15. BUDGETS AND BUDGETARY CONTROL

BLOCK NO 1: Budget

It means establishment of future targets on the basis of past experience and other relevant factors.

MEANING OF BUDGETING

Budgeting is the art of building budgets. Budgeting is a process of (i) making budgets and (ii) making use of budgets for further planning, co-ordinating and control purposes.

CHARACTERISTICS

The main characteristics of a budget are:

1. Prepared in Advance: It is prepared in advance and is derived from the long-term strategy of the organisation.

2. Relates to Future: It is related to future period for which objectives or goals have already been laid down

3. Expressed in Quantitative/Financial Terms: It is expressed in quantitative form, physical or monetary units, or both.

BB-2

BLOCK NO 2: Control Ratio

$$\text{Activity Ratio} = \frac{\text{Standard hours for actual output}}{\text{Budgeted hours for budgeted output}} \times 100$$

$$\text{Capacity Ratio} = \frac{\text{Actual hours worked for actual output}}{\text{Budgeted hours for budgeted output}} \times 100$$

$$\text{Efficiency Ratio} = \frac{\text{Standard hours for actual output}}{\text{Actual hours worked}} \times 100$$

$$\text{Activity Ratio} = \text{Capacity Ratio} \times \text{Efficiency ratio}$$

BB-3

BLOCK NO 3: Sales Budget

This Budget shows sales target to be achieved by business organization.
It shows quantity and amount to be achieved during budgeted Period.

At the end of period, Budgeted sales are compared with actual sales to calculate variance.
In case of negative (Adverse) variance, Reasons are identified so that such negative variance do not repeat in future.

BLOCK NO 4: Production Budget

BB-4

This Budget shows the production "units" which will be produced in Budgeted period.

This budget is prepared with the help of following equation :

Budgeted Production = Budgeted sales + Cl. Stock of FG(Budgeted) - Op. stock of FG

Raw material consumed = Budgeted production x Raw material reqd. p.u.

Labour hours to be utilized = Budgeted production x Labour hours reqd. p.u.

BLOCK NO 5: Production Cost Budget

BB-5

This Budget shows the cost which should have been incurred to produce Budgeted output.

In future, we compose budgeted production cost with actual production cost to calculate Variance.

BLOCK NO 6: Cash Budget

BB-6

This Budget shows estimated cash inflow and estimated cash outflows during budgeted Period.

Cash A/c is prepared for past cash inflows and out flows while cash Budget is made for future inflows and outflows.

This budget is prepared with the help of following equation:

Opening cash Balance + Estimated cash inflows - Estimated cash outflows = Closing cash balance

BLOCK NO 7: Flexible Budget

When Budget is prepared at different activity level it is called flexible Budget.

For this we will divide all expense into 3 categories:

1. Variable Exp: If cost p.u. of an expense is same at different level or production then it is variable Expense.
2. Fixed Expense: If total cost of an expense is same at different of level of production, then it is fixed Expense.
3. Semi variable Expense: If an expense is neither variable nor fixed expense then it is semi-variable Expense.

$$\text{Variable portion in SVC} = \frac{\text{Difference in total SVC}}{\text{Difference in units}}$$

Fixed portion in SVC = Total SVC - Total variable portion of that SVC

Note 1: Any increase or decrease in variable cost shall be applied on variable cost per unit.

Note 2: Any increase or decrease in fixed cost shall be applied on total fixed cost.

BB-7

FORMAT OF FLEXIBLE BUDGET

Particulars	Capacity Level		
	60%	80%	90%
A. Sales (in units)	……..	……..	……..
B. Selling Price per unit	……..	……..	……..
C. Total Sales (A x B)	……..	……..	……..
D. Variable Cost of Sales:			
(a) Direct Material @ ….. per unit	……..	……..	……..
(b) Direct Labour @ per unit	……..	……..	……..
(c) Direct Expenses @ ….. per unit	……..	……..	……..
(d) Production Overheads @ per unit	……..	……..	……..
(e) Adm. Overheads @ ….. per unit	……..	……..	……..
(f) Selling & Distribution Overheads @ per unit	……..	……..	……..
E. Contribution (C - D)	……..	……..	……..
F. Fixed Costs:			
(a) Production Overheads	……..	……..	……..
(b) Adm. Overheads	……..	……..	……..
(c) Selling & Distribution Overheads	……..	……..	……..
G. Profit (E-F)	……..	……..	……..

DISTINCTION BETWEEN FIXED BUDGET AND FLEXIBLE BUDGET

Basis of Distinction	Fixed Budget	Flexible Budget
1. Change with Activity	It does not change with actual volume of activity achieved. Thus, it is known as rigid or inflexible budget.	It can be recasted on the basis of activity level to be achieved. Thus, it is not rigid.
2. One Level or different levels of activity	It operates on one level of activity and under one set of conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.	It consists of various budgets for different levels of activity.
3. Utility of Variance Analysis	Since all costs like-fixed, variable and semi-variable are related to only one level of activity, variance analysis does not give useful information.	Here analysis of variance provides useful information as each cost is analysed according to its behaviour.
4. Decision Making	If the budgeted and actual activity levels differ significantly, then the aspects like cost ascertainment and price fixation do not give a correct picture.	Flexible budgeting at different levels of activity, facilitates the ascertainment of cost, fixation of selling price and tendering of quotations.
5. Basis of Comparison	Comparison of actual performance with budgeted targets will be meaningless specially when there is a difference between the two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgeted targets.

BLOCK NO 8: OTHER BUDGETS

Functional Budgets

Budgets which relate to the individual functions in an organization are known as Functional Budgets.

For Example, purchase budget; sales budget; production budget; plant-utilisation budget and cash budget.

Master Budget

It is a consolidated summary of the various functional budgets. It serves as the basis upon which budgeted P & L A/c and forecasted Balance Sheet are built up.

Long-term Budgets

The 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.

Capital expenditure budget and Research and Development budget are examples of long-term budgets.

Short-term Budgets

Budgets which are prepared for period upto a year are known as short- term budgets.

Such type of budgets are prepared in cases where a specific action has to be immediately taken to bring any variation under control, as in cash budgets.

Cash budget is an example of short-term budget.

Basic Budget

A budget which remains unaltered over a long period of time is called basic budget.

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.