

Budgets

A public sector budget is used as an instrument to allocate public resources toward achieving some public value. Public decisions must weigh the cost of public action against the worth of the activity to society.

General Definitions:

A *budget* is a financial plan that serves as a formal statement of revenue and expenses of an organization. A budget provides a time frame for decisions about the services and activities. A budget provides indications of revenue flows. Budgets can be used for looking forward (planning) or for looking backward (monitoring). Budgets have three general functions: a) budgeting; b) control, accountability and c) evaluation.

Control

There are three types of control: a) expenditure control; b) accountability for purposes of management and efficiency; and c) evaluation for purposes of monitoring, assessing and planning for future service requirements

Control constrains. At local levels of government public budgets originally were designed primarily to prevent theft. Why is this important? Budgetary control acts as a deterrent against misappropriation of funds. Rules establish procedures, but they also establish the boundaries of behavior.

Control assumes that expenditure must agree with appropriation. Appropriation expresses the intent of the authorizing agent or the legislature. Control maintains information about expenditure to preserve an audit trail. An audit trail is a sequence of documents—invoices, receipts, canceled checks, and so on—that permits an outside observer—such as a government or non-governmental auditor—to reconstruct the transaction to determine whether the money was spent as it was intended.

Consider the principle of fiscal accountability. As we noted, this principle applies to private goods but is often suspended when we are speaking of public goods. Nevertheless, public goods involve public expenditures, consequently there must be some accountability. There are a variety of accounting systems:

- 1) cash accounting—money is disbursed or spent only when a check is written
- 2) modified accrual—system required under GAAP (generally accepted accounting procedures) expenditure is recorded when liability is recognized, generally when a good or service is delivered to the purchaser and normally well before any check is written.
- 3) accrual

Note that budget control requires encumbrance control throughout the year, not just at the end of a budget period. Budget managers must be able to track the flow of resources accurately.

Transparency in the public sector refers to the freedom from deceit and misrepresentation. Policies and procedures that increase transparency are devices to prevent theft, but also prevent the problems associated with allegations or suspicion of theft.

Evaluation

Evaluation is used to assess progress toward established goals (backward looking) but it is also critical in program planning (forward looking). Evaluation is used for extrapolation and programming of future activities.

We cannot predict the future, but have to prepare for it. Activities have to position themselves. Planning is designed to ensure the continuity of program activities.

Types of Budgets

Budgets may be classified by organization and structure:

Line Item Budget The Object of expenditure is the key to classification. This may also be called an “indicative budget” if it is in a preliminary stage (pre-approval stage). Focus on input. Characteristic: expenditure by commodity or resource purchased primary feature: resources acquired orientation: control

Performance Budget Classification according to direct output of activity, intermediate product, activities, and purpose. Focus on output or outcome. Characteristic: expenditure by work load or unit cost of activity primary feature: tasks, activities orientation: management

Program Budget Classification according to the reasons or rationale of the activity. Focus on goals and purposes. Characteristic: expenditure by public goal primary feature: results, product, outcome orientation: planning

Budget Dynamic Flows

—3 Levels of Flows of Resources

Inputs—(intelligence, labor, equipment, supplies)—(input data)

Activities—(activities, tasks, outputs)—(process data)

Outcomes—(outcomes)—(outcome data)

Effects—(well being)

Budget Cycle

Stages in the budget process

- 1) preparation
- 2) consideration and approval
- 3) execution
- 4) audit and evaluation

These cycles are linked. They are not independent acts. For instance, audits are carried out to detect fraud and to deter fraud, but they also function to provide input for the next preparation cycle.

NOTE ON BUDGET PROCESS IN THE US

Federal fiscal year begins in October 1, 1997

State governments start fiscal year July 1, 1997 (Alabama, Michigan, New York have April 1 starts and Texas has a September start).

Fiscal years are named after the year in which they end.

Thus on Wednesday, October 1, 2004, the federal government will start the 2005 fiscal year.

Stage: Budget Preparation—involves agency planning, estimation of needs of activities, and cost estimates for staffing, for material and supplies, for contingency, etc.

Estimates are collated by the executive and then a budget is prepared.

Stage: Budget Consideration When there is legislative approval, agencies often use this as their chance to return to their budget requests.

Stage: Budget Execution The units carry out their activities. The approved budget then becomes a monitoring device.

Law typically forbids agencies from spending more than has been appropriated but common sense forbids them from spending less.

Hence, finance officers must continuously monitor the relationship between actual expenditures and planned-approved expenditures (appropriations) during the fiscal year. This is often done with preexpenditure audits to determine whether the expenditure fits in the appropriation.

Stage: Evaluation and Audits. An audit is a comparison of actual expenditures with the legislation to assess conformance. Examine record, facilities, systems, and other evidence to verify information.

Post-expenditure Audits determine compliance with appropriations and report findings to the legislature or to a judicial body.

Audits may be: A) financial statement audits or B) performance audits

Financial audits determine whether the records fairly present the financial position, results of operations, cash flows, or changes in financial position in accordance with Generally Accepted Accounting Procedures (GAAP)

Types of Performance Audits:

Economy and Efficiency audits—whether an entity is acquiring, using, and protecting its assets economically and efficiently

Program Audits

- 1) The extent to which the desired results or benefits established by the legislation or mission statement are being achieved
- 2) effectiveness of organizations, programs, activities, functions
- 3) compliance with law, mission statement, specialization of function

Budget Reform: Universal Requirements

Public budgets must satisfy certain requirements that are not necessary for private organization budgets.

These requirements include: a) unity; b) universality (also called the *gross budget rule*); c) solidarity and d) transparency.

Unity means that all resources and all expenditures of the public organization must be provided for in a single document. This principle gives fiscal authorities a comprehensive view of all public finance matters.

Universality means that all revenues are accounted for in their gross amount. This principle requires that all revenues are accounted for without any offsetting against spending items. The gross budget rule also prohibits agencies from increasing their resources beyond their budget appropriation in any way other than those provided by law.

Solidarity means that all revenues serve to fund all expenditures. This principle avoids “ear-marking” by which parts of the budget are sequestered or reserved for special interests.

Transparency means that the budget is free from misrepresentation and deceit. The principle of transparency requires that the budget document be a public document.