CROWN AGENTS
ACCELERATING SELF-SUFFICIENCY & PROSPERITY

Financial Management of Development Projects
14 May 2019

PLANNING & BUDGETING

Session Introduction

Session Aim

- Explore planning and budgeting, how they are linked, and the evolution toward modern budgeting
- Highlight the linkages between budgets and cashflow forecasts
- Describe the process of preparing a cashflow forecast

Learning Objectives – by the end of this session you will be able to

- Understand the evolution of the current budget formulation and preparation reforms
- Understand of the underlying principles of budgeting
- Understand the linkages between budgets and cashflow forecasts
- Appreciate the steps involved in the preparation of a cashflow forecast

Session Agenda

Our Learning Journey – how we will achieve our objectives:

1. Discuss the evolution of current budget formulation and preparation reforms
2. Describe the linkages between budgets and cashflow forecasts
3. Describe the the steps involved in the preparation of a cashflow forecast

What is a budget and its purpose?

What is a budget?

What is the purpose for having a budget?

Budget: A definition

- A budget is a plan expressed in financial terms
- An estimation of the revenue and expenses over a specified future period of time”
- A budget…
  - provides a framework for spending (**allocation and management**)
  - facilitates the **classification** of all expenditures
  - promote **transparency** of allocation of public finances
  - provides a framework for **accountability** for inputs, outputs (and outcomes)
  - facilitate prudent **management** of those allocations
  - helps an organisation to realise its **objectives**
  - should facilitate measurement of **actual performance** (otherwise it is pointless).

Purpose of budgets

- Accountability
  - As a central element of accountable management
- Control
  - Limit/fix levels of overall expenditure (public accountability)
- Legality
  - Authorisation of expenditure – 'permission to spend'
- Service Delivery
  - Framework the release of funds to entities delivering services
- Underpins accounting and reporting (via chart of accounts)
- Monitoring and evaluation
  - Provides basis for monitoring and reviewing performance (financial, operational)

A good budget

What do you think are the main features of a good budget system?

A good budget

- Reflects government / organisational **policy**, **priorities** and social **objectives.**
- Reflects **strategic objectives** and aspirations of the entity aligned with objectives of government
- Provides **adequate funds** to carry out the activities planned during its lifetime
- **Integrates** day-to-day spending **needs** with **costs** and **impact of development** activity
- Matches **operational needs** of the entity to its **financial needs**
- Defines a framework of **accountability** bringing together financial and operational responsibilities and decision making
- Provides a basis for **monitoring** financial and operational performance over its lifetime

Budget: other considerations

- Realistic vs. unrealistic
  - Realistic budgets based on objective (re-computable) inputs
  - Potentially wide spectrum from realistic to unrealistic
  - Extent to which S.M.A.R.T principles applied
  - Some objects may be difficult to measure (e.g. qualitative targets)
- Optimistic vs. pessimistic
  - Both for revenue (macro envelop) and expenditure.
  - Element of judgement required to deal with many cost items
  - Clear guidelines and standards will help limit the impact of personal judgement

Budgets: private vs. public sector

What is the difference between a private sector budget and public sector budget?

Budgets: private vs. public sector

Private sector

- In general private sector entities are involved in “exchange activity”
- Exchange activity occurs where goods / services are exchanged for equal or approximate equal value (IPSAS 9; IAS 18)
- Expenditure is generally in return for economic benefit
- Relatively strong tradition for budgeting (as basis for financing, management remuneration, etc.)
- Clearer performance targets expressed in production or service units
- Flexible budgets used extensively (esp. in manufacturing)
- Extensive use of ERP software for budgeting and reporting

Budgets: private vs. public sector

Public sector

- Mostly involved in “non-exchange activity”, i.e. not for economic benefit
- Major part of revenue is received as taxation or other mandatory payments by citizens or companies, grants and donations
- Most revenue not directly in exchange for good and services
- Major part of public sector expenditure involves making payments or providing services for no cost (e.g. poverty reduction)
- Expenditure made for its “service potential” (IPSAS 23)
- However, costs involved in delivery of service potential are measurable

Public sector budgeting

Public sector

- The budget is arrived at by applying objective costing procedures to all the inputs needed to deliver the requisite service potential

Note:

Government Business Enterprises (GBE) generally have private sector characteristics (and are regarded as such by IPSASs)

Approaches to budgeting

- Traditional / Line-Item / Incremental Budgeting
- Performance Budgeting
- Program Budgeting
- Zero-Based Budgeting

Line-item budgeting

- Used to apply centralised control
- Aims to promote accountability in detailed use of resources
- Specifies maximum spending per line item
  - Payroll, travel, stationery
- Focus is to avoid over-spending on inputs

Line-item budgeting

Strengths

- Relative simplicity
- Unambiguous/Explicit
- Easy to control through comparison with previous years

Weaknesses

- No information on why money was spent
- Focus on short-term horizon and does not take into account longer term costs
- Tendency for central budget offices and finance ministries to micromanage agencies’ budget implementation
- Tends to be incremental

Performance budgeting

- Proposed as an improvement on line item budgeting
- Tries to address concern for longer-term efficiency of government / organisation by integrating information on activities
- Total budget within an entity is divided into measures of workload based on activities
  - Budget is derived by multiplying the cost of unit of outputs by the number needed in a year

Performance budgeting

Strengths

- Allows the budget to be built up based on projected activity
- Represents a shift from expenditure controls to budgeting based on management concerns

Weaknesses

- Rarely adopted as government-wide budgetary process
- The emphasis is not on making government trade-offs but on measuring workloads
- Focus is on the workload not on the usefulness of the objectives themselves
- Even though it gives some information on efficiency that is not an adequate criterion for allocation
- By concentrating on outputs it took attention away from policy outcomes or the effectiveness of expenditure

Zero-based budgeting

- Emerged from the 1970s
- Evaluates all programmes each year (not just making decisions at the margin)
- It leads to questions such as ‘What will happen if Ministry X or Y didn’t exist?’
- It has been found to be a useful tool in some instances
- It has also been applied to say ‘If Department X had to cut back by 20%?’

Cash flow forecasts

- A cash flow forecast describes the anticipated cash inflows and outflows of an entity or project with its resulting surpluses or shortfalls for a specified period
- In addition to a thorough knowledge your entity or project's operations it is vital to know the state of its present and future cash flows
  - where your money is
  - where it is coming from
  - where it is going to, and
  - when

Many entities fail because they fail to control their cash flow

Uses of cash flow forecasts

- Establishes how much liquid money is needed and when it will be needed
- Helps to ensure that expenditure is properly controlled
- Reduces the need for borrowing
- Encourages efficient use of resources through the analysis of over and under spending
- Helps maximize investment earnings by showing when funds will be available for investment
- Helps with facing facts and with decision making

Difference between cash flow forecasts and budgets

BUDGETS	CASHFLOW
Focuses on all incomes and all expenditures over a period	Focuses on physical inflows & outflows of cash and when they will occur
Helps you determine if your resources can achieve your objectives over project life	Helps you plan for short term financial sustenance of activities e.g. to borrow
Best used as a strategic and planning tool	Best used as a routine operational tool
Tells you if you have sufficient resources to start and end but not in-between	Can give hints as to when to invest / expand / cut costs

Cash flow forecasts - considerations

- Focus on the cash implications of budgeted activity (expenditure and revenues)
- The critical factor is not when expenditure is incurred but when it is paid in cash
- Use historical information as a base line
  - Impact of existing obligations
  - As a basis for best-guess estimates
- Capital expenditure / revenue, taxation and other transactions with a cash implication will have an effect on the cash forecast

Cash flow forecasts - steps

- Start with what you know and gradually build up the reliability of your forecast
  - Keep it simple
- Monitor and fine-tune your forecast
  - Watch the revenue side for significant changes
  - Review heavy user expenditure patterns
  - Monitor the incidental user
  - Make adjustments to your forecast to accommodate changes
- Incorporate lessons learnt in future forecasts

Cash flow forecasts - steps

- Decide on the time period your forecast should cover (e.g. one year) and the periodicity of the forecasts (e.g. monthly)
- Review your accounting history for revenue and expenditures
  - Get the general picture
  - Establish your baselines
- Create a forecasting form to begin tracking your revenue, expenditures and investments
  - Use categories that are relevant to your entity
- Determine the timing of each cash inflow / outflow based on your knowledge of known and expected events

Monthly Cash flow Forecast - example

	Week 1	Week 2	Week 3	Week 4
Income	£000	£000	£000	£000
Monthly fees	4,000	1,000	5,000	3,500
Cash	1,600	1,400	1,600	1,700
Total	**5,600**	**2,400**	**6,600**	**5,200**
Payments				
Staff salaries				5,300
Other Expenditure	600	200	800	400
Total	**600**	**200**	**800**	**5,700**
Net cash flow	5,000	2,200	5,800	(500)
Balance b/fwd	0	5,000	7,200	13,000
Balance c/fwd	**5,000**	**7,200**	**13,000**	**12,500**

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Session close

Let’s wrap up the session:

- Recap of key learning
- Final questions?
- Revisit session objectives – achieved?
- Application of learning – update your action plans
- What’s next?

THANK YOU /

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