

Managing the Devolved Budget

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Second
Edition

essential skills
for the public sector

Managing the **Devolved** **Budget**

Second Edition

Essential skills for
The public sector

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Chapter 1

Introduction

The control of public finances is always a key issue for scrutiny by Government. With increasing pressure on resources and increasing demand for public services, good financial management is essential. In response, the public sector has had to take a positive approach to implementing successful systems for financial management and control. Devolving budgets to individuals, making them responsible and accountable, has become a commonly adopted method for achieving the effective control of financial resources, and obtaining value for money. This is often a new area of activity and requires them to have a certain level of financial skill.

Managing the Devolved Budget has been developed to meet the needs of those working in public sector environments such as central government; local and regional authorities; health authorities; police authorities; educational institutions, and so on. The text is particularly relevant as many public sector employees have now been given some form of budgetary responsibility.

The publication has been designed to be used for reference and act as an important part of a managers own personal development. At the conclusion of each chapter is a series of

exercises which encourage the reader to focus on the key issues covered. Suggested solutions to the exercises are provided in the final section.

Managing The Devolved Budget is presented in a simple format which is easy to read and makes practical sense. It will give those who have any form of budgetary responsibility an understanding of the process behind budget setting and control, and will provide tools with which they can undertake these tasks with greater awareness and confidence.

It is recognised that many budget holders work within constraints. This may be with respect to policies, limited resources, limited support, and restricted access to financial experts. Although circumstances may not be perfect, ideas are given within the text which will enable the most common constraints to be taken into account whilst allowing the budget holder to achieve the objective of controlling a budget.

The task of financial management and control is now relevant to many job descriptions in the public sector. For those who may wish to pursue a career within public service, this book will highlight the type of knowledge and skill now required to be fully prepared for acquiring budgetary responsibilities.

This book is one of a series of “Essential Skills for the Public Sector” titles. The series aims to assist public sector managers become more efficient and effective in carrying out their important management responsibilities. We consider this book to be an important part of the tool kit for public sector management development.

Chapter 3

Setting the Budget

What is a Budget?

A budget can be defined in a number of different ways. Popular definitions talk about an amount of money that can be spent on a particular item, or a projection of next year's income and expenditure. The definition that will be used in this text is “**a financial plan**”. This definition is important because it emphasises the need to link finance to planned activity; the financial plan has to be part of an overall plan.

The ideal way to prepare a budget is to initially begin with the organisation's objectives by asking, “what is the organisation trying to achieve?” This principle is relevant for organisations in all sectors. A clear direction is a key factor to successful budget setting. Understanding exactly what the organisation is trying to achieve, allows the various departments and sections to establish their own objectives which are consistent with the overarching organisational goals.

Business Plans

Many organisations produce business or service plans on a regular basis. These set out organisational objectives and how they are to be achieved. A business plan should always be

supported by a financial plan which sets out how finance will be generated and utilised over the period of the plan. The business plan is becoming an increasingly important tool as public sector organisations take a more "business like" approach to service delivery. The process of developing a business plan is not covered in this book, but is an ideal tool to be used as part of the budget setting process.

Budget Setting Cycle

Most publicly funded organisations are expected to prepare an annual budget to justify their funding. In many cases the approved budget is then made public to ensure transparency. It is usual for the annual budget to be prepared by a particular time each year. This may be to meet the requirements of Committees, Boards, Trustees, Funders, Grant Givers, Government, etc. In order to achieve this, many organisations establish a regular cycle of activities as part of the process of creating the budget. This is often referred to as a "budget setting cycle" which may be formally published. This should then be distributed to all those contributing to the process, to follow each year. It is important for managers responsible for any part of the budgeting process to be familiar with the budget setting cycle. The cycle can be driven by either a top down or bottom up approach, or a mixture of the two. Both of these approaches are explained as follows:

Top Down Approach

The top down approach to the cycle is where the organisation's main decision making body

establishes the broad budget parameters, e.g. councillors in a local authority, school governors in a school, the trust board in a NHS trust, the management committee in a voluntary organisation. These parameters will include:

- * *expenditure targets which may involve savings and cuts*
- * *income strategies such as the level of charges, tax rates, grants*
- * *use of reserves, whether to build or utilise them*
- * *key priorities for services*

Having made these decisions, departments are then set cash limited budgets within which to develop their budget proposals.

Bottom Up Approach

The bottom up approach starts with the service areas or divisions setting out their plans for the year and the amount of resources needed to achieve those plans. Within public and voluntary services this is usually a “net expenditure” position which will have to be funded with some type of budget allocation. (*i.e., many public sector services do not generate any income, and those that do may not generate sufficient to cover the service costs*). This information is fed up the decision making ladder and consolidated at departmental level. At this stage, decisions on priorities have to

be made to ensure the departmental budget is realistic. Changes to budgets are referred back to those who originally set the budget to make the necessary adjustments - quite often savings.

This process is continued until the department achieves a budget that reflects the divisional plans and agreement is reached over the level of financial resources required to deliver front line services. The departments will then consolidate their budgets to produce an overall organisational budget. The funding of the budget then needs to be identified and decisions made as to whether or not to raise income by charge increases, borrowing, tax increases, use of reserves, higher demands for grant income and so on. In the bottom up approach these decisions are driven by the service needs as identified at the bottom of the organisation and not the priorities set at the top.

Important aspects of the budget setting cycle include:

- *The business plan, or at least organisational objectives*
- *Fixed and variable assumptions on inflation rates, pay rates, contract terms, etc.*
- *Detailed service action plans produced, (ideally costed)*
- *Check and challenge process, where plans are scrutinised, prioritised, and if necessary changed*
- *Overall budget requirement calculated*
- *Budget availability confirmed, often subject to income targets be they from grants, taxes, rents, etc.*
- *Budget agreed and allocations given*
- *Budget sometimes formally published*

- *Timescales set for all of the above and communicated to relevant staff*

The length of the cycle tends to vary depending on the size, structure, and the levels of decision making that exist within the organisation. For example, the budget setting cycle of some local authorities stretches across the whole year, whereas in a small voluntary organisation the cycle may be complete within a few weeks.

Key Elements of a Budget

Most public sector services will have a number of budget headings relating to categories of income and expenditure. The headings will be referred to using a variety of terms such as budget heads, cost codes, etc. Even though there may be a range of expenditure and income headings, they are usually grouped together into core areas. These core areas include:

- Employee Costs*** ⇒ Including salaries, on-costs (such as national insurance and pensions), overtime, agency fees, etc.
- Accommodation costs*** ⇒ Including rents, rates, repairs, heat, light, etc.
- Transportation Costs*** ⇒ Including travelling expenses, vehicle maintenance, etc.

Supplies and Services ⇒ Includes all direct revenue expenditure budgets required to operate the service, such as materials, professional fees, contractors fees, postage, stationery and so on.

Support Service Costs ⇒ Includes service department costs such as finance, legal, personnel, IT, etc.

Income ⇒ Charges, fees, grants, etc.

Budget Setting Techniques

There are a number of budget setting techniques that can be applied to both expenditure and income budgets. They can be used independently, or combined depending on the type of budget being set. The key techniques to be discussed are as follows:

- ***Incremental Budgeting***
- ***Zero Based Budgeting***
- ***Cash Limited Budgeting***
- ***Resource Restricted Budgeting***
- ***Activity Based Budgeting***
- ***Contingency Budgeting***

Incremental Budgeting

This technique relies on using an historic base as a starting point for budget setting. This is often the budget or the actual figures for the previous year, or some combination of the two. The base is then used to formulate the budget for the following year by taking each budget heading and either adding or subtracting an inflation factor from the base figures and adjusting for other known factors such as savings or approved growth.

An example of the incremental approach is shown as follows:

It is September and a nursery school is to develop a budget for next year. Its financial year runs from 1 April to 31 March. They have agreed the pay award at 4% for the following year with effect from 1 July of that year, and inflation is to be 3% for all other non-pay items.

Budget Heading	Previous Year Budget Figures	Incremental Adjustments	Budget for next year
	£	£	£
Salaries	200,000	*6,000	206,000
Food	40,000	1,200	41,200
Supplies and Services	40,000	1,200	41,200
TOTAL	<u>280,000</u>	<u>8,400</u>	<u>288,400</u>

Note: *Pay award for only 9 months of year, as only effective from 1 July.

The advantages and dis-advantages of this type of budgeting technique can be summarised as follows:

Advantages

- Simple
- Quick
- Accurate, if little change in activity

Dis-Advantages

- Historic
- No account taken of necessary future changes
- Assumes the base is accurate
- Compounds historic errors

Incremental budgeting is best used for certain items of expenditure which are unlikely to change from year to year. For example, when staffing remains constant, salaries can be budgeted for incrementally where the increment reflects the pay award, or in the case of fixed price contracts there may be an agreed annual inflation rate.

Zero Based Budgeting

This approach to budget setting is most strongly recommended as it is linked to the business planning process. The zero based budget assumes that all budgets are derived from first principles and that the organisation can start with a blank piece of paper; a zero base. They are based on the objectives to be achieved for the period without necessarily referring to the past. The key steps to be taken when using this technique are summarised as follows:

Exercise 3

Developing a Budget from First Principles

Take one of the following areas:

- ~A leisure centre
- ~A secondary school
- ~A meals on wheels service
- ~A residential nursing home
- ~A contracts management unit
- ~An advice centre
- ~A personnel department
- ~A quality assurance division
- ~A hospital
- ~A fire brigade

- a) For the area selected what are the first steps that you would take to prepare a zero based budget?

List Action Points Below:



- b) In order to construct the budget, what would be the key income/expenditure items for the activity and how would you obtain the information in order to budget for them accurately?

List Key Income/Expenditure
Areas

What Information would you need
and where from?



- c) Taking the complete list of services shown on the previous page, rank the activities in terms of their ease of budget setting in the order of 1 to 10, where 1 is the easiest.

Suggested solutions to this exercise can be found on page 132

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