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Budgeting Starter Kit

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OBJECTIVES

The main objectives of this unit are to acquaint you with

- the concepts of budgeting and budgetary control;
- the establishment of effective budgeting system; and
- classification of various types of budgets.

INTRODUCTION

The efficiency of a management depends upon the attainment of the objectives of the

enterprise. It is effective when it achieves the objectives with minimum effort and

cost. This requires proper planning and therefore, management must chart out its

course of action in advance. One systematic approach for attaining effective

management performance is profit planning and control or budgeting. Profit planning

or budgeting is an integral part of management. Budgeting is an important control

technique of cost control. This is the process of pre-estimation of cost, revenue, profit

and other figures for the next year or period and on that basis, actual expenses

incurred, revenue generated/earned. Afterwards budget is used as a standard for

measuring actual performance. The deviations are found out and responsibility fixed

for deviations. Thus, this is indirectly management control process, which involves

planning, control, coordination, communication, etc. In this unit you will study about the

basic concept of budgeting, establishment of a system of budgeting and classification

of budgets.

MEANING OF BUDGETING

In our daily life, we use to prepare budgets for matching the expenses with income; and available funds can be invested in a profitable manner. Similarly in business, budgets are prepared on the basis of future estimated production and sales in order to find out the profit in a specified period. A budget is in the nature of an estimate and is a quantified plan for future activities to coordinate and control the use of resources for a specified period. Thus, budget is a quantitative statement of management plans and policies for a given period and is used as a guide for the purpose of attaining the given objectives. It is also used as standard with which actual performance is measured. Budgets must be prepared with full

knowledge and acceptance by the executives whose performance is to be measured against the budget. Different types of budgets are prepared for different purposes.

Budgeting may be defined as the process of preparing plans for future activities of a business enterprise after considering and involving the objectives of the said organization. This also provides process/steps of collection and comparison of data, by which deviations from the plan, either favorable or adverse, can be measured. This analysis is helpful in performance analysis, cost estimation, minimizing wastage and better utilization of resources of the organization.

DEFINITION OF BUDGET AND BUDGETARY CONTROL.

Budgeting is a process, which includes two important functions: Budget and Budgetary control. Budget is a planning function and budgetary control is a controlling system or technique. A manager looks to the future, searches for alternative courses of action and predetermines a course of action to be taken in relation to known events and the possibilities of future problems. Thus, the budget will do this work for the activities of a business enterprise. I.C.M.A., London defines the budget as “Budget is 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 object”. At the same time, controlling is the process of measuring current performances

and guiding them towards some predetermined goals. The essence of control lies in checking existing actions against some desired results determined in the planning process. Thus, the budgetary control is a tool of control to achieve the budgeted goals. I.C.M.A., London defines budgetary control as, “Budgetary control is the establishment of budgets relating to the responsibilities of executives to the requirement of a policy and the continuous comparison of actual with budgeted results either to secure by individual action the objectives of that policy or to provide a basis for its revision.” In nutshell, Budgetary control is a system and a technique which uses budgets as a means of controlling all aspects of the business and is designed to assist management in the allocation of responsibility and authority, in the measurement of actual performance, in the analysis of variations between budgeted and actual results and to develop basis of measurement, in the light of experience gained and results achieved, with which to evaluate performance and efficiency of the operations. Thus, a budget is a means and budgetary control is the end result

OBJECTIVES OF BUDGETING.

It is a well-known fact that a planned activity has better chances of success than an unplanned one. The budgeting is a forward planning and effective control tool. Thus, the objectives of the budgeting are:

- a) To control the cost and increase revenue and thereby maximize profit, so as to know profit at different level of production and best production level.
- b) To run production activities in efficient manner by lay behind the chances of interruption in production process due to lack of material, labour etc.
- c) To bring about coordination between different functions of an enterprise, which is essential for the success of any enterprise.
- d) To incorporate measures of calculation of deviations from budgeted results and analysis of the same, whereby responsibility can be fixed and controlling measures/action can be taken.
- e) To ensure that actions taken are in accordance with the targets and if required, to take suitable corrective action.
- f) To predict short-term and long-term financial positions for better financial position and management of working capital in better manner.

ADVANTAGES OF BUDGETING.

The following are the advantages of budgeting:

- a) Budgeting leads to maximum utilization of resources with a view to ensuring maximum return.
- b) Budgeting increases the awareness about business enterprise at all levels of management in the process of fulfillment of targets.

- c) Budgeting is helpful in better co-ordination between different functions/activities of business/organisation and hence, better understanding between different functions.
- d) Budgeting is a process of self-examination and self-criticism which is essential for the success of any organisation.
- e) Budgeting makes a path for active participation and support of top management
- f) Budgeting enables the organisation to prefix its goals and push up the forces towards their achievements.
- g) Budgeting stimulates the effective use of resources and creates an attitude of cost consciousness throughout the organisation.
- h) It creates the bases for measuring performances of different departments as well as different functions of the production activities.

LIMITATIONS OF BUDGETING.

Inspite of the above advantages, budgeting has the following limitations:

- a) Forecasting, planning or budgeting is not an exact science and a certain amount of judgement is present in any budgeting plan.

- b) The basic requirement for the success of budgeting is the absolute support and enthusing provided by the top management. If it is lacking at any time, the whole system will collapse.
- c) Budgeting should be followed up by effective control action, this is often lacking in many organizations, which defeats the very purpose of budgeting.
- d) The installation of budgeting system is an elaborate process and it takes time.
- e) It is only a source and not a target and hence, cannot take the place of management, while it is only a tool of management. Thus, the budget should be regarded not as a master, but as a servant.
- f) It requires the experienced man-power, technical staff, analysis, control etc., hence, it is costly affair

ESSENTIALS OF EFFECTIVE BUDGETING.

A good budgeting system requires good organisational system with lines of authority and responsibility clearly mentioned. There must be perfect co-ordination among different functions as well as participation of responsible managers / supervisors in the decision-making process. Thus, the main essentials of effective budgeting may be as follows:

- a) There should be well-planned organisational set-up, authority and responsibility clearly defined, budget committee should be formed consisting of all top executives.
- b) There should be a good accounting system which provides accurate and timely information.
- c) Variations should be reported promptly and clearly to the appropriate levels of management.
- d) Budgets have no meaning unless they lead to control action as a consequence of feedback provided.
- e) The whole system should enjoy the support and co-operation of top management.
- f) Staff should be strongly and properly motivated towards the systems.
- g) Budgets should be prepared on the basis of clearly defined business policies after discussion held with the head of individual department so that they may provide their suggestions in this regard.