Budget and Budgetary Control: Definitions

A budget is a financial plan for a corporation that covers a specific future period. It is an expression of **income** and **expenditures** over a certain period. Budgets are plans that cover all functional areas of a business for a specific future period.

Budgetary Control

Budgetary control does not merely involve the matching of estimated expenses to actual expenses. In addition, it involves placing responsibility for failures.

The periodic checking up of income, costs, and expenses related to the administration of the budget is known as budgetary control.

Objectives, Importance, and Functions of Budgetary Control

The main **objectives of budgetary control** are as follows:
1. Production efficiency. Budgetary control is a technique marked by advanced planning for the effective use of materials. Thus, it leads to smooth production chains.

2. Success of costing records. Budgetary control improves the utility of cost accounts, which provides knowledge about future **costs**. Hence, cost variations can be minimized.

3. Future planning. Every producer plans a definite output for a specific period for which it is possible to use budgets to estimate the required amount of finance, materials, labor, and other expenditures.

4. Cost control. Budgetary control is useful for cost control because the production process rotates around predetermined targets. Here, actual costs are compared to budgeted costs and any variations are corrected by the management.

5. Helpful in policy framing. Budgeting provides a tool through which basic policies are periodically examined, restated, and established as guidelines for the entire organization.

6. Budgets are solutions to basic problems. Budgeting obliges management to make an early study of its basic problems. It is useful in making rational decisions.

7. Control on income and expenditure. In modern times budgeting is used to direct capital and energy into the most profitable channels. Every producer classifies expenditure, and fixed expenses and variable expenses are useful to learn the break-even points for output and **sales**.

8. Knowledge of required capital. Budgetary control provides information about the amount of **capital** required for the smooth running of the organization.

9. Knowledge of potential for expansion. Every business leader aims to expand their business. Budgetary control provides helpful information about how much extra capital, labor, and risk will be needed for expansion efforts.

10. Administrative usefulness. Budgetary control is the eye of the managerial staff. No other form of management control reveals weaknesses in an organization as quickly as the orderly procedure needed for systematic budgeting.

11. Helpful to the nation. When proper budgeting is undertaken in nearly every enterprise, it can bolster the national economy by providing stable employment, economical use of tools, and effective prevention of waste.

Budget organisation and administration:

In organising and administering a budget system the following characteristics may apply:

- **a)** ***Budget centres:*** Units responsible for the preparation of budgets. A budget centre may encompass several cost centres.

b) ***Budget committee:*** This may consist of senior members of the organisation, e.g. departmental heads and executives (with the managing director as chairman). Every part of the organisation should be represented on the committee, so there should be a representative from sales, production, marketing and so on. Functions of the budget committee include:
· Coordination of the preparation of budgets, including the issue of a manual
· Issuing of timetables for preparation of budgets
· Provision of information to assist budget preparations
· Comparison of actual results with budget and investigation of variances.

c) ***Budget Officer:*** Controls the budget administration The job involves:
· liaising between the budget committee and managers responsible for budget preparation
· dealing with budgetary control problems
· ensuring that deadlines are met
· educating people about budgetary control.

d) ***Budget manual:***
This document:
· charts the organisation
· details the budget procedures

· contains account codes for items of expenditure and revenue
· timetables the process
· clearly defines the responsibility of persons involved in the budgeting system.

Budget preparation

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 labour.

a) 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.
In using these techniques consider:
· company's pricing policy
· general economic and political conditions
· changes in the population
· competition
· consumers' income and tastes
· advertising and other sales promotion techniques
· after sales service
· credit terms offered.

b) Production budget: expressed in quantitative terms only and is geared to the sales budget. The production manager's duties include:
· analysis of plant utilisation
· work-in-progress budgets.
If requirements exceed capacity he may:
· subcontract
· plan for overtime
· introduce shift work
· hire or buy additional machinery
· The materials purchases budget's both quantitative and financial.

c) Raw materials and purchasing budget:
· The materials usage budget is in quantities.
· The materials purchases budget is both quantitative and financial.
Factors influencing a) and b) include:
· Production requirements
· planning stock levels
· storage space
· trends of material prices.

d) Labor budget: is both quantitative and financial. This is influenced by:
· production requirements
· man-hours available
· grades of labor required
· wage rates (union agreements)
· the need for incentives.

e) Cash budget: a cash plan for a defined period of time. It summarises 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
· to illustrate the financial impact of changes in management policy, e.g. change of credit terms offered to customers.
Receipts of cash may come from one of the following:
· cash sales
· payments by debtors
· the sale of fixed assets
· the issue of new shares
· the receipt of interest and dividends from investments.
Payments of cash may be for one or more of the following:
· purchase of stocks
· payments of wages or other expenses
· purchase of capital items
· payment of interest, dividends or taxation.

Limitations of Budgeting

Inaccuracy

Budgeting is based on a lot of assumptions in estimating expenses and revenues. These are generally based on trends and the market scenario prevailing when making the budget. Budgets can also be based on the predictions made for the coming year considering the data available at the time of budgeting.

Time-Consuming & Costly

Budgeting exercise can be, at times, a very time-consuming exercise. It involves an extra workforce to get the estimates as accurate as possible. Especially for a big company with various departments, budgeting exercise takes a huge effort.

Excessive Spending

Some managers believe that all the funds that are allocated to their department need to be spent. It is believed that if they do not use as much as they are authorized to in the current budget, the funds budgeted for them in the next budget will be reduced. This leads to unnecessary wastage of funds and proves harmful to the company, affecting its profits.

Scope for Manipulation
At times, an experienced manager may deliberately inflate his expenses and try to reduce the revenue targets to be set in the budget. This way, he can easily get an opportunity to get the favorable variances against the budgeted numbers

Allocation of Expenses
The allocation of expenditure between the departments is generally the call senior management takes. Managers of some departments may raise issues in the method used for the allocation of these expenses, and this may create controversies.

Conflicts in the Organization
At times when a particular department is unable to meet the budgeted targets, they end up blaming the other department that provides services to it for not providing the necessary support. They even conflict on the transfer price that is decided internally between the departments.