

# MAKING

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# BUDGETS

VALUE FOR MONEY SERVICES

# WORK

WRITTEN BY

# HB PUBLICATIONS

ESSENTIAL SKILLS FOR THE PUBLIC SECTOR



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# Chapter 1

## Introduction

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The control of public finances is always a key issue for scrutiny by Government. With increasing pressure on resources, and the austerity measures that have been implemented, making budgets work is becoming more difficult. There is now little flexibility or room for error, with budgets stretched to the limit. A recent casualty has been Northamptonshire County Council which said it faces “very real risks” in trying to balance its budget. Their auditors believe that the council’s financial plans do not add up and that they could breach the local audit and accountability Act 2014. (BBC News 20th February 2018). Whilst this case has had a great deal of publicity, there are many other publicly funded organisations that may find themselves in a similar position.

This eBook has been written as a taster to some of HB Publications excellent titles in the series “Essential Skills for the Public Sector”. It will hopefully engage readers to see the importance of having a financial awareness along with an understanding of good business principles in ensuring budgets deliver on service objectives. Also, it will emphasise the need for appropriate continuing training and development in this fundamental area. Services cannot be delivered without finance and the link between the two must be made.

It is recognised that many budget holders work within constraints. This may be with respect to policies, procedures, limited resources, limited support, and restricted access to financial experts. Although circumstances may not be perfect, ideas are given in our publications to help budget holders identify actions that can be

taken. Making the budget work for the budget holder is simple to say but not always easy to achieve. Creativity and control are two of the skills budget holders now need to achieve service objectives within budget.

For those working within public service, or the non-profit sector, who wish to obtain senior roles, an understanding of finance and budgetary control is now essential. Financial responsibilities are often devolved, however, when things go wrong it will be senior officers that will be held to account. It is not unusual for those in senior roles to be over-dependent on finance staff who do not have the depth of service knowledge to take control of budgets. Whilst they can prepare the financial reports it is the senior officers that must make the financial decisions. The impact of those decisions will determine how the budget works for staff and service users.

# Chapter 2

## What is a Budget?

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A budget can be defined in several 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 must 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 business units to establish their own objectives within the framework of the overarching organisational goals.

Planning is about forward thinking and taking account of different scenarios which may have an impact on the service. Historic budgets often bear no relation to the future and hence those responsible for budgets must ensure the budget has a relationship with the future plan. The budget should set the framework for service delivery and in itself will be a constraint. This should be a positive if the budget is used to regularly check that everything is on course, as planned. Problems arise when there is no plan and staff are unsure as to how the budget should be used. This can lead to the budget being ignored and hence changes that should be made in order to stay within the budget constraints are not implemented.

A budget should give budget holders confidence to make financial decisions. It is not a subjective figure – it is a known quantity or should be. What may cause some confusion is how the budget was set and therefore the budget figure becomes vague; not linked to anything, and therefore left to subjective interpretations by the budget holder.

It is very difficult to work with a budget which is not linked to budget drivers (underlying assumptions). If you are in a position where this is a case, the first step is to make the budget “real”. Attach the budget to specific items and activities so that you can begin to work with it.

The next chapter will consider budget setting which we consider to be a fundamental key to managing a budget.



# Chapter 3

## Setting the Budget

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Most publicly funded organisations are expected to prepare an annual budget before the beginning of the financial year. In many cases, the approved budget is then made public to ensure transparency. 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 also be formally published. It is important for all those responsible for a budget, to be aware of when the budget setting activities are taking place such that they can contribute. 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 in our book "Managing the Devolved Budget".

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, fees, rents, charges, etc.*
- *Budget agreed and allocations made. This does not always have to be a balanced budget.*



- *Budget approved by the Committee, Board, Trustees, Council, or other authorising body*
- *Timescales set for all the above and communicated to relevant staff and stakeholders*

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.

## **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 include:

- ***Incremental Budgeting***
- ***Zero Based Budgeting***
- ***Cash Limited Budgeting***
- ***Resource Restricted Budgeting***
- ***Activity Based Budgeting***
- ***Contingency Budgeting***
- ***Income-led Budgeting***
- ***Performance Based budgeting***
- ***Rolling Programme Budgeting***

Most of these are explained in detail in our publication “Managing the Devolved Budget” and are discussed whenever we deliver training on budget setting. Although finance courses are sometimes offered to staff, many do not cover this topic in the depth that it deserves. Budget setting underpins the way in which budgets can

be made to work. One of the key budget setting principles is understanding the service or activity being undertaken and setting out the budget drivers. These are the actions that drive the expenditure or income and hence the budget. Understanding budget drivers enables budget holders to begin the creative thinking and implement control.

## **Profiling Budgets**

In addition to setting an annual budget it is also important to “profile” the budget. Profiling involves estimating how income and expenditure will arise over the year; for example, considering seasonal variations. Understanding the budget drivers will assist with establishing the profile. The budget profile is fundamental to effective budget monitoring.



# Chapter 4

## Budgetary Control – Making the Budget Work

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Budgetary control is about managing the funds allocated to the budget, whilst ensuring the funds are properly utilised in delivering the plan. This should take account of the level, quantity, and quality of output required from those resources.

For example:

If questioned, many budget holders would say they can manage a furniture budget of £10,000, meaning they would ensure the budget was not over spent. However, this is only one aspect of budget management. To fully manage the budget, the budget holder needs to know what the £10,000 budget was expected to purchase (quantity and quality) and over what time frame (i.e. the plan).

If the objectives for the £10,000 furniture budget are to purchase 100 specialist chairs without arms, of average quality over the next three months, the budget holder may then begin to manage the budget. The budget holder will not just monitor the amount of money being spent on the chairs during the period, but also the number of chairs being purchased, and the quality of those chairs. (Cost per specialist chair being the key driver of the expenditure)

## **Monitoring and Managing the Budget**

In some organisations these functions are separated. If the budgets are delegated, then the budget holder may only undertake monitoring with no real power to manage the budget. If the budget is fully devolved, then the budget holder will both monitor and manage the budget. The difference between monitoring and managing budgets is not clearly defined, however, they can be broadly distinguished as follows:

### **Monitoring Budgets**

Checking accuracy of actual income and expenditure; comparing actuals with budgets; comparing actual with expected outputs; identifying trends; highlighting areas of over and under spending to the person managing the budget.

### **Managing Budgets**

As a result of detailed monitoring, taking the necessary action to ensure the budget remains in control.

Just how much ability a budget holder has to both monitor and manage will depend on the decision-making structure within the organisation.

## **Budgetary Control Process**

The process of controlling budgets can be broken down into several stages:

- Establish Actual Position***
- Compare Actual with Budget***
- Calculate Variances***
- Establish Reasons for Variances***
- Take Action to exert control***

## Variance Analysis

In the context of budgetary control, the term variance refers to the difference between actual and budget. An example of a variance is shown as follows:

<b>Month 6</b>			
<b>Budget Heading</b>	<b>Budget to Date</b>	<b>Actual to Date</b>	<b>Variance</b>
Salaries	£120,000	£132,000	(£12,000)

The above example shows that by the six-month period, the budgeted expenditure on salaries was £120,000, however, actual spending on salaries for those six months totalled £132,000. The difference between these two figures is £12,000 which represents the variance from the budget. In this case the variance is negative, hence the brackets, representing an overspend.

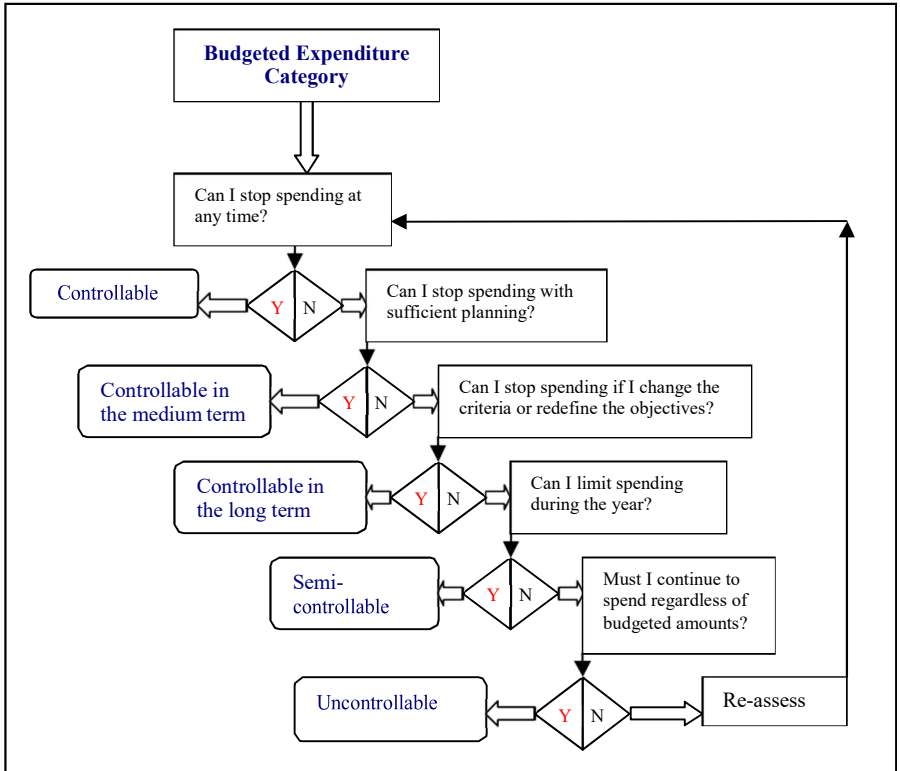
Budget to date will show the amount of the budget that should have been spent by month 6. Ideally the budget will be profiled to reflect the pattern of spending over the year such that when actual expenditure for the period is compared with the budget, the true variance is calculated.

Variances can be calculated in many ways and variance analysis assists the budget holder to monitor the progress of the financial plan and its implementation. It shows over and underspending, both of which may show deviations away from the plan subject to the interpretation of the variance.

We cover variance analysis in details within our books and training courses. Details of which are available on our website. [www.hbpublications.com](http://www.hbpublications.com)

## Controllable and Uncontrollable Budgets

The following diagram illustrates the process for identifying an uncontrollable budget.

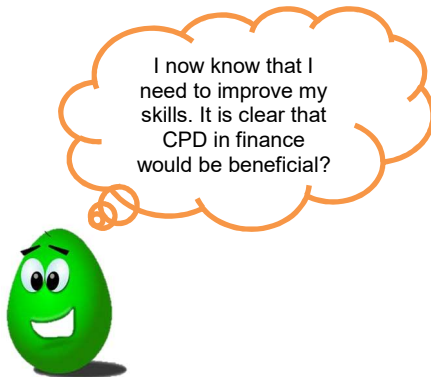


It is relatively straight forward to identify actions that may be taken with respect to controllable budgets. In the case of uncontrollable budgets, where there is an overspend, the action may be to identify compensating savings from controllable budgets. This scenario can arise when there is a demand led statutory service which cannot be halted in the short term, regardless of the level of spending.

## Projecting the Outturn

To fully control the budget, it is necessary to remain focussed on the future position. The calculation of the **outturn** becomes an important process as it reflects the projected financial position at the end of the year. The projected outturn should be calculated on a regular basis considering assumptions about changes to the budgeted income and expenditure during the year. It should take into account trends, known events, fixed/uncontrollable expenditure, budget profiles, supply and demand. Often a very basic formula is applied to calculate the outturn based on the expenditure to date and rolling it forward at the same rate per month to the end of the year. This method should only be used for areas of expenditure that do not change month by month and are fixed in nature. Again, this is a subject which all budget holders should take really seriously so that they can see whether the budget is working or not.

With this knowledge, managers at the appropriate level can take corrective action where needed. The sooner there is an awareness of the outturn position, the more time there is to implement an action plan which may impact services or substantial organisational change.



# Chapter 5

## Common Problems in Making Budgets Work – Solved!

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In this chapter we set out several typical problems that budget holders and managers may encounter in managing a devolved budget, and we suggest answers that may provide a practical way of solving these problems.

### **PROBLEM 1**

***I manage a budget but do not have the authority required to make the type of changes I would wish to make to the budget for the good of the service. For example, I cannot use salary budgets to fund other types of goods and services because salaries are ring fenced. Also, I cannot change the grades of staff that I manage because the “establishment” is fixed, and the personnel department does not allow changes.***

### **ANSWER 1**

If the budget holder is to adequately control the service, they should be able to create a staffing structure that matches the service even if this involves establishment changes. Any changes to staffing would have to be performed within the context of the organisation's personnel policies, and in some organisations, this may take time to implement.

In order to work successfully within the current regime, the budget holder must clarify what can be done with savings made



on salary budgets, i.e. can they be used to support overtime, or temporary staff payments, etc. This may provide some flexibility in the way in which staffing resources can be deployed. The best advice with respect to trying to achieve establishment changes is to lobby the organisation's key decision makers with proposals. Gaining senior management support is essential to align appropriate decision-making power with budgetary responsibility.

**PROBLEM 2**

***I consider myself to have good budgetary control skills, but I am frustrated in my efforts to manage my budget because half way through the year my budget is often cut without warning or explanation.***

**ANSWER 2**

Central government has had a continuing policy to achieve efficiencies in public sector expenditure, and hence efficiency savings have been sought in all areas of public life including the police force, armed forces, local authorities, education and health authorities. This is even more prevalent in a climate of austerity. It is difficult to set the perfect budget regardless of the method used and care taken. Consistent budget management throughout the year is the only way that an organisation can aim to stay within budget by the year end. This includes monthly outturn projections.

One action that may arise as a result of budgetary control activities, is that budgets may need to be cut in some areas to account for overspending in others. Hence, budget holders who may have managed their budgets well during the year may experience cuts for the sake of the organisation, even though this may seem unfair. It helps if all staff are aware of the "big picture" and have a financial awareness and understanding of the

organisation's finances.

The most frustrating aspect of the current process seems to be budget changes are made without warning and explanation. Budget holders may have to absorb cuts midway through the year which will affect all the existing plans for their service. The reasons for such change should always be explained with sufficient notice given.

Budget holders must also inform senior management of the impact that budget cuts will have on the achievement of objectives. Including service delivery and related income targets. This can only be done accurately if the budget holder really understands the budget drivers, the profile of their budget and where they are in achieving the original plan.

In these cases, the budget holder when informed of the extent of the cuts needs to re-forecast the whole budget, and then develop a new plan for the service

**PROBLEM 3**

***At this organisation there has been no financial training or preparation for being a budget holder. We have a demand led service and it is no wonder we have overspent again as usual. However, there always seems to be enough money in the "contingency" to help our service so no-one seems to worry!***

**ANSWER 3**

When an organisation devolves budgets, and particularly where a great many staff become budget holders, financial training is essential. Due to the technical nature of this training, it may be an area that cannot be delivered by the in-house training department (if one exists). Occasionally the organisation looks to the finance department to provide the training. The difficulty with this

approach comes if there is no individual within the department with trainer skills, or who wishes to develop those skills. Also training budgets are often the first to be squeezed when budget cuts are required, even though it may prove to be a false economy. These are some of the reasons for insufficient finance training for budget holders.

Timing of the training is also important, as many organisations have joiners and leavers constantly throughout the year. Hence a continuous rolling programme of training, pitched at different levels, to meet the different skills and abilities of budget holders is recommended.

There are external courses run from time to time, particularly by representative bodies of the sector, and by professional institutes and associations to which public sector employees may belong. For example, courses are sometimes delivered by some public sector unions for the benefit of members and non- members.

It is possible to obtain training aids, books, etc. to help budget holders with their self-development. Although there are many products on the market, most are focused on private sector finance and not easily transferable to the public sector. The books in our series provide excellent material to assist budget holders improve their skills.

# Next Steps

- Continue to develop your finance skills with one or more of our [books](#), all of which have self-development activities, exercises and practical examples.
- Assess your current level of competency with one of our online competency [assessments](#)
- Gain CPD points with our self-development course combining books and assessments or participate in our [training courses](#)
- Many organisations have purchased books for all their budget holders as a cost-effective alternative to having consultants deliver classroom based training, or as an addition to enhance their competency.
- All our assessments and courses can be developed and designed to meet the needs of individual organisations. [Bespoke courses](#) are often more effective as participants and learners can implement their knowledge immediately in the workplace

HB Publications is owned by Lascelles Hussey and Jennifer Bean who have authored this eBook.

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