CHAPTER

16

Budget and Budgetary Control

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16.1 NEEDS OF MODERN MANAGEMENT

Various systems of costing provide information about the expenses incurred. Their objective is ascertainment of cost. As information provided is related to past, it is only a postmortem–what has happened.

Modern Management wants something more to make the concern successful. Modern Management wants:

(A) All operations should be forecasted and planned ahead, as far as possible.

(B) Compare actual results with the planned action for exercising control.

For the above two functions of Planning and Control, two new techniques are applied, namely Standard Costing and Budgetary Control.

Planning is a management function. In this competitive environment, the business enterprise becomes successful only with planning. Plans are framed to achieve better results. However, planning for the sake of it is of no use. Plans should work to achieve the results planned. This is possible through co-ordination, as all the tasks cannot be performed, in isolation. Where more than one individual is involved; only co-ordination can bring the required results. For it, control is needed.

Management is termed efficient, if maximum results are achieved with minimum costs and efforts.

To achieve the anticipated targets, Planning, Co-ordination and Control are the important main tasks of management, achieved through budgeting and budgetary control.

16.2 MEANING OF BUDGET AND BUDGETING

A budget is a monetary and/or quantitative expression of business plans and policies, prepared in advance, to be pursued in the future period of time. According to Certified Institute of Management Accountants, Budget is defined as **"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 the objective".**

Budget is a systematic plan for utilisation of all types of resources, at its command. It acts as a barometer of a business as it measures the success from time to time, against the standard set for achievement.

Budgeting is a technique of formulating budgets.

Characteristics of a Budget: The main characteristics of a budget are:

(A) A Comprehensive Business Plan showing what the enterprise wants to achieve.

(B) Prepared in Advance.

(C) For a Definite Period of Time.

(D) Expressed in quantitative form, physical or monetary terms, or both.

(E) For achieving a given objective.

(F) A proper system of Accounting is essential.

(G) System of Proper Fixation of Authority and Responsibility has to be in place.

Need of Budget

A budget is prepared to have effective utilisation of resources and for the realisation of objectives, as efficiently as possible.

16.3 MEANING AND NATURE OF BUDGETARY CONTROL

Budgetary control is the process of determining various budgeted figures for the enterprise and then comparing the actual performance with the budgeted figures for calculating the variances, if any. In this process, first budgets are to be prepared. Second, actual results are to be recorded. Third, comparison is to be made between the actual with the planned action for calculating the variances. Once the discrepancies are known, remedial measures are to be taken, at proper time. Then only, planned results can be achieved. A budget is a means and budgetary control is the end result.

Definition of Budgetary Control: The Chartered Institute of Management Accountants, London, defines the Budgetary Control as

"The establishment of budgets relating to the responsibilities of executives to the requirements of a policy, and the continuous comparison of the actual with the budgeted result, either to secure by individual action the objective of the policy or to provide a basis for its revision".

Thus, establishment of budgetary control involves the following:

1. Establishment of budgets.
2. Continuous comparison of actual with the budgets for achievement of targets and fixing the responsibility for failure to achieve the budget figures.
3. Revision of budgets in the light of changed circumstances.

The position of budgetary control can be likened or compared to the navigation of a ship, across the seas. The navigating officer works out the course, ahead, and records the happening of the position of the ship from hour to hour in a log-book. To navigate the ship across the seven seas, safely, the captain wants the navigating officer to check his ship's position, constantly, against the predetermined one. If the ship is off its course, the navigating officer must report, immediately, to the captain for prompt action to regain the course. Valuable lessons are learnt by the captain of the ship from a study of the factors that have caused misadventure in the past. Exactly, so it is with the industrial ship.

What the modern management requires for day to operating purposes is detailed forecasts and immediate reporting of variances, with explanations of the reasons for variations.

This facilitates the management to take the required corrective action by the persons who have been made responsible, but contributed for the failure.

16.4 OBJECTIVES OF BUDGETARY CONTROL

The main objectives of budgetary control are as under:

1. Planning

Budgetary control forces the management at all levels to plan, in time, all the activities to be done during the future period.

2. Co-ordination

Normally, employees are efficient. If they are not considered efficient, they would not have been recruited. Most of the employees can work very efficiently, individually, but they fail to deliver better or improved results when they work, as a group. Majority of the functions in an organisation cannot be done in isolation. The functions, be it production or marketing, are to be performed in a greater coordination for smooth completion and better results. Budget exercise develops team spirit amongst the employees to work in a coordinated manner. The role of Budgetary Control is immense in integrating the activities of different departments.

Budgetary Control forces executives to think and think as a group.

3. Communication

A budget is a communicating device. Budget cannot be achieved without communicating to the concerned, what is expected of them to achieve. The approved budget shows, in detail, the plans of management, which are communicated to the concerned departments. This would help them to give adequate understanding and knowledge of the programmes and policies, but also the restrictions to which the organisation is expected to adhere to. For example, maximum amount that can be spent on advertisement, maintenance will be brought to the knowledge of the executives for exercising the restraint and achieving the results.

4. Control

Control refers to that action, necessary to bring the performance according to the original plan. Control is possible with pre-determined standards laid down in the budget. Budgetary control becomes possible with continuous comparison of actual performance with that of budget to find out the variances and report them for necessary corrective action.

Standard Costing and Budgetary Control are complementary to each other for achieving improved performance in an organisation.

16.5 REQUISITES FOR SUCCESSFUL BUDGETARY CONTROL SYSTEM

The following requisites are essential for effective budgetary control system.

1. **Determination of the Objectives:** There should be clear perspective of the objectives to be achieved through the budgetary control system. In most of the cases, the basic objective is to achieve desired/increased profits. To achieve, the following problems are to be sorted out:
   (A) **Laying down the Plan** for implementation to achieve the objectives,
   (B) Bringing **co-ordination** amongst the different departments and
   (C) **Controlling** each function so as to bring the best possible results.

   The steps needed to be followed to achieve the above are explained further, here.
2. **Proper Delegation of Authority and Responsibility:** The first step is to have clear organisation chart explaining the authority and responsibility of each individual executive. **There should be no uncertainty regarding the point where the jurisdiction of one authority ends and that of another begins.**
3. **Proper Communication System:** The flow of information should be quick so that the budgets are implemented. **Two-way communications is important.** What is required to be achieved and how it is to be achieved should reach the lowest level. Similarly, upward communication in respect of implementation difficulties should reach the top level to sort out, without loss of time. The performance reports at the various levels help the management in monitoring and leading to the achievement of the budgeted goals.
4. **Participation of All Employees:** Budget preparation and control are done at the top level. However, involvement of all persons, including at the lower level, is necessary in framing the budget and its implementation for the success of budgetary control. In practice, budgets are executed at the lower level. With experience, they can offer practical suggestions that can lead to success.

   The success of Budgetary Control depends more on the active participation of all employees of the organisation.
5. **Flexibility:** Future is uncertain. Despite the best planning and foresight, still there may be occurrences that may require adjustments. Budgets should work in the changed circumstances. **Flexibility in budgets is required to make them work under changed circumstances.**
6. **Motivation:** Human beings execute Budgets. **There should be incentive in achieving the required targets.** All persons should be motivated to improve their working to achieve the goals set in the budgets.

16.6 ESSENTIAL STEPS FOR INSTALLATION OF BUDGETARY CONTROL SYSTEM

In order to have effective Budgetary Control System, it is appropriate to take the following steps:

1. **Budget Manual:** This is a written document specifying the objectives and procedures of budgetary control. **It spells out the duties and responsibilities of executives.** The budget manual defines the sanctioning powers of the various authorities.

2. **Budget Centres:** A budget centre is that part of organisation for which the budget is prepared. **Budget centre can be a department, section of a department or any other part of department.** Budget centres are necessary for the purpose of ascertaining cost, performance and its control.
3. **Budget Committee:** In a large concern, all the functional heads are the members of the budget committee. They discuss their respective budgets and finalise the budget, after collective decisions. **The committee is responsible for its execution and achievement of the goals set.**
4. **Budget Officer:** The chief executive appoints some person as the budget officer. He is conversant with the functioning of the various departments. All budgets are presented to the budget officer who places before the budget committee, after making the necessary changes, for its approval. The actual performance of each department is communicated to the budget officer. He determines the variances, analyses the reasons and reports to the top management to take the necessary steps to remove the deviations. The variances are reported to the concerned departments too for necessary action, as may be necessary.

   As the convenor of the budget committee, the main function of Budget officer is co-ordination to ensure achievement of the budgeted targets.
5. **Functional Budgets: Separate functional budgets have to be prepared.** Examples are Production Budget, Sales Budget, HR Budget, Cash Budget, Capital expenditure Budget and R & D Budget.
6. **Budget Period: A budget period is the length of the period for which budget is prepared.** Normally, budgets like purchases and sales budgets are prepared for one year. However, a capital expenditure budget is prepared for a longer period i.e. 3 to 5 years.
7. **Determination of Key Factor:** Budgets are prepared for all the functional areas such as production, sales, purchases, finance, human resources and research and development. These activities are inter-connected and inter-dependent and so the budgets are. For example, raw material supply may be limited. So, production and sales budgets are prepared, based on the purchase budget. To some of the firms, finance may be a constraint. Then, all other budgets are prepared based on the availability of finance.

   A factor, which influences all other budgets, is known as key factor or principal factor.

A better co-ordination brings better performance, even while facing constraints.

The influence of key factor may neither be permanent nor the same factor may be constant. Limited supply of raw materials may be the key factor, till an alternative source of supply for that material is found. When the raw material supply problem is cleared, another factor may create the problem and become key factor. After raw materials problem is eased, sales may become a problem and become a key factor, due to change in trends. The management would be constantly endeavouring to remove the problems associated with key factor for better performance.

16.7 ADVANTAGES OF BUDGETARY CONTROL

The following are the advantages of budgetary control system.

1. Profit Maximisation

The resources are put to best possible use, eliminating wastage. Proper control is exercised both on revenue and capital expenditure. To achieve this, proper planning and co-ordination of various functions is undertaken. So, the system helps in reducing losses and increasing profits.

2. Co-ordination

Co-ordination between the plans, policy and control is established.

The budgets of various departments have a bearing with each other, as activities are inter-related. As the size of operations increases, co-ordination amongst the different departments for achieving a common goal assumes more importance. This is possible through budgetary control system.

As all the personnel in the management team are involved and coordinated, there is bound to be maximum profits.

> **Budgetary control system acts as a friend, philosopher and guide to the management.**

3. Communication

A budget serves as a means of communicating information through out the organisation. A sales manager for a district knows what is expected of his performance. Similarly, production manager knows the amount of material, labour and other expenses that can be incurred by him to achieve the goal set to him. So, every department knows the performance expectation and authority for achieving the same.

4. Tool for Measuring Performance

Budgetary control system provides a tool for measuring the performance of various departments. The performance of each department is reported to the top management.

The system helps the management to set the goals. The current performance is compared with the pre-planned performance to ascertain deviations so that corrective measures are taken, well at the right time.

It helps the management to economise costs and maximise profits.

5. Economy

Planning at each level brings efficiency and economy in the working of the business enterprise. Resources are put to optimum use. All this leads to elimination of wastage and achievement of overall efficiency.

6. Determining Weaknesses

Actual performance is compared with the planned performance, periodically, and deviations are found out. This shows the variances highlighting the weaknesses, where concentration for action is needed.

7. Consciousness

Budgets are prepared in advance. So, every employee knows what is expected of him and they are made aware of their responsibility. So, they do their job uninterrupted for achieving, what is set to him to do.

8. Timely Corrective Action

The deviations are reported to the attention of the top management as well as functional heads for suitable corrective action, in time. In the absence of budgetary control, deviations would be known only at the end of the period. There is no time and opportunity for necessary corrective action.

9. Motivation

Success is measured by comparing the actual performance with the planned performance. Suitable recognition and reward system can be introduced to motivate the employees, at all levels, provided the budgets are prepared with adequate planning and foresight.

10. Management by Exception

The management is required to exercise action only when there are deviations. So long as the plans are achieved, management need not be alerted. This system enables the introduction of 'Management by Exception' for effective delegation and control.

11. Overall Efficiency

Every one in the management is associated with the preparation of budget. There is involvement from the top functionaries and each one knows how the target fixed can be achieved. Budgets once, finally, approved by the Budget Committee, it represents the collective decision of the organisation. With the implementation of budgetary control, there would be over all alertness and improved working in all the departments, with better coordination.

> **Budgetary Control acts like an impersonal policeman to bring all round efficiency in performance.**

12. Optimum Utilisation of Resources

As there is effective control over production, the resources of the organisation would be put to optimum utilisation.

16.8 CLASSIFICATION OF BUDGETS

Budgets can be classified on the basis of time, function and flexibility.

(A) Classification on the basis of Time: Budgets can be long-term and short-term. Long-term budgets relate to a period ranging from 5 to 10 years. Only the top level knows these budgets and lower level would not be aware of them. These budgets are prepared for certain areas of the enterprise such as capital expenditure and research and development. Short-term budgets are for one or two years. Generally, budgets are prepared to coincide with the financial year so that comparison of the actual performance with budgeted estimates would facilitate better interpretation and understanding.

(B) Classification on the basis of Function: Budgets are divided on the basis of different functions performed in the organisation. They are Sales Budget, Production Budget, Purchase Budget, Direct Labour Budget, Overheads Budget, Cash Budget and, finally, Master Budget.

The Master or Final Budget is a summary budget, which incorporates all functional budgets, in a summarised form.

(C) Classification on the basis of Flexibility: There are two types of budgets on the basis of flexibility.

(i) Fixed Budgets: The budget is prepared on the basis of fixed level of activity. In other words, **a fixed budget remains unchanged, irrespective of the change in volume or level of activity.** It is presumed that the forecast and actual level of activity, both production and sales, would be one and the same. In other words, if the budget is prepared for a particular quantity of production and sales, at a particular cost and selling price, the same should happen. Then only, this type of budgeting would be useful. Where static conditions occur, this is useful. In practical life, it does not happen on account of changes that cannot be anticipated or foreseen. It is not, practically possible to anticipate the likely production and sales, accurately. Due to this limitation, fixed budgets are not followed, where the forecast cannot be done, accurately, both for production and sales.

(ii) Flexible Budgets: Flexible Budget is a good budgeting technique as well as tool of control.

Flexible budgets are prepared, where the level of activity cannot be estimated with accuracy. Preparation of Flexible Budgets is, normally, adopted in real life working.

This type of budget is prepared for a range of production activity say 15,000 to 25,000 units.

A flexible budget recognises the difference between fixed, semi-fixed and variable cost and is designed to change, in relation to change in level of activity.

The flexible budgets will be useful, where the level of activity changes and cannot be estimated at the time of preparation of budget.

16.9 DIFFERENCES BETWEEN FIXED AND FLEXIBLE BUDGET

Base of Difference	Fixed Budget	Flexible Budget
1. Level of Activity	It is based on single level of activity.	It is based on more than one level of activity.
2. Assumptions	Assumes that conditions and level of activity remain constant.	Assumes that level of activity may change.
3. Cost Classification	Costs are not classified, according to their nature.	Costs are classified as per their nature i.e. fixed, semi-fixed and variable.
4. Comparison	If the level of activity changes, budget and actual performance cannot be compared.	If there is a change in the level of activity, budget can be recast to make it possible for comparison.
5. Adjustment	Fixed budget is not able to provide any automatic adjustment, when the volume of production/sales changes.	Flexible budget is automatically geared to changes in production/sales activity.
6. Utility	A fixed budget has limited utility and may give misleading results, when level of activity changes.	Flexible budget provides wider acceptance to several organisations as it provides a reliable basis for changed level of activity.

Illustration No. 1

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

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

Solution:

Production Budget at 80% and 100% capicity

	80% capacity	100 % capacity
Production activity	**800 units**	**1,000 units**
Variable Cost:		
Materials @Rs.100 per unit	80,000	1,00,000

Labour @Rs. 40 per unit	32,000	40,000
Expenses @Rs.10 per unit	8,000	10,000
Factory Expenses @Rs.40 per unit	32,000	40,000
Administration Expenses @Rs.20 per unit	16,000	20,000
Total Variable Cost	**1,68,000**	**2,10,000**
Fixed Cost:		
Factory Expenses	16,000	16,000
Administration Expenses	18,000	18,000
Total Fixed Cost	**34,000**	**34,000**
Total Cost	**2,02,000**	**2,44,000**

Illustration No. 2

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

	Per Unit Rs.
Materials	50
Labour	20
Variable Overhead	15
Fixed Overhead (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 and 9,000 units.

Solution:

Production Budget for 7,000 units and 9,000 units

(Rs.)

Production Activity	7,000 Units	9,000 Units
Variable Cost:		
Material Cost Rs. 50 per unit	3,50,000	4,50,000
Labour Rs. 20 per unit	1,40,000	1,80,000
Variable overhead Rs. 15 per unit	1,05,000	1,35,000
Administrative Expenses @ 0.50 p per unit *	3,500	4,500

Selling Expenses @ Rs.4.80 per unit **	33,600	43,200
Distribution Expenses @ Rs.4.50 per unit ***	31,500	40,500
Total Variable Cost	**6,63,600**	**8,53,200**
Fixed Cost:		
Fixed overheads	50,000	50,000
Administrative Expenses	47,500	47,500
Selling Expenses	6,000	6,000
Distribution Expenses	2,500	2,500
Total Fixed Cost	**1,06,000**	**1,06,000**
Total Cost of Sales	**7,69,600**	**9,59,200**

Note: * In the problem, expenses per unit are calculated on the production level of 5,000 units. So, administrative expenses were Rs. 10 per unit, when the production level was 5,000 units. So, total administrative expenses were Rs. 50,000. Out of which, 5% was variable cost (Rs. 0.50 per unit) and balance 95% was fixed cost, which works out to Rs. 47,500. Fixed costs Rs. 47,500 are constant, whatever be the level of activity.

** Total Selling Expenses are Rs. 30,000. Out of which, 20% were fixed costs, which works out Rs. 6,000. Balance amount was variable cost Rs. 24,000, which works out to Rs. 4.80 per unit.

*** Total Distribution costs were Rs. 25,000. Out of which 10% were fixed costs, which works out to Rs. 2,500. Balance amount was variable cost Rs. 22,500, which works out to Rs. 4.50 per unit.

Illustration No. 3

Prepare a Production Budget for each month and summarized Production Budget for the six months period ending 31st Dec., 1989 from the following of product X.

(i) The units to be sold for different months are as follows:

July 1989	1,100
August	1,100
September	1,700
October	1,900
November	2,500
December 1989	2,300
January 1990	2,200

(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 will be in stock at the end of each month (including June 1989).

(iv) Budgeted production and production cost for the year ending 31st December, 1989 are as follows:

Production Units	Rs. 22,000
Direct Materials Per Unit	Rs. 10
Direct Wages Per Unit	Rs. 4
Total Factory Overheads Apportioned to Product	Rs. 88,000

Solution:

Summarized Production Budget for the period ending 31st Dec., 1989 for product X (in terms of units)

Month (Year 1989)	Opening Stock	Production	Sales	Closing Stock
June				550
July	550	1,100	1,100	550
August	550	1,400	1,100	850
Sept	850	1,800	1,700	950
Oct	950	2,200	1,900	1,250
Nov	1,250	2,400	2,500	1,150
Dec	1,150	2,250	2,300	1,100
Total		11,150	10,600	

Summarized Production Budget for the period ending 31st Dec., 1989 for product X (in Rs.)

Month (Year 1989)	Production (in Units)	Direct Materials Rs. 10 per unit	Direct Wages Rs. 4 per Unit	Total factory overheads apportioned @ Rs. 4 per Unit	Total
July	1,100	11,000	4,400	4,400	19,800
August	1,400	14,000	5,600	5,600	25,200
Sept	1,800	18,000	7,200	7,200	32,400
Oct	2,200	22,000	8,800	8,800	39,600
Nov	2,400	24,000	9,600	9,600	43,200
Dec	2,250	22,500	9,000	9,000	40,500
Total	11,150	1,11,500	44,600	44,600	2,00,700

Illustration No. 4

Following are the budget estimates of a repairs and maintenance department, which are to be used to construct a flexible budget for the ensuing year:

(Rs.)

Details of cost	Planned at 6,000 direct hours	Planned at 9,000 direct hours
Employee salaries	28,000	28,000
Indirect Repair Material	42,000	63,000
Miscellaneous cost	16,000	20,500

(i) Prepare a flexible budget for the department up to activity level of 10,000 direct repair hours using increment of 1,000 hours.

(ii) What would be the budget allowance for 9,500 direct repair hours?

(B.U. MBA-2002)

Solution:

(i)

Flexible Budget of Repairs and Maintenance Department						
Details of Cost	**Planned Activity (Direct Hours)**					
	6,000 hours	**7,000 hours**	**8,000 hours**	**9,000 hours**	**9,500 hours**	**10,000 hours**
Fixed Cost Employee salaries	28,000	28,000	28,000	28,000	28,000	28,000
Variable Cost Indirect Repair Material (@ Rs.7 per hour)	42,000	49,000	56,000	63,000	66,500	70,000
Semi-fixed cost Miscellaneous cost*	16,000	17,500	19,000	20,500	21,250	22,000
Total Cost	86,000	94,500	1,03,000	1,11,500	1,15,750	1,20,000

*** Miscellaneous cost is a semi-variable cost, containing fixed cost and variable cost components. Fixed cost is Rs. 16,000. Balance amount Rs. 4,500 (20,500 – 16,000) is variable cost component, which works out to Rs. 1.50 per hour (4,500/3,000).**

(ii) At 9,500 hours, for the incremental increase of 500 hours, the cost increases by Rs. 4,250 due to the following:

Variable Cost

Indirect Repair Material (@ Rs. 7 per hour) = 500 × 7 =	3,500
Semi-fixed cost	
Miscellaneous cost (@ Rs. 1.50 per hour = 500 × 1.50 =	750
-Variable cost component)	
Total incremental cost	4,250

16.10 PREPARATION OF CASH BUDGET

A cash budget is an estimate of cash receipts and disbursements during a future period. The anticipated cash receipts from various sources are taken into account. Similarly, the amount spent on various heads, both revenue and capital, are taken into cash budget. In short, it is a summary of cash intake and outlay.

Illustration No. 5

Prepare a Cash-Budget of a company for April, May and June 2003 in a columnar form using the following information:

(Rs.)

Month, 03	Sales	Purchases	Wages	Expenses
January (Actual)	80,000	45,000	20,000	5,000
February (Actual)	80,000	40,000	18,000	6,000
March (Actual)	75,000	42,000	22,000	6,000
April (Budgeted)	90,000	50,000	24,000	7,000
May (Budgeted)	85,000	45,000	20,000	6,000
June (Budgeted)	80,000	35,000	18,000	5,000

You are further informed that:

(a) 10% of the purchases and 20% of the sales are for cash;

(b) The average collection period of the company ½ month and the credit purchases are paid off regularly after one month;

(c) Wages are paid half monthly, and the rent of Rs. 500 included in expenses is paid monthly;

(d) Cash and Bank Balance as on April, was Rs. 15,000 and the company wants to keep it at the end of every month approximately this figure, the excess cash being put in fixed deposits in the bank.

(B.U. MBA-2003)

Solution:

(Rs.)

Cash Budget For the months from April to June, 2003			
	April	**May**	**June**
Receipts:			
Opening Balance of Cash at Bank	15,000	15,000	15,000
Cash Sales	18,000	17,000	16,000
Collections from Debtors	66,000	70,000	66,000
Total Receipts	**99,000**	**1,02,000**	**97,000**
Payments			
Cash Purchases	5,000	4,500	3,500
Payments for Credit Purchases	37,800	45,000	40,500
Wages	23,000	22,000	19,000
Expenses	6,500	5,500	4,500
Rent	500	500	500
Total Payments	**72 ,800**	**77,500**	**68,000**
Cash Balance Left	26, 200	24,500	29,000
Fixed Deposit Placed	11,200	9,500	14,000
Closing Cash Balance	15,000	15,000	15,000

Calculation of cash sales and realisation of credit sales				
Month	**Total Sales**	**Cash Sales (20% of Total Sales)**	**Credit Sales**	**Collections During Month**
March (Actual)	75,000	15,000	60,000	Current month 30,000 + previous month 32,000 = 62,000
April (Budgeted)	90,000	18,000	72,000	Current month 36,000 + Previous month 30,000 = 66,000

May (Budgeted)	85,000	17,000	68,000	Current month 34,000 + Previous month 36,000 = 70,000
June (Budgeted)	80,000	16,000	64,000	Current month 32,000 + Previous month 34,000 = 66,000

Calculation of Payments for Purchases				
Month	**Total Purchases**	**Cash Purchases (10%)**	**Credit Purchases**	**Payments for Credit Purchases**
March (Actual)	42,000	4,200	37,800	36,000
April (Budgeted)	50,000	5,000	45,000	37,800
May (Budgeted)	45,000	4,500	40,500	45,000
June (Budgeted)	35,000	3,500	31,500	40,500

Calculation for Payment of Wages				
	Total Wages	**Payment for Current Month's wages (50 %)**	**Payment for Previous Month's wages**	**Total Payment of wages**
March (Actual)	22,000	11,000	9,000	20,000
April (Budgeted)	24,000	12,000	11,000	23,000
May (Budgeted)	20,000	10,000	12,000	22,000
June (Budgeted)	18,000	9,000	10,000	19,000

Illustration No. 6

From the following forecast of income and expenditure, prepare a cash budget for the months January to April 2001.

Months	Sales (Credit)	Purchases (Credit)	Wages	Manufacturing Expenses	Administrative Expenses	Selling Expenses
2000, Nov	30,000	15,000	3,000	1,150	1,060	500
2000, Dec	35,000	20,000	3,200	1,225	1,040	550
2001, Jan	25,000	15,000	2,500	990	1,100	600
Feb	30,000	20,000	3,000	1,050	1,150	620
March	35,000	22,500	2,400	1,100	1,220	570
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 January for Rs. 5,000, a Building has been purchased on 1st 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 1st on the next month.
6. Lag in payment of other expenses is one month.
7. Balance of cash in hand on 1st January, 2001 is Rs. 15,000

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Solution:

	January 2001	**February 2001**	**March 2001**	**April 2001**
Opening Balance	15,000	23,985	31,795	33,975
Sales	30,000	35,000	25,000	30,000
Total Receipts	45,000	58,985	56,795	**63,975**
Payments				
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
Capital expenditure instalment (Plant)		2,000	2,000	1,000
Capital expenditure instalment (Building)				2,000
Dividend				10,000
Total Payments	21,015	27,190	22,820	38,290
Closing Balance	**23,985**	**31,795**	**33,975**	**25,685**

16.11 LIMITATIONS OF BUDGETARY CONTROL

Budgetary control is a sound technique of control but is not a perfect tool. Despite many good points, it suffers from the following limitations:

1. Uncertainty of Future

Budgets are prepared for the future periods. So, budgets are prepared, with certain assumptions. There is no certainty that all the assumptions prevail in future. With the change in assumptions, the situation, in future, changes. Due to this, the utility of budgetary control reduces.

2. Problem of Co-ordination

The success of budgetary control, largely, depends upon effective co-ordination. The performance of one department depends on the performance of the other department. To ensure necessary co-ordination, organisation appoints a budget officer. All organisations cannot afford the additional expenditure involved with the appointment of a budget officer, separately. In case, budget officer is not appointed, lack of co-ordination results in poor performance.

3. Not a Substitute for Management

Budgetary control helps in decision-making, but is not a substitute for management. A budgetary programme can be successful, if there is proper administration and supervision.

4. Discourages Efficiency

Every person is given a target to achieve. So, every one is concerned only achieving the target of his own. This is the common tendency. Even capable and competent people too would concentrate just to achieve their individual targets. So, budgets may become managerial constraints, unless suitable award or incentive system is introduced. In the absence of award system to recognise efficiency and exceptional talents, budgets may dampen the people, with initiative and enthusiasm.

5. Timely Revision Required

Budgets are prepared on certain assumptions. When those conditions do not prevail, it becomes inevitable to revise the budget. Such frequent revision of budgets reduces reliability and value. Revision of budgets involves additional expenditure too.

6. Conflict among Different Departments

For the success of budgetary control, co-ordination of the different departments is essential. Every department is concerned with the achievement of the individual department's goal, not concerned with the final goal of the enterprise. In this process, each department tries to secure maximum fund allocation and this creates conflict among the different departments.

7. Depends upon Support of Top management

The success of budgetary control depends upon the support of top management. If the top management is not enthusiastic for its success, the budgetary control collapses. So, the whole-hearted interest of top management is highly essential for its implementation, in its true spirit, to make it workable and succeed.

16.12 COMPARISON OF STANDARD COSTING WITH BUDGETARY CONTROL

Standard Costing with Budgetary Control aims at maximising efficiency and controlling costs. They are useful tools to management. However, they differ in the following aspects.

Base	Budgetary Control	Standard Costing
1. Coverage	It covers all the functions of a business such as purchases, production, sales, finance, capital expenditure and research and development etc. In other words, it has a macro-approach.	Standard costs are, basically, developed for the manufacturing function i.e. production. In other words, it has a micro-approach.
2. Objective	Objective is to delegate responsibility and ensure performance, without sacrificing control.	Objective is to enable the management to fix standards, control variances and value closing stock.
3. Application	It can be implemented in all industries.	It is not possible to implement in all types of industries. It cannot be applied in jobbing activity, in all operations.
4. Scope	It is more extensive as it covers all the departments or operations of the business, as a whole.	It is more intensive in application as it calls for detailed analysis of variances. Concentration is on various elements of cost like raw materials, labour and overheads.
5. Implementation	It can be implemented, even in parts. To certain areas or departments, it can be implemented, while leaving rest of the areas. For example, it can be implemented in the sales department, alone.	It cannot be operated in parts. It has to cover all items of expenses, without leaving any item.
6. Emphasis	Emphasis is on Limits. Targets are to be achieved.	Emphasis is on Standards. Costs should not exceed the standards set.
7. Projection	It is based on the past actual records and suitably adjusted to future trends and expectations. It is a projection of financial accounts.	It is based on the technical assessments. It is a projection of cost accounts.
8. Variances	Budgetary control deals with total variances. The variances are calculated for the different departments or the organisation, as a whole.	Variances are calculated for different elements of costs i.e. material, labour and overheads. Further, they are analysed, in detail, for their causes.
9. Orientation	It is more management oriented.	It is more engineering oriented.
10. Relationship	Budgetary control can be applied, even without the help of standard costing.	To establish standard costing, some form of budgeting is needed to forecast the level of output and prescribed set of working conditions in which standard costs would be used.

11. Difference in Advantages	It aims in policy determination and facilitates introduction of ‚Delegation of Authority'.	Standard costs are used in various management decisions, price fixing and valuation of closing stock etc.

Both standard costing and budgetary control are complementary to each other. Both should be used to achieve maximum efficiency.

Check Your Understanding

(A) State whether the following Statements are True or False

1. Budget is a means and budgetary control is the end result.
2. To achieve the anticipated targets, Planning, Co-ordination and Control are the important main tasks of management, achieved through budgeting and budgetary control.
3. A key factor or principal factor does not influence the preparation of all other budgets.
4. Budgetary control does not facilitate introduction of 'Management by Exception'.
5. Generally, budgets are prepared to coincide with the financial year so that comparison of the actual performance with budgeted estimates would facilitate better interpretation and understanding.
6. A flexible budget is one, which changes from year to year.
7. A flexible budget recognises the difference between fixed, semi-fixed and variable cost and is designed to change in relation to the change in level of activity.
8. Sales budget, normally, is the most important budget among all budgets.
9. The principal factor is the starting point for the preparation of various budgets.
10. A budget manual is the summary of all functional budgets.
11. Budgeting is a technique for formulating budgets.
12. Budgets are blueprints for action.
13. Standard Costing and Budgetary Control are not complementary to each other for achieving improved performance in an organisation.
14. On the basis of budget, next year's financial statements–profit and loss account and balance sheet can be drawn up.
15. A flexible budget is quickly recast based on changed volumes of activity.
16. A budget is nothing but an estimate based on the past records.
17. Budget is drawn by the accountant of the organisation.
18. The Master Budget is a summary budget, which incorporates all functional budgets in a summarised form.
19. Raw materials supply can be a key factor.
20. Standard costing can operate without the support of budgetary control in any manner.
21. Standard costing cannot be introduced when budgetary control is in operation.
22. Normally, sales budget is prepared first and the other budgets are coordinated with it.

23. Materials Budget and Purchase Budget mean one and the same.
24. A fixed budget is preferable to flexible budget.
25. Budgetary control has a macro-approach, while standard costing has a micro-approach.
26. Before the functional budgets are prepared, master budget is prepared.

(A) Answers

1. True 2. True 3. False 4. False 5. True 6. False 7. True 8. True 9. True 10. False. 11. True 12. True 13. False 14. True 15. True 16. False 17. False 18. True 19. True 20. False 21. False 22. True 23. False 24. False 25. True 26. False

(B) Choose the appropriate answer

1. The basic difference between a fixed budget and flexible budget is that a fixed budget…….
   (a) is concerned with a single level of activity, while flexible budget is prepared for different levels of activity.
   (b) is concerned with fixed costs, while flexible budget is concerned with variable costs.
   (c) is fixed while flexible budget changes.
2. A flexible budget requires a careful study of
   (a) Fixed, semi-fixed and variable expenses
   (b) Past and current expenses
   (c) Overheads, selling and administrative expenses.
3. Sales budget is a …
   (a) expenditure budget
   (b) functional budget
   (c) Master budget
4. The budget that is prepared first of all is …
   (a) Master budget (b) Budget, with key factor
   (c) Cash Budget (d) Capital expenditure budget
5. The difference between fixed cost and variable cost assumes significance in the preparation of the following budget.
   (a) Master Budget (b) Flexible Budget
   (c) Cash Budget (d) Capital Budget
6. Materials become key factor, if
   (a) quota restrictions exist (b) insufficient advertisement prevails
   (c) there is low demand (d) there is no problem with supplies of materials
7. Which of the following is a long-term budget?
   (a) Master Budget (b) Flexible Budget
   (c) Cash Budget (d) Capital Budget

8. Which of the following is not a potential benefit of using a budget?
   (a) Enhanced coordination of firm activities
   (b) More motivated managers
   (c) Improved interdepartmental communication
   (d) More accurate external financial statements
9. Which of the following is not an element of master budget?
   (a) Capital Expenditure Budget (b) Production Schedule
   (c) Operating Expenses Budget (d) All above
   (e) None of the above
10. Budgets are shown in ……. Terms
   (a) Qualitative (b) Quantitative
   (c) Materialistic (d) both (b) and (c)

(B) Answers

1. (a) 2. (a) 3. (b) 4. (b) 5 (b) 6 (a) 7 (d) 8 (d) 9 (b) 10 (d)

Descriptive Questions

1. How Budget fulfils the needs of Modern Management? Explain the meaning of 'Budget' and describe its characteristics. **(16.1 and 16.2)**
2. Explain 'Budget' and 'Budgeting'. Describe the characteristics of Budget. **(16.2)**
3. What does Budgetary Control mean? Discuss, in brief, the objectives and advantages of budgetary control. **(16.2 to 16.4, and 16.7)**
4. Discuss the requisites of a good budgetary control system. Explain briefly the essential steps in setting up of a budgetary control system so that its working efficiency is ensured. **(16.5 and 16.6)**
5. Explain the classification of Budgets. **(16.8)**
6. Bring out the differences between Fixed and Flexible Budget. **(16.9)**
7. Detail the advantages and limitations of Budgetary Control. **(16.7 and 16.11)**
8. Compare Standard Costing with Budgetary Control and bring out the differences between them. **(16.12)**

Interview Questions

Q.1. What is 'Budgetary Control' and how is this achieved?

Ans. A budget is a financial and quantitative statement, prepared prior to a defined period of time. Budgetary Control is a technique of exercising control to achieve the desired objective of the firm. In this process, budget, having a key factor, is prepared, first. Based on that budget, all other budgets are prepared. Later, actual results are compared with the budgets and variances are found out for action to be exercised. Person who has contributed the shortfall is the proper person who can take the corrective action.

Q.2. What is the importance of Budgetary Control in the current context?

Ans. Organisations are becoming big, with increasing volumes of production, associated with complex problems. Delegation of authority is necessary for achieving the results, bringing coordination between the different departments. At the same time, fixation of responsibility and initiating corrective action are essential. Budgetary control is an important tool to execute the principle of 'Management by Exception'. Top management would be concerned only when the actual result is off the planned action. Corrective action is to be initiated, in time, to achieve the planned result, without loss of time and resources. In this light, budgetary control is essential in the current context.

Q.3. What is a key factor in the context of Budgetary Control? What is its importance?

Ans. A factor, which influences all other budgets, is known as key factor or principal factor. A key factor is a limiting factor in any organisation. First, the key factory in the organisation is identified. Budget related to that key factor is prepared, first. For example, raw materials may be a key factor to a particular firm. In such an event, the firm first prepares the raw materials budget and based on that budget, all other budgets are prepared.

Q.4. What is a Master Budget?

Ans. Master Budget is a summary budget, which incorporates all functional budgets, in a summarised form. When all the functional budgets are prepared, then 'Master Budget' is prepared. Master budget is a consolidated plan of overall proposed operations developed by management for the company, covering a definite period of time, normally a year.

Q.5. Which method of budgeting is preferred and explain the reasoning for preference?

Ans. A flexible budget is the most ideal form of budgeting as it would suit different levels of production. Despite best planning, in the light of growing uncertainties, it is rather difficult to predict the demand for any product, with certainty. Flexible budget overcomes the disadvantage of a fixed budget and would meet the different levels of production and changing conditions of sales.

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