

# Examining different types of budgets and their uses



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Budgeting operations are very important for any kind of an organization, that is involved in making profits or not. This is the case because all forms of organizations have a number of resources, both material and human, which have to be managed in order to promote and effective realization of goals and objectives. As well, all organizations shall have a number of obligations and missions that have to be realized within stated time durations, and hence budgeting acts as one of the major tools that can be greatly applicable towards realization of goals and objectives. This paper shall hence give the major findings on the budgetary framework, usage and benefits of the 8 types of budgets.

## Introduction

Definitively, a budget refers to forecast of company's incomes and expenses anticipated for a given period of time. With a budget, an organization is able to analyze how much money they are making and spending, and they are able to figure the best way to channel it among various categories and departments. Budgeting depicts the entire process of analyzing and planning using a budget. Since budgets are vital tools for management and planning, the process of budgeting generally affects all types of organizations regardless of their size and composition. Many organizations participate in budgeting process with the view of determining the most cost effective and efficient strategies of making profits and intensifying its capital and asset base. In management, budgeting guides an organization to use its scarce resources in a way that exploits the existing business opportunities well. Good budgeting concepts integrate efficient business judgment and help the management to make decisions regarding the overall performance of the <https://assignbuster.com/examining-different-types-of-budgets-and-their-uses/>

company. In budgeting, an organization typically develop long-term and short-term plans that assist in implementation of its policies and even though its expensive and time consuming, it increases awareness of costs and coordination of activities channeled towards achievement of company goals and objectives. In any organization, an effective budget always explains the projected route a company would follow in achieving its objectives and goals, and it summarizes the forecasted result of production and marketing efforts, and acts as a benchmark in which the management compares its performance against the actual outcomes.

The major functions of budgeting include planning and control. Planning activities convey the views and plans of a company in scientific terms and the eventual planning on its part creates the framework for control, which an organization uses to delegate duties and standardizes procedures (Banham, 2000).

Budgeting process is chronological in nature, and consists of many budgets that are roughly classified according to methods and techniques of an organization in generating and spending its money. Different budgets are used for different applications. Some of these mentioned budgets deal with income coming from dividends, sales and interest. Consequently, other budgets give details of sources of expenditures like labor, selling costs, purchases, and factory costs. Some unique types of budgets are chiefly concerned with investments and forecast for company productivity and performance. These budgets are classified according to their usage and include , Sales budget, Production budget, Direct materials usage budget,

Direct materials purchase budget, Direct labor budget, Factory overhead budget, Selling and administration budget and Cash budget (Colin, 2005).

## **Types of budgets**

### **Sales budget**

In any organization, it's the sales department that has the overall responsibility of preparing the sales forecast. Sales forecast is a requirement in devising sales budget on which an organization can schedule its production. Sales budget refers to a comprehensive schedule that shows the anticipated sales for a given period of time. The plan for this given period is usually expressed in terms of volume of total sales and selling prices of each class of goods or services. An accurate sales budget is an important element in budgeting as it contributes to the overall organization budgeting process. If sloppily done and formulated, the rest of the budgeting process becomes a waste (Adams, et al., 2008). The sales budget is also referred to as revenue budget since it's a preliminary step in preparation of master budget. In an organization, sales budget assist the management to determine the amount of units to be produced thus the production budget is formulated after the sales budget, which in turn is used to determine budgets for production costs that include direct materials , production overhead costs and direct labor budget. In essence, the sales budget is very critical in that it elicits a chain of reaction that often leads to growth and development of other types of budgets. The sales budget consists of sales that are expressed in terms of number of units and the amount of revenue including all expenses that support sales, advertising and the cost of distribution of goods sold. Sales

budget also consist of forecast of distribution of expenditure for goods sold (Banham, 2000)

When developing a sales budget, the following calculations are formulated; the sales budget is erected by multiplying the budgeted sales in units by the selling price.

Budgeted Sales = [Budgeted Unit Sales] [Budgeted Sales Prices]

For the management, sales budget is often the preliminary step in preparation of the master budget. All other components in the master budget do depend on it in some way.

## **Production budget**

It's mostly prepared with data from sales budget. Companies that are product oriented usually create production budget that tends to estimate the number of units that ought to be produced in order to meet the sales goals and objectives. The other function of production budget is that it estimates different types of costs involved in production or manufacturing of the said units, inclusive of material and labor costs (Colin, 2005). Any typical organization spends huge amount of money in production than in any other type of expense. For this reason, it's vital to create production budget that include all production expenditures so as to estimate the future working capital and future effects on inventory and levels. Production budget is an all-inclusive plan that considers all manufacturing works to be done within the period including the amount expenditures to be incurred on these projects. When creating production budget, it requires individuals involved to be accurate with detailed production estimates . This kind of estimates are <https://assignbuster.com/examining-different-types-of-budgets-and-their-uses/>

typically prepared in combination with the title budgets, which must be finished prior to contracting of other project (Horace, et al., 2007).

Before production budget is prepared, the management should always review the production period of budget. The major function of production budget is that it calculates approximately different costs involved in production or manufacturing of products including the cost of materials and labor. When calculating the total production needs, an organization adds anticipated sales to ending inventory and deducts the commencement of inventory from that sum.

Total production = (projected sales) + (ending inventory) - (starting inventory).

### **Direct materials usage budget**

Direct material budget refers to analytical plan that shows how much materials would be required in manufacturing or production and the amount of material required to meet the production needs. It's usually prepared after calculation of production needs or requirements. Materials budgeting show the amount of raw material to be purchased in order to accomplish production requirements and the necessary amount to provide adequate inventories. Preparation of this kind of budget constitutes the organizational overall use of material requirements planning (MRP). This organization tool help manage inventories and materials, and ensures the required materials are available in the right quality and quantity and at the required time to meet the production needs of the company. Direct materials budget regularly go along with a schedule of anticipated cash payouts for raw

materials and this plan is required for the preparation of the overall cash budget. Expenditures for materials include the cost of purchases of purchases the present budget period. Direct material budget is mostly constructed to determine the amount and cost of any additional materials needed to fulfill the anticipated production levels. Most organizations depicts this in two tables, where the first table shows the number of units to be purchased and the total cost for those purchases while the second table shows a plan of the projected distributions of cash to suppliers of materials. The formula for the computation of materials purchases is given by:-

$$\text{Purchase costs} = (\text{Materials Purchase Costs Unit of Materials to Be Purchased}) \times (\text{Unit Price}).$$

Most successful organizations uses the planning and control of a direct-materials budget in order to determine the level of competence in their cargo space, inventory system success and to appraise the capacity of dealers to supply raw materials in the estimates and qualities that are required, and plan material purchases in relation with movement of funds into the organization (Livingstone & Leslie, 1994).

### **Direct materials purchase budget**

Production budget provide necessary information for determining the projected amount of direct materials that ought to be purchased. Simply by multiplying these amounts with the anticipated costs of purchase price, gives the total costs of materials to be purchased. The major function of direct material purchases budget, is that it provides the essential framework to plan and schedule cash payments for direct materials (Peter & McLaney,

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1997). This budget also critically reveals the company's planned end of the fiscal year inventory. This value is very important in cost accounting techniques because it is a vital component in preparation of the budgeted year ending balance sheet.

For effective implementation, the direct purchases budget should be incorporated with the production budget to make sure any level of production is not interrupted during the period of production. This budget tends to estimate the quantity of materials to be purchased in order to promote the budgeted production level and keep desired inventory levels. Direct materials to be purchased are given by:-

Materials to be purchased = (materials required for production) + (desired ending materials inventory) - (estimated beginning materials inventory)  
(Horace, et al., 2007).

## **Direct labor budget**

Definitively, direct labor budget refers to a fixed Schedule for anticipated labor cost. The anticipated labor costs is chiefly reliant on projected volume of production or production budget. The labor needs are dependent on production volume multiplied by direct labor-hours per unit. The derived product is then multiplied by direct labor cost per hour to achieve the exact budgeted direct labor costs. This budget is created from the production budget where direct labor needs are computed to make the management know whether there is sufficient labor time to fulfill the budgeted manufacturing requirements. This advance knowledge helps the management in to develop plans to regulate labor force when adverse



situations occur (Livingstone & Leslie, 1994). Organizations that fail to budget well always face the risk of having labor shortages or increases in unwarranted times. This kind of unpredictable often leads to inconsistent labor policies that contribute to insecurity, low workers morale, and low productivity. Direct materials budget is used in an organization to illustrate the amount and cost of direct materials to be purchased. It also provides the foundation for preparation of direct labor cost budget (Colin, 2005). Most organizations give this budget in terms of the number of units and the total costs. Labor hours are displayed using parameters like the type of operation, workers used, and the overall cost centers involved. Total direct labor cost is given by:-

$$\text{Total direct labor cost} = (\text{Expected production}) + (\text{direct labor hour per unit}) + (\text{direct labor cost per hour})$$

## **Factory overhead budget**

In cost accounting, factory overhead budget is referred to as a to-do list of all anticipated manufacturing or production costs apart from for costs related to direct material and labor. Factory overhead include items like indirect material and labor, cost of insurance, rent and rates Factory overhead are usually variable or fixed, or a blend of the two.

The major function for this schedule is that it critically analyzes all the anticipated production costs for the specific period of time. Factory overhead budget does not include miscellaneous expenses incurred in marketing and administration. These expenses are considered miscellaneous because they are not involved in the production process. As mentioned earlier, production

overhead costs determine the total production factory overhead costs and also determine the manufacturing overhead cost per unit. The overall overhead costs include the costs of materials required to make the finished product, direct labor costs needed to produce one unit and the factory expenses required to create one finished unit. The summation of the three costs gives the manufacturer a rough idea of the cost required to produce one unit or finished product (Horace, et al., 2007).

### **Selling and administration budget**

Selling and administrative expense budget refers to a schedule of budgeted expenses for other areas rather than manufacturing. In organizations this type of budget consists of assemblage of many and individual budgets that are forwarded by various departments. It provides a detailed plan involving all the company's operating expenses, other than the ones involved in production. The said expenses are required in maximum in order to maintain the sales and organization overall operations for a given period of time (Peter & McLaney, 1997). This comprehensive financial plan is analytically used by the management to plan and control the day-to-day running of business affairs and activities. In this budget the organization gives details of the amount of money it projects to spend in support of manufacturing or production and sales efforts to be taken. Selling and administrative expense budget consists of employee's salaries and benefits, office supplies and expenses; expenses sustaining administration, taxes, and any other professional services (Livingstone & Leslie, 1994). Normally, these expenses differ little for changes in the volume of production which fall within the

period of budget. As a result, the selling and administrative budget is always a fixed budget.

## **Cash Budget**

Cash budget is definitively referred to as an evaluation of cash outflows and inflows for an organization for a given period of time. They are mostly used to appraise the performance of an organization and check whether it has adequate cash to accomplish the overall regular operations of a company. The budget is also used to check whether funds are being used as per laid down guidelines. The cash budget shows the company's liquidity position and shows the capability of an organization to meet its goals and objectives. Even though profits promote liquidity, they do not have a high relationship. This budget assists the management in keeping proper cash balances that relates with needs and objectives of the organization. It also helps the management to plan usage of cash where by it avoids cash from lying idle and prevents possible funds shortages. Most budgets consist of four sections that include receipts section, disbursement section, cash surplus section and finally the financing section which gives details of payments and borrowings expected during the budget period (Horace, et al., 2007).

A budget properly prepared shows how funds flow in and out of the organizations and identify any loopholes that may slow organization productivity. The cash budget also determines the organization's future ability to pay expenses, loans and as well as debts. Banks and other financial institutions grant loans to organizations that have effective liquidity ratio and proper systematic cash plan. Similarly, organizations that function on a

casual basis are able to borrow more funds at unfortunate times (Colin, 2005). Cash budgets are commonly given by:-

Budgeted Cash Available = (Beginning Cash Balance) + (Budgeted Cash Collections)

## **Conclusion**

Therefore, for any organization, Budgeting involves the process of controlling and planning the overall activities of a company. It analytically covers precise details of management, sales, marketing, operations, and finance, and thereby provides the management effective guidelines for future performance. Through the concept of budgeting, the management is also able to verify the most profitable use of its limited resources and also it increases the organization ability to deploy resources effectively. In conclusion, it's imperative for any organization to trade effectively and efficiently without proper budgeting skills. It's important for individuals and organizations to build budgets to ensure proper movements of resources.

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## **Question Two**

### **Budgeting and its functions**

#### Introduction

Budgeting refers to the process of predicting or forecasting the organization incomes and expenses for a given period of time. Budgeting depicts the entire process of analyzing and planning using a budget. Since budgets are vital tools for management and planning, the process of budgeting generally affects all types of organizations regardless of their size and composition.

Many organizations participate in budgeting process with the view of determining the most cost effective and efficient strategies of making profits and intensifying its capital and asset base. I budgeting is vital in an organization in that it provide measurements that help the organization management in planning and setting of goals and objectives. Effective

budgeting assists an organization to forecast future performances and productivity. They make available a feasibility analysis that help an organization create an effective business model; identify required resource and capital requirements.

Budgeting at times also helps in finding funding. Budgeting guides an organization to use its scarce resources in a way that exploits the existing business opportunities well. Good budgeting concepts integrate efficient business judgment and help the management to make decisions regarding the overall performance of the company. In budgeting, an organization typically develop long-term and short-term plans that assist in implementation of its policies and even though its expensive and time consuming, it increases awareness of costs and coordination of activities channeled towards achievement of company goals and meet its objective, and to measure up to standards set (Iain, 2003).

## **Functions of budgeting**

For any individual or organization with the yearning for financial freedom, the most significant thing they can do is to appreciate the fundamental functions of budgeting. Generally without figuring what one owns and spends it would be impossible to make changes in ones spending habits. With the use of adequate budgeting schedule, it acts as a tool that assist individuals and organizations track areas where changes can be done to improve monetary situation. Budgets serve a number of useful purposes that includes planning, coordinating, communicating, motivating, controlling and evaluating (Rubin & Irene, 1997).

## Planning

Generally, a budget is a plan for the operations of a company for a given period of time. As a planning tool, budgets are vested with the sole function of determining an organizational programs and objectives . They tend to evaluate available alternatives as a way of achieving its goals and objectives. Planning also involves prioritizing where the most beneficial projects are put forward first and the less beneficial ones follow suit. In all financing activities, budgeting is the core function. Proper budget makes planning easier because it allows people to know which direction the company is following and what business activities it plans to engage in, in the future. Budget planning involves discovering and looking for sources of revenue and expenses, with the intention of meeting personal or organizational goals and objectives (Downes & Goodman, 2006). Planning as the primary function of budgeting, it makes sure there is savings after the funds have been allocated for spending. Organizations that plan and use effective budgeting strategies, they are ensured of successful management of their expenses and savings hence they are able to secure better investments in the future. The major advantages of budget planning are that they put checks and balances at specific points to prevent overspending I future at various levels, also they assist the management of an organization to take account of any unexpected need or requirements for funds. Though beneficial, planning as a function of budgeting has few shortcomings that include, it affects the quality of life and productivity of people and organizations especially in situations where there is excessive emphasis on savings. Also when the budget is planned to rigid, devotion to it tends to

become a problem and fulfillment of organizational goals and objectives becomes a problem (Brookson, 2000).

## **Coordinating**

In order an organization to properly grow and develop, the management needs to know what is happening within the company and have an unambiguous idea of what they expect in the future. Coordination as a component of budgeting has fundamental objectives that are important to the management. The act of Coordination makes budgets from various specific departments to work together with sole function of meeting the organization goals and objectives. The way budget are constructed is very vital including the figures it carries. The entire process of putting budget together involves correction of data regarding the business and the present and future needs of the company (Iain, 2003). Coordination of activities makes different individuals to participate in the making of budget where each of them contributes his or her knowledge to the areas of their expertise. In the process, employees learn from each other and this promotes the concept of teamwork and working together. Diverse units found in the company should coordinate different works they do.

## **Communicating**

Budgets act as communication tools in that they allow individuals and management of organizations to pass information regarding the goals and objectives of the company. The management is able to promote goal congruence that allows the company's limited resources to be coordinated and channeled to key areas. Budgeting process gives organization

opportunities communicate and this allows them to accomplish their goals,  
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and hence gives them chances scrutinize those achievements as well (Rubin & Irene, 1997). Communication being a core purpose of budgeting provides information that is significant in the entire business strategic planning. The communication between the management and employees helps establish a mutual understanding that is geared towards achieving the company's goals and objectives. Also different units in the company must communicate with each other during budget making process in order to effectively and efficiently coordinate their plans and efforts.

## **Motivating**

Effective Budgeting and budgets allow an organization to motivate its workers by involving them in the budget making process. This concept of giving them a chance to make organizational decisions makes them feel valued and appreciated, and they respond by working harder with the sole aim of meeting the goals and objectives they set in the budget. Even if top-down budgeting technique does not realize this objective effectively, participative budgeting can be very encouraging and motivating. Budgeting can be an effective tool in promoting teamwork in places of work though many people and businesses don't realize it. Since the employees know the company's performance and productivity, they tend to channel all their effort in adhering to budgetary policies and work extra harder to make sure the company's goals are met (Sullivan, Arthur & Steven, 2003).

## **Controlling**

Budgetary control involves deliberate actions that are performed analytically with the guidance of a budget plan. Budget control involves the use of budget plan to control expenses with the aim of maximizing accountability. <https://assignbuster.com/examining-different-types-of-budgets-and-their-uses/>

This purpose is mostly connected with line-item budgets. Technically once the budget is created; it acts as a planning tool for the organization operations. Management has power to use up funds within the set budget and to generate revenues within the specified margin of the budget. These Budgets are scrutinized regularly to countercheck variations and to establish whether the company is moving on the right target. If the company performance and productivity does not meet the requirements of the budget, immediate action is always taken to adjust its activities. The general aspect of budgeting allows an organization to control costs and avoid things not budgeted to be done. Proper budgets also give organizations a benchmark from which they evaluate the company's performance. Control involves monitoring, and involves comparison of different information's to a given standard from where it is used to make corrective actions (Brookson, 2000).

## **Evaluating**

The aspects of budgetary control are much valued and appreciated in an organization since they help an organization to evaluate and monitor team and organizational performance and provides the management of the organization with a clear idea of the company financial position and makes information and data available on which they base their action. Budgets at times are used as a tool of management, which reward and punish managers and their employees and also they are used as a basis for modifying future plans and budgets (Iain, 2003). One way to evaluate the management and employees performance is by comparing the company budget and the overall actual performance. Though an important concept of business, budgeting can cause massive problems in parts of workers especially in

situations where they are not involved, and also where their jobs are dependent on meeting certain organizational goals and objectives established by the budgets. This happens in organizations that concentrate so much on evaluation purposes of budgeting and those organizations that conduct top-down budget process, rather than the bottom -up or participative one. Effective evaluation and monitoring of employees and the management as a whole, improves the efficiency and effectiveness of the company products and services and makes them competitive in the global scene (Rubin & Irene, 1997)

## **Conclusion**

Budgeting always form an integral part in our society. It's ideal concepts require individuals and companies to look ahead and sanctify future goals. Budgeting involves the process of controlling and planning the overall activities of a company. It analytically covers precise details of management, sales, marketing, operations, and finance, and thereby provides the management effective guidelines for future performance. Budgeting depicts the entire process of analyzing and planning using a budget. Since budgets are vital tools for management and planning, the process of budgeting generally affects all types of organizations regardless of their size and composition. Many organizations participate in budgeting process with the view of determining the most cost effective and efficient strategies of making profits and intensifying its capital and asset base. Budgeting is vital in an organization in that it provide measurements that help the organization management in planning and setting of goals and objectives. Through the concept of budgeting, the management is also able to verify the most

profitable use of its limited resources and also it increases the organization ability to deploy resources effectively. In conclusion, it's imperative for any organization to trade effectively and efficiently without proper budgeting skills (Budgeting is vital in an organization in that it provide measurements, 2009). It's important for individuals and organizations to build budgets to ensure proper movements of resources.