

## UNIT-III

### Budget and Budgetary Control

#### Introduction:

A budget is an accounting plan. It is a formal plan of action expressed in monetary terms. It could be seen as a statement of expected income and expenses under certain anticipated operating conditions. It is a quantified plan for future activities – quantitative blue print for action.

Every organization achieves its purposes by coordinating different activities. For the execution of goals efficient planning of these activities is very important and that is why the management has a crucial role to play in drawing out the plans for its business. Various activities within a company should be synchronized by the preparation of plans of actions for future periods. These comprehensive plans are usually referred to as budgets. Budgeting is a management device used for short-term planning and control. It is not just accounting exercise.

#### Meaning and Definition:

##### Budget:

*According to CIMA (Chartered Institute of Management Accountants) UK, a budget is “A plan quantified in monetary terms prepared and approved prior to a defined period of time, usually showing planned income to be generated and, expenditure to be incurred during the period and the capital to be employed to attain a given objective.”*

In a view of Keller & Ferrara, “a budget is a plan of action to achieve stated objectives based on predetermined series of related assumptions.”

G.A.Welsh states, “A budget is a written plan covering projected activities of a firm for a definite time period.”

One can elicit the explicit characteristics of budget after observing the above definitions. They are...

- It is mainly a forecasting and controlling device.
- It is prepared in advance before the actual operation of the company or project.
- It is in connection with definite future period.
- Before implementation, it is to be approved by the management.
- It also shows capital to be employed during the period.

##### Budgetary Control:

Budgetary Control is a method of managing costs through preparation of budgets. Budgeting is thus only a part of the budgetary control. According to CIMA, “Budgetary control is the establishment of budgets relating to the responsibilities of executives of a policy and the continuous comparison of the actual with the budgeted

results, either to secure by individual action, the objective of the policy or to provide a basis for its revision.”

The main features of budgetary control are:

1. Establishment of budgets for each purpose of the business.
2. Revision of budget in view of changes in conditions.
3. Comparison of actual performances with the budget on a continuous basis.
4. Taking suitable remedial action, wherever necessary.
5. Analysis of variations of actual performance from that of the budgeted performance to know the reasons thereof.

### Objectives of Budgetary Control:

Budgeting is a forward planning. It serves basically as a tool for management control; it is rather a pivot of any effective scheme of control.

The objectives of budgeting may be summarized as follows:

1. **Planning:** Planning has been defined as the design of a desired future position for an entity and it rests on the belief that the future position can be attained by uninterrupted management action. Detailed plans relating to production, sales, raw-material requirements, labour needs, capital additions, etc. are drawn out. By planning many problems estimated long before they arise and solution can be thought of through careful study. In short, budgeting forces the management to think ahead, to foresee and prepare for the anticipated conditions. Planning is a constant process since it requires constant revision with changing conditions.
2. **Co-ordination:** Budgeting plays a significant role in establishing and maintaining coordination. Budgeting assists managers in coordinating their efforts so that problems of the business are solved in harmony with the objectives of its divisions. Efficient planning and business contribute a lot in achieving the targets. Lack of co-ordination in an organization is observed when a department head is permitted to enlarge the department on the specific needs of that department only, although such development may negatively affect other departments and alter their performances. Thus, co-ordination is required at all vertical as well as horizontal levels.
3. **Measurement of Success:** Budgets present a useful means of informing managers how well they are performing in meeting targets they have previously helped to set. In many companies, there is a practice of rewarding employees on the basis of their accomplished low budget targets or promotion of a manager is linked to his budget success record. Success is determined by comparing the past performance with previous period's performance.
4. **Motivation:** Budget is always considered a useful tool for encouraging managers to complete things in line with the business objectives. If individuals have intensely participated in the preparation of budgets, it acts as a strong motivating force to achieve the goals.
5. **Communication:** A budget serves as a means of communicating information within a

firm. The standard budget copies are distributed to all management people provide not only sufficient understanding and knowledge of the programmes and guidelines to be followed but also give knowledge about the restrictions to be adhered to.

6. **Control:** Control is essential to make sure that plans and objectives laid down in the budget are being achieved. Control, when applied to budgeting, as a systematized effort is to keep the management informed of whether planned performance is being achieved or not.

### **Advantages of Budgetary control:**

In the light of above discussion one can see that, coordination and control help the planning. These are the advantages of budgetary control. But this tool offer many other advantages as follows:

1. This system provides basic policies for initiatives.
2. It enables the management to perform business in the most professional manner because budgets are prepared to get the optimum use of resources and the objectives framed.
3. It ensures team work and thus encourages the spirit of support and mutual understanding among the staff.
4. It increases production efficiency, eliminates waste and controls the costs.
5. It shows to the management where action is needed to remedy a position.
6. Budgeting also aids in obtaining bank credit.
7. It reviews the present situation and pinpoints the changes which are necessary.
8. With its help, tasks such as like planning, coordination and control happen effectively and efficiently.
9. It involves an advance planning which is looked upon with support by many credit agencies as a marker of sound management.

### **Limitations of Budgetary control:**

1. It tends to bring about rigidity in operation, which is harmful. As budget estimates are quantitative expression of all relevant data, there is a tendency to attach some sort of rigidity or finality to them.
2. It being expensive is beyond the capacity of small undertakings. The mechanism of budgeting system is a detailed process involving too much time and costs.
3. Budgeting cannot take the position of management but it is only an instrument of management. 'The budget should be considered not as a master, but as a servant.' It is totally misconception to think that the introduction of budgeting alone is enough to ensure success and to security of future profits.
4. It sometimes leads to produce conflicts among the managers as each of them tries to take credit to achieve the budget targets.
5. Simple preparation of budget will not ensure its proper implementation. If it is not implemented properly, it may lower morale.
6. The installation and function of a budgetary control system is a costly affair as it requires employing the specialized staff and involves other expenditure which small companies may find difficult to incur.

## Essentials of Effective Budgeting:

- 1) Support of top management:** If the budget structure is to be made successful, the consideration by every member of the management not only is fully supported but also the impulsion and direction should also come from the top management. No control system can be effective unless the organization is convinced that the management considers the system to be important.
- 2) Team Work:** This is an essential requirement, if the budgets are ready from “the bottom up” in a grass root manner. The top management must understand and give enthusiastic support to the system. In fact, it requires education and participation at all levels. The benefits of budgeting need to be sold to all.
- 3) Realistic Objectives:** The budget figures should be realistic and represent logically attainable goals. The responsible executives should agree that the budget goals are reasonable and attainable.
- 4) Excellent Reporting System:** Reports comparing budget and actual results should be promptly prepared and special attention focused on significant exceptions i.e. figures that are significantly different from expected. An effective budgeting system also requires the presence of a proper feed-back system.
- 5) Structure of Budget team:** This team receives the forecasts and targets of each department as well as periodic reports and confirms the final acceptable targets in form of Master Budget. The team also approves the departmental budgets.
- 6) Well defined Business Policies:** All budgets reveal that the business policies formulated by the higher level management. In other words, budgets should always be after taking into account the policies set for particular department or function. But for this purpose, policies should be precise and clearly defined as well as free from any ambiguity.
- 7) Integration with Standard Costing System:** Where standard costing system is also used, it should be completely integrated with the budget programme, in respect of both budget preparation and variance analysis.
- 8) Inspirational Approach:** All the employees or staff other than executives should be strongly and properly inspired towards budgeting system. Human beings by nature do not like any pressure and they dislike or even rebel against anything forced upon them.