SES'S L.S.RAHEJA COLLEGE OF ARTS AND COMMERCE

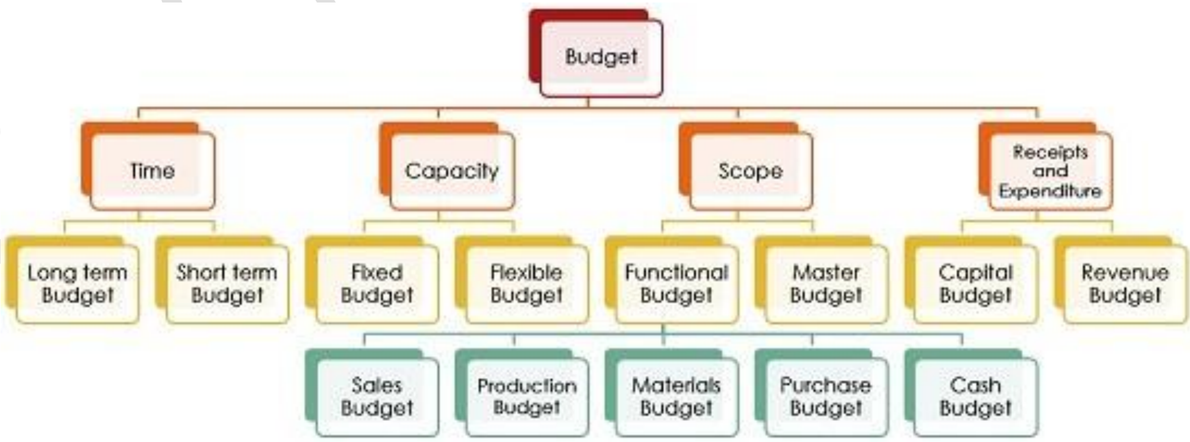
Course: Financial Management - II Unit: III Prepared by: Raju D. Gole

Budgeting

Definition:

Budgeting is the process of creating a plan to spend your money. This spending plan is called a budget. Creating this spending plan allows you to determine in advance whether you will have enough money to do the things you need to do or would like to do. Budgeting is simply balancing your expenses with your income.

Types of Budgets:



a) Long Term Budget:

A **long**-range **budget** is a financial plan that extends for more than one year into the future. This type of **budget** typically covers a five-year period and is focused on the strategic direction of the business.

b) Short Term Budget:

A **budget** prepared for a **period** less than a year is called **short-term budget**. **Short term budgets** are prepared for actual implementation and it has a practical value.

c) Fixed Budget:

A **fixed budget** is a **budget** that does not change for increases or decreases in volume. ("Volume" could be sales, units produced, or some other activity.) A **fixed budget** is also known as a static **budget**.

d) Flexible Budget:

A **flexible budget** is a **budget** that adjusts or flexes with changes in volume or activity. The **flexible budget** is more sophisticated and useful than a static **budget**. (The static **budget** amounts do not change. They remain unchanged from the amounts established at the time that the static **budget** was prepared and approved.)

e) Sales Budget:

A **sales budget** provides an estimate of the volume of goods and services that a company proposes to sell in a future period. It is usually made for the following year. Most **sales budgets** include monthly and quarterly figures as well.

f) Purchase Budget:

A **purchases budget** contains the amount of inventory that a company must **purchase** during each **budget** period. The amount stated in the **budget** is the amount needed to ensure that there is sufficient inventory on hand to meet customer orders for products.

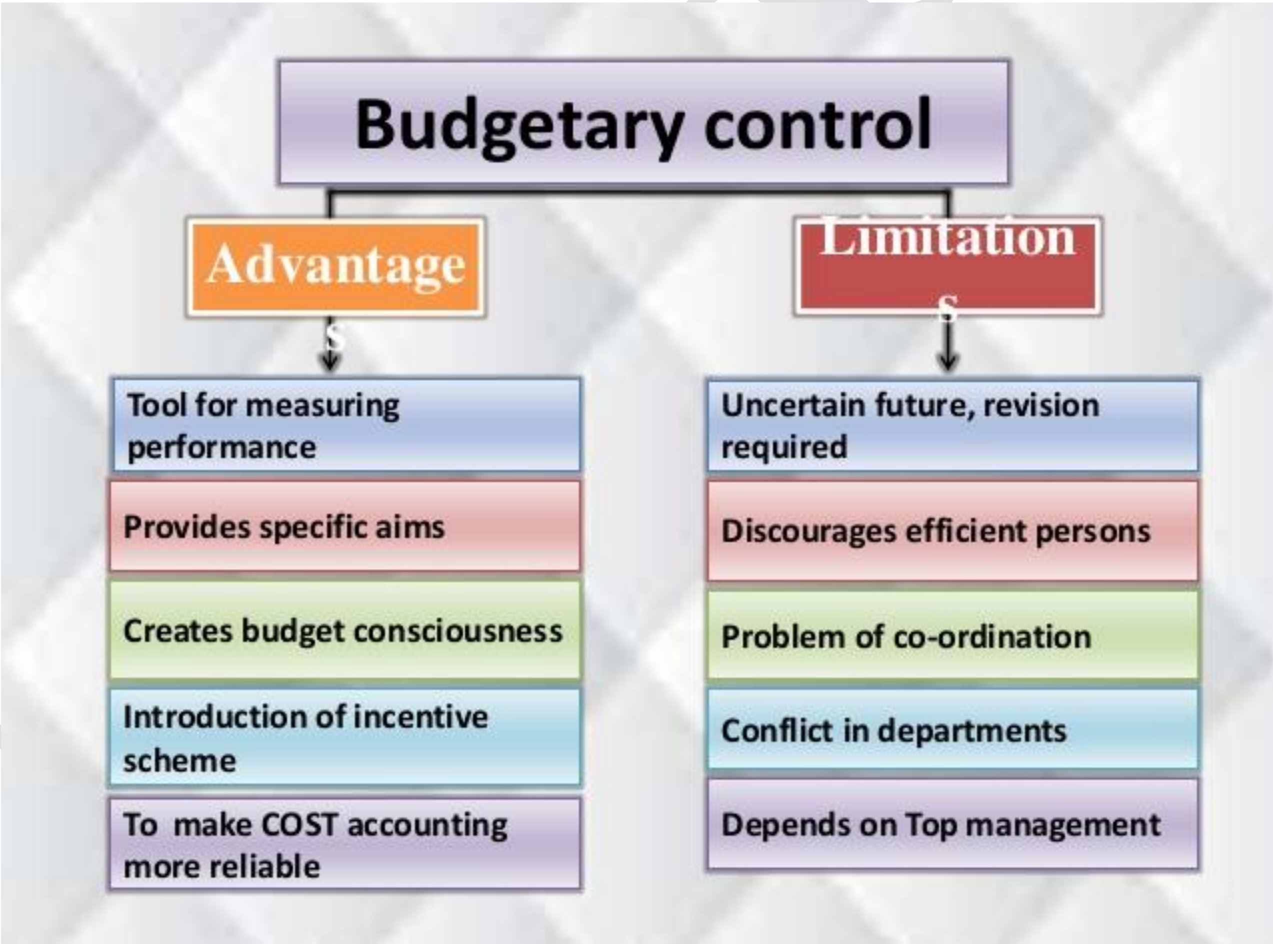
g) Production Budget:

The **production budget** contains details of the number of units that are intended to be produced by a business in a particular period. This **budget** is made after the preparation of the sales **budget**. It helps a company to plan its manufacturing schedule and ensure that it produces an adequate quantity of goods.

Budgetary Control

Objectives of budgetary control

- Planning
- Co-ordination
- Communication
- Motivation
- Control
- Performance evaluation



NOTE: ABOVE MENTIONED POINTS ARE INDICATIVE AND NOT EXHAUSTIVE. PLEASE EXPLAIN THE ANSWERS IN DEATAIL WITH PROPER EXAMPLES WHEREVER NECESSARY. ALSO REFER NOTES & BOOK(S) FOR THE SAME.

Important Questions

a. AB Ltd. manufactures two product P and Q and sells them through divisions North and South.

Budget sales units for current year:

Product	**North**	**South**
P	2,000 units at Rs.9	3,000 units at Rs.9
Q	1,500 units at Rs.21	1,500 units at Rs.21

Actual sales units for the current year:

Product	**North**	**South**
P	2,500 units at Rs.9	3,500 units at Rs.9
Q	1,000 units at Rs.21	2,500 units at Rs.21

Market studies reveal that product P is popular but under-priced. It is observed that if the price of P is increased by Rs.1, it will still find ready market. On the other hand, Q is over-priced and the market could absorb more if sales price of Q be reduced by Rs.1. To promote sales, the management has agreed to do so.

With the above price changes the following estimates have been prepared by the salesman:

Product	**North**	**South**
P	+10%	+5%
Q	+20%	+10%

You are required to prepare the sales budget for the current year as well as budget for the next year.

b. ACC Ltd manufactures two products X and Y and sells them through two divisions: North and South. For the submission of Sales budget to the budget committee the following information has been made available:

Budget sales units for current year:

Product	**North**	**South**
X	4,000 units at Rs.9	6,000 units at Rs.9
Y	3,000 units at Rs.24	5,000 units at Rs.24

Actual sales units for the current year:

Product	**North**	**South**
X	5,000 units at Rs.9	7,000 units at Rs.9
Y	2,000 units at Rs.24	4,000 units at Rs.24

Adequate market studies reveal that product X is popular but under-priced. It is observed that if the price of X is increased by Rs.1, it will still find ready market. On the other hand, Y is over-priced and the market could absorb more if sales price of Y be reduced by Rs.4. The management has agreed to do so.

For the information based on these price changes and reports from salesman, the following estimates have been prepared by divisional managers.

Percentage increase in sales:

Product	**North**	**South**
X	+10%	+5%
Y	+20%	+10%

You are required to prepare the sales budget for the current year as well as budget for the next year.

c. Write short notes

1. Functional Budget
2. Flexible Budget
3. Objectives of Budgetary Control