

BUDGETARY CONTROL

Definition: Budgetary Control is defined as "the establishment of budgets, relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results either to secure by individual action the objective of that policy or to provide a base for its revision.

Salient features:

- **Objectives:** Determining the objectives to be achieved, over the budget period, and the policy that might be adopted for the achievement of these ends.
- **Activities:** Determining the variety of activities that should be undertaken for achievement of the objectives.
- **Plans:** Drawing up a plan or a scheme of operation in respect of each class of activity, in physical as well as monetary terms for the full budget period and its parts.
- **Performance Evaluation:** Laying out a system of comparison of actual performance by each person section or department with the relevant budget and determination of causes for the discrepancies, if any.
- **Control Action:** Ensuring that when the plans are not achieved, corrective actions are taken; and when corrective actions are not possible, ensuring that the plans are revised and objective achieved

CLASSIFICATION OF BUDGETS

Budgets may be classified on the following bases –

a) **BASED ON TIME PERIOD:**

- (i) **Long Term Budget:** Budgets which are prepared for periods longer than a year are called Long Term Budgets. Such Budgets are helpful in business forecasting and forward planning. Eg: Capital Expenditure Budget and R&D Budget.
- (ii) **Short Term Budget:** Budgets which are prepared for periods less than a year are known as Short Term Budgets. Such Budgets are prepared in cases where a specific action has to be immediately taken to bring any variation under control. Eg: Cash Budget.

b) **BASED ON CONDITION:**

- (i) **Basic Budget:** A Budget, which remains unaltered over a long period of time, is called Basic Budget.
- (ii) **Current Budget:** A Budget, which is established for use over a short period of time and is related to the current conditions, is called Current Budget.

c) **BASED ON CAPACITY:**

- (i) **Fixed Budget:** It is a Budget designed to remain unchanged irrespective of the level of activity actually attained. It operates on one level of activity and less than one set of conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.
- (ii) **Flexible Budget:** It is a Budget, which by recognizing the difference between fixed, semi variable and variable costs is designed to change in relation to level of activity attained. It consists of various budgets for different levels of activity

d) **BASED ON COVERAGE**

- (i) **Functional Budget:** Budgets, which relate to the individual functions in an organization, are known as Functional Budgets, e.g. purchase Budget, Sales Budget,

Production Budget, plant Utilization Budget and Cash Budget.

- (ii) **Master Budget:** It is a consolidated summary of the various functional budgets. It serves as the basis upon which budgeted Profit & Loss Account and forecasted Balance Sheet are built up.

BUDGETARY CONTROL TECHNIQUES

The various types of budgets are as follows

- **Revenue and Expense Budgets:** The most common budgets spell out plans for revenues and operating expenses in rupee terms. The most basic of revenue budget is the sales budget which is a formal and detailed expression of the sales forecast. The revenue from sales of products or services furnishes the principal income to pay operating expenses and yield profits. Expense budgets may deal with individual items of expense, such as travel, data processing, entertainment, advertising, telephone, and insurance.
- **Time, Space, Material, and Product Budgets:** Many budgets are better expressed in quantities rather than in monetary terms. e.g. Direct-labour-hours, machine-hours, units of materials, square feet allocated, and units produced. The Rupee cost would not accurately measure the resources used or the results intended.
- **Capital Expenditure Budgets:** Capital expenditure budgets outline specifically capital expenditures for plant, machinery, equipment, inventories, and other items. These budgets require care because they give definite form to plans for spending the funds of an enterprise. Since a business takes a long time to recover its investment in plant and equipment, (Payback period or gestation period) capital expenditure budgets should usually be tied in with fairly long-range planning.
- **Cash Budgets:** The cash budget is simply a forecast of cash receipts and disbursements against which actual cash "experience" is measured. The availability of cash to meet obligations as they fall due is the first requirement of existence, and handsome business profits do little good when tied up in inventory, machinery, or other noncash assets.
- **Variable Budget:** The variable budget is based on an analysis of expense items to determine how individual costs should vary with volume of output.

Some costs do not vary with volume, particularly in so short a period as 1 month, 6 months, or a year. Among these are depreciation, property taxes and insurance, maintenance of plant and equipment, and costs of keeping a minimum staff of supervisory and other key personnel. Costs that vary with volume of output range from those that are completely variable to those that are only slightly variable.

The task of variable budgeting involves selecting some unit of measure that reflects volume; inspecting the various categories of costs (usually by reference to the chart of accounts); and, by statistical studies, methods of engineering analyses, and other means, determining how these costs should vary with volume of output.

- **Zero Based Budget:** The idea behind this technique is to divide enterprise programs into "packages" composed of goals, activities, and needed resources and then to calculate costs for each package from the ground up. By starting the budget of each package from base zero, budgeters calculate costs afresh for each budget period; thus they avoid the common tendency in budgeting of looking only at changes from a previous period.

Advantages

There are a number of advantages of budgetary control:

- Promotes coordination and communication.
- Enables remedial action to be taken as variances emerge.
- Motivates employees by participating in the setting of budgets.
- Improves the allocation of scarce resources.
- Economises management time by using the management by exception principle.

Problems in budgeting

- Whilst budgets may be an essential part of any marketing activity they do have a number of disadvantages, particularly in perception terms.
- Budgets can be seen as pressure devices imposed by management, thus resulting in:
 - Bad labour relations
 - Inaccurate record-keeping.
- Departmental conflict arises due to:
 - Disputes over resource allocation
 - Departments blaming each other if targets are not attained.
- It is difficult to reconcile personal/individual and corporate goals.
- Responsibility versus controlling, i.e. some costs are under the influence of more than one person, e.g. power costs.
- Managers may overestimate costs so that they will not be blamed in the future should they overspend.

NON-BUDGETARY CONTROL TECHNIQUES

There are, of course, many traditional control devices not connected with budgets, although some may be related to, and used with, budgetary controls.

- **Statistical data:** Statistical analyses of innumerable aspects of a business operation and the clear presentation of statistical data, whether of a historical or forecast nature are, of course, important to control. Some managers can readily interpret tabular statistical data, but most managers prefer presentation of the data on charts.
- **Break- even point analysis:** An interesting control device is the break even chart. This chart depicts the relationship of sales and expenses in such a way as to show at what volume revenues exactly cover expenses.
- **Operational audit:** Another effective tool of managerial control is the internal audit or, as it is now coming to be called, the operational audit. Operational auditing, in its broadest sense, is the regular and independent appraisal, by a staff of internal auditors, of the accounting, financial, and other operations of a business.
- **Personal observation:** In any preoccupation with the devices of managerial control, one should never overlook the importance of control through personal observation.
- **PERT:** The Program (or Project) Evaluation and Review Technique, commonly abbreviated PERT, is a method to analyze the involved tasks in completing a given project, especially the time needed to complete each task, and identifying the minimum time needed to complete the total project.
- **GANTT CHART:** A Gantt chart is a type of bar chart that illustrates a project schedule. Gantt charts illustrate the start and finish dates of the terminal elements and summary elements of a project. Terminal elements and summary elements comprise the work breakdown structure of the project. Some Gantt charts also show the dependency (i.e., precedence network) relationships between activities.