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PREFACE

This booklet explains the principles of devolved budgets in a straightforward and succinct manner. It has been prepared for use by middle managers who may have limited experience of financial management, as well as by senior finance staff at the early stages of programmes of devolving budgets.

It can be used:

- to explain to management with responsibility for devolved budgets the importance of financial discipline and control;
- by budget-holders, as a source of day-to-day practical guidance; and
- to encourage and assist budget managers secure the maximum ‘value for money’ that can be gained from effective budget management and to increase awareness of the full cost of direct and service support provision.

PART 1: THE PRINCIPLES

BUDGETING – THE CONTEXT

The budgeting process is one component of an organisation's management system. Other aspects include:

- policy formulation;
- strategy formulation and implementation;
- planning systems;
- structure;
- production/marketing system;
- reporting/control system;
- review and revision procedures.

As management tools, budgets cannot exist effectively in isolation. They are an integral element of the corporate plan which acts as a guide, framework and constraint for operations.

The corporate plan:

- asks key questions about the organisation;
- appraises the current and potential market for the organisation;
- creates the framework within which the budgets are set;
- sets the operational context – timeframe, culture;
- identifies objectives; and
- assigns responsibility for the achievement of certain measurable objectives to individual budget holders through the allocation of resources.

PLANNING

Forward planning allows an organisation to shape its future, rather than to react to events, and is critical to the achievement of organisational objectives. Reasons behind the planning process are:

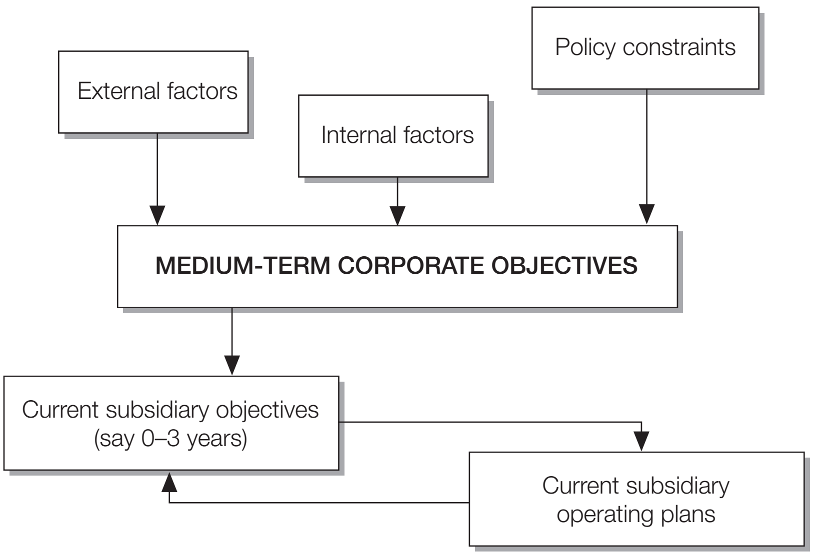
- to achieve acceptable performances;
- to harness different skills in different people;
- to create maximum freedom within minimum constraints;
- to identify and guide training and personal development;
- to instil stewardship and ensure succession;
- to provide a framework for perpetual review and revision.

Through the planning process local actions are coordinated to fulfil organisational objectives. To ensure that these objectives are achieved and that it is followed effectively the budgeting process must take account of:

- external constraints; and
- internal operating conditions.

Further information concerning the planning process can be found in the companion booklet in this series 'A Guide to Business Planning'.

PROCESS OVERVIEW



THE ROLE OF BUDGETS

Budgets combine a **managerial function**:

- by defining the resources likely to be available;
- by agreeing performance and resource availability;
- by identifying the constraints under which an organisation operates – recognising what can and cannot be achieved within given resources and optimising their use;
- by encouraging initiative, how inputs may be effectively managed to produce the desired outcomes; and
- by clarifying responsibilities, accountability and ownership of problems and opportunities;

and a **monitoring/appraisal** function:

- by setting periods for review of the cost-effectiveness of operations;
- by enabling continuous monitoring, e.g. by appropriate phasing of the budget and comparison of budget with actual; and
- by highlighting areas for change i.e. reduce, consolidate or expand.

THE BUDGET-SETTING PROCESS

Budgeting comprises several basic steps:

1. Prioritisation of objectives identified in the planning process;
2. Assessment/quantification of total available resources, both financial and non-financial. The overall corporate budget is likely to include income from several different sources:
    - direct earnings;
    - income from investments;
    - donations;
    - grants;
    - other regular income sources (expected tax rebates etc.);
    - non-recurrent windfalls.
3. Identification and quantification of the inputs and processes (physical/managerial etc) required to fulfil the stated objectives and the associated financial resource required. The role of each function and its significance in achieving the objectives stated in the original business plan should be taken into account.

    In setting budgets, consideration should be given to the inclusion of a non-allocated contingency element so that reasonable allowance can be made for changes which cannot be reasonably anticipated in time or value.
4. Assignment of proportion(s) of the total resources necessary to acquire/manage inputs to achieve the stated objectives. Each dedicated proportion of the total resource constitutes a 'budget'.

FEATURES OF AN EFFECTIVE BUDGET

To operate as an effective management tool, budgets should have the following qualities.

- **Fair.** There is a significant danger in setting performance targets by reference to previous budgets. Reliance on incremental budgeting can result in a limited awareness of changing operating conditions and relationships. A wider and independent perspective is valuable;
- **Participative.** All available experience and knowledge should be drawn on as well as increasing the concept of budget ownership;
- **Even-handed.** Resource allocation decisions should reflect the priority levels set in the planning process;
- **Reasonable.** Set at reasonable levels for the achievement of stated objectives;
- **Cognitive of the real environment in which they operate.** Budgets cannot be set in isolation from the wider operating environment;
- **Supportive and supported.** By those implementing them.
- **Committed.** Guaranteed.

METHODS OF BUDGET SETTING

In an organisation with different management levels, budgets may be set and implemented in several different ways. They may be:

- 'top-down' (imposed) budgets;
- 'bottom-up' (participative) budgets;
- 'parallel' (negotiated) budgets.

Top down (imposed) budgets

The 'top-down' budget is a plan handed down by senior management to middle or departmental management. All the decisions are made by the senior management without consulting the lower levels of the organisation.

Key aspects of this process are that:

– the allocation of budgets is from senior management to budget managers;

– allocation decisions are taken centrally;

– budgets are cascaded down throughout the organisation.

Advantages can include:

- minimal expense;
- saves time, as few people are involved in budget preparation;
- encourages a broad, organisation-wide perspective as top-level management is less likely to suffer from narrow departmental considerations.

Disadvantages can include:

- Potential loss of 'local' knowledge. Senior management may be remote from the environment in which the budgets will be implemented and are likely to have less of a feel for the situation than those who will implement them.
- Potential lack of commitment of lower level budget managers. Lack of involvement in setting quantitative plans for the future may reduce the budget managers' commitment to corporate goals and policies.

Bottom-up (participative) budgets

All levels of management are involved in this budget setting process.

Key aspects are that:

- information regarding resource requirements is collected at the lowest management levels;
- information is consolidated and fed up to senior management;
- senior management considers the information received and sets budgets accordingly.

Advantages can include:

- Staff involvement. Budgets are drafted by the people affected by them. This can promote a sense of commitment which is lacking in imposed budgets.
- Budgets are more realistic than imposed budgets as the information which supports them is provided by people close to the scene of the action where the budgets are actually being implemented.

Disadvantages can include:

- expensive and time-consuming;
- managers taking a narrow view of their activities, ignoring the impact of their actions/demands on other departments or divisions;
- inflated or deflated estimates of resource requirements as managers seek to protect their own interests/projects and performance;
- greater input required at departmental and central level;
- total resource needs will almost certainly be unacceptable.

Negotiated (parallel) budgets

Negotiated, or parallel budgets are, in essence, an extension of the participative approach.

Key aspects are that:

- senior management sets broad goals and constraints; and
- the process of allocation involves active participation, discussion and negotiation with departmental management.

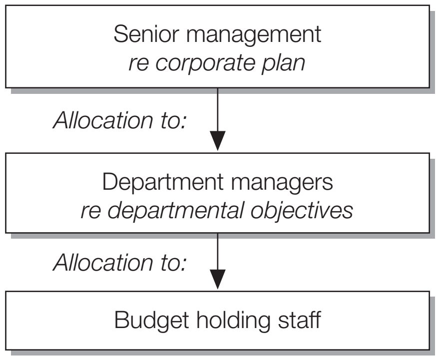
Advantages can include:

- increased commitment and the feeling of budget ownership due to involvement in the negotiation process;
- appreciation that concerns and requirements have been considered;
- greater understanding of how the actions and demands of individual departments impact the organisation as a whole; and
- greater corporate cohesion.

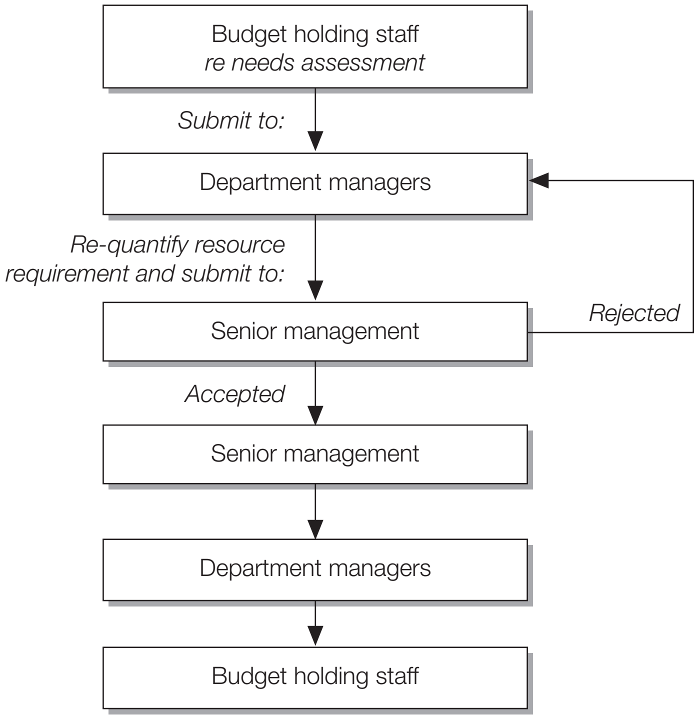
One disadvantage is that:

- the final allocation will always be a compromise. It is likely that no budget holder will receive the resources originally requested.

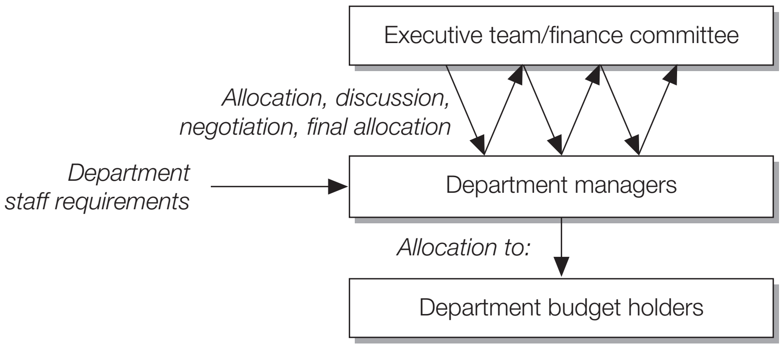
'Top-down' budgeting



'Bottom-up' budgeting



Negotiated budgeting



DEVOLVING BUDGETS

Devolution involves the:

- transfer of responsibility for budget management to local level;
- identification of departmental objectives by local budget managers with reference to:
  - the objectives of the organisation as a whole; and
  - internal and external constraints; and the
- quantification of resources required to deliver the identified outputs.

Advantages for managers

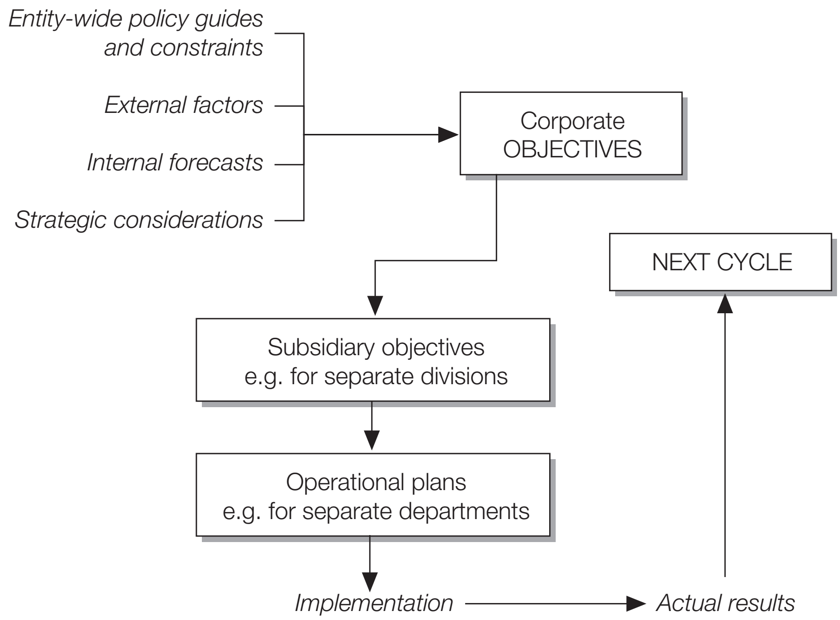
- Increased sensitivity to changing conditions, effectively testing the validity of assumptions.
- Greater understanding of more detailed information generated at local level.
- Clear identification of responsibilities.
- Increased involvement of budget holders and commitment to corporate objectives.
- Assistance in changing the attitude and behaviour of staff within the organisation.
- An incentive for efficiency and income generation.
- Encourages greater financial control by raising financial awareness.

Advantages for budgetholding staff

- Improves control of spending through individual accountability.
- Broadens involvement in the budget setting process, allowing wider ownership of the budget and a clearer focus on the meeting of local needs.
- Nurtures a culture of empowerment rather than control.
- Makes effective use of local/specialised knowledge in informing the budget-setting process.
- Encourages both innovation and a cost-conscious approach by staff.
- Enables identification of the most economic and efficient departmental operations for further development.
- Identifies inefficient and non cost-effective areas for further examination.

PART 2: APPLYING THE PRINCIPLES

PROCESS OVERVIEW



MISSION, OBJECTIVES AND PLANS

The business plan and the planning process formally set out the actions to be implemented to ensure the continued effective operation of the organisation.

Mission statement

The highest level expression of the purpose and direction of the organisation can be set out in a 'mission statement'. This is a statement of long term ‘cultural’ aims sometimes accompanied by a further, brief, explanation of its components. It is timeless and unquantified. It is the foundation stone around which the corporate plan is built.

Mission Statement

The purpose of this Organisation is to encourage and enable individuals to develop their full potential by providing a high quality and stimulating learning environment.

Policies (constraints)

Organisational policies govern the manner in which the organisation will operate to achieve the objectives identified in and from the mission statement. These too are likely to be timeless and may often provide constraints on the manner in which objectives will be satisfied.

Policy constraints may include, for example:

- the organisations' environmental stance; and
- its personnel attitudes.

Corporate objectives

The next stage is the corporate plan. The corporate plan translates the long-term vision set out in the mission statement into identifiable objectives and an actionable long term strategy. The objectives in the corporate plan are specific and measurable and will cover the longer term, often three to five years. It will be subject to annual review.

Departmental objectives

Departmental objectives cascade from corporate objectives to ensure that through its activity each department contributes to the achievement of the corporate objectives.

Departmental objectives are specific and measurable but cover the medium term, often 18-24 months. These too will be reviewed at least annually.

Departmental operating plans

Departmental operating plans are concerned with the more detailed activity of the department and cover staffing requirements, procedures, output requirements etc. They are short-term, specific and measurable.

The resources to be devoted to each component action are quantified in departmental budgets.

Further information on objectives setting can be found in the companion booklet 'From Corporate to Individual: the Objectives Cascade'.

IDENTIFYING KEY FACTORS

Before setting an effective budget, the variables which are key to the organisation markets, products, prices, costs, financial surpluses need to be identified.

Key factors to be considered include:

Pre-budget, planning issues

- the comprehensiveness of the model to be adopted;
- factors, internal and external, influencing the key variables, and the inter-relationships between them; and
- any unproven assumptions (internal or external) on which the model is based.

Post-budget, monitoring and accountability issues.

The assumptions are important in assessing the value of the budget as a management tool. Where continual overspends are observed there should be further investigation of the assumptions on which the financial model is based. This may reveal that variables are not behaving as expected, for example, unprecedented increases in overheads, one-off increases in unit costs, unforeseen tax liabilities. Appropriate corrective action to amend the budget system can then be taken.

DEVELOPING DEVOLUTION

Different organisations will implement devolved budgeting according to their own needs. However, the following basic steps will be common to many:

- Preparation of updated cost/activity forecasts for current year.
- Preparation of rolling budgets. It is recognised that the accounting year is not the only feasible focus for twelve month budgets.
- Consideration of likely changes to both inputs (resources) and outputs (objectives).
- Preparation of a rolling forecast, taking into account anticipated opportunities and problems.
- Adjustment of the time frame to the natural planning horizon.
- Recognition of the futility of arbitrary time periods and a move to an 'update as necessary' basis for forecasting.
- Pump-priming of (selected) areas to stimulate activity.
- Establishment of a performance measurement/reward mechanism.

SOME EXAMPLES

EXAMPLE 1: The 'income-generation-based' devolved budget

Steps:
- Attribute and devolve **all** the income derived from each individual activity to the unit earning it.
- Charge all direct costs and set up service agreements for all indirect costs.

Perceived advantages:
- Income generation is clearly identified;
- Costs are identified accurately, but should not be used out of context;
- Total costs of outputs are more easily identified;
- The opportunity to retain income is matched directly with the ability to generate income.

EXAMPLE 2: The 'expenditure – based' devolved budget

Steps:
- Identify total income available to the organisation and fix the net affordable total cost; and
- Determine expenditure levels for each department within the package created from net availability.

Perceived advantages:
- Allows the centre the facility to exercise demand management by 'pump-priming' certain activities;
- Allows the organisation as a whole to react to problems in one area, rather than giving the responsibility for management and resolution of the problem to that small section;
- Allows for an easier linkage between short and longer term planning as expenditure profiles can be determined in advance;
- Can foster and encourage a corporate philosophy, as departments are affected by the efficiency, economy and effectiveness of others.

WHAT IT TAKES

Leadership

- Clear accounting principles and practices need to be established, approved, disseminated and followed throughout the entity.
- Financial expertise: monitoring and training in skills and techniques.
- Awareness of and commitment to the objectives underlying devolution, from central management and throughout the organisation.

Communication

- Clear understanding of the collective and individual needs.
- Involvement of middle management from initial stages.
- Publication, promotion and understanding of the objectives and expected benefits of devolution.

Training

- Explanation and training in budgeting and other management tools.
- Provision of adequate manuals or help lines for day-to-day assistance.
- On-going financial training for budget holders.
- Continuous training for post-holding staff.

Sanctions

- Following negotiation and informal agreement, sanctions in the form of contractual terms and conditions between the centre and local budget managers may be established.

Continuing commitment

- Continuation of budget holding expertise. Where staff changes occur, 'new' budget holders should be trained and committed to achieving the budget.

INCREASING FINANCIAL AWARENESS

Introducing a system of devolved budgeting may involve considerable change for staff at all levels and training may be required to ensure that staff have the necessary skills required under the new system.

Training programmes should be specific to the individual organisation but all will need to refer to, for example:

- the rationale behind devolution and the management programme for its implementation;
- financial terminology, kept as simple as possible;
- budget methodology and allocation policy;
- the use of budgets for planning and control;
  - integration with the strategic plan
  - performance measurement and reward systems
  - the human factors
  - budgets as plans/targets?
- opportunity to feedback to the departmental and corporate plans; and
- planning long range, longer term financial forecasts.

CHECKLIST FOR ACTION

- Match authorisation levels to budget responsibility.
- Assess training needs in both financial management and business planning. Ensure training is delivered and maintained.
- Involve heads of department and budget holders at an early stage in the annual budget setting process.
- Provide a user friendly manual to all budget holders. Update as necessary.
- Ensure that each budget is controlled by one named budget holder who understands his or her role within the overall corporate framework. Budget management should be an element of annual appraisals.
- Ensure that monitoring reports clearly identify expenditure items for which the budget holder is directly responsible.
- Where possible, group budget holders together to facilitate effective overall management. Review virement levels regularly.
- Establish a clear policy on carrying forward savings and overspends. The mechanisms for recording accruals and commitments must provide adequate safeguards against unauthorised overspends.
- Canvass budget holders about the quality, accuracy and frequency of financial monitoring information provided to them, and ensure appropriate action is taken to address inadequacies.
- Ensure that appropriate training is delivered and maintained, and that this is suitably tailored to the needs of relevant staff, particularly where there are changes to budget-holding staff.

BEYOND DEVOLVED BUDGETS: THE SPECTRUM OF APPROACHES

Budget considerations

- More budgeting techniques, e.g. zero-based, priority-based budgeting etc.
- Service Level Agreements between internal departments.
- Internal charging. **Further information on this is available in the companion guide 'Internal Charging: A Guide for Managers'.**
- Contracting in/out. It may be appropriate to put in place constraints to ensure that the in-house service is a consideration for service provision.
- Costing bases for the allocation of the cost of services such as information; administration; computing; finance; buildings; marketing.

Service Level Agreements

Where support service departments charge internal departments for their services, Service Level Agreements (SLAs) may be used. Issues to be addressed include:

- nature and quality of service to be provided;
- service provider and service user (possible reciprocal relationships);
- duration of SLA and timetable for review of SLA;
- frequency of service delivery;
- basis of charging;
- performance criteria/measurement;
- procedure for settling disputes;
- remedies for failure to perform/deliver.

The above criteria may modify the services provided between departments. Radical changes require complete freedom of choice regarding the level of support service purchased and choice of supplier, including the use of external suppliers.

The booklet has been prepared by the Education Group of the Institute's Public Services Committee. The Group comprises:

Ian Haythornthwaite FCMA (Chair)	Director of Finance, University of Central Lancashire
David Allen ACMA MA LLB	Finance Officer, University of Leeds
Steven Chicken FCMA	Director of Finance, The Open University
David Everest ACMA	Deputy Director of Finance, University of Sheffield
Bernard Lillis FCMA BA	Bursar, UMIST
Ian Nicol ACMA BA IPFA	Director (Finance & Information), University of Luton
Paul Smelt FCA BA	Director of Finance, University of Huddersfield
Rex Smith FCMA	Finance Director, Anglia Polytechnic University

with Liz Murby of the Institute's Public Affairs Department.

The Group gratefully acknowledges the assistance of Peter Layhe, Chairman of the Institute's Public Services Committee.

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ELEMENTS OF THE FINANCE MODEL IN THE EDUCATION SECTOR

The key income and expenditure elements of the financial model must be identified, and any relationships established:

Expenditure items	**Income sources**
Current costs: staffing • central services • support services (estates, administration, welfare etc.)	Funding body grants
Unusual items (eg: staff restructuring)	Income from day-to-day activities (eg. academic tuition fees from local authorities)
Capital expenditure	Income from investments
Non-pay items	Charitable donations
Interest and loan servicing	
Depreciation	Research and commercial contracts
Finance charges	Other operating income

EXTERNAL FACTORS AFFECTING THE BUDGET-SETTING PROCESS

Despite underlying similarities, no two higher education institutions, and therefore no two 'corporate budgets', are identical. The general structure of the budgets must reflect the needs of the institution and responsibility levels in the departments for which the departmental budgets are produced.

Within the sector, for example, the following external considerations are some of the factors likely to influence the budget setting process:

- funding methodology of the Funding Council;
- demand led student choice - the ability to recruit student members to target;
- tuition fee levels;
- research assessment exercise;
- education contracts;
- European funding;
- capital financing
  - private finance initiative
  - funding council
  - consortium financing
  - borrowings;
- research council contracts; and
- trading/commercial activities.

EXAMPLES

1 A CORPORATE APPROACH

1 Summary process

1.1 Planning parameters agreed by Board

A series of key planning parameters are presented to the Board for discussion, including debate on strategic direction, which is set with reference to agreed corporate objectives.

1.2 Five-year plan produced

Following approval of planning parameters, a five-year plan is produced by the director of finance and the head of planning to incorporate all strategic variables of the institution.

1.3 One-year budget calculated from five-year plan

Following calculation of the five-year plan at the strategic level, a series of allocation models are calculated to determine the detailed budget for the first 12 months of the plan.

1.4 Discussion and approval by executive team

Five-year plan and subsequent 12-month budget presented to executive team for discussion and approval. Discussion at this level will concentrate on the strategic direction and overall allocation principles.

1.5 Approval of level of delegated authority

Executive team approves the scheme of delegated authority applicable to the financial management of the budget for the following 12 months. This can be achieved only by ensuring that each budget holder has a direct line-management responsibility to a member of executive team.

1.6 Issue of budgets to primary and secondary budget holders

The finance director issues all budgets to primary budget holders.

1.7 Preparation of monthly reports identifying key variances

To assist managers in the financial management of their budgets and to inform members of the executive team, a set of management accounts, together with appropriate transaction analyses, is prepared on a monthly basis.

1.8 Above process used to inform future forecasts

Feedback from monthly information is regularly fed into the management information database to ensure that appropriate action is taken in future budget revisions.

2. Detailed implementation

2.1 Five-year plan.

The institution approves an annual planning cycle which commences with the identification of key variables affecting its core business. These include:
- S/HEFCE core funding
- non-pay items
- student numbers
- major capital funding
- tuition fee income
- research and trading activities
- staffing costs, (including proportional splits between academic and non-academic pay).

The above variables must ensure that the institution can fulfil its corporate objectives whilst maintaining its overall character and mission. From a discussion of the key variables, the Board can debate the overall strategic direction it wishes to take.

2.2 From an analysis of the key variables, a strategic planning team is appointed to work through the preparation of a strategic five-year forecast. In preparing this forecast, a number of financial and statistical models are used to ensure that there is consistency throughout the plan, eg staffing numbers and that student numbers are consistent with the final income and expenditure calculations. All calculations ensure that the subsequent Funding Council forecasts can be completed following approval of the plan.

2.3 The strategic planning process will determine the overall shape and direction of the institution and it is necessary, following preparation of the five-year plan, to convert this into detailed budgets capable of delegation.

With respect to income, a financial model is used to convert student numbers into projected core funding from the Funding Council and tuition fees receivable. This calculation takes account of contract arrangements with the Funding Council and the approved academic development programme of the institution.

In addition to the above income, detailed assessments are made of research grants and contracts, education contracts and other income-generating activities.

Using the staff and student numbers determined within the plan, the institution has developed a detailed staff distribution model to assist primary budget holders with the determination of the staffing structure. This model takes into account projected student numbers and the conversion of these using staff/student ratios into overall staffing numbers priced at standard costing rates.

Expenditure on research and education contracts is determined from input from groups tasked with advising the executive team on these matters.

Trading activities are provided for in accordance with previously approved business plans ensuring that the focus of these activities is in line with the strategic direction determined by the board.

Other areas of the institution's budget are determined by a needs analysis compiled by the director of finance following a review of the previous year's activity. Within this review, efficiency gains will be expected and implemented.

2.4 **Approval mechanisms**. All plans are submitted to the executive team for detailed discussion and comment prior to the submission of the plans to the Board. Implementation of the plans is the responsibility of the executive team and strategic or operational issues will be addressed at this stage.

2.5 **Scheme of delegated authority**. The director of finance will propose to the executive team a scheme of delegated financial responsibility which will be applicable for the forthcoming year. The scheme of delegated authority will ensure that responsibilities lead directly from the executive team in accordance with the approved financial regulations.

2 BUDGET TIMESCALE METHODOLOGY

Methodology

Wherever possible, income that can be directly attributable to a department is so attributed. The model for budgetary allocation may be supplemented by judgemental factors where circumstances warrant this.

Timescale

Autumn term

- All spending committees and groups review existing activities to assist strategic planning committee (SPC) to fine-tune operational plans if necessary.
- SPC confirms existing broad strategy and makes changes where necessary, depending upon newly identified internal – and more importantly – external factors.

January/February

- Review of all planned operational activity by all spending committees, including formal interview sessions with all academic departments.

February

- Rolling budgets compiled using existing baseline activity.
- Bids for new developments are proposed by spending committees and groups.
- SPC gives a steer to new developments that it wishes to support.
- HEFCE funding allocation integrated into base budget.

March

- New development bids are reviewed administratively to ensure consistency with SPC strategy.
- SPC approve new developments for incorporation into forward budget proposals.

March/April

- Following proposed incorporation of new developments into the forward budget, further reviews of existing activities may be undertaken to ensure that an agreed budgeted out-turn can be achieved.
- In order to achieve a balanced budget, additional income and/or expenditure savings targets for spending committees and groups may be set, either globally, or specifically targeted at spending areas.

May

- Formal approval is given to proposed budget by SPC, finance committee and council. Budgets are communicated to spending committees.

June

- Financial forecasts are forwarded to HEFCE.

3 STAFF/STUDENT FOCUSED MODEL

1. Identify key factors

- the extent of top slicing
- a process for building up new development funds
- formulation of 3- to 5-year rolling plans
- size of budgetary units (department may be too small, faculty may be too large).

2. Identify parameters/constraints:

- Institution's financial viability must be maintained.
- Devolution must be carried out within the constraint of strategic planning.

3. Review expected operating income

4. Note the amount of income to be devolved: i.e. *that income which results directly from the enrolment of students*. This income is identified according to source as:

- S/HEFEC recurrent grant for teaching (T)
- S/HEFCE recurrent grant for research (R)

the largest section of revenue to be allocated

- TTA recurrent funding for teaching;
- FEFC recurrent funding for teaching;
- HE tuition fee income;
- FE tuition fee income;
- ESF income;
- Other school income.

For T and R, this is received by modes and levels within 11 identified Academic Subject Categories (ASCs). Since income is generated according to the 11 ASCs, revenue is allocated on the same basis. The income generated by each school for each of the eight income categories identified is attributed to various ASCs at the individual student level. This is then aggregated to give a category total for the school in that ASC.

5. Note the recipients of the income to be devolved. These fall into three broad areas.

Services

These include computing, library and printing services, estates, student services, financial services, secretariat and administration, registry, payroll and personnel, vice-chancellery, international office and external affairs.

The allocation for each service is calculated by subtracting any income that a service is expected to generate in the year from its expected total expenditure in the revenue budget. The difference is the year's allocation, A_{budg}. It is possible to calculate from the annual budget the total allocation per FTE to the schools and from this methodology, the devolved revenue figure.

The ratio of allocations, S_{devrev}/S_{budg} is multiplied by A_{budg} to give A_{dvl}, the initial services allocation. The services therefore receive the same percentage change in their allocation as the academic area.

Strategic provision

This is accumulated for a variety of uses including:

- to contribute to the cost of innovations in schools and services
- to fund development posts in their first year
- to provide for waived tuition fees
- to provide for long-term sickness cover and for magistrates and trades union duties.

Schools

Because income is generated according to ASCs, revenue for schools is allocated on the same basis.

Income is allocated as follows:

- calculate the income for each source category
- apply a top slice to give a sum of money for the strategic provision
- multiply the remainder by $\mathbf{d}_i$ to give the amount attributed to the school
- attribute the remainder to the services (on a formula based allocation).

In the final stage for schools allocation, the S/HEFCE research grant, the school-based ‘other income-generating activities’ and ‘other school income’, plus the servicing adjustment are added to give the schools allocation.

4 THE TOP-DOWN/BOTTOM-UP APPROACH

Key players

- The Funding Council which allocates overall external income;
- Principal's Advisory Groups, which formulate broad-brush planning assumptions;
- Planning Support Group, which is used in setting the initial (benchmark) budget;
- Budget Group, a sub-group of the finance committee, which ensures at all times that the institution is operating to break-even budget and allocates resources to the three spending areas.

Key spending areas and controlling committees

- Academic departments; the academic resources and development committee (ARDC).
- Administrative and central support departments; the general services committee (GSC).
- The estate; the estates committee (EC).

The devolution process

1. The planning process is an incremental process, using current year's funding as the starting point for setting the budget for the forthcoming year.
2. In accordance with the assumptions established by the planning support group, the budget group devises the initial 'top-down' or 'benchmark' budget, and allocates this between the three key spending areas. This is the initial 'top-down' process.
3. The controlling committee of each spending areas allocates the resources further to the departments within its own area of responsibility.

   ARDC

   The ARDC is chaired by a pro-vice chancellor and comprises 15 appointed members drawn from the ranks of senior academics. (Representation covers all subject areas but not necessarily all departments.) Members are not permitted to put forward or support their own departmental cases.

   Budgets are devolved to departmental level, and each department must submit an academic plan, including both teaching and research, which is up-dated annually. The plan is submitted to the ARDC for consideration and must address the department's medium-term planning aspirations and the specific resources required for implementation.

   Each department must indicate what it will deliver in return for the resources it has requested. The ARDC meets representatives of each department every year to discuss in detail the academic plans and the allocation of performance targets and resources.

GSC and EC

The GSC and EC committees also follow a process of consultation with the relevant non-academic departments to agree the appropriate size of the budget.

4. Following consultation between the committees and their relevant departments, the individual allocations to the three key spending areas will be either affirmed or noted as too small/too large. Each of the three committees may bid for additional resource and may or may not be successful. This constitutes the 'bottom-up' section of the devolved budgeting process.
5. A final allocation is made by the budget group. This represents the final 'top-down' section of the procedure.
6. The resultant figures are slotted into the resource accounting model outlined below.

The fact that the academic resourcing committee comprises academics making decisions about other academics gives the system: credibility; allows for judgement, positive cross-subsidisation and flexibility and provides a mechanism for legitimising the pump-priming of new initiatives which will be income-generating in time. A purely mechanistic system may not do this.

The model

The resource accounting procedure has five elements:

- the attribution of all income to departmental level;
- the allocation of income to the major academic and non-academic areas;
- the establishment of departmental budgets for income and expenditure; and
- the calculation of the level of cross-subsidisation 'given' or 'received' by a department.

Within the resource accounting model, an income/expenditure 'balance sheet' is prepared for each academic department.

The departmental income/expenditure balance sheet

Income attribution reconciles departmental income attracted with the ARDC budget and provides time-series income and allocation data: prior year's actual outturn; the current year's budget; and next year's benchmark or final budget.

Unrestricted income (made available from S/HEFCE) includes teaching grant; research grant; special needs/non-formula funding allocation and is allocated by the Funding Council. Most external income is easily and unambiguously attributed to individual academic departments.

Allocation to major academic/non-academic areas is done by one of three methods:

- by establishing an appropriate cost driver eg. space for departmental contributions to estates costs;
- by a percentage of gross income for administration and central support costs where the above is not appropriate; and
- by a 'tax' of 20% of departmental income to an ARDC fund to provide for cross-subsidy. (Departments receiving more than 20% 'back' from ARDC are explicitly seen as receiving a subsidy in the section below, and vice versa).

Establishment of departmental income and expenditure budgets

Departmental income has a recurrent core (relatively stable) and a performance-related non-recurrent element. The recurrent core which is guaranteed changes only as a result of inflation/efficiency gains and/or major changes to baseline activity agreed with the ARDC. The performance-related, non-recurrent grant has four elements:

- overhead income;
- overseas student performance-related funding;
- HEF student performance-related funding;
- service teaching performance-related funding.

The distribution formulae for overhead income earned on research grants etc. remains unchanged year-on-year, except in the case of crisis, or unless ARDC wishes to increase the resource available for central allocation. Expenditure has pay and non-pay elements. Core non-pay funding is a single allocation to each department to contribute to consumables, equipment, travel, minor works and non-permanent staff. Year-end underspends are carried forward, over-spends are visited on departments. The actual level of resource is agreed with ARDC as part of the 'bottom-up' element of the procedure outlined above. At any one time, therefore, a department may be in balance, may require a subsidy from the ARDC fund or may be in surplus.

Calculation of the level of cross-subsidy

By comparing the balance needed to equalise the income and expenditure with the sum contributed by the department to ARDC (by way of tax), the degree and direction of cross-subsidy is made explicit. ARDC, operating in collegiate mode, are in a position to determine the desirability of continuing the degree of level of cross-subsidy thereby established.

5 A DEVELOPMENTAL PERSPECTIVE

Scenario

A large institution operating on traditional and long-established departmental structures, had reacted to changes in funding by percentage increases or decreases applied equally, with small variations, across all categories of expenditure to all academic and administrative departments.

The institution was beginning to function less well than many against which it had traditionally compared itself. The allocation of funds to institutions, previously determined by annual adjustments to an historical base, was now constituted on the number of students per subject, and the volume and quality of research. The result was a significant reduction in funding for the institution.

The traditional method of allocating resources within the institution was to retain control over staffing establishment/costs centrally but to devolve responsibility for determining how non-staff allocations were spent to departments. Virement between staff and non-staff costs was permitted only in exceptional circumstances.

Devolving the Budget

Stage 1

As a strategic move to reverse the downward drift it was agreed that the institution should move to a basis of funding departments which reflected the income drivers on which the institution itself was funded. The steps identified were:

1.1 The allocation of budgeted income to academic departments on agreed bases which reflected student numbers, the nature of the course, and the research activity of the department in relation to quality and volume;

1.2 The determination of the cost of central support services and costs as a percentage of the total income. These costs included a significant restructuring provision;

1.3 The departmental allocation to each academic department was net of the central support costs percentage;

1.4 Comparison of the net allocation with the current total cost platform for each academic department. Significant variations were identified;

1.5 An agreed period in which traditionally over-funded departments would reduce their expenditure while traditionally under-funded departments would increase their expenditure to the net allocations. Support teams were provided to assist departments in reducing expenditure;

1.6 The department could determine the split of expenditure between staff and non-staff costs;

1.7 Departments were encouraged to seek increases in their allocations by responding to the income drivers;

1.8 Over- or under-spends against net allocation were carried forward to the next year.

Result

Overall, academic, research and financial performance of the institution greatly improved.

Local, better-informed decision-making with the incentive of financial gain for the individual department generating more efficient use of available resources.

On an individual departmental basis, it soon became apparent that a wide spectrum of financial management competency existed. Some managed their finances extremely well while others did not. In some departments this was due to a perceived conflict with traditional concepts.

A downside to the exercise was the feeling that the community spirit between departments had been lessened. Staff were less willing to do service work for other departments. However, this meant that hidden costs were eradicated.

Stage 2

Five years on from the implementation of devolved budgets, the process of educating and training the budget holders to hone their financial management skills and to consequently optimise efficiency and effectiveness of the whole institution is beginning in earnest.

This will be achieved by:

2.1 Planned training on general financial management/budget operation together with specific training on internal systems/markets. The training will be supplemented by the production of 'best practice' financial procedures and regulations manuals;

2.2 Ownership of financial responsibility will be increased through promulgation and execution of incentives and sanctions for good and bad performance respectively;

2.3 Full absorption costing for pricing decisions will be enhanced through improved transparency of support service costs to all departments by greater sophistication in apportioning central costs by the identification of cost drivers;

2.4 Enhanced and more detailed financial reporting and information gathering will be undertaken to ensure corporate and departmental objectives/action plans are in harmony. This will mean increased financial administrative support so that departments can concentrate primarily on their teaching and research objectives.

Summary

The institution has regained its position relative to its peer group in teaching and research and has a healthy financial position.