BUDGETARY CONTROL AND MONITORING

Final Distribution

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January 2010
# TABLE OF CONTENTS

EXECUTIVE SUMMARY .................................................................................................................. 2

1  INTRODUCTION.......................................................................................................................... 2

2  OBJECTIVES AND SCOPE ......................................................................................................... 3

3  AUDIT OPINION .......................................................................................................................... 4

4  CONCLUSIONS ............................................................................................................................ 5

5  WAY FORWARD ........................................................................................................................... 7

MANAGEMENT ACTION PLAN ......................................................................................................... 9

BUDGET MANAGEMENT PRINCIPLES ....................................................................................... ANNEX B
EXECUTIVE SUMMARY

1 INTRODUCTION

Background

1.1 The provenance of this report has led to Annex a attached to the report to ensure that the findings are considered in the correct context. The audit found various different views of the purpose of budgetary management and its application that indicated that the proper context needed to be set out. The Audit found different views of the purpose of budgetary management and its application. This was considered to be a factor at the time of the review, but it is highlighted that work is in progress to ensure there is clarity going forward and that specific training is now being rolled out alongside improvement to key processes.

1.2 The 2008/09 Outturn report presented to Cabinet on 23 June 2009 showed an over spend of £2,193k. The Revenue Budget Monitoring Report for Period 11 presented on 7th April 2009 showed a forecast under spend of £1,394k. Internal Audit was, therefore, asked to review the robustness of the council’s revenue budget monitoring procedures focussing upon the financial year ending March 2009.

1.3 Internal Audit issued a final report on budgetary management in June 2008, having reviewed the previous year’s monitoring, i.e. 2007/08. Since then the Corporate Director for Finance left, an interim occupie

1.4 On 30th July 2009 the newly appointed Corporate Director Finance and Risk Management presented a series of principles to guide the upcoming Medium Term Financial Planning (MTFP) exercise. These principles seek to put in place or reinforce the Council’s processes to achieve the relevant principles and standards for effective budgetary management throughout all Council services. These processes reflect best practice.

- Emerging pressures managed within existing cash limits (stop Budget creep)
- Spending aligned to Key Priorities
- Income only included in budget where supported by robust proposals
- Future Liabilities are anticipated (PFI / Pensions)
- Budgets are Sustainable
- Distinguish between Base Budget / One-off/ Capital expenditure
  - 4 types of Investment proposals:
    1. Unavoidable – Revenue Budget
    2. Priority – Revenue Budget
    3. One-off expenditure
    4. Capital Expenditure
- Savings Proposals supported by project plans (efficiency / VfM)
MKC INTERNAL AUDIT SERVICE  BUDGETARY CONTROL AND MONITORING

- Capital schemes – Project allocation of resources is separate from expenditure approval
- Integrated Capital & Revenue implications need to be provided
- Specific Grant Funding – Changes do not lead to Revenue Budget pressures
- Reduce our dependency on Reserves to balance Budget

1.5 As these principles are being addressed through MTFP they are currently being implemented and were approved by Cabinet on 22nd September.

1.6 Throughout this report the terms over spend and under spend are used.
   - An over spend is expenditure in excess of the planned figure for a particular service over a specified time and also where an income target was not achieved.
   - An under spend is where less expenditure is incurred than planned for over the specified time and where income collected is more than planned.

2 OBJECTIVES AND SCOPE

The objectives of the audit agreed with MKC were to evaluate:

a) To review the budgetary control system from a corporate, management and user perspective, to identify weaknesses and strengths within budgetary management and control processes (THE BUDGETARY CONTROL SYSTEM);

b) To identify, record and consider the key budget variations throughout 2008/09, specifically;
   - Variances from period 1 (budget), to period 12 (actual);
   - Significant variances from period 11 (forecast) to 12 (actual) (YEAR END BUDGET VARIATION)

c) To evaluate the management of budget risks in relation to:
   - The means, viability of and challenge to achieving target outturns;
   - The volatility of budgets; (BUDGET VARIATION RISK MANAGEMENT)

d) To follow up the recommendations for improvements to the budgetary monitoring system made in the 2007/08 audit. (FOLLOW UP)

The period reviewed was April 2008 to March 2009. The audit included interviewing a selection of Budget Managers and hence also considered working practices in the 2009/10 period.
3  AUDIT OPINION

3.1 Limited Assurance - The Audit found good control in many areas but also control weaknesses (some significant) within the governance arrangements that prevent a Satisfactory opinion. The key issues that prevent a Satisfactory opinion include:

- budget monitoring was found to be carried out as a monthly expectation rather than being a control process to manage limited resources to deliver required outcomes.
- Some income budgets were found that are unachievable
- Budget Managers (BM's) competencies and needs were not always considered fully
- The value of reports to members was found to be undermined by the repetitive nature of content, delays in publication, and the absence of focus on actions needed / taken in response to the information contained in the report.

3.2 A series of measures are being implemented by the Corporate Director of Finance and Risk Management to address many of the system weaknesses. However, these had not been implemented or embedded at the time of this audit (Sept / Oct 2009) and as such improvements, whilst expected, could not be evaluated.

3.3 Despite the overarching system weaknesses it was encouraging that the audit found areas of effective budgetary management involving complex and volatile financial matters.
4 CONCLUSIONS

4.1 In respect of the audit’s 4 key objectives the key findings were:

4.2 Budgetary Control System

4.2.1. A clear, specified and understood purpose was found to be absent for the budget monitoring process. This Corporate Vision for budgetary control exists within the new processes proposed by the Director of Finance & Risk Management but the audit found that monitoring of budgets is carried out because budgeting is an expectation (e.g., viewed as only one of many administrative tasks competing for the attention of managers) rather than understood as an effective management tool to achieve the objectives of the organisation. Examples of this included where budgets were found that had unachievable targets; for example, CYPS income targets and LLC library income targets. We are satisfied with assurances given that these were being addressed in the 2009/10 budget build.

4.2.2. The Accountability of some BMs was found to be unclear at the time of the Audit. BM’s should be accountable to Assistant Directors (ADs) who in turn should be accountable at DMT level. The turnover of 2nd tier officers throughout the Council undermined this governance structure during 2008/9 and has now been addressed with the confirmed appointment of all 1st and 2nd tier officers.

4.2.3. SAP is not perceived as a User-friendly tool by BMs. This is a particular problem for BMs that lack confidence and are unfamiliar with finance and accounting matters. This was found to have resulted in higher demands on the services of the Mouchel Accountants who help BMs to forecast and input budget changes onto SAP.

4.2.4. In previous audit’s it was found that up to 33% of purchase orders were raised after the receipt of the invoice (This represented invoices to the value of £67m [36%] of total creditor’s expenditure). The systems weakness was found to be still evident in recent testing. This means that the accuracy of committed expenditure information on SAP was found to be poor and resulted in the forecasting process being more complicated, open to more error and, therefore, less reliable. The audit found this was a combination of both a lack of Compliance culture (i.e., users not complying with the rules and agreed processes) and a lack of Understanding by users of how to apply this SAP requirement whilst delivering to often urgent service pressures.

4.3 Year End Budget Variation

4.3.1. The audit found that even accounting for the variation experienced in the year end outturn the council delivered its projected budget as at 1st April 2008 to within 3.78% of the original budget and 1% of the revised budget, despite the pressures faced from additional spending on Radcliffe and Architecture MK (which together represent 2.76% of the revised budget).

4.3.2. Actual outturn balances moving in excess of +/- £50,000 from the P11 forecast were reviewed. In all cases there was no evidence of any intention to mislead.
4.3.3. Of the 35 variances in excess of £50k (total value £2.4m) 5 variances totalling £463k were found where it was known at P11 and it could, possibly should, have been processed / reported at that time. Other variances were found that whilst officers were aware, evidence shows that they could not be processed / reported at the time. Evidence showed that these variances were being monitored.

4.3.4. A particularly significant movement from P11 to outturn was found which related to expenditure on the Radcliffe School and the associated Project Radcliffe which affected Children and Young People’s Services (CYPS) and Learning, Leisure and Culture (LLC) to the total value of £2.76m.

4.3.5. Therefore, on balance, the 2008/09 year end out-turn variation was not considered to have been caused by poor budgetary management during the year.

4.4 **Budget Variation Risk Management**

4.4.1. The process for forecasting budgets across the Council is an essential risk management and governance tool. Whilst the audit found that forecasting was evidenced across all services it was also found to be unnecessarily complex and control weaknesses were found that reduced its effectiveness. These complexities link to audit findings set out elsewhere eg user understanding and DMT accountability and approach.

4.4.2. The Audit also examined the process of control for reporting budget management to Cabinet / Members. Reports were found to be often out of date by the time Cabinet have an opportunity to review and act. This undermined the value and purpose of these reports.

4.4.3. The audit found different approaches applied to service volatility. In some areas there was active and effective monitoring of known risks but in other areas governance was significantly undermined by the finding that it was considered too difficult to predict / manage volatile areas. BM’s were found to commonly predict forecast over spends towards the beginning of the year which then decline. This is considered to be an indication that a culture of effective budgetary control was not evident across the Council.

4.5 **Previous Audit Follow up**

4.6 The findings and recommendations resulting from the previous audit with the comments made by the Deputy Head of Strategic Finance were considered and can be provided if requested but those findings have now been superseded by the results of this audit.
5 WAY FORWARD

5.1 The Management Action Plan reflected the findings of the audit in relation to the 2008/09 out-turn. Subsequent evidence of significant improvement to the Financial Management arrangements are acknowledged but could not be evaluated as part of the scope of this audit, and in any case would partially duplicate audit activity in respect of the whole of the 2009/10 financial year. It is also fair to reflect that some findings can be addressed fairly quickly whilst other areas form part of the long term improvement plan. The new Corporate Director of Finance and Risk Management has made it very clear that these are central to the finance improvements that need to be made and this is reflected in the management response.

5.2 All the recommendations are in the Management Action Plan with key issues are highlighted below:

5.3 **The council should adopt an agreed purpose or vision for the budget monitoring process.** A suggested purpose could be to “aid the delivery of the council’s strategic objectives”. This would both provide required clarity and direction for BMs, DMT etc. and also provide a framework that promotes the valuable budget behaviours throughout the council and challenge the negative behaviours sometimes visible in response to budgetary information. This is being addressed as part of the 2010/11 budget build.

5.4 **Budgets should not be set that are unachievable.** This finding is not targeting in-year difficulties that should be dealt with through virement processes etc. The Audit found that recurring budgets exist that do not reflect the reality of the service eg income targets that cannot be achieved.

5.5 **There needs to be uniformity of approach with DMT’s in how revenue budget monitoring is delivered, including the relationship with the Mouchel Finance Manager.** The new process implemented by the Director F&RM highlights that AD’s and DMT’s are accountable for effective budgetary management.

5.6 **SAP users should be consulted to determine if there are any common areas of concern and their needs are being met.** A significant upgrade to SAP is planned for later this year. Though some changes to the GUI have already been made more needs to be done to improve SAP, help BMs to better understand the system and reduce demands on the Mouchel Accountants.

5.7 **It is important that all opportunities for training and mentoring of BMs are fully utilised.** An approach that BM’s must simply comply with process is not considered sufficient. Non-compliance must be monitored and reported to AD and DMT’s but it should also prompt better, focussed support to BM’s to improve understanding of the system and highlight where SAP needs to change to meet the needs of services. Two key examples are:

- BM’s involved in highly volatile services should be targeted for increased support and mentoring to enable better, more realistic monitoring
- BM’s that commonly forecast large overspends that reduce during the year should provide written explanations detailing the likelihood and consequences of volatility issues. Analysis should be made to aide
understanding rather than criticise.

5.8 Reports to Cabinet and other relevant Committees should be accurate and timely. The Director F&RM has revised Cabinet reporting content and processes. The new controls implemented by the Director F&RM need time to embed and then the adequacy of Member reporting can re-considered. A “stop press” section in Cabinet reports is suggested.
# MANAGEMENT ACTION PLAN

The recommendations are categorised on the following basis:

- **Essential** - Implementation is required with immediate effect to address a weakness that fundamentally undermines the control/objective of that system.
- **Important** - Implementation is required within a short period of time to address weaknesses that seriously undermine the control/objective of that system.
- **Standard** - Management need to take recommended action within a reasonable period to address weaknesses that may undermine controls/objectives.

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<tr>
<td>1.</td>
<td>Budget monitoring is currently carried out as an expectation within itself as opposed to contributing to the more effective delivery of organisational outcomes.</td>
<td>Budgets do not reflect the organisations declared priorities. Organisational outcomes are not achieved</td>
<td><strong>Essential</strong> The council more clearly define and communicate how the budgetary control system should contribute to the delivery of its organisational objectives by clarifying the purpose of the budgetary control system. (Rec 1)</td>
<td>Agreed. Financial procedures are being re-written and a new system is being considered. The revised financial regulations will be reported to Members in March 2010.</td>
<td>Tim Hannam Corporate Director of Finance and Risk Management 31/3/10 – financial procedures re-written 01/04/11 – new process in place</td>
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<td>2.</td>
<td>Income targets have not been regularly re-assessed and are no longer achievable. Income targets in some instances are used to balance budgets.</td>
<td>Credibility of the budgetary control system is reduced leading to lower levels of involvement and poorer forecasting accuracy</td>
<td><strong>Essential</strong> Income targets should be reassessed to determine stretching but achievable targets that are supported by robust business cases/delivery plans covering the next 3-5 years. Income targets must never be changed just to simply balance budgets. (Rec 2)</td>
<td>Agreed. The process relating to income collection is being reviewed. There will be two income targets; a stretched one and a budget set target. The Corporate Director of Finance and Risk Management will not accept income targets to balance budgets.</td>
<td>Tim Hannam Corporate Director of Finance and Risk Management 31/03/10</td>
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<td>3.</td>
<td>Revenues budget pressure were not clearly described or quantified in the Revenue Budget Monitoring reports.</td>
<td>Budget pressures hit the revenue reserves instead of being managed during the year.</td>
<td><strong>Essential</strong> Cabinet revenue monitoring reports should clearly indicate the likely impact of key risks using an agreed methodology. (Rec 3)</td>
<td>Agreed. Reports need to be more action orientated.</td>
<td>Gary Waghorn Deputy Head of Finance wef 1/04/10; first report by 31/07/10</td>
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<td>4.</td>
<td>The timing of Revenue Budget Monitoring reports, which deal with prior periods, results in current information not being disclosed despite its being known at date of publication.</td>
<td>Decisions are not based on the most up to date information</td>
<td><strong>Essential</strong> In addition to detailed information relating to the period of account, reports should include current key financial information necessary to aid Cabinet’s understanding of the financial situation (a &quot;stop press&quot; section to the report). (Rec 4)</td>
<td>This cannot be addressed though a stop press to Cabinet because it wouldn’t follow the democratic process – BUT, improvements have been made as within 3/4 weeks reports are given to CLT and a draft report is taken to Budget Review Group with 4/5 weeks.</td>
<td>Tim Hannam Corporate Director of Finance and Risk Management 31/03/10</td>
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| 5.  | Reports often highlight the same area of concern month on month with no apparent action being taken to deal with the issue both corporately or at management level. | Reserves are used to deal with known council business. | **Essential**
A simpler monthly highlight/exception financial report should be produced to include current key financial information necessary to aid Cabinet’s understanding of the financial situation (Rec 5). | Reports have been condensed and are more action orientated. | Gary Waghorn Deputy Head of Finance wef 1/04/10; first report by 31/07/10 |
|     |          |                  | **Essential**
Detailed Cabinet Financial Monitoring Reports should be produced on a quarterly basis as is the normal practice in other unitary Authorities. (Rec 6) | This has improved and is continuing to improve. | |
|     |          |                  | **Essential**
Where risks are discussed there should be a clear indication of the likely impact and necessary mitigation for the risks. In addition reports should be more focussed on identifying whether, or not, action is to resolve reported risks, issues and exceptions is effective. (Rec 7) | Disagree – BUT management actions are now clearly described within the report. | |
|     |          |                  | **Essential**
Action plans should be appended to provide detail of how directorates intend to deal with income shortfalls and expenditure overspends. (Rec 8) | Agreed | |
|     |          |                  | **Essential**
In addition Cabinet need to demonstrate that they understand the known risks and support Directors in their management of overspends and Cabinet Members/Directors should be tasked with ensuring delivery of specified outcomes. (Rec 9) | | |
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| 6.  | Some BMs continue to lack confidence when using the SAP system to manage their budgets | Forecasting is not accurate       | **Important**  
Refresher training to be made available as necessary (Rec 10)  
**Important**  
Better “on-line” help and guidance for users (Rec 11)  
**Essential**  
A programme of mentoring for inexperienced BMs should be developed and publicised. Mentors should be drawn from those BMs who have demonstrated budgetary competence. (Rec 12)  
**Essential**  
If a new BM is in place the budget risk profile should be high until they have proved their competence. Following training and meetings with the Mouchel accountant the risk may reduce. Training should focus on the development of individual BM competencies as well as the implementation of standardised budgetary control practices. (Rec 13) | The Corporate Director of Finance and Risk Management is leading a project to put in place improvements to the reporting capability of SAP management reporting that will ensure these recommendations and the resultant improvements in reporting are seen.  
This project will look at all aspects of SAP reporting throughout 2010/11 and aims to introduce improvements by the end of the financial year.                                                                                                                                                                                                 | Tim Hannam Corporate Director of Finance and Risk Management wef 1/04/10 |
| 7.  | Some managers continue to have much support and scrutiny despite their proven abilities to be able to manage their budgets effectively | Resources not effectively focused | **Essential**  
Effective BMs should be trusted to make the right decisions and should be left alone so long as regular forecasts are being made. More effective budget and BM risk identification will help to prioritise support towards the areas that it is really needed. (Rec 14) | The message has gone out via Finance Lead Officers Group that budget scrutiny will be on a risk basis.                                                                                                                                                                                                                                                 | Tim Hannam Corporate Director of Finance and Risk Management 31/03/10 |
| 8.  | Managers tend to forecast overspends at the beginning of the year. Internal audit doesn’t think this behaviour will or should change but it should be better understood. | Forecasting is inaccurate          | **Essential**  
BM should provide written explanations to support their forecasts particularly where there are exceptional over/under spends. | Agree. There are various profiles available in the SAP system and budget managers will be encouraged to make use of this facility.                                                                                                                                                                                                                      | Tim Hannam Corporate Director of Finance and Risk Management wef 1/04/10 |
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<td>This will allow Senior Management to make a judgement on the appropriateness of a forecast which should then be adjusted the following month if the conclusion is deemed inappropriate. If, however, the forecast is justified appropriate support should be given to the BM. (Rec 15)</td>
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| 9.  | Many BMs find SAP difficult to use. Some BMs have not been on the SAP Budget Management training course. | Ineffective decision making and incorrect forecasting. | **Essential** SAP users should be asked for their views on the adequacy of the current SAP system and their preferences for future system improvements. (Rec 16)  
**Essential** Assistant Directors to ensure that all their BMs receive the necessary training in budgetary management and SAP within three months of being given budget responsibilities. (Rec 17)  
**Essential** A check should be carried out to ensure that all current BMs have been trained and if not the training be provided immediately. (Rec 18) | The Corporate Director of Finance and Risk Management is leading a project to put in place improvements to the reporting capability of SAP management reporting that will ensure these recommendations and the resultant improvements in reporting are seen.  
This project will look at all aspects of SAP reporting throughout 2010/11 and aims to introduce improvements by the end of the financial year. | Tim Hannam  
Corporate Director of Finance and Risk Management 31/03/10 |
| 10. | In 2007/08 up to 33% of invoices were received before the purchase order was raised. This situation is unlikely to have improved since then. | SAP information is not correct | **Essential** There must also be a re-emphasis by DMTs of the requirement to follow the approved procedure for raising orders on SAP wherever possible. (Rec 19) | This information is being reported to CLT. By 31/03/10 there will be data cleansing carried out allowing easier identification of departments that do not follow the defined process. | Tim Hannam  
Corporate Director of Finance and Risk Management 31/03/10 |

NB Any cost implications arising from implementation of the recommendations by Mouchel must be agreed in advance with the appropriate Client Officer and the Partnership Delivery Manager.
Annex A

Budget Management Principles

The CIPFA Statement of Professional Practice - Budgetary Planning and Control issued in January 2009 provides the following explanation of the budget process.

“All organisations need to manage performance so that their financial and strategic objectives are achieved and management and financial stakeholders can be confident in the associated control processes.

The proper construction and control of budgets is central to this, to safeguard the organisation’s viability and the effective delivery of its objectives.

This requires a comprehensive financial planning and approval framework;

- Consistent and rigorous processes for constructing budgets, both capital and revenue;
- Sound methodologies for assessing the financial impact of proposed expenditure;
- Compatibility with other management and performance data, and a
- Control system that sets clear responsibilities and produces prompt and accurate monitoring information on performance against budgets."

The definition of a budget

CIPFA has defined budgets as:

“The plan of an organisation expressed in financial terms.

The resources which are forecast to be consumed in undertaking activities and the resources forecast to be generated as a result of those activities or made available from external sources to enable activities to be undertaken.

A public statement of intent against which the organisation will be held publicly accountable for its actual performance.

The budget also has an important role as a control mechanism.”

Local Authorities, have to be accountable for the money they spend which can give rise to an adverse reaction to any variation between budgeted and actual expenditure. However, a better understanding that a budget relates to a plan to deliver outcomes by which resources are predicted to be consumed, seeks to avoid the inappropriate “knee jerk” reaction that a variance to the budget figure must be “bad”. The appropriate reaction to variations should result in the investigation of how and what resources were used and whether outcomes were secured achieving value for money.

Thus budgets should be a management tool to inform the delivery of outcomes and aid understanding of the service and not just a mechanical process used to identify under or over spending. Put simply it is not appropriate to conclude that budgetary
management (or the manager) has failed simply because actual income/expenditure has varied from the budgeted amount.

Budget variations

An exact spend to budget is not necessarily good budgetary control as it may disguise a situation where resources are continually committed regardless of the achievement of the required outcomes. Milton Keynes Council must be fully committed to understanding exactly the purpose of budgets including the fact that the outcome isn’t monitoring budgets per se, but rather, understanding service provision in the context of the organisation’s priorities within the finite resources available.

Indeed, there should not be an assumption that services have poor budgetary control simply on the basis of an under or over spent budget. The key is to understand the reasons for variations and whether they indicate an underlying weakness with the basis of the budget or the failure to properly control finances. Therefore, budgets should be used to understand the problem and what should be done about it. In that context budgets should be considered as a management tool, not purely a financial process.

Balanced budgets

An important feature of local authority accounting is that overall income and expenditure should balance. All expenditure should be met by sources of income, grants, council tax etc to achieve the balanced budget. Ideally this should be within a single financial year but it is appropriate to ensure such balance over several years when necessary.

It is important that the budgetary control system is not used to artificially inflate expenditure by the inclusion of unrealistic or unachievable income targets. The net result of which is to increase reliance on reserves as a means of balancing the budget.

It is, therefore, important that income targets are realistic and achievable and that expenditure is suitably controlled to ensure that the balance between achieving both is not lost.

Income budgets

Many council departments have budgets that are solely expenditure budgets – cost centres. Other departments also have income budgets – profit centres. Whilst it has to be acknowledged that some expenditure budgets are highly volatile (for instance, the adult care budget which it is difficult to predict new intake and significant costs per case can be involved) many expenditure budgets are relatively straightforward to manage (for instance, a salary budget). However, income budgets are not as straightforward, as their nature varies and can include the following:

- Fixed income – for instance, grant income which is guaranteed for the year. Hopefully a simple budget to manage.

- Variable income – for instance, pay and display income which is predictable but uncontrollable in detail. A budget variance should thus be treated similarly to the discussion in paragraphs 1.6 through 1.8 above
o Debt income – for instance, former tenant arrears. There may be a budget of £10,000. However, if every tenant pays there will be no arrears and no income to collect and therefore an "overspend". Such areas must be treated with care. Inappropriate responses by the centre to budgetary "over spend" can de-motivate the behaviours that are in the interest of the council. For example, if more rent is collected than expected the budget for bad debt will be over spent. This type of overspend should be viewed in this light rather than criticising the responsible officer.

o Subsidy income – DWP payments in respect of benefits paid out. Despite its variable nature it would be more appropriate to view this like grant income rather than variable income.

Budget governance and oversight

To drive the proper understanding of services and derive the appropriate budgetary structures it is important that there is an effective governance process in place to challenge weak or ineffective service delivery and weak budgetary/financial understanding and control. As budgetary management should be the financial representation of service performance/plans the Directorate Management Teams are the appropriate place for budgetary control to be managed. The DMT should act to ensure that emerging service and budgetary pressures are identified and appropriate action taken to resolve, the results being reported as required. However, where a BM has a proven track record of good quality budget management the DMT may delegate more responsibility to the BM only needing to be involved when the BM requires their input.