Diploma in Financial Management & Accountability

- a joint initiative of TISS & FMSF

Course Material

Budgeting & Monitoring

Paper - IV

Unit -4

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UNIT 4
BUDGETING

4.1. INTRODUCTION:

A budget is a document that translates plans into money - money that will need to be spent to get your planned activities done (expenditure) and money that will need to be generated to cover the costs of getting the work done (income). It is an estimate, or informed guess, about what you will need in monetary terms to do your work.

Non-Profit organizations exist to achieve certain objectives and hence a budget is the translation of a objective plan in financial terms. The budgeting process is one of the most important aspects of an NGO. Planning and budgeting are two important functions in project management. They are like two sides of the same coin. It is often misunderstood that planning and budgeting are very essential to profit-making organizations and not to not-for-profit organizations, but this is not correct. However, the fact is that these aspects are very critical in a non- profit organization.

Once the plans are set, the organization draws up budgets to help implement the plans. Budgeting is nothing but the financial planning which includes the cost element to the planned actions. Financial Planning is an integral part of the total planning. For the successful implementation of any mission, however noble it might be depends a lot on financial resources. As the focus in non-profit organizations is service to the community, economic resources are only a means. Hence, the challenge in a non-profit organization is to put the limited financial resources to the best use to achieve the maximum benefit.

Budget is also a significant document for any organization with the donors. The budget sets out in detail what the organization will do with the grant, including where the money will be spent on and what results are to be achieved. Thus, during a given time frame, these plans and budgets enables the organization to compare it with actual performance.

Hence a budget is an essential management tool, without, which one is like a pilot navigating in the dark without instruments.

- The budget brings to focus how much money is required to carry out the activities.
- It channelizes the thought process through the implications of the activity planning. There are times when the realities of the budgeting process force a rethink of action plans.
- The budget through the cash flow statement brings out when certain amounts of money is required to carry out the activities and when will the funds be available.
- The budget enables monitoring of income and expenditure. In the process problems can be identified.
- The budget is a basis for financial accountability and transparency.
- Donors use the budget as a basis for deciding whether what you are asking for is reasonable and well-planned.

A budget is **NOT:**

- **Written in Stone** – A budget can be modified from time to time provided steps are taken to deal with the implications of the changes. As an example if you have budgeted for five fishing boats but realize that you need equipment to store fish and other agriculture produce, then three fishing boats can be purchased and the budget allocated for the other two boats can be used to purchase refrigeration equipment.
- **A Mark up of 10% Above the Previous Year's Expenditure: T**he budgeting process needs to assess in real terms what is really required and not repeat the previous expenses. If it is a repetition of the previous year then mistakes of the previous year will be repeated and the organization will not be addressing strategic planning and growth for the future. This is linked to incremental budgeting.
- **Just a Donor Requirement:** The budget should not be prepared as part of a funding proposal and then taken out and dusted when it is time to do a financial report for the donor. It is a living tool that must

be consulted in day to day work, checked monthly, monitored constantly and used creatively.

- **An Optimistic And Unrealistic Picture Of What Things Actually Cost**: Costs should never be under-estimated or camouflaged. You will be surprised how quickly all the hidden costs appear once the programme begins to be implemented. This will spell the death knell for implementing a programme successfully. It is better to return unspent money to donors than to be short on funds.

4.2. WHO SHOULD BE INVOLVED IN BUDGETING?

Budgeting is a serious and responsible activity. Your organisation's ability to do what it has planned to do and to survive financially depends on the budgeting process. Whoever does the budgeting must:

- Understand the values, strategy and plans of the organisation or project;
- Understand what it means to be cost effective and cost efficient (see Glossary of Terms);
- Understand what is involved in generating and raising funds.

It is always advisable to have a small budgeting team. This may only mean that one person does a draft budget which is then discussed and commented on by the team. Where staff is competent to take full responsibility for the financial side of the organisation or project, the following would normally be involved in the budgeting process:

- The Finance Manager and / or Accountants
- The Project Manager and Senior Programme Staff
- Director of the organisation or department.

The budget is the business of everyone in the organisation. Each person mentioned above must hold internal discussions with his / her team that he / she represents in the budgeting process. Senior staff must understand the budget, how it has been drawn up, why it has been drawn up, why it is important, and how to monitor it.

The members of the Board / Governing Body / Trustees should also be involved in the process since the ultimate responsibility vests with them. They can constitute a Finance Committee comprising of experts to assess the budget and make recommendations.

Where an organisation has branches and/or regions, or several departments, then each branch, region or department should draw up the budget for its own work. These budgets then need to be consolidated (put together) in an overall budget for the organisation. Each branch, region or department should be able to see how its budget fits into the overall budget, and should be able to monitor its budget on a monthly basis. Financial monitoring works best when those closest to the spending take responsibility for the budget.

4.3. GOOD PRACTICES IN BUDGETING:

- **Clarity:** As there are different users of a budget document for different purposes, they should be able to understand it more clearly. Hence, budget document needs to be prepared with adequate details and accuracy. Some of the areas where clarity is required are the following:
    1. **Name of the Project**: Very often the name keeps changing as different persons refer to the programme with short names of based on geographical location or nature of programme. Whatever name is agreed to during the budgeting exercise and which is formally approved should be adhered to for the entire duration of the programme.
    2. **Nature of Programme:** What is sought to be achieved should be clear.
    3. **Geographical Area**: What is the geographical area where the programme will be implemented.
    4. **Approach to be Followed for Implementation**: Will the programme be participatory, will it be contractor driven, will it involve use of other development agencies / not for profit agencies, will be implemented by

the NGO on its own, what will be the exit policy at the conclusion of the programme to ensure self sustainability.

5. **Budget Components**: The budget must have clarity with regard to the different broad budget components. What does each component mean and what is the difference between the different components.
6. **Time Period**: The time period to which the budget relates to must be clearly specified, i.e. date of commencement and date of conclusion of the programme. It is always advisable to start and enda programme at the beginning of an easily identifiable time period e.g. 1st April to next 31st March or 1st January to next 31st December or 1st July to next 30th June. Try and follow the financial year wherever possible i.e. 1st April onwards. It is inconvenient to have project periods commencing or ending in the middle of a month e.g. 18th June to 23rd September and this must be avoided. In such a case the project period recommended would be 1st June to 30th September.

- **Time frame:** There are generally several stages before a budget is finally approved by the Governing Body of an organization. Hence the process needs to start early and therefore needs to be prepared well in advance, say atleast six months in advance, before the start of the respective period for which it is being prepared. However, this time frame may vary from organizations to organization depending on its size, structure etc. It deciding the time frame for the programme it is not advisable to define the programme as Year 1, Year 2, Year 3. In all cases the date must be specified, i.e. 1st April 2008 to 31st March 2009, 1st April 2009 to 31st March 2010 and 1st April 2010 to 31st March 2011. If the time is not specifically defined then each stakeholder will can interpret it differently and this will jeopardize the reporting process since reports are linked to a specific time frame. The organization could be thinking as Year 1 to be April to next March, whereas the donor could think it to be January to December and the beneficiaries could link it to the rainy season e.g. July to June. This ambiguity would lead to unnecessary complications and correspondence and ultimately affect the flow of funds and their utilization.

- **Budget items:** Adequate care is to be given while setting the budget items. It is these budget items on which the program activities will be carried out and it is these budget items that will also appear in the financial reports. If the budget items and the accounting records are not consistent, then it will be difficult if not virtually impossible to produce the required reports.
- **Estimating the Costs:** The very important aspect in the process of preparation of budget is the estimation of costs. An organization may follow any method for preparing the budgets, but the cost estimation made has to have adequate justification. It will be always helpful to make a list of all the inputs required along the number and unit cost of each item of such inputs. From this detailed work sheet, it will be quite easy to prepare a summarized budget for each line item of the budget. In the case of foreign donations the rate of exchange should be specified as this will affect the finance plan. It may desirable to purchase items in bulk or in a particular season so as to reduce costs e.g. purchase of seeds for crops, cattle at an annual cattle fair, implement labour oriented programmes when labour is easily available and cheaper etc.
- **Contingencies:** Contingencies are generally provided for unforeseen expenditure and also for meeting any cost escalation of a given item. It will also take into affect foreign exchange fluctuations in the case of foreign donations. There are different methods of providing for contingencies. Many organizations provide a line at the bottom of the budget items for "contingencies" and a percentage of the overall budget is shown as the estimated amount of it. Some may add an element of contingency amount to each line item of the budget and would not show it as a separate item. What ever may be the method, the point to be ensured is to provide for contingencies especially if inflation in the economy is a major issue, so as to avoid any difficulty during implementation. However, utilization of such an item depends on the approval of the donor and needs to be within the conditions agreed upon.
- **Program and Administrative Cost:** Generally, most of the organizations prepare Program Cost separately and the Program Support cost i.e. the Administrative Cost separately. Program Support Cost represents the recurring expenses relating to administration in implementation of a program. It is important to clearly define what will constitute programme cost and what will

form administrative cost. As an example, salaries are normally taken as administrative cost but in a hospital the salary paid to the doctors, the nurses, ward boys would be programme cost as it is not possible to run the the hospital without these persons. The salaries paid to the office staff in the hospital can be classified as Administrative Cost. Similarly travel is taken as administrative cost but travel to field locations for programme implementation and monitoring should form part of Programme Cost.

- **Preparation of a Budget:** Budget involves a system of planning, executing the plan and evaluating performance and financial working of an organization in which activities are planned in advance. The philosophy behind the budget is that, nothing would be allowed to occur in a haphazard manner but there should be an objective towards which the organization is to progress in an orderly and pre-planned manner. In order to aid this process of planning, the mechanism of a plan (which is the picture at a given point of time, the planning process would lead to) is adopted. Thus the plan is the commitment to a set course of action required to realize the results that are depicted in the plan. The planning process stipulates thinking at all levels of management and serves as a measure of performance. In this system of control, performances are checked with the pre-planned figures and the variances are analyzed.

4.4. BUDGET CALENDAR

The budget calendar may be different than that of the overall organization because the grantor may have a different time period and the contract may have stipulated due dates. A budget calendar sets forth the timetable in the budget process. Each step should be completed by the due date. Individual programs may also have their own budget calendar.

An illustrative budget calendar follows:

Activity	*Date*	*Responsible Party*
Preliminary budget request	Oct 1	Department manager
Prepare draft budget	Nov. 1	Department manager
Review budget	Nov. 15	Controller
Prepare final budget	Dec. 1	Controller
Review budget	Jan. 1	Budget committee
Final budget	Feb. 1	Budget committee
Budget revisions	Feb 15	Department manager
Final budget presentation	March 1	Chief Functionary

4.4. CHARACTERISTICS OF A BUDGET:

Hence, the following are the important characteristics of a budget:

a) It is a financial and/or quantitative statement;

b) Prepared well in advance;

c) For a definite period;

d) For the attainment of objectives and measures agreed upon.

It would therefore be advisable for every organization to prepare a budget since this would enable it to plan out the activities of the ensuing year/s. This also helps in planning the commitments and to activate resource mobilization to meet such commitments.

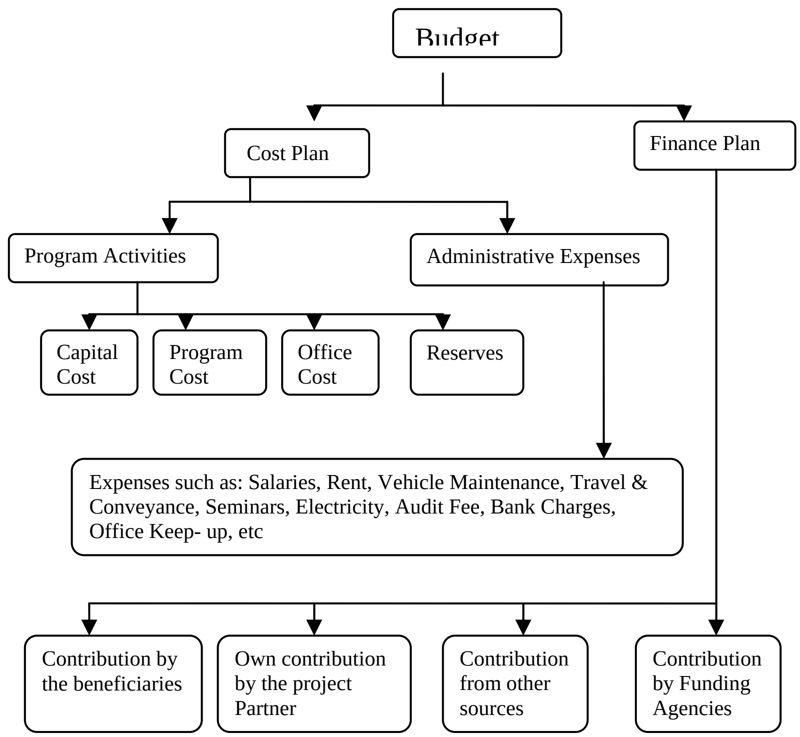
The voluntary organizations which receive contribution/grants from National and International Funding Agencies are usually required to present a budget of program activities for a specified period.

4.5. BUDGET PLANS:

An organization would normally prepare the following plans to budget their activities for the ensuing year(s) in foreign currency and in national currency:

- **Cost plan**
- **Finance plan**

Flowchart showing various aspects of budgeting is as under:



Cost plan and Finance Plan are the two sides of the same coin. In cost plan all the expenditures and payments of the project are anticipated and provided for in advance. In the Finance Plan all the possible/expected sources of income are mentioned.

4.5.1 Cost Plan Budgeting: A 'Cost Plan' is a schedule of budgeted costs divided into two major parts, namely:

- Programme Activities Budget
- Administrative Budget for Project Programme Co-ordination.

Within the above broad areas for budgeting the following types of budgets are prepared:

1. Capital Budget
2. Recurring and Operational Budget
3. Cash Budget or Cash Flow Projection Statement
4. Long Term Budget (Two to five years)
5. Short Term Budget (Upto Two years)

1. Capital Budgets: As the name suggests, capital budget includes all capital expenses i.e those items which are non-recurring in nature. Capital purchases include land, building, equipment, machinery, computers, furniture and fittings, vehicles, livestock.

2. Recurring and Operational Budgets: This budget takes into account expenses which incurred regularly or periodically by the organization and / or the programmes. This budget will include the costs of programme recurring expenses, training costs, salaries, stationery, provident fund costs, stationery, telephone expenses, audit fees, insurance expenses, vehicle maintenance expenses, conveyance, bank charges, office up keep etc.

3. Cash Budget or Cash Flow Projection Statement: This represents the projected cash inflow and out flow for both the capital budget and the Recurring and Operational Budget. This will reflect the timing of the cash inflow and the corresponding expenditure being prioritized so as to ensure that the organization / programme is not hampered for the lack of budgets. Basically it is to cut the cloth according to the requirement.

4. Long Term Budget: This is the combination of the capital and recurring and operational budget for upto five years at a time. It is projects a holistic financial picture of the organization and encompasses all programmes and activities within this time span of five years. It facilitates decisions in planning the growth of the organization and to address the building of capacities to match the projected growth. This budget will also take into account extraneous factors such as political changes envisaged, proposed legislation, slow down in economies etc.

5. Short term Budget: This is the combination of the capital and recurring and operational budget for upto two years at a time. It also projects a holistic financial picture of the organization and encompasses all programmes and activities within this time span of two years. This budget is far more realistic since the time frame is shorter, the variables are fewer and the 'unknown' factors are greatly reduced if not completely dealt with.

4.5.2. Cost Plan - Programme Activities Budget: This is a combination of the budgets that we have dealt with above i.e. capital budgets, recurring and programme budgets and the cash budget. It could also include a component for the project co-ordination and administration and Reserves or allocation of a budget towards contingencies.

The critical issues are two fold viz.:

(i) **Definitions:** Clearly define each line item in the budget as to what it means and what expenditure can be debited and what cannot be debited as accurately as possible. Define the time period will facilitate determination of flow of funds and the programme implementation time schedule. The level of ambiguity should be kept to the bare minimum.

(ii) **Assumptions:** Clearly specifying the assumptions taken into account for each line item in the budget. This could include rate per item, no. of items etc.

Why are the above critical, lets see this through some examples, with regard to definitions:

(a) **Training Expenses**: This programme envisages expenditure relating:

i. to hire of hall / room for conducting the training programme
ii. payment of honorarium to the faculty
iii. food and refreshments
iv. training kit
v. travel of resource persons and participants by bus, train, air
vi. lodging expenses
vii. stationery

If the training budget head is not defined then the above expenses could be debited to natural heads of account like stationery, travel, boarding and lodging etc. rather than being debited to training expenditure or it could debited to seminar expenses, which would again not be correct.

(b) Rallies and Campaigns: This would include expenses on:

i. posters and banners
ii. Public address system
iii. food
iv. transportation

In the absence of a proper definition the expenses be debited to natural heads of account, which would not be correct, such as posters could get debited to printing and stationery, transportation to vehicle costs etc.

(c) Travel For Conference / Local Travel / Travel / Governing Body Travel: Here again each of the above heads of account need to be defined since the nomenclature could reflect overlapping of expenses.

(d) In a Hospital, expenditure on salaries to doctors, electricity, water, ambulance running expenses, telephone expenses in the hospital, stationery used writing prescriptions and maintaining patients files should be debited to programme costs or hospital running expenses rather than administrative expenses. Salaries to office staff, telephone in the office, stationery used in the office would however be debited to programme support costs or administrative expenses. Hence the same type of expenditure is being treated differently depending on the purpose for whch it was incurred.

(e) Construction of houses for beneficiaries, purchasing of land for setting up a colony or training centre for beneficiaries, vehicle for beneficiaries being given to them, should be treated as programme running costs and not capital expenditure of the organization. Thes assets do not belong to the organization and hence should not be capitalized in the books of account of the organization unless the asset would belong to the organization and the beneficiaries have only been allowed temporary use of them. Here again on expenditure is being treated differently depending on the purpose of the expenditure.

Assumptions are also of critical importance as this would affect costing and nature of expenditure. This can be seen from the following examples:

(i) **Travel:** Has the travel been budgeted for train travel or air travel. If train travel then is it budgeted for sleeper class or 3rd AC or 2nd AC. This assumption needs to be documented so that when the actual need to travel arises then the assumption will be the basis for the sanction. Similarly if the organization has a travel policy then the budgeting should be done as per the travel policy entitlements. Further the number of persons who would travel should be specified so that this number is not exceeded. IN case a lump sum figure has been budgeted then the amount must be divided between number of trips expected in a year or month and this would be the guiding factor for sanctioning travel.

(ii) **Labour Costs**: If the programme involves payment of labour for work in the fields, construction or repair of tanks then the daily wage rate, no. of persons and no. of days to be worked should be specifed. Further labour rates must be specified separately for masons, ordinary labour and women. At the time of actual implementation then the rates specified in the assumption, no. of masons and workers and no. of days must be complied with or reduced so that there is no cost over-run.

(iii) **Purchase of Plants, seeds, fertilizers etc.** Here again the rate per piece and numbers must be specified. Further the cost of travel also needs to be budgeted specifically as that will also be incurred for transportation.

(iv) **Dharnas and Rallies:** The no. of rallies and dharnas need to be specified. The no. of persons expected to attend should be specified and the place needs to be specified since this could involve transportation costs. Based on the nos. and per unit costs the budet should be computed.

(v) **Vehicle:** The type of vehicle needs to be specified as this would affect costs and also running costs e.g. will it run of petrol, diesel or CNG. Will the vehicle be a four wheel drive or two wheel drive, this would depend on the train where it would be used and again affect cost. Will the vehicle be air-conditioned or not and possible names of manufacturers. Any variation will affect the cost and the budget.

(vi) **Construction of Houses**: The assumption needs to be clearly specified and based on a architect's drawing and cost computation, e.g. what material will be used, will the roof be pucca or thatched, will there be cement flooring or a mud pack flooring, each component in the house should be specified.

As can be seen from the above the definition to the different components and the assumptions are very critical as any failure here has the potential to derail the programme and will make the difference between a successful implementation and a failure. Further it could affect relationship with the funding agency as they could have a different assumption than that of the organization, which could lead to avoidable unpleasantness.

Further assumptions and definitions are directly linked to the objects and goals of the programme as seen in the following examples:

- an adult education programme to make 5000 Harijan women and men in 50 villages of Nalgonda dist. in Andhra Pradesh, functionally literate within a time horizon of one year ; or
- an immunization programme to immunize 10,000 children under 6 years in age in 50 villages of Nalgonda dist. in Andhra Pradesh against DPT (Disease) within 2 years.

A programme may include one specific target and the programme component to achieve it or several targets and accordingly several programme components to achieve the same. The above targets also specify basic assumptions i.e. number of people / children and time frame. What the object does not specify and which the budgeting process must take into account is the remuneration to teachers / nurses, cost of travel within the district, stationery cost, medicine cost (will this be purchased or will it be sourced free of cost under a government programme), follow up costs with the beneficiaries to ensure success in programme implementation, cost towards creating awareness of the primary stakeholders so that they are motivated and resilient in accessing the benefit that the programme brings with it.

Cost Plan - Administrative Budget for Project Programme Co-ordination

The Cost Plan for the Administrative Budget for Project Programme Co-ordination will include administrative expenses (not directly related to project/programme) incurred for co-ordination of various programmes i.e. staff salary and benefits (excluding project staff which is involved in implementation of the project/programme), travel and conveyance, operating costs of vehicle, rent, rates & taxes, water and electricity expenses, office up-keep, communications, meetings, seminars, legal expenses, audit fees and expenses, bank charges etc.

Whenever needed, separate sub-schedule for details should be prepared, for example staff salary and benefits.

Where a number of programmes are being implemented then there are certain common costs which are incurred e.g. rent for the office, electricity and water, stationery, internet and telephone usage, audit costs, property tax, vehicle maintenance, conveyance, computer and photocopy costs and their maintenance, bank charges, which cannot be directly allocated to a particular project. In such cases these common costs are allocated to the Administrative Budget for Project Programme Co-ordination of each of the projects being implemented on the basis of appropriate rationale e.g. a percentage –wise allocation based on the budget of each programme or on the basis of time i.e. where a project is only for a part of the year then costs related to that time period or on the basis of space utilization e.g. for rent and property tax. However once the basis of allocation is agreed upon within the organization by the management then it must be adhered to continuously. When new projects ar added or some project is completed and wound up then the basis of allocation must be reviewed so that it takes into account the current scenario at that point in time.

A typical example of item structure of a cost plan (schedule of budgeted costs) in respect of a building project versus other projects/programmes, say, establishment of village industries, and village industries oriented training centers is given in below:

COST PLAN: Item Structure of a Building project

Particulars	In Foreign Currency	In National Currency
1.Value of Site	xx	xx
2.Preparation of Site		
(Clearing, leveling, demolition, access etc.)	xx	xx
3.Building	xx	xx
….M2…at (currency) per M2…………		
(Cost of each building to be given separately indicating area, type of construction, rate per M2)	xx	xx
4.Equipement		
(A separate list of equipment and furnishing proposed for the building is required)	xx	xx
5.External Works		
- Water supply, surface and soil drainage, electricity supply		
-Fencing, landscaping, retaining walls, roads, foot-paths, yards, paved area	xx	xx
6. Professional Fees		
-Architect		

-Structural Engineer -Supervisor -Other Consultants -Local Authority Charges -Prints and Copying -Audit Fees - Audit Expenses (i.e. Travel, conveyance etc.)		
7. Sub-total 1 to6	xx	xx
8. Contingencies	xx	xx
Total 7 + 8	xx	xx

COST PLAN: Item Structure of Village Industries and Training Centre

Schedule of Budgeted Cost (Basis of calculation 3 years)	In Foreign Currency	In National Currency
3.0 **Establishment of Village Industries**		
3.1 Processing centers(including working capital)	…..	…..
3.2 Raw materials deposits(including working capital)	….. …..	…. …..
3.3 Rural Marketing & artisans service centers(including working capital)	…..	…..
3.4 Service and spare parts workshop (working capital for tools, spare parts, sundries)	……	…..
3.5 Starting capital for village industries(marginal / fixed deposit to bank, initial capital of revolving funds)	…….	……
3.6 Technical information, publicity centre	…….	……
3.7 Mobilize industries exhibition	…….	……
3.8 Managerial help to artisans co-operatives (honoraria to experts, traveling expenses other		

expenses) Total-1		
2.0 Training		
2.1 Village industries oriented training		
2.1.1 Construction and equipment of….training centers of approx. DM each	……. …….	…… ……
2.1.2 Other training expenses for… persons(teaching material, honoria, for teachers/ instructors, living expense for trainees etc)		
2.2 Industry Oriented Training:	…….	…….
2.2.1 construction and equipment of …training centers of approx DM…each	…….	…….
2.2.2 Other Training expenses for trainees Other training expenses for… persons (teaching material, honoria, for teachers/ instructors, living expense for trainees etc)	…….	……..
2.2.3 Allowances to….. trainees/instructors@DM...pm		
Total-2	…….. ……..	…….. …….
3.0 Reserves		
Total-3		
4.0 Administrative Expenses for Program Coordination		
4.1 Administration and office expenses	………	………

4.2 Salaries of staff members of central promotional unit		
Total-4		
5.0 Grand Total(1+2+3+4+)		

4.6. FINANCE PLAN- BUDGETING

A finance plan is a schedule of budgeted source of funds for financing project/program related expenditure and administration /coordination of various programs. The normal pattern of financing the Program Activities Budget and Administrative Budget (for project program coordination) is as under:

- Promised donations / Contributions say from Funding Agencues
- Probable donations say from other Agencies and Individuals
- Possible donations
- Contribution from Beneficiaries
- Income generated from sales
- Income generated from services
- Subscriptions
- Membership fees
- Special events
- Investments i.e. interest income and income on maturing of investments
- Campaigns
- Contribution in Kind from different stakeholders and well wishers.

The total of the Funds available to the project is normally referred to as Project / Programme Funds. It shall however, be ensured that the contribution to be made by the funding agencies and the implementing organizations should be finalized and agreed upon at an early date, so that; there is no ambiguity at a later date.

Cost Plan

Activity:			
Budget Head	**Unit cost**	**Quantity**	**Total cost of item**
1. Programme Costs: **1.1 Running Costs:** (i) Materials (ii) Services (iii) Labour (iv) Vehicle Running (v) Advocacy (vi) Training Programmes (vii) Own Means in Kind **Sub-total (A)** **1.2 Capital Costs:** (i) Vehicle (ii) Computer (iii) Photocopy Machine **Sub -total (B)** 2.**Programme Co-ordination Costs:** (i) Salaries (ii) Stationery (iv) Communication Costs	*The unit cost is the cost of a single item, or one unit.* *e.g. Cost per day, per kilometer, per person.*	*This is the number of units (how many) you will need for the activity. e.g. 200 training packs, 130 days of trainers' time.*	*Multiply the total number of units by the unit cost.*

(v) Conveyance (vi) Staff Welfare (vii) Audit Fees **Sub-total (C)**			
Total cost for Activity *(A) + (B) + (C)*	-	-	*The sum of all the individual costs*

Notes: (i)

(ii)

Income Plan:

Activity:			
Budget Head	**Unit cost**	**Quantity**	**Total cost of item**
1. Grants (i) **Funds from Funding Agency** (ii) **Government Grants** (iii) **Individual Donors** **Sub-total (A)** 2. **Income Generation:** (i) Programme Receipts (ii) Training Fee Receipts	*The unit income is*	*This is the*	*As Per Commitments from Donors* *Multiply the*

(iv) Beneficiary Contribution (v) Membership Fees (vi) Bank Interest **Sub -total (B)** **3.Own Means in Kind** (i) Labour (ii) Material (i) Transportation (iv) Hire of Rooms **Sub-total (C)** **Total Income (A) +(B)+(C)** **SURPLUS / DEFICIT**	*the receipt of a single item, or one unit.*	*number of units (how many) you will be undertaken for the activity*	*total number of units by the unit cost.*

4.7. OWN MEANS CONTRIBUTION

"Own Means Contribution" is the commitment or contribution of various stakeholders to the project other than from the funding agency. Technically only the contribution by the NGO and the beneficiaries should be taken as own means contribution, since that is the actual contribution by them. However very often in the context of the funding agency, they look at funding provided by them and that raised by the NGO as the two broad sources in the finance plan. In this context the funds raised by the NGO is taken as own means. This could include funds raised from other agencies, the government, donations from other parties including individuals and funds raised through fund raising events or campaigns. It should be ensured that the contributions are directly relevant to the project.

4.7.1. Rationale for Own means Contribution: There are good reasons for the Project Implementing Organization to participate in the expenditure (upto a certain percentage) to be incurred on a program/ project.

- Strengthening of responsibility and decisions making; as all the stakeholders play a proactive role rather than doing the job only of implementation.
- Motivation and a sense of ownership for the beneficiaries to contribute to their project/ program.
- Better cooperation between beneficiaries and credit institutions in case of bank financing.
- Creating conditions for the contribution of the project (project sustainability) after contribution from the funding agencies have been exhausted.

4.7.2. Types of Own Means Contribution: Own Means Contribution can be of two types:

(i) In cash or investments
(ii) In kind.

When the contribution is to be received in the form of cash or investments like bank fixed deposits or mutual funds, the budgeting is done on the basis of the value so expected. However where the own means contribution is to be received in kind then the basis for valuation needs to be built in the budget. The documents that would be required for accounting for each contribution item in kind should also be specified so that there is no arbitrary valuation or at a later time in the accounting for such own means in kind. Separate books need to be maintained since they cannot be accounted for alongwith the financial books of account. These would be subsidiary registers duly supported by vouchers and documents to evidence that the own means in kind was actually contributed and used for the project. The own means in kind at no stage should be arbitrary or notional figures.

Own means must not be that expenses are inflated and paid for and that the supplier returns some amount as a contribution. This would be wrong and against the principle or concept of own means. Own means must be voluntary contribution by a stakeholder.

Own means in kind would include the following, which are not paid for:

- Labour
- Supply of agricultural produce or seeds
- Supply of transportation e.g. bus or tractor for ferrying the beneficiaries or use of tractor for carrying material e.g. mud, cement, stones etc.
- Material for the Programme e.g. wood, stones, mud, cement, teaching aids such as copies and books, medicines,
- Use of Equipment or Facilities e.g. hall or room for training programme, computers for teaching, electricity etc.
- Food and Physical Arrangements such as tents, durries for a rally or campaign.

The above is only an indicative list and the own means in kind will be determined by the nature of the project and its objectives.

In the budgeting process, the issue to be addressed is how to value the own means in kind. The basis for valuation must be clearly defined and based on reality. Notes must be given to the budget clearly specifying the basis for valuation and the rationale. Examples for the basis of valuation are given below:

Own Means Contribution in Kind	**Basis For Valuation**
Labour	The daily wage rate that the labour would normally earn in that particular area. If there are different rates for men and women; between mason and ordinary labour, then those should be taken into account for

	computing the value. At times the government specifies the wages to be paid and that rate could form the basis. However often the local labour is not able to get the government rate and normally work for a lower rate. In such a case the lower rate should be taken as the basis since that is the reality.
Supply of agricultural produce or seeds	Cost of the produce or seeds if purchased at say the wholesale price or retail price, whichever would have normally be availed of had on to buy it.
Supply of transportation e.g. bus or tractor for ferrying the beneficiaries or use of tractor for carrying material e.g. mud, cement, stones etc.	Cost of hiring of the bus or the tractor. This could be based on a daily rate or per trip basis or distance traveled.
Material for the Programme e.g. wood, stones, mud, cement, teaching aids such as copies and books, medicines,	Cost of the material had one to buy it. The value could be a wholesale or bargained rate or the retail price depending on the reality of the situation.
Use of Equipment or Facilities e.g. hall or room for training programme, computers for teaching, electricity etc	Cost of hiring such hall or the price at which the concerned agency would normally hire out the premises. Hire of computers and other equipment would be at a market rate or a negotiated rate , which is reasonable. Expenses like electricity can be accounted for at taking the value given in a bill. If a generator is used then the cost of diesel and marked up for the hire of the generator.
Food and Physical Arrangements such as tents, durries for a rally	Cost of cooking or a per person rate for food. Cost of hiring tents, durries, chairs, generator

or campaign.	that one would pay.
Teachers Honorarium / Coach	Persons voluntary teaching or providing coaching then the fee that would normally be paid to such teacher or coach.

4.8. TECHNIQUES FOR BUDGETING

The two main techniques for budgeting are **incremental budgeting** and **zero based budgeting.**

1. **In zero based budgets**, past figures are not used as the starting point. The budgeting process starts from "scratch" with the proposed activities for the year. The result is a more detailed and accurate budget, but it takes more time and energy to prepare a budget in this way. This technique is essential for both new organisations and projects and ongoing programmes. It is probably the best route to go in a dynamic organisation that is proactive in taking on new challenges.

2. **Incremental budgets** are budgets in which the figures are based on those of the actual expenditure for the previous year, with a percentage added for an inflationary increase for the new year. This is an easy method that saves time but it is the "lazy" way and is often inaccurate. This budgeting technique is only suitable for organisations where each year is very similar to the previous one in terms of activities. Very few dynamic organisations or projects are so stable that this budgeting technique really works for them.

Zero Based Budgeting: Zero base budgeting (ZBB) was first applied by Texas Instruments in 1969 and is used today by nonprofit organizations. It may be done for the entire organization or just selected areas of activity. It usually has a one year focus. It starts anew each period without considering what happened in the previous period(s). ZBB is like "cleaning house" and getting rid of the "dead wood." A current service (previously undertaken) that is inefficient or not needed will be discontinued. Under Zero Based Budgeting one must be open minded and evaluate proposed alternatives. Nothing is taken for granted. Managers must justify each budget line item - Is a particular activity useful or is it not needed? Does it allow better management of the organization. ZBB requires detailed information on the costs and benefits of alternative programmess. Values should be assigned to benefits to be achieved.

ZBB may uncover redundancies and duplication of efforts, focus on actual monetary outflow and inflow is required for programs rather than percentages. The limited resources have to be allotted in the most efficient and effective way. The process must permit comparison among responsibility units, set forth priorities within and among responsibility units, and allow a performance audit to determine efficiency of operations.

Hence Zero Based Budgeting is:

- priority based
- analyzes services, activities, operations, projects, and programs in order to find ways of enhancing efficiency at lower costs.
- input-output relationships are considered. alternative ways of achieving the final objective are reviewed considering time and cost..
- the proper funding level is decided upon
- performance and effectiveness are evaluated
- allows for the elimination of duplicate or overlapping programmes

The ZBB approach budgets funds at the minimum funding level to activities and operations. The survival level is the one in which funding below would eliminate the programme / project. Any funding above the minimum level must be supported and justified to a reasonable degree. All activities, whether existing or new, must be justified. If the service, activity, program, or operation cannot be justified, it should be terminated.

ZBB is a time-consuming process and may best be implemented to decision units on a rotating basis over a longer-term time period (e.g., every 5 years). To do it yearly is probably not cost-effective considering the cost and time.

Budget amounts for an activity start at zero or a stated percentage of the current year's amount (e.g., 60%). It is a means of review of existing and prospective programs to reallocate resources to result in more effectiveness and efficiency. ZBB should be modified as circumstances dictate.

For example, funding for one package may cause a change in the funding for another package. Alternative options in ZBB include:

- Keeping the service as it is
- Ceasing the activity.
- Curtailing the program.
- Expanding the function.
- Decentralizing the operation
- Centralizing the program.
- Integrating functions.

In looking at a service, the following questions should be asked:

- What is the purpose of the activity?
- Are objectives being measured properly?
- Are objectives being achieved?
- What is the negative effect of not funding the activity?
- Will an alternative way of performing the function reduce quality?
- How will the alternative impact cost and time to achieve?
- What is the risk involved?

Activity Units: The basic cost element of ZBB is the activity unit, representing the lowest unit for which a budget applies. The objective(s) of an activity unit should be clearly stated and specific. An activity unit may be an operation, function, program activity, organizational unit, and/or line item. A person is designated to be responsible for each unit. The unit must achieve its designated purposes.

Examples of decision units are data processing, quality control, research and development, and legal services. Priority is given to services required by law, government dictate, or other limitations. Those responsible for an activity must also have the control over it. Decision units of comparable size in terms of value, quantity, staff, etc. should be compared.

Zero Base Budgeting Procedures: ZBB is a continual process. Each manager must justify his budget request in detail from a zero base. There should be an appraisal of the output for each activity, service, operation, or function of a cost/responsibility center. The consequences of turning down a proposed service or activity should also be considered.

The process begins with determining objectives and assumptions. Assumptions include growth rate in wages and fringe benefits. It is recommended to test ZBB in one responsibility unit before employing it throughout the entire organization. ZBB should be phased in gradually. For example, initially only 10% of the budget may be based on ZBB before proceeding further so that adequate experience is acquired with regard to the process. Flexibility should exist to adjust to new information, assumptions, and limitations.

The activities or services of the unit are expressed in "decision packages" that are to be reviewed and ranked in priority order throughout different levels in the organization. Funds should be allocated based on those activities achieving the best results. One approach in ZBB is for administrators to identify different effort levels to conduct each activity. A minimum-spending amount is used, say 60% of the current operating level. Then, administrators stipulate separate decision packages, the costs and benefits of additional spending levels for that activity. This evaluation forces administrators to take into account and evaluate a spending level lower than the current operating level. This provides management with an alternative of terminating an activity or choosing from several effort levels. This provides trade-offs and shifts in expenditure levels among units. A program is not funded unless justifiable. Procedures and policies are evaluated on whether they still accomplish goals. Funding levels may be revised.

Decision Package: A "Decision Package" as the name suggests is a level or package which will facilitate the taking of a decision. A decision package is one of the first steps in ZBB. The decision package enumerates the way the manager recommends the activity to be performed in terms of both cost and time. Alternative ways to conduct the service in rupee terms and the time required are also specified. Cost may be lowered by decreasing quality but that may not be in the best interest of the nonprofit entity. If completion time is accelerated, this may increase costs such as because of overtime.

Decision packages may take the following forms and alternatives are specified for each package to facilitate a decision:

- A package for new operations or services.
- A package leaving the activity "as is" (status quo).
- A package at a base amount plus additional amounts of activity for ongoing programs.

Decision packages should be specific, focused, and have realistic goals. A decision package should not lump together many aspects because it becomes "cloudy." The decision package should contain the following:

(i) narrative of why the activity is needed
(ii) the reasons for the cost and time specified (financial and non financial)
(iii) Risk and uncertainty associated with the activity.
(iv) Priority specification
(v) alternative ways of achieving objectives
(vi) consequences for not engaging in the activity
(vii) benefits to be achieved
(viii) cost/benefit analysis

A decision package may be mutually exclusive or incremental. In mutually exclusive, the acceptance of one precludes the acceptance of another. In incremental, different effort levels exist. For example, one package may need 200 manhours per week while another may require 250 manhours per week. The interrelationship between decision packages may cause ranking problems.

The Evaluation Of Decision Units: The different decision packages are evaluated in the following manner:

- Comparing actual results to budget yardsticks.
- Input (cost and time) - output (income, quality) relationship.
- Quality control including difficulties experienced.
- Net cash flow generated.
- Internal audit of each responsibility unit.

Ranking Packages: Each activity is ranked to determine if it meets the nonprofit organization's mission. The ranking is done in decreasing order by importance to the organization. Ranking should consider the advantages and disadvantages of the decision package. Prioritization of decision packages includes consideration of legal requirements, operating needs, time, risk, and staff requirements. All relevant quantitative and qualitative factors should be considered.

Cost/benefit analysis should be conducted for each decision unit. Highest priority is given to the minimum increment of service representing the amount of service the organization must conduct so as to perform useful service.

Final ranking is done by senior administrators after receiving input from managers. Initial ranking is done at lower management levels where the packages are first developed. Intermediate rankings are done by middle management after reviewing lower management recommendations. If lower level management recommendations are rejected, the reasons should be provided. To avoid overwhelming upper managerial levels with too much detail, the ranked decision packages may be combined into major candidates for review and ranking. There should be a cutoff for operations and services at each of the approved levels. For instance, a 70% cutoff may be set for middle management but a 90% cutoff may be set for upper management. The 70% middle management cut-off line would necessitate the manager to remove the highest ranked package until the expenditure represented for the removed packages equal 70% of the previous year's budget. These packages are then reviewed for appropriateness. The balance of the decision packages is then closely appraised.

There should be a ranking table for decision packages by responsibility unit so as to aid in their review such as meeting financial and non financial criteria. Even non funded projects should be ranked in the event unexpected funding becomes available (e.g., sudden donation). Further, what is low priority today may be high priority tomorrow. An example might be new government regulations making a program legally required (e.g., environmental protection, affirmative action). Therefore, modifications may be made to the priority listing based on changing circumstances. Different ranking approaches are possible such as single standard, voting, and major category.

Single standard is most suitable for similar packages. All packages are appraised based on just one feature (e.g., return on investment, net present value, profit, cash savings, cost/benefit ratio). This approach is not appropriate for dissimilar packages because a vital activity (e.g., safety, health) may be absent. The voting approach involves action by a voting committee. The majority vote determines the ranking. Of course, a legally required program is funded. Special consideration is given to projects involving minimum organizational requirements. Under the major category system, decision packages are segregated. The decision packages in each category are then ranked. Some categories are more important than others.

Budgets for each category are different. For instance, a grouping having significant growth expectation may be funded five times as much as one with doubtful prospects. The emphasis is on "key" categories. Once the allocations are made, budgets are detailed.

EXAMPLE

A manager completes a decision package for each activity to be conducted in a unit. If there are 25 possible services (existing and new), 25 decision packages will be prepared. A typical decision package for activity X to be carried out in unit A appears as follows:

Decision Package for Activity X

Cost Time

-------------------------------------Alternative 1

-------------------------------------Recommended Approach

-------------------------------------Alternative 2

Each of the decision packages for all 25 activities is then submitted to upper management. Upper management then evaluates the decision packages from all the units including unit A. A budget ceiling puts a monetary cutoff on how many activities will be supported. The packages are ranked in priority order. Those exceeding the budget cutoff are funded fully or partly. If partly funded, the activity might be done an alternative cheaper (or less time consuming) way than that recommended.

Under Zero Based Budgeting the final decision for approving a budget will be based on the answers to the following questions and based on them the decision packages will be ranked and approved or rejected.

(i) Will the proposed activity generate immediate and tangible results?

(ii) Can a function be undertaken at a lower activity level without sacrificing productivity / programme implementation.

(iii) Are resources matched with the objectives specified?

(iv) What is the time period covered (short-term, long-term) for the project / programme.

(v) If the project / programme is not undertaken or is eliminated what are the consequences?

4.9. CONCLUSION

In the budgeting process the following issues at times get forgotten and it should be ensured that this does not happen:

- Start-up costs – for a new organisation or project, such as large-scale recruitment, moving in, building alterations, launching the project or organisation.
- Research and development – consultation, needs assessment, planning processes
- Democracy and governance – establishing the structures, recruiting for them, getting a constitution developed and accepted, training members of voluntary structures
- Marketing or public relations – building a professional image
- Replacement of capital goods
- Monitoring and evaluation costs for projects
- Audit Fees and Audit Expenses
- Property taxes
- Salaries i.e. annual increments that would be payble.
- Retirement and superannuation costs e.g. provident fund cost, gratuity payment
- Inflation realting to material, salaries, programme costs, transportation. Get quotations and discuss with suppliers about trends expected in prices.

- Contingency needs to be built in. This amount is put aside to deal with unforeseen events. However funding agencies may not agree on this and hence should be inbuilt in the main budget heads of account.

- Expanding programme area or increase inpopulation because of migration and other causes such as disturbances.

- Income generation aspects should be computed and the basis be carefully computed.

- Growth projection of the organization, quality of work must not suffer.

- Standardize budget heads and terminology and do not make changes in this as it will affect accounting and allocation of expenses. Terminology must be distinct and not lead to any ambiguity.

- Ground Reality relating to the constituency that will be served and their profile could have a bearing on programme implementation e.g. caste equations etc.

- Maintain a balance between too much detail in a budget and too little detail. Have the full details as part of your working papers and present the budget with broad headings and notes related thereto.

- Break down the annual budget into calendar quarters to facilitate reviews and effective monitoring leading to corrective action wherever required.

- Every page must specify the name of the project, have a page no. and carry the date and date of revision of budget, when that occurs.

- Every page must be signed both by the organization and funding agency to prove that the budget is the final and authenticate budget. It should state "approved on ______."

- Distinguish between "Cost Control" and "Raising of Revenue" to achieve programme objects. Cost control beyond a point is harmful for an organization in the long term. Revenue generation must be continually addressed.

4.10 BUDGET PROCESS:

Getting Ready

The above has dealt with what the various requirements are but there is a need to begin the process, so how does one begin in simple terms:

1 List the items on which you spend money. You will know what these are from your action planning process. After that group the items under headings or cost centres.

2 Estimate the unit cost of the line items and then the annual costs.

3 List your likely sources of income or revenue. Then group them under suitable budget heads. This is the basis of your income budget.

Now you are ready to begin putting your budget into a budget format. The remaining steps are:

Budget Preparation

4 Prepare the budget format.

5 Do the addition and multiplication.

6 Add in notes to explain items that may not be clear.

7 Get feedback on your budget.

8 Finalise the budget.

The budget can be prepared on the computer using the excel programme. If a computer is not availble then it can be prepared manually.

Feedback

Once the budget is ready , duly checked and the explanatory notes are incorporated, it is time to get feedback.

From whom should feedback be obtained:

- From the people who worked on drawing up the budget.
- From others in the project or department.
- From the finance department and accountants
- From the Director (unless you are the Director).
- From the Board or the Finance Sub-Committee or Budgeting Sub-Committee of the Board.

What should be done with the feedback?

- On the categories and line items – has everything that needs to be included been included?
- Consider the suggestions and taken an informed decision.
- On the notes – do they explain everything that needs a special explanation?
- On the addition – is it right?

Finalization

Once the feedback obtained is considered, amendments made, if they were required and calculations and dates checked, the budget is fanalized. Finalising the budget does not mean filing it away and never looking at it again. Once the budget is finalised, it is time to implement it – both in terms of generating the necessary income and carrying out the activities that incur expenses. The budget gives the basis for monitoring the programme / organiztion financially.

4.11. MONITORING THE BUDGET

The budget is the most important tool for monitoring the finances of the organisation, project or department. The budget is used for :

- Monitoring the income and expenditure to see whether or not target are being met.
- Reporting to the Board and Stakeholders.
- Preparing the cash flow projections;
- Making financial decisions.

Finally the planning cycle and budgeting should look something like this:

4.12. SUMMARY

- What is a Budget & What a Budget is Not
- Good Practices in Budgeting
- Cost Plan & Finance Plan
- Kinds of Cost Plans Budgets
- Own Means Contribution
- Techniques for Budgeting – Incremental & Zero Based Budgeting
- Conclusion

Self Assessment Exercise

1. *What do you understand by the terms 'Budgeting' What are the good practices that should be followed in a budgeting exercise.*
2. *What are the characteristics of a good budget?*
3. *What are the critical issues that need to be taken care of in a budget. Explain with examples.*
4. *What is the difference between Cost- Plan Budgeting and Finance- Plan Budgeting?*
5. *Prepare a cost plan item wise for a building project. The line wise expense may be taken as per your best judgment.*
6. *Explain the technique of Zero Based Budgeting.*
7. *What is a 'Decision Package' How is it used in Budgeting*
8. *Explain in detail the steps involved in the Budget process*

9. Prepare the budget for the year 2006 from the following information:

Revenue Budget for the year 2005:

Income		**Expenditure**	
Grant form DFID	*100,000*	**Salaries**	**1,50,000**
Grant from E.U.	*3,50,000*	**Rent of premises**	**95,000**
Department of Education	*1,25,000*	**Purchase of drugs**	**1,10,000**
		Medical Supplies	**63,000**
		Electricity	**12,540**
		Traveling Expenses	**21,500**
		Office Cost (including audit)	
		11,000	
		Depreciation	**13,200**

Information about the Year 2006

1. *Grant for the year 2006: DFID is to remain at 100,000 and E.U. to increase to 7,00,000.*
2. *The Department of Health to increase the contribution by another 50,000*
3. *Salaries are expected to be as follows:*

   3 staff at 60,000 per year, 2 staff at 25,000 per year

   2 staff at 45,000 per year 3 staff at 30,000 per year
4. *Rent will be increased to 10,000 per month*
5. *Drugs, medical supplies and electricity and office cost would increase by 5% as compared to last year's budget.*
6. *Traveling expense is expected to be 1,50,000.*
7. *A training program has been planned for the year, the expenses id estimated to be 25,000.*
8. *The centre wishes to buy a new vehicle in the middle of the year' 2006. This I estimated to cost 75,000*
9. *Depreciation should be included and it should be charged at the rate of 10% p.a.*

Short Answer Type questions:

1. **Why a donor / funding agency normally do not finance hundred percent of the project cost?**
2. **What do you understand by the term "Own Means of Contribution"?**
3. **What would be the treatment for "Donation of Labour" by the beneficiaries in the books of accounts of a project implementing organization?**
4. **What policy should be followed in the valuation of capital equipments?**
5. **Can own means of contribution be utilized for a program, if it is not a part of the "Program Cost Plan"? Explain**

Practical Problem:

From the following information asses the "own means of contribution" of Lokjagriti Kendra, in its "Reproductive Child Health Project".

Agha Khan Foundation (Funding agency)	**5,00,000**
Lokjagriti Kendra	**70,000**
State Government	**1,00,000**
Jindal Lights Limited (local company)	**50,000**
District Health Department	**50,000**
Community (Beneficiaries)	**10,000**