UNIT V

SUBJECT NAME	SUBJECT CODE	SEMESTER	PREPARED BY
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BUDGETING AND BUDGETARY CONTROL

Meaning - A budget is the monetary or/and quantitative expansion of business plans and policies to be pursued in the future period of time. The term budgeting is used for preparing budgets and other procedures for planning, co-ordination and control of business enterprise. According to I.C.W.A., London "A budget is a financial and/or quantitative statement prepared prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objective". In the words of Crown and Howard, "A budget is a pre-determined statement of management policy during a given period which provides a standard for comparison with the results actually achieved."

Characteristics of Good Budgeting

1. A good budgeting system should involve persons at different levels while preparing the budgets. The subordinates should not feel any imposition on them.
2. There should be a proper fixation of authority and responsibility. The delegation of authority should be done in a proper way.
3. The targets of the budgets should be realistic, if the targets are difficult to be achieved then they will not enthuse the persons concerned.
4. A good system of accounting is also essential to make the budgeting successful.
5. The budgeting system should have a whole-hearted support of the top management.
6. The employees should be imparted budgeting education. There should be meetings and discussions and the targets should be explained to the employees concerned.
7. A proper reporting system should be introduced, the actual results should be promptly reported so that performance appraisal is undertaken.

BUDGETARY CONTROL

Budgetary control is the process of determining various budgeted figures for the enterprises for the future period and then comparing the budgeted figures with the actual performance for calculating variances, if any. First of all budgets are prepared and then actual results are recorded. The comparison of budgeted and actual figures will enable the management to find out discrepancies and take remedial measures at a proper time. The budgetary control is a continuous process which helps in planning and coordination. It provides a method of control too. A budget is a means and budgetary control is the end-result.

Budgetary control involves the following :

(a) The objects are set by preparing budgets.

(b) The business is divided into various responsibility centres for preparing various budgets.

(c) The actual figures are recorded.

(d) The budgeted and actual figures are compared for studying the performance of different cost centres.

(e) If actual performance is less than the budgeted norms, a remedial action is taken immediately.

Budget, Budgeting and Budgetary Control

A budget is a blue print of a plan expressed in quantitative terms. Budgeting is technique for formulating budgets. Budgetary control, on the other hand, refers to the principles, procedures and practices of achieving given objectives through budgets. Rowland and William have differentiated the three terms as : "Budgets are the individual objectives of a department, etc. whereas Budgeting may be said to be the act of building budgets. Budgetary control embraces all and in addition includes the science of planning the budgets to effect an overall management tool for the business planning and control". Objectives of Budgetary Control

Budgetary control is essential for policy planning and control. It also acts as an instrument of co-ordination. The main objectives of budgetary control are as follows:

1. To ensure planning for future by setting up various budgets. The requirements and expected performance of the enterprise are anticipated.

2. To co-ordinate the activities of different departments.

3. To operate various cost centres and departments with efficiency and economy.

4. Elimination of wastes and increase in profitability.

5. To anticipate capital expenditures for future. _

6. To centralise the control system.

7. Correction of deviations from the established standards.

8. Fixation of responsibility of various individuals in the organisation.

Requisites for a Successful Budgetary Control System

For making a budgetary control system successful, following requisites are required :

(1) **Clarifying objectives.** The budgets are used to realise objectives of the business. The objectives must be clearly spelt out so that budgets are properly prepared. In the absence of clear goals, the budgets will also be unrealistic.

(2) **Proper Delegation of Authority and Responsibility**. Budget preparation and control is done at every level of management. Even though budgets are finalised at top level but involvement of persons from lower levels of management is essential for their success. This necessitates proper delegation of authority and responsibility.

(3) **Proper Communication System**. An effective system of communication is required for a successful budgetary control. The flow of information regarding budgets should be quick so that these are implemented. The upward communication will help in knowing the difficulties in implementation of budgets. The performance reports of various levels will help top management in budgetary control.

(4) **Budget Education**. The employees should be properly educated about the benefits of budgeting system. They should be educated about their role in the success of this system. Budgetary control may be used as a tool to improve their efficiency.

(5) **Participation of All Employees**. Budgeting is done for every segment of the business. It will also require the active participation and involvement of all employees. In practice the budgets are to be executed at lower levels of management. Those for whom the budgets are framed should be actively associated with their preparation and execution. The employees, on the basis of their past experience, may give more practical and useful suggestions. The success of budgetary control system depends upon the participation of all employees of the organisation.

(6) **Flexibility.** Flexibility in budgets is required to make them suitable under changed circumstances. Budgets are prepared for the future, which is always uncertain. Even though budgets are prepared by considering the future possibilities but still some occurrences later on may necessitate certain adjustments. Flexibility will make the budgets more appropriate and realistic.

(7) **Motivation.** Budgets are to be implemented by human beings. Their successful implementation will depend upon the interest shown by the employees. All persons should be motivated to improve their working so that budgeting is successful. A proper system of motivation should be introduced for making this system a success.

ADVANTAGES OF BUDGETARY CONTROL

The budgetary control system helps in fixing the total for the organisation as a whole and concerted efforts are made for its achievement. It enables economies in the enterprise. Some of the advantages of budgetary control are:

1. The budgetary control aims at the maximisation of profits of the enterprise. To achieve this aim, a proper planning and co-ordination of different, proper control over various capital and revenue expenditures. The resources are put to the best possible use.
2. The working of different departments and sectors is properly coordinated. The budgets of different departments have a bearing on one another. The co-operation of various executives and subordinates is necessary for achieving budgeted targets.
3. The plans, policies and goals are decided by the top management. All efforts are put together to reach the common goal of the organisation. Every department is given a target to be achieved. The efforts are directed towards achieving some specific aims. If there is no definite aim then the efforts will be wasted in pursuing different aims.
4. By providing targets to various departments, budgetary control provides a tool for measuring managerial performance. The budgeted targets are compared to actual results and deviations are determined. The performance of each department is reported to the top management. This system enables the introduction of management by exception.
5. The planning of expenditure will be systematic and there will be an economy in spending. The finances will be put to optimum use. The benefits derived for the concern will ultimately extend to industry and then to national economy. The national resources will be used economically and wastage will be eliminated.
6. The deviations in budgeted and actual performance will enable the determination of weak spots. Efforts are concentrated on those aspects where performance is less than stipulated.
7. The management will be able to take corrective measures whenever there is a discrepancy in performance. The deviations will be regularly reported so that necessary action is taken at the earliest. In the absence of a budgetary control system, the deviations can be determined only at the end of the financial period.
8. It creates budget consciousness among the employees. By fixing targets for the employees, they are made conscious of their responsibility. Everybody knows what he is expected to do and he continues with his work uninterrupted.
9. In the present day competitive world budgetary control has Significant role to play. Every businessman tries to reduce the cost of production for increasing sales. He tries to

have those combinations of products where profitability is more.

10. Budgetary control system also enables the introduction of incentive schemes of remuneration. The comparison of budgeted and actual performance will enable the use of such schemes.

LIMITATIONS OF BUDGETARY CONTROL

Despite the many good points of budgetary control there are some limitations of this system. Some of the limitations are discussed as follows :

(1) **Uncertain Future** - The budgets are prepared for the future period. Despite best estimates made for the future, the predictions may not always come true. The future is always uncertain and the situation which is presumed to prevail in future may change. The change in future conditions upsets the budgets which have to be prepared on the basis of certain assumptions. The ‘future uncertainties reduce the utility of budgetary control system.

(2) **Budgetary Revisions Required** - Budgets are prepared on the assumptions that certain conditions will prevail. Because of future uncertainties, assumed conditions may not prevail necessitating the revision of budgetary targets. The frequent revision of targets will reduce the value of budgets and revisions involve huge expenditures too.

(3) **Discourage Efficient Persons -** Under budgetary control system the targets are given to every person in the organisation. The common tendency of people is to achieve the targets only. There may be some efficient persons who can exceed the targets but they will also feel contented by reaching the targets. So budgets may serve as constraints on managerial initiatives.

(4) **Problem of Co-ordination** - The success of budgetary control system depends upon the co-ordination among different departments. The performance of one department affect the results of other departments. To overcome the problem of coordination a Budgetary officer is needed. Every concern cannot afford to appoint a Budgetary Officer. The lack of co-ordination among different departments results in poor performance.

(5) **Conflict among Different Departments** - Budgetary control may lead to conflicts among functional departments. Every departmental head worries for his departmental goals without thinking of business goals. Every department tries to get maximum allocations of funds and this raises a conflict among different departments.

(6) **Depends upon Support of Top Management -** Budgetary control system depends upon the support of top management. The management should be enthusiastic for the

success of this system and should give full support for it. If at any time there is a lack of support from top management then this system will collapse.

CLASSIFICATION AND TYPES OF BUDGETS

The budgets are usually classified according to their nature. The following are the types of budgets which are commonly used.

(A) Classification according to Time

1. Long-term budgets. 2. Short-term budgets. 3. Current budgets.

(B) Classification on the Basis of Functions

1. Functional or Subsidiary Budget 2. Master Budget.

(C) Classification on the Basis of Flexibility

1. Fixed budget, 2. Flexible budget

(A) Classification According to Time

1. Long Term Budgets. The budgets are prepared to depict long term planning of the business, The period of long term budgets varies between five to ten years, The long term planning is done by the top level Management ; it is not generally known to lower levels of management. These budgets are useful for those industries where gestation period is long i.e. machinery, electricity, engineering, etc.

2. Short-term Budgets. These budgets are generally for one or two years and are in the form of monetary terms. The consumer's goods industries like sugar, cotton, textile, etc. use short-term budgets.

3. Current Budgets. The period of current budgets is generally of months and weeks. These budgets relate to the current activities of the business.

(B) Classification on the Basis of Functions

1. **Functional Budgets**. These budgets relate to different functions, the number of these budgets depends upon the size and nature of the business. The commonly used functional budgets are :

(a) Sales Budget (b) Production budget including (i) Raw material budget (ii) Labour Budget (iii) Plant utilisation Budget (c) Purchase Budget (d) Cash Budget (e) Finance Budget.

2. Master Budget. Various functional budgets are integrated into master budget. This budget is prepared by the ultimate integration of separate functional budgets. Master budget is prepared by the budget officer and it remains with the top level management. This budget is used to co-ordinate the activities of various functional departments and is also helping as a control device.

(C) Classification on the Basis of Flexibility

1. Fixed Budget. The fixed budgets are prepared for a given level of activity; the budget is prepared before the beginning of the financial year. If the financial year starts in January then the budget will be prepared a month or two earlier, i.e., November or December. The changes in expenditure arising out of the anticipated changes will not be adjusted in the budget. There is a difference of about twelve months in the budgeted and actual figures.

2. Flexible Budgets. A flexible budget consists of a series of budgets for different level of activity. It, therefore, varies with the level of activity attained. A flexible budget is prepared after taking into consideration unforeseen changes in the conditions of the business. When the forecasting of demand is uncertain and the undertaking operates under conditions of shortage of materials, labour, etc., then this budget will be more suited.

Difference between a Fixed and Flexible Budget

Basis of Distinction	**Fixed Budget**	**Flexible Budget**
1. Rigidity	A fixed budget remains the same irrespective of changed situations. It remains inflexible even if volume of business is changed.	A flexible budget is recast to suit the changed circumstances . Suitable adjustments are made if the situation so demands.
2. Conditions	A fixed budget assumes that conditions will remain constant.	This budget is. changed if level of activity varies.
3. Cost classification	In fixed budgets costs are not classified according to their nature.	The costs are studied as per their nature, i.e. fixed, variable, semi-variable.
4.Changes in Volume	If the level of activity changes then budgeted and actual results cannot be compared because of change in basis.	The budgets are redrafted as per the changed volume and a comparison between budgeted and actual figures will be possible.

5. Forecasting	Forecasting of accurate results is difficult.	Flexible budgets clearly show the impact of expenses on operations and it helps in making accurate forecasts.
6. Cost Ascertainment	Under changed circumstances costs cannot be ascertained.	The costs can be easily ascertained under different levels of activity. This helps in fixing prices.

Ex 1: The expenses for the production of 5,000 units in a factory are given as follows :

	Per Unit Rs.
Materials	50
Labour	20
Variable Overheads	15
Fixed Overheads (Rs. 50,000)	10
Administrative expenses (5% variable)	10
Selling expenses (20% Fixed)	6
Distribution expenses (10% Fixed)	5
Total cost of sales per unit	116

You are required to prepare a budget for the production of 7,000 units.

Solution:

Particulars	**Output 5,000 Units**		**Output 7,000. Units**	
	Per Unit	**Amount**	**Per Unit**	**Amount**
Materials	50.00	2,50,000	50.00	3,50,000
Labour	20.00	1,00,000	20.00	1,40,000
Prime Cost	**70.00**	**3,50,000**	**70.00**	**4,90,000**
Factory Overheads :				
Variable Overheads	15.00	75,000	15.00	1,05,000
Fixed Overheads	10.00	50,000	7.14	50,000
Works Cost	**95.00**	**4,75,000**	**92.14**	**6,45,000**
Administrative Expenses	10.00	90,000	7.28	51,000
Cost of Production	**105.00**	**5,25,000**	**99.42**	**6,96,000**
Selling & Distribution Expenses:				
Selling Expenses	6.00	30,000	5.66	39,600
Distribution Expenses	5.00	25,000	4.86	34,000
Total Cost of Sales	**116.00**	**5,80,000**	**109.94**	**7,69,000**

Ex 2. The following information at 50% capacity is given. Prepare a flexible budget and forecast the profit or loss at 60%, 70% and 90% capacity.

	Expenses at 50% capacity (Rs.)
Fixed Expenses :	
Salaries	50,000
Rent and Taxes	40,000
Depreciation	60,000
Administrative Expenses	70,000
Variable Expenses :	
Materials	2,00,000
Labour	2,50,000
Others	40,000
Semi-Variable Expenses :	
Repairs	1,00,000
Indirect Labour	1,50,000
Others	90,000

It is estimated that fixed expenses will remain constant at all capacities. Semi-Variable expenses will not change between 45% and 60% capacity, will rise by 10% between 60% and 15% capacity, a further increase of 5% when capacity crosses 75%.

Estimated sales at various levels of capacity are :

Capacity	**Sales (Rs.)**
60%	11,00,000
70%	13,00,000
90%	15,00,000

Solution :

Flexible Budget

(Showing Profit and Loss at various capacities)

Particulars	**Capacities**			
	50% (Rs.)	**60% (Rs.)**	**70% (Rs.)**	**80% (Rs.)**
Fixed Expenses :				
Salaries	50,000	50,000	50,000	50,000
Rent & Taxes	40,000	40,000	40,000	40,000
Depreciation	60,000	60,000	60,000	60,000
Administrative Expenses	70,000	70,000	70,000	70,000
Variable Expenses :				
Materials	2,00,000	2,40,000	2,80,000	3,60,000
Labour	2,50,000	3,00,000	3,50,000	4,50,000
Others	40,000	48,000	56,000	72,000
Semi-Variable Expenses :				
Repairs	1,00,000	1,00,000	1,10,000	1,15,000
Indirect labour	1,50,000	1,50,000	1,65,000	1,72,500
Others	90,000	90,000	99,000	1,03,500
Total Cost	**10,50,000**	**11,48 ,000**	**12,80,000**	**14,93 ,000**

Profit (+) or Loss (-)		**- 48,000**	**+20,000**	**+ 7,000**
Estimated Sales		**11,00,000**	**13,00,000**	**15,00,000**

Ex 3: With the following data for a 60% activity, prepare a budget for production at 80% and 100% capacity:

Production at 60% activity - 600 units
Materials Rs. 100 per unit
Labour Rs. 40 per unit
Direct Expenses Rs. 10 per unit
Factory overheads Rs. 40,000 (40% fixed)
Administration Expenses Rs. 30,000 (60% fixed)

Flexible Production Budget

(In Rs.)

	60% capacities 600 units		**70% capacities 800 units**		**80% capacities 1,000 units**	
	Unit Cost	**Total Cost**	**Unit Cost**	**Total Cost**	**Unit Cost**	**Total Cost**
Materials	100	60,000	100	80,000	100	1,00,000
Labour	40	24,000	40	32,000	40	40,000
Direct expenses	10	6,000	10	8,000	10	10,000
Prime Cost	**150**	**90,000**	**150**	**1,20,000**	**150**	**1,50,000**
Factory overheads:						
Fixed (40% of Rs.40,000)	26.67	16,000	20	16,000	16	16,000
Variable	40	24,000	40	32,000	40	40,000
Works Cost	**216.67**	**1,30,000**	**210**	**1,68,000**	**206**	**2,06,000**
Administrative Expenses:						
Fixed (60% of Rs.30,000)	30	18,000	22.50	18,000	18	18,000
Variable	20	12,000	20	16,000	20	20,000
Total Cost	**266.67**	**1,60,000**	**252.50**	**2,02,000**	**244**	**2,44,000**

Ex 4: Mr. A manufactures two types of toys Raja and Rani and sells them in Agra and Mumbai markets. The following information is made available for the current year:

Market	Types	Budgeted Sales	Actual Sales
Agra	Raja	400 at Rs. 9 each	500 at Rs. 9 each
	Rani	300 atRs.2l each	200 at Rs. 21 each
Mumbai	Raja	600 at Rs. 9 each	700 at Rs. 9 each
	Rani	500 atRs.2leach	400 at Rs. 21 each

Market studies reveal that toy Raja is popular as it is under-priced. It is observed that if its price is increased by Re. 1 it will find a readymade market. On the other hand, Rani is over-priced and market could absorb more sales if its selling price is reduced to Rs. 20. The management has agreed to give effect to the above price changes.

On the above basis, the following estimates have been prepared by Sales Manager :

Product	% increase in sales	Over current budget
	Agra	Mumbai
Raja	+10%	+5%
Rani	+20%	+10%

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With the help of an intensive advertisement campaign, the following 4 additional sales above the estimated sales of sales manager are possible:

Product	Agra	Mumbai
Raja	60 units	70 units
Rani	40 units	50 units

You are required to prepare a budget for sales incorporating the above estimates.

Solution:
Working Notes :

Budgeted Sales for Agra

	Raja Units	Rani Units
Budgeted	400	300
Add : Increase	(10%) 40	(20%) 60
	440	360
Increase due to Advertisement	60	40
	500	400

Budgeted Sales for Mumbai

	Raja Units	Rani Units
Budgeted	600	500
Add : Increase	(5%) 30	(10%) 50
	630	550
Increase due to Advertisement	70	50
	700	600

Solution:
Sales Budget

Area	**Product**	**Budget for the Current year**			**Actual Sales**			**Budget for the future period**		
		Units	**Price (Rs.)**	**Value**	**Units**	**Price (Rs.)**	**Value**	**Units**	**Price (Rs.)**	**Value**
Agra	Raja	400	9	3,600	500	9	4,500	500	10	5,000
	Rani	300	21	6,300	200	21	4,200	400	20	8,000
	Total	700		9,900	700		8,700	900		13,000
Mumbai	Raja	600	9	5,400	700	9	6,300	700	10	7,000
	Rani	500	21	10,500	400	21	8,400	600	20	12,000
	Total	1,100		15,900	1,100		14,700	1,300		19,000
Total	Raja	1000		9,000	1,200		14,800	1,200		12,000
	Rani	800		16,800	600		12,600	1,000		20,000
Total Sales		1,800		25,800	1,800		23,400	2,200		32,000

Ex 5: Prepare a Production Budget for each month and a summarised Production Cost Budget for the six months period ending 31st December, 2018 from the following data of product 'X'.

(i) The units to be sold for different months are as follows : July, 2018 -1,100;August - 1,100 ;September - 1,700; October - 1,900; November - 2,500; December - 2,300;January, 2019- 2,000.

(ii) There will be no work in progress at the end of any month ;

(iii) Finished units equal to half the sales for the next month in Stock at the end of each month (including June, 2018).

(iv) Budgeted production and production cost for the year ending 31st December, 2018 are as follows :

Production (units) 22,000; Direct Materials (per unit) Rs.10; Direct Wages (per unit) Rs.4.
Total Factory Overheads apportioned to products Rs. 88,000.

Solution:

Production Budget
(for the month from July, 2018 to December, 2018)

Month 2018	Opening Stock (units)	Sales (units)	Closing Stock (units)	Production (units)
July	550	1,100	550	1,100
August	550	1,100	850	1,400
September	850	1,700	950	1,800
October	950	1,900	1,250	2,200
November	1,250	2,500	1,150	2,400
December	1,153	2,300	1,000	2,156
			Total	11,050 units

Production = Sales + Closing stock - Opening stock

(iii) Production cost Budget for six months ending 31st Dec. 2018

(Production Units 11,050)

	Rate per unit (Rs.)	Amount (Rs.)
Direct Materials	10.00	1,10,500
Direct Wages	4.00	44,200
Factory Overheads (88,000/22,000)	4.00	44,200
	Total	Rs. 1,98,900

Cash Budget - A cash budget is an estimate of cash receipts and disbursements during a future period of time. It precedes various other budgets like materials budgets and research and development budget. The cash budget is an analysis of flow of cash in a business over a future, short or long period of time. It is a forecast of expected cash intake and outlay. The cash budget should be co-ordinated with other activities of the business. The functional budgets may be adjusted according to the cash budget. The available funds should be fruitfully used and the concern should not suffer for want of funds.

Ex 6. From the following forecasts of income and expenditure, prepare a cash budget for the months January to April, 2016 :

Months	**Sales (Credit) Rs.**	**Purchases (Credit) Rs.**	**Wages Rs.**	**Manufacturing expenses Rs.**	**Administrative expenses Rs.**	**Selling expenses Rs.**
2015 Nov.	30,000	15,000	3,000	1,150	1,060	500
Dec.	35,000	20,000	3,200	1,225	1,040	550
2016 Jan.	25,000	15,000	2,500	990	1,100	600
Feb.	30,000	20,000	3,000	1,050	1,150	620
Mar.	35,000	22,500	2,400	1,100	1,220	370
April	40,000	25,000	2,600	1,200	1,180	710

Additional information is as follows :

1. The customers are allowed a credit period of 2 months.
2. A dividend of Rs. 10,000 is payable in April.
3. Capital expenditure to be incurred : Plant purchased on 15th of January for Rs. 5,000 ; a Building has been purchased on Ist March and the payments are to be made in monthly instalments of Rs. 2,000 each.
4. The creditors are allowing a credit of 2 months.
5. Wages are paid on the Ist of the next month.
6. Lag in payment of other expenses is one-month.
7. Balance of cash in hand on Ist January, 2016 is Rs. 15,000.

Solution :

CASH BUDGET

For the months from January to April 2016

Details	**January Rs.**	**February Rs.**	**March Rs.**	**April Rs.**
Receipts :				
Balance b/d	15,000	18,983	28,795	30,975
Cash realised from Debtors	30,000	35,000	25,000	30,000
Cash available	**45,000**	**53,988**	**53,795**	**60,975**
Payments :				
Payments of Customers(for purchases)	15,000	20,000	15,000	20,000
Wages	3,200	2,500	3,000	2,400
Manufacturing Expenses	1,225	990	1,050	1,100
Administrative Expenses	1,040	1,100	1,150	1,220
Selling Expenses	550	600	620	570
Payment of Dividend				10,000
Purchase of Plant	5,000			
Instalments of Building Loan			2,000	2,000
Total Payments	**26,015**	**25,190**	**22,820**	**37,290**
Closing Balance	**18,985**	**28,795**	**30,975**	**23,685**