

Unit 3 budgeting techniques. Module name - Incremental budgeting- concept, significance and limitations. Outline- Concept of incremental budgeting. Significance of incremental budgeting. Limitations of incremental budgeting and conclusion.

Learning outcomes - students will be able to understand the concept of incremental budgeting. Explain the significance of incremental budgeting. Examine the limitations of incremental budgeting.

First, let's see the concept of incremental budgeting.

Incremental budgeting is a type of budgeting technique which is based on the idea that a new budget can be developed by making only some marginal changes to the current budget. In other words, with incremental budgeting, the current budget is used as a base to which incremental assumptions are added or subtracted from the base amounts to determine new budget amounts. An increment budget is a budget which is prepared by using a previous year's budget or actual performance as a basis with incremental amounts added for the new budget period. The resources or funds which are allocated in the new budgets are based on the allocation of funds from the previous year's budget. It is based on the premise of making a small change to the existing budget or previous budget to arrive at new budget. Only additional amounts are added to arrive at the new budget. Thus, it is a way of budgeting where future allocations are based on the current allocations.

Now let's see the significance or importance of incremental budgeting.

1. Easy and Simple

Incremental budgeting is the easiest budgeting technique. Since it uses the budget for the current period to project the future budget, it does not require complex calculations. An increment budget is easy to understand, simple to calculate and easy to implement since allocation of funds in the new budget period is based on the previous year's budget allocations.

2. Consistent and Stable

The dependence on the figures from the previous year's budgets ensures that the budgets remain fairly consistent and relatively stable over time. The incremental budget is stable and the change is gradual. The new budget which is prepared under incremental budgeting is stable and a small change is made in the previous year's budget to arrive at the new budget.

3. Coordination between the budgets is possible

The coordination between the budgets is easier to achieve when the new budget is prepared based on previous year's budget. Thus, there is a coordination between the two budgets.

4. Funding stability

Incremental budgeting may also help in ensuring that funding remains stable over time, as expenses are relatively easy to project. It ensures continuity of funds for the various departments without much detailed analysis of funds requirements.

Now let's see the disadvantages or limitations of incremental budgeting.

1. Assumes activities will continue in the same manner

Incremental budget assumes that the activities and the methods of working will continue in the same manner as in the previous year's budget which is not possible in reality.

2. Promotes unnecessary spending

Incremental budgeting can result in unnecessary spending for the government. The reason behind this is that the government departments generally tend to spend all the money that they've been allocated in a budget one year in order to obtain a greater amount of money in the next budgeting period. Incremental budgeting takes the position of increasing each part of the budget by a certain amount each year. There is no incentive to reduce the cost but it only adds to the cost to arrive at the new budget.

3. Discourages innovation

This type of budgeting may discourage the production of innovative ideas and growth. Since new budgets are based on figures from previous budgets, there is a little room for the financing of completely new ideas or activities. Thus, the budgeting process discourages the implementation of new ideas and fosters a conservative approach. There is no incentive for developing new ideas in the new budget since allocations are based on the last year's budget.

4. Priority for funding may have changed

For example, in the previous year's budget priority for funding was given for agricultural sector but according to the incremental budget the importance may be given to the agriculture sector instead of industrial or service sector in the new budget.

Conclusion

To sum up, we can say that incremental budgeting though very easy to compute and implement, it also has larger limitations.

These are the references which I have used for this module. Thank you.