Principles and practice of devolved budgets
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Introduction
I would like to start with an extract from a book by Brian Knight called Managing School Finance.1 It concerns teachers’ attitudes towards school budgets. Whilst written in 1983, it is particularly relevant now, given that local management of schools is the foremost example of delegated budgets in the public sector today.

Those who live in scholastic realms share a simple cosmological view of their financial world. They seem to believe that the source of all finance is mysterious; beyond their control and beyond their understanding, as if somewhere in the fiscal heavens there is some celestial creature from whose udder financial nourishment descends. Sometimes the flow falters and they must tweak it until it resumes. In recent years interruptions to the precious stream have become more serious, but this has not fundamentally affected the prevailing and comforting belief.

Although the central belief is simple, more developed ideas spring from it. These have to do with the nature of money.

Money to the average teacher is of two kinds: their money and my money: their money is neither allotted nor spent according to normal financial values; normal restraints or doubts do not apply. It must always be spent for its initial justification, even though there may be greater priorities. Value for money should never be questioned.
My money is normal money. It has to be treasured and spent wisely.

A related belief is that of the bottomless pocket. Their money comes from a bottomless pocket. However much has been spent there is always more to be asked for. Somewhere there must be more tucked away.

My money, on the other hand, is depressingly finite.

Now, of course, with Local Management of Schools, it will be their own money!

I think many of you will recognise the attitudes captured so well in that passage. The fact is that attitudes are critical to the success of delegated budgets – both in theory and in practice. Whilst organisations can work hard at providing the wherewithal for a system of delegated budgets – the computers, the information systems and management hierarchies, timely budget reports and so on – the fundamental purpose of delegated budgets must be to instil a sense of motivation in the budget holder: the motivation to provide and manage their service better, that is, economically, efficiently and effectively.

Delegated budgets are therefore a means to an end; the cost-effective provision of services to meet needs. Delegated budgets which are simply the product of fashion or ideology, and are not instrumental to meeting the objective of cost-effective provision, will inevitably fail.

The experience of introducing Local Management in Schools has shown that delegated budgets are not always welcomed in the first instance. In part this is because it brings home to people the essential message that there is no such thing as a free lunch. It has been a luxury for some to dwell in a world which says ‘we are about providing services’, without wishing to have regard to the cost; and it is difficult at first to accept the responsibility which has to be taken for making financial trade-offs and acting with some innovation to achieve the best service with the resources at your disposal. There is also no easy fallback of blaming it all on ‘them’ for any shortfall in the provision of resources to meet your vision of the ideal service.

Having said this, I do not want to impugn the motives of those who in the past have tried to provide services without full regard to cost. It is always with the best of intentions. But we have to recognise that if this approach leads to waste – and it will – that waste has to paid for by somebody – either directly or in less services than there might have
been. *Devolved budgets mean taking responsibility for your actions.* And for those devolving budgets, it means giving real freedom of action to others. Sometimes an equally difficult thing to do.

Fine in theory, you may say. And am I suggesting that devolved budgets are a panacea to all the problems of public service underfunding? Or are they just a swing of the pendulum from one extreme to another, with a return in due course to the traditional forms of central financial control? At which point the cynic can sit back and wait for it all to go away.

On the pendulum point, I think we have seen a permanent change, which has been cemented during the years from 1979 onwards. The public sector will never be the same again, and there seems to be a broad consensus, notwithstanding the overall level of funding - which is a political decision - that the financial management of the public sector is best achieved by getting decisions as close to the client (or consumer) as possible; and letting their preferences dictate the broad direction of the flow of the resources.

I think you will all accept the logic of this. Wherever possible the purchasing power is put directly into the hands of the client. In this case, what goods and services they buy directly reflects their preferences. But in many cases this will not be possible and there will have to be someone directing the resources on behalf of the client. If so, that person should be as near to the client as possible. If it is the community carer, that person should be the budget holder. It will be that person who aims to respond to clients’ needs.

Whatever happens, social services departments are not walking down the road of delegated budgets alone. Throughout the public sector there are examples:

**The National Health Service**
- Proposed budgets for clinicians and GPs; supported by costing information based on diagnostically related groups.

**Central Government**
- The Financial Management Initiative, with budgets for departmental line managers and budgets for services such as property and training given direct to client departments, as opposed to providing departments, such as the PSA and the Civil Service College. Costs are then recovered on a full charging basis.
Local Management in Schools, Direct Service Organisations formed with separate trading accounts to facilitate competition and, ultimately, devolution of support service budgets, to be underpinned by service agreements with the client department. The end result of the process of bringing budgets closer to clients in the case of schools could be to give the budget directly to the client – as proposed in the voucher system.

It can all be summed up as a ‘cultural revolution’ in the public sector. Rather a grandiose term, but one which is widely used and reflects the fundamental importance of what has been taking place over the last ten years.

Of course, devolved budgets cannot be a panacea for underfunding. But as I said earlier, to the extent that they motivate and enable more effective use to be made of resources, then they can make a major contribution to alleviating the problems. In short, more output for the same input.

Such gains can be achieved because the present system may mean that full account is not taken of:

- the relative prices of providing different services;
- the relative preferences of individuals receiving those services;
- the productivity gains which may be identified through the financial yardsticks and disciplines provided by a more effective system of budget holders and cost centres.

In theory a social services department might be able to get all this right even within the present, centralised system, and without devolving budgets. However, to rely on it would be to rely on the triumph of hope over experience. The 1986 Audit Commission report *Making a Reality of Community Care* shows only too well that where the supply of services is institutionalised and allocated centrally, the department often becomes overly concerned with ensuring the take up of its existing mix of services, which gradually moves away from meeting the needs of clients in the most effective way.

It is this tendency which needs to be overcome. Delegating budgets to those who assess and design care for individuals in need, whilst separating their decisions from the management and supply of specific services, is one way of achieving this. The efficient management of the care management team as a whole will itself require a delegated budget, but at a higher level of management.
But lest we all swing violently from initial concern about devolved budgets to an enthusiastic embrace, we should dispel some false hopes about what they might mean:

- that delegated budgets mean more awareness of the needs and therefore more money will be forthcoming;
  - you only have to think of LMS, where the same overall school budget is being allocated by formula to schools and will lead to many losers;
- that all savings can be ploughed back in the budget holders’ service;
  - some distinction has to be made between savings which result from the budget holders’ action and windfall gains
- that conflicts of interest and trade-offs are eliminated, either with other budget holders or for the authority as a whole;
  - budget holders cannot be allowed to pursue individual actions which, when taken collectively, are inconsistent, e.g., in staff training or maintenance of property or the economies of scale of central purchasing
- that central financial control is eliminated;
  - treasurers, like the poor, are always with us!
- that delegated budgets are costless;
  - there has to be a considerable investment in new systems and training; as we have seen with DSOs.

Dispelling these naive hopes can be summed up by the fact that delegated budget holders have to be managed in order to achieve the overall aims of the department and the authority. But devolved budgetary systems will improve the financial awareness within which this central management process takes place, and may go some way to achieving the hopes described above, but not all.

**Griffiths and the principles of devolved budgets and care management in social services**

The Griffiths report *Community Care – Agenda for Action* sets the context for devolved budgets in social services. The five key requirements in Griffiths which I identify are that the social services should:

- be responsible for an integrated community care budget (and taking over certain responsibilities previously with health authorities and central government);
• provide the overall assessment of the community care needs of the locality;
• arrange for the delivery of packages of care to individuals, building first on informal carers and neighbourhood support, then, as required, through the provision of domiciliary and day services, to finally, if appropriate, residential care;
• create a one-to-one relationship with an individual ‘community carer’ and the individual in need;
• facilitate and ensure the delivery of the care packages, whilst not necessarily providing it directly.

If implemented – and I believe a Government announcement on Griffiths is due next week* – these proposals will be facilitated through the introduction of related delegated budgets, bringing a close relationship between manager’s decision, the financial consequences and the wishes and needs of the client.

Devolved budgets will be a radical change for social services. And the move from budgets based on the function or the institution to the individual will have to managed. *You will be looking for a new matrix budgeting system, in which the demanders – the budget holders – are separated from the suppliers – who will be treated as cost centres.*

In outline, the matrix will look like this (see next page):

The service cost centres, running from home help through to residential care and contracted services, are on one axis, whilst the budgets devolved to individual care managers are on the other axis.

You only have to consider the transfer of a budget for X Rays from the radiologist to the clinician in the NHS to see a good example of the application of this principle.

Now what does Griffiths have to say about these proposals and their direct implications for devolved budgets?

First - that:

Social services should prepare plans with costed objectives and timetables for implementation which demonstrate their approach to the delivery of community care in their area and the adequacy of their management systems. **Paragraph 6.35**

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Second - on control - that:

In cases where a significant level of resources are involved, a ‘care manager’ should be nominated from within the social services authority’s staff to oversee the assessment and reassessment function and manage the resulting action. **Paragraph 6.6**

This links with his comments on professional roles:

Many social services staff already have a managerial function, but my approach will give this added emphasis, for example, in the development of the skills needed to buy in services. Other new skills, particularly in the design of successful management accounting systems and the effective use of the information produced by them, will be needed. **Paragraph 8.11**.

and this leads to training:

Ensuring that staff have the necessary skills to discharge their functions is a key task for any organisation, particularly one which is undergoing a significant degree of change. **Paragraph 8.5**.

which suggests, finally, that:

Recruitment and in-service training systems for professional social services staff at both the national and local level will need to give greater emphasis to management skills to reflect the proposed
change in emphasis of social services authorities’ role. \textbf{Paragraph 8.6.}

Other than these few references, Griffiths talks very little about the practical ways in which a devolved budgetary system might work, but clearly he has identified the need for training. Indeed, if I may echo here the experience CIPFA has had with LMS, and the reaction non-finance specialists have had to taking on financial responsibility, in particular primary school head teachers, the need for training must not be underestimated. I suggest it may be timely for the ADSS to consider with CIPFA whether an initiative should be taken to ensure adequate practical financial management training manuals and training packages are made available which are tailored to the needs of social services departments.

What Griffiths does say on the practical application of delegated budgets, however, gets to the nub of the issue. Whilst he:

‘has no wish to be over-prescriptive about management’, he says ‘some things are fundamental’. In particular, ‘the creation of a budgetary approach centrally and locally which aligns responsibility for achieving objectives with control over the resources needed to achieve them, so that there is an in-built incentive and the facility to make the best use of the resources available’. \textbf{Paragraph 5.6.}

He goes on to say:

It is self evident that resources must be consistent with the agreed responsibilities and objectives to be achieved within a given timescale. So, for example, if resources are not great enough to meet agreed objectives, a budgetary system will provide a firm information base from which to make decisions about either reducing the scale of the set objectives or identifying the precise resources needed to discharge them. Such a system will also provide a spur to managers to provide themselves with better information and to search for the most effective and efficient ways of meeting needs.

Reading from this, the model of devolved budgets relevant to the social services [post Griffiths] would seem to be as set out in the diagram.

There is a separation of the care manager as the budget holder from the providers of services, whether those services are from the voluntary sector, home helps or residential care.
The budget process for devolving budgets to care managers

The local authority decides on the overall allocation to Social Services and other services corporately.

The Social Services Department splits its budget into functional areas (say inspection, care management, service delivery, support services) and prices services.

Identifies budget holders and managers within each functional area.

[These holders determine the menu they want - the care packages - depending on preference, need and price.]

The budget holders take services from cost centres at known unit costs to meet client needs.

[These can be voluntary service, residential care, home help etc; and are managed as cost centres]. Budget holders should have service agreements with support service budget holders.

The senior care manager and management team co-ordinate and arbitrate in relation to the care manager budget holders and service providers.

The management hierarchy and responsibilities are established.

Monitoring of under or over demand for specific service providers.
The care manager will assess the needs of the clients, and arrange specific care packages, costed according to the type of service being provided. Different types of service will cost different amounts and the best combination required to meet the needs can be selected and controlled within the care manager’s overall budget.

In effect, there is an internal market of supply and demand aimed at meeting clients’ needs.

The matrix budget will require the use of standard costing – the technique in which a standard charge is made to internal budget holders for each unit of service. The budget holder becomes responsible for the volume of service taken. The producer or supplier becomes responsible for any variations between the standard cost and the actual – which is controlled through a variance account. If there were standard costs per home help hour or residential place, then the home help manager would be responsible for delivering at the agreed price; the social worker or community carer for the volume of that particular service consumed.

The management team will plan to achieve a balance between supply and demand, taking account of actual costs. In the early years of the new system, however, there may be distinctive changes in the balance of services provided, and contraction and expansion will have to be coordinated and managed by the senior management team. It will also want to review the effectiveness of the individual care managers in operating the system.

Are the proposals good practice?
The Audit Commission has endorsed the general principles of such an approach, and – along with CIPFA – sees devolved budgets as simply good financial management. The Commission’s recent management paper Better Financial Management sets out the reasons. I think you will see that what follows matches well the overall recommendations of the Griffiths report.

A good authority has:
• policy planning
  - the framework of objectives and priorities;
• people management
  - making sure that the right people are recruited and that they are well trained and motivated;
• financial control
- a system which matches budgets with decision makers and ensures budgets are not overspent;
- performance review
- holds budget holders accountable for their actions and reviews their performance.

Their criticisms of many existing budgetary practices in the public sector are that either:

1. the budget holder is divorced from the decision maker – which usually means ill-informed decisions are made by the decision maker – or at least decisions are made regardless of cost – resulting in waste and mis-allocation of resources. The consequence of this is also the tendency to have either arbitrary rationing by providers to the decision makers if the authority as a whole is to keep to its budget, or a fall in the quality of service;
2. over detailed control of the budget, as with restricted carry-over or virement provisions, or that the manager has no choice but to accept certain services and their costs, in particular the central support costs.

Financial information is also often poorly presented, and financial advice too remote, as can be the case with separate Treasurer’s Departments.

**The precepts for a good devolved budget system are to:**

- identify the decision takers and what they are required to do;
- match a budget to their responsibilities by sensible means – and only delegate to those who control the decision;
- separate the budget holder from the providers of the service where there are alternative modes of provision;
- ensure that capital and revenue effects are included in the consequences of the budget holder making a decision;
- have a sensible system for dealing with exceptional circumstances or requirements which might affect individual budget holders;
- clearly identify any constraints which are being placed on budget holders, and why, and the procedures for resolving conflicts;
• determine an equitable incentive system to encourage the budget holder, but which makes sense from the authority’s or department’s view as a whole in respect of allocating savings;
• seek to involve all budget holders in the collective strategy of the department – hopefully avoiding gamesmanship;
• ensure there is tight central control and monitoring.

If the inexorable conclusion is that delegated budgets are a good thing and should be implemented in social services, then what are the practical implications of these basic precepts?

**Delegated budgets are no substitute for tight central control.**
It is ironic that the arguments for increased delegation increase the need for an even tighter overall discipline. There is no inconsistency in this, although there will be tensions – let us hope creative tensions. The control from the centre, however, ought not to be about detail, but about establishing the agenda; setting the objectives and how they are to be measured, prioritising and identifying the resources to be made available, instituting systems of financial control, monitoring outcomes, reconciling conflicting demands, resolving trade-offs and reviewing performance.

**Incentives must be built into the budget which has been aligned with the managers’ responsibilities.**
A system which is just an allocation of costs is not a devolved budget. The budget must have incentives, and a ceiling, and the way savings may be used must be identified.

This raises a whole host of problems, such as where
• demand is through statutory entitlements;
• political pressures make it unacceptable to stop the service once a budget has notionally run out;
• savings arise from causes unrelated to the managers’ activities;
• year end spending sprees;
• budgets only cover part of the impact of decisions, e.g. where capital expenditure is an alternative to revenue expenditure.

For maximum incentives, the benefits of all savings should accrue to the budget holder. However, there is always a need to accumulate some savings at the centre. The balance between the two is one of judgement, depending on the nature of the savings made. There
should always be some pressure put on budget holders to find savings just to keep within their budget total.

From one point of view it could be argued that no savings should accrue to the individual manager. This is because the purpose of the central control is to define the level of service to be provided, and the manager’s job is to provide that at least cost by both measures aimed at economy [the cheapest buy], efficiency [the best combination of resources] and effectiveness [meeting the objective at the lowest cost per unit of output]. Savings achieved in that process are not necessarily to be used for increasing the quality of provision or the level of care at the margin. The authority may see better ways in which those savings might meet the community’s needs.

This is a major unresolved tension for local authorities – where there is a trade-off between corporate needs over many services and the need to instil motivation to achieve, given human nature and the need for incentives. At departmental level the problem can be offset to some extent by improving involvement and communication of all staff, so that they identify with the overall aims of the department and are willing to work for savings which are to be released for the general good.

**Delegated budgets must not conflict with either:-**
(i) the achievement of other budget holders;
(ii) the sensible management of the authority or department as a whole.

In relation to the first point, where there are alternative decisions possible, the consequence of each decision should fall on the holder’s budget, not some decisions on others’ budgets [the so-called perverse effect]. If so, then the budget should be held by at a higher level of management where the consequences of decisions made all fall within the manager’s responsibility.

Devolved budgets should also not be allowed to lessen expenditure in the short run at the expense of greater costs in the future i.e. maintenance expenditure.
Devolved budgets should be arranged such that wherever possible the decision maker is buying in at arms length.
This means:

- uncontrolled costs (such as support services) should be based on service agreements [i.e. attributed to a particular budget but managed elsewhere];
- capital charges should be analysed so the trade-off between capital and revenue is fully identified. If capital is properly charged for, then this will encourage all types of resource available to the budget holder to be considered on a like basis [the current proposals by CIPFA and the local authority associations6 to change the system of capital accounting by local authorities will help this];-
- competitive testing, either comparatively or by external tender, to ensure the lowest unit cost.

Budgets should be delegated only to the level appropriate to the span of control.
Budgets should not be allocated over too small areas that are swamped by factors beyond the budget holder’s control.

Objectives, level of service and performance targets should be clearly expressed.

Virement should be allowed within the overall budget and carry forward allowed.
This is the major way in which incentives can lead to savings, i.e., do not waste heat or light because it can be used in other parts of my budget. However virements which create long run commitments need to be separately authorised e.g. staff.

Conclusion
In conclusion, three principles are at the heart of an aligned structure of devolved financial management:

- every budget has only one budget holder;
- front line managers are budget holders only for items under their control. Care managers are responsible for defining the service to be provided by central services and suppliers of services
which meet their objective of providing effective community care;

- senior managers should supervise the financial management of those reporting to them; ensuring there is a match between responsibility and accountability for those who hold delegated budgets.

But a word of warning on the pace of change. It is likely that the change to devolved budgets will be too great to be accomplished in one go. It will be sensible to phase change in, moving down the management hierarchy in stages if that is possible. This will not only benefit coordination and management in bringing in a new system, but will allow time for the training of the ‘new’ care manager, who will have to inculcate the practice of more entrepreneurial attitudes than has been typically present in the past.

References
3. Audit Commission, Making a Reality of Community Care, 1986.