

5.2 BUDGETARY CONTROL

Definition: Budgetary Control is defined as "the establishment of budgets, relating the responsibilities of executives to the requirements of a policy, and the continuous comparison of actual with budgeted results either to secure by individual action the objective of that policy or to provide a base for its revision.

Salient features:

- a. **Objectives:** Determining the objectives to be achieved, over the budget period, and the policy(ies) that might be adopted for the achievement of these ends.
- b. **Activities:** Determining the variety of activities that should be undertaken for achievement of the objectives.
- c. **Plans:** Drawing up a plan or a scheme of operation in respect of each class of activity, in physical as well as monetary terms for the full budget period and its parts.
- d. **Performance Evaluation:** Laying out a system of comparison of actual performance by each person section or department with the relevant budget and determination of causes for the discrepancies, if any.
- e. **Control Action:** Ensuring that when the plans are not achieved, corrective actions are taken; and when corrective actions are not possible, ensuring that the plans are revised and objective achieved

Classification Of Budgets

Budgets may be classified on the following bases –

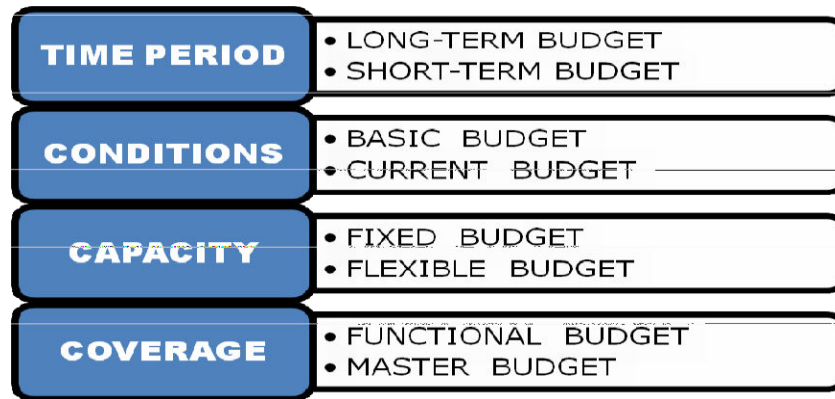


Fig 1: Classification Of Budgets

Source: JAF Stoner, Freeman R.E and Daniel R Gilbert — “Management”

a) BASED ON TIME PERIOD:

(i) Long Term Budget

Budgets which are prepared for periods longer than a year are called Long Term Budgets. Such Budgets are helpful in business forecasting and forward planning. Eg: Capital Expenditure Budget and R&D Budget.

(ii) Short Term Budget

Budgets which are prepared for periods less than a year are known as ShortTerm Budgets. Such Budgets are prepared in cases where a specific action has to be immediately taken to bring any variation under control.

Eg: Cash Budget.

b) BASED ON CONDITION:

(i) Basic Budget

A Budget, which remains unaltered over a long period of time, is called Basic Budget.

(ii) Current Budget

A Budget, which is established for use over a short period of time and is related to the current conditions, is called Current Budget.

c) **BASED ON CAPACITY:**

(i) **Fixed Budget**

It is a Budget designed to remain unchanged irrespective of the level of activity actually attained. It operates on one level of activity and less than one set of conditions. It assumes that there will be no change in the prevailing conditions, which is unrealistic.

(ii) **Flexible Budget**

It is a Budget, which by recognizing the difference between fixed, semi variable and variable costs is designed to change in relation to level of activity attained. It consists of various budgets for different levels of activity

d) **BASED ON COVERAGE:**

(i) **Functional Budget**

Budgets, which relate to the individual functions in an organization, are known as Functional Budgets, e.g. purchase Budget, Sales Budget, Production Budget, plant Utilization Budget and Cash Budget.

(ii) **Master Budget**

It is a consolidated summary of the various functional budgets. It serves as the basis upon which budgeted Profit & Loss Account and forecasted Balance Sheet are built up.

5.2. 1 Budgetary Control Techniques

The various types of budgets are as follows

i) **Revenue and Expense Budgets:**

The most common budgets spell out plans for revenues and operating expenses in rupee terms. The most basic of revenue budget is the sales budget which is a formal and

etailed expression of the sales forecast. The revenue from sales of products or services furnishes the principal income to pay operating expenses and yield profits.

Expense budgets may deal with individual items of expense, such as travel, data

processing, entertainment, advertising, telephone, and insurance.

ii) Time, Space, Material, and Product Budgets:

Many budgets are better expressed in quantities rather than in monetary terms. e.g. direct- labor-hours, machine-hours, units of materials, square feet allocated, and units produced. The Rupee cost would not accurately measure the resources used or the results intended.

iii) Capital Expenditure Budgets:

Capital expenditure budgets outline specifically capital expenditures for plant, machinery, equipment, inventories, and other items. These budgets require care because they give definite form to plans for spending the funds of an enterprise. Since a business takes a long time to recover its investment in plant and equipment, (Payback period or gestation period) capital expenditure budgets should usually be tied in with fairly long-range planning.

iv) Cash Budgets:

The cash budget is simply a forecast of cash receipts and disbursements against which actual cash "experience" is measured. The availability of cash to meet obligations as they fall due is the first requirement of existence, and handsome business profits do little good when tied up in inventory, machinery, or other noncash assets.

v) Variable Budget:

The variable budget is based on an analysis of expense items to determine how individual costs should vary with volume of output.

Some costs do not vary with volume, particularly in so short a period as 1 month, 6 months, or a year. Among these are depreciation, property taxes and insurance, maintenance of plant and equipment, and costs of keeping a minimum staff of supervisory and other key personnel. Costs that vary with volume of output range from those that are completely variable to those that are only slightly variable.

The task of variable budgeting involves selecting some unit of measure that

reflects volume; inspecting the various categories of costs (usually by reference to the chart of accounts); and, by statistical studies, methods of engineering analyses, and other means, determining how these costs should vary with volume of output.

vi) **Zero Based Budget:**

The idea behind this technique is to divide enterprise programs into "packages" composed of goals, activities, and needed resources and then to calculate costs for each package from the ground up. By starting the budget of each package from base zero, budgeters calculate costs afresh for each budget period; thus they avoid the common tendency in budgeting of looking only at changes from a previous period.

Advantages

There are a number of advantages of budgetary control:

- Compels management to think about the future, which is probably the most important feature of a budgetary planning and control system. Forces management to look ahead, to set out detailed plans for achieving the targets for each department, operation and (ideally) each manager, to anticipate and give the organization purpose and direction.
- Promotes coordination and communication.
- Clearly defines areas of responsibility. Requires managers of budget centre's to be made responsible for the achievement of budget targets for the operations under their personal control.
- Provides a basis for performance appraisal (variance analysis). A budget is basically a yardstick against which actual performance is measured and assessed. Control is provided by comparisons of actual results against budget plan. Departures from budget can then be investigated and the reasons for the differences can be divided into controllable and non- controllable factors.
- Enables remedial action to be taken as variances emerge.

- Motivates employees by participating in the setting of budgets.
- Improves the allocation of scarce resources.
- Economises management time by using the management by exception principle.

Problems in budgeting

- Whilst budgets may be an essential part of any marketing activity they do have a number of disadvantages, particularly in perception terms.
- Budgets can be seen as pressure devices imposed by management, thus resulting in:
 - a) bad labour relations
 - b) inaccurate record-keeping.
- Departmental conflict arises due to:
 - a) disputes over resource allocation
 - b) departments blaming each other if targets are not attained.
- It is difficult to reconcile personal/individual and corporate goals.
- Waste may arise as managers adopt the view, "we had better spend it or we will lose it". This is often coupled with "empire building" in order to enhance the prestige of a department.
- Responsibility versus controlling, i.e. some costs are under the influence of more than one person, e.g. power costs.
- Managers may overestimate costs so that they will not be blamed in the future should they overspend.

MASTER BUDGET:

The master budget is a review budget which combines all functional budgets and it may take the form of Financial Statements at the end of budget period. It is also called the operating budget. It embraces the impact of both operating decisions and financing decisions. It provides the necessary plan for operations during the period when all detailed budgets have been completed. A master budget becomes a principal document for the operations of the industry during the period it covers. Actually, budgets have to be amended several times before the position disclosed by the summary budget is accepted. A

master budget is an annual profit plan, which may be broken into months or quarters.

As a result a master budget is:

- A statement of a company's operating policy for the budget period, and
- A budgeted profit and loss account for the budget period and a balance sheet as at the end of the period.

Merits of the Master Budget:

- A review of all the functional budgets in specific form is available in one report.
- It presents an overall profit position of the organization for the budget.
- It also contains the information regarding the forecast balance sheet.
- It examines the fitness of all the functional budgets

Performance Budgeting(PB):

This term was used for the first time in the United States by the Hoover Commission. In India, Performance Budgeting was first discussed in 1954 during the Lok-Sabha debates.

But it was only in 1961 that the government of India issued general orders drawing the attention of the administrative ministries to the recommendations of the Estimates Committee, and requesting them to consider the issuance of suitable instructions. It was

left to the Administrative Reforms Commission to come out with more elaborate emphasis on PB in 1967. Performance budgeting is a budgeting system, which involves the assessment of the performance of the business, and both its specific and overall objectives. It gives clarity about organizational objectives and provides an exact direction to each employee in the business.

Meaning:

The term performance implies results or outputs. 'A performance budget is one which presents the purposes and objectives for which funds are required, the costs of the programmes proposed for achieving those objectives, and quantitative data measuring the accomplishments and work performed under programme. Thus, PB is a technique of presenting budgets for costs and revenues in terms of functions, programmes and activities and correlating the physical and financial aspects of the individual items

comprising the budget.

As per the National Institute of Bank Management, PB technique is, "the process of analyzing, identifying, simplifying and crystallizing specific performance objectives of a job to be achieved over a period in the framework of the organizational objectives, the purpose and objectives of the job. The technique is characterized by its specific direction towards the business objectives of the organization." As a result, performance budget accentuates the execution of specific goals over a period of time.

Steps in Performing Budgeting (PB):

- ✓ Establishment of performance targets
- ✓ Establishment of responsibility centre
- ✓ Estimating financial requirements
- ✓ Comparison of actual with budgeted performance
- ✓ Reporting and action

Zero Base Budgeting:

The 'Zero-Base' refers to a 'nil-budget' as the starting point. It starts with a presumption that the budget for the next period is 'zero' until the demand for a function, process, or project is not justified for single penny. The assumption is that without such justification, no expenditure will be allowed. In effect, each manager or functional head is required to carry out cost-benefit analysis of each of the activities, etc. under his control and for which he is responsible.

The method of ZBB suggests that the business should not only make decision about the proposed new programmes but it should also, regularly, review the suitability of the existing programmes. This approach of preparing a budget is called incremental budgeting since the budget process is concerned mainly with the increases or changes in operations that are likely to occur during the budget period.

This method for the first time was used by the Department of Agriculture, U.S.A. in the 19th century. Other State Governments of the U.S.A. found this method helpful and so almost all the states took deep interest in the ZBB method. A number of states of America

use this technique even today. The ICAI has brought out a research in the form of a monograph showing the application of the ZBB method that worries in tandem with the concerns for national environment and its requirements. In India, however, the ZBB approach has not been fully accepted and actualized.

"ZBB is a management tool, which provides a systematic method for evaluating all operations and programmes, current or new, allows for budget reductions and expansions in a rational manner and allows re-allocation of sources from low to high priority programmes."

- David Lieninger

ZBB is a planning, resource allocation and control tool. It, however, presupposes that

- (a) There is an efficient budgeting system within the enterprise.
- (b) Managers can develop quantitative measures for use in performance evaluation.
- (c) Among the new suggestions and programmes, along with old ones are put to a strict scrutiny.
- (d) Funds are diverted from low-priority suggestions to high priority suggestions.

Procedure of Zero-base Budgeting:

- (1) **Determination of the objective:** This is an initial step for determining the objective to introduce ZBB. It may result into the decreased cost in personnel overheads or de-bunk the projects which do not fit in the business structure or which are not likely to help accomplish the business objectives.
- (2) **Degree at the ZBB is to be introduced:** It is not possible every time to evaluate every activity of the whole business. After studying the business structure, the management can decide whether ZBB is to be introduced in all areas of business activities or only in a few selected areas on the trial basis.

Growth of Decision units: Decision units submit their data as to which cost benefit analysis should be done in order to arrive at a decision that helps them decide to continue or abandon. It could be a functional department, a programme, a product-line or a

sub-line. Here the decision unit exist independent of all the other units so that when the cost analysis turns unfavourable that particular unit could be closed down.

(3) **Growth of Decision packages:** Decision units are to be identified for preparing data relating to the proposals to be included in the budget, concerned manager analyzes the activities of his or her own decision units. His job is to consider possible different ways to fulfill objectives. The size of the business unit and the volume of goods it deals with determine the number of decision units and packages. The decision package has to contain all the information which helps the management in deciding whether the information is necessary for the business, what would be the estimated costs and benefits expected from it.

(4) **Assessment and Grading of decision packages:** These packages invented and formulated are submitted to the next level of responsibility within the organization for ranking purposes. Ranking basically decides as to whether or not to include the proposals in the budget. The management ranks the different decision packages in the order from decreasing benefit or importance to the organization. Preliminary ranking is done by the unit manager himself and for the further review it is sent to the superior officers who consider overall objectives of the organization.

(5) **Allotment of money through Budgets:** It is the last step engaged in the ZBB process. According to the cost benefit analysis and availability of the funds management has ranks and thereby a cut-off point is established. Keeping in view reasonable standards, the approved designed packages are accepted and others are rejected. The funds are then allotted to different decision units and budgets relating to each unit are prepared.

Budgets Reports:

Ascertaining budget in itself is of no use unless there is a constant flow of budget reports showing assessment of the actual and the budget figures. It should be prepared at regular intervals like every month showing results of the difference between actual and budgeting figure. The reports should be prepared in such a way that they establish

responsibility for the variances. Reports should also disclose whether or not variances are favourable and that they are controllable.

The contents of the budget report vary according to the need of the managerial level. Reports are prepared in such a way that the concerned manager is directly concerned to be provided with detailed information. As the level grows higher, the amount of detail becomes less although the coverage of the report will widen.

Essentials of a Budget Report:

The following essentials should be kept in view while preparing budget reports:

- ✓ The budget reports should be simple, appropriate and understandable for the concerned person.
- ✓ The report should be presented in time.
- ✓ The report should be precise. However, its accuracy should not be at the cost of clarity.
- ✓ The principle of exemptions should be utilized, where possible.
- ✓ It should contain only necessary information according to the need of the concerned person.

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5.3 NON-BUDGETARY CONTROL TECHNIQUES

There are, of course, many traditional control devices not connected with budgets, although some may be related to, and used with, budgetary controls. Among the most important of these are: statistical data, special reports and analysis, analysis of break- even points, the operational audit, and the personal observation.

i) Statistical data:

Statistical analyses of innumerable aspects of a business operation and the clear presentation of statistical data, whether of a historical or forecast nature are, of course, important to control. Some managers can readily interpret tabular statistical data, but most managers prefer presentation of the data on charts.

ii) Break- even point analysis:

An interesting control device is the break even chart. This chart depicts the relationship of sales and expenses in such a way as to show at what volume revenues exactly cover expenses.

iii) Operational audit:

Another effective tool of managerial control is the internal audit or, as it is now coming to be called, the operational audit. Operational auditing, in its broadest sense, is the regular and independent appraisal, by a staff of internal auditors, of the accounting, financial, and other operations of a business.

iv) Personal observation:

In any preoccupation with the devices of managerial control, one should never overlook the importance of control through personal observation.

v) PERT:

The Program (or Project) Evaluation and Review Technique, commonly abbreviated PERT, is a method to analyze the involved tasks in completing a given project, especially the time needed to complete each task, and identifying the minimum time needed to complete the total project.

vi) GANTT CHART:

A Gantt chart is a type of bar chart that illustrates a project schedule. Gantt charts illustrate the start and finish dates of the terminal elements and summary elements of a project. Terminal elements and summary elements comprise the work breakdown structure of the project. Some Gantt charts also show the dependency (i.e., precedence network) relationships between activities.

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5.4 Productivity

Productivity refers to the ratio between the output from production processes to its input. Productivity may be conceived of as a measure of the technical or engineering efficiency of production. As such quantitative measures of input, and sometimes output, are emphasized.

Typical Productivity Calculations

Measures of size and resources may be combined in many different ways. The three common approaches to defining productivity based on the model of Figure 2 are referred to as physical, functional, and economic productivity. Regardless of the approach selected, adjustments may be needed for the factors of diseconomy of scale, reuse, requirements churn, and quality at delivery.

a) Physical Productivity

This is a ratio of the amount of product to the resources consumed (usually effort). Product may be measured in lines of code, classes, screens, or any other unit of product. Typically, effort is measured in terms of staff hours, days, or months. The physical size also may be used to estimate software performance factors (e.g., memory utilization as a function of lines of code).

b) Functional Productivity

This is a ratio of the amount of the functionality delivered to the resources consumed (usually effort). Functionality may be measured in terms of use cases, requirements, features, or function points (as appropriate to the nature of the software and the development method).

Typically, effort is measured in terms of staff hours, days, or months. Traditional measures of Function Points work best with information processing systems. The effort involved in embedded and scientific software is likely to be underestimated with these measures, although several variations of Function Points have been developed that attempt to deal with this issue.

c) **Economic Productivity**

This is a ratio of the value of the product produced to the cost of the resources used to produce it. Economic productivity helps to evaluate the economic efficiency of an organization. Economic productivity usually is not used to predict project cost because the outcome can be affected by many factors outside the control of the project, such as sales volume, inflation, interest rates, and substitutions in resources or materials, as well as all the other factors that affect physical and functional measures of productivity. However, understanding economic productivity is essential to making good decisions about outsourcing and subcontracting. The basic calculation of economic productivity is as follows:

Economic Productivity = Value/Cost

5.4.1 PROBLEMS IN MEASUREMENT OF PRODUCTIVITY OF KNOWLEDGE WORKERS

Productivity implies measurement, which in turn, is an essential step in the control process. Although there is a general agreement about the need for improving productivity, there is little consensus about the fundamental causes of the problem and what to do about them. The blame has been assigned to various factors. Some people place it on the greater proportion of less skilled workers with respect to the total labor force, but others disagree. There are those who see cutback in research and the emphasis on immediate results as the main culprit. Another reason given for the productivity dilemma is the growing affluence of people, which makes them less ambitious. Still others cite the breakdown in family structure, the workers' attitudes, and government policies and regulations. Another problem is that the measurement of skills work is relatively easy, but it becomes more difficult for knowledge work. The difference between the two kinds is the relative use of knowledge and skills.

1) COSTCONTROL

Cost control is the measure taken by management to assure that the cost objectives set down in the planning stage are attained and to assure that all segments of the organization function in a manner consistent with its policies.

Steps involved in designing process of cost control system:

- **Establishing norms:** To exercise cost control it is essential to establish norms, targets or parameters which may serve as yardsticks to achieve the ultimate objective. These standards, norms or targets may be set on the basis of research, study or past actual.
- **Appraisal:** The actual results are compared with the set norms to ascertain the degree of utilization of men, machines and materials. The deviations are analyzed so as to arrive at the causes which are controllable and uncontrollable.
- **Corrective measures:** The variances are reviewed and remedial measures or revision of targets, norms, standards etc., as required are taken.

Advantages of cost control

- Better utilization of resources
- To prepare for meeting a future competitive position.
- Reasonable price for the customers
- Firm standing in domestic and export markets.
- Improved methods of production and use of latest manufacturing techniques which have the effect of rising productivity and minimizing cost. By a continuous search for improvement creates proper climate for the increase efficiency.
- Improves the image of company for long-term benefits.
- Improve the rate of return on investment.

2) PurchaseControl

Purchase control is an element of material control. Material procurement is known as the purchase function. The functional responsibility of purchasing is that of the purchase manager or the purchaser. Purchasing is an important function of materials management because in purchase of materials, a substantial portion of the company's finance is committed which affects cash flow position of the company. Success of a business is to a large extent influenced by the efficiency of its purchase organization. The advantages derived from a good and adequate system of the purchase control are as follows:

a) **Continuous availability of materials:** It ensures the continuous flow of materials. so production work may not be held up for want of materials. A manufacturer can complete schedule of production in time.

b) **Purchasing of right quantity:** Purchase of right quantity of materials avoids locking up of working capital. It minimizes risk of surplus and obsolete stores.

It means there should not be possibility of overstocking and understocking.

c) **Purchasing of right quality:** Purchase of materials of proper quality and specification avoids waste of materials and loss in production. Effective purchase control prevents wastes and losses of materials right from the purchase till their consumptions. It enables the management to reduce cost of production.

d) **Economy in purchasing:** The purchasing of materials is a highly specialized function. By

purchasing materials at reasonable prices, the efficient purchaser is able to make a valuable contribution to the success of a business.

e) **Works as information centre:** It serves as a function centre on the materials knowledge relating to prices, sources of supply, specifications, mode of delivery, etc. By providing continuous information to the management it is possible to prepare planning for production.

f) **Development of business relationship:** Purchasing of materials from the best market and from reliable suppliers develops business relationships. The result is that there may be smooth supply of materials in time and so it avoid disputes and financial losses.

g) **Finding of alternative source of supply:** If a particular supplier fails to supply the materials in time, it is possible to develop alternate sources of supply. the effect of this is that the production work is not disturbed.

h) **Fixing responsibilities:** Effective purchase control fix the responsibilities of operating units and individuals connected with the purchase, storage and handling of materials.

In short, the basic objective of the effective purchase control is to ensure continuity of supply of requisite quantity of material, to avoid held up of production and loss in production and at the same time reduces the ultimate cost of the finished products.

3) Maintenance Control

Maintenance department has to exercise effective cost control, to carry out the maintenance functions in a pre-specified budget, which is possible only through the following measures:

First line supervisors must be apprised of the cost information of the various materials so that the objective of the management can be met without extra expenditure on maintenance functions

A monthly review of the budget provisions and expenditures actually incurred in respect of each center/shop will provide guidelines to the departmental head to exercise better cost control.

The total expenditure to be incurred can be uniformly spread over the year for better budgetary control. however, the same may not be true in all cases particularly where overhauling of equipment has to be carried out due to unforeseen breakdowns. some budgetary provisions must be set aside, to meet

out unforeseen exigencies.

The controllable elements of cost such as manpower cost and material cost can be discussed with the concerned personnel, which may help in reducing the total cost of maintenance. Emphasis should be given to reduce the overhead expenditures, as other expenditures cannot be compromised.

It is observed through studies that the manpower cost is normally fixed, but the same way increase due to overtime cost. However, the material cost, which is the prime factor in maintenance cost, can be reduced by timely inspections designed, to detect failures. If the

inspection is carried out as per schedule, the total failure of parts may be avoided, which otherwise would increase the maintenance cost. The proper handling of the equipment by the operators also reduces the frequency of repair and material requirements. Operators, who check their equipment regularly and use it within the operating limits, can help avoid many unwanted repairs. In the same way a good record of equipment failures/ maintenance would indicate the nature of failures, which can then be corrected even permanently.

4) Quality Control

Quality control refers to the technical process that gathers, examines, analyze & report the progress of the project & conformance with the performance requirements

The steps involved in quality control process are

- 1) Determine what parameter is to be controlled.
- 2) Establish its criticality and whether you need to control before, during or after results are produced.
- 3) Establish a specification for the parameter to be controlled which provides limits of acceptability and units of measure.
- 4) Produce plans for control which specify the means by which the characteristics will be achieved and variation detected and removed.

- 5) Organize resources to implement the plans for quality control.
- 6) Install a sensor at an appropriate point in the process to sense variance from specification.
- 7) Collect and transmit data to a place for analysis.
- 8) Verify the results and diagnose the cause of variance.
- 9) Propose remedies and decide on the action needed to restore the status quo.
- 10) Take the agreed action and check that the variance has been corrected.

Advantages and disadvantages

Ø Advantages include better products and services ultimately establishing a good reputation for a company and higher revenue from having more satisfied customers.

Ø Disadvantages include needing more man power/operations to maintain quality control and adding more time to the initial process.

Planning Operations

An **operational planning** is a subset of strategic work plan. It describes short-term ways of achieving milestones and explains how, or what portion of, a strategic plan will be put into operation during a given operational period, in the case of commercial application, a fiscal year or another given budgetary term. An operational plan is the basis for, and justification of an annual operating budget request. Therefore, a five-year strategic plan would need five operational plans funded by five operating budgets. Operational plans should establish the activities and budgets for each part of the organization for the next 1 – 3 years. They link the strategic plan with the activities the organization will deliver and the resources required to deliver them.

An operational plan draws directly from agency and program strategic plans to describe agency and program missions and goals, program objectives, and program activities. Like a strategic plan, an operational plan addresses four questions:

- Where are we now?
- Where do we want to be?
- How do we get there?
- How do we measure our progress?

The OP is both the first and the last step in preparing an operating budget request. As the first step, the OP provides a plan for resource allocation; as the last step, the OP may be modified to reflect policy decisions or financial changes made during the budget development process. Operational plans should be prepared by the people who will be involved in implementation. There is often a need for significant cross-departmental dialogue as plans created by one part of the organization inevitably have implications for other parts.

Operational plans should contain:

- clear objectives
- activities to be delivered
- quality standards
- desired outcomes
- staffing and resource requirements
- implementation timetables
- a process for monitoring progress.

5.4.2 Direct control and Preventive Control

The ultimate success of any plan depends on the individuals who implement them. For example, a manufacturing unit producing inferior products cannot adopt a control system of directing inferior products to the scrap heap. In such a case, the individual responsible for taking the incorrect decision is the sole cause of deviations. Therefore direct control and preventive control are the two methods suggested so that such individuals are able to modify their future actions.

□ **Direct Control:** in this, the cause of the unsatisfactory outcome is traced back to the individuals responsible for it and they are made to correct their practices. For

example: in a milk processing plant , if an individual decides that the pasteurization temperature should be increased by, say 5°C, it will affect the nutritive as well as the organoleptic properties of milk, then under direct control the person responsible for taking such a decision is traced back and is made to correct his actions.

□ **Preventive Control:** focuses on developing better managers who skillfully apply concepts, principles and techniques so that the undesirable outcomes are eliminated completely i.e. higher the quality of the managers and their subordinates, less will be the need for direct control.

(I) Types of Controls

Control can be divided into different types and these are Shown in Fig 1:

□ Controls based on **timing**: on the basis of timing, the controls can be divided into three types:

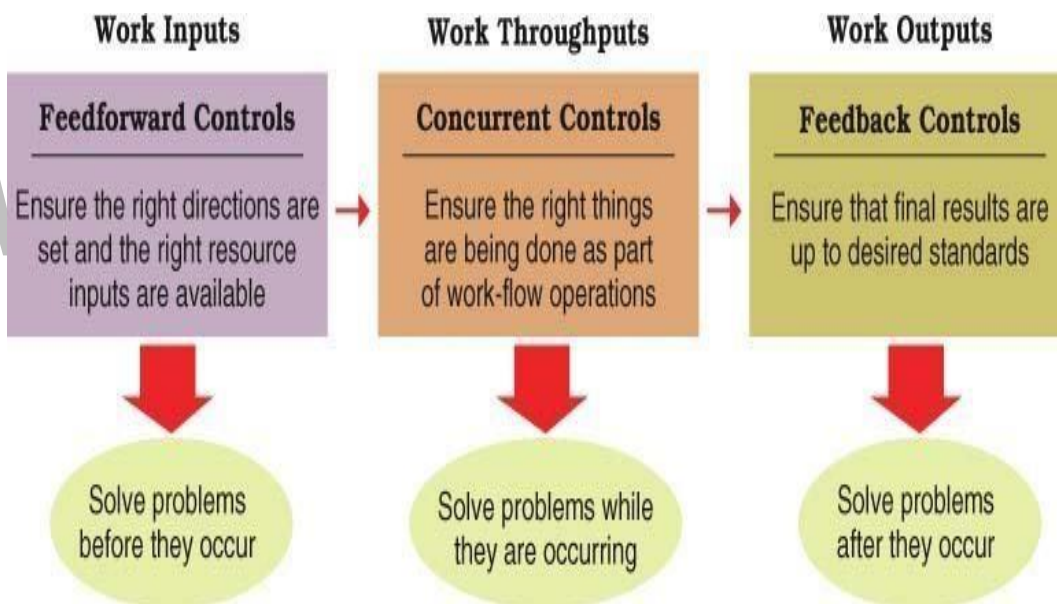


Fig 1 Types of control

(Ref: www.wiley.com/canada/schermerhorn)

□ **Feedforward control:** A control that prevents anticipated problems before actual occurrences of the problem.

□ **Concurrent control:** A control that takes place while the monitored activity is in progress. Sometimes called steering controls, they monitor ongoing operations and

activities to make sure that things are being done correctly.

Feedback control: A control that takes place after an activity is done. Corrective action is after-the-fact, when the problem has already occurred. They focus on end results, as opposed to inputs and activities.

□ Multiple controls: multiple control systems use two or more control processes and are necessary to cater to the need of different phases of a firm's operations.

□ Control based on **degree of human discretion** required

□ Cybernetic Control system: It is a self regulating control system which once put into action, can automatically monitor the situation and take corrective action when necessary, thus preventing any kind of human intervention.

□ Non-cybernetic control system: This type of control system relies on human discretion i.e. managerial discretion is required to determine when and what corrective actions are to be taken when the practical output differs from the standards.

(II) Requirements for effective controls

Effective control system must have the following characteristics:

□ Should reflect plans, positions and structures: control systems should provide managers relevant information about the progress of the plans; they should be specific to positions/ levels of authority within an organization; and controls must be designed keeping the organization structures in mind i.e. they should clearly indicate the individual with whom lies the responsibility of the execution of plans within an organization.

□ Should be understandable: the control systems must be easy to understand. Therefore, it is advisable to develop systems that are less complex and provide moderate benefits than to have a highly complex system that is difficult to understand by the managers.

□ Should be cost-effective: the benefits derived from the control system must

outweigh the cost required to implement them, only then can it be called as a cost effective system.

- Should be flexible: control systems must be flexible to accommodate changes that may crop up within an organization after their implementation.
- Should provide accurate information: for effective implementation of the control system, it is essential that accurate information must be provided regarding the performance of the organization.

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5.5 REPORTING

Management reporting is that part of management control system which provides the various information to the management in the form of report and statement at regular interval. Management reporting is the instrument for making control and decision effective.

According to Kohler reporting refers to “A body of information organized for presentation or transmission to others. It often includes interpretations, recommendations and findings with supporting evidence in the form of other reports”

Management reporting may be defined as “A system of communication, normally in the written form, of facts which should be brought to the attention of various levels of management who use them to take suitable action.” In other words the process of providing information to the management is known as management reporting.

5.5.1 Objectives of management Reporting

- To obtain the required information relating to the business to discharge its managerial functions of planning, organizing, controlling, directing, and decision making etc., efficiently and effectively.
- To ensure the operational efficiency of the concern.
- To facilitate the maximum utilization of resources.
- To secure industrial understanding among people who are engaged in various aspects of work of enterprise.
- To enable to motivating improving discipline and morale
- To help the management for effective decision making

5.5.2 Essentials of Good Reporting System

This following are the essentials of a good management reporting system:

- i. **Proper form:** A good report should have a comprehensive form with suggestive title, heading, sub heading and number of paragraphs as and where necessary for easy and quick reference.

- ii. **Contents:** Simplicity is one of the requisites of reporting in relation to the contents of a report. Further the contents should follow a logical sequence. Wherever necessary the contents should be represented in the form of visual aids such as charts and diagrams etc.
- iii. **Promptness:** It means that the system should ensure the preparation and submission of report at the proper time. It facilitates business executives to make suitable decisions based on quick reports without delay.
- iv. **Accuracy:** Information conveyed should be accurate. This means that the person responsible for reporting should have sufficient care in preparing the report as correctly as possible
- v. **Comparability:** In order to ensure that the furnished information is useful, it is essential that reports are also meant for comparison. The report should provide information about both the actual and the budgeted performance of the budget period. So that meaningful comparison can be made to find out the deviations and to initiate appropriate action.
- vi. **Consistency:** In order to make a meaningful and useful comparison, uniform accounting principles and procedures should be followed on consistent basis over a period of time for collection, classification and presentation of accounting information.
- vii. **Relevancy:** The report should be presented with relevant data to disclose the fact in unambiguous terms. Because, inclusion of both the relevant and the irrelevant data in the management reports may result in faulty decision.
- viii. **Simplicity:** The report should be as far as possible in simple form. In other words, report should avoid technical jargons, duplication of work and presented in a simple style.
- ix. **Cost-Benefit Analysis:** Cost- Benefit Analysis should be made and the cost of reporting should commensurate with the expenditure involved.

- x. **Principle of Exception:** Since the time and effort of managerial personnel are precious, the principle of management by exception has become the rule of the day instead of exception. It is necessary therefore to draw the attention of management, through reports, only towards exceptional matters.
- xi. **Flexibility:** The system should be capable of being adjusted according to the requirement of the users.
- xii. **Controllability:** It is necessary that every report should be addressed to a responsibility centre and analyzed the factors into controllable and uncontrollable separately. So that the head of the responsibility centre can be held responsible only for controllable variance but not for variances which are beyond his control.

5.5.3 Classification of Reports

Basically, there are two ways to report to the management. They are:

- 1) Oral report and
- 2) Written report.

The written reports may be classified into number of ways. The following are the important types:

i) According to Object or Purpose:

- (1) External reports
- (2) Internal reports
 - (a) Reports meant for top management
 - (b) Reports meant for middle level management
 - (c) Reports meant for junior level management

ii) According to Period

- (1) Routine reports
- (2) Special reports

iii) According to Functions:

- (1) Operating reports
 - (a) Control reports

- (b) Information reports
- (c) Venture measurement reports
- (2) Financial Reports
 - (a) Static reports
 - (b) Dynamic reports

The important types of reports are described here:

1) External Reports:

These reports prepared for persons outside the business such as Government, Shareholders, Bankers, Investors and financial institutions etc. external Reports usually represent published annual reports. Annual Reports of Trading, Profit and Loss Accounting and Balance Sheet of the Indian Companies are to be prepared in terms of Schedule VI of the Indian Companies Act of 1956.

2) Internal Reports:

Internal Reports are those which are prepared for internal uses of different levels of management. These reports are not meant for disclosure to those who are outsiders to the business. They do not have to comply with any statutory requirements.

5.1 CONTROLLING

5.1.1 Meaning & Definition

Control is the process through which managers assure that actual activities conform to planned activities.

In the words of Koontz and O'Donnell - "Managerial control implies measurement of accomplishment against the standard and the correction of deviations to assure attainment of objectives according to plans."

Nature & Purpose of Control

- Control is an essential function of management
- Control is an ongoing process
- Control is forward – working because past cannot be controlled
- Control involves measurement
- The essence of control is action
- Control is an integrated system

5.1.2 Control Process

The basic control process involves mainly these steps as shown in Figure

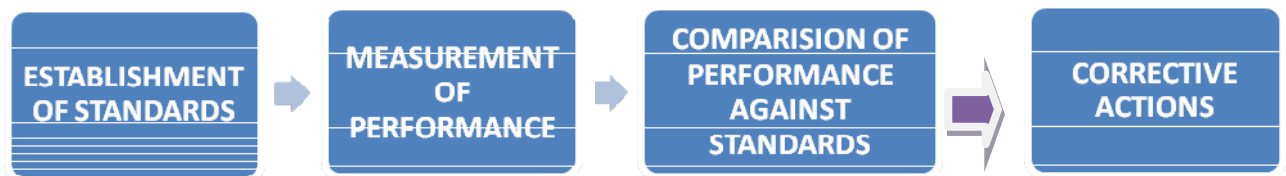


Fig: 1 The basic control process

Source: JAF Stoner, Freeman R.E and Daniel R Gilbert — “Management”

a) The Establishment of Standards:

Because plans are the yardsticks against which controls must be revised, it follows logically that the first step in the control process would be to accomplish plans. Plans can be considered as the criterion or the standards against which we compare the actual performance in order to figure out the

deviations.

Examples for the standards

- Profitability standards: In general, these standards indicate how much the company would like to make as profit over a given time period- that is, its return on investment.
- Market position standards: These standards indicate the share of total sales in a particular market that the company would like to have relative to its competitors.
- Productivity standards: How much that various segments of the organization should produce is the focus of these standards.
- Product leadership standards: These indicate what must be done to attain such a position.
- Employee attitude standards: These standards indicate what types of attitudes the company managers should strive to indicate in the company's employees.
- Social responsibility standards: Such as making contribution to the society.
- Standards reflecting the relative balance between short and long range goals.

a) Measurement of Performance:

The measurement of performance against standards should be on a forward looking basis so that deviations may be detected in advance by appropriate actions. The degree of difficulty in measuring various types of organizational performance, of course, is determined primarily by the activity being measured. For example, it is far more difficult to measure the performance of highway maintenance worker than to measure the performance of a student enrolled in a college level management course.

b) Comparing Measured Performance to Stated Standards:

When managers have taken a measure of organizational performance, their next step in controlling is to compare this measure against some standard. A standard is the level of activity established to serve as a model for evaluating organizational performance. The performance evaluated can be for the organization as a whole or for some individuals working within the organization. In essence, standards are the yardsticks that determine whether organizational performance is adequate or inadequate.

c) Taking Corrective Actions:

After actual performance has been measured compared with established performance standards, the next step in the controlling process is to take corrective action, if necessary. Corrective action is managerial activity aimed at bringing organizational performance up to the level of performance standards. In other words, corrective action focuses on correcting organizational mistakes that hinder organizational performance. Before taking any corrective action, however, managers should make sure that the standards they are using were properly established and that their measurements of organizational performance are valid and reliable.

At first glance, it seems a fairly simple proposition that managers should take corrective action to eliminate problems - the factors within an organization that are barriers to organizational goal attainment. In practice, however, it is often difficult to pinpoint the problem causing some undesirable organizational effect.

d) Barriers For Controlling

There are many barriers, among the most important of them:

- Control activities can create an undesirable overemphasis on short-term production as opposed to long-term production.
- Control activities can increase employees' frustration with their jobs and thereby reduce morale. This reaction tends to occur primarily where

management exerts too much control.

- Control activities can encourage the falsification of reports.
- Control activities can cause the perspectives of organization members to be too narrow for the good of the organization.
- Control activities can be perceived as the goals of the control process rather than the means by which corrective action is taken.

Requirements For Effective Control

The requirements for effective control are

a) Control should be tailored to plans and positions

This means that, all control techniques and systems should reflect the plans they are designed to follow. This is because every plan and every kind and phase of an operation has its unique characteristics.

b) Control must be tailored to individual managers and their responsibilities

This means that controls must be tailored to the personality of individual managers. This is because control systems and information are intended to help individual managers carry out their function of control. If they are not of a type that a manager can or will understand, they will not be useful.

c) Control should point up exceptions as critical points

This is because by concentration on exceptions from planned performance, controls based on the time honored exception principle allow managers to detect those places where their attention is required and should be given. However, it is not enough to look at exceptions, because some deviations from standards have little meaning and others have a great deal of significance.

d) Control should be objective

This is because when controls are subjective, a manager's personality may influence judgments of performance inaccuracy. Objective standards can be quantitative such as costs or man hours per unit or date of job completion. They can also be qualitative in the case of training programs that have specific

characteristics or are designed to accomplish a specific kind of upgrading of the quality of personnel.

e) Control should be flexible

This means that controls should remain workable in the case of changed plans, unforeseen circumstances, or oversight failures. Much flexibility in control can be provided by having alternative plans for various probable situations.

f) Control should be economical

This means that control must worth their cost. Although this requirement is simple, its practice is often complex. This is because a manager may find it difficult to know what a particular system is worth, or to know what it costs.

g) Control should lead to corrective actions

This is because a control system will be of little benefit if it does not lead to corrective action, control is justified only if the indicated or experienced deviations from plans are corrected through appropriate planning, organizing, directing, and leading.

Types Of Control Systems

The control systems can be classified into three types namely feed forward, concurrent and feedback control systems.

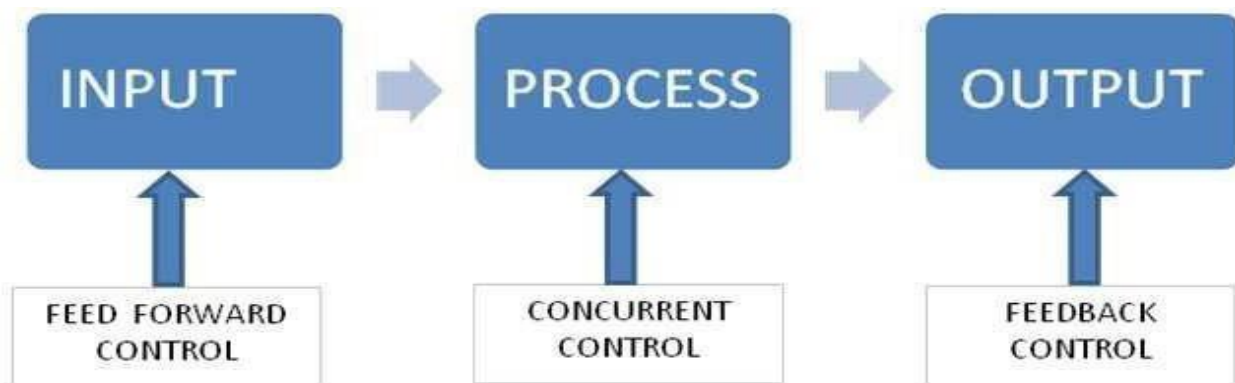


Fig 2: Types of Control Systems

Source: JAF Stoner, Freeman R.E and Daniel R Gilbert — “Management”

a) **Feed forward controls:** They are preventive controls that try to anticipate

problems and take corrective action before they occur. Example – a team leader checks the quality, completeness and reliability of their tools prior to going to the site.

- b) Concurrent controls:** They (sometimes called screening controls) occur while an activity is taking place. Example – the team leader checks the quality or performance of his members while performing.
- c) Feedback controls:** They measure activities that have already been completed. Thus corrections can take place after performance is over. Example – feedback from facilities engineers regarding the completed job.

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