
Report To:	Policy & Resources Committee	Date: 27 March 2012
Report By:	Chief Financial Officer	Report No: FIN/25/12/AP/JB
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Subject:	Budget Profiling and Zero Based Budgeting	

1.0 PURPOSE

- 1.1 The purpose of this report is to allow Committee to consider the Council's approach to Budget Profiling and Zero Based Budgeting (ZBB), an issue highlighted in the 2011/12 Audit Members Letter.

2.0 SUMMARY

Budget Profiling

- 2.1 Audit Scotland has recommended on a number of occasions that all Council budgets should be profiled at the start of each financial year. Budget Profiling requires the budget holder to translate their service delivery activity into financial terms. This allows budget holders to identify deviations from planned activity and take early corrective action. It would also allow Members and officers to assess the actual performance against planned activity throughout the year rather than reviewing performance against annual budget. All employee costs are currently profiled in this manner however there is currently little or no specific profiling of other budgets lines.
- 2.2 Having undertaken a review of the Revenue budget lines it would be achievable within the existing resources to profile all revenue budget lines above £100,000, around 80% of controllable spend and 80% of total income budgets for 2012/13. This can then be reviewed against the actual activity at each monitoring meeting.
- 2.3 Material Capital budgets could also be profiled for all projects with spend of £250,000, in 2012/13, the profiling of capital projects would be agreed with key officers, reviewed and signed off by the CAMS group and then monitored and reported at each monitoring meeting.

Zero Based Budgeting (ZBB)

- 2.4 Audit Scotland has recently suggested that the Council should consider adopting a ZBB methodology when setting the Council's budget. ZBB assumes that all budgets should be built up from first principles. This requires each Service area to be comprehensively reviewed with all expenditure requiring justification and approval. In order to implement and apply a ZBB methodology, Services and members must set clear measurable outcomes and these outcomes require to be costed.
- 2.5 The reported benefits from ZBB is that it removes inefficiencies, avoids incremental budgeting and eliminates unnecessary spend. Additionally it can be quicker to respond to changes in the business environment, is more focused on outputs and has clearer links between budgets and objectives. However ZBB is complex and costly to deliver. The time and effort involved in preparing a ZBB taking into account the number of activities

undertaken by the Council creates significant work and requires more resources in both Finance and Services. It can also be difficult to identify suitable performance measures and criteria.

- 2.6 Inverclyde Council currently adopts an incremental approach to budget setting – the budget is based on prior year budget adjusted for any known changes. Where new functions have been introduced the budgets have been calculated on a ZBB methodology with incremental budget setting applied in subsequent budget rounds.
- 2.7 CIPFA recommend that a hybrid approach is the most practical method of budgeting setting, with ZBB being used on the less complex areas to build up skills and experience. Based on the above then it is believed that this is the approach being adopted by the Council at present.
- 2.8 The Corporate Management Team have considered the contents of this report and support its recommendations.

3.0 RECOMMENDATIONS

- 3.1 It is recommended that Committee agree that all revenue budget lines above £100,000 and capital projects with projected spend in 2012/13 of £250,000, are profiled. This change will take place for 2012/13.
- 3.2 It is recommended that Committee agree to continue with the hybrid budget setting methodology currently in place.

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

- 4.1 Audit Scotland had raised the issue of profiling budgets on several occasions during their appointment and an action was included in the Council's External Audit Members Letter 2011/12 for the Chief Financial Officer to bring a report to Committee on this matter. Whilst the Council profiles all former APT&C employee budgets there is little or no profiling of the other budget lines, Capital or Revenue. Audit Scotland highlighted that this exposed the Council to the potential risk that Members and budget holders were not aware of the actual financial position of the budget throughout the year but only against the year overall.

5.0 BUDGET PROFILING

- 5.1 Budget profiling translates the annual budget into the activities which will be carried out throughout the year. Budget holders currently control their budgets on an annual basis with the focus on ensuring spend comes in on budget on an annual basis rather than focusing on actual against planned activity on a monthly basis. In profiling budgets throughout the year budget holders can analyse their progress against the plan and take early corrective action where appropriate.
- 5.2 The Financial Management System (FMS) has the capability to profile budgets on any basis the budget holder deems appropriate. The finance staff have analysed the Revenue and Capital budget lines and that for 2012/13 Revenue budget lines above £100,000, income and expenditure, be profiled. The method of profiling will be agreed with the budget holder and be informed by analysing spending trends of prior years and discussing the planned activity with the relevant service. This will account for around 80% of the Council's Revenue budget and can be managed within existing resources.
- 5.3 Capital Budgets where the 2012/13 spend is budgeted to be over £250,000 can also be profiled and it is proposed that in conjunction with the budget holders, profiling of these budgets be undertaken. The CAMS group will review and agree the profile of each project. Profiling of the Capital Programme may also identify slippage at an earlier stage to allow corrective action to be taken or other Capital projects to be advanced to reduce the overall slippage in the Capital Programme.
- 5.4 Monitoring of the profiled budgets will take place monthly between finance officers and budget holders and reported to the relevant Committees in line with current practice. The revenue and capital reports presented to the Committees will highlight material variations between profiled budgets and actual spend to date with suitable explanation.

6.0 ZERO BASED BUDGETING

- 6.1 Audit Scotland suggested that the Council should consider Zero Based Budgeting (ZBB) as a method of budget setting. ZBB is a methodology which assumes all budgets start from zero and are worked up from first principle to provide the resources required to deliver a specific outcome. There is limited consideration of prior budgets or outcomes with each service area being comprehensively reviewed and all expenditure requiring justification and approval. It is therefore essential that prior to implementing ZBB methodology, Services and Committees set clear measurable outcomes. This can be difficult in an environment where the outcomes are largely qualitative and difficult to quantify/cost

- 6.2 Organisations which have introduced ZBB report benefits such as eliminating unnecessary spend, removing inefficiencies and avoiding incremental budgeting. It can respond to changes in the business environment more quickly, focuses on outputs with clearer links between budget and objectives. ZBB is however a complex and resource intensive process and organisations that have adopted ZBB have introduced the methodology on a rolling programme.
- 6.3 Inverclyde Council primarily adopts an incremental method of budget setting, basing the budget on prior year's budget and activity adjusting for known changes eg inflationary increases, approved pressures and savings highlighted throughout the year.
- 6.4 Where new functions have been introduced eg Customer Service Centre, reprovision of Children's Homes then budgets have been calculated on a ZBB methodology with incremental budget setting applied in subsequent budget rounds.
- 6.5 It would be impractical to adopt a complete zero based approach to all budgets across the Council significant additional resources would be required initially to identify the areas which are measurable and could be zero based, then to develop the performance measures against which they would be assessed, to establish how these budgets would link into Service Strategies and finally to prepare the ZBB on an annual or rolling programme.
- 6.6 CIPFA recommend that a hybrid approach is the most practical method of budgeting setting, which is the current practice within Inverclyde. It is therefore not recommended that any added value would be achieved by changing the method of budget setting or increasing the ZBB principles any further across the Council

7.0 CONSULTATION

7.1 Financial

If the recommendations are accepted then there is no direct financial implications however there are potentially significant financial pressures in the Council moving towards ZBB.

7.2 CMT

CMT have been consulted and are in agreement with the recommendations in this report.

7.3 Legal

There are no legal issues arising from the content of this report and as such the Head of Legal & Democratic Services has not been consulted.

7.4 Human Resources

The Head of OD, HR & Performance has been consulted and if the recommendations are approved, they will have no impact on staffing.

7.5 Equalities

This report has no impact on the Council's Equality Agenda.