

## **BUDGETS AND BUDGETING**

Profit-planning *or* budgeting is a systematic approach for attaining effective management performance.

A budget is a comprehensive and coordinated plan expressed in financial terms, for the operations and resources of an enterprise, for some specific period in future.

### **PURPOSE OF BUDGETING**

- ✓ To attain the management's objectives.
- ✓ To communicate expectations to all concerned.
- ✓ To help in making detailed plans.
- ✓ To provide a basis for measuring and controlling activities.

### **STEPS IN PREPARING A BUDGET**

1. Establish budget centers and form a committee.
2. Prepare budget manual (budget manual is procedures to be followed and forms to be used).
3. Form budget committee.
4. Determine the limiting *or* the key factor.
5. Select the budget period.
6. Select the objectives to be achieved at the end of the budget period.
7. Prepare forecasts.
8. From forecast prepare provisional budget
9. Review and prepare final budget.

### **ADVANTAGES OF BUDGETING**

1. Compels management to plan for future.
2. Coordinates integrates and balances the effort of various department.
3. Forms a basis of evaluation and control.
4. Forms a basis of communication.
5. Helps in optimum utilization of resources.

### **LIMITATIONS OF BUDGET**

1. Restricts creativity
2. Must be continuously adapted.
3. Everybody must be involved as otherwise execution is difficult.
4. Estimates are basis for budgets which might not match results.

### **BUDGETARY CONTROL**

Budgetary control involves the use of budgets and budgetary reports through out the period of budget to co-ordinate evaluate and control day to day operations in accordance with the goals specified by the budget.

### **OBJECTIVES OF BUDGETARY CONTROL**

The objectives of budgetary control are:

1. **To compel planning.** This is the most important feature of budgetary control, because management is forced to look ahead, set targets, anticipate problems and give the organization purpose and direction,
2. **To communicate Ideas and Plans.** To everyone affected by them. It is necessary to have a formal system to make sure that each person is aware of what he is supposed to be doing.
3. **To co-ordinate the activities.** Of different department or sub-units of the organization, this concept of co-ordination implies, for example, that the purchasing department should base its budget on production requirements, and that the production budget should in turn be based on sales expectations.
4. **To establish a system of control** by having a plan against which actual results can be progressively compared.
5. **To motivate Employees** to improve their performance.

### **Key Factor**

In each organization there is always some factor which governs the scale of its activity. Such a factor is known as the 'limiting factor,' 'principal budget factor' or 'key factor'. Some examples of limiting factor are:

- (a) Production capacity:
- (b) Shortage of space :
- (c) Shortage of skilled labour:
- (d) Shortage of material:
- (e) Low market demand:
- (f) Lack of capital:

### **DIFFERENT TYPES OF BUDGETS**

Budgets may be classified into number of categories. This classification is based on some features, connected with the operational activities of a business. The classification along with the features that have led to the said classifications, are discussed hereunder:

1. **Budget based on coverage:** Budgets are often drawn encompassing the different areas of activities of a business undertaking. That is to say, a budget is often drawn covering different functions of business unit. On the basis of the coverage, the budget is classified into two
  - (a) Functional budget;
  - (b) Master budget.
  
2. **Budgets based on capacity:** The operation of a business unit is characterized by level of activity. This level of activity is known as the capacity at which the business functions. This capacity depends on the extent of the demand of the product of the business entity. The budgets which are drawn considering the operational capacity of a business concern may be classified into two:
  - (a) Fixed budget;
  - (b) Flexible budget.

3. **Budgets based on the length of the period:** Some budgets are drawn for a long period of time. This period may cover 5 years or so. Some budgets are to run for a short period of time, say for a day, a week or a month as the case may be. The budget that covers a long period of time is known as a Long range budget or long term budget. When the budgets are drawn covering a short period of time, as stated above, are called short term budget or short range budget.
  
4. **Budgets drawn based on conditions:** It is sometimes found that budgets are based on some conditions required to be taken into account for efficient management. The budgets based on conditions may be classified in to the following:
  - (a) Basic budget ;
  - (b) Current budget.



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