

Fixed Budget:

This budget is drawn for one level of activity and one set of conditions. It has been defined as a budget which is designed to remain unchanged irrespective of the volume of output or turnover attained. It is rigid budget and is drawn on the assumption that there will be no change in the budgeted level of activity. It does not take into consideration any change in expenditure arising out of changes in the level of activity.

Thus, it does not provide for changes in expenditure arising out of change in the anticipated conditions and activity. A fixed budget will, therefore, be useful only when the actual level of activity corresponds to the budgeted level of activity.

It is hardly of any use as a mechanism of budgetary control because it does not make any distinction between fixed, variable and semi-variable costs and provides for no adjustment in the budgeted figures as a result of change in cost due to change in level of activity. It does not provide a meaningful basis for comparison and control. It is also not helpful at all in the fixation of price and submission offenders.

Flexible Budget:

The Chartered Institute of Management Accountants, England, defines a flexible budget as a budget which, by recognising the difference in behaviour between fixed and variable costs in relation to fluctuations in output, turnover, or other variable factors such as number of employees, is designed to change appropriately with such fluctuations. Thus, a flexible budget gives different budgeted costs for different levels of activity.

A flexible budget is prepared after making an intelligent classification of all expenses between fixed, semi-variable and variable.

Such a budget is prescribed in the following cases:

- (i) Where the level of activity during the year varies from period to period, either due to the seasonal nature of the industry or to variation in demand.
- (ii) Where the business is a new one and it is difficult to foresee the demand.
- (iii) Where the undertaking is suffering from shortage of a factor of production such as materials, labour, plant capacity etc. The level of activity depends upon the availability of such a factor of production.
- (iv) Where the business units keep on introducing new products or make changes in the design of its products frequently.
- (v) Where the industries are engaged in make to order business like ship-building.

Distinction between Fixed Budget and Flexible Budget:

Following are the main differences between these budgets:

<i>Point of Distinction</i>	<i>Fixed Budget</i>	<i>Flexible Budget</i>
1. Flexibility	It is inflexible and does not change with the actual volume of output achieved.	It is flexible and can be suitably recasted quickly according to the level of activity attained.
2. Condition	It assumes that conditions would remain static.	It is designed to change according to changed conditions.
3. Classification of costs	Costs are not classified according to their variability <i>i.e.</i> fixed, variable and semi- variable	Costs are classified according to the nature of their variability.
4. Comparison	Comparison of actual and budgeted performance cannot be done correctly if the volume of output differs.	Comparisons are realistic as the changed plan figures are placed against actual ones.
5. Forecasting	It is difficult to forecast accurately the results in it.	It clearly shows the impact of various expenses on the operational aspect of the business.
6. Budget	Only one budget at a fixed level of activity is prepared due to an unrealistic expectation on the part of the management <i>i.e.</i> , all conditions will remain unaltered.	Under it, series of budgets are prepared at different levels of activity.
7. Ascertainment of costs	It is not possible to ascertain costs correctly if there is a change in circumstances.	Costs can be easily ascertained at different levels of activity under this type of budget.
8. Tool for cost control	It has a limited application and is ineffective as a tool for cost control.	It has more applications and can be used as a tool for effective cost control
9. Fixation of prices & submission of tenders.	If the budgeted and actual activity levels vary, the correct ascertainment of costs and fixation of prices becomes difficult.	It helps in fixation of price and submission of tenders due to correct ascertainment of costs.

Utility (or Importance) of Flexible Budget:

1. With flexible budget, it is possible to establish budgeted cost for any range of activity.
2. A flexible budget is very useful for purposes of budgetary control because it corresponds with changes in the level of activity.
3. It is helpful in assessing the performance of departmental heads because their performance can be judged in relation to the level of activity attained by the organisation.
4. Cost ascertainment at different levels of activity is possible because a flexible budget is prepared for various levels of activity.
5. It is helpful in price fixation and sending quotations.

To conclude, a flexible budget is more useful, elastic and practical.

Illustration 1:

The expenses budget for production of 10,000 units in a factory are furnished below:

	<i>Per unit</i> Rs.
Materials	70
Labour	25
Variable Factory Overheads	20
Fixed Factory Overheads (Rs. 1,00,000)	10
Variable Expenses (Direct)	5
Selling Expenses (10% fixed)	13
Distribution Expenses (20% fixed)	7
Administrative Expenses (Fixed – Rs. 50,000)	5
Total cost of sales per unit	155

You are required to prepare a budget for the production of 6000 units and 8,000 units.

SOLUTION

FLEXIBLE BUDGET

<i>Particulars</i>	<i>Output 6,000 units</i>		<i>Output 8,000 units</i>	
	<i>Per Unit</i> Rs.	<i>Amount</i> Rs.	<i>Per Unit</i> Rs.	<i>Amount</i> Rs.
Variable or Production Expenses :				
Material	70.00	4,20,000	70.00	5,60,000
Labour	25.00	1,50,000	25.00	2,00,000
Direct Variable Expenses	5.00	30,000	5.00	40,000
Prime Cost	100.00	6,00,000	100.00	8,00,000
Factory Overheads :				
Variable Overheads	20.00	1,20,000	20.00	1,60,000
Fixed Overheads	16.67	1,00,000	12.50	1,00,000
Works Cost	136.67	8,20,000	132.50	10,60,000
Administrative Expenses Fixed	8.33	50,000	6.25	50,000
Cost of Production	145.00	8,70,000	138.75	11,10,000
Selling Expenses :				
Fixed 10% of Rs. 13	2.17	13,000	1.63	13,000
Variable—90% of Rs. 13	11.70	70,200	11.70	93,600
Distribution Expenses :				
Fixed 20% of Rs. 7	2.33	14,000	1.75	14,000
Variable—80% of Rs. 7	5.60	33,600	5.60	44,800
Total Cost of Sales	166.80	10,00,800	159.43	12,75,400