# BUDGET AND BUDGETARY CONTROL

**Introduction :** 'No risk no gain' is the slogan of business. The higher the risk, the higher is the profit in order to maintain the profitability and solvency of any business, plan has to be formulated in relation to future financial requirements. This plan is known as budget. Thus budgeting is related to various methods of planning and preparation of budget plans.

## DEFNITIONS:

1. W.J.BATTY:-

   "Budgeting is kinds of future accounting in which the problems of future are met on paper before the transaction actually occur."
2. GEORGE R. TERRY :-

   "A budget is an estimate of future needs arranged according to an orderly basis covering some or all of the activities of enterprises for a definite period of time."
3. INSTITUTE OF COST AND WORK ACCOUNTANTS, ENGLAND :-

   "Budget is a financial and quantitative statement prepared prior to defined period of time of the policy to be pursued during that period for the purpose of attaining a given objective."
4. G.A.WELSCH :-

   'A business budget is a plan covering all phases of operation for definite period in the future.'
5. BARTIZOL :-

   "A budget is a forecast, in detail of results of an officially recognized program me of operation based on the highest reasonable expectations operating efficiency."
6. PROF.SAVDERS :-

   "The essence of a budget is a defined plan of operation for some specific future period, followed by a system of records which will serve as a check upon the plan."

**MEANING OF BUDGET:-**

The word 'budget' is derived from ' bougette' a French word denoting a leather pouch , in which funds are appropriated for meeting anticipated expenses. This in reality, is the basic purpose of budgeting.

A budgeting is merely a plan relating to a period time in future expressed in quantitative or financial terms. A budget is a numerical statement expressing the plans, policies and goals of the enterprise for a definite period in the future .It is plan laying down the targets to be achieved. The targets may be expressed either in monetary or financial terms or may take the form of statement of anticipated result ,as s reflected by the quantity produced , materials , number of hours worked and quantity produced , materials , number of hours worked and quantity sold etc. budget involves planning of all function of the business in advance .it covers not only payments and expenses , but also receipt and incomes, both capital and revenue character . it includes not only financial transactions but also physical operation . It brings within its fold every aspect of the business or industry viz. material, labour, plant and equipment, production, sales, finance etc.

It Covers all phases of the business enterprise and as such is usually identified as the management instrument of planning, organizing , Co-ordination and control. It lays down in advance the intention of the management regarding the business in concrete terms.

**ADVANTAGES OF BUDGETING:-**

1. It ascertains the responsibilities of employees.
2. It throws light on capabilities of deficiencies of business and help in taking measures for improvements.
3. It compels management to maintain adequate statistics.
4. It develops amongst members the habit of giving timely and serious thoughts to all the factors.
5. It increases the profits of organization as budget expenses are controlled.
6. It initiates thought on basic policies.
7. It compels members to participate in determination on of goal.
8. It facilitates maximum utilization of labour, material, capital and other resources.
9. It develops feelings of coordination amongst various department of business.
10. It increases the productivity and morale of employees.

**IMPORTANCE OF BUDETIING;-**

1. **Planning**; - setting up of objectives and proper organization of various factors is known as planning. Budgets play an important role in the attainment of determined objectives. Production cost, research etc. help in the attainment of objectives related to business planning.
2. **Control**; - Control is very essential for the growth of business. Functions of control can be performed better with the help of budget. Under it targets, objectives and policies are as curtained and reasons of variation are located and efforts are made to control them.
3. **Coordination** ;- It is a system under which every department functions for its own interest and for that purpose mutual cooperation is required budgeting helps in brining coordination amongst various business activities.

**PRECAUTIONS IN PREPARATION BUDGET**

1. **Budget period**;- In every business house, long term as well as short term budget are needed, sales budget, cost budget, are short term, whereas capital expenditure, research budget and development budgets are known as long term budgets.

2. **Flexibility of Budget**; - Budget should not be rigid but proper flexibility should be there in the budget when budgets are prepared efforts should be made to have proper flexibility in it.
3. **Statistical information** ;- Necessary information relating to every department should be made available at the time of preparation of budget.
4. **Top management support**; - Support from all the heads of departments should be ensured. While preparing budgets and **proper coordination** amongst them is to be maintained.
5. **Proper knowledge and limitation of budgeting**; - Every officer should know the use and Limitations of budgeting. It should be known that how budgets help in planning, coordination and control.
6. **Business policy**; - Budget is prepared for the attainment of business objectives. While Preparing **budget objectives** of the business should be given proper attention.
7. **Persons responsible for budgets**; - Persons who are responsible for the preparation of budget should be unbiased and neutral. These person should possesses full knowledge of business and be should be capable of preparing balanced budgets.
8. **Sound forecasting**; - Due consideration should be given to past records also. Knowledge of past condition is necessary for the budget. Forecasts should be based on statistical methods.
9. **Adequate accounting system**; - Correct and up to date figure are necessary for the preparation of budget and on the basis of that forecasting is made. Thus accounting system should be adequate and planned one for the preparation of the budget.
10. **Budget committee**;- A budget committee is to be formed for the preparation of the budget in this committee all departmental heads should be taken; The officer in charge should collect the budget from all the departments and should present them before the budget committee.

**CLASSIFICATION OF BUDGETS/ TYPES OF BUDGETS:**

1) **Sales Budget :-** The Success of any enterprise depends upon the quick turnover of its production. Every company wants to maximize its sales.

It is an estimate of total sales to be made during a definite period sales budget is prepared in quantity period. Sales budget is prepared in quantity as well as in rupees. It should be prepared with great caution.

A sales budget is an estimate of future sales expressed in quantity and in money. Every company may have Sales projection, which will be made on a periodic basis and the sales budget will be prepared accordingly. Some internal and external should try to get important in formation in order to get the changes in sales. The sales budget is broken down by:

1) Geographical territories,

2) Types of customers.
3) Product lines.
4) Time span

A forecast of sales on an industry wise basis must be, broken, so that it applies to a particular firm. Each firm looks at its position and calculates its shares of the market .In some areas, anyone firm may dominate, while other products, the sales may be divided into different proportions. The following techniques may be used for sales forecasts

I) Past trends.
II) Survey methods.
III) Sales executives opinion

**2) Production budget :-**It is a forecast of total production of a business organization during a definite period. It is prepared keeping in the view the sales budgets, productions, capacity, probable changes in stock and loss in production. Production budget is prepared by production manager.

Production budget is a part of master budget and it establishes the level of production for budget period. It fixes the target for the future output. It attempts to estimate the number of units of each product which a company plans to produce during a year. There should be sufficient quantity of goods which many are available at the time of sales. A portion of these goods may already be available in the form of opening stock .The quantity to be produced is determined after taking into account the following points.

i) Opening and closing stock of goods.
ii) Quantity required to meet projected sales.

The following points are also to be considered in the preparation of production budget

i) Production planning.
ii) Available storage facilities.
iii) Amount of investment required.
iv) Maximum production capacity of the concern.
v) Management policy regarding purchase of goods.
vi) There should be a close ordination with the sales department of the concern. Formula :- production (units)= Unit required + closing Stock - opening finished goods.

**a) Material Budget :-** It is a forecast of quantity , quality and cost of material used in production . While preparing this budget, value of material to be purchased. Availability of finance should be given due consideration, quantity of material is an important function budget loss of materials and other types of losses should be given due consideration.

Material budget is prepared with a view to ensure regular supply of raw materials according to the requirements of production schedule . A schedule of material required is prepared. The quantity material required for production and the required inventory will indicate the quantity of each material, which should be made available. The inventory of raw materials at the beginning of the budget period is deducted and the balance quantity is produced during the budget period. Materials budget checks wastage of raw material and at the same time helps in the determination of economic order quantity.

Formula :- Material budget =Closing stock required.
Add :- Closing stock required
Less :- opening stock

b) **Factory Cost Budget :-** It is also known as ' Production cost budget'.
It is a forecast of cost of that production which has been as curtained in production budget. Material, labour and other direct expenses are including in production cost. Probable increase or decrease in prices of raw material, increases or decreases in labour cost. Probable increase or decrease in labour cost is kept into mind, at the time of preparation of this budget.

It is a forecast of indirect expenses to be incurred in relation to production for budget period, both fixed and variable expenses are include in it. Separate budgets can be prepared for fixed and variable expenses. If production is carried on by various departments, separate budgets can be prepared for different departments and one master budget can also be prepared.

c) **Selling & distribution overhead budget**; - It is a forecast of expenses to be incurred on selling and distributing the finished product. This budget is based on sales budget. This budget should be prepared only after analysis of selling and distribution overheads of past years. Market research should be given due consideration.

d) **Administration overhead budget**; - It is a forecast of expenses to be incurred on administrative works for budget period for this purpose; expenses incurred in past years should be analyzed. Administrative expenses can be divided into various departments such as legal, accounts, research, planning, public relation etc.

e) **Labour budget**; - It is a forecast of number of labour hours to be worked by labour in production. Amount paid to workers and other perquisites are recorded in this budget. Time and motion study is kept into mind, while preparing this budget on the basis of this budget; recruitment department makes arrangements for recruitment of labour.

**3) Capital Budget / Capital Expenditure Budget:**

It is a forecast of expenditure to be incurred in purchase and expansion of fixed assets. It is prepared keeping in mind the probable increase in demand of products, finance available in long term production capacity. This budget is prepared for long term.

Capital budget involved the planning to acquire worthwhile projected, together with the timings of the estimated cost and cash flow of each project. Such projects require large sum of funds and have long terms implication for the firms. Capital budget are different to prepare because estimated of the cash flow over a long period have to be made which involve a large degree of uncertainly.

The terms capital budget can be applied to budgets. That lay down the estimates in respect, of the capital resources of the firm. The operating budget helps to prepare the estimated income statement the capital budget facilities in the task of compiling of a projected balance sheet

The capital budget usually precedes the revenue or operating budget and is in fact complimentary to it. The capital budget can be prepared for long terms as well as for the short terms period.

The capital budget specify the capital intention of the management policy in respect of investment expansion, a growth contraction production and profits capital budgeting includes both raising of long terms funds as well as their utilization. It may be defined as “the firms” formal process for acquisition and investment of capital “It involves firm’s decision to invest its current funds for addition, disposition, modification and replacement of long-term or fixed assts.

**4) Zero base budgets:-**

In business Zero-base budgeting was introduced by peter Peher of USA in 1969 .But in military it was in use since 1960.It helps the manager in implementation and formation of various managerial activities. Under this system, every item is checked independently before the preparation of the budget, so that is utility can be ascertained in real life. Under convention budget amendments are made to previous budget, where as in Zero base budget every activity and items tested and then budget is prepared accordingly for the future.

**5) Cash Budget :-**

It is a forecast of cash required for successful and smooth operation of activities. This budget is prepared by giving due consideration to receipts and payment. Cash budget can be prepared for short term as well as for long term basis It is to be divided into two parts one part of probable receipts and the second part of probable payments. Cash budget are prepared keeping in mind all the financial resources. It is prepared by chief accountant. Cash budget is a forecast related to cash for a certain period. Under it flow of cash is controlled by estimating cash receipts and payment for a different period. Cash should be available in sufficient quantity in future. Cash is received from the sale, rent, interest, dividend and sale of assets etc.

Definitions:-

1] H.G.Gruthmann and H.F.Dougell :-

“The cash budget is an estimate of cash receipts and disbursements for a future period.”

2] Malchman and salvin :-

“The cash budgets are plans for financing the budgeted activities of the company.”

3] S.C.Kuchal :- “Cash budget is a schedule to record cash on flows and out flows over a period. With a view to locating the timing and magnitude of cash surplus and shortage”

**Importance of cash budget:**

1] Amount of cash can be controlled through cash budget.

2] Surplus or deficiency of cash can be ascertained easily.

3] Effect of seasonal changes on cash be ascertained with the help of cash budget.

4] Other budget can be regularized on the basis of cash budget.

5] Information about other condition can be obtained easily.

6] It becomes easier to formulate strong dividend policy on the basis of availability of cash through to cash budget.

7] Cash budget prepares solid base for getting further loans.

8] Co-ordination of cash can be established with the working capital, sales, loans, investment etc.

**Method of preparation of cash budget :**

**1] Receipt and payment method:-**

Under this method, a statement is prepared under which all receipts from various sources and all payments to various items are recorded .The difference of both the side is known as cash balance and cash is forecasted.

**2] Projected balance sheet method :-**

Under this method, efforts are made to forecast cash position at special points. At the end of the budget period, a projected balance sheet is prepared for all the assets and liabilities, but it excludes cash, bank balance, and overdraft.

**5) Master Budget :-**

The master budget is expressed in financial terms and set plan for the operation and resources of the firm .It is a summary of the budget schedules high lighting the budget period. The master budget called the comprehensive budget is the complex blueprint of the planned operations of the firm.

Master budget is an overall budget of the firm which includes all other small departmental budgets. It is a networking consisting of many separate budgets it coordinates various activities of the business. It contains consolidated summary of the entire budget prepared. Such budget is of no use for the departmental executives. It draws the attention to those issues which provide immediate attention.

Preparation of master budget is a complex process. It includes all preparation of a projected profit and loss a/c and balance sheet. Preparation of master budget involves the following steps.

a. preparation of sales budget
b. Cost Budget.
c. Projected profit and loss a/c.
d. Cash budget.
e. Production cost budget.
f. Projected balance sheet.

**6) Flexible budget:-**

Flexible budget is a budget which by recognizing the difference between fixed, semi variable and variable cost is designed to change in relation to the level of activity attained. A flexible budget is a series of cost budget each prepared for a low costs change with changes in the activity level. Flexible budget do not distinguish between variable and fixed overhead. Flexible budgeting can be prepared in two ways-

I) Step budget :- Budget are developed for different levels of operation.
II) Variable budget :- Where budgets are prepared on a variable cost basis.

Business executives prefer the technique of flexible budgeting, as it can be easily under stood by the supervisors at all levels. The main significance of flexible budgeting is that it provides completely realistic budget amounts. There are fewer changes for variances which can be the result of inefficient control in operating conditions.

**Method for preparation of flexible budget:,**

Fixed variable and semi – variable costs are mind while preparing flexible budget. Fixed expenses do not change and variable expenses change at every level of activity .semi-variable expenses change at every level of activity. There are some semi-variable expenses which remain fixed at different level of activities and some of them change at different levels. The following points are to be kept into mind:

a) Fixed expenses always remain fixed at each level of production.
b) Variable expenses per unit remain the same.
The total variable expenses increase with the increase in production and vice-versa.
c) Some part of semi-variable is variable and other part is of fixed nature.
d) There may be changes in the rates of sales for different level of production.

**LIMITATIONS OF BUDGETARY CONTROL**

**1) Incorrect Forecasting :-**
Source of budget depends upon the accuracy of forecasting. But it has been observed that forecast made for future are not correct and success of budgets becomes doubtful

**2) Rigidity in control :-**

Budgetary Control gives birth to rigidity in control .Sometimes achievements of these forecasts becomes uncontrollable and the manager has to face so many difficulties.

**3) More weightage to paper work :-**

It has been observed that undue weightage is given to the paper work and the main purpose of preparing the budget is not achieved.

**4) Expensive:-**

Experienced persons are appointed in this system and it becomes very expensive which is not possible to adopt it by the small concerns.

**5) Departmental Competition :-**

It develops competition amongst various departments of the organization and then it becomes difficult to control the affairs of the organization. Every officer tries to get maximum benefits for his own departments due to competition.

References-

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