

## Briefing Paper

# Budgetary Control and Monitoring

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### Introduction

This briefing paper considers how budgets are controlled and monitored. It considers budgets and business planning, management accounts, capital programmes, financial regulations, standing orders and virement.

### How to Monitor and Control Budgets

Behavioural aspects are important. Budgeting is not a purely technical process. Too often budgetary control and monitoring becomes overly focused on the production of the information with too little time (resources) given to understanding, solving and acting on the problems revealed.

Academic theory would consider such concepts as goal congruence, the idea that the goals of individuals and groups should coincide with the goals and objectives of the organisation as a whole. This may be easier in the private sector with objectives such as market share, profits or share value to aim for. The public sector can be more complicated. Service priorities really do diverge in some ways from the finance department.

Goal definition is helpful, people like clearly defined targets, particularly agreed and accepted targets. Of course when a target is set, then areas where targets are not set may suffer. Some areas lend themselves more to target setting than others, for example, NHS Waiting List times. Other areas whose outputs are harder to quantify may require more creative effort, for example, with medical procedures, quality adjusted life years seek to measure the quantity and quality of outcomes.

Communication to give feedback on performance must be timely and accurate to encourage success of the budget. Budget monitoring in particular has to be timely. There may well be trade-offs between accuracy and timeliness. Materiality is a useful accounting concept here.

The International Accounting Standards Board defines materiality in the following terms:-

*"Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."*

In other words budgetary control information does not have to be perfect to be useful.

Problems that may arise within budgetary control include:

- Variances may be due to changing circumstances
- Budgets are developed around existing organisational structures which may not be appropriate
- Budgets may lead to inertia, so that a lack of flexibility will result in poor adaptation to changes in the environment
- Poorly organised budgets may lead to antagonism within the organisation.

Variances and changing circumstances threaten most budgets. The organisation may have limited capacity to respond. Sometimes creativity can help.

There may be good organisational reasons for budgeting around existing structures. When and how to change these requires care.

New methods of service provision may be cheaper, or not. For example Waste Collection and Recycling, changing service provision may be more expensive in the short term, but cheaper in the long. Deciding when and how far to change are difficult issues.

Controllability as mentioned before is not a black and white matter. A manager may be deemed responsible for a budget without having complete control. This may be seen as flouting basic principles but it is sometimes occurs.

## **Budgets and Business Planning**

Business Planning is about where the organisation wants to go.

A business plan is a formal statement of a set of goals, the reasons why they are believed attainable, and the plan for reaching those goals. It may also contain background information about the organisation or team attempting to reach those goals.

The goals being attempted may be for-profit or non-profit. For-profit business plans typically focus on financial goals. Non-profit and government business plans tend to focus on service goals. Business plans may also target changes in perception by the customer, client, tax-payer, or larger community.

Business plans may be internally or externally focused. Externally focused plans target goals that are important to external stakeholders, particularly financial stakeholders, for example, Banks or Building Societies. The business plans of housing associations are an example of this. They typically have detailed information about the organisation attempting to reach the goals. External stake-holders of non-profits include donors and the clients of the non-profit's services. For government agencies, external stakeholders include taxpayers, central government agencies. An example would be to secure finance, as with a Large Scale Voluntary Transfer (LSVT), where to obtain long-term finance a business plan with a 30 year (typically) time-frame will be prepared.

Internally focused business plans target intermediate goals required to reach the external goals. They may cover the development of a new service, a new IT system, a restructuring of finance, or a restructuring of the organisation. An internal business plan is often developed in conjunction with a balanced scorecard or a list of critical success factors. This allows the success of the plan to be measured using non-financial measures. Business plans that identify and target internal goals, but provide only general guidance on how they will be met are sometimes called strategic plans.

Operational plans describe the goals of an internal organisation, working group or department. Project plans, sometimes known as project frameworks, describe the goals of a particular project. They may also address the project's place within the organisation's larger strategic goals. For example, perhaps called Service Planning, sometimes focused on quick wins and short term objectives, sometimes focused on the Medium Term (3-5 years).

Business Plans may well use information from Budgets, but their focus tends to be longer than the annual budget. They may be agreed with a Medium Term Financial Plan but they are often constructed for different purposes. As mentioned a Local Authority's budget is partly for tax-setting purposes and to demonstrate that the resources exist.

For example, a Housing Revenue Account Business Plan is usually based on the first year's budgets that are then extrapolated forward for thirty years based on a series of assumptions about future trends in variables including housing subsidy determinations, inflation and interest rates.

Goals in Business Plans will be financial but also non-financial.

### **Management Accounts**

Management accounts are those used internally by the organisation. They usually share the same financial system as the Financial Accounts and where this is not the case there is a need to make regular reconciliations between the two. Financial Accounts are produced in accordance with statute. For a Local Authority, the Chartered Institute of Public Finance and Accountancy's Code of Practice on Local Authority Accounting constitutes a statement of recommended practice in accounting (SORP) and constitutes a proper accounting practice under the terms of Section 21(2) of the Local Government Act 2003. A Housing Association operates under the Companies Acts and perhaps under the Industrial and Provident Societies Act 1965.

Objective and subjective analysis, profiling and budgetary control come together in the management accounts. They may take the form of the example below:-

Objective Heading	Annual Budget	Profiled Budget	Actual to date	Variance	Year end Projection	Variance
Employees						
Premises						
Transport						
Supplies & Services						
Third Party Payments						
Transfer Payments						
Support Services						
Capital Charges						
Gross Expenditure						
Customer & Client receipts						
Other grants & reimbursements & contributions						
Recharges						
Specific & Special Government Grants						
Income						
Net Expenditure						

One way to interpret such a format is to fasten upon significant variances. Check that they are absolutely and proportionately significant to the annual budget / actual to date. From there interrogate the detail, into cost centres, subjectives and individual transactions. Good accounting systems will facilitate such drilling down.

### Capital Programmes

The Public sector takes the distinction between capital and revenue quite seriously. FRS15 was issued in February 1999 and, with a minor exception, is the standard to be followed by public authorities as well as the private sector. The standard sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets, with the exception of investment properties.

In overly simple terms Capital concerns longer lived assets, longer than a year, where the value of the asset is significant. Many organisations have a de minimis level for capital, for example of £5,000. In Local Authorities the definition of revenue is easy, it's everything that is not capital!

The detailed capital programme (or budget), which is likely to cover a number of years, should be produced in line with the capital strategy and adhere to the Chartered Institute of Public Finance and Accountancy's Prudential Code.

The development of the programme must be a joint effort between officers from the finance department, technical departments, and service departments. In Local Authorities, Capital programmes are usually submitted for final approval by members in January/February prior to the authority's council tax or precept being set.

Capital Programmes include schemes that have already been approved but where spending is expected to continue into the following financial years, and new schemes where spending will not commence until the following financial years. Member approval is usually only required for the new schemes; the schemes in progress are usually included in the programme to provide an indication of the overall level of capital spending in future years.

The initial stage in preparing a capital programme is the identification of schemes. In line with the organisation's capital strategy these should largely be identified as a result of a perceived need to meet organisational and service objectives. However, many potential schemes are identified by members or officers as part of the regular process of operating services. This approach to scheme identification is largely reactive, and there is clearly a substantial element of subjective judgement in the process. Schemes identified in this way should still be compared to corporate and service objectives.

In Local Government, the overarching planning document in relation to the capital programme is the capital strategy. All local authorities have been required to produce a capital strategy since 2001. The capital strategy is intended to enhance the effective use of scarce capital resources.

The capital strategy addresses the management and monitoring of the council's capital programme, developing cross-cutting activity and how the authority procures its capital. This last point will include the council's attitude to public/private partnerships and partnership work in general. Asset management planning is also undertaken to improve asset use.

Potential schemes will be subject to prioritisation within the service in consultation with members. There is no definitive system for prioritising between capital schemes. It is possible to develop some methodology for scoring proposed projects against set criteria; alternatively the prioritisation process could assign projects to different class of schemes, for example, essential, priority or desirable.

The Programme period depends on the policy objectives adopted by an authority for the development of its services, and the expected time taken to complete the schemes that follow from those objectives.

The contents of a programme encompass all of the information generated on each scheme during the selection process. Typically the following data would be held on each scheme: title; description ; priority rating ; actual capital expenditure up to the end of the last financial year, revised estimates of capital expenditure for the current year and future years, and a revised estimate of the total capital cost. But it could be more detailed.

The programme will include summaries of total capital costs for the current and following financial year on all schemes, compared with the overall resources available to finance capital expenditure in each of those years.

Capital programmes must be approved by the full council after being considered by the cabinet and members responsible for specific services.

Monitoring and Control of Capital Programmes - the major area of uncertainty in the monitoring of capital programmes is slippage, although cost increases can also need to be monitored closely. It is good practice for regular monitoring statements for the authority to be produced. These should be reported to the management board and members as required.

Financing of Capital programmes in local authorities - all capital expenditure incurred in a year must be financed by borrowing, capital receipts, grants or contributions, or revenue contributions.

## **Financial Regulations and Standing Orders**

Financial Regulations are a written code of procedures approved by the authority, intended to provide a framework for proper financial management. Financial regulations usually set out rules on accounting, audit, administrative procedures and budgeting systems.

Financial regulations should contain rules on how budgetary control is to be exercised. The scope and level of detail written into financial regulations is a matter for each organisation to decide. Different parts of the organisation may be subject to different regulations depending upon the nature of the organisation.

For instance in a local authority, trading services and schools with delegated budgets may well be governed by separate financial regulations approved by the authority, as greater flexibility and independence may be required and expected.

In some organisations it is the practice to support financial regulations with a revenue budget monitoring 'code of practice' setting out the role of the parties involved in the process. In a local authority relevant parties would include the Chief Financial Officer, finance department staff, directors and relevant staff within the service and elected members.

The key areas in budgetary control include the procedures and responsibilities in preparing revenue and capital budgets; the delegation of power to spend money to officers; the procedures for virement, supplementary budgets and carry forward of over/under spends. The latter in particular, not being a feature of most of the Local Authority's budgets, is the source of the "spend it or lose it" behaviour not uncommon in the Public Sector.

Because of the need for an unambiguous set of rules, financial regulations have tended to be written in legalistic language which does not assist comprehension. Recently, however, there has been a welcome tendency in some organisations to develop 'plain English' standing orders and financial regulations.

However, very detailed controls can have the opposite effect than that intended because the regulations become so onerous that in time they tend to be ignored. The aim should therefore be to strike a balance between the two extremes which will enable the officers to exercise adequate budgetary control whilst at the same time allowing them appropriate flexibility.

Standing Orders are the set of rules adopted by the authority which establish the procedures by which it should conduct its business; in particular, there must be standing orders relating to tendering and contract procedures under which there will be standing orders and financial regulations to govern financial administration, for example, authorisation of payments, income collection and accounting and audit. They also often refer to the conduct of the Council, the powers of Executive and Committees. Though this may be covered elsewhere, for example, Schemes of Delegation.

Standing orders are also partly shaped by statute in public authorities. For example, the Local Authorities (Standing Orders) Regulations 1993 (No. 202) as amended for England and Wales.

## **Virement**

Virement can be defined as the transfer of resources from one budget head to finance additional spending on another budget head in accordance with financial regulations.

The process changes the approved budget and is thus usually subject to control by management and Members. Typically this involves internal rules such as allowing managers to transfer up to £5,000 between budget heads and up to £20,000 requiring the further approval of Directors, and beyond that the approval of Members.

Virement allows managers to control their budgets, to shift resources as they monitor, control and adjust their budgets. There are often rules pertaining to the creation of long term commitments. Thus a supplies and services budget cannot be vired into a budget for Employees. The reason being that a one-off saving that is used to create a “permanent” budget requirement is not what virement is designed for.

Fresh commitments that arise outside the annual budget process may in some organisations have been dealt with by supplementary budget estimates approved by Members. Although this approach is not common, and there is often an expectation that managers will manage their budgets without further resources.

When a virement is approved it will be reflected on the financial information system, the general or nominal ledger, so that subsequent budgetary control reports show the subtraction from the source of virement and the addition to the target of the virement.

## **Conclusions**

Budgetary Control and Monitoring are achieved through linking budgets to business plans, preparing management accounts, having effective financial regulations and standing orders and allowing appropriate virement to take place. There are also specific requirements for budgetary control and monitoring in capital programmes.

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