UNIT -4

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.

A budget is a system that is related to plan and **control**. Therefore, **budgets** also include budgetary control.

In a nutshell, a budget is concerned with policy framing whereas control is the budgetary implementation of the policy.

In a narrow sense, budgetary control is a cost control technique wherein **actual cost** is compared to budgeted cost, and thus is aimed at **profit**.

Definitions

The main definitions of the budget are summarized as follows:
Brown and Howard: "The budget is a predetermined statement of management policy during a given period which provides a standard for comparison with the results actually achieved."
George R. Terry: "A budget is an estimate of future needs arranged according to an orderly basis covering some or all the activities of an enterprise for a definite period of time."
Harry L. Wyllie: "Budgets are finished products…They are formal programs of future operations and expected results. Budgets result from forward thinking and planning."
Sanders: "The essence of a budget is a detailed plan of operations for some specific future period, followed by a system of records which serves as a check upon plan."
H. J. Weldon: "A budget is thus a standard with which to measure the actual achievement of people, departments, etc."
Hemass C. Heiser: "A budget is an overall blueprint of a comprehensive plan of operations and actions expressed in financial terms."

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.

Responsibility Accounting: Example

What is Responsibility Accounting?

Responsibility accounting is a kind of management accounting that is accountable for all the management, budgeting, and internal accounting of a company. The primary objective of this accounting is to support all the Planning, costing, and responsibility centres of a company.

The accounting generally includes the preparation of a monthly and annual budget for an individual responsibility centre. It also accounts for the cost and revenue of a company, where reports are accumulated monthly or annually and reported to the concerned manager for the feedback. Responsibility accounting mainly focuses on responsibilities centres.

For instance, if Mr X, the manager of a unit, plans the budget of his department, he is responsible for keeping the budget under control. Mr X will have all the required information about the cost of his department. In case, if the expenditure is more than the allocated budget than Mr X will try to find the error and take necessary action and measures to correct it. Mr X will be personally accountable for the performance of his unit.

Advantages of Responsibility Accounting:

- It urges the management to acknowledge the company structure and checks who is accountable for what and fix the problems.
- It enhances attention and awareness of the managers as they have to explain the variations for which they are responsible.
- It helps to compare the achievements between the pre-planned goals and actual results.
- It creates a sense of efficiency within individual employees as their work and achievements will be reviewed.
- It guides the management to plan and structure the future expenditure and revenue of a company.
- Being a cost control tool, it creates 'cost consciousness' among workers.
- Individual and company goals are established and communicated in the best way.
- It improves and controls the company's operating activities for an effective and efficient outcome.
- Simplifies the report structure and guides to prompt reporting.

Types of Responsibility Accounting

There are various types, let us discuss them in detail below:

- **Cost Center:** As the name suggests the persons involved in this center are responsible for controlling cost for the company and they are not responsible for any other functions in the company. However, there are two types of costs namely controlled and uncontrolled, a person should be held responsible for the controlled costs, and the performance of each center is evaluated by comparing the actual vs estimated costs.

- **Revenue Center:** Revenue takes care of the revenue for the company and no other related responsibilities, mostly the sales related teams are accountable for this center.
- **Profit Center:** The performance of this center is measured in terms of revenue and cost and the team working in this center has to make sure to report accurate numbers. Generally, a factory can be considered as a profit center where the raw materials as input are a part of the cost center and sales of the finished goods are revenue center.
- **Investment Center:** We can say that this is a very important center to be on, as this team has to make sure that the assets of the company are properly utilized in the best manner so that the company effectively capitalize on the deployed capital and earn handsome revenues from the same.

Prerequisites of Responsibility Accounting

- As much as effective is responsibility accounting it is equally important to have some prerequisites as a company.
- The initial one is to have a well-defined organizational structure, where the levels of employees are clearly defined, and authorization is efficiently established within the firm.
- The measures which will help to analyze the performance and evaluate must be clearly established and explained to the entire team.

Advantages of Responsibility Accounting

Some of the advantages are:

- The most and the crucial advantage of responsibility accounting is that every accounted person knows the roles and responsibilities he has towards the company, this helps to maintain transparency in the firm.
- Since there are different departments accountable for different activities within the organization, chances of any information mishandling or misreporting are very slim.

- It surely enhances and improves the accuracy of managers working closely with different centers as they are liable for every action within that particular center.