**TRAINING IN FINANCIAL AND BUSINESS MANAGEMENT FOR ROAD CONTRACTORS**

**MODULE THREE SESSION THREE PARTICIPANTS’ NOTES**

**BUDGET CONTROL AND MANAGEMENT**

1. **SESSION OBJECTIVES**

The session objectives are to enable trainees to use the budget as a control tool. By the end of the session, trainees will be able to compare budgeted to actual performance and derive and interpret cost variances. In particular, the intentions of the objectives are:

* To explain the connection between contract implementation and compliance with budgeted provisions as a means of ensuring profitability and sustainability and
* Interpretation of variances and their implications.

1. **What is budget control?**

A budget is a tool to ensure both financial discipline and achievement of goals within expected costs. Budget control constitutes activities and processes that the company undertakes internally to ensure that implementation corresponds to plans, objectives, outputs, timing, outcomes, costs and ensuring that the profit motive is not undermined. Management must continually identify deviations in all respects and make corrective decisions in a timely manner. Why did the deviation occur? Who is responsible? Is it controllable? Did the price change? Were materials wasted? This continual monitoring is meant to assess trends and make decisions to correct the situation. Management reports are meant to serve this purpose among others.

1. **Variance Analysis**

A variance is any unplanned change from the budgeted figure. Budget variance refers to differences between budgeted amounts and actual amounts, both revenues and expenditures. Any such variation must be quickly identified and explained and relevant action taken. Variance analysis refers tothe studying of the variances into its component parts and the explanation of variances. Variance analysis is a part of the process of control and involves the calculation of variance and the interpretation of results so as to isolate and focus on the different factors that are responsible for the variance.

A change in the cost of road construction could for instance be due to rising prices, a case of material wastage, and pilferage of materials or frequent machine break downs.

The magnitude of each variable must be assessed, investigated and acted upon. Variances can be favourable or adverse (unfavourable). Favourable when expenditure is less than what was budgeted, or revenues more than anticipated; Adverse when expenditure is higher than what was budgeted or revenues are lower than what was expected.

1. **Common Causes of Budget Variances:**
2. Unrealistic budgeting , either too ambitious or too conservative
3. Poor logistical planning where machines break down often, or there is idle machinery time or delays in placing orders.
4. Poor time management where projects are not completed on time
5. Contract variations
6. Increased material costs and other direct costs.
7. Increased labour costs due to pay rates or labour efficiency hours worked.
8. Failure to meet works targets

In controlling budget variance, administrators should identify the budget items they can control versus those they can't, explain possible cause of variances, decide on corrective action, e.g. slow down work or revise the budget. Effort should focus on controllable variances for example to follow up electricity price variance would be futile while following up its usage variance could yield results.

1. **Types of variances** 
   1. **Total variances:**

Total variance is the difference between the budgeted figure and the actual figure. If the budget was shs 100m and actual was 90m, the total variance is the difference between shs 100m and 90m. The total variance can further be broken down into volume, usage/efficiency and price/rate variances.

* 1. **Volume variance**

This is the effect of the difference between actual activity and the budgeted activity. If the budget is to do 24 kms of road but actually 20 kms is done, the difference of 4 kms is a volume variance. A volume variance is converted at the budgeted amount. For example the total revenue volume variance is 4kmsx 450m equals shs 1,800m adverse. This is revenue foregone because 4 kms of road was not done.

Such an adverse variance should be investigated to ascertain why the four kilometres were not done. The material volume variance is 4kmsx8,000 tones x 24,000 equals shs 768m favourable.

The net total of volume variances equals the profit foregone by a reduced output or the profit gained due to the incremental output. Volume variance could be caused due to variations in the job, or working at a speed different from what was planned for.

* 1. **Variances of usage/efficiency :**

Usage or efficiency variances results when expected inputs defer from actual inputs. For example the material used to do 20 kms of road compared to the expected materials when valued at the budgeted price. The variance is computed by deducting actual quantities used from planned quantities to be used, reference may be made to bills of quantities in the validated bid. The difference in quantity is multiplied by the budgeted price i.e. (planned quantity – actual quantity) x budgeted unit cost. If actual quantity used exceeds the planned, the variance is adverse and vice versa.

Where the items refer to time such as labour or machines, the variance is an efficiency variance. Where less time is used, the favourable difference means efficiency and where more time is used it means inefficiency.

* 1. **Variances of price or rates:**

These refer to variances due to difference between actual price and budgeted prices. When talking about labour and machine hire, the variances are referred to as labour or machine rates. Where prices or rates are lower, the variances are favourable and where the prices or rates are higher the variance are adverse.

The sum of all variances total up to the total variance, that is total material cost variance equals the sum of material volume variance, material usage and material price variances.

1. **Expenditure control report**

Record expenses as they occur preferably in a budget control book, this book will be arranged to show amounts budgeted for each item. Record each spending against the budget line in the budget book. Continually obtain budget balance after each spending. At the end of an appointed period management should examine this record and note the variance so that appropriate action is taken.

The format of record may appear as below:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | Total budgeted | Budget for 6 kms | Actual | Variance | Comments |
| Gravel | 240,000 | 120,000 | 150,000 | (30,000) | Adverse, why? |
| Tools | 120,000 | 60,000 | 50,000 | 10,000 | Favourable - why? Is this good? |

1. **Group activity**
2. Using the budget developed from the previous session and the actual performance provided, find out the causes of cost variances and suggest persons responsible.
3. Develop a simple control budget for Munaku
4. Use the control budget to propose a budget for 5kms of road done.