INTRODUCTION

Management primarily performs three major functions viz.

• Planning
• Directing and Motivating
• Controlling

One of the three main functions of management is to control. Budgets are useful in controlling operations. The budgetary control has now become an essential tool of the management for controlling costs and maximizing profits. Costs can be reduced, wastage can be prevented and proper relationship between cost and incomes can be established only when the various factors of production are combined in the most profitable way. This requires carefully working out plans in advance for all divisions of the industrial plants, there implementation and investigating the causes of variance between anticipated and actual result. The budget and its administration are one of the principal means of meeting this end. A budget is a detailed plan of operations for some specific future period. It is an estimate prepared in advance to which it applies. It acts as a business barometer as it is a complete program of activities of the business for the period covered. The charted institute of management accountants, London, defines the budget as “A financial and/or quantitative statement, prepared prior to a defined period of time , of the policy to be pursued during that period for the purpose of attaining a given objective thus the essentials of budget are.

•It is prepared in advance and is based on a future plan of action;
•It relates to a future period and is based on objective to be attained;
•It is a statement expressed in monetary and/or physical units prepared for the implementation of the policy formulated by the management;

Budgetary control is defined by the Institute of Cost and Management Accountant s (CIMA) 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 basis for its revision".

Budgetary control methods a) Budget:

• A formal statement of the financial resources set aside for carrying out specific activities in a given period of time.
• It helps to co-ordinate the activities of the organization
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An example would be an advertising budget or sales force budget.

Budgetary control:

• A control technique whereby actual results are compared with budgets.
• Any differences (variances) are made the responsibility of key individuals who can either exercise control action or revise the original budgets.

STEPS IN BUDGETARY CONTROL

1) Organization for Budgeting.

The setting up of a definite plan of organization is the first step towards installing budgetary control system in an organization a budget manual should be pre pared giving details of the powers, duties, responsibilities and areas of operation of each executive in the organization.

2) Budget manual

There are many advantages attached to the use of budget manual. It is a formal record defining the functions and responsibilities of each executive. The methods and procedures of budgetary control are standardized. There is synchronization of the efforts of all which result in maximization of the profits of the organization. The budget manual is a written document or booklet that specifies the objectives of budgeting organization and procedures. Following are some of the important matters covered in a budget manual:

1. A statement regarding the objectives of the organization and how they can be achieved through budgetary control.

2. A statement regarding the functions and responsibilities of each Executive by designation both regarding preparation and execution of budgets.

3. Procedures to be followed for obtaining the necessary approval of budgets.

4. The authority of granting approval should be stated in explicit terms. Whether one, two or more signatures are to be required on each document should also be clearly stated.

5. Timetable for all stages of budgeting.

6. Reports, statements, forms and other records to be maintained.

7. The accounts classification to be employed. It is necessary that the framework within which the costs, revenues and other financial amount are classified must be identical both in accounts and the budget departments.

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3) Responsibility for budgeting

"A document which sets out, inter alias, the responsibilities of the persons eng
aged in, the routine of and forms and records required for budgetary control."

Budget Controller

Although the chief executive is finally responsible for the budget programme, it is better if a large part of the supervisory responsibility is delegated to an official designated as Budget Controller or Budget Director. Such a person should have knowledge of the technical details of the business and should report directly to the president or the Chief Executive of the organization.

Fixation of the budget period

Budget period mean the period for which a budget is prepared and employed. The budget period depends upon the nature of the business and the control techniques.

For example, a seasonal industry will budget for each season while an industry requiring long periods to complete work will budget for four, five or even larger number of year. However, it is necessary of control purposes to prepare budgets both for long as well as short periods.

Budget committee

This may consist of senior members of the organization, e.g. departmental heads and executives (with the managing director as chairman). Every part of the organization should be represented on the committee, so there should be a representative from sales, production, marketing and so on.

4) Budget Procedures

Having established the budget organization and fixed the budget period, the actual work or budgetary control can be taken upon the following pattern:

Determination of key factor

Key factor is that factor whose influence must be first assessed in order to ensure that functional budgets (relating to the different functions of the business e.g. Sales, production, purchase, cash etc.) are reasonably capable of fulfillment.

Making of forecasts

Forecasts means an estimate about the profitable events at a given period of time. Forecasts are made regarding sales, production and financial requirements of the business.

Consideration of alternative combination of forecasts

Alternative combinations of forecasts are considered with a view to contain the most efficient overall plan so as to maximize profits. When the optimum-profit combination of forecasts is selected, the forecasts should be regarded as being finalized.

Preparation of budgets

On the finalization of the forecasts the budgets will be prepared. e.g. Product ion budget will be prepared on the basis of sales budget and also after taking into consideration the available productive capacities .financial budget will be prepared on the basis of sales forecasts and production budget. All these budget s will be combined and coordinated into one master budget.

Static Budget

A type of budget that incorporates anticipated values about inputs and outputs t hat are conceived before the period in question begins. When compared to the actual results that are received after the fact, the numbers from static budgets are often quite different from the actual results

Flexible budget

A flexible budget is a budget that adjusts or flexes for changes in the volume o
f activity. The flexible budget is more sophisticated and useful than a static budget, which remains at one amount regardless of the volume of activity

Types of budget:

Firstly, determine the principal budget factor. This is also known as the key budget factor or limiting budget factor and is the factor which will limit the activities of an undertaking. This limits output, e.g. sales, material or labor.

• Sales budget

This involves a realistic sales forecast. This is prepared in units of each product and also in sales value. Methods of sales forecasting include:

• Sales force opinions
• market research
• statistical methods (correlation analysis and examination of trends)
• mathematical models.

• Production budget

Expressed in quantitative terms only and is geared to the sales budget. The production manager's duties include:

• Analysis of plant utilization.
• work-in-progress budgets.

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• Labour budget

Is both quantitative and financial. This is influenced by:

• Production requirements
• man-hours available
• grades of labour required
• wage rates (union agreements)
• the need for incentives.

• Cash budget

A cash plan for a defined period of time. It summarizes monthly receipts and payments. Hence, it highlights monthly surpluses and deficits of actual cash. Its main uses are:

• To maintain control over a firm's cash requirements, e.g. stock and debtors
• To enable a firm to take precautionary measures and arrange in advance for investment and loan facilities whenever cash surpluses or deficits arises
• To show the feasibility of management's plans in cash terms

• Master budget

OPERATING BUDGET	FINANCIAL BUDGET
Consists Of:-	Consists Of:-
Budget P/L acc: get:	Cash budget
Production budget	Balance sheet
Materials budget	Funds statement
Labour budget	

Admin. budget
Stocks budget

•Other budgets
These include budgets for:
• Administration
• research and development
• selling and distribution expenses
• capital expenditures
• working capital (debtors and creditors).

The following example shows some of the common elements of a Budget. Sample

Company Budget
January 1, xxxx to December 31, xxxx

Category

Actual
Budget
Difference

Inflows
Net Sales 385,400 300,000 85,400

Cost of Goods
Merchandise Inventory, January 1 160,000 160,000 0
Purchases 120,000 90,000 30,000
Freight Charges 2,500 2,000 500
Total Merchandise Handled 282,500 252,000 30,500

Less Inventory, December 31 100,000 120,000 (20,000) Cost

of Goods Sold 182,500 132,000 50,500

Gross Profit 202,900 168,000 34,900

Interest Income 500 700 (200)
Total Income 202,500 168,700 33,800

Expenses
Salaries 68,250 45,000 23,250
Utilities 5,800 4,500 1,300
Rent 23,000 23,000 0
Office Supplies 2,250 3,000 (750)
Insurance 3,900 3,900 0

Advertising	8,650	9,000	(350)
Telephone	2,700	2,300	400
Travel and Entertainment	2,550	2,000	550
Dues & Subscriptions	1,100	1,000	100
Interest Paid	2,140	2,500	(360)
Repairs & Maintenance	1,250	1,000	250
Taxes & Licenses	11,700	10,000	1,700
Total Expenses	133,290	106,850	26,440
Net Income	69,210	61,850	7,360

Name of Report	Frequency	Purpose	Primary Recipient(s)
Sales	Weekly	Determine whether sales goals are being met	Top management and sales manager
Labor	Weekly	Control direct and indirect labor costs	Vice president of production and production department managers
Scrap	Daily	Determine efficient use of materials	Production manager
Department Overhead costs	Monthly	Control overhead costs	Department manager
Selling expenses	Monthly	Control selling expenses	Sales manager
Income Statement	Monthly & quarterly	Determine whether income objectives are being met	Top manager

Budgetary Control Reporting System

Responsibility ACCOUNTING

Responsibility accounting is a system of control by delegating and locating the responsibility for cost. It is similar to any other system of cost such as standard costing or budgetary control but with greater emphasis on fixing of the responsibility if the persons entrusted with the execution of specific jobs'

In case of responsibility accounting there is identification of costs with the person responsible. This helps in having a better control over costs because strictly speaking cost control is not as much as a control over costs as it is a control over the people who incur the cost.

The organization should be classified into suitable responsibility centres, so that the authority and responsibility if each individual can be well defined. Each executive must know;

1. What is expected of him
2. What has been his performance.

For this purpose the reporting system is so developed that the executive getste requisite information. Thus , in case of responsibility accounting the main emphasis is on cost control, rather than on cost ascertainment.

The concept of responsibility accounting has emerged to accommodate the need for management information at a more specific level of detail than can be provided by financial accounting procedures. Responsibility accounting attempts to report results (actual performance) in such a way that:

(1) Significant variances from planned performance can be identified,
(2) Reasons for variances can be determined,
(3) Responsibility can be fixed
(4) Timely action can be taken to correct problems.

Under this approach, pertinent costs and revenues are assigned to various organizational units--departments, bureaus, and programs--designated as responsibility centers. In the private sector, responsibility centers may take several forms:

(1) A cost center is the smallest segment of activity or area of responsibility for which costs are accumulated.

(2) A profit Outside of relatively large corporations, the cost center is the mo st common building block for responsibility accounting center is a segment of a

business, often called a division that is responsible for both revenue and expenses.
(3) An investment center, like a profit center, is responsible for both revenue and expenses, but also for related investments of capital.

In fact, the terms cost center and responsibility center are often used interchangeably. Responsibility accounting placing emphasis on specific costs in relation to well -defined areas of responsibility. Managers often inherit the effects of their predecessors decisions. Long-term effects of such costs as depreciation, long-term lease arrangements, and the like, seldom qualify as controllable costs on the performance report of a specific manager.
Performance data can be developed for management purposes independent of the budget and control accounts. This kind of performance reporting has been used in the justification of resource requests and in the assessment of cost and work progress where activities are fairly routine and repetitive. Under this approach, units of work are identified, and changes in quantity (and, on occasion, quality) of such units are measured as a basis for analyzing financial requirements. The impact of various levels of service can be tested, and an assessment can be made of changes in the size of the client groups to be served. This approach is built on the assumption that certain fixed costs remain fairly constant regardless of the level of service provided and that certain variable costs change with the level of service or the size of the clientele group served. Marginal costs for each additional increment of service provided can be determined through such an approach. With the application of appropriate budgetary guide-lines, these costs can then be converted into total cost estimates.
Variances, budgeted results, and other techniques of responsibility accounting are relatively neutral devices. When viewed positively, they can provide managers with significant means of improving future decisions. They can also assist in the delegation of decision responsibility to lower levels within an organization.
These techniques, however, are frequently misused as negative management tools--as means of finding fault or placing blame. This negative use stems, in large part, from a misunderstanding of the rationale of responsibility accounting.

PERFORMANCE BUDGETING

Performance budgeting involves evaluation of the performance of an organization in the context of both specific as well as overall objectives of the organization.
This requires complete clarity about both the short term and long term organizational objectives. The responsibility of various levels of management should be predetermined in terms of result expected from them and the authority vested in t hem.
Basic features:
1) The budget is prepared for each managerial level. The manager concerned is made responsible and held accountable for performance at his level over the specific period of time as given in the budget.
2) The jurisdiction of the authority and the responsibility for different costs controllable by the executive concerned is fixed up.
3) The concerned executive is vested with the requisite authority required for he responsibility entrusted to him
Steps for preparation of performance budgets:
1) An organization chart should be prepared giving the responsibility and a

uthority of each level of management.

2) The performance budgets should not be imposed from above. The concerned executive should be taken in confidence while preparing the budgets relating to this area of operations.

3) The concerned executive should be continuously fed with periodical reports, statements etc. showing the budgeted and actual performance so that remedial measures may be taken during the relevant period .

4) The statements and reports mentioned above should be prepared regularly, accurately and timely.

Zero base budgeting

After a budgeting system has been in operation for some time, there is a tendency for next year s budget to be justified by reference to the actual levels being achieved at present. In fact this is part of the financial analysis discussed so far, but the proper analysis process takes into account all the changes which should affect the future activities of the company. Even using such an analytical base, some businesses find that historical comparisons, and particularly the current level of constraints on resources, can inhibit really innovative changes in budgets. This can cause a severe handicap for the business because the budget should be the first year of the long range plan. Thus, if changes are not started in the budget period, it will be difficult for the business to make the progress necessary to achieve longer term objectives.

One way of breaking out of this cyclical budgeting problem is to go back to basics and develop the budget from an assumption of no existing resources (that is, a zero base). This means all resources will have to be justified and the chosen way of achieving any specified objectives will have to be compared with the alternatives. For example, in the sales area, the current existing field sales force will be ignored, and the optimum way of achieving the sales objectives in that particular market for the particular goods or services should be developed. This might not include any field sales force, or a different-sized team, and the company then has to plan how to implement this new strategy.

The obvious problem of this zero-base budgeting process is the massive amount of managerial time needed to carry out the exercise. Hence, some companies carry out the full process every five years, but in that year the business can almost grind to a halt. Thus, an alternative way is to look in depth at one area of the business each year on a rolling basis, so that each sector does a zero base budget every five years or so.

Applications :

1. Identifying Decision Units(DU)

2. Listing programs, activities of each DU

3. Setting goals of activities of each DU

4. Identifying alternatives of activities

5. Designing Decision Package

6. Evaluating & Ranking each DP

7. Allocating Resources according to priority