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# The next generation of Government Budget Formulation

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## The Challenge

Managing budget formulation can be a challenge for any organization, large or small, private sector or government. All too often collecting and arriving at final budget figures tends to be a sophisticated “guessing game” that flows through a process of iteration with stakeholders until a series of “best guesses” based on past and anticipated performance is arrived at. Some methodologies are legacies from the 20th century, while others tend to be little more than a series of customized spreadsheets relying on historical rather than real time inputs.

Despite advances in technology, very few systems cater adequately for the often lengthy iterative processes that are an essential part of modern budget formulation.

## Government Budget Formulation

Governments are now placing greater emphasis on their financial and performance management, requiring an approach that differs to that of the commercial world. Corporate budgeting systems are often engineered to budget over a rolling 12 to 18 month period, whereas Governments typically need to budget over a 3 to 5 year time frame.

Compiling a budget within Public Sector organizations often requires a greater level of detail, both non-financial and explanatory in nature, than their Private Sector counterparts. Within Government, greater scrutiny from opposition parties and the general public over funding decisions and the requirement for transparency of new funding proposals is essential. Governments also tend to involve a wider cross-section of stakeholders, each with vested interests in the outcome of the budget process.

Budget proposals are usually evaluated through more iterations than their private sector equivalents (often referred to as second, third or more budget passes) to consolidate these figures and arrive at a final budget position. The result can be several months of intense effort to create a budget where the final numbers attempt to satisfy everyone, or comply with predetermined expenditure and revenue projections, rather than being a realistic forecast of the organization's capabilities.

Additionally, once a budget is approved and implemented, governments need to be able to quickly identify if and when it deviates from the approved budget position – a process requiring the capability to accurately track the budget in real time and publish that information in response to political and economic considerations.

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# Managing the Budget Process in Government

Government organizations, from Central Agencies coordinating the budget for an entire country, state or city – to individual Agencies managing budgets in collaboration with that Central Agency, might adopt a process that collates Budget Requests or Budget Change Proposals, then prioritizes decisions that need to be made. There may also be much iteration of these decision making processes required, before what constitutes the final budget position is arrived at.

To meet their requirements, Government organisations will have different needs for technology solutions to support their budget process. However, the system must adhere to best practice principles of capturing information, minimizing unnecessary duplication of data entry, and removing uncertainty about the validity and currency of the information.

A system to manage Government budget formulation typically requires strong process control to ensure the validity and transparency of each budget step. This process control should be rigid enough to provide the required level of governance, but flexible enough to ensure that budget proposals receive the right attention from the right people.

To accommodate performance management best practice, a budget management system should align budget proposals with the strategic objectives of the organization and also provide the capability of linking each budget proposal to a specific goal. This will allow Government to better analyze the allocation of resources to meet each component of their overall strategy

## Supporting Decision Making

As central budget committees evaluate the impact of each budget proposal, there should be a high degree of support provided by the management system to facilitate this process, enabling central budget committees to assess the impact of each decision and to provide an ongoing record that justifies those decisions.

As Government decision making processes tend to remain fluid until the final budget is locked down, the capability should exist to define and compare differing scenarios to allow the Government to gauge the effect of their decisions, depending on the priorities of the day.

Wherever possible, when introducing a system to manage budget formulation, the system should integrate with existing processes and practices, where possible, to ensure minimal interruption of the day to day business of the organization. This integration should include the ability to leverage data already captured in established systems.

The challenge is to:

- Streamline budget formulation – particularly the process of departmental proposal submission and reiteration.
- Project the effect of individual and collective proposals across all areas of the budget.
- Permit speedy amendment of proposals and assess their effect on the budget.
- Consolidate finalized proposals and submissions into a draft budget.
- Simplify the draft budget submission and approval process
- Publish the final budget papers.

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## New Methods

In an effort to redefine the budget formulation process and achieve a better level of realism, large organizations are now adopting rolling forecasts to complement, or replace, their traditional budgeting methods. For some, this stems from a realization that annual planning makes little sense in a world where predicting the future beyond a six or even a three month period is virtually impossible. Others have discovered that by watching future trends and keeping track of actual results in real time, they can react quickly to variations in expenditure or revenue to keep the budget on track or make changes that benefit the organization.

Real-time tracking of budget performance has been highlighted as one of the most difficult aspects of budget management to achieve, as often many agencies are involved in a variety of programs, conducted on behalf of the Government, and compiling the range of information needed to create an accurate snapshot of the expenditure to date, requires collecting and processing information from many different agencies. In addition many government agencies are dependent on legacy systems and consideration should be given to ensuring that a new budget management system can eventually link to or integrate with these systems.

Due to the nature of politics, responding quickly to change and being able to analyze the cause and effect is an essential requirement for a government budgetary system, which allows Agency heads to produce facts on demand and formulate the appropriate follow up action.

To stay on track, organisations must formulate, then implement a budget plan while evaluating their performance against that plan, and then be able to respond quickly to any deviations. This requires a continuous process of monitoring, replanning and adjustment that involves the entire organization.

The budget formulation process can be defined as a number of distinct steps:

- Planning identifies the activities needed to achieve the organization's goals, whether it is a return on capital in the case of a corporation - or as in the case of government – the implementation of policies that require expenditure and the delivery of programs such as Law and Order, Health, Defence and Education.
- The budgeting process allocates resources to those activities over a defined period.
- Actuals are reported against the budget and variances highlighted each month,
- Forecasting predicts the financial position at the end of the year.

That is the theory – reality tends to be somewhat different.

The problem with many budget planning systems in use today is that rather than following an integrated and continuous process, many have a disjointed, non-integrated approach. These systems primarily focus on collecting financial information by an organization for a prescribed period, when the decision-making process should also be about selecting what programs and activities should be funded in order to achieve the organization's goals.

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## Is there a Perfect Budget Management System?

Perfection in anything is always difficult to achieve – including a Budget Formulation and Management System. With so many factors to be considered, particularly in Government where many agencies contribute to the financial mix, the perfect system should be one that is flexible enough to be capable of being configured and customised to the needs of those agencies.

## Consider a system using a modular approach.

The primary module would be used by the Central Budget Agency to oversee the budget preparation process. This Budget Preparation module should support:

- Multiple out-years
- A variation style approach to budgeting
- Scenario analysis
- Submission review and approval, culminating in the publication of formal budget papers.

The Budget Preparation system should include the ability to:

- Capture and approve proposals from agencies
- Submission of the proposal to the Central Budget area for evaluation
- Review and refinement of proposals
- Management of the budget process including budget reviews occurring with internal and external stakeholders
- Analysis of proposals, including 'what if' evaluation and creation of financial budget 'scenarios'
- Printing of financial reports for each scenario
- Finalisation of a scenario for publication of the final budget

For governments with multi-cultural constituencies, the ability to invoke regional language capabilities may also be desirable.

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## Managing Budget Proposals – the Detail

A Budget Proposal - also known as a Budget Change Proposal, a submission, variation, adjustment, or journal – is a way for an agency to request funding and is either a new initiative or a variation to an existing agreed expenditure.

A Budget Proposal may include the following information:

- Title and description of the request
- The requesting agency
- The budget year for this proposal
- The budget stage where this proposal applies
- The dimensions for the proposal (e.g. program, outcome, component, element)
- categorisation of the proposal for reporting purposes
- Financial impacts captured at the account (or summary account level) of the proposal in the following categories:
  - a) Income Statement
  - b) Balance Sheet
  - c) Cash flow
- Headcount impacts of the request
- Benefits of the request typically measured in changes to quality, quantity, timelines or cost
- Supporting documentation
- History of approvals and sign-offs

The system should support multiple forward years for financial and headcount impacts.

## The Budget Formulation Process – A Suggested Workflow

Most budget processes begin with a baseline typically created from the forward budget estimates from previous years - although they can also be based on current year actual values.

A new proposal is created by an agency - or created on behalf of that agency by the central budget group – and initially captures information at the highest level (summary accounts), though the level of data capture allowed can be varied using implementation specific business rules.

When a proposal is created it should then move through an approval process that is applicable to that agency. Once an agency collects a set of proposals it can 'release' those proposals as formal requests to the Central Budget Group. There may be multiple approval processes and also multiple levels in the organisation hierarchy – for example an agency is part of a larger group of agencies. The Central Budget Group should receive, review and accept proposals, then liaise with the submitting agencies to clarify, refine and amend those proposals.

The Central Budget Group should also be able to readily analyse the state of the budget - or any part of the budget - by including proposals into one or more 'scenarios'. A scenario should simply be a set of proposals that together form a complete budget.

The Central Budget Group can then add and remove proposal options to scenarios, refer proposals back to agencies - perhaps to call for new options - or amend the financial impact of any proposals.

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## Budget Finalisation

At some point in the scenario process a recommended budget will be agreed on. The proposals and their specified options in the recommended budget, will then become the budget 'measures'.

The measures should then be capable of being further refined to ensure their financial impacts are captured at the appropriate level of detail – as determined by business rules – and that the necessary supplemental information is available. As measures are refined, there should be a review and approval process for each measure, and for changes to the overall budget.

The difference between the more detailed impacts in a measure and the impacts in the agreed or 'recommended' budget should be subject to business rules governing the allowable tolerance.

The recommended budget should then proceed through a number of iterations and reviews (e.g. finance, legislature, governor). Budget iterations may fall within a single budget stage or iterations may span multiple budget stages.

## Budget Production and Reporting

Typically, at the end of the budget process, Governments have to present their budget documents formally. A budget management system should support the formal production and output of the budget decisions. The system should be able to extract captured information and make it available to desktop publishing tools used to produce the final budget documents.

## Conclusion

Budget formulation within Government has traditionally been a lengthy process that has not always fully benefited from or kept pace with advances in technology. With increased scrutiny of budgetary processes, and transparency being demanded by the public, plus requirements to be able to react quickly to economic change, governments are now placing greater emphasis on budget performance management.

To achieve these aims, governments should be looking for new approaches to Budget Management Systems – systems designed to be flexible enough to accommodate changing requirements, able to streamline the budget formulation and promulgation procedure, yet still maintain the appropriate levels of transaction integrity and security required.

## About Performa Group

Performa Australia is a software and services organisation dedicated to changing the way organisations manage their future.

Performa Solutions include central budget management systems for local State and Federal Governments business management systems for government departments, agencies and state owned enterprises; enhanced performance management for corporations; and the automation of critical management processes across the board.

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