Chapter 5

BUDGETS AND BUDGETARY CONTROL

INTRODUCTION

- The complexity of modern managerial problems has led to the development of various tools, techniques and procedures which may help the management in resolving the problems they face.
- One of these important tools is business budgeting. The modern management have now realized the importance of planning their business operations in advance. They know that the success or otherwise of any business activity depends on careful planning.
- The management prepare themselves to face successfully the possible adversities by visualizing them in advance and can also avoid or minimize the errors that may inflict a heavy loss on the business. The management endeavor, through business budgeting, to give a definite direction to the activities of their organization.

DEFINITION

- A budget is forecast of future activities. It is a chart of future incomes and expenses. It is a coordinating financial plan for a business enterprise. It includes estimates of sales, production, purchases, labour cost, overheads and financial position.
- According to Shubin, “A budget is a comprehensive overall plan in which management, on the basis of estimated sales volume and receipts, establishes cost and expense allowances for future operations. In this way effectively integrating and directing activities towards carefully determined goals.”
- The above definitions make it clear that budgets are prepared to achieve objectives and targets of business. It is prepared for a definite period of future time. It expresses targets either in quantitative terms of in financial terms or in both.

CHARACTERISTICS

- **It is a comprehensive plan of the business**, in the sense that it covers all aspects of business operations.
- **It is an integrated plan.** The budget committee or the budget officer has to reconcile and co-ordinate various budgets prepared by the heads of different departments in the unit.
- **It is expressed in financial form.** In its original form, the budget lays down its targets and estimates in physical terms. For instance, estimates of sales are expressed in physical units of the product. But finally, these estimates are converted in monetary units.
- **It covers a definite period of time in future.** The targets have no meaning unless they are linked to a definite period of time. A company, for example, may envisage a total profit of ₹ 10,00,000. But if it does not specify the time period within which this profit is to be made, its target loses its meaning.

Characteristics (cont.)

- **Business budget is a plan not only of the resources of an enterprise, but of its operation as well.** The targets are fixed for all aspects of the operations of the firm and estimates of expenses and revenues involved are also stated precisely.
- **Budgeting is a continuous process.** The framing of business budget and its implementation both go hand in hand. At the same time, control is exercised over the actual operation of the business to ensure that it does not deviate from the plan of action as indicated in the budget.
- **Business budget is an important instrument of control.** The budget reports indicate whether and to what extent have the original targets been realized. Moreover, the responsibilities for different operations are clearly located before budgets are framed.

MEANING OF BUDGETARY CONTROL

- Budgetary control is a process which covers making of a business budget, comparison of the actual performance with the budgeted one and detecting the errors and mistakes committed so that an attempt may be made to rectify them in future.

- **According to Glen Welsch**, " Budgetary control is the use of budgets and budgetary reports throughout the period to co-ordinate evaluate and control day to day operations in accordance with the goals specified by the budget are compared with the targets and are kept under constant control."

- **According to Moore and Jakedine**, "Budgetary control is using budget as tool of controlling the actual operation of business."

OBJECTIVES OF BUDGETARY CONTROL

- To define in clear terms the basic goals of the business.
- To inform the persons concerned of these goals.
- To chalk out a detailed plan of action.
- To co-ordinate various activities in such a manner that optimum utilization of resources.
- To provide a method of evaluating the actual activity.

ADVANTAGES OF BUDGETARY CONTROL

- Co-ordination of all functions and activities
- Responsibility accounting - information is provided to managers responsible for revenue and expenditure
- Utilisation of resources - capital and effort are used to achieve the financial objectives
- Motivation of managers through the use of clearly defined objectives and monitoring of achievement
- Planning ahead gives time to take corrective action
- Establishes a system of control if plans are reviewed regularly against actual
- Transfer of authority to individual managers for decisions

Disadvantages of Budgetary Control

- Set in stone - managers may be constrained by the original budget (eg make no attempt to spend less than maximum or exceed target income)
- Time consuming process may deflect managers from their prime responsibilities of running the business
- Unrealistic if fixed budgets are set and actual activity level is not as planned
- Disillusioning for managers if fixed budgets are set and not achieved merely due to changes in activity
- Demotivating for managers if budgets are imposed by top management with no consultation

CONCLUSION

- Preparation of budgets is the first step in the budgetary control system.
- Implementation of budgets is the second phase.
- But preparation and implementation of budgets alone will not achieve much unless a comparison is made regularly between the actual performance and the budgeted performance.
- Continuous and proper reporting makes this possible.
- To ensure the success of budgetary control system, proper follow up action has to be taken immediately for the reports submitted.