Diploma in Financial Management & Accountability

- a joint initiative of TISS & FMSF

Course Material

Budgeting & Monitoring
Paper - IV
Unit -7
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UNIT- 7
BUDGETARY CONTROL

7.1. VARIANCE DETERMINATION AND ANALYSIS

Budgeted revenue and costs are what they should be. Actual revenue and costs are what they are. A variance is the difference between the two. Such difference must be investigated as to cause and who is responsible, if controllable. Sometimes the variance is due to incorrect forecasting (e.g., outdated standards, deficient planning), other times it is due to poor performance. Budget figures should be adjusted when circumstances have changed (e.g., increased competition, new technology). Computerized models and quantitative techniques may be used in this regard. Immediate corrective action must be undertaken for unfavorable variances. Favorable variances should be further taken advantage of. However, even favorable variances may reflect a problem. For example, if actual spending is below planned amounts, this may be due to laggard program performance. Variances may be determined and evaluated by program, service, cost center, or department.

Variances are interrelated, so an unfavorable variance in one responsibility unit may result in a favorable one in another segment. Insignificant variances need not be considered unless they recur repeatedly and/or reflect potential problems. For example, even a variance below a cut-off rupee or percent amount may need analysis if the variance is continually unfavorable because it indicates a problem (e.g., poor supervision). The cumulative effect of a repeated minor unfavorable variance may be just as harmful as an occasional one. Variances should be thorough and as detailed as needed. It may be expressed in aggregate monetary terms, per unit fee, per unit cost, service units, volume, and percentages. It may be computed yearly, quarterly, monthly, daily, or hourly depending on how important it is to identify the problem.

Variance analysis shows whether resources (physical and human) have been effectively used. It may result in rearranging resources to result in cost savings and efficiencies. The objective of cost control is to result in the least possible cost based on predetermined quality standards. Variances indicating cost overruns can be a problem in contracts because the excess costs may not be reimbursable. If responsibility for a variance is joint, corrective steps should also be joint. If correcting for an unfavorable variance conflicts with organizational policy, the policy should be reappraised and perhaps changed. If the policy is not changed, the variance should be considered uncontrollable.

A measure of materiality is to divide the variance by the budgeted cost. A 10% deviation would typically be considered significant and require corrective action especially when the NPO is using tight standards. Materiality may be considered in terms of rupee value or service units. Stricter materiality guidelines should be set for crucial items such as laboratory equipment and x-ray machines in hospitals or labour and equipment hiring in land based activities etc. The efficiency variance is the difference between actual costs and budgeted costs that are not explained by the volume, price, or mix variances. Effectiveness is the extent to which the NPO achieves its objectives. It is measured by the difference between planned and actual output. Effectiveness measures emphasize the program's results instead of the operation of a program. If there is a long-term program, variances determined when the program is completed may be too late for prompt corrective steps to be taken. In such a case, analysis may be conducted at "key" points during the program. This allows problems to be corrected at early stages.

Budgets should be realistic. Standards are based on the situation being evaluated. For example, a "tight" standard should be set for cost reduction. A "perfection" standard should be used for high quality services. However, tight standards may discourage workers while loose standards may cause inefficiency.

7.2. REVENUE VARIANCES

Revenue variances examine the difference between actual revenue and budgeted revenue in aggregate monetary value terms, per unit fee, and service units. If actual revenue exceeds expected revenue, a favorable variance arises. In the opposite case, there is an unfavorable variance. Such unfavorable variance points to a need for corrective steps such as increasing user fees, increasing membership, etc. Membership and fund raising quotas may be set. Such quotas may be stated in rupees and units (e.g., number of members, new donors, retaining existing donors).

7.3. COST VARIANCES

Cost variances look at the difference between actual cost and budgeted cost and may be expressed in total rupees, per unit cost, and service units. If actual cost exceeds budgeted cost, an unfavorable variance arises. Identification of the problem is needed, including whether the variance is controllable or uncontrollable. If controllable, corrective actions must be implemented and if necessary appropriate administrative action maybe called for.

7.4. FUND RAISING COSTS

Some fund raising costs can be standardized, such as presentations for which a standard time call can be established. Calling up frequency should be determined. If percentages are tied to charitable contributions obtained, standards can be based on a percentage of those contributions. Actual funds raised may not be the best measure of fundraisers' performance. They do not take into account different territory potentials. Also, a high volume fundraiser may have to cover a high promotion cost. What has been the trend in funds raised over the years in total and as a percentage of related fund raising costs? Standards for fundraisers' vehicle expenses may be expressed in cost per k.m. traveled and cost per day. The standard may relate to cost per donor or cost per rupee of funds raised. The fund raisers' effectiveness with a territory should be considered, including hours spent and expenses incurred.

The control variance is broken down between fund raisers' days and fund raisers' costs.
Variance in days = (Actual days vs. standard days) * standard rate per day
Variance in cost = (Actual rate vs. standard rate) * actual days
Total variance equals: Actual calls * actual amount raised less Standard calls * standard amount raised.
The elements of the total variance above equals:
Variance in calls = (Actual calls vs standard calls) X standard amount raised
Variance in funds raised = (Actual amount raised vs standard amount raised) X actual calls.

An evaluation should be made of whether fund raising expenses are realistic taking into account contributions generated. Are excessive costs (above limits set) due to the failure of controls or deficient management?

7.5. LABOR COSTS

Standard labor rates may be based on the current rates adjusted for future changes in the following factors: union contracts, changes in the environment, and average experience of staff. Worker hours may be set by administrators by observing and timing workers. When salary rates are established by union contract, the labor rate variance will usually be minimal. Worker time standards should include only the elements controllable by the employee or work center. The standard time may include allowances for normal breaks and personal needs. The causes of an unfavorable labor price variance might be poor scheduling resulting in overtime, use of workers receiving higher hourly rates than budgeted, and increase in wages. An unfavorable labor efficiency variance may arise from poor supervision, use of poor quality resources, inadequately trained staff, and employee unrest.

Variances may be by service category. Standards may be used for office personnel performing clerical work, and a standard unit cost for processing a form (e.g., welfare application). The variance between the actual cost of processing a form vs. the standard cost can be analyzed by administrators and corrective action implemented. Variances may be in physical and dollar measures. Examples of physical measures are the number of employees, number of welfare recipients serviced, and the number of files handled. Cost variances may be presented to administrators in special reports. For example, the variance in time and cost to process payments to retirees may be evaluated.

7.6. VARIANCE ANALYSIS REPORTS

Variance analysis reports include examining the difference between actual and budget figures for:

(1) revenue

(2) costs

(3) quality, and

(4) growth.

Variance analysis reports may be expressed in rupees, ratios, graphs, percentages, and narrative, e.g. revenue volume may be declining because of inadequacy in fund raising. Variance analysis reports should be broken down between that resulting from providing more or less services than initially budgeted and that due to efficiency (inefficiency) or unplanned changes in input prices.

An evaluation should be made of whether fund raising expenses are realistic taking into account contributions generated. Are excessive costs (above limits set) due to the failure of controls or deficient management?

7.7. BUDGETARY CONTROL AND DECISIONS REQUIRED

Budgetary control should exist over revenue and expenses. Cost controls should be established. Spending limits may be placed on personnel, time, funds, and assets. Any expenditure above the preset amount must be authorized. A cost containment report should be prepared identifying above average costs.

Budget cuts, when needed (e.g., poor economy, political factors) should be in the areas of least importance and/or having the least severe consequences (e.g., on quality of service performed). Some programs may be downgraded, where the same level of service or comparable results are sought through less expensive ways. The community may be invited to give their input to program cuts.

What effect do budget cuts have on the scope, volume, quality, and character of programs and services? Improved productivity results in lower unit cost. This may be achieved through volunteers who are very motivated. Administrative costs may be lowered by improving work office procedures so as to increase productivity. Automating administrative work enhances efficiency. Distribution costs may be lowered by using commercial mailing services to reduce mailing costs by utilizing bulk zone mailing and other methods, and combining appropriate mailing at specific times. Demographically targeted fund raising campaigns may be more cost effective than wide distributions. Costs can be reduced by updating mailing lists for people who have moved or not responded. Word-of-mouth solicitation should be encouraged because little or no cost is involved. Computer bulletin boards can be very cost-effective. This reduces the need for mailings of fund raising material. Publicity costs may be reduced by having in-house desktop publishing to produce the NPO's own flyers and promotional material. Financial control are procedures designed to collect, categorize, and report information on daily activities. Revenue and cost information should be provided by service line, patient, program, and activity. Resource utilization performance measures should be established. Performance reports should discuss potential problems and opportunities. Timely and analytical information should be provided. Strengths and weaknesses should be included. Effectiveness measures should be used for fundraisers by donation obtained, call frequency, cost per donor, dollar amount of contributions per hour spent, and incentives. Less reliance on professional fundraisers will lower costs. Perhaps the same funds can be raised by internal staff (e.g., clergy). Fund raising activities have to be looked at in terms of net return. Budget allocation procedures may have to be adjusted. The reasons for a change in budget allotment in whole or between major elements should be determined.

Managers preparing program or department budgets must have operating authority over their responsibility units and be accountable for performance. Otherwise, there is deficient planning and control.

7.8. SUPPORT OR CAPITAL ADDITIONS

Grants, gifts, and bequests are usually accounted for as support or capital additions. The principal source is typically nonreciprocal giving to support activities. Support may be donor restricted or unrestricted. Restrictions may exist as to how the resource may be used; a time limitation may be placed on such support. Nonexpendable grants, gifts, and bequests may be restricted for endowment, loan, permanently or temporarily.

7.9. ENCUMBRANCES

Encumbrances are an element of budget accountability. They are commitments for unfilled contracts for goods and services (e.g., purchase orders). The purpose of an encumbrance is to prevent further expenditure of funds because of commitments already made. At year-end, open encumbrances are treated as reservations of fund balance.

7.10 FUND RAISING

Fund raising is essential. Are contributions being received as expected? Actual contributions are compared to expected contributions. Budget revisions may be required.

7.11. SUMMARY

- Variance Determination & Analysis
- Budgetary Control & Decision

Self Assessment Exercise

1. **Explain what you understand by Variance determination and how are variances analysed?**
2. **Explain the importance of variance analysis in Budgetary control**