Budgeting

Budget may be defined as "A plan quantified in monetary terms prepared and approved prior to a defined period of time usually showing planned income to be generated and / or expenditure to be incurred during that period and the capital to employed to attain a given objective."

Simply stated, a budget fixes a target in terms of rupees or quantities against which the actual performance is measured.

Fixed budget and Flexible budget

Fixed Budget: has been defined as a budget which is designed to remain unchanged irrespective of the volume of output or turnover attained.

Flexible Budget: is a budget which, by recognizing the difference in behavior between fixed and variable cost in relation to fluctuations in output, turnover or other variable factors such as number of employees, is designed to change appropriately with such fluctuations.
Thus a flexible budget gives different budgeted costs for different levels of activity.

Difference between Fixed Budget and Flexible Budget

	Basis	Fixed Budget	Flexible Budget
1.	Flexibility	Inflexible; does not change with the actual volume of output achieved	Flexible; can be re-casted according to the level of activity achieved
2.	Condition	It assumes conditions would remain same	It is designed to change according to changed conditions
3.	Classification of costs	Costs are not classified according to their variability	Costs are classified according to the nature of their variability
4.	Comparison	Comparison of budgeted and actual performance cannot be done if volume of output differs	Comparisons are realistic as the changed plan figures are placed against actual ones
5.	Forecasting	It is difficult to forecast accurately the results in it	It clearly shows the impact of various expenses on the operational aspect of the business
6.	Assumptions	Unrealistic expectation on the part of management that all conditions will remain unaltered	Series of budgets are prepared at different levels of activity to fit changing conditions
7.	Tool for cost control	It has limited application and is ineffective as a tool for cost control	It has more applications and can be used as a tool for effective cost control

Cash Budget

Cash budget gives an estimate of the anticipated receipts and payments of cash during the budget period. Therefore this budget is divided into 2 parts – one showing the estimated cash receipts on account of cash sales, credit collections and miscellaneous receipts and the other showing the estimated disbursement on account of cash purchases, amount payable to creditors, wages payable to workers, indirect expenses payable, income tax payable, dividend payable, budgeted capital expenditure etc. In short every factor which affects the receipts and payments of the cash is taken into account in the preparation of this budget.

Cash budget makes a provision for a minimum cash balance which will be available at all times The minimum balance of cash will help in tiding over adverse conditions of a minor nature. Meanwhile management can make alternative arrangement for additional cash.

Advantages:

1. It provides an opportunity to review the cash flow for the future periods as realistically as possible and make sure that cash is available for revenue and capital expenditure.
2. Where adequate amount of cash is not likely to be available during certain periods e.g. when payment of tax, bonus, dividend etc. fall due, the company can know in advance so that advance action can be taken to make available the required amount at the most advantageous terms.
3. If large surplus of cash is likely to result during certain periods then it will be possible to plan for most profitable investment of these funds.
4. Preparation of cash budget by a company will help to plan its cash position in such a way that maximum seasonal discounts can be availed of.
5. Even for obtaining funds from financial institutions, the system of preparing cash budget helps to convince such institutions about the bonafides of the company’s requirements.
6. The importance of cash budget may be more in some industries than the other e.g. in industries where there are wide seasonal fluctuations or where long contracts are undertaken.