RAMA UNIVERSITY

www.ramauniversity.ac.in

FACULTY OF COMMERCE & MANAGEMENT

COURSE: B.COM 3rd SEMESTER

SUBJECT: MANAGEMENT ACCOUNTING

SUBJECT CODE: BCH 302

LECTURE: 7

NAME OF FACULTY: DR. R. S. BISARIYA

Lecture-7

Budgeting

Budgeting

CONTENTS

Objectives

After studying this Chapter, you will be able to:

Explain the meaning and features of budgeting

Describe the types of budgets

Prepare budgets and budgetary control

Describe the features and objectives of budgetary

control Illustrate Zero-base budgeting

Notes

Introduction

Budget is an estimate prepared for definite future period either in terms of financial or non-financial terms. Budget is prepared for any course of action or business or state or Nation, as a whole. The budget is usually expressed in terms of total volume.

According to ICMA, England, a budget is as follows "a financial and or quantitative statement prepared and approved prior to a defined period of time, of the policy to be pursed during the period for the purpose of attaining a given objective."

It is in other words as "detailed plan of action of the business for a definite period of time." It is a statement of financial affairs/quantitative terms of an activity for a defined period, to achieve the enlisted objectives.

Did u know? ***What is budgeting?***

Budgeting is the course involved in the preparation of budget of an activity.

7.1 Meaning and Features of Budgeting

Budgeting means the process of preparing budgets. In other words, budgeting refers to the management action of formulating budgets. Preparation of budgets involves study of business situations and understanding of management goals as also the capacity of the organisation.

According to **Welsch,** "budgeting is the principal tool of planning and control offered to management by accounting functions."

In the words of **J. Batty,** "the entire process of preparing the budgets is known as budgeting."

Rowland and Harr has defined budgeting as, "budgeting may be said to be the act of building budgets."

According to the definition, the essential features of a budget are as follows:

1. It is prepared for a definite period well in advance.
2. It may be stated in terms of money or quantity or both.
3. It is a statement defining the objectives to be attained and the policy to be followed to achieve them in a future period.
4. It is a statement expressed in monetary and/or physical Chapters prepared for the implementation of policy formulated by the management.
5. It is laid down prior to the budget period during which it is followed.
6. The policy to be followed to attain the given objective must be laid before the budget is prepared.

Notes

Table 7.1: Forecast vs. Budget

	Forecast	Budget
(i)	Forecasts, being statements of future events, do not connote any sense of control.	A budget is a tool of control, since it represents actions that can be shaped according to will so that it can be suited to the conditions which may or may not happen.
(ii)	Forecast is a mere estimate of what is likely to happen. It is a statement of probable events that are likely to happen under anticipated conditions during a specified period of time.	Budget shows that policy and programme to be followed in a future period under planned conditions.
(iii)	Forecasts have wider scope, since they can be made in those spheres also where budgets cannot interfere.	Budgets have limited scope. They can be made of phenomenon not capable of being expressed quantitatively.
(iv)	Forecasting is a preliminary step for budgeting. It ends with the forecast of likely events.	It begins when forecasting ends. Forecasts are converted into budgets.

Self Assessment

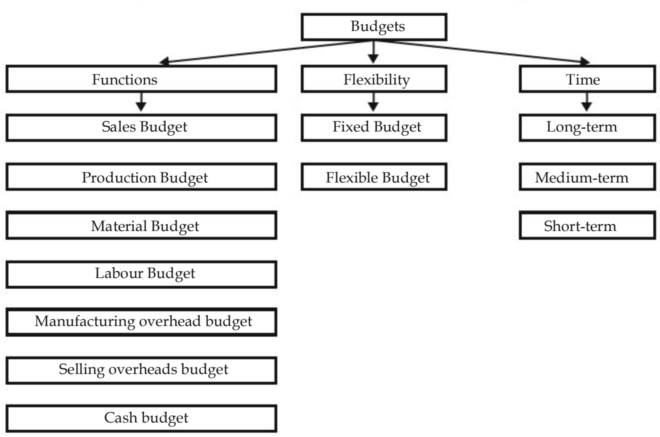
Fill in the blanks:

7. ………………… means the process of preparing budgets.
8. Preparation of budgets involves study of business situations and understanding of ………………… as also the capacity of the organisation.

7.2 Types and Preparation of Budgets

The following figure explains the classification of budgets:

Figure 7.1: Classification of Budgets



Notes

7.2.1 Production Budget

The preparation of the production budget is mainly dependent on the sales budget. The production budget is a statement of goods, how much should be produced. It may be in terms of quantities, Kilograms in monetary terms and so on.

Did u know? ***What is the purpose of the production budget?***

The ultimate aim of the production budget is to find out the volume of production to be made during the year based on the sale volume.

The production and sales volume should go hand-in-hand with each other; otherwise the firm would require to face the acute problem on holding unnecessary excessive stock or inadequate stock to meet the needs of the buyers in time; which will disrepute in the supply of goods in time to them as already agreed upon.

Chapters to be produced = Budgeted Sales + Closing Stock – Opening Stock

The methodology of production budget includes three different components, viz. sales, closing stock and opening stock. Sales have to be added with the stock of the year at the end and to be deducted the opening stock.

Why sales have to be given paramount importance in the preparation of production budget?

The major sales of the business enterprise is being regularly made out of only through the current year production.

Why the closing stock has to be added?

The purpose of the closing stock to be added is that it is a stock at end of the year-end out of the current year production.

Why the opening stock has to be deducted?

The aim of deducting the opening stock is that the stock at the beginning is the stock out of the yester or previous year production.

If sales is normally equivalent to the entire year of production, the firm need not to concentrate on the volume of opening stock and closing stock. It means that, what ever produced during the year is equivalent to current year sales. If the entire production is sold out, there won't be closing stock at the end of the year and opening stock i.e. subsequent years.

If Current year production is equivalent to current year sales

Current year production		Current year sales
↑	=	↓
Internal environment		Demand and Supply

Resultant: No closing stock and opening stock for the subsequent years. This situation may not be possible at always

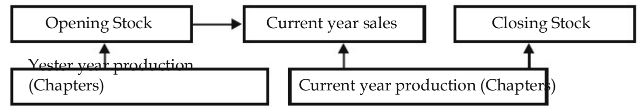
Why it is not possible at always?

The production volume is connected to the internal environment of the firm, which can be maintained through a systematic approach, but the sales cannot be easily administered by the firm which is being highly influenced by the demand and supply factors of the goods.

If the current year production is not equivalent to the current year sales

Notes

Figure 7.2: Flow of goods from Production of One Period to Another



Did u know? ***Why the closing stock arises in the business?***

The closing stock is stock due to the excessive production over the sales volume. The reasons for excessive production are as follows:

9. Ineffective study of market potential through market research leads to the expression of excessive demand from the market, which signals the production department to produce to the tune of MR conducted.
10. Due to price fluctuations in the market may affect the volume of sales.
11. Due to meet the future demand.
12. The excessive production due to the cheaper availability of raw materials, which leads to greater amount of closing stock. If the storage cost is more than the hike takes place on the cost of raw materials leads to abnormal storage of the stock.

The above diagram clearly illustrates that the emergence of the opening stock and closing stock during the year out of sales and production volume of the enterprise.

Example: Prepare a production budget for three months ending March 31, 2006 for a factory manufacturing four different articles on the basis of the following information:

Type of the Product	Estimated Stock on Jan 1, 2006 Chapters	Estimated sales during Jan-Mar, 2006 Chapters	Desired Closing Stock on Mar 31, 2006 Chapters
AA	2000	10,000	5,000
BB	3000	15,000	4,000
CC	4000	13,000	3,000
DD	5000	12,000	2,000

Solution:

Production Budget for three months ending March 31, 2006

Particulars	AA Chapters	BB Chapters	CC Chapters	DD Chapters
Estimated Sales	10,000	15,000	13,000	12,000
Add: Desired closing stock	5,000	4,000	3,000	2,000
	15,000	19,000	16,000	14,000
Less: Opening Stock	2,000	3,000	4,000	5,000
Estimated Production	**13,000**	**16,000**	**12,000**	**9,000**

Notes

Task Mr. X Co. Ltd. manufactures two different products X and Y. X forecast of the number of Chapters to be sold in first seven months of the year is given below:

Months	Product X	Product Y
Jan.	1,000	2,800
Feb.	1,200	2,800
Mar.	1,600	2,400
Apr.	2,000	2,000
May	2,400	1,600
June	2,400	1,600
July	2,000	1,800

It is expected that (a) there will be no work in progress at the end of every month,
13. finished Chapters equal to half the sales for the next month will be in stock at the end of each month (including the previous December).

Budgeted production and production costs for the whole year are as follows:

Production in Chapters		Product X	Product Y
		22,000	24,000
Per Chapter (`)	Direct Material	10.00	15.00
	Direct Labour	5.00	10.00
Total factory overhead apportioned		88,000	72,000

7.2.2 Materials/Purchase Budget

This budget takes place only after identifying the number of finished products expected to produce to the tune of production budget, in meeting the needs and demands of the customers and consumers during the season.

In order to produce to the tune of production budget to meet the market demands, the raw materials for the production should be maintained sufficient to supply them without any interruption. To have uninterrupted flow of production, the firm should go for the immediate procurement of raw materials through the multiplication of raw material required to produce for a single product with number of Chapters expected to produce.

Caution Why the stock of raw materials is deducted from the expected volume of materials procured for production to the tune of production budget?

If there is any existing stock of raw materials, i.e. opening stock of raw materials available from the yester seasons or years should be deducted from the volume of materials required for production to be ordered and placed. The remaining volume should be the volume to be ordered for production.

Example: The sales manager of the MR Ltd. reports that next year he anticipates to sell 50,000 Chapters of a particular product.

The production manager consults the storekeeper and casts his figures as follows:

Notes

Two kinds of raw materials A and B are required for manufacturing the product. Each Chapter of the product requires 2 Chapters of A and 3 Chapters of B. The estimated opening balances at the commencement of the next year are:

Finished product : 10,000 Chapters

Raw Materials A : 12,000 Chapters Raw Materials B : 15,000 Chapters

The desirable closing balances at the end of the next year are:

Finished products : 14,000 Chapters

Raw materials A : 13,000 Chapters Raw materials B : 1,000 Chapters

Prepare production budget and materials purchase budget for the next year.

Solution:

The first step is to prepare the production budget. To identify the volume of materials required for production by considering the production budget and the closing stock of materials of A and B respectively.

Why the closing stock of raw materials has to be added with estimated consumption? The purpose of adding the closing stock of raw materials is to anticipate the future demand of them, due to market influence; which warrants the firm to go for placement of order not only taking into consideration of expected consumption of raw materials but also the closing stock of raw materials to be maintained at the end of the season, in order to facilitate to have uninterrupted flow of production.

Why the opening stock of raw materials has to be deducted?

The opening stock of raw materials, which is available in the firm, should be considered for the placement of order of raw materials. The materials to be ordered should be other than that of the materials available in the firm.

Production Budget (Chapters)

Estimated sales	50,000
Add: Desired Closing stock	14,000
	64,000
Less: Opening Stock	10,000
Estimated Production	54,000

Materials Procurement or Purchase Budget (Chapters)

	Material A	Material B
Estimated Consumption For A 2 Chapters × 54, 000 For B 3 Chapters × 54,000	 1,08,000 	 1,62,000
Add: Closing Stock	13,000	16,000
	1,21,000	1,78,000
Less: Opening Stock	12,000	15,000
Estimated Purchases	1,09,000	1,63,000

Notes

7.2.3 Sales Budget

Sales Budget is an estimate of anticipation of sales in the near future prepared by the responsible person for the sale of a product by considering the various factors of influence. Sales budget is usually prepared in terms of quantity and value. The following factors are normally considered for the preparation of sales budget of a firm:

14. Last sales figures
15. Estimates of the salesmen who is frequently operating in the market, known much greater than any body in the market
16. Capacity of the plant and machinery to produce
17. Funds availability
18. Availability of raw materials to the tune of demand in the respective time period
19. Changes in the taste and preferences of the customer or consumer
20. Changers in the competition structure - Monopoly to Perfect competition — Previously BSNL was known as DOT as a monopoly in the market in affording the services till early 2000. Then later, the changes taken place in the market environment i.e. competition due to invasion of new entrants like Reliance, Hutch, Bharti tele ventures and so on; warrants careful preparation of sales budget of number of telephone connection expected to sell.

Example: Reynolds Pvt. Ltd. manufactures two brands of pen Light & Elite. The sales department of the company has three departments in different regions of the country.

The sales budgets for the year ending 31st Dec, 2006 Light department I=3,00,000; department II=5,62,500; department III=1,80,000: Elite-department I=4,00,000; department II=6,00,000; department III=20,000.

Sales prices are ` 3 and ` 1.20 in all departments. It is estimated that by forced sales promotion the sales of Elite in department I will increase by 1,75,000. It is also expected that by increasing production and arranging extensive advertisement, department III will be enabled to increase the sale of Elite by 50,000.

It is recognized that the estimated sales by department II represent and unsatisfactory target. It is agreed to increase both estimates by 20%.

Prepare a sales budget for the year 2006.

Solution:

Sales budget should be prepared to the tune of various influences of forthcoming seasons' sales. The expected increase or decrease in the sales volume should be incorporated at the time of preparing the sales budget from the yester periods sale figures.

21. There is no change in the volume of existing sales of the department of I Light; the existing sales of the department I of the Light should be retained as it is for the computation of the budgeted figures, but there is a change expected to occur in the existing volume of sales of the department I of the Elite. The change expected amounted to increase 1,75,000 Chapters in addition to the volume of existing sales, i.e. the total volume of sales is equivalent to 4,00,000 Chapters of existing volume of sales + 1,75,000 Chapters expectation of increase= 5,75,000 Chapters for Elite Department I.
22. In the II department of both Light & Elite expected to have an increase on the volume of existing sales amounted is 20% i.e. 20% increase on the Department II of Light 5,62,500 Chapters amounted 6,75,000 Chapters and similarly in the case of Department II of Elite 6,00,000 Chapters amounted 7,20,000 Chapters.

Notes

3. In the III department of Light does not have any change in the volume of existing sales, it means that 1,80,000 Chapters has to be retained as it is in the computation of the budgeted figure but in the case of Elite, department III expected to have an increase in the volume of sales which amounted 20,000 Chapters i.e. 70,000 Chapters.

Sales Budget for the Year 2006

Selling Price	Light `3		Elite `1.20		Total
	Quantity	`	Quantity	`	`
Department I	3,00,000	9,00,000	5,75,000	6,90,000	15,90,000
Department II	6,75,000	20,25,000	7,20,000	8,64,000	28,89,000
Department III	1,80,000	5,40,000	70,000	84,000	6,24,000
	11,55,000	4,65,000	13,65,000	16,38,000	51,03,000

7.2.4 Sales Overhead Budget

It is one of the important sub functional budgets, prepared by the sales manager who is responsible for the sales volume of the enterprise to increase through various devices/tools of sales promotion.

The sales overhead can be classified into two categories viz fixed sales overhead and variable sales overhead.

What is meant by the Fixed Sales Overhead?

Fixed sales overhead is the expenses incurred for promoting the sales, which remains the same or fixed irrespective of the volume of the sales.

Example: 1. Salaries to Sales Department

23. Salaries to the Administrative Staff

24. Salary to Salesmen

Variable sales overhead is the expenses incurred for the promotion of the sales, which is varying along with the volume of sales of the firm.

Example: 1. Sales commission

25. Agents commission

26. Carriage outward expenses.

The sales overhead budget is the statement of estimates of the various sales promotional expenses not only based on the early/yester period sales promotional expenses but also on the sales of previous years.

Example: The following expenses were extracted from the books of M/s Sudhir & Sons, to prepare the sales overhead budget for the year 2006.

	`
Advertisement on	
Radio	2,000
Television	12,000

Notes

Salary to

Sales Administrative Staff	20,000
Sales force	15,000
Expenses of the sales department	
Rent of the building	5,000
Carriage outward	5% on sales
Commission at sales	2%
Agents' commission	6.5%

The sales during the period were estimated as follows:

` 80,000 including Agents Sales ` 8,000

` 1,00,000 including Agents Sales ` 10,500

Solution:

The most important step is to find out the variable portion of the sales overhead of M/s Sudhir & Sons.

1. The calculation of salesmen's commission is on the basis of the sales volume generated by the salesmen force. The total sales volume consists of two different parts viz. Sales contributed by the sales force and another one is contribution of the agents. To find out the sales volume of the sales man, the portion of the agents' sales volume should be deducted from the total sales volume.

   Sales Force's/Men's Volume = Total Sales Volume – Agent's Sales Volume

   Similarly, the agents' sales volume can be computed.

2. From the early step, the amount of commission is to be computed from the volume of sales.

3. Carriage outward should be computed on the volume of sales.

Sales Overhead Budget for the Year 2006

Estimated Sales	` 80,000 Level	` 1,00,000 Level
Fixed Overhead		
Advertisement on Radio	2,000	2,000
Advertisement on TV	12,000	12,000
Salary to Sales Admin. Staff	20,000	20,000
Salary to Sales force	15,000	15,000
Expenses of the sales dept – Rent	5,000	5,000
Total Sales Fixed Overhead (A)	54,000	54,000
Variable Overhead		
Salesmen's Commission 2%	1,440	10,290
Agents' Commission 6.5%	520	682.5
Carriage outward 5%	4,000	5,000
Total Variable Overhead (B)	5,960	5682.5
Total Sales overhead(A+B)	**59,960**	**59682.5**

7.2.5 Cash Budget

Notes

Cash budget is nothing but an estimation of cash receipts and cash payments for specified period. It is prepared by the head of the accounts department i.e. chief accounts officer.

The utility of the cash budget is as follows:

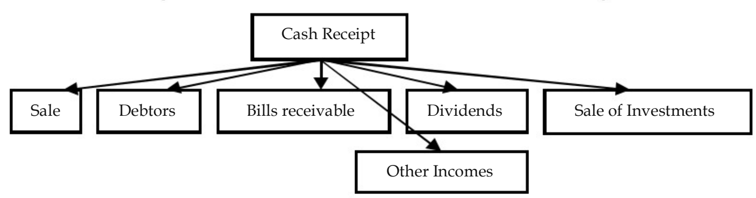
27. To meet the revenue and capital expenditures with adequate funds.
28. It should highlight the additional requirement cash whenever the need arises.
29. Keeping of excessive funds available in the business firm would not fetch any return to the enterprise but this estimate of future cash needs and resources will guide the firm to plan for an effective investment out of the surplus funds estimated; enhances the wealth of the investors through proper investment planning out of the future funds available

Cash budget can be prepared in three different ways:

30. Receipts and payments method
31. Adjusted profit and loss account
32. Balance Sheet Method

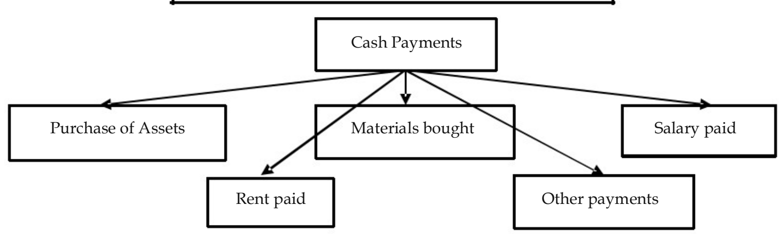
Cash receipts can be classified into various categories:

Figure 7.3: Classification of Cash Receipts



Cash payments are as follows:

Figure 7.4: Classification of Cash Payments



Example: From the estimates of income and expenditure, prepare cash budget for the months from April to June.

Month	Sales (`)	Purchases (`)	Wages (`)	Office Exp. (`)	Selling Exp. (`)
Feb.	1,20,000	80,000	8,000	5,000	3,600
Mar.	1,24,000	76,000	8,400	5,600	4,000
Apr.	1,30,000	78,000	8,800	5,400	4,400
May	1,22,000	72,000	9,000	5,600	4,200
June	1,20,000	76,000	9,000	5,200	3,800

Notes

1. Plant worth ` 20,000 purchase in June 25% payable immediately and the remaining in two equal instalments in the subsequent months.
2. Advance payment of tax payable in Jan. and April ` 6,000.
3. Period of credit allowed:
   (a) By suppliers 2 months
   (b) To customers 1 month
4. Dividend payable ` 10,000 in the month of June.
5. Delay in payment of wages and office expenses 1 month and selling expenses ½ month. Expected cash balance on 1st April is ` 40,000.

Solution:

1. Plant worth ` 20,000 purchased, payable immediately is 25% i.e. ` 5,000 should be paid in the month of June. The remaining cost of the machine has to be paid in the subsequent months, after June. The payments whatever are expected to make after June is not relevant as far as the budget preparation concerned.
2. Delay in the payment of wages and office expenses is only one month. It means wages and office expenses of Feb. month are paid in the next month, March.

   Selling expenses from the above coloured boxes, it is obviously understood that during the months of April, May and June; the following will be stream of payment of selling expenses.

   April = ` 2,000 of Mar. (Previous Month) and ` 2,200 of April (Current month) = ` 4,200

   May = ` 2,200 of April (Previous Month) and ` 2,100 of May (Current month) = ` 4,300

   June = ` 2,100 of May (Previous Month) and ` 1,900 of June (Current month) = ` 4,000
3. Selling expenses is having the delay of ½ month, which means 50% of the selling expenses is paid only in the current month and the remaining 50% is paid in the next

Particulars	Feb.	Mar.	April	May	June
Selling Expenses	3,600	4,000	4,400	4,200	3,800
Payment 50% in the current month	1,800	2,000	2,200	2,100	1,900
Delay 50% will be paid in the subsequent month	1,800	2,000	2,200	2,100	1,900

Every month 50% of the selling expenses of the current month and 50% of the previous month selling expenses are paid together; the above coloured boxes depict the payment of 50% of the current selling expenses along with 50% expenses of previous month.

Cash Budget for the Periods (April and June)

Particulars	April (`)	May (`)	June (`)
Opening Cash Balance	40,000	59,800	95,300
Cash Receipts			
Sales	1,24,000	1,30,000	1,22,000
Total Receipts (A)	1,64,000	1,89,800	2,17,300

Contd…

Notes

Payments Plant Purchased	----------	---------	5,000
Tax payable	6,000	---------	--------
Purchases	80,000	76,000	78,000
Dividend payable	---------	---------	10,000
Wages	8,400	8,800	9,000
Office expenses	5,600	5,400	5,600
Selling expenses	4,200	4,300	4,000
Total Payments(B)	1,04,200	94,500	1,11,600
Balance (A-B)	59,800	95,300	1,05,700

Self Assessment

Fill in the blanks:

3. The preparation of the production budget is mainly dependent on the .... budget.
4. The production volume is connected to the .... environment of the firm.
5. .... budget takes place only after identifying the number of finished products expected to produce to the tune of production budget.
6. ....budget is one of the important sub functional budgets, prepared by the sales manager.
7. Cost control contains two different processes one is the .... of the budget and another one is the .... of the prepared budget.
8. .... overhead is the expense incurred for the promotion of the sales.

7.3 Classification of the Budget in Accordance with the Flexibility

7.3.1 Fixed Budget

It is a budget known as constant budget, never registers the changes in the preparation of a budget, being prepared for irrespective level of output or production. This budget is mainly meant for the fixed overheads of the firm which are constant in volume irrespective level of production. The ultimate utility of the budget is to control the cost as a cost controlling measure, but the fixed budget is meaningless in having comparison with the actual performance.

7.3.2 Flexible Budget

Flexible budget is prepared for any level of production as an estimate of statement of all expenses i.e. the expenses are classified into three categories viz. variable, semi-variable and fixed expenses. The structure of the budget for any output is only to the tune of the actual performance achieved. This is the budget facilitates not only to have comparison in between various levels of production but also to identify the level of lowest production cost.

Notes

Notes Utilities of the flexible budget:

33. This budget is most useful tool of analysis in studying the sales at when the circumstances are not warranting to predict.
34. It is mostly suited to the seasonal business, where the sales volume is getting differed from one period to another due to changes taken place in the taste and preferences of the buyers.
35. The production is being done on the basis of demand of the products in the market. The demand of the products is studied only through demand forecasting. The flexible budget is more applicable in the case of products, which are greatly finding difficult to forecast the demand.
36. The budget is prepared only during the time of acute shortage of resources of production viz. Men, Material and so on.

Example: Draft a flexible budget for overhead expenses on the basis of following information and determine the overhead rates at 70%, 80% and 90% plant capacity.

Particulars	70% capacity	80% capacity (`)	90% capacity
Variable Overheads			
Indirect Labour	----------------	24,000	---------------
Stores including spares	----------------	8,000	---------------
Semi-variable overheads	----------------		---------------
Power 30% fixed ,70% variable		40,000	
Repairs and maintenance	----------------	4,000	---------------
80% fixed and 20% variable			
Fixed Overheads	----------------		----------------
Depreciation		22,000	
Insurance	----------------	6,000	----------------
Salaries	----------------	20,000	----------------
Total overheads	----------------	1,24,000	----------------

Flexible Budget for the Period

Particulars	70% capacity	80% capacity	90% capacity
Variable overheads			
Indirect labour	21,000	24,000	27,000
Stores including spares	7,000	8,000	9,000
Semi-variable Expenses - Power* Fixed 30%			
**Variable 70%	8,000	8,000	8,000
	28,000	32,000	36,000
Repairs and maintenance			
***Fixed 80%	3,200	3,200	3,200
****Variable 20%	700	800	900

Contd…

Notes

Fixed Overheads			
Depreciation	22,000	22,000	22,000
Insurance	6,000	6,000	6,000
Salaries	20,000	20,000	20,000
Total Overheads	1,15,900	1,24,000	1,32,100

Master Budget

Immediately after the completion of functional or departmental level budgets, the major responsibility of the budget officer is to consolidate the various budgets together, which is detailed report of all operations of the firm for a definite period.

Self Assessment

State whether the following statements are true or false:

37. Fixed budget is a budget known as constant budget.
38. Fixed budget is most useful tool of analysis in studying the sales at when the circumstances are not warranting to predict.
39. Flexible budget is prepared for any level of production as an estimate of statement of all expenses

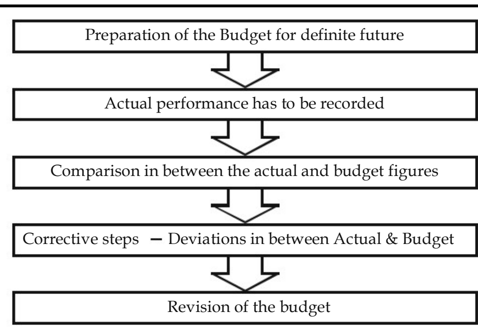
7.4 Budgetary Control System

Budgetary control contains two different processes one is the preparation of the budget and another one is the control of the prepared budget.

According to J. Batty, "Budgetary control is a system which uses budgets as a means of planning and controlling all aspects of producing and/or selling commodities and services."

According to ICMA, England, a budgetary control is, "the establishment of budgets relating to the responsibilities of executives to the requirements 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".

Figure 7.5: Steps Involved in Budgetary Control



Notes

Self Assessment

Fill in the blanks:

40. Budgetary control contains two different processes one is the preparation of the budget and another one is the .... of the prepared budget.
41. .... is a system which uses budgets as a means of planning and controlling all aspects of producing and/or selling commodities and services.

7.5 Features of Budgetary Control System

The following are the essentials or pre-requisites for the successful implementation of a sound system of budgetary control:

42. The business objectives, plans and policies should be clearly defined.
43. The organisational chart should be clear with responsibility and authority.
44. The budgeted output should be stated in clear terms.
45. Budget committee should be setup for the establishment and efficient execution of the plan.
46. Budget centres should be established for cost control and all budgets should be related to cost centres.
47. The budgetary control system should have full support of top management of the organisation.
48. The accounting system should provide accurate and timely information.
49. Staff of the organisation should be strongly and properly motivated towards the system.
50. The budget should lay down the targets which are realistic and attainable, and
51. The budgets should be flexible nature for permit the adjustments in the light of changed operational circumstances.

7.6 Objectives of Budgetary Control

The following are the key objectives of budgetary control:

52. To use different levels of management in a co-operative endeavour for achievement of the objectives of the firm.
53. To facilitate centralised control with delegated authority and responsibility.
54. To achieve maximum profitability by planning income and expenditure through optimum use of the available resources.
55. To ensure adequate working capital in other resources for efficient operation of business.
56. To reduce losses and wastes to the minimum.
57. To bring out clearly where effort is needed to remedy the situation.
58. To see that the firm is not deflected from marching towards its long-term objectives without being overwhelmed by emergencies.
59. Various activities like production, sales, purchase of materials, etc., are coordinated with the help of budgetary control.
60. To define the goal of the enterprise.

Self Assessment

Notes

Fill in the blanks:

61. Budget is a statement of …………………
62. ………………… contains two different processes one is the preparation of the budget and another one is the control of the prepared budget.
63. Budget is an estimate prepared for definite .... period.
64. Budgetary control facilitates centralised control with ………………… authority and responsibility.
65. The budget is usually expressed in terms of …………………

7.7 Zero-base Budgeting (ZBB)

Zero-base budgeting is one of the renowned managerial tools, developed in the year 1962 in America by the Former President Jimmy Carter. The name suggests, it is commencing from the scratch, which never incorporates the methodology of the other types of budgeting in determining the estimates. The Zero base budgeting considers the current year as a new year for the preparation of the budget but the yester period is not considered for consideration. The future activities are forecasted through the zero base budgeting in accordance with the future activities.

Peter A Pyher "A planning and budgeting process which requires each manager to justify his entire budget request in detail from scratch (Hence zero base) and shifts the burden of proof to each manger to justify why he should spend money at all. The approach requires that all activities be analysed in "decision packages" which are evaluated by systematic analysis and ranked in order of importance."

This type of budgeting requires the manager to reason out the aim of spending, but in the case of traditional budgeting is unlike, which are never emphasize the reasons of spending in terms of expenses.

Table 7.2: Traditional Budgeting vs. Zero Base Budgeting

Basis of Difference	Traditional Budgeting	Zero-base Budgeting
Emphasis	It is accounting oriented; emphasis on "How Much"	It is more decision oriented; emphasis on "Why"
Approach	It is monitoring towards the expenditures	It is towards the achievement of objectives
Focus	To study the changes in the expenditures	To study the cost benefit analysis
Communication	It operates only Vertical communication	It operates in both directions horizontally and vertically
Method	It is based on the extrapolation i.e from the yester figures future projections are carried out	Its decision package is totally based on the cost benefit analysis.

7.7.1 Steps involved Zero-base Budgeting

66. The very first step is to prepare the Zero-base Budgeting is to enlist the objectives.
67. The extent of application should be decided in the next phase of the ZBB.

Notes

3. The next important stage is to prioritize the activities.
68. The Most important step involved in the process of ABB is cost benefit analysis.
69. The final step is to select, approve the decision packages and finalise the budget.

7.7.2 Benefits of Zero-base Budgeting

70. It acts as guide for the management to allocate the resources more accurately depends upon the priority for an effective implementation.
71. It enhances capability of the managers who prepares the budget for future action.
72. It paves way for optimum utilization of resources available.
73. It is a technique of utilitarian of the resources with reference to the activity involved.
74. It is dome shaped only towards the achievement of organizational goals.

7.7.3 Criticism of Zero-based Budgeting

75. Non-financial matters cannot be considered for the cost and benefit analysis.
76. Difficulties involved in the process of ranking of the decision packages.
77. It needs more time span for preparation and cost of operations is more and more.

Self Assessment

Fill in the blanks:

78. The ……………… considers the current year as a new year for the preparation of the budget.
79. The very first step is to prepare the Zero-base Budgeting is to enlist the ………………

7.8 Summary

Budget is an estimate prepared for definite future period either in terms of financial or non-financial terms.

Budgeting means the process of preparing budgets. In other words, budgeting refers to the management action of formulating budgets.

Cost control contains two different processes one is the preparation of the budget and another one is the control of the prepared budget.

The production budget is a statement of goods, how much should be produced.

The ultimate aim of the production budget is to find out the volume of production to be made during the year based on the sale volume.

Sales Budget is an estimate of anticipation of sales in the near future prepared by the responsible person for the sale of a product by considering the various factors of influence.

The expected increase or decrease in the sales volume should be incorporated at the time of preparing the sales budget from the yester periods sale figures.

Cash budget is nothing but an estimation of cash receipts and cash payments for specified period. It is prepared by the head of the accounts department, i.e. Chief Accounts Officer.

Notes

Constant budget is mainly meant for the fixed overheads of the firm, which are constant in volume irrespective level of production.

Zero-base budgeting is one of the renowned managerial tools, developed in the year 1962 in America by the Former President Jimmy Carter.

The Zero-base budgeting considers the current year as a new year for the preparation of the budget but the yester period is not considered for consideration.

7.9 Keywords

Budget: A financial statement prepared for specified activity for future periods.

Budgeting: Activity of preparing the budget is known as budgeting.

Budget Control: Quantitative controlling technique to assess the performance of the organization.

Cash Budget: It is a statement prepared by the organization to identify the future needs and receipts of cash from the yester activities.

Flexible Budget: It is a financial statement prepared on the basis of principle of flexibility to identify the cost of the unknown level of production from the existing level of operational capacity.

7.10 Review Questions

80. From the following figures extracted from the books of KPZ Ltd., Prepare raw materials procurement budget on cost:

Particulars	A	B	C	D	E	F
Estimated stock on Jan. 1	16,000	6,000	24,000	2,000	14,000	28,000
Estimated stock on Jan. 31	20,000	8,000	28,000	4,000	16,000	32,000
Estimated consumption	1,20,000	44,000	1,32,000	36,000	88,000	1,72,000
Standard price per Chapter	25 p	.10p	.50p	.30p	.40p	.50p

2. Sankaran Bros sell two products A and B, which are manufactured in one plant. During the year 2006, the firm plans to sell the following quantities of each product.

Product	April-June	July-September	October- December	January-March
Product A	90,000	2,50,000	3,00,000	80,000
Product B	80,000	75,000	60,000	90,000

Each of these two products is sold on a seasonal basis Sankaran Bros, plan to sell product A through out the year at price of ` 10 a Chapter and product B at a price of ` 20 per Chapter.

A study of the past experiences reveals that Sankaran bros has lost about 3% of its billed revenue each year because of returns (constituting 2% of loss if revenue allowances and bad debts 1% loss).

Prepare a sales budget incorporating the above information.

3. Gopi & Co. Ltd. produces two products, Alpha and Beta. There are two sales divisions viz. North and South. Budgeted sales of the year ended 31st December 2009 were as follows.

Division	Products	Chapters	Price per Chapter (`)
North	Alpha	25,000	10
	Beta	15,000	5

Contd...

Notes

South	Alpha	24,000	10
	Beta	30,000	5

Actual sales for the period were

Product	North	South
Alpha	28,000 Chapters @`10 each	25,000 Chapters @ ` 10 each
Beta	18,000 Chapters @ `5 each	33,000 Chapters @ ` 5 each

On the basis of assessments of the salesmen the following are the observations of sales division for the year ending 31st December 2010:

North   Alpha budgeted increase of 40% on 2009 budget

Beta budgeted increase of 10% on 2009 budget

South   Alpha budgeted increase of 12% on 2009 budget

Beta budgeted increase of 15% on 2009 budget

It was further decided that because of the increased sales campaign in North an additional sales of 5,000 Chapters of product will result.

Prepare the sales budget for 2010 (a) zonewise (b) productwise.

81. From the following information prepare a cash budget for the months of June and July.

Month	Credit sales (`)	Credit purchase (`)	Manufacturing overheads (`)	Selling overheads (`)
April	80,000	60,000	2,000	3,000
May	84,000	64,000	2,400	2,800
June	90,000	66,000	2,600	2,800
July	84,000	64,000	2,000	2,600

Additional Information:

Advance tax of ` 4,000 payable in June and in December 2008.

Credit period allowed to debtors is two months.

Credit period allowed by the vendors or suppliers.

Delay in the payment of other expenses one month.

Opening balance of cash on 1st June is estimated as ` 20,000.

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

Particulars	Per Chapter
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 cost per Chapter	155

Prepare a budget for production of:

83. 8,000 Chapters
84. 6,000 Chapters
85. Calculate the cost per Chapter at both levels.

Assume that administration expenses are fixed for all level of production.

86. From the following information relating to 2008 and conditions expected to prevail in 2009, prepare a budget for 2009.

State the assumption you have made, 2008 actuals

Sales	1,00,000 (40,000 Chapters)
Raw materials	53,000
Wages	11,000
Variable overheads	16,000
Fixed overheads	10,000
2009 prospects	
Sales	1,50,000 (60,000 Chapters)
Raw Materials	5 per cent price increase
Wages	10 per cent increase in wage rates
	5 per cent increase in productivity
Additional plant	One lathe `25,000
	One drill `,12,000

87. "Budgetary control is a system which uses budgets as a means of planning and controlling all aspects of producing and/or selling commodities and services." Comment.
88. If the current year production is not equivalent to the current year sales, why does the closing stock arise in the business?
89. What do you think are the causes behind an unfavorable fixed overhead budget variance?
90. "Zero-base budgeting is a planning, resource allocation and control tool." Explain and what are its advantages?

Answers: Self Assessment

1.	Budgeting	2.	management goals
3.	sales	4.	internal
5.	Materials/Purchase	6.	Sales Overhead
7.	preparation, control	8.	Variable sales
9.	True	10.	False
11.	True	12.	control
13.	Budgetary control	14.	quantitative
15.	Budgetary control	16.	Future

Notes

17. delegated
18. total volume
19. Zero-base budgeting
20. objectives

7.11 Further Readings

Books

B.M. Lall Nigam and I.C. Jain, *Cost Accounting*, Prentice-Hall of India (P) Ltd.

Hilton, Maher and Selto, *Cost Management*, 2nd Edition, Tata McGraw-Hill Publishing Company Ltd.

M.N. Arora, *Cost and Management Accounting*, 8th Edition, Vikas Publishing House (P) Ltd.

M.P. Pandikumar, *Management Accounting*, Excel Books.

Online links

www.authorstream.com

www.allinterview.com