Classification of Expenditure and Preparation of Budgets

By: Errol Gardner
For MOE Bursar Training
Objectives

At the end of this presentation participants should be able to:

- To examine the structure of the expenditure and revenue budgets
- To define relevant terms associated with these budgets
- Define what is a budget
- Understand the importance of a budget to an organization
- Understand the Budget Process and Individual’s Contribution
- Identify the different types of Budgets
- Understand Budget Structure
- Understand the Imperatives of Expenditure Management and Budget as a Management tool.
Classification of Expenditure

Expenditure classification defined:

- The process of grouping expenditure according...initially divided into capital expenditure and revenue expenditure. In a production organization the revenue expenditure is classified sequentially to enable a product...
Two of the most important documents in respect of each financial year are:

1. the Expenditure Estimates
2. the Revenue Estimates and Financial Statements

The estimates of expenditure is usually laid in the House on the same day of the Throne Speech, while the Revenue estimates and Financial Statements are normally laid on the day the Minister makes his opening budget presentation.
Ministries, departments and executive agencies are assigned head numbers in the budget and are funded directly through the warrant process.

Public Bodies, Government companies etc, that are supported by Government are included in their portfolio ministry’s budget.

The first two digit of the head number represents the ministry. Hence it is always possible to determine under which ministry a department falls.
EXPENDITURE

- AUTHORITY FOR EXPENDITURE
  - All funds expended by ministries and departments must have prior approval of Parliament either by way of the Appropriation Act, the Constitution or some other Statute.

- VOTED PROVISION
  - An Appropriation Act is passed each year stipulating the funds appropriated to Ministries and Departments as approved (i.e. Voted) by Parliament. These funds are referred to as “Voted Provision”.
The Constitution and some statutes stipulates that in respect of certain critical areas, funds must be provided for and be a first charge on the Consolidated Fund. These funds are referred to as “Statutory Provision”. They do not require the Vote of Parliament by way of the Appropriation Act.
EXAMPLES OF STATUTORY PROVISION

- His Excellency the Governor General & Staff-GG Act
- Houses of Parliament-Salaries for Clerk & Deputy clerk-Constitution
- Office of the Public Defender-Salary-Act
- Office of the Contractor General-Salary- Act
- Auditor General-Salary- Constitution
- Office the Services Commission-Salary- Constitution
- Pensions-Pensions Act
- Loans-Constitution
The estimate is presented in the PROGRAMME BUDGETING format and it distinguishes between Recurrent and Capital Expenditure. This distinction is referred to as the Financial Pattern and are as follows:
<table>
<thead>
<tr>
<th>CODE</th>
<th>FINANCIAL PATTERN</th>
<th>PURPOSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Recurrent</td>
<td>Voted housekeeping/expenses</td>
</tr>
<tr>
<td>20</td>
<td>Capital A</td>
<td>Voted expend. (develop) –GOJ taxation</td>
</tr>
<tr>
<td>30</td>
<td>Capital B</td>
<td>Voted expend. for develop-GOJ/foreign funds</td>
</tr>
</tbody>
</table>
EXPENDITURE

- Only Ministries are provided with capital budgets except for the Office of the Cabinet.
- The Capital budgets for departments and agencies are included in their portfolio ministry’s capital budget
- *Statutory Provisions are shown separately
- 11-Recurrent Statutory
- 21-Capital A Statutory
Budget Defined

A Budget is a financial and or quantitative statement prepared and approved prior to a defined period of time – taking into consideration the policies of the organisation/department to be pursued during the period for which the budget is prepared.
Why Budget?

- To provide a basis for controlling actual results, by comparing them with budget and analysing reasons for variance.
- To promote communication up the line on what managers and supervisors need to carry out their activities and down the line on what is expected of them.
The ability to budget effectively is a very important part of being a successful organization. Continued careful budgeting will be useful in maintaining standards of performance for Management, Faculty and other staff members. It will also continue to be the tool to measure results, fulfilling the organization's mission and its main goals.
The Three (3) P’s of Budgeting

If you know where you are going, you’re more likely to get there.

- Budget Process
- Budget Planning
- Budget Performance
The budget process is the system of tying together *Planning* and *Doing*.

The process is also called the process of financial control/parliamentary control and is a continuous process in which one phase depends on the previous phase.

The preparation of the budget depends on whatever figures are available for the current year and the review of results for the previous year, or even the year before that. If this experience is too historic, it is of little value.
The Budget Cycle

1. **Department** prepare estimates
2. **Parliament** authorises expenditure
3. **MOF** releases funds
4. **Departments** record expenditure
5. **Auditor General** audits records
6. **Parliament** reviews results (PAC)
What is Involved in Planning the Annual Budget?

- Forecasting Income, Expenditure and profit targets by Divisions:
  - Define human resources needs
  - Plan for introduction of new school products or services
  - Set time timetables

- Who are involved?
  - Principal & Vice Principal
  - Department Heads & Snr. Staff
  - Other employees
The budget and the corporate plan at schools should be closely integrated with the latter driving the former.

The corporate plan outlines the organisation’s mission/reason for existence, which defines what it is to achieve and specific strategies which outline how its objectives are to achieved.

It also sets out the system of monitoring and evaluating the performance of the plan.
What is Involved in the Budget Performance

Identifying and controlling budgeted against actual income, expenditure and their variances. Any differences between budgeted figures and actual figures are seen as favourable or unfavourable variances.
Example: Income

Actual income that exceed budgeted income result in favorable income variances.

<table>
<thead>
<tr>
<th>Actual</th>
<th>Budget</th>
<th>Variance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$400,000</td>
<td>$380,000</td>
<td>$20,000</td>
<td>F</td>
</tr>
<tr>
<td>$370,000</td>
<td>$380,000</td>
<td>$10,000</td>
<td>U</td>
</tr>
</tbody>
</table>
Example: Expenses

Actual expenses that exceed budgeted expenses result in unfavorable expense variances.

<table>
<thead>
<tr>
<th>Actual</th>
<th>Budget</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>$400,000</td>
<td>$380,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>$370,000</td>
<td>$380,000</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

U = Unfavorable
F = Favorable
We must distinguish between Budget effectiveness and efficiency.

**Budget effectiveness** is the degree to which a goal, objective, or target is met.

**Budget efficiency** is the degree to which inputs are used in relation to a given level of outputs.
Performance report is a generic term that usually means a comparison of actual results with some budget.
When to Investigate Variances

<table>
<thead>
<tr>
<th>When should variances be investigated?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowing exactly when to investigate is difficult.</td>
</tr>
<tr>
<td>Many organizations have developed such rules of thumb as “investigate all variances exceeding $5,000 or 25% of expected cost, whichever is lower”.</td>
</tr>
</tbody>
</table>
Types of Budgets

- Revenue & Capital Expenditures Budgets
- Cash Budget
- Revenue Budget
Operating Budget Defined

- Detailed projection of all estimated income and expenses based on forecasted sales revenue during a given period (usually one year). It generally consists of several sub-budgets, most important one being the Sales budget which is prepared first.
Cash Budget Defined

- Financial plan that is a summary of estimated receipts (cash inflows) and payments (cash outflows) over a stated period. Two common methods of cash-budgeting are (1) Adjusted net income approach and (2) Cash receipts and disbursements approach.
Capital Budget Defined

Capital budgeting is the process by which the financial manager decides whether to invest in specific capital projects or assets. In some situations, the process may entail acquiring assets that are completely new to the firm. In other situations, it may mean replacing an existing obsolete asset to maintain efficiency.
SAMPLE BUDGET STRUCTURE OF A SCHOOL

Activity Principal

Activity Vice Principal

Sub Activity Canteen
Sub Activity Lab
Sub Activity Art Dept.
Sub Activity Math. Dept
Sub Activity Language Dept.
Sub Activity Admin.
Sub Activity HR
## Cash Flow Projections for period ending Oct. 31, 2008

<table>
<thead>
<tr>
<th></th>
<th>April</th>
<th>May</th>
<th>July</th>
<th>Aug.</th>
<th>Sept</th>
<th>Oct</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2008-2009</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>B/F</strong></td>
<td>10,183</td>
<td>6,331</td>
<td>10,664</td>
<td>14,100</td>
<td>17,539</td>
<td>19,329</td>
<td>95,246</td>
</tr>
<tr>
<td><strong>Inflows</strong></td>
<td>9,024</td>
<td>15,267</td>
<td>15,267</td>
<td>15,267</td>
<td>15,267</td>
<td>15,267</td>
<td>85,359</td>
</tr>
<tr>
<td><strong>Outflow</strong></td>
<td>22,291</td>
<td>20,349</td>
<td>21,246</td>
<td>21,243</td>
<td>22,892</td>
<td>20,349</td>
<td>128,370</td>
</tr>
<tr>
<td><strong>Net inflow/outflow</strong></td>
<td>(3084)</td>
<td>1,249</td>
<td>4,685</td>
<td>8,124</td>
<td>9,914</td>
<td>14,247</td>
<td>52,235</td>
</tr>
<tr>
<td><strong>Warrant</strong></td>
<td>9,415</td>
<td>9,415</td>
<td>9,415</td>
<td>9,415</td>
<td>9,415</td>
<td>9,415</td>
<td>56,490</td>
</tr>
<tr>
<td><strong>Balance C/F</strong></td>
<td><strong>6,331</strong></td>
<td><strong>10,664</strong></td>
<td><strong>14,100</strong></td>
<td><strong>17,539</strong></td>
<td><strong>19,329</strong></td>
<td><strong>23,662</strong></td>
<td><strong>108,725</strong></td>
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</table>
## HR & Communication Expenditure Projections “000”

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Compensation</td>
<td>853</td>
<td>853</td>
<td>853</td>
<td>853</td>
<td>853</td>
<td>853</td>
<td>5,118</td>
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<tr>
<td>Travel</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>300</td>
</tr>
<tr>
<td>Rental</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of Goods</td>
<td>878</td>
<td>18</td>
<td>518</td>
<td>18</td>
<td>78</td>
<td>18</td>
<td>1,528</td>
</tr>
<tr>
<td>Capital Exp.</td>
<td>1,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Capital &amp; Recurrent</td>
<td>2,781</td>
<td>921</td>
<td>1,421</td>
<td>921</td>
<td>981</td>
<td>921</td>
<td>6,946</td>
</tr>
</tbody>
</table>
Imperatives of Expenditure Management

Aggregate Fiscal Discipline:
Budget totals should be the result of explicit, enforced decisions. They should not merely accommodate spending demands. These totals should be set before spending decisions are made, should be enforced during implementation of budget, and should be sustainable over the medium term and beyond.
Allocation Efficiency:
Expenditure decisions should be based on government priorities and on evidence concerning the effectiveness of public programs. The budget system should facilitate reallocation from lesser to higher priorities and from less to more effective programs.

Operational Efficiency:
Agencies should provide goods and services at a cost that achieves ongoing efficiency gains. These services should be accessible to citizens and responsive to their needs and should be provided in a fair and courteous manner.