

MULTI YEARS BUDGETING

THE FRAMEWORK

1 OVERVIEW

- 1.1 Multi Years Budgeting [MYB] is an attempt to set out, in figures, the policy choices of an organisation over a 3 to 5 year period. MYB is not a rolling forward of figures from the first year's budget over a few other years.
- 1.2 MKC has an existing three year budget model; this paper builds on that excellent work. It has to be said that many of the details of MYB are not new. It is how they are assembled, and the way the Council responds to them that will be new.
- 1.3 The MYB process is another aspect of a culture change and an acceptance of a constant budget constraint within the requirements of continuous improvement. At the same time, MYB should more directly support policy development, and help promote a 'can do' culture.

2 STRATEGY - WHY MYB?

- 2.1 The world has changed and we must respond to it. There are two external reasons for adopting MYB, both flowing from Government decisions:
 - The 'Modernising Local Government' programme, includes a Best Value regime, which has to be in place by April 2000. One feature of the BV regime is the five year programme of reviews, the aim of which is to achieve targets which will bring performance up to the standard of the top 25% of authorities. Annual stepping-stone targets will show progress, on the way to achieving the fifth-year 'destination', and appear in an Annual Plan. MYB has to complement the BV regime. MYB has also been designed to assist the 'Cabinet' style of working, with its greater emphasis on scrutiny.
 - The Government's longer term financial planning, the Comprehensive Spending Review, no longer offers the excitement of a generous settlement, but the dull certainty of what we have to live with. A further development includes the April 1999 DETR announcement that, along with eleven other authorities, MKC was "put.. on warning for next year" concerning the level of its budget for 2000-01.

- 2.2 And there is a set of MKC reasons for adopting MYB. The major one is that MKC is maturing and is not only in a position to develop its budget process, but needs to. However, we have to recognise that where we want to get to cannot be achieved in 1999. It is important in 1999 for the organisation to keep to the agreed timetable; we will then be able to make further improvements in 2000.

3 HOW IT WORKS - AN OVERVIEW

- 3.1 In broad terms, MYB has three things going on in a year, to produce the following years' budgets. Firstly there are continuous programmes that 'surface' at key points in the budget year to deliver their goods (savings/costs). Secondly, the main features of the budget round are decided as early as possible, and the basic work is completed before the August recess. This is to give the space for the third thing. From September there is wide political discussion, and consultation with the users, as well as refinement of the figures. This third thing is very much a health check against policy. All these three processes consider the budget over a three to five year span.
- 3.2 However, reality requires that in 1999 the main work will not be completed before August, but by the end of October. This is reflected in the attached chart at page 8, which also presents the key features of this report on one page.

4 BUILDING A MYB MODEL

- 4.1 We will build the MYB in easy stages, and illustrate it by modelling a simple school budget, but sometimes having to flick over to a Council example, where the school illustration is inappropriate.
- 4.2 A comprehensive approach should be the starting point, in three senses:
- A Council should apply the same processes and timetable to the General Fund, Housing Revenue Account and Capital [but see note on capital at 5.2];
 - A Council should have an over-riding vision inside which all other policies develop. Two examples will illustrate the point:
 - Firstly, a complex one. A policy to increase quality by 10%, in a given range of services, and reduce costs by 5% , for such services over a given period [taken from the London Borough of Newham, period 3 years]. It has been argued that these are a type of stretch target - ie save 20% over five years - which are an aspirational device to 'concentrate the mind', rather than specifically deliver the exact figure.
 - Secondly, a simple one. To have a Council Tax that is lower than all the following neighbours - Bedford, Mid Beds, South Beds, Aylesbury Vale, Northampton, South Northants, or, the Council Tax only rises by inflation. A variation of a simple vision is that of 'efficiency savings', to reflect the micro improvements all businesses should be making, which is a general assumption made by Government about productivity in the economy. It would usually be expressed as a percentage and should also apply to contractors, as well as in-house providers.

- The approach should be simple and encourage creativity. Simplicity needs no illustration. Creativity, on the other hand, does. It can arise from cost centre managers having their responsibility reinforced by a reward system. If budget holders keep [say] 50% of their underspend (and all of an overspend), rather than the Centre accruing it, they have a stake in financial performance. It also fits with longer term budgeting - budget holders will be able to collect investment funds over a 2/3 year period, for projects they currently do not undertake. The downside, the loss of funds to the Centre, could be outweighed by the upside of promoting an entrepreneurial 'solve it' culture, which itself will reduce overspends. Where a department cannot generate underspends for investment, the centre should consider acting as a bank, for projects that produce savings.

4.3 The production of the Administration's annual budget proposals takes work by officers which the Administration amend and develop before presenting for political decision. Because it is one integrated process it is presented when the whole process is complete, and not at stages when it is 'work in progress'. For 1999, the work of the officers should consist of two strands:

- The Finance Managers produce the 'base budget' on which the eventual proposals rest. They have available to them, in May, the forward forecast which has been disaggregated over the Committees. Finance Managers can then develop the forward forecast at cost centre level, which gives them an interest in the future. More detail at 4.4
- At the same time, the Directorates produce the initial options for change, which include, growth, savings, and redistribution proposals. The targets for the Directorates should, in the future, be agreed at an early P&R Committee. More detail at 4.6

4.4 We'll start from existing spend - issues such as zero based budgeting will be considered later. Budgets are reviewed by Finance Managers and updated for known changes, effectively producing a 'base budget' [of current policies], at the latest, by the end of October. These changes should fall into the following four categories:

- Full year effects - increase or decrease - of previous years decisions, including efficiency changes brought about by the introduction of new technology;
- Income - increases or decreases brought about by changes in Government formula. Changes in the level of fees and charges due to higher or lower levels of demand. The cessation or introduction of grants;
- Expenditure - inflation, pay increments, demographic changes [including effect on contracts];
- Underspends/ overspends - reviewing outturn to see if variances have a policy effect.

4.5 The School example identified £17k of salary growth in Year2, due to the full year effects and increments, and a further £9k of salary growth in Year 3. The forward view caused four policies to be adopted in Year1, that otherwise would not have been. They were:

1. To ring-fence £17k in Year1's budget, so that it could fund the Year2 growth; The ringfenced Year1 budget was used on one-off projects;
2. To invest some of the Y1 one-off in efforts to increase income for Y2 and onwards;
3. To limit the percentage that could be spent on pay;
4. As a consequence of 3, to introduce personnel policies to manage pay costs [by the recruitment process taking cost into account and to review the usage of staff].

It is this aspect of MYB that is most powerful - as a consequence of forward-looking, policies have been introduced now that would otherwise have not have been considered. MYB becomes more powerful when the policies are followed through to produce management programmes that are 'project managed' to deliver the desired outcomes.

4.6 There are then changes to the 'base budget'. These arise from four drivers and should be considered over the whole budget period:

1. Externally driven financial factors - for example, changed taxation, changed bank rate, reduced SSA/RSG, responding to District Audit. These may be hard to predict beyond 2 or 3 years;
2. Externally driven policy changes - Government changes - Modernising Government, Quality Protects, Fair Funding etc - and the demands of the new regulatory bodies;
3. Local Government changes, in the form of the Administration's political programme and the derived policy changes - these can either result from responding to 1 & 2 above, or from local initiatives:
 - Reshaping services, including overall targets (4.2);
 - Investment;
 - Resource redistribution between services.

The shape and timing of the administrations input is developing and may further change when the new political structures come into being around the end of the year.

4. Change process programmes - these can be programmed over the whole timeframe' and give services time to prepare for such reviews. They include:
 - Best Value reviews;
 - Zero based budgeting;
 - PI's;
 - Benchmarking, including SSA/spend imbalance.

The conclusion of these processes is an Administration's budget proposals that are presented for decision.

4.7 Timetable - MYB is more complex than annual budgeting, but the added value of the approach outweighs the costs of complexity. MYB demands an earlier start, 'in year' than annual budgeting; typically kicking off the process in April/May rather than July with the basic work starting in August. There are two reasons for the early start:

- The lead-in time to deliver more complex change is longer;
- Programmes that are delivered over several years require longer lead-in planning.

4.8 MYB is a continuous process, which has its underpinning programmes, as set out above at 4.6, to aid delivery. *This is a key difference from annual budgeting - MYB has an underlying machinery churning away to help deliver the policy goals.* This machinery is active, depending on project management skills to deliver results. MKC already has an officer structure for running MYB, the Business Management Programme Group [BMPG], which has its political counterpart in the Policy & Resources Committee. Further examples of underlying machinery are:

- Peer Review - processes can deliberately mix staff from different Directorates to improve, rigour, pro-activity and networking. Peer Review may best be exploited in the two drivers set out above, *Change Process Programmes* and *Targets*.
- Task Review - most often used in MYB to 'close the deal' and reach a conclusion when preparing the immediate budget.

4.9 MYB should be better able to respond to short term shocks, than annual budgeting, for there will be any underling machinery that can factor in such shocks, the solution to which may already be in planned. Our School found, as it was setting its budget, £4k of additional non-pay costs, which it was able to deal with in Y1 by using balances, safe in the knowledge that in the later years, it would be picked up by the additional income from its programme for increasing resources.

5 SUMMARY

5.1 To summarise, MYB is distinctive because:

- it looks at budgeting over a rolling 3 year period [as a minimum];
- it advances policy consideration;
- mechanisms to deliver the policies are provided;
- the four drivers of MYB embed continuous review;
- underpinning programmes will deliver the policy goals;

5.2 Note on capital - it has to be recognised that, in the short-term, a new approach to capital it to be devised, partly in response to the Government's proposed implementation of asset planning and BV, but also the delayed completion of the planning for the 1999-2000 programme, the implementation of which is being held up by uncertainty arising from the sale of the Denbeigh site. Consequently, MYB will not be fully implemented, as far as capital is concerned until 2000-01. A strategy overview is planned for the next P&R Committee.

MULTI YEARS BUDGETING [MYB]

FUTUROLOGY

- 3 -> 5 years
- Two way street:
 - Future alters present
 - Present delivers the future

ONE CYCLE

- * Policy
- * General fund
- * Housing Revenue Account
- * Capital

START EARLIER

2000-01 year

April-July 1999 - initial outlines

Sept 1999 - public consultation on broad choices

Sept-Oct 1999 - Base budget and Policy options to Administration

Late Nov/early Dec - RSG announcement

March 2000 - budget formally agreed

TWO STREAMS

[underlying machinery to produce options for Administration]

Base - Finance Managers

- Full year effects
- Income - formula changes, usage changes, grant change
- Expend - inflation, pay increments, demographic change
- Under/overspends - base or policy implications

Policy - Heads of Service

- * External financial - RSA/SSA/DA
- * Ext policy - Central Government
- * Administration - Reshaping services, overall targets, Investment, Redistribution between services
- * Process change programmes - Best Value, Zero budgeting, PI's, Benchmarking

MORE RESPONSIBILITY

- * Best Value - Service Level Agreements
- * Carry-forwards, between years
- * Cost centre management
- * Virements

MULTI YEARS BUDGETING

BEST VALUE - SERVICE LEVEL AGREEMENTS

1 STRATEGY - OVERVIEW

- 1.1 The Best Value approach is about finding out about costs, proving efficiency, and demonstrating to customers that the service is relevant to their needs. Service Level Agreements [SLA's] are a part of that process.
- 1.2 The change to a 'trading' environment, which brings support costs into the spotlight, is driven by two activities:
 - Legislative Commercialisation - the DSO's face external competition and should be constantly hunting to reduce costs. They are to be joined by Schools, who will have the freedom to purchase elsewhere, from April 2000, but will effectively be making trading decisions in autumn 1999. Best Value will reinforce the competition requirements in these two areas, for DSO's and schools will themselves come under greater scrutiny.
 - Best Value - the remaining departments in the Council [MKC] will be put under cost pressures by PI's, BV and tightening budgets.
- 1.2 The internal reason for moving to different arrangements are found in the MYB model, which seeks to encourage Cost Centre Management [CCM's] and foster an entrepreneurial approach to deliver a more cost effective set of services. CCM's can only do this if they understand and can control their costs .
- 1.3 CIPFA recently produced a consultation paper on Accounting for Best Value. This paper suggested that "trading accounts are needed whenever in-house service providers provide services at quoted prices rather than at cost" including "operating accounts for support services which make charges under service level agreements which state the price and specifications of the support services covered". The paper also suggests that surpluses and deficits on trading accounts should remain within these accounts. The responses to this consultation paper are currently under consideration by a steering group and a further draft is expected shortly.

2 STRATEGY - FROM EXISTING PROCESS TO..

- 2.1 The existing process reflects the youth of MKC and the priority to establish sound budgets, before moving on to greater sophistication. The recharge budgets for 1999-2000 were developed as a special exercise [from Nov 1998 to Jan 1999] and more closely reflects usage. End users were consulted during this process. However, trading documents, setting out the 'contract' and analysis of charge remain outstanding for nearly all services. The first posting of recharges will take place at Month 6, to be followed by further monthly postings.
- 2.2 For 1999-2000, the intention is to charge what is in the budget, but provide information on actuals. This will enable departments to begin to take a view on the service provided. The provider Department will pick up any surplus or deficit in 1999-2000.
- 2.3 The other intention is to produce trading documents by July 1999 in preparation for the negotiations with Schools and the 2000-01 budget.

3 ...TO NEW ARRANGEMENTS..

- 3.1 MKC has to agree a policy on SLA's. The most likely route is to adopt the Adjusted Trading Model [ATM] set out on the next page.
- 3.2 The ATM would need to be phased in to manage the transition to the new arrangements. The following timetable is suggested:

Budget year	What to do	When done
1999-2000	<p>Consolidation.</p> <ul style="list-style-type: none"> Current Reallocation Model arrangements remain. Providers produce Trading documents to support/explain charge. Charge is equal to the budget, with Providers producing statements, from September of what the charge would be, if it were to be on volume DSO & existing Traders charging unaffected. 	<ul style="list-style-type: none"> May 1999 -level of charges agreed Sept - ATM agreed by P&R Oct 1999 - trading documents produced. from November 1999 - 'Shadow' charges [actuals] available monthly.
2000-01	<p>Adjusted Trading Model adopted</p> <ul style="list-style-type: none"> Between Departments, from Depts to DSO's, Depts to Schools. Providers still produce Trading documents. End Users responsible for budget. [both end user and provider can make surplus or loss]. Small amount of costs remain, for example, the costs of democracy. 	<ul style="list-style-type: none"> Oct 1999 - P&R agree no external choice on nearly all items? From Oct 1999, Trading documents available By December 1999, End Users agree charging basis/budget. Appeal process. Jan 2000- providers set up Trading Accounts
2001-02	<p>Trading Model extended</p> <ul style="list-style-type: none"> Inside departments [between Heads of Service] - Trading documents produced 	<ul style="list-style-type: none"> May 2000 - P&R decide on Core services, allowing external choice

Budget year	What to do	When done
		for non-core services. <ul style="list-style-type: none"> • May 2000 - P&R set Core charges for 2001-02.

3.4 An officer working party, reporting to the Business Management Programme Group will project manage the process.

SERVICE LEVEL AGREEMENTS - TRADING MODELS

The table below compares two models, a different extremes of the spectrum. The model that is recommended for adoption is the Trading Model, as adjusted by the provisos:

- the ability to trade externally, is managed by P&R;
- however, P&R will act as a 'Monopolies Regulator' to dictate provider prices where a case can be sustained that a price reduction should occur.

REALLOCATION MODEL [Provider driven]	TRADING MODEL [User driven]
<ul style="list-style-type: none"> • Provider tells end user of service to be delivered, as described. No choice for end user. • Provider notifies budget to end user. Prices dictated by provider budget • Charge by provider is equal to budget, OR Charge is based on budget or, usage where it is high. End user breaks even/makes loss; provider doesn't lose. 	<ul style="list-style-type: none"> • End user agrees to take service from provider, to end user specification. End user can buy service from elsewhere. • End user agrees basis of charge and budget. Prices dictated by market/end user; may not be enough for provider. Provider has to run a Trading Account • Charge is by usage - both end user and provider can make surplus or loss. <p>BUT</p> <p>the above model can be adjusted, as follows:</p> <p>By Corporate fiat, some 'core' services have to be taken by the end user. Whilst this policy decision, may weaken the competitive imperative, a corporate dictat can provide a substitute by</p>

	dictating a reduction in prices charged by providers. Core services still have to produce a specification. All providers should report satisfaction surveys as part of their specification
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MULTI YEARS BUDGETING

RULES FOR CARRY FORWARD OF OVER AND UNDERSPENDS

The over-riding aim is to develop budget holder responsibility by creating a framework to encourage a culture of innovation, whilst containing expenditure within budget. The rules have deliberately been kept simple for the first year of operation; as the organisation matures, it will want to consider refining the rules:

1. Timescale - the provisional outturn position would be reported to Members in July, to be confirmed in September. Directorates would then report to Committee on how they plan to invest their underspend, or deal with the overspend. The 1998-99 outturn would run under the current rules; these new rules would apply to the 1999-2000 budget, the outturn of which would be reported in July 2000.
2. Calculation of underspend/overspend position - the calculation would be the net Directorate position, reflecting the current 'whole-Directorate' arrangements. The total of a Directorates underspends would be reduced by its overspends, to produce a net position, to which the following rules will apply:
 - Net Directorate Underspend - 50% to remain with the Directorate [the other 50% is returned to the centre]. The intention is that the percentage remaining with the Directorate will increase, when balances reach a reasonable level.
 - Net Directorate Overspend - 100% to remain with the Directorate.
3. How overspends and underspends will be calculated - as follows:
 - they will be calculated at activity level (i.e. Budget Book Page). To encourage cost centre rigour, Strategic Directors should monitor their Directorates using the principle of 'cost centre reward'. However, it will be for Directorates to decide how far to cascade the principle of 'cost centre reward' and, whether to institute actual budgetary penalties on cost centre managers;
 - the outturn will be measured against the Original Budget, plus any supplementary estimates agreed by Policy & Resources Committee during the course of the year. Together with the whole-Directorate approach, this will keep the system simple and emphasise the importance of correct budgets. For example, it will avoid the quagmire of virements in-year to offset

projected overspends and underspends, or the temptation for Directorates to manipulate virements to produce a more favourable result.

- all budgets will need to be allocated to a Budget Book Page, to give cost centre managers realistic targets. This will include the cascading of vacancy provisions which are currently shown on the Committee summary pages.
4. Underspends - a Directorate net underspend, will be reported to Committee, provisionally in July, and in September for a decision on how it will be invested. When an underspend is allocated, it gets re-named to become a 'supplementary budget' [or SB]. This will aid monitoring, as will the separate identification of the supplementary budget in the Council's accounting system. It is important to draw out three points:
- Firstly that the use of the underspend/SB is a Member decision - it is 'new money' that requires the cover of a Committee decision to be implemented;
 - Secondly, Members may take the view that a Directorate's underspend should be used to support a service of another Directorate;
 - Thirdly, the investment of an underspend/SB should not be in support of continuing expenditure.
5. Overspends - any overspends which are carried forward will be subject to an interest charge equal to borrowing costs to reflect the detrimental cashflow which arises from spending above budget.
6. Other considerations - set out below are other matters, of smaller importance, that nevertheless need to be adopted:
- Supplementary Budget [SB] - an underspend takes place in Year 1 and 'travels forward' into the next year [Year 2], where a decision is made on what to do with it [when it becomes a 'supplementary budget']. If, at the end of Year 2, the SB is not fully spent, then the balance 'travels' in full to Year 3 and is not subject to a 50% abatement. This will ensure that the Member decision, taken in September of Year 2, on how to spend the SB, is carried out. So, at the end of Year 2, a Directorate could have:
 - an underspend on its annual budget [of which they keep some percentage];
 - a SB, on which it keeps all the unused balance, to complete the agreed scheme
- SB's that have become overspends will form part of the calculation of that Directorate's net outturn position.
- Appropriations to/from Earmarked Reserves - this process will be pre-signalled and be the subject of the Treasurer's approval. It usually occurs where a budget has been consciously set at an average level which recognises that expenditure is "lumpy". This will usually be the case for repairs and maintenance budgets where there will eventually be a need to undertake major repairs in one particular year. This is managed by transferring underspends to an earmarked reserve which is built up and called upon when the major repairs occur. This effectively amounts to a 100% carry forward and is why it will not be the subject of a post-hoc request and is subject to the Treasurer's approval.

- Third parties - where funds have been allocated, or received from a third party, for a specific one-off project in one financial year but have not been spent in that year then application can be made to the Treasurer to carry forward 100% of the resulting “underspend” and each will be considered on its merits. This is similar to the current “budget rollover” process.
- Windfalls - where a Directorate receives a windfall, because (say) of a change of legislation, P&R Committee may decide that other Directorates should share in the good fortune.
- The implementation of this system will require changes to be made to financial regulations and virement powers via a Committee report.

RULES FOR BORROWING TO INVEST

1. Providing that balances are at reasonable levels, budget holders will be able to borrow from the centre to invest in initiatives, e.g. new technology, which will produce savings in subsequent years.
2. Funds may be borrowed for a maximum of three years and will be subject to interest (at the level of borrowing) on the balance outstanding at the start of each financial year.
3. This process will be subject to approval by Policy & Resources Committee and proposals must be backed up by a full financial appraisal.

In practice these processes will be achieved through virements between individual activities and the corporate “contribution to/from reserves” budget. Full accounts of the position will need to be maintained by the Corporate Finance Division on behalf of the Treasurer.

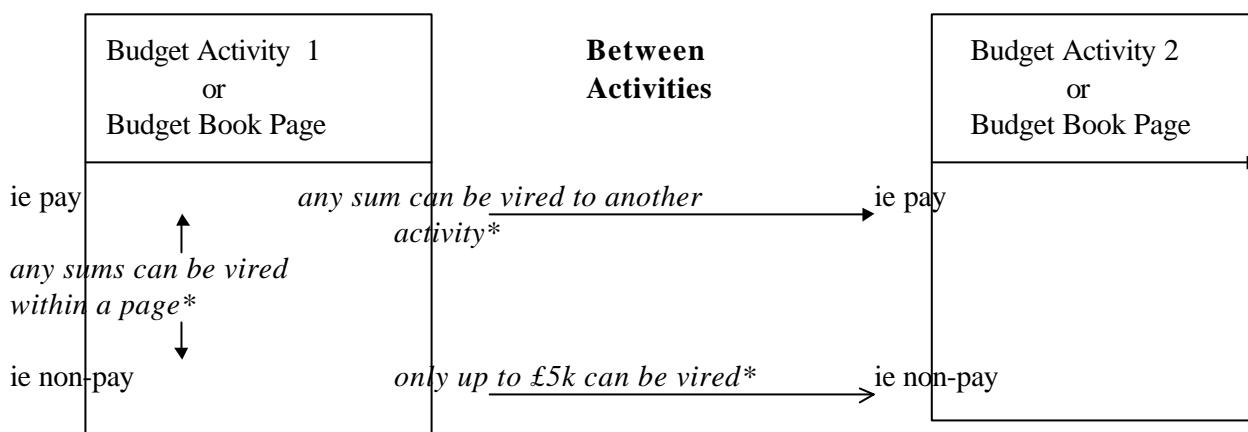
MULTI YEARS BUDGETING

RULES FOR REVENUE VIREMENTS [excluding School budgets, the HRA and DSO's]

1 DEFINITION & CURRENT RULES

A virement is the transfer of spending power [or budget] from one place to another. The current revenue virement rules, were agreed by the September 1998 P&R Committee. They operate at two levels, with the addition of a 'special' case. The current rules are illustrated below:

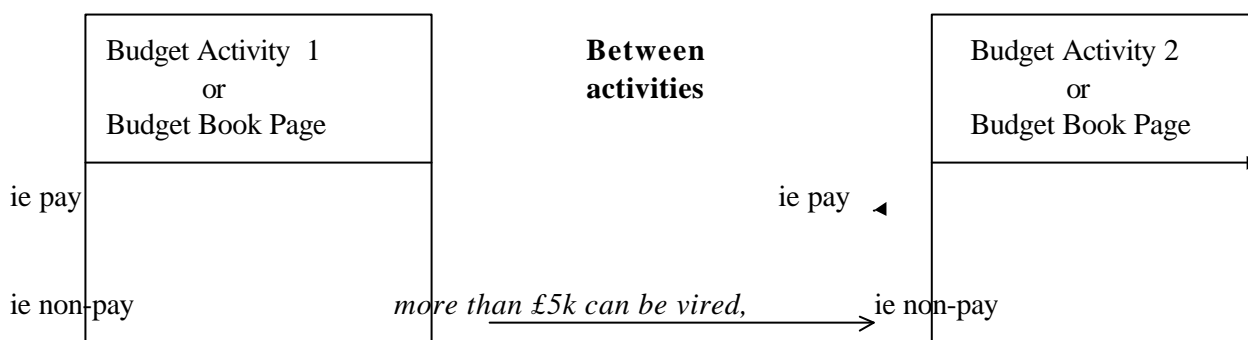
Level 1 - devolved to Directors and Heads of Service, to apply within a Directorate.



Notes:

- * provided the actions support the Council's policies and do not result in enhanced service levels
- Must notify the Treasurer and report it to the next Committee as part of their revenue monitor

Level 2 - retained by P&R Committee; P&R to receive recommendation from a relevant Service Committee.



Note: must notify Treasurer and report it to the next Committee as part of their revenue monitor

Special case - transfers regarded as ‘technical’ may be authorised by the Treasurer, and then reported to the next Committee

2 ISSUES

As the budgetary system of MKC matures, there is less need to impose spending controls through the restrictive virements rules [which, with some effort, can be circumvented]. Equally, the virement rules should support the development of budget holder, and Committee, responsibility and the forthcoming new political arrangements. The underlying themes behind the proposed new virement rules are:

- Growth or Virement - a proposal to extend a service or start a new service, is a policy matter that requires Committee agreement; it is a ‘growth’ issue, and does not fall within the virement process. This applies even if the growth can be funded from existing resources. In short, virements are a device for managing the funding of existing services, usually in the short term. Virements should support the Council’s policies and not result in enhanced service levels or budget commitments beyond the base budget;
- Virements between Directorates - these should rarely happen, but where they occur, they should be reserved to P&R Committee [unless ‘technical’ and can be authorised by the Treasurer];
- Virements inside a Directorate - All virements inside Directorates should be a matter for those Directorates and their Committees and need not involve the P&R Committee. All virements, be they inside an Activity or between Activities, should be delegated to officers. They should be reported to the next Committee as part of the latest monitor. It is suggested that the form of reporting should be the cumulative total amount, expressed as £’s and as a percentage of the net budget. A higher percentage would suggest the original budget was not as accurate as it should have been.

3 PROPOSED NEW RULES

The proposed new rules are simple and meet the objective of enhancing cost centre responsibility. They number four, as follows:

1. Definition - a virement is a device for managing the funding of existing services, usually in the short term. Virements should support the Council’s policies and not result in enhanced service levels or budget commitments beyond the base budget;
2. Virements between Directorates - these are reserved to the P&R Committee [unless ‘technical’ and can be authorised by the Treasurer];
3. Virements inside Directorates - all virements, be they inside an Activity or between Activities, should be delegated to officers;
4. Reporting and monitoring - each Committee will receive, as part of its revenue monitor, a summary of virement activity, including the cumulative total amount, expressed as £’s and as a percentage of the net budget. Departments are to maintain a log of virements, in a form prescribed by the

Treasurer, to be available for inspection by the Treasurer, in accordance with the statutory S151 precepts.

Financial Regulations will need to be changed if the above is agreed by Committee.