

8. BUDGETARY CONTROL

1. DEFINE THE TERM BUDGET.

Definition: Budget is 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 employment of capital.

Features:

1. Financial and/or Quantitative Statement.
2. Futuristic - prepared and approved prior to a defined period of time.
3. Goal Oriented - for the purpose of attaining a given objective.
4. Components - Income, Expenditure and Employment of Capital.

2. WHAT ARE THE OBJECTIVES OF BUDGETING/PERFORMANCE BUDGETING?

The objectives of Budgeting are-

1. To encourage self-study in all aspects of a Company's operations.
2. To get all members of management to "put their heads" to the basic question of how the business should be run, to make them of a co-ordinated team operating in unison towards clearly defined objectives.
3. To promote the planning process and provide a sense of direction to every member of the organization.
4. To force a definition and crystallization of Company policies and aims.
5. To increase the effectiveness with which people and capital are employed.
6. To disclose areas of potential improvement in the Company's operations.
7. To stimulate study of relationship of the Company to its external economic environment for improving the effectiveness of its direction.
8. To direct and co-ordinate business activities and units to achieve stated targets of performance.
9. To facilitate the control process, by comparing actual results with plan, and provide feedback to the employees about their performance.

3. DEFINE THE TERM BUDGETARY CONTROL. WHAT ARE ITS SALIENT FEATURES?

1. **Definition:** Budgetary Control is defined as "the establishment of budgets, relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results either to secure by individual action the objective of that policy or to provide a base for its revision.

2. **Salient features:**

- a. **Objectives:** Determining the objectives to be achieved, over the budget period, and the policy (ies) that might be adopted for the achievement of these ends.
- b. **Activities:** Determining the variety of activities that should be undertaken for achievement of the objectives.
- c. **Plans:** Drawing up a plan or a scheme of operation in respect of each class of activity, in physical as well as monetary terms for the full budget period and its parts.
- d. **Performance Evaluation:** Laying out a system of comparison of actual performance by each person section or department with the relevant budget and determination of causes for the discrepancies, if any.
- e. **Control Action:** Ensuring that when the plans are not achieved, corrective action are taken; and when corrective actions are not possible, ensuring that the plans are revised and objective achieved

4. WHAT ARE THE OBJECTIVES OF BUDGETARY CONTROL SYSTEM?

The objectives of a Budgetary Control System are -

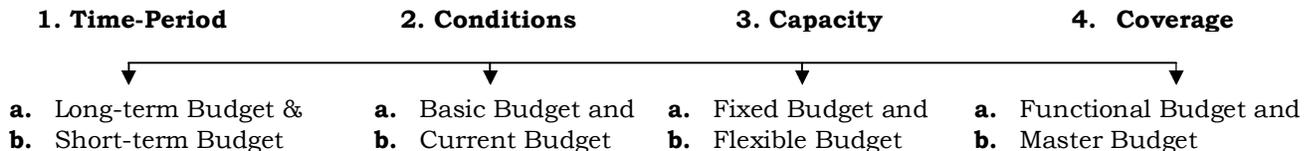
1. **Definition of Goals:** Portraying with precision, the overall aims of the business and determining targets of performance for each section or department of the business.
2. **Defining Responsibilities:** Laying down the responsibilities of each individual so that everyone knows what is expected of him and how he will be judged.
3. **Basis for Performance Evaluation:** Providing basis for the comparison of actual performance with the predetermined targets and investigation of deviation, if any, of actual performance and expenses from the budgeted figures. It helps to take timely corrective measures.
4. **Optimum use of Resources:** Ensuring the best use of all available resources to maximize profit or production, subject to the limiting factors.
5. **Co-ordination:** Coordinating the various activities of the business and centralizing control, but also making a facility for the Management to decentralize responsibility and delegate authority.
6. **Planned action:** Engendering a spirit of careful forethought, assessment of what is possible and an attempt at it. It leads to dynamism without recklessness. It also helps to draw up long range plans with a fair measure of accuracy.
7. **Basis for policy:** Providing a basis for revision of current and future policies.

5. WHAT ARE THE DISADVANTAGES/LIMITATIONS OF THE BUDGETARY CONTROL SYSTEM?

1. **Estimates:** Budgets may or may not be true, as they are based on estimates. The assumptions about future events may or may not actually happen.
2. **Rigidity:** Budgets are considered as rigid document. Too much emphasis on budgets may affect day-today operations and ignores the dynamic state of organizational functioning.
3. **False Sense of Security:** Mere budgeting cannot lead to profitability. Budgets cannot be executed automatically. It may create a false sense of security that everything has been taken care of in the budgets.
4. **Lack of co-ordination:** Staff co-operation is usually not available during Budgetary Control exercise.
5. **Time and Cost:** The introduction and implementation of the system may be expensive.

**6. WHAT ARE THE DIFFERENT TYPES OF BUDGETS?
DISTINGUISH BETWEEN FIXED AND FLEXIBLE BUDGETS.**

Budgets may be classified on the following bases –



1. BASED ON TIME PERIOD:

Long Term Budget	Short Term Budget
a. Budgets which are prepared for periods longer than a year are called Long-Term Budgets. b. Such Budgets are helpful in business forecasting and forward planning. c. Examples: Capital Expenditure Budget and R&D Budget.	a. Budgets which are prepared for periods less than a year are known as Short-Term Budgets. b. Such Budgets are prepared in cases where a specific action has to be immediately taken to bring any variation under control. c. Example: Cash Budget.

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2. BASED ON CONDITION:

Basic Budget	Current Budget
A Budget, which remains unaltered over a long period of time, is called Basic Budget.	A Budget, which is established for use over a short period of time and is related to the current conditions, is called Current Budget.

3. BASED ON CAPACITY:

Particulars	Fixed Budget	Flexible Budget
a. Definition	It is a Budget designed to remain unchanged irrespective of the level of activity actually attained.	It is a Budget, which by recognizing the difference between fixed, semi-variable and variable costs is designed to change in relation to level of activity attained.
b. Rigidity	It does not change with actual volume of activity achieved. Thus it is known as a Rigid or Inflexible budget.	It can be re-casted on the basis of activity level to be achieved. Thus it is not rigid.
c. Level of Activity	It operates on one level of activity and under one set of conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.	It consists of various budgets for different levels of activity
d. Effect of variance analysis	Variance Analysis does not give useful information as all Costs (fixed, variable and semi-variable) are related to only one level of activity.	Variance Analysis provides useful information as each cost is analysed according to its behaviour.
e. Use for Decision making	If the budgeted and actual activity levels differ significantly, then aspects like cost ascertainment and price fixation do not give a correct picture.	If facilitates the ascertainment of cost, fixation of selling price and submission of quotations.
f. Performance Evaluation	Comparison of actual performance with budgeted targets will be meaningless, especially when there is a difference between two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgeted targets.

4. BASED ON COVERAGE:

Functional Budget	Master Budget
Budgets, which relate to the individual functions in an organization, are known as Functional Budgets, e.g. purchase Budget, Sales Budget, Production Budget, plant-Utilization Budget and Cash Budget.	It is a consolidated summary of the various functional budgets. It serves as the basis upon which budgeted Profit & Loss Account and forecasted Balance Sheet are built up.

7. WHAT ARE THE ADVANTAGES OF THE BUDGETARY CONTROL SYSTEM?

1. The use of budgetary control system enables the management of a business concern to conduct its business activities in the efficient manner.
2. It is a powerful instrument used by business houses for the control of their expenditure. It infact provides a yardstick for measuring and evaluating the performance of individuals and their departments.
3. It reveals the deviations to management, from the budgeted figures after making a comparison with actual figures.

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4. Effective utilization of various resources like-men, material, machinery and money is made possible, as the production is planned after taking them into account.
5. It helps in the review of current trends and framing of future policies.
6. It creates suitable conditions for the implementation of standard costing system in a business organization.
7. It inculcates the feeling of cost consciousness among workers.

8. Write about different steps in preparation of budgets?

1. **Definition of objectives** – A budget being a plan for the achievement of certain operational objectives, it is desirable that the same are defined precisely. The objectives should be written out; the areas of control demarcated; and items of revenue and expenditure to be covered by the budget stated. This will give a clear understanding of the plan and its scope to all those who must cooperate to make it a success.
2. **Location of the key (or budget) factor** – There is usually one factor (sometimes there may be more than one) which sets a limit to the total activity. For instance, in India today sometimes non-availability of power does not allow production to increase inspite of heavy demand. Similarly, lack of demand may limit production. Such a factor is known as key factor. For proper budgeting, it must be located and estimated properly.
3. **Appointment of controller** – Formulation of a budget usually required whole time services of a senior executive; he must be assisted in this work by a Budget Committee, consisting of all the heads of department along with the Managing Director as the Chairman. The Controller is responsible for co-ordinating and development of budget programmes and preparing the manual of instruction, known as Budget manual. The Budget manual is a schedule, document or booklet which shows, in written forms the budgeting organization and procedures. The manual should be well written and indexed so that a copy thereof may be given to each departmental head for guidance.
4. **Budget Period** – The period covered by a budget is known as budget period. There is no general rule governing the selection of the budget period. In practice the budget committee determines the length of the budget period suitable for the business. Normally, a calendar year or a period coterminous with the financial year is adopted. The budget period is then sub-divided into shorter periods-it may be months or quarters or such periods as coincide with period of trading activity.
5. **Standard of activity or output** – For preparing budgets for the future, past statistics cannot be completely relied upon, for the past usually represents as combination of good and bad factors. Therefore, though results of the past should be studied but these should only be applied when there is a likelihood of similar conditions repeating in the future. Also, while setting the targets for the future, it must be remembered that in a progressive business, the achievement of a year must exceed those of earlier years. Therefore what was good in the past is only fair for the current year.

9. Write about Functional budget?

Functional budget – A functional budget is one which is related to function of the business as for example, production budget relating to the manufacturing function. Functional budgets are prepared for each function and they are subsidiary to the master budget of the business. The various types of functional budgets to be prepared will vary according to the size and nature of the business. The various commonly used functional budgets are:

1. Sales budget
2. Production budget
3. Plant utilization budget
4. Direct-material usage budget
5. Direct-material purchase budget
6. Direct-labour (personnel) budget
7. Factory overhead budget
8. Production cost budget

9. Ending-inventory budget
10. Cost-of-goods-sold budget
11. Selling and distribution cost budget
12. Administration expenses budget
13. Research and development cost budget
14. Capital expenditure budget
15. Cash budget
16. Budget Summaries / master budget – budgeted income statement and Budgeted balance sheet.

10. Write about Flexible budget?

Flexible budget: A flexible budget is defined as “a budget which, by recognizing the difference between fixed, semi-variable and variable costs is designed to change in relation to the level of activity attained”. A fixed budget, on the other hand is a budget which is designed to remain unchanged irrespective of the level of activity actually attained. In a fixed budgetary control, budgets are prepared for one level of activity whereas in a flexible budgetary control system, a series of budgets are prepared one for each of a number of alternative production levels or volumes. Flexible budgets represent the amount of expenses that is reasonably necessary to achieve each level of output specified. In other words, the allowances given under flexible budgetary control system serve as standards of what costs should be at each level of output.

Need: The need for the preparation of the flexible budgets arises in the following circumstances:

1. Seasonal fluctuations in sales and/or production, for example in soft drinks industry;
2. A company which keeps on introducing new products or makes changes in the design of its products frequently;
3. industries engaged in make-to-order business like ship building;
4. an industry which is influenced by changes in fashion; and
5. general changes in sales.

The End