UNIT 4 1. Budgets and Budgetary Control

Definition:
A budget is a financial plan that estimates income and expenses for a specific period.
Budgetary control is the process of comparing actual performance with budgeted figures and taking corrective actions .

Types of Budgets:

- **Fixed Budget:** Remains unchanged regardless of actual production levels.
- **Flexible Budget:** Adjusts based on changes in production or sales volume.

Steps in Budgetary Control:

1. Set budget goals.
2. Compare actual vs. budgeted performance.
3. Analyze variances and take corrective actions.

Objectives of Budgeting

- **Resource Allocation:** Ensures optimal use of resources.
- **Coordination:** Aligns departmental goals with overall organizational objectives.
- **Control and Monitoring:** Provides a benchmark for comparing actual performance.
- **Cost Reduction:** Identifies areas to minimize unnecessary spending.
- **Decision-Making:** Aids in evaluating financial implications of decisions.

Fixed Budget (Static Budget)

A fixed budget remains constant regardless of changes in business activity or production levels. It's based on predicted revenue and expenses over a specific period (usually annually).

☑ **Key Characteristics:**

- Doesn't adjust for variations in sales or production.
- Suitable for stable environments with minimal changes.
- Easier to prepare and monitor.

Pros:

- Simple to manage and track.
- Provides a clear financial roadmap.

Cons:

- Becomes inaccurate if business conditions change.
- Can lead to inefficiencies if actual performance deviates significantly from projections.

Example:
A company sets a fixed budget of $100,000 for marketing for the year. Even if sales increase or decrease, the marketing budget remains unchanged.

Flexible Budget (Variable Budget)

A flexible budget adjusts based on changes in business activity, such as sales volume or production levels. It is more dynamic and provides a realistic view of expenses.

Key Characteristics:

- Adapts to fluctuations in operational conditions.
- Suitable for industries with variable costs and unpredictable demand.
- Helps analyze performance more accurately.

Pros:

- Provides a more realistic view of actual costs.
- Identifies variances and helps control costs effectively.

Cons:

- More complex to develop and monitor.
- Requires constant updating and analysis.

Example:
A company allocates 5% of its revenue to marketing. If revenue increases, the marketing budget grows; if revenue decreases, the budget shrinks accordingly.

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2. Standard Costing and Variance Analysis

Standard Costing:

- Predetermined cost estimates for materials, labor, and overheads.
- Helps in setting cost control measures.

Variance Analysis:

- Compares actual costs with standard costs to find deviations (variances).
- **Material Variance:** Difference between standard and actual material costs.
- **Labor Variance:** Difference between standard and actual labor costs.

The **Material Variance** analyzes the difference between the standard cost and the actual cost of materials used in production.

1. **Material Cost Variance : Material Cost Variance=Standard Cost−Actual Cost**
2. Material Price Variance (MPV):
   Material Price Variance=Actual Quantity×(Standard Price−Actual Price)
3. Material Usage/Quantity Variance (MUV) :
   Material Usage Variance=Standard Price×(Standard Quantity−Actual Quantity)
4. Material Mix Variance (MMV):
   Material Mix Variance=Standard Cost of Actual Mix−Standard Cost of Standard Mix
5. **Material Yield Variance (MYV):**
   Material Yield Variance=(Actual Yield−Standard Yield)×Standard Cost per Unit

Labour variance is used to analyze the difference between the actual labor costs and the standard (budgeted) labor costs. The key labor variance formulas are:

1. **Labour Cost Variance (LCV):**
   Labour Cost Variance=(Actual Hours×Actual Rate)−(Standard Hours×Standard Rate)
2. **Labour Rate Variance (LRV):** =Actual Hours×(Actual Rate−Standard Rate)
3. Labour Efficiency Variance=Standard Rate×(Standard Hours−Actual Hours)
4. Idle Time Variance=Idle Hours×Standard Rate
5. Labour Mix Variance=Standard Cost of Actual Time at Standard Mix−Standard Cost of Actual Time at Actual Mix

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3. Responsibility Accounting

Meaning:
Responsibility accounting assigns accountability to managers for controlling costs and performance within their departments.

Types of Responsibility Centers:

1. **Cost Center:** Responsible for cost control (e.g., production department).
2. **Revenue Center:** Responsible for revenue generation (e.g., sales department).
3. **Profit Center:** Responsible for both revenues and costs (e.g., branch office).
4. **Investment Center:** Responsible for costs, revenues, and investment decisions (e.g., a subsidiary).
