

# **BUDGETARY CONTROL**

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# **BUDGET**

Budget is simply a forecast of future events expressed in quantitative terms.

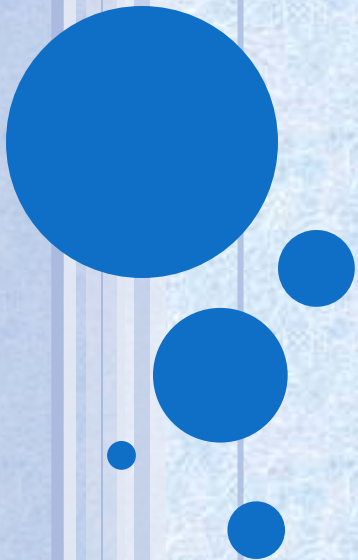
# **BUDGETING**

Budgeting is a technique for formulating budgets. It helps the management to anticipate the various problems of the business and to put corrective measures.

# **BUDGETARY CONTROL**

“The establishment of budgets relating to the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with the budgeted result either to secure by individual action the objectives of that policy or to provide a firm basis for its revision.”

**- CIMA, London**



# **FEATURES OF BUDGETARY CONTROL**



**Establishment of budgets**

**Executive responsibility**

**Continuous comparison**

**Taking suitable remedial  
action**

**Revision of budgets**

# **OBJECTIVES OF BUDGETARY CONTROL**



<b>Planning</b>
<b>Co-ordination</b>
<b>Control</b>
<b>Reporting and evaluating</b>

# **ESSENTIALS OF EFFECTIVE BUDGETARY CONTROL**

**Support of top management**

**Reasonable goals**

**Clear objectives**

**Participation by responsible executives**

**Appropriate accounting system**

**Continuous budget education**

**Maximum profit**

**Constant vigilance**

**Cost of the system**

**Co-ordination with standard costing**

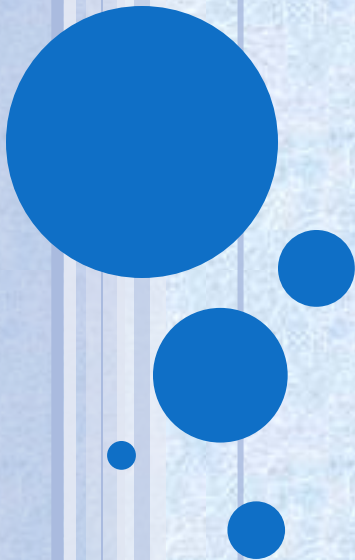
# ORGANISATON FOR BUDGETARY CONTROL



# **BUDGET MANUAL**

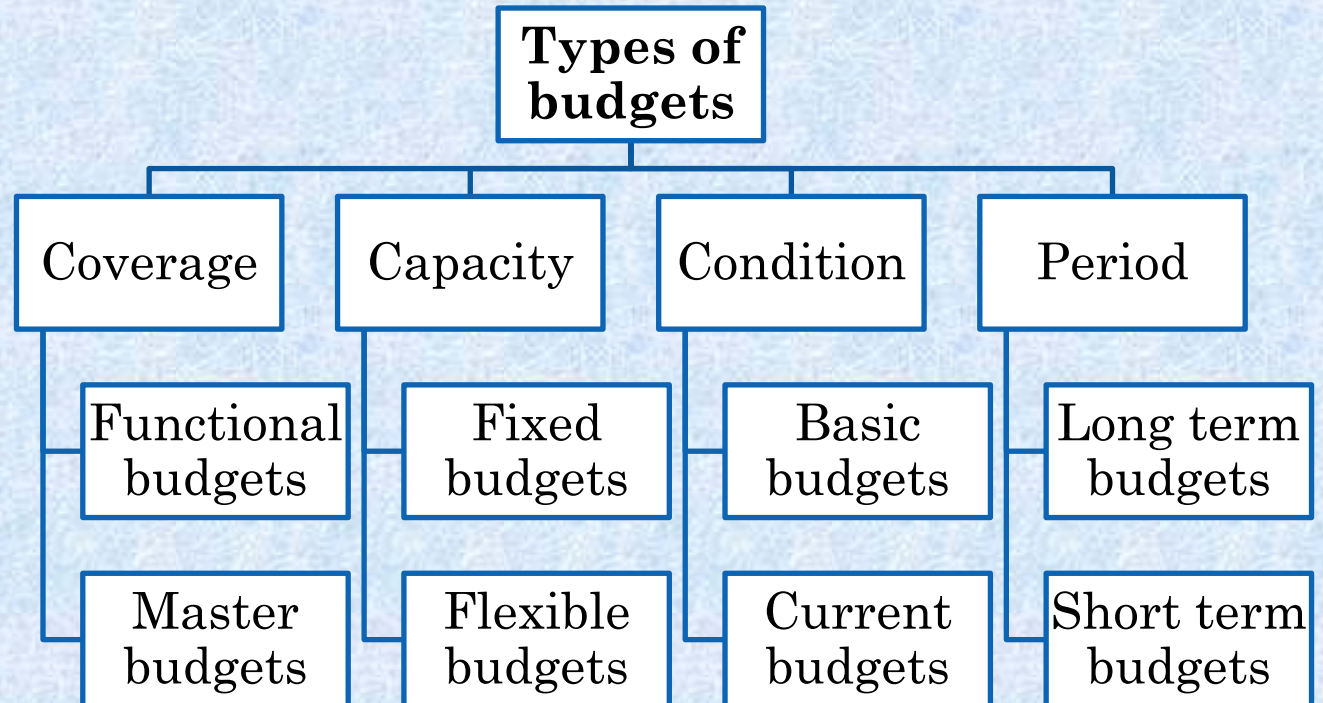
“A document schedule or a booklet which sets out, *inter alia*, the responsibilities of the persons engaged in the routine of and the forms and records required for budgetary control.”

- CIMA, London





# TYPES OF BUDGETS



# **I. FUNCTIONAL BUDGETS**

- Sales budget
- Production budget
- Materials budget
- Labour and personnel budget
- Manufacturing overhead budget
- Administration cost budget
- Plant utilisation budget
- Capital expenditure budget
- Research and development cost budget
- Cash budget

# SALES BUDGET

- Sales budget is the first and basic component of master budget and it shows the expected number of sales units of a period and the expected price per unit. It also shows total sales which are simply the product of expected sales units and expected price per unit.

**Sales Budget**  
**For the Year Ended December 31, 2010**

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Units	2,000	6,000	6,000	2,000	16,000
Unit selling price	×\$0.70	×\$0.70	×\$0.80	×\$0.80	×\$0.75
Sales	<u>\$1,400</u>	<u>\$4,200</u>	<u>\$4,800</u>	<u>\$1,600</u>	<u>\$12,000</u>



# PRODUCTION BUDGET

- Production budget is a schedule showing planned production in units which must be made by a manufacturer during a specific period to meet the expected demand for sales and the planned finished goods inventory.

**Production Budget**  
**For the Year Ended December 31, 2010**

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Sales (Schedule 1)	2,000	6,000	6,000	2,000	16,000
Desired ending inventory	<u>500</u>	<u>500</u>	<u>100</u>	<u>100</u>	<u>100</u>
Total needs	2,500	6,500	6,100	2,100	16,100
Less: Beginning inventory	<u>100</u>	<u>500</u>	<u>500</u>	<u>100</u>	<u>100</u>
Units to be produced	<u><u>2,400</u></u>	<u><u>6,000</u></u>	<u><u>5,600</u></u>	<u><u>2,000</u></u>	<u><u>16,000</u></u>



# PURCHASES BUDGET

- Purchases budget shows budgeted beginning and ending direct material inventory, the quantity of direct material that will be used in production, the amount of direct material that must be purchased and its cost during a specific period.

## Direct Materials Purchases Budget For the Year Ended December 31, 2010

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Units to be produced (Schedule 2)	2,400	6,000	5,600	2,000	16,000
Direct materials per unit (lbs.)	× 26	× 26	× 26	× 26	× 26
Production needs (lbs.)	62,400	156,000	145,600	52,000	416,000
Desired ending inventory (lbs.)	8,000	8,000	5,000	5,000	5,000
Total needs	70,400	164,000	150,600	57,000	421,000
Less: Beginning inventory*	5,000	8,000	8,000	5,000	5,000
Direct materials to be purchased (lbs.)	65,400	156,000	142,600	52,000	416,000
Cost per pound	× \$0.01	× \$0.01	× \$0.01	× \$0.01	× \$0.01
Total purchase cost	<u>\$ 654</u>	<u>\$ 1,560</u>	<u>\$ 1,426</u>	<u>\$ 520</u>	<u>\$ 4,160</u>

# DIRECT LABOR BUDGET

- Direct labor budget shows the total direct labor cost and number of direct labor hours needed for production. It helps the management to plan its labor force requirements.

**Direct Labor Budget**  
**For the Year Ended December 31, 2010**

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Units to be produced (Schedule 2)	2,400	6,000	5,600	2,000	16,000
Direct labor time per unit (hrs.)	<u>×0.015</u>	<u>×0.015</u>	<u>×0.015</u>	<u>×0.015</u>	<u>×0.015</u>
Total hours needed	36	90	84	30	240
Wage per hour	<u>× \$8</u>	<u>× \$8</u>	<u>× \$8</u>	<u>× \$8</u>	<u>× \$8</u>
Total direct labor cost	<u>\$ 288</u>	<u>\$ 720</u>	<u>\$ 672</u>	<u>\$ 240</u>	<u>\$1,920</u>



# FACTORY OVERHEAD BUDGET

- The factory overhead budget shows all the planned manufacturing costs which are needed to produce the budgeted production level of a period, other than direct costs.

**Overhead Budget**  
For the Year Ended December 31, 2010

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Budgeted direct labor hours (Schedule 4)	36	90	84	30	240
Variable overhead rate	× \$8	× \$8	× \$8	× \$8	× \$8
Budgeted variable overhead	\$288	\$ 720	\$672	\$240	\$1,920
Budgeted fixed overhead*	320	320	320	320	1,280
Total overhead	<u>\$608</u>	<u>\$1,040</u>	<u>\$992</u>	<u>\$560</u>	<u>\$3,200</u>

# ADMINISTRATIVE EXPENSE BUDGET

## Administrative Expense Budget For the Year Ended December 31, 2010

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Salaries	\$25	\$25	\$25	\$25	\$100
Insurance	—	—	15	—	15
Depreciation	10	10	10	10	40
Travel	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>8</u>
Total administrative expenses	<u>\$37</u>	<u>\$37</u>	<u>\$52</u>	<u>\$37</u>	<u>\$163</u>





# RESEARCH AND DEVELOPMENT EXPENSE BUDGET

## Research and Development Expense Budget For the Year Ended December 31, 2010

	<i>Quarter</i>				<i>Year</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
Salaries	\$18	\$18	\$18	\$18	\$ 72
Prototype design and development	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>40</u>
Total R&D expenses	<u>\$28</u>	<u>\$28</u>	<u>\$28</u>	<u>\$28</u>	<u>\$112</u>



# CASH BUDGET

- Cash budget is a financial budget prepared to calculate the budgeted cash inflows and outflows during a period and the budgeted cash balance at the end of the period. Cash budget helps the managers to determine any excessive idle cash or cash shortage that is expected during the period.



# CASH BUDGET

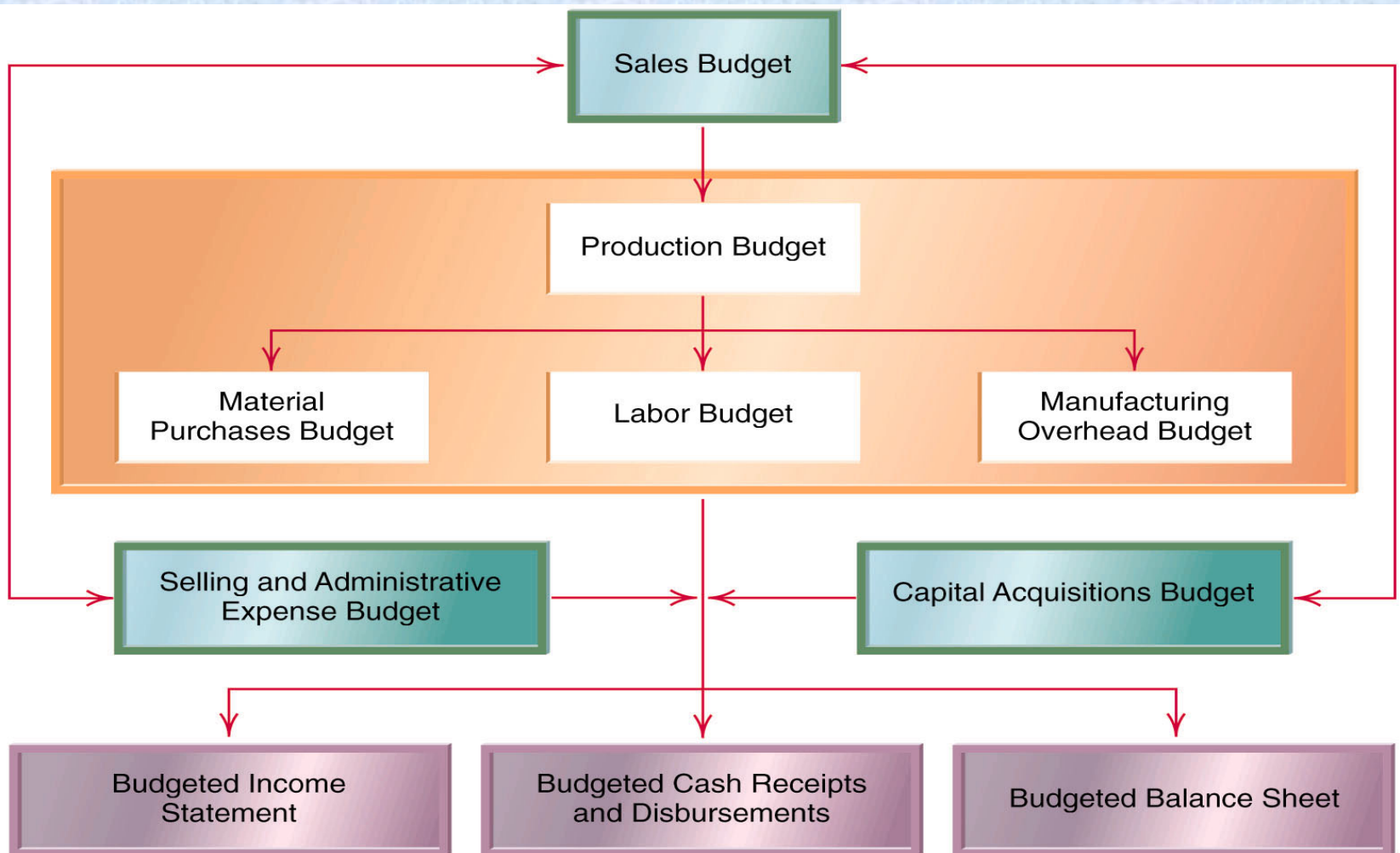
	Month 1	Month 1	Month 3
	\$	\$	\$
<b>Receipts:</b>			
Cash sales	xxx	xxx	xxx
Collection from credit sales	xxx	xxx	xxx
Collections from sales of non-current assets	xxx	xxx	xxx
Receipts from loans	xxx	xxx	xxx
Other receipts	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
<b>Total receipts (a)</b>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
<b>Payments:</b>			
Payment for cash and credit Purchases	xxx	xxx	xxx
Payment for expenses	xxx	xxx	xxx
Cash drawings	xxx	xxx	xxx
Purchase of non-current assets	xxx	xxx	xxx
Repayment of loans or debentures	xxx	xxx	xxx
Other payments	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
<b>Total payments (b)</b>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
<b>Net receipts (payments) (a-b)</b>	xxx	xxx	xxx
<b>Bank balance at start</b>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
<b>Bank balance at end</b>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>



## **II. MASTER BUDGET**

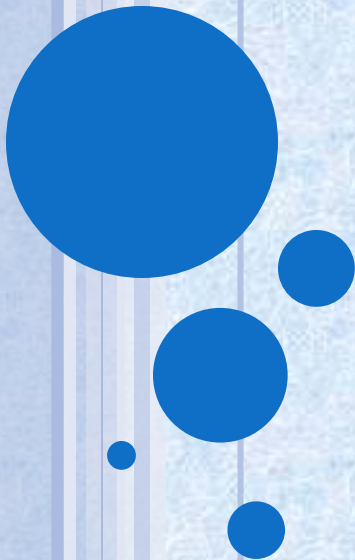
A master budget is a set of interconnected budgets of sales, production costs, purchases, incomes, etc. and it also includes pro forma financial statements. A budget is a plan of future financial transactions. A master budget serves as planning and control tool to the management since they can plan the business activities during the period on the basis of master budget. At the end of each period, actual results can be compared with the master budget and necessary control actions can be taken.

# MASTER BUDGET



# **FIXED BUDGET**

This budget is drawn for one level of activity and one set of conditions. It has been defined as a budget which is designed to remain unchanged irrespective of the volume of output or turnover attained. It is rigid budget and is drawn on the assumption that there will be no change in the budgeted level of activity.



# **FLEXIBLE BUDGET**

**A flexible budget is prepared after making an intelligent classification of all expenses between fixed, semi-variable and variable because the usefulness of such a budget depends upon the accuracy with which the expenses can be classified.**

**Such a budget is prescribed in the following cases:**

(i) Where the level of activity during the year varies from period to period, either due to the seasonal nature of the industry or to variation in demand.

(ii) Where the business is a new one and it is difficult to foresee the demand.

(iii) Where an industry is influenced by changes in fashion.

(iv) Where there are general changes in sales.

- **Basic Budgets:**

A basic budget has been defined as a budget which is prepared for use unaltered over a long period of time. This does not take into consideration current conditions and can be attainable under standard conditions.

- **Current Budgets:**

A current budget can be defined as a budget which is related to the current conditions and is prepared for use over a short period of time. This budget is more useful than a basic budget, as a target it lays down will be corrected to current conditions.





- **Long-Term Budgets:**

A long-term budget can be defined as a budget which is prepared for periods longer than a year. These budgets help in business forecasting and forward planning. Capital Expenditure Budget and Research and Development Budget are examples of long-term budgets.

- **Short-term Budgets:**

This budget is defined as a budget which is prepared for period less than a year and is very useful to lower levels of management for control purposes. Such budgets are prepared for those activities, the trend in which is difficult to foresee over longer periods. Cash budget and material budget are examples of short-term budgets.



# PERFORMANCE BUDGETING

- In performance budgeting classification of expenditure follows a three tier pattern viz. Function— Programme—Activity. Programme or production goals in physical and financial terms are established in accordance with this new classification and after the period, the actual performance is compared.
- Performance oriented budgets are established in such a manner that each item of expenditure related to a specific responsibility centre is closely linked with the performance of that centre.



# ZERO-BASE BUDGETING

- Zero-base budgeting is not based on the incremental approach and previous year's figures are not adopted as a base. Rather, zero is taken as a base as the name goes. Taking zero as a base, a budget is developed on the basis of likely activities for the future period.
- In ZBB, by delinking the budget from the past, the past mistakes are not repeated.
- CIMA has defined it **“as a method of budgeting whereby all activities are revaluated each time a budget is set. Discrete levels of each activity are valued and a combination chosen to match funds available”**.



## **Steps in ZBB:**

- (i) Identification of decision units in order to justify each item of expenditure in their proposed budget.
- (ii) Preparation of Decision Packages. Each package is a separate and identifiable activity. These packages are linked with corporate objectives.
- (iii) Ranking of decision packages based on cost benefit analysis.
- (iv) Allotment of funds based on the above resulting by following pyramid ranking system to ensure optimum results.



## BUDGETARY CONTROL

### ADVANTAGES

1. Maximisation of Profits
2. Proper co-ordination
3. Provides Specific Aims
4. Tool for Measuring Performance
5. Economy
6. Corrective Action
7. Creates Budget Consciousness
8. Reduced Costs
9. Determine Weaknesses
10. Introduction of Incentive Schemes

### LIMITATIONS

1. Uncertain Future
2. Revision Required
3. Discourage Efficient Persons
4. Problem of Co-ordination
5. Conflict among different departments
6. Depends upon support of top management

**THANK  
YOU**

