Diploma in Financial Management & Accountability

- a joint initiative of TISS & FMSF

Course Material

Budgeting & Monitoring
Paper - IV
Unit -1
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UNIT 1
CONCEPT OF BUDGETING

1.1. CONCEPT:

Budget is a means to achieving financial success and yet it is a term that tends to cause many a person's hair to stand up and blood pressure to rise. However let me assure you that it would not lead to any of this if you are keen to it simple and realistic.

A budget can also be understood to mean a "Resource Plan" to understand from where and how resources will be raised over a period of time. It could also mean an "Expenditure Plan" to know what expenditure needs to be met and the quantum of such expenditure over a specific time period. If we combine these two plans it would be known as a "Resource cum Expenditure Plan", wherein the resources and expenditure is matched, gaps that may exist between expenditure and resources to be raised are looked into and realistic steps are identified to ensure matching of the two and also for allocation of resources towards reserves. Budgeting does not always mean reducing cost but it is a combination of reducing over expenditure, increasing revenue and setting aside funds towards reserves.

The key would be to maintain an attitude to look at Budgeting as a means to achieving your financial goals and dreams, rather than a tool to crunch numbers, make rupee pinching sacrifices and to financially deprive yourself and the organization. If you can keep the budget process simple, customize it to serve your needs and be realistic, including considering the inflation angle and remain committed to the process long enough, this should keep you motivated as you begin to taste the success arising from this measure. A budget is a way to look ahead in achieving the objects of the organization and its financial goals.

1.2. LINKAGE BETWEEN THE VISION AND MISSION OF THE ORGANIZATION:

To understand what areas of work can be undertaken and the concerns that can be addressed it is always important to read and re-read from time to time the objects specified in the incorporation document i.e. the Memorandum of Association or the Trust Deed, as the case maybe. In addition, the powers of the Governing Body or Trustees should also be read to understand how they can utilize the resources. The objects clause of the Memorandum of Association or the Trust Deed lists out the areas and the activities that can be undertaken. If any activity is not specified in the objects clause then it cannot be undertaken no matter how noble or interesting it might be and accordingly cannot be budgeted for. The objects clause forms the basis for the vision and mission of the organization and provides the foundation for working towards common goals.

In preparing a budget, resources can be raised and expenditure can be incurred only on the objects specified in the Objects Clause and thereby on programmes and activities arising from them. The powers f the Governing Body or that of the Trustees lists out how they can utilize the funds to meet the expenditure arising from implementing the objects, e.g. payment of salaries, honorarium, other administration and establishment expenses, which should be considered while formulation of the budget. Resources and expenditure, which is outside or not covered by the Objects Clause, the programmes and activities arising from them would not be permissible and hence cannot be budgeted for.

Having clearly identified the objects of the organization, the next step is to identify the programmes and activities, within these objects which would be implemented within the budget period, e.g. next six months or next one year. Each such programme to be implemented needs to be broken down into simple headings such Resources to be raised, Programme Expenses, Personnel Expenses and Administrative Expenses.

1.3. DRIVERS IN BUDGETING:

Budgeting is a responsible money management plan initiated by that small "inner voice' that repeatedly sends out those subtle reminders to attend to finances. Absence or inadequacy of budgeting "leaves too much month at the end of the money" or too much programme to be implemented at the end of the money", both these are not desirable situations.

Successful budgeting basically requires the following:

(i) Commitment
(ii) Action and
(iii) Discipline

"Commitment" is the key driver of the budgeting process from the beginning to the end, which is carried through action and persists through discipline. Firstly there is a need to create or set aside time for budgeting. If time is invested in making a comprehensive and realistic budget, it will always be easier to manage programmes, be more effective and successful. After you have made a firm commitment to curb unnecessary expenditure and to stick to the budget, then you are ready for "action."

"Action" reflects implementing the programme and its activities within the overall structure and time frame envisaged in the budget document. Action is being realistic about the receipt of funds, its outlay covering all direct and variable costs, having no hidden costs or expenditure not budgeted, having enough information to understand and implement the programme (not too much or too little information) and an accurate assessment of the time required to implement the programmes and its activities (consider limitations arising from the monsoon, power shortages, bandhs, migration of labour etc). Action in budgeting also includes involving the right people, e.g. finance, programme and administration people to obtain their inputs in the formulation of the budget and in the programme implementation. It is important to involve the beneficiaries from the inception. The involvement of the right people facilitates the preparation of a more realistic budget and their involvement gives them a greater commitment to achieving the goals envisaged in the budget and thereby the success of the programme.

Action also involves periodic and systematic review of the actual receipts, expenses and programme components implemented with what was budgeted. This review or monitoring would provide timely signals for any re-allocation of funds within budget heads and re-scheduling of time periods for specific components but within the overall time span for the programme as a whole. This would facilitate the issues related to 'flexibility' and 'inflexibility' within the budgeting process. In this way the budget will be used to measure performance and for the annual planning process.

"Discipline" is like the backbone that will ensure that the programme is kept on a "straight" path. Discipline inculcates the values of obtaining or ensuring 'value for money' at all stages and dedication to the time allocated for completion of the programme. Discipline does not mean rigidity. Success in budgeting must ensure that there is both 'flexibility' and 'inflexibility'. There are unexpected events which could drastically alter priorities, greater benefits could arise from pursuing particular activities rather than restricting them to what was envisaged, restrict or abandon activities, which do not appear to be too helpful. All these issues need to be addressed within the concept of flexibility. Without flexible budgeting, money allocated for one purpose would not be usable for another purpose in the event of the changing circumstances. On the inflexibility aspect, it is important to understand that the overall funds allocated would possibly remain the same or maybe reduced or in some circumstances could increase and hence any modification or re-allocation of funds will always have to be within the confines of the money actually available. Further certain expenditures are fixed e.g. salaries, rent, electricity etc. and need to be paid. Nevertheless there should be no deficit or over-expenditure. All the programme components need to be implemented and the time schedule must be adhered to. If a budget is modified for some reason then all the stakeholders must agree to it and authenticate it in writing before it is accepted for utilization. The reasons for the variations must be properly documented in a simple and crisp manner.

The "Budget Period" is an important aspect that facilitates an easier understanding of the budget, the programme schedule and the ultimate auditing and reporting. In India the accounts are normally maintained for a financial year i.e. from 1st April to 31st March of the next calendar year. The Income Tax Act 1961 and the Foreign Contribution (Regulation) Act 1976 If a programme is for part of the year then it should be budgeted for from the commencement i.e. 1st of a calendar moth to the last date of a calendar month rather than from a date within a month e.g. 6th to the 18th etc. At times funding agencies provide funds for different ime periods e.g. January to December, October to September, June to May etc., in such circumstances it would be better to break-up the budgets into suitable calendar quarters. The calendar quarters would be January to March and then April to December for a January to December grant allocation. Similarly it would be October to March and April to September for a October to September grant allocation and a 1st June to 30th June followed by 1st July to 31st March and then 1st April to 31st May for a June to May allocation for grant.

If the financial year or period is followed for budgeting for the organization as a whole and for individual programmes then comparison with the actual receipts and expenses, allocation of common expenses is simpler and easier to understand and auditing and reporting is easier. Hence the Budget period should always be linked to the financial year or based on this period of time.

In budgeting there is definitely a close affinity between resources and time. Both the issues have to be addressed simultaneously in the budgeting process. One without the other will lead to a yawning gap in the budgeting process. Time is money as the saying goes and money must bring in value. When the money is low and the bills are high then prioritizing is a key to success rather building up debt or depriving one project for the other.

1.4. FEATURES OF A SUCCESSFUL BUDGET:

A successful budget envisages the following features:

1. Start with the objectives for the organization / activity and involve people so that ownership of the budget is established.
2. Have realistic goals for programme implementation.
3. Accurate income assessment.

4. Identify broad components that are specific to the organization or programme.
5. Classify the broad components into meaningful and easy to understand costs but not into too minute details.
6. Clearly define each broad component and each related cost as to its nature and which expense will be accounted against each such component and cost. Do not have any scope for ambiguity with regard to the interpretation of each component and cost.
7. Do not have any hidden costs.
8. Ensure that every person involved in the budgeting and accounting process clearly understands the definition of each component and its related costs.
9. Commitment to the budgeting process and programme implementation at each level within the organization.
10. Segregate expenditure into a time frame i.e. monthly / quarterly / annual, depending on the periodicity of their occurrence and link this with the cash flow.
11. Identify the possible challenges that will impede each task.
12. Reduce cash expenses to the minimum.
13. Have all advances settled within a period of a week and stop advances if the earlier advances are not settled even at the cost of delaying or hampering the programme and stopping the remuneration to the concerned person(s).
14. Identify possible savings for the organization and how these will be accounted.
15. Review the budget and programme implementation at least on a half yearly basis.
16. Have a positive attitude to the process and do not use it as a fault finding exercise.

1.5. SUMMARY

- Concept of Budgeting
- Linkage between Vision & Mission of an Organization
- Drivers in Budgeting
- Features of a Successful Budget

Self- Assessment Exercises

1. **What to you understand by the term Budget ? What are the features of a successful budget?**
2. **Explain what are the Drivers in Budgeting?**
3. **What do you understand by Vision Statement? How does the Vision Statement compare with the Mission Statement?**