theories related to resource allocation and budgeting methods. Additionally, the findings of the study will impact the supervisory responsibilities of the Commission for University Education (CUE) as a regulatory body for both public and private universities in Kenya. The regulator will ensure that all budgets approved by University Governing Councils (UGC), as stipulated in the Kenyan Universities Act of 2012, undergo participatory budgeting processes in all institutions across the country. Furthermore, the study's recommendations will promote Management University of Africa's (MUA) engagement in its budgeting process, enabling it to benefit from decreased budget padding through the responsible participation of its staff in budgeting activities.

2. Literature Review

2.1 Theoretical Literature Review

2.1.1 Goal Setting Theory

The concept of goal-setting theory was introduced by Edwin A. Locke in 1968 (Locke, 1968). Locke and Latham (2006) identified five principles of goal setting that can enhance productivity: task complexity, clarity, challenge, commitment, and feedback. Gkizani and Galanakis (2022) argue that optimal performance is achieved when goals are specific and challenging, when they allow for performance measurement and are associated with feedback on outcomes, and when they foster commitment and acceptance. According to Ngumi and Njogo (2017), an organization that has established goals or objectives will be driven to work diligently and maintain focus on achieving those aims. A budget can be seen as a predefined plan, and goal-setting theory treats the budget as a target to be accomplished, highlighting its relevance to the study. Thus, goal-setting theory served as the anchor theory for this research.

2.1.2 Agency Theory

Agency theory was formulated by Stephen Ross and Barry Mitnick in 1973 and 1975, respectively (Mitnick, 2019). This theory revolves around the concept of authoritative relationships between two parties with differing goals: principals and agents (Keng'ara & Makina, 2020). When budgeting systems are effectively designed, principals can encourage agents to focus on activities that serve the principal's interests and share valuable insights about local conditions with them (Covaleski et al., 2006). In the context of participatory budgeting (PB), agents enhance the principals' understanding of departmental conditions, reduce information asymmetry, and ultimately improve principals' satisfaction with the budgeting outcomes (Wagner et al., 2021). At the Management University of Africa (MUA), budgeting is the responsibility of the University Governing Council (UGC), the principal, who delegates this task to the University Management Board (UMB), the agents, highlighting the relevance of this theory to the study.

2.2 Empirical Literature Review

2.2.1 Budget Padding and Financial Performance

Omeje and Ogbu (2019) and Aguguom and Ehiogu (2016) separately researched the economic impact of budget padding in the economy of Nigeria. Their research showed that budget padding had been a long-standing practice in Nigerian finance and budgeting, but that it reached a worrying new level in 2016, when the budget was illegally padded by N100 billion, according to information from articles they reviewed, bringing the total to N6.06 trillion. The studies were conducted to assess how Nigeria's economy was affected by higher project estimates. The studies used the content analytical method and secondary data to gather information.

These studies' findings revealed that an increase in project estimates had a negative impact on the Nigerian economy, that budget padding had socioeconomic and political implications, and that budget padding had moral consequences for the Nigerian economy. The studies focused on the effect of budget padding on a public institution and this study examined the said effect on financial performance of the Management University of Africa.

2.2.2 Conceptual Framework

According to Mugenda and Mugenda (2003), a conceptual model serves to provide the reader with a clear and immediate understanding of the proposed relationships. This research aimed to investigate the impact of budget padding on the financial performance of the Management University of Africa. Below, Figure 1 illustrates the independent and dependent variables involved in the study.

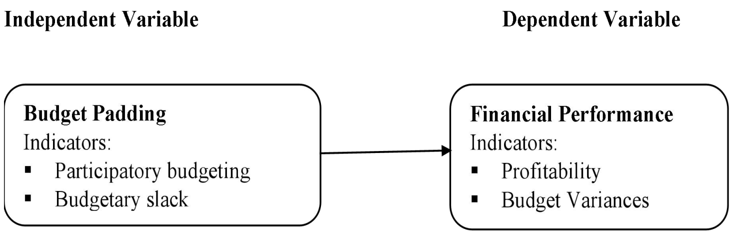

Figure 1 Conceptual Framework

3. Research Methodology

3.1 Research Design

The researcher utilized a descriptive research design for this study. According to Saunders et al. (2015), descriptive research aims to create an accurate depiction of individuals, events, or situations. Sekaran and Bougie (2016) noted that this type of research is used when a researcher seeks to describe populations, events, or situations and is interested in the relationships among various factors. Cooper and Schindler (2014) explained that a descriptive study aims to characterize a subject by developing a profile of a group of problems, individuals, or events through data collection and frequency tabulation of research variables or their interactions. This approach typically addresses questions related to who or what. In this study, the researcher aimed to assess the impact of participatory budgeting on the financial performance of the Management University of Africa. The interest in identifying who participated in the budgeting process and the extent of their participation further supported the choice of this research design.

3.2 Target Population

Cooper and Schindler (2014) state that the target population consists of individuals, events, or records that hold the relevant information necessary for the research, which helps determine whether a sample or a census should be utilized. Similarly, Mugenda and Mugenda (2003) describe a population as the complete set of individuals, events, or objects that share a common observable characteristic. In this study, the population consisted of 80 staff members from various departments at the Management University of Africa, as outlined in Table 1.

Table 1 Target Population

Employees	Total	Percentage
Top-Level Management	11	14%
Middle-Level Management	13	16%
Lower-Level Management	56	70%
Total	**80**	**100**

Source: Research Findings (2023)

3.3 Sample and Sampling Technique

After identifying the target population, the researcher decides whether to sample the population or conduct a census (Cooper & Schindler, 2014). A census is suitable when it is feasible for the researcher to survey the entire population and when there is ample time available for such an undertaking (Saunders et al., 2015). Conducting a census requires the researcher to examine or count every member of the target population. Since it was feasible to gather data from all respondents at the Management University of Africa, the researcher opted to conduct a census.

3.4 Data Collection Instrument

Data collection tools are defined as the instruments used to gather information needed to validate or support facts (Mugenda & Mugenda, 2003). For this research, the data was collected through a structured questionnaire. Given the geographical spread of the respondents, an electronic questionnaire was selected for its convenience and cost-effectiveness (Sekaran & Bougie, 2016). However, a potential drawback of this method is its generally low response rates, along with the uncertainty regarding the objectivity of the data, as those who did not respond may hold different opinions compared to those who did.

3.5 Pilot Study

The pilot test aims to enhance the questionnaire to ensure that respondents can answer the questions easily and that data can be recorded without issues (Saunders et al., 2015). Before collecting data, a pilot test was conducted to evaluate both the reliability and validity of the questionnaire. Five percent of the 80 respondents participated in this pilot test. Based on the results, modifications were made to the data collection tool to strengthen its reliability and validity. Participants in the pilot study were excluded from the final research findings.

3.6 Data Analysis and Presentation

Mugenda and Mugenda (2003) indicate that raw data gathered from the field can be difficult to interpret and requires a series of steps before analysis, including cleaning, processing, and entering it into a computer. The analysis of the collected data was performed using SPSS software. The data was presented descriptively based on the information provided by the respondents in the questionnaire. Both descriptive and inferential results were used to illustrate the relationships between the variables under investigation.

The multiple regression model used in the study was as follows:

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

Where:

Y = dependent variable (financial performance)

β_0 = a constant

β_1 = changes induced in Y by X_1

X_1 = independent variable (budget padding)

ε = error term

4. Research Findings and Discussion

4.1 Validity and Reliability Test Results

The validity of the questionnaire was verified by accounting professionals. Experts at the Management University of Africa, who are Certified Public Accountants of Kenya (CPAK), helped ensure that the questionnaire included a comprehensive and representative set of questions that accurately reflected the study's content. After considering all suggested modifications, the research instrument was revised accordingly. As indicated in Table 2, Cronbach's coefficient (α) confirmed the reliability of the questionnaire for data collection, as stated by Sekaran and Bougie (2016).

Table 2 Reliability Test Results

Variable	Variable Type	No of Items	Cronbach's Alpha (α)	Interpretation
Budget Padding	Independent	7	0.798	Reliable
Financial Performance	Dependent	7	0.959	Reliable

Source: Research Findings (2023)

4.2 Descriptive Statistics

Descriptive statistics, including frequencies, means, and standard deviations, offer information that characterizes a dataset (Sekaran & Bougie, 2016). According to Saunders et al. (2015), descriptive statistics allow for numerical description and comparison of variables. Table 3 displays the descriptive statistics obtained from the study.

Table 3 Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Financial Performance	66	1	5	3.47	1.00
Budget Padding	66	1	5	3.63	0.72

Source: Research Findings (2023)

From Table 3 above, the mean is greater than 3 meaning that respondents believed that the financial performance of the Management University of Africa was affected by budget padding.

4.3 Correlation Statistics

According to Saunders et al. (2015), Pearson's correlation coefficient (r) is described as "a statistical test that evaluates the strength of the relationship between two numerical data variables." A coefficient greater than 0 (+1) indicates a positive relationship, while a coefficient less than 0 (-1) indicates a negative relationship. A perfect positive correlation is represented by a value of 1, meaning that as one variable increases, the other variable also increases, and conversely, a negative correlation suggests that as one variable increases, the other decreases. Table 4 below displays the correlation statistics from the study.

Table 4 Correlation Analysis

		Financial Performance	Budget Padding
Financial Performance	Pearson Correlation	1	.674**
	Sig. (2-tailed)		.000
	N		66
Budget Padding	Pearson Correlation		1
	Sig. (2-tailed)		
	N		

Source: Research Findings (2023)

Correlation analysis results for financial performance and budget padding in Management University of Africa were $r = 0.674$ and $p < 0.01$. This result implied a significant strong and positive connection between reduced budget padding and the financial performance. MUA's staff believed that, though there was a need to set an achievable budget, an overstated budget was unwelcome. Knowing the negative impact of budget padding, they resoundingly agreed that the participatory budgeting process approach had reduced the chances of budget padding. The negative impact of budget padding was corroborated by Omeje and Ogbu (2019) and Aguguom and Ehiogu (2016) who separately researched the national economic effect of budget padding in Nigeria. The findings in their studies revealed that an increase in budget padding (increased project estimates) had worsened the Nigerian economy. This implied that the said economy would improve if budget padding was significantly reduced or eliminated.

4.4 Regression Statistics

Multiple regression is an analytical method used to evaluate the relationship between the dependent variable and one or more independent variables in research (Sekaran & Bougie, 2016). Each coefficient within the regression model indicates how much the predicted variable is expected to change for a one-unit increase in a predictor variable, while keeping the other predictors constant. Regression statistics from the study are presented in Tables 6, 7, and 8.

Table 6 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.674[a]	0.454	0.446	0.7421	0.454	53.291	1	64	.000

a Predictors: (Constant), Budget Padding

Source: Research Findings (2023)

The research intended to determine the correlation between budget padding and financial performance. In the model summary table (Table 6), there was a direct association between budget padding and financial performance given an R-value of 0.674. According to the coefficient of determination of 0.454, a unit change in budget padding was responsible for a 45.4% variation in financial performance. Other regressors missing in the regression model accounted for the remaining 54.6% variation in the regressand.

Table 7 ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	29.348	1	29.348	53.291	.000[b]
	Residual	35.246	64	0.551		
	Total	64.594	65			

Note 1 [a] Dependent Variable: Financial Performance

[b] Predictors: (Constant), Budget Padding

Source: Research Findings (2023)

From Table 7, the probability value associated with the F-value of 53.291 was below the level of significance ($p < 0.05$). The regression model, therefore, was statistically significant for predicting the change in the financial performance of the Management University of Africa.

Table 8 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.060	0.476		0.126	0.900
	Budget Padding	0.939	0.129	0.674	7.300	0.000

Note [a] Dependent Variable: Financial Performance

Source: Research Findings (2023)

Table 8 shows that the constant was insignificant in the regression model with a t-statistic of 0.126 ($t < 1.997$) and a probability of 0.900 ($p > 0.05$). This meant that the financial performance was not affected where the value of the independent variable was zero. Budget padding had a t-statistic of 7.300 ($t > 1.997$) and a probability of 0.000 ($p < 0.05$) hence the variable was statistically significant. This finding indicated that financial performance was affected by staff participation in budget padding in Management University of Africa. This finding indicated that a one-unit increase in reduced budget padding increased 0.939 units of performance of the Management University of Africa. The finding confirmed Omeje and Ogbu's (2019) and Aguguom and Ehiogu's (2016) conclusions that budget padding had a negative impact on the Nigerian economy. Their studies implied that little or no budget padding would directly improve Nigerian economic performance.

The regression coefficients in Table 8 presented an overall regression model as follows:

$$\mathrm{Y} = 0.060 + 0.939\mathrm{X}_1 + \varepsilon$$

Where:

Y = Financial performance

X_1 = Budget padding

ε = Error term

5. Summary, Conclusion and Recommendations

5.1 Summary of Findings

The study examined the impact of budget padding on the financial performance of Management University of Africa. 83% of respondents stated that the setting of an achievable budget reduced the vice of budget padding and thus better financial performance was expected. This meant that the lesser the budget padding, the higher the financial performance. Unbelievably, 30% of respondents believed in a padded budget. Correlation results yielded a coefficient of 0.674 with a level of significance of less than 0.05. There was, therefore, a strong positive connection between financial performance and reduced budget padding in Management University of Africa. Knowing the negative impact of budget padding, most of the respondents felt that PB had reduced the chances of budget padding. The negative impact of budget padding was corroborated by Omeje and Ogbu (2019) and Aguguom and Ehiogu (2016) who concluded that increased budget estimates had a negative national economic impact in Nigeria.

The research demonstrated a significant improvement in financial performance from reduced budget padding in Management University of Africa. The finding indicated that a unit increase in reduction of budget padding increased 0.939 units of the economic well-being of Management University of Africa. This finding confirmed Omeje and Ogbu's (2019) and Aguguom and Ehiogu's (2016) conclusions that an increase in budget padding worsened Nigerian economic performance.

5.2 Conclusion

The study indicated that a reduction in budget padding was strongly, positively and significantly correlated with financial performance of Management University of Africa. A reduction in budget padding would increase performance. This implied that more avoidance of budget padding resulted in an improvement in the economic well-being of Management University of Africa. This is because budget padding leads to overspending, and limiting it results in the use of funds in other productive budget operations, increasing financial performance.

5.3 Recommendations

The study recommends Management University of Africa (MUA) to establish and communicate clear ethical standards that forbid budget padding. The University should encourage an open and honest culture when it comes to financial reporting. To find and remove any instances of budget padding, MUA should employ extensive review procedures during the budget development process. The University should also verify the accuracy and justification of every budget entry. It should set up channels for its staff to report anonymously suspected instances of budget padding without worrying about repercussions.

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