4.1 Budgetary control can take a variety of forms. The simplest and most basic is to record expenditures in relation to approved appropriations and allotments to ensure that they are not exceeded. This form, for which there is a statutory requirement, is designed only to ensure that expenditure limits are respected. It makes no provision for ensuring that desired results are obtained.

4.2 A more effective approach compares actual expenditures to a predetermined plan so departures may be spotted for investigation. This is achieved through a system of financial reporting that compares actual expenditures with planned expenditures, with variances being explained on an exception basis. Such systems are more useful if they include data on planned and actual operational results to which expenditures may be related.

4.3 Budgetary control systems are essential for departmental management. The government as a whole also needs some means of assurance that spending limits are respected and that resources allocated are attaining the desired results. This can be achieved in two ways: first, by ensuring that departmental systems are adequate for this purpose; and second, by monitoring the information provided by such systems to ensure that its significance is fully appreciated and is reported to those responsible for taking corrective action.

4.4 These subjects are discussed under the following headings:

- Cash control systems
- Control through periodic financial reporting
- Central budgetary control

CASH CONTROL SYSTEMS

4.5 The Financial Administration Act requires departments to maintain various records for budgetary control and reporting purposes. These include appropriation, allotment and commitment records.

4.6 The requirement for appropriation control begins as soon as the authority for expenditures is released to departments. Section 21 requires departments to maintain cash control records to ensure that payments do not exceed approved appropriation levels. This is further reinforced by Section 26(3), which requires a person approving an account for payment to ensure that it will not result in expenditures exceeding appropriation levels or in balances insufficient to honour outstanding commitments.

4.7 Section 24 requires appropriations to be divided into such allotments as Treasury Board may require and departments to maintain
records and control systems to ensure that these are not exceeded.

4.8 Departments are also required to maintain a record of undischarged commitments. Section 25 requires that commitment records be maintained in order to have an accurate record of free balances available for additional commitments.

4.9 In addition to the requirements of the Act, the Treasury Board Guide on Financial Administration contains three directives which state:

"Control accounts shall be maintained, on behalf of the deputy head, by financial officers or by other officers with payment authority for each appropriation and for each allotment prescribed by Treasury Board, whether departments are operating under full or interim supply appropriations or special Governor General's warrants, so that expenditures in relation to these limits can be determined at any time.

"Where payment authority is delegated to officers in decentralized locations, allotments shall be divided into sub-allotments for each such officer, and control accounts shall be maintained for each sub-allotment so that officers requisitioning payments are able to control requisitions in relation to the undischarged commitments and free balances in their sub-allotments.

"To comply with the statutory requirement to keep records of commitments and to certify the availability of funds before entering into commitments, departments shall:

"- for administration, operation and maintenance expenditures, retain for each responsibility centre copies of all documents recording undischarged commitments and report the total of all such items for inclusion in periodic budgetary control reports; and

"- for capital, and grants and contributions expenditures and for multi-year expenditures, maintain a continuing record of individual commitments by fiscal year."

These directives for the most part re-emphasize departmental control systems required by the Act. In addition, there are three guidelines which state:

"Because annual appropriations are for services coming in course of payment during the fiscal year, departments should ensure that payments are requisitioned and processed promptly so that all accounts are paid in the fiscal year in which goods or services are supplied and in which funds are provided.

"Cash forecasts which recognize the impact of operational and seasonal factors on cash flow should be prepared periodically in each department; a simple extrapolation of the current or prior
year's disbursements will seldom provide a sufficiently accurate cash forecast.

"Separate financial reports, which provide information on disbursements, undischarged commitments and free balances by appropriation, allotment and sub-allotment, should be provided to financial officers and other officers with payment authority to enable them on behalf of the deputy head to control cash flow in relation to limits imposed by annual and other appropriations and by allotment."

Use of allotments

4.10 Departments generally are maintaining adequate records of appropriations and allotments. In recent years, standard Treasury Board allotments were established for grants and contributions, salary adjustment reserves, operating costs, and capital items. Commencing April 1, 1975, salary funds have been placed in separate allotments. There are other situations where separate allotments should be created. Examples were observed where departments forecast expenditures for a specific purpose for the year based on the average amount required over the preceding years. Where these allotments are insufficient for this purpose, departments request additional resources through Supplementary Estimates. Where the actual costs are less than the estimates, they tend to use the balance for other purposes.

4.11 The purpose of subdividing appropriations into allotments is to ensure that departments do not use funds intended for a specific purpose for other matters. Too many allotments within appropriations would be overly restrictive to departments in conducting day-to-day operations. Nevertheless, it would appear that the statutory provision which is available to Treasury Board is now too little used to guard against departments covering up operating inefficiencies by using funds for different purposes than originally intended.

4.12 Treasury Board should give more consideration to establishing separate allotments where significant amounts of funds are provided for purposes that are discretionary and therefore controllable by management.

Need for Commitment Accounting

4.13 To exercise even a minimum level of control, departments should record transactions promptly in relation to appropriations and allotments to ensure they are not exceeded. Although this provides little control within the year and does not measure amounts spent in relation to planned results, it ensures that ceilings are not exceeded.

4.14 Cash forecasting adds a further degree of control over appropriations and allotments by estimating excesses or lapses at the end of the year. Essentially, cash forecasting involves projecting cash requirements based on experience to date so that comparisons can
be made with appropriations to determine whether a shortfall or overrun for the year is anticipated. This can be done by combining projections of individual managers with budgetary responsibility or by analysing trends of the current and prior year. It is prudent for departments to make both of these projections so that differences may be examined further. This helps a department to control cash during the year, but it provides no assurance that the money is spent for the purposes for which it was appropriated.

4.15 Departments can improve control over appropriations and allotments by recording commitments and by earmarking funds to discharge them, thereby identifying free balances left before entering into additional commitments. Although this procedure helps to ensure that appropriations and allotments are not exceeded, it provides neither budgetary control during the year, nor assurance that the spending was for the purposes intended.

4.16 Legally all departments are required to maintain detailed commitment records throughout the year, but many departments do not feel that this is necessary as they have not exceeded their appropriations in the past and are unlikely to do so in future. Other departments feel that other types of controls, such as through operating budgets and financial reports, make them aware of any danger of exceeding appropriations in time to take corrective action. Also, they feel that recording of commitments to ensure that appropriations are not exceeded is generally not required until near the end of the fiscal year when departments may be approaching their annual spending ceilings.

4.17 Departments with appropriate systems of budgetary control and financial reporting should be required to record commitments only as necessary towards the end of the year.

CONTROL THROUGH PERIODIC FINANCIAL REPORTING

4.18 The Guide on Financial Administration has two important guidelines associated with control of operating budgets and financial reporting, which state:

"Each responsibility centre manager should control the utilization of the resources in his budget through a system whereby:

"- costs by activity elements and reporting objects are budgeted by period in relation to planned output;

"- actual costs and outputs are reported by period; and

"- variances between budgeted and actual costs in relation to outputs are analysed with a view to corrective action."

"Financial management reports, which periodically relate actual and planned costs to outputs, should be prepared for responsibility centre managers, for their supervisors and for staff advisers responsible for activities to provide them with the information required to control costs in relation to outputs."

These emphasize the need for the budgeting by results anticipated from each organizational unit with these being forecast in turn by reporting periods. Prompt reporting of actual costs and results by the same time periods permits variances to be analysed with a view to corrective action.

4.19 Activity structures of most departments are not well defined for purposes of budgetary control and financial reporting. In many, activities are defined so that they represent the costs of organizational units within the department. In others, headings are used to indicate the purpose or nature of the operations being provided for, but the amounts are only broad approximations of costs. Most departments do not appear to have made much effort to determine the costs of the various services or products for which they are responsible. Where individual operations, services or projects are planned and costed for managerial purposes, often the information does not become an integral part of the budgetary control and financial reporting system of the department.

4.20 It is possible to have a good system of budgetary control and financial reporting on a variance basis only when the basic building blocks of the budget are identified properly and costs and results are accumulated so as to disclose the relationship between money expended and value produced. If cost elements are properly identified, data can be accumulated to justify organizational budgets and to provide a useful basis for compiling costs in a significant manner. Costs are particularly useful when the same process is carried on in a number of organizational units as it permits the performance of responsibility centres to be compared.

4.21 If an employee is involved in more than one activity, it is necessary to have some means of accurately estimating time spent on each so as to distribute costs correctly. Without accurate analysis of such costs, comparisons and aggregations of cost data become meaningless where labour is a significant cost component.

Budgetary Data Used

4.22 Most departmental budgetary control and financial reporting systems are unsatisfactory because detailed operating budgets prepared by many departments are frequently unrealistic. Many departments prepare operating budgets as part of the Program Forecast or Main Estimates processes, each of which is too far in advance of the beginning of the fiscal year to provide a good basis for subsequent control. Many managers begin the fiscal year with detailed budgets based on totals either in the Main Estimates submission prepared five
to six months earlier or in the Program Forecasts prepared up to IS months earlier. Budgets may not reflect reductions made in submissions. If they do, only the totals are arbitrarily reduced and specific reductions are not identified. Moreover, detailed budgets may not reflect changes in prices, economic conditions, operating plans or the availability of staff since the original amounts were approved. The problems of comparison are made more difficult since many departments have over recent years developed reserves within their budgets applicable to unfilled positions. As a result, many operating budgets are excessive. There are few organizational units without one or more unfilled positions and these funds provide a hedge against deficiencies in budgeting for other types of expenditure. Thus, it is not surprising that in the past some departments have been able to operate with inadequate budgetary control systems.

4.23 For operating budgets to be effective, the detailed budgets should always be a realistic month-by-month estimate of anticipated costs and performance against which managers can be held accountable. Where plans change after preparing the detailed operating budgets it is appropriate to amend them as long as controls are maintained to ensure that in aggregate they do not exceed given allotments. Budget amendments should go through the same process as the original budgets to ensure that changes are approved at the appropriate level of authority. Any changes to the detailed operating budgets of managers should be discussed with them. For example, it may be appropriate to:

- delete from detailed operating budgets costs and performance data related to unfilled positions until these are filled;
- review detailed operating budgets and possibly adjust them for significant price increases occurring following their preparation to ensure that the budgets reflect current costs and that managers are held accountable only for deviations within their control; and
- introduce flexible budgeting techniques for internal management purposes where costs vary in accordance with a required volume and level of service.

Impact of cash basis of reporting

4.24 Most departments prepare operating budgets on a cash, not on a cost, basis. This gives them flexibility in managing year-end payments and in building up or depleting inventories so they are not dependent on proper budgetary control systems. Many departments with monthly operating budgets merely pro-rate over 12 months the cash they expect to spend instead of budgeting it by months, and they manage their cash payments at the year-end to use up excess funds on assets that otherwise might not have been acquired, or delay payments to avoid overspending their appropriations.

4.25 Cash-based budgets inevitably lead to major differences between actual and budget data attributable to delays in initiating and processing payrolls, payroll adjustments and travel claims, and in
receipt of invoices. These timing differences can become significant in any comparison between budgeted and actual costs. In addition, cash disbursement information for an accounting period may not bear any relationship to the sort of information that discloses the performance of a manager. Where departments merely pro-rate in equal instalments the cash they expect to spend rather than basing it on liabilities incurred in each month, it is difficult to monitor a subordinate's performance by what he has accomplished as compared to costs incurred.

4.26 A more effective approach to budgetary control requires an appropriate matching of budgeted and actual costs to budgeted and actual results. This requires action to reduce timing deficiencies inherent in cash accounting, and to facilitate the identification and allocation of costs within organizational units. Departments should have systems with the facility to produce accurate costs. Departmental systems are not now capable of satisfying those managers who want effective means of budgetary control through financial reporting.

4.27 For managers to be responsible for variances between actual results and the plan, the variances must be capable of analysis in relation to data measuring results so as to reveal the effect of changes: in volume of output, in quantity of resources used, and in prices of such resources.

4.28 Not all departments require the same system of budgetary control and financial reporting. For some departments, the instructions in the Treasury Board Guide on Financial Administration should be mandatory and action should be taken immediately to improve their systems; other departments can function with simpler forms of managerial control. For example, in departments where results are intangible and cannot easily be measured, and where expenditures are largely for a fixed payroll, it may suffice to control cash expenses by appropriation and allotment, coupled with periodic cash forecasts. Most departments, however, require a budgetary control system permitting costs to be compared with information measuring operational performance so that variances can be analysed with a view to corrective action.

4.29 Departmental budgetary control and reporting systems need as a minimum:

- properly defined cost components and cost information so managers can be held accountable for performance;
- detailed budgets by time period in accordance with the assignment of managerial responsibility;
- consistency between budgeting and accounting;
- timely preparation and distribution of periodic financial reports; and
- analysis of variances between planned and actual results.

Use of non-financial data

4.30 In the private sector, performance is measured directly or indirectly by comparing revenues and expenditures. Measurement of performance is just as important in the public sector but different systems have to be developed to offset the absence of the competitive market place for measuring the value of goods and services produced.

4.31 The Planning Branch of the Treasury Board Secretariat was given responsibility in 1970 for developing a system through which departmental management, Treasury Board and Cabinet could evaluate the effectiveness and efficiency of programs. The primary benefit was to be improved rationale for allocating resources, but it was felt that managerial performance would also be more visible. In January, 1974, the Planning Branch issued a booklet on evaluating operational performance in terms of efficiency and effectiveness titled Operational Performance Measurement Systems (OPMS). OPMS measures operational efficiency by determining the ratio of operational outputs to inputs or costs used in their production. It requires that data be gathered for a base year and that all future years be compared to it.

4.32 Most departments do not now systematically measure performance. Where performance data are gathered, much unit-cost information is not reliable. Managers in some departments have made a sincere effort to accumulate meaningful operational data. However, the data are not integrated with departmental financial systems. In other departments, efforts to implement OPMS have been superficial, lacking the priority necessary for effective action.

4.33 In holding managers responsible for their actions, it is fundamental that a system to measure their performance be developed. Such a system should be capable of reporting results as well as costs. Wherever possible, this should be quantitative data measuring outputs, but qualitative data measuring progress towards assigned objectives can also be useful.

4.34 By comparing the data for all future years to that gathered for the base year, the OPMS system penalizes departments that already have an acceptable level of performance since it leaves them little room for improvement. It would be better to use performance indicators derived from previous years but recognizing that circumstances change and allowing for targets based on a challenging, yet attainable, level of performance. As well, cost information should be derived from the departmental financial reporting system to ensure that costs are reliable. By integrating reporting of results and of costs, it should be possible to reduce the variety of reports which burden managers, and which lead to conflicting data. A good system for measuring performance would require that each department budget its results and its costs and compare them with actual results through an integrated financial reporting system.

4.35 Performance indicators are needed as an integral part of
departmental budgetary control and financial reporting systems in all areas that can be effectively measured.

Central approval of systems

4.36 The Treasury Board Guide on Financial Administration provides general instructions to departments to help them implement more sophisticated systems of financial control. Most departments, however, have not designed or implemented good systems of budgetary control and financial reporting, often due to a lack of concern related to the attitude that funds are readily available. This attitude combined with the lack of an effective central review has resulted in the poor financial systems most departments have today.

4.37 Instructions concerning budgetary control in the Treasury Board Guide on Financial Administration should be mandatory in most cases. In addition, a central agency should review each department's system of budgetary control and financial reporting with a view to approving the systems that are sound or to withholding approval until corrective action is taken.

4.38 A central agency should approve and periodically reassess departmental budgetary control and financial reporting systems to ensure their adequacy for purposes of satisfying the needs of Parliament and of the government, as well as of departments.

CENTRAL BUDGETARY CONTROL

4.39 The Treasury Board Secretariat receives two financial reports monthly from the Department, of Supply and Services. The first, Summary of Travel Public Servants, goes to the Administrative Policy Branch as an indicator of costs incurred under the Board's travel and relocation policies. The second, Listing of Imprest Accounts and Standing Advances, goes to the Financial Administration Division of the same Branch for monitoring levels of departmental working capital advances in relation to those authorized. These reports relate to monitoring specific types of expenditures and are not useful in central monitoring of the aggregate expenditures of departments in relation to approved Estimates.

4.40 The Program Branch receives a copy of monthly Cash Forecast Briefing Books prepared by the Department of Finance. These books show for each major program actual expenditure by months to date and forecast expenditures by months to the end of the fiscal year. The Department of Finance prepares them as part of its task of determining short and mid-term cash requirements. The Department of Supply and Services supplies actual expenditures to date. Departments submit directly to the Department of Finance forecasts of expenditures to the end of the year. These are adjusted to take into account Finance's own projections based on past experience, and on current and future
economic factors. If departments fail to submit monthly operating cash forecasts the Department of Finance uses the preceding month's forecast or its own forecast to prepare the Cash Forecast Briefing Book. This report does not appear to be used by the Treasury Board Secretariat to monitor or to report on departmental spending.

4.41 In addition, the Program Branch receives a quarterly report on the utilization of man-years and a forecast by quarters for the balance of the year.

4.42 Functions of the Program Branch, as outlined by the Treasury Board Secretariat, include the responsibility to "review approved programs to ensure effective expenditure management including the monitoring of expenditures against authorized allotments; the utilization of authorized man-years; the organization and management of allocated resources; and the program results achieved in accordance with implementation plans". These evaluation tasks are vital under any system of budgeting, but the Program Branch has no formal system, other than the quarterly manpower reports, for carrying out this responsibility. It gets low priority; efforts to monitor utilization of allocated resources are sparse and ad hoc.

4.43 Treasury Board has not assumed its statutory responsibility for the general monitoring of the expenditures of departments. Thus, extensive authority is delegated to deputy heads without any effective central means to make them accountable for their actions. Effective central monitoring of departmental expenditures would be difficult to achieve within the Program Branch as it is now organized. The Program Branch is a compact unit intentionally kept small to ensure flexibility and effective internal communication and it must respond to the pressure of constant deadlines. A detailed monitoring function is not consistent with the present qualifications and training of the Program Branch's staff.

4.44 Not only should individual departments exercise effective control over funds appropriated to them by Parliament, but the government as a whole should exercise control over its planned and actual expenditures. Some form of government-wide budgetary control and financial reporting is necessary to do so.

4.45 Some central agency should be responsible for detailed monitoring of departmental expenditures in relation to information supporting their approved Estimates. The agency should require certain standard financial information from each department, supplemented by copies of financial reports each department gives its own deputy head. Significant variances between actual and planned results should be further investigated. So they can interpret the significance of the financial information with which they are provided the agency staff should become familiar with the detailed operating budgets and operations of the departments. This information would be prepared monthly to inform Treasury Board of anticipated variances, thereby facilitating any corrective action deemed necessary.

4.46 A monthly report, based on analysis of departmental budgets
and expenditures and variances between them, should be prepared so that Treasury Board can take action to control overspending or to freeze excessive resources.