



# Budgetary Control & Project Budget

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# Agenda

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1. Concept of budget
2. Types of budget
3. Essentials of a budgetary control
4. Techniques of budgetary control
5. Concept of a project budget
6. Essentials of a project budget
7. Process to create a project budget
8. Approaches to estimate a project budget
9. Steps to create a successful project budget
10. Hands-on experience on developing a project budget using spreadsheet.

# Planning

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- ❖ What to do?
- ❖ When to do?
- ❖ How to do?
- ❖ Who will do it?

# Control

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- Setting standards
- Receiving feedback on actual performance
- Taking corrective action

# Techniques of Control

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1. Budgetary control
2. Standard costing
3. Break-even analysis
4. Responsibility Accounting
5. PERT and CPM
6. Statistical report
7. Management audit

# What is a Budget?

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Quantitative plans for the future, stated in either physical or financial terms or both

“A budget is a pre-determined statement of management policy during a given period which provides a standard for comparison with the results actually achieved”.....Crown and Howard

**Budgets - developed within the context of ongoing business and is ruled by previous decisions that have been taken within the long-term planning process.**

# Why do we produce a budget?

## (1/2)

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1. To aid the planning of actual operations:

- by forcing managers to consider how conditions might change and what steps should be taken now.
- by encouraging managers to consider problems before they arise.

2. To co-ordinate the activities of the organization:

- by compelling managers to examine relationships between their own operation and those of other departments. in the process - identify and resolve conflicts

# Why do we produce a budget?

## (2/2)

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### 3. To communicate plans to various responsibility centre managers:

- everyone in the organization should have a clear understanding of the part they are expected to play in achieving the annual budget.
- by ensuring appropriate individuals are made accountable for implementing the budget.

### 4. To motivate managers to strive to achieve the budget goals: budget provides a standard that under the right circumstances, a manager will be motivated to strive to achieve

- by focusing on participation
- by providing a challenge/target.

### 5. To control activities:

- by comparison of actual with budget (attention directing/management by exception).

### 6. To evaluate the performance of managers:

- by providing a means of informing managers of how well they are performing in meeting targets they have previously set.

# Budgetary control?

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# Essentials of a budgetary control system

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- ❑ Clarifying objectives
- ❑ Proper delegation of authority & responsibility
- ❑ Proper communication system
- ❑ Budget education
- ❑ Participation of all employees
- ❑ Flexibility
- ❑ Motivation

# Organization of a budget

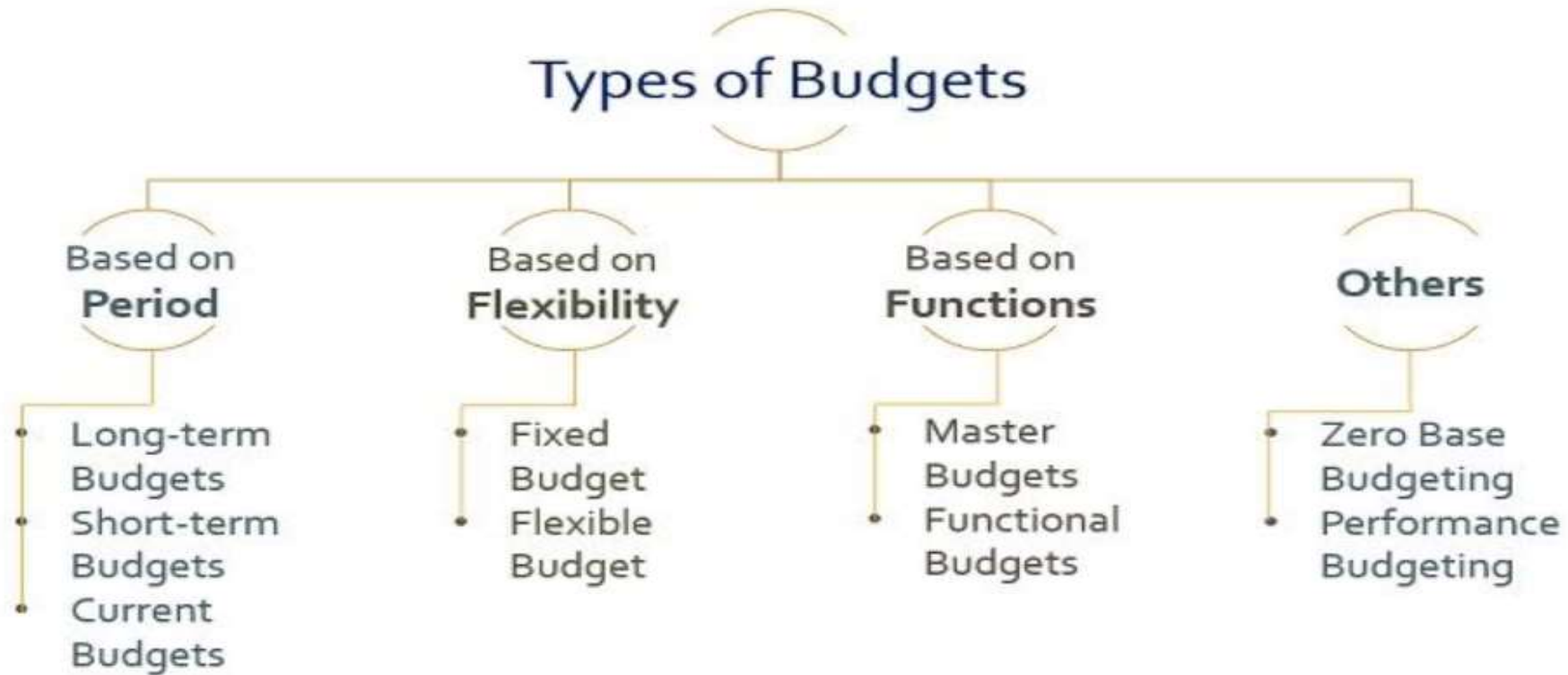
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ORGANIZATION CHART FOR BUDGETARY CONTROL

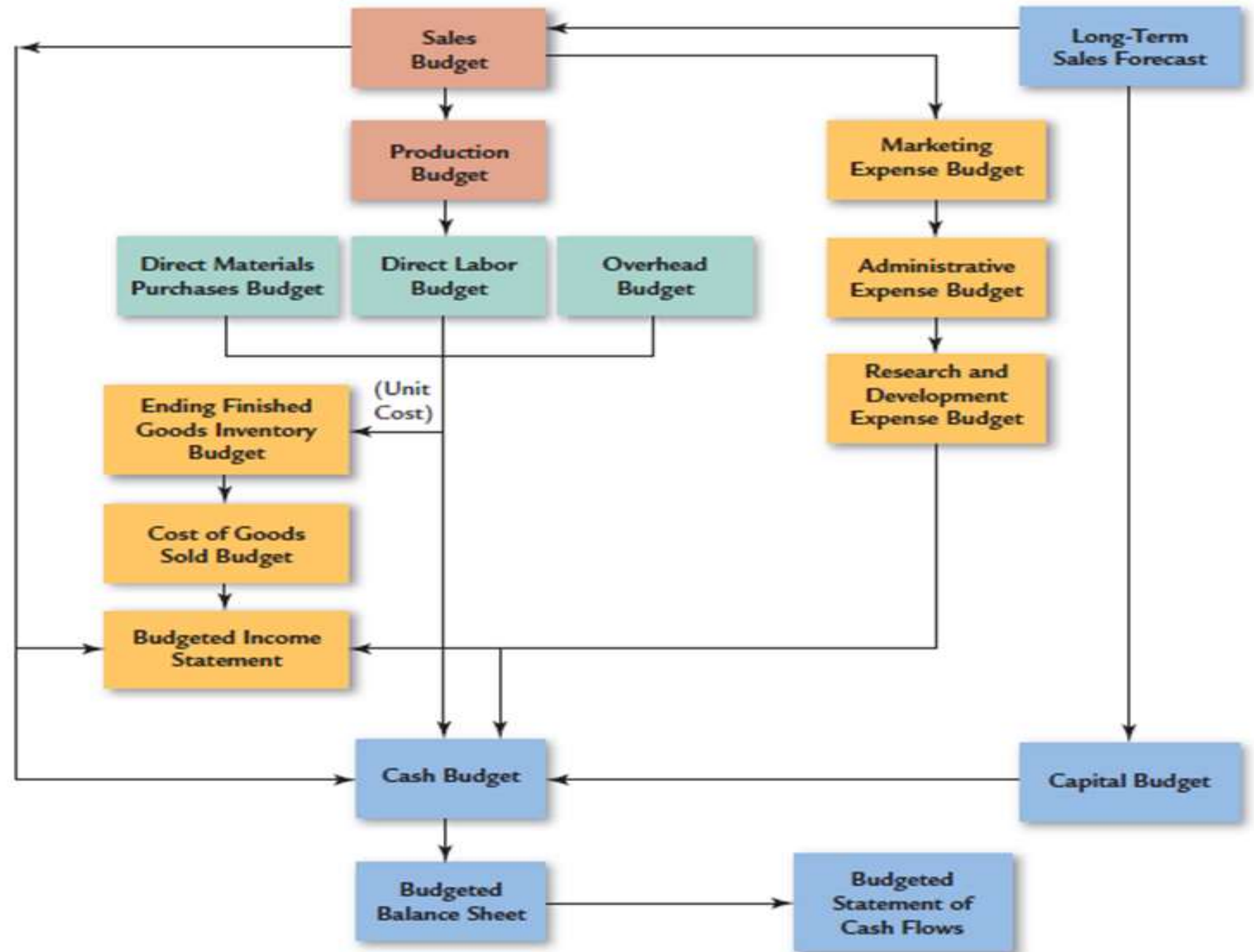


# Classification of budget

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# Master Budget



# Gathering Information for Budgeting

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## Forecasting sales

- It is the basis for the sales budget, and, in turn, is the basis for all other operating budgets and most of the financial budgets
- It strongly affects the soundness of the master budget

## Forecasting other variables

- Costs and cash-related items are critical in budgeting
- Historical amounts can be of real value

# Knowledge Check Activity 1

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Identify the true statement about “control”

- a. A method for translating the goals and strategies of an organization into operational terms
- b. A process that is concerned only with the inflows and outflows of cash and with financial position
- c. A process of setting standards, receiving feedback on actual performance, and taking corrective action
- d. A method that does not consider the sales forecast and cash-related items in its decision making

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- **Sales budget:** Describes expected sales for each product in units and dollars
  - **Production budget:** Describes how many units must be produced in order to:
    - Meet sales needs
    - Satisfy ending inventory requirements
  - ▶ **Units to be produced = Unit sales + Desired units in ending inventory – Units in beginning inventory**

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## **Direct materials purchases budget**

- Based on the amount of materials needed for production and the inventories of direct materials
- $\text{Purchases} = \text{Expected usage} + \text{Desired ending inventory of direct materials} - \text{Beginning inventory of direct materials}$

## **Direct labor budget**

- Shows the total direct labor hours and direct labor cost needed for the number of units in the production budget

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**Overhead budget:** Shows the expected cost of all indirect manufacturing items

**Ending finished goods inventory budget**

- Supplies information for the balance sheet
- Serves as an input for the preparation of the cost of goods sold budget

**Cost of goods sold budget**

- Used in preparing the budgeted income statement

**Marketing expense budget:** Outlines planned expenditures for selling and distribution activities

**Administrative expense budget:** Consists of estimated expenditures for the overall organization and operation of the company

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## **Research and development expense budget**

- Contains planned expenditures for a separate department devoted to new product research and development

## **Budgeted income statement**

- Compiles the results of all the operating budgets
- Helps managers determine what the company's performance will be by the end of the year

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**Capital expenditures budget:** Financial plan outlining the expected acquisition of long-term assets

**Cash budget**

- Detailed plan that shows all expected sources and uses of cash
- Main sections - Total cash available, cash disbursements, cash excess or deficiency, financing, and cash balance

# The Cash Budget

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Beginning cash balance

+ Cash receipts

Cash available

– Cash disbursements

– Minimum cash balance

Excess or deficiency of cash

– Repayments

+ Loans

+ Minimum cash balance

Ending cash balance

# Shortcomings of the Traditional Master Budget Process

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Department oriented and does not recognize the interdependencies among departments

Static, not dynamic

- **Static budget:** Developed for a single level of activity
- **Incremental approach:** Current budget based on last year's amounts as adjusted for inflation

# Flexible Budget

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Provides:

- Expected costs for a variety of activity levels
- Budgeted costs for the actual level of activity

Referred to as a **variable budget**

Powerful tool for planning and control

- Shows what costs will be at various levels of activity
- Computes what costs should have been for the actual level of activity

# Zero-base budgeting?

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# Activity-Based Budget?

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Conventional budgeting is inappropriate for those activities where the consumption of resources does not vary proportionately with the volume of the final output of products or services.

- For support activities conventional incremental budgets merely serve as authorization levels for certain levels of spending.
- Incremental budgeting results in the cost of non-unit level activities becoming fixed.
- ABB aims to authorize only the supply of those resources that are needed to perform activities required to meet budgeted production and sales volumes.

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- The ABB process is the reverse of the ABC process:

Budgeted output of cost objects



Determine the necessary activities



Determine the resources required for the budget period

# Behavioural Dimension of Budgeting

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Positive or negative effect of budgets depends on how budgets are used

- Positive behavior occurs when there is goal congruence
  - **Goal congruence:** Alignment of managerial and organizational goals
- **Dysfunctional behavior:** Involves individual behavior that is in basic conflict with the goals of the organization

# Characteristics of a Good Budgetary System (1 / 2)

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## **Frequent feedback on performance**

- Frequent performance reports can reinforce positive behavior and give managers the time and opportunity to adapt to changing conditions

## **Monetary and nonmonetary incentives**

- Incentives: Means that are used to encourage managers to work toward achieving the organization's goals
  - Negative incentives use fear of punishment
  - Positive incentives use rewards

# Characteristics of a Good Budgetary System (2/2)

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## **Participative budgeting**

- Allows subordinate managers considerable say in how the budgets are established
- Communicates a sense of responsibility to subordinate managers and fosters creativity

## **Realistic standards**

- Budgets should reflect operating realities such as actual levels of activity, seasonal variations, efficiencies, and general economic trends

# Why project budget?

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- Funding
- Basis for cost control
- Impact on company's financials

# What is a project budget?

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- ❑ It is an estimation of entire expenditure for completing a project over a specified time.
- ❑ How much a project will cost at each stage?
- ❑ It starts from the time a project kicks-off and continues until it gets completed.

# Things to consider for a project budget

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- ❑ **Cost estimates:** A budget includes various costs including direct, indirect, capex and operational costs, cost associated with project deliverables, etc.
- ❑ **Budget contingency:** How a project plan will incorporate some slacks in its timelines and it is a good idea to set aside some funds for emergency.
- ❑ **Budget monitoring:** To track and monitor expenditure throughout the project. It helps to identify additional funding needs with enough lead time before the work must halt.

# Process to create a project budget

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- Define project scope
- Identify resources
- Assign amounts
- Create budget
- Get approval and implement

# Approaches to estimate a project budget

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- Bottom-up estimation
- Top-down estimation
- Analogous estimation
- Parametric estimation
- Three-point estimation

# Steps to create a successful project budget

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- Use previous data history of successful projects about to be launched.
- Use of acquired knowledge
- Contact experts
- Confirm accuracy
- Keep your budget dynamic
- Update the budget in real time