**DEPARTMENT OF COMMERCE AND FINANCIAL STUDIES**
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**MBA (Financial Management)**

**Course Code and Name: FMCC1/24-ACCOUNTING FOR DECISION MAKING**

**Unit –IV/Topic: STANDARD COSTING AND BUDGETARY CONTROL**

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# Standard Costing and Budgetary Control (Content)

-Standard Costing
-Variance Analysis
-Material and Labour Only
-Budgets and Budgetary
-Control
-Classification of Budgets
-Functional Budget
-Production, Sales, Raw Materials
-Purchase and Cash Budget
-Flexible Budgeting
-Zero Based Budgeting.

# Budget

1. A budget is a detailed plan of operations for some specific period.

2. The Chartered Institute of Management Accountants, London, defines, a budget as, "A financial and or quantitative statement, prepared prior to a defined period of time, of the policy to be pursued during that period for the purpose of attaining a given objectives.

# Essential features of a budget

**The following are the important features of budget:**

- A budget is prepared in advance and is based on a future plan of actions.
- It relates to a future period and is based on objectives to be attained.
- It is a statement expressed in monetary and/or physical units prepared for the implementation of policy formulated by the management.

# Budget Manual

The Chartered Institute of Management Accounting, London, defines a budget manual - as a document which sets out, inter alia, the responsibilities of the persons engaged in, the routine of, and the forms and records required for budgetary control. It is a written document which specifies the objectives of the budgeting organization and procedures.

# Budget Procedure

**Budget period:**

- A budget period means the period for which a budget is prepared and employed. Normally, it will be a year.

**Members of the Budget Committee:**

- All the managers of the various departments of the organization are the members of the budget committee.

**Budget procedure:**

**The following are the procedure of budget**

- 1.Determination of the key factor
- 2.Making of forecasts
- 3.Consideration of alternative combinations of forecasts.
- 4.Preparation of budgets.

# Classification of Budgets

**Budgets classification**

**Budgets are classified in the following way:**

i. According to Time:(a) short term (b) long term budgets (c ) Current budgets

**long Term budget**

A budget designed for a longer period, generally for a period of 5 to 10 years is called as a long term budget.

**Short term budget**

A .budget designed for a period, not exceeding 5 years, is called a short term budget.

**Current Budget**

Current budgets are budgets covering a very short period eg. a month or a quarter.

# According to Functions:

(a) Sales (b) Production (c) Cash
(d) Purchase (e) Cost of production budgets (f) Master Budget

## (a) Sales

Take a moment to think about what the word ”selling” **means** to you. Every time I ask **sales** executives to define ”selling,” I get answers like these: Selling is a process of persuasion to get a prospect to take action. Selling is finding a need and filling that need. Selling is an exchange of goods or services for money.

## (b) Production

1. The action of making or manufacturing from components or raw materials, or the process of being so manufactured.

2. The provision of something for consideration, inspection, or use.

**(c) Cash**

1.Money in coins or notes, as distinct from cheques, money orders, or credit.

**(d)Purchase**

1. Acquire (something) by paying for it; buy.

**(e) Cost of production budgets**

Production costs refer to the costs incurred by a business when manufacturing a good or providing a service. Production costs include a variety of expenses, such as labor, raw materials, consumable manufacturing supplies, and general overhead.

**(f) Master Budget**

The master budget is the aggregation of all lower-level budgets produced by a company's various functional areas, and also includes budgeted financial statements, a cash forecast, and a financing plan. Direct materials budget .

iii. According to flexibility: (a) Fixed budget (b) flexible budget

**(a) Fixed budget**

A **fixed budget** is a **budget** that does not change or flex when sales or some other activity increases or decreases. A **fixed budget** is also referred to as a static **budget**. To illustrate a **fixed budget**, let's assume that a company pays commission on its sales at a rate of 5%.

**(b) flexible budget**

A **flexible budget** is a **budget** that adjusts or flexes for changes in the volume of activity. The **flexible budget** is more sophisticated and useful than a static **budget**, which remains at one amount regardless of the volume of activity.

**Sales budgets:** is an estimate of expected sales during a budget period. It lays down potential sales figures in value as well as in quantity. A sales budget is the starting point on which other budgets are also based.

**Production budget:** is a forecast of production for the budget period. It is prepared for the number of units to be produced and also for the cost to be incurred on materials, Labour and factory overheads.

**Cost of production**: budget estimates the cost of production in advance.

**A Purchase:** budget estimates the raw materials to be purchased for a future period.

**A cash budget:** is an estimate of cash receipts and cash payments for a future period. It is a short term budget. It is a functional budget.

**Master Budget:** If a budget incorporates all functional budgets, it will be called as a Master Budget. It is a combination of all functional budgets and used to co-ordinate the activities of all departments and as a control device.

# Fixed budget / Flexible budget

- According to Chartered Institute of Management Accounting, London,
- Fixed budget is a budget which is designed to remain unchanged irrespective of the level of activity actually attained".
- A Flexible budget consists of a series of budgets for different levels of activity.

# Zero Base Budgeting (ZBB)

- ZBB is a new technique designed to revitalize budgeting. It was first introduced in USA in the Agriculture department in 1961.
- According to Peter A.Pyher, Zero based Budgeting, is "A planning
- and budgeting process which requires each manager to justify his
- entire budget request; in details from scratch (hence zero basis )
- and shifts the burden of proof to each manager to justify
- why he needs money at all.
- Normally for the preparation of Budget, previous year figures are taken as the base. In Zero base Budgeting, every year is taken as a new year and a manager has to justify why he wants to spend .

# Advantages of ZBB

1. It provides an organization with a systematic way to evaluate different operations and programmes undertaken by the management. It enables mgt. to allocate resources according to priority of the mgt.
2. It ensures that every Programme undertaken by the manager is essential for the organization and is being performed in the best possible way.
3. It enables the mgt. to approve departmental budgets on the basis if cost-benefit analysis.
4. It is helpful to identify areas of wasteful expenditure.
5. It links budgets with the corporate objectives.

# Limitations of ZBB

1. It has implementation problems. Successful implementation of ZBB requires the support of top level mgt. There should not be frequent transfer of managers.
2. Considerable problems are faced while formulating decision packages.
3. Ranking the decisions is also not easy.
4. ZBB involves time and cost . It needs properly trained managerial personnel to do the required job.

# Definition of Budgetary Control:

The CIMA of London defines Budgetary control as "the establishment of budgets relating to the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with the budgeted results, either to secure by individual action the objective of that policy or to provide a basis for its revision."

**Budgetary control involves the following steps.**

1.Establishment of Budgets

2.Continuous comparison of actuals with the budgets for achievement of targets

3.Revision of Budgets in the light of the changed circumstances.

# **Advantages of budgetary control**:-

1.Brings economy in working

2.No buck-passing of responsibility

3.Establishes co-ordination

4.Guards against undue optimism

5.Acts as a safety signal

6.Adoption of uniform policy

7.Decreases production costs 8.Adoption of standard costing principles

9.Mgt. by exception

10.Favour with credit agencies

# **Limitations of budgetary control:-**

1.Opposition to budgeting

2.Time factor

3.Not a substitute for mgt.

4.Need for co-operation.

# What are Standard Costs?

- Std. costs are the pre-determined costs. Such costs are determined in advance.
- Standard costing is “ the preparation and use of std. costs , their comparison with the actual costs and the analysis of variances to their causes and points of incidence”

-ICMA, England

## Differences Between Standard Costing and Budgetary Control

1. Budgetary control is concerned with the operations of the business as a whole and hence it is more extensive.
2. Standard Costing is related with the control of the expenses and hence is more intensive
3. Budgetary control is a projection of financial a/cs.
4. Standard Costing is projection of cost a/cs.
5. Budgetary control does not involve standardization of products.
6. Standard Costing requires standardization of products.
7. Budgetary control can be adopted in part also
8. Standard Costing cannot be adopted in part.
9. Budgetary control can be operated without budgets
10. Standard Costing cannot exist without budgets
11. Budgetary control Budgets determine ceilings of expenses
12. Standard Costing Are minimum targets.

# Advantages of Standard Costing

**The following are the advantages of Standard Costing**

1.Formulation of price and production policies

2.Comparision and analysis of data

3.Cost conscious

4.Better capacity to anticipate.

5.Delegatiom of authority and responsibility

6,Mgt. by exception

7.Better economy, efficiency and productivity

# Limitations of Std. Costing

**The following are the limitations of Standard Costing:**

1. Heavy cost
2. Frequent revision of stds.
3. Suitable for non-standardized products only.
4. Fixation of responsibility is difficult
5. Adverse psychological effect
6. Opposition from managers.

# Variance Analysis

Variance analysis is analyzing the reasons for the difference between the std. costs and the actual costs. This analysis can be done for Material, labour, Overheads (Fixed and Variable) and Sales.

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