K.T.S.P.Mandal's

SAHEBRAOJI BUTTEPATIL MAHAVIDYALAYA

Rajgurunagar, Tal-Khed, Dist-Pune,410505

Department of Commerce

T.Y.B.COM

SEM-V

Subject
Cost and Works Accounting-III

Chapter 2
Budgetary Control
Theory

Cost and Works Accounting-III

Chapter 2nd Budgetary Control

Remaining Theory

Introduction:-

Budgets are business estimates for future period. The term budget is derived from the French word bougette which means a little bag containing documents and accounts. A budget is a plan which relates to a definite period of time and which is expressed in quantitative term.

Thus, a budget is a tool in the hands of the management which serves as a guide to all the employees in achieving their , objectives and targets.

Definition of budget

Kohler

A financial planner serving as a pattern for and a control over future operation

Brown and Howard

It is a pre-determined statement of management policy during a given period which provides a standard for comparison with the results actually achieved.

Features of budget

1) It is statement expressed in numbers
2) It is financial and quantitative statement
3) It is prepared for a future specific period of time
4) It is based on the policies to be pursued
5) It is prepared for the purpose of attaining a given objective
6) It may be prepared for a short medium or long term period.
7) It may relate to fall of organisation or various departments.
8) It is an instrument of financial control

Budgetary control

It involves use of budgeting techniques to help the management for carrying out various functions that is planning organising coordinating and controlling activities of business.

Definition

"Budgetary control is a system whereby the budgets are used as a means of planning and controlling cost."

"Budgetary control is the process of determining various actual results with budgeted figures."

"Budgetary control is the process by which budgets are prepared for future period and are compared with the actual performance."

Features of budgetary control

1) Establishment of budgets for each department or function of organisation.
2) Coordination of various budgets as a total plan for entire organisation.
3) Recording and reporting of actual results.
4) Comparing the actual result continuously with the budgeted performance.
5) Analysing the reasons to stop fixing responsibilities for every controllable variance.
6) To see that mistakes of past are not repeated in future.
7) Taking corrective actions where as possible.
8) Concerned with planning coordination control.

Objectives of budgetary control

1) To identify the overall aims of business enterprise.
2) To determine specific target of performance for each division of the business.
3) To fix up the responsibilities of the top executives and other personal.
4) To provide a basis for comparison of actual performance with the predetermined targets.
5) To analyse the differences more carefully for taking for a maximization of quality production.
6) To delegate authority for increasing efficiency.
7) To ensure the best use of the available resources for a maximization of quality production.
8) To draw long term plan with absolute accuracy.
9) To find out capital requirements for achieving plan targets.
10) To provide suitable standard performance with which actual can be compared.

Essentials of Budgetary Control

1) Sound organisation
2) Cost factor
3) Interpersonal relationship
4) Systematic accounting system
5) High profits
6) Goals should be achievable
7) Constant review
8) Fixing of responsibilities and preparation of budget
9) Budget committee
10) Involvement of top management

Procedure of Budgetary Control

1) Establishment of budget centre

A budget centre is a section of the organisation of an undertaking defined for the purpose of budgetary control budget centre should be clearly defined and established for each of which a budget will be set with the help of head of departments concert by the accountant in conjunction with production managers other executives.

2) Preparation of an organisation chart

3) Preparation of adequate accounting records

It is essential that the accounting system should be able to record and analyse the transactions involved there in. Accounts code should be maintained with main linked with the budget centre for establishment of budgets and finally control through budgets.

4) Preparation of budget committee

5) Preparation of budget manual

6) Fixation of budget period

7) Determination of governing factors

A governing factors are key factors of principal budget factor is that factor that extent of whose influence must first be assessed in order to ensure that functional budgets are reasonably capable of fulfilment. The key factor serves as a starting point for preparation of budget.

Generally sales become the key factor but other factors of production such as main material machine capital etc. may also be factors.

Advantages and limitations of budgetary control

Advantages of budgetary control

1) It locates the inefficient areas and persons in the business.

2) It helps to increase the efficiency reduce wastage and control cost.

3) It helps to co-ordinate the activities of the various employs departments and thus helps to achieve the goals of the management.

4) Maximisation of profits is possible through budgeting.

5) It helps to introduce the standard costing techniques.

6) Tips to ensure your cash flow and hence bank credit can be obtained.

7) Authority can be delegated and responsibilities fixed.

8) Important decisions can be taken by the management based on the budgets.

9) Corrective action can be taken in the time.

Limitations of budgetary control

1) Budgetary control does not replace management.

2) Less flexibility

3) Budgets are based on estimated figures.

4) Costly system

5) Budgetary control deals with quantitative data only.

Steps of budgetary control

1) Preparation of budgets.
2) Measurement of actual performance.
3) Comparison of actual performance.
4) Analysis of reasons for if not achieved targets.

Types of budgets

A) According to time

1) Long term budget

The budget which covers the period over 1 year termed as long term budget. They are related to plan the operation of the business concern.

2) Short term budget

The budget which cover the period of one year or even less than one year are termed as short term budget.

3) Current budgets

The budgets which cover the period of quarter or less than 1 quarter eg. a monthly or a fortnightly or a weekly period are termed as current budgets.

B) According to flexibility

1) Fixed budget

A budget which is designed to remain unchanged irrespective of the value of output or turnover achieved. Fixed or static budgets are prepared for only one level of activity under the same conditions.

2) Flexible budget

A flexible or variable budget is a concise statement of how cost are related to fluctuations in output it is one which is designed to change according to the level of activity actually achieved the budgeted figures can be changed according to the changing conditions hence a flexible budget is just opposite of fixed budget.

C) According to functions

1) Sales budget

Statement of planned sales expressed in terms of quantity and value is called sales budget.

2) Production budget

This budget is prepared after the sales budget because the sales to be made are estimated in the sales budget so that how much quantity should be produced can be known. Thus a production budget is one which is an estimate for the quantities of goods to be purchased during the budget period to stop it is expressed either in units for standard hours.

3) Purchase budget

This budget is prepared by the purchase manager to show the purchase which must be made during the budgeted period to stop it includes the direct and indirect materials to be purchased and also the service required by the management.

4) Administrative cost budget

This comprises the salaries and other related expenses of administrative office and management for a stipulated period.

5) Research and development cost budget

It includes the salaries of research assistants' technical expenses of a research and development department's product development expenses etc. this concern the continuous improvement in the quality of the product or introduction of new products as per customer requirements.

6) Capital expenditure budget

This represents the forecast of the total financial outlay on acquisition of fixed assets such as plant and machinery land and buildings furniture fixtures and fittings as also of a different source of capital required.

7) Cash budget

Cash budget is a forecast of cash position for a particular period. It represents the cash requirements of the business during the budget period. It is financial budget prepared after the preparation of all functional budgets.

An estimate of receipts and payments for each month or any other relevant period forming part of the entire budget period is called cash budget.

Methods of preparation of cash budget

A) Receipt and payment method

According to this method cash budget includes all the cash receipts whether they are on revenue account or capital account. Similarly all expected capital and revenue expenditure are brought in a cash budgets. In this method all the cash receipts which are expected and all the cash payments which are expected to be made at taken into account full stop does the cash balance will represent the difference between the total cash receipts expected and total cash payments to be made.

B) Profit and loss method

Under this method the profit as shown in the profit and loss account prepared in the conventional manner forms the basis for cash forecast. The profit is adjusted by adding back to eat the non cash items such as depreciation outstanding expenses other provisions etc.

C) Balance sheet method

As per this method a projected balance sheet is prepared in which cash balance is not an estimated item but a difference between total projected assets and total estimated liabilities. In other words the excess of projected assets over projected liabilities represents cash balance. If the liabilities are more than the assets the balance shows the overdraft.

Management control instruments

Are:-

1) Program budgeting

The program budget is developed in terms of products that are regarded as the principal of programs of the business. Such a budget shows expected revenues and cost of various products.

Program budgeting is the budgetary process that was used for the first time in USA in 1962 in government organisation.

"A projection of government activities and expenditure their on for the budget period classified budget expenses by functions and activities."

2) Performance budgeting

The performers are constantly controlled with the help of budgets. At short intervals budget reports are prepared showing actual and budgeted amount and the difference is shown as favourable or unfavourable viruses together with the originating causes.

"process of analysing identifying simplifying and crystallizing specific performance activities of a job to be achieved over a period of within the framework of organisational objectives."

3) Revenue budget

Revenue budget have three components principal budgets secondary budgets and summary budgets.

Principal budgets- principal budget have a revenue earning or income budgets marketing expenses budgets.

Secondary budget-secondary budget have a working capital budget demand analysis of sales forecasting budget expenses behaviour analysis and manpower planning and personal budgets.

Summary budgets-summary budgets are the budgeted profit and loss account and the budgeted balance sheet.

Zero based budgeting

Zero based budgeting is a method of budgeting whereby all activities are re-evaluated each time A budget is formulated and every time of expenditure in the budget is fully justified. That is zero based budgeting in world starting from scratch or zero.

Zero based budgeting rejects the traditional view of annual budgeting as an incremental process which takes into account current expenditure Plus and estimate of next year's expenditure to arrive at the next budget.

Definition

"A planning and budgeting process which requires each manager to justify his entire budget request in detail right from scratch and shifts the burden of proof to its manager to justify why he should spend any money at all."

Zero based budgeting is an approach to making a budget from scratch to stop the budget is not based on previous budgets to stop in state the budget start at zero. With zero based budgeting you need to justify every expenses before adding it to the official budget.the goal of zero based budgeting is to reduce spending by looking at where cost can be cut.

The **process** of zero-based budgeting follows the following basic steps

1.Business goals

2.Develop and analyse new way to achieve goals

3.Discover new way to fund business processes

4.Priorities funds

Advantages of zero based budgeting

1) It helps in management of projects programs and activities according to availability of funds.

2) It provides an inbuilt system for reviewing actual cost and performance.

3) It improves communication all round.

4) It promotes innovative ideas in terms of alternative ways of performing an activity.

5) It helps in identifying areas of wasteful expenditure

Disadvantages of zero based budgeting

1) The cost involved in preparing a vast number of decision packages in a large form are very high.

2) It is very time consuming and large amount of additional paperwork is involved.

3)Administration and Communication of zero based budgeting process may become critical problems because more managers become involved in this process then in most budgeting and planning procedures.

Reference:-

- Techniques of Cost Accounting- Dr, Suhas Mahajan & Dr, Mahesh Kulkarni, Nirali Prakashan
- Costing Techniques and Cost Audit- Dr. Arun Gaikwad , H. M. Jare , Dr. Kishor Jagtap , Dr. Sunil Zagade , Success Publications