BUDGETS & BUDGETARY CONTROL

Budget:

- A detailed **plan** of operations for some specific future period
- Budgets are usually, set up in the light of **past experience** after taking into account the **changes** that are **expected** to occur in the future.

It is statement of an **estimated performance** to be achieved in given time, expressed in currency **value** or **quantity** or both

Essentials of Budget:

1. It is prepared in **advance** and is based on a **future plan** of actions.
2. It relates to a **future period** and is based on **objective** to be obtained.
3. It is a statement expressed in **monetary and/or physical units** prepared for the implementation of **policy** formulated by the management.

BUDGETS & BUDGETARY CONTROL

Characteristic of Budget:

- A budget is concerned for a definite future period.
- A budget is a written document.
- A budget is a detailed plan of all the **economic activities** of a business.
- All the departments of a business unit co-operate for the preparation of a business budget.
- Budget is a **mean** to achieve business and it is not an end in itself.
- Budget needs to be **updated, corrected and controlled** every time when circumstances changes. Therefore it is a continuous process.
- Budget helps in **planning, coordination and control**.
- Different types of budgets are prepared by industries according to business **requirements**.

BUDGETS & BUDGETARY CONTROL

Budget centre:

A **section** of an organization for which separate budget can be prepared and control exercised

Budget period:

The period of time **for which a budget is prepared** and used. It may be a year, quarter or a month.

Budget manual:

The Budget manual is a schedule, document or booklet which shows, in written forms the **budgeting** organisation and **procedures**

BUDGETS & BUDGETARY CONTROL

Fixed Budget:

Budget designed to remain **unchanged** irrespective of the **level of activity** actually attained

Flexible Budget:

Budget which, by **recognizing** the difference between ***fixed***, ***semi-variable*** and ***variable*** costs is designed to change in relation to the **level of activity** attained

Functional Budgets:

Budgets which relate to the **individual functions** in an organisation are known as Functional budgets.
Ex – Sales, Production, Plant utilisation, Direct Material Usage, Direct Material Purchase, Direct Labour (Personnel), Factory OH, S&D expenses 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

BUDGETS & BUDGETARY CONTROL

Budgetary Control:

Guiding and regulating activities with a view to attaining predetermined objectives, effectively and efficiently

CIMA of England and Wales has defined the terms ‘budgetary control’ as

“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.”

Budgetary control involves:

- **Establishment** of budgets
- Continuous **comparison** of actuals with budgets for achievement of targets
- **Revision** of budgets after considering changed circumstances
- Placing the **responsibility** for failure to achieve the budget targets.

BUDGETS & BUDGETARY CONTROL

Components of budgetary control system

The policy of a business for a defined period is represented by the master budget the details of which are given in a number of functional budgets. The functional budgets are broadly grouped under the following heads

- **Physical Budgets**: Those budgets which contains information in terms of physical units about sales, production etc. for example Sales Qty., Production Qty., Manpower budgets
- **Cost Budgets:** Budgets which provide cost information in respect of manufacturing, selling, administration etc. for example, manufacturing costs, selling costs, administration cost, and research and development cost budgets
- **Profit Budgets:** A budget which enables in the ascertainment of profit, for example, sales budget, profit and loss budget, etc.
- **Financial Budgets:** A budget which facilitates in ascertaining the financial position of a concern, for example, cash budgets, capital expenditure budget, budgeted balance sheet etc.

BUDGETS & BUDGETARY CONTROL

Difference between Fixed and Flexible Budget

Fixed Budget	Flexible budget
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.
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
Here as all costs like - fixed, variable and semi-variable are related to only one level of activity so variance analysis does not give useful information.	Here analysis of variance provide useful information as each cost is analysed according to its behaviour.
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.
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.

BUDGETS & BUDGETARY CONTROL

Capacity Ratio:

$$\frac{\text{Actual hours worked}}{\text{Budgeted hours}}$$

Efficiency Ratio:

$$\frac{\text{Actual output in terms of } \textit{STANDARD HOURS*}}{\text{Actual hour worked}}$$

(*Hours that should be required to produce AO as per Standard)

Activity Ratio:

$$\frac{\text{Actual output}}{\text{Budgeted output}}$$

(*Activity Ratio* = Capacity Ratio **X** Efficiency Ratio)

BUDGETS & BUDGETARY CONTROL

Question 1:

Calculate efficiency and capacity ratio from the following data:
Budgeted production = 80 units
Actual production = 60 units
Standard time per unit = 8 hours
Actual hours worked 500

Question 2:

Calculate efficiency and activity ratio from the following data:
Capacity ratio = 75%
Budgeted output = 6,000 units
Actual output = 5,000 units
Standard Time per unit = 4 hours

SALES BUDGET

In estimating the quantity of sales for each product, **past sales** volumes are often used as a starting point.

These amounts are revised for **factors** that are **expected to affect** future sales, such as the factors listed below:

- Pending sales orders
- Productive capacity
- Projected pricing
- Planned advertising and promotion
- Expected industry and general economic conditions
- Findings of market research studies
- Relative product profitability
- Competition

SALES BUDGET

Question:

A company predicts that in the forthcoming month, December, 2012, the sales will take a pattern in the ratio of 3 : 4 : 2 respectively of product A, B and C.

The selling price and variable cost per unit of the products are as below:

Product	Selling Price (in ₹)	Variable cost (in ₹)
A	520	424
B	500	370
C	350	288

Fixed overheads amount to ₹7,57,200 for the month and a monthly profit target of ₹12 lacs has been set.

Prepare the Sales budget for the month of December, 2012

[Ans: A-32.76; B-42; C-14.70]

BUDGETS & BUDGETARY CONTROL

PRODUCTION BUDGET

Production budget shows the production for the budget period based upon :

- Sales budget,
- Production capacity of the factory,
- Planned increase or decrease in finished stocks, and
- Policy governing outside purchase.

PRODUCTION BUDGET

Question:

Prepare monthly Production budget for Jan, Feb & Mar, 2013 from the following details for XYZ Ltd.

(Sales in units)

	Jan	Feb	Mar	Apr
Sales (Year - 2013)	100,000	120,000	145,000	80,000

The company has a policy to maintain the (month end) stock level at 10% of next months budgeted sales.

PURCHASE BUDGET

- The production budget is the starting point for determining the estimated quantities of direct materials to be purchased
- Purchase of direct materials(Qty.) = {(Prod'n quantity **X** Usage rate) + Increase in stock}
- Multiplying these quantities by the expected unit purchase price determines the total cost of direct materials to be purchased
- The direct material purchases budget helps management to maintain inventory levels within reasonable limits. For this purpose, the timing of the direct materials purchases should be coordinated between the purchasing and production departments

BUDGETS & BUDGETARY CONTROL

FLEXIBLE BUDGET

Budget which, by **recognizing** the difference between ***fixed***, ***semi-variable*** and ***variable*** costs is designed to change in relation to the **level of activity** attained

Flexible Budget (*Sample*)		(Figures in ₹)				
Particulars	**Nature of cost**	**Fixed amount**	**Per unit**	**X%**	**Y%**	**Z%**
D. Material	Variable	-	12	..	..	..
D. Labour	Variable	-	7	..	..	..
Salary of Executive	Fixed	50,000	-	50,000	50,000	50,000
Rent	Fixed	70,000	-	70,000	70,000	70,000
Distribution expenses*	Fixed	5,000	-	5,000	5,000	5,000
Distribution expenses*	Variable	-	2	..	..	..
....						
Total						

* Please refer working note No. 1

BUDGETS & BUDGETARY CONTROL

FLEXIBLE BUDGET

Question:

The expenses budgeted for production of 10,000 units in a factory are furnished below :

Particulars	**₹ Per unit**
Material	70
Labour	25
Variable overheads	20
Fixed overheads (₹1,00,000)	10
Variable expenses (direct)	5
Selling expenses (10% fixed)	13
Distribution expenses (20% fixed)	7
Administration expenses (₹50,000)	5
Total	**155**

Prepare a budget for the production of (a) 8,000 units, and (b) 6,000 units

[Ans: (a) ₹12,75,400; (b) ₹ 10,00,800

CASH BUDGET

Cash budget represents the cash requirements of the business during the budget period.

It is the plan of receipts and payments of cash for the budget period, analysed to show the monthly flow of cash drawn up in such a way that the balance can be forecasted at regular intervals

BUDGETS & BUDGETARY CONTROL

Question:

A newly started company wishes to prepare Cash Budget from January 2012. Prepare a Cash Budget for the first six months from the following estimated receipts and expenditures.

(Figures in ₹)

Month	Total Sales	Materials	Wages	Production OH	Selling & Distribution OH
January	20,000	20,000	4,000	3,200	800
February	22,000	14,000	4,400	3,300	900
March	24,000	14,000	4,600	3,300	800
April	26,000	12,000	4,600	3,400	900
May	28,000	12,000	4,800	3,500	900
June	30,000	16,000	4,800	3,600	1,000

Cash balance on 1st January was Rs.10,000. A new machine is to be installed at Rs.30,000 on credit to be repaid by two equal instalments in March and April. Sales commission @ 5% on total sales is to be paid within the month following actual sales. Rs.10,000 being the amount of 2nd call on shares may be received in March. Share premium amounting to Rs.2,000 is also receivable with 2nd call. Credit allowed by suppliers is 2 months, credit allowed to customers is 1 month, delay in payment of overheads is 1 month, and delay in payment in wages is ½ month. 50% of total sales are credit sales.

BUDGETS & BUDGETARY CONTROL

PRACTICAL PROBLEMS

- For additional theory refer study mat

THANK YOU

E-mail Id	carabindran@gmail.com
E-mail Id for FB	mentaldoctor.ravi@gmail.com
FB group	BINAYAK COST CLASSES