CIMA

Research Report

Annuality in public budgeting

An exploratory study

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Contents

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Executive Summary

The impact of annuality is felt by everyone involved with government budgeting. Annuality requires budget allocations to be spent by the end of the financial year or surrendered to the centre. It therefore provides an incentive to spend and, as the end of the financial year approaches, the incentive intensifies. This, it is argued, leads to the possibility of wasteful and extravagant spending. The first chapter of this report discusses the principle of annuality and its rationale.

The second chapter discusses the relatively limited literature on annuality. Statistics reporting the quarterly pattern of public sector spending show a very clear surge in capital spending in the final quarter of the year, which supports an annuality effect. The few who do write on annuality point to the perverse incentives it gives to budget holders and there is certainly much anecdotal evidence supporting the claim that the rush of spending is uneconomic, inefficient and ineffective and therefore fails to provide value for money. The terms used to refer to annuality such as 'March madness' or the 'silly season' reflect these concerns and yet, in spite of these, annuality persists. It is against the backdrop of these concerns that this exploratory study was undertaken. It was felt important to obtain the perceptions of a cross-section of budget holders, financial controllers and consultants on the impact of annuality in public sector organisations. A total of 17 organisations were therefore visited and interviews undertaken in each of these. The sample was chosen to cover different types of organisation and also budget holders at different levels in the organisational hierarchy.

Of the 17 interviews, 13 were conducted with controllers or budget holders in government organisations, two were with firms of consultants, one was with a non-departmental public body, and one with a public sector funded charity.

It was interesting to note that all of the controllers or budget holders in government organisations were fully aware of the criticisms and limitations of annuality and yet all of them, either implicitly or explicitly, supported annuality. They were comfortable with annuality because they felt that they had procedures in place that enabled them to operate within the constraints thereof but, at the same time, avoid the significant levels of wasteful and extravagant expenditure that is often associated with annuality. The responses suggest that an important example of these procedures was the early identification of possible underspendings. Many of our interviewees drew attention to their systems for dealing with this. Other examples included the existence of carefully prepared 'off the shelf' projects that were fully consistent with the aims and objectives of the organisation and which could be quickly implemented to make use of any underspendings, and also being ready to undertake quick discretionary spending on areas such as repairs and maintenance, staff training and the acquisition of IT and other equipment.

However, the respondents from the non-departmental public body and the voluntary sector charity were much more critical of annuality and although they both provided examples of how their organisations benefited from being offered additional funding close to the end of the financial year, the rush they were then faced with to ensure that the money was spent by the year end was not always consistent with the objective of achieving best value for public money.

The UK government's response to the potential adverse impacts of annuality has been to permit full end-year flexibility (i.e. the ability to carry forward underspendings to the next financial year) to the 'departmental expenditure limit' component of government departments' budgets. From our sample of interviews it was clear that although end-year flexibility was welcomed at the centralised control level of government departments, this flexibility did not cascade down to lower levels within those departments.

1. Annuality: the principle and its rationale

A financial reckoning at annual rests – annuality – is natural. We can break out of natural cycles, as we increasingly do in so many other contexts, but the natural order of things has largely been retained in accounting, even when shorter and longer accounting periods have been grafted on to the financial year. The particular annual cycle chosen is, of course, arbitrary. In the UK, public sector organisations use '1 April to 31 March' for their financial statements; many, but far from all, businesses and charities use the calendar year, as does the European Commission; individuals and organisations are required to use '6 April to 5 April' for their tax returns. In the wider management of organisations (i.e. beyond financial management) there are obvious cases in which organisations are managed on an annual cycle that is different from the financial year: the academic years used within education are prime examples. And while it is natural to focus on annual cycles, it is also natural to focus on the seasons within those annual cycles, a focus which is, however, sometimes forgotten: spending in one season may be better or worse than spending in another, merely by virtue of that season.

Annuality is a fundamental problem for financial accounting theory (in which it is usually referred to as 'periodicity') because it requires accounts to be prepared on an annual basis. Particular challenges are created when both budgeting and accounting adopt annuality. In this case, there is not only accounting and reporting at annual rests but also funding at the same annual rests. The strict interpretation of annuality is when the funding is only for one year, and no longer, and it is this that has predominated in the public sector.

In generic language, the principles are as follows:

- There is a budget (at any level in the organisation, and can be one line-item or many), which is an authorisation to spend (the spending being subject to other rules about legality, propriety, economy, efficiency, effectiveness and quality). The principle of annuality is that the authorised spending must take place during the related year.
- There is an annual reckoning of spending against the budget, which has explicit intended consequences. If there is underspending, the unspent amount is lost by the budget-holder. If there is overspending, there is a range of possible penalties, including personal liability of the budget-holder for the overspent amount. It is important to emphasise that budget-holders usually function in a setting in which there are major political and managerial implications of overspending, implications which have tended to become even more severe in some areas in recent years. Hence, the consequences of underspending, however strongly felt, are often not as strongly felt as the consequences of overspending. In an uncertain world, the primary focus is on not overspending, with not underspending being secondary.

Central to this principle is the definition of spending. The financial accounting system, in the UK at least, is some form of accrual accounting. Exceptionally, in central government, the traditional cash accounting, and indeed cash management, has been retained in the application of annuality, despite the addition of accrual budgeting and accounting, and despite the three-years' budgeting of the Spending Review (HM Treasury, 2002). In addition, many organisations have systems of commitment accounting for specific parts of their budgets (for management accounting not financial accounting), which can have implications for annuality[i].

The particular significance of the annual financial reckoning is not its length but that the reckoning is not continuous; the budget-holder is not simultaneously taking account of every financial effect on the organisation at the time each amount is spent. If there were a continuous budgeting and accounting system, there would be no budget in the conventional sense and there would be no annuality.

A conventional budget emerges when the individual spending decisions during the period are divorced from their financing. It is the discontinuous periodic (the annual) reckoning that provides the comprehensive analysis of revenues, expenses, assets, liabilities and cash flows; and out of this come the budgets, as authorisations to spend. These authorisations could be authorisations to spend whenever the budget-holder decided it was appropriate to spend, possibly years in advance. It is easy to imagine, and not least because there have been such systems in practice, that there could be an annual accounting which, among other things, kept track of the unspent budget amounts, notwithstanding the fact that this accounting would quickly become very complicated (as unspent budgets from different years accumulated). Indeed, it might even be argued that politicians would not naturally set a time limit to the authorisations they give. In contrast, annuality sets a definite time limit, being the one adopted for the accounting; this at least has the merits of relative simplicity.

Budgets can, of course be overspent, although there will often be severe penalties for overspending[ii]. It is also typical of many public sector budgets that there are substantial amounts within them that are not strictly controllable by the budget-holder (they are forecasts of spending that is determined by outside factors, such as laws passed giving people the right to government benefits, rather than limits within which budget-holders must manage their spending). It follows from these possibilities of overspending that it is the responsibility of the periodic reckoning to finance such overspendings, and it is natural to want to have any underspendings available for this purpose. Anyone who is responsible for the financial control of budget-holders (rather than the purposes of their spending) has, therefore, a natural incentive to impose annuality, even if other incentives not to impose annuality outweigh this. Such a person does not have to be an accountant or a financial officer (even broadly defined).

In the UK, annuality is a principle that is, for the most part, practiced rather than stated; it is, in this sense, typical of management accounting rather than financial accounting, being unregulated. This is in marked contrast with much of continental Europe, where annuality tends to be a legal requirement. One consequence of this in the UK is that, as pervasive and familiar as the principle is, there is a wide variety of practice. And even though a trend away from strict annuality might be detectable, at least in ways of thinking, it is important to understand that the traditional incentives for annuality remain strong. Thus, while it is easy to observe the total break with annuality at the level of state schools, it is equally easy to observe that a new government, the Welsh Assembly, has adopted a strict form of the principle. Similarly, despite the fact that the principle is stated by central government (in *Government Accounting,* (HM Treasury))[iii], there are many significant exceptions.

That annuality is a practice, with a range of interpretations, is reflected in the fact that many organisations do not give the practice a name. All senior civil servants know its name, perhaps because the name is used in *Government Accounting,* although this may be an effect rather than a cause. Another way of referring to the essence of annuality is to refer to 'lapsing budgets', a usage that appears now to be more typical in the private sector.

The reality that financial controllers tend to welcome the advantages of annuality, while tolerating its disadvantages, applies also to other forms of implementing financial control through budgeting. In continental Europe financial controls through budgeting tend to be matters of law, about which lawyers have, at least in the past, theorised. Thus, there are associated 'classic rules of budgetary theory' (Jones, 2001):

- Unity or comprehensiveness. In its strictest form, this requires that there is only one budget and that the only way to spend money is against this budget.

- No hypothecation of taxation (non-assignment of revenues). This requires that the purposes for which taxation will be used are not defined before the taxes are collected. Thus, taxes are paid into general coffers and it is the budget that determines how money is then spent.

- Gross budget principle. This requires that income and expenditure are segregated so that all income is paid into the general coffers gross. Hence, spending can only take place against the budget.

- Specification, and virement rules. Budgets traditionally specify in detail what can be spent, and virement rules control movements from one budget heading to another.

- Balanced budget. In its strictest form, a balanced budget is one in which all net spending is financed by taxation, not by borrowing.

In the UK, all of these are practiced to some extent, in some parts of government, although there is a general trend towards relaxation of some of them (e.g. greater use of virement, fewer budget headings, more opportunities to spend additional income without involving the centre). However, for the most part, the principle of annuality has been addressed separately in this research.

Budgets 'cascade' throughout the public sector (and the private sector). In the UK in particular, they often 'start' from the centre of government, in which case annuality can be observed 'from above'. But at all other levels, there are often two views of annuality: one looking upwards to the source of the budget and one looking downwards to where the budget is delegated. Thus, budget-holders in spending departments, whether or not their budgets are subject to annuality, might disaggregate those budgets further and impose the rule on subordinates. Another important feature of the cascade is that spending a budget can be viewed as having taken place once a budget is passed to another entity, either within the public sector or the private sector.

But perhaps the most important part of the cascade, which may not be best reflected in the choice of metaphor, is the complexity of budgets (and therefore the complexity of any principles of budgeting). In the UK the budget's unitary status implies an interlocking of all government budgets, as well as a relationship between these budgets and the finances of many private sector organisations, not-for-profit and for-profit alike. This complexity affects, not least, the principle of annuality and the purpose of this study is to explore how this principle is applied and used in practice.

The first stage of the study involved a review of the extant literature on annuality. This proved to be surprisingly limited and is discussed in the next chapter. Interviews were then undertaken with a number of budget holders in a wide range of organisations. A summary of each interview is provided in the Appendix to this report and the results of the interviews are discussed in Chapter three. The final chapter contains the conclusions that can be drawn from this study and outlines the opportunities for further research.

2. 'March Madness'

There is one widely acknowledged effect of annuality. Put simply, annuality can lead to a disproportionately large amount of spending during the final quarter of the financial year (which in the UK means between January and March). As we know, however, organisations are not simple, and neither is budgeting. Yet the phenomenon is known, and it is true that neither economists nor value for money auditors generally address the timing of spending.

2.1 Evidence for the effect of annuality

Although the effect of annuality is widely acknowledged, evidence is not easy to obtain without access to an organisation's accounting system. Even with access, commonsense suggests that many budgets will not be affected by annuality. The major such example, which will apply to most governmental organisations, is the basic salaries budget. Because salaries budgets will tend to be a large proportion of revenue budgets, any increase in spending in the remainder during the final quarter may be masked. The US Senate Subcommittee (1980, p.7) makes the point that, although the rush of spending is small as a percentage of budgets, it amounts to large sums of money.

One area of public sector expenditure where UK national statistics do provide some evidence of an increase in spending in the final quarter of the year is that of capital expenditure. In the UK public sector, national statistics provide some evidence of an increase in capital expenditure in the final quarter of the fiscal year, as can be seen from Table 2.1, which provides a quarterly analysis of 'general government capital expenditure' (which includes central and local government). For example, capital expenditure in the last quarter of each of the fiscal years from 1998/1999 to 2003/2004 averaged over £4,800 million (see shaded cells in Table 2.1), while average capital expenditure in all other quarters reported in the table was only 44 per cent of that (just over £2,100 million). In the six years of data reported, the average capital spend in the last quarter of the fiscal year was approximately 45 per cent of the year's total.

Comparable statistics for current expenditure do not show a disproportionate amount of spending in the last quarter of the fiscal year but rather show a small but significant increase in spending in the third quarter of the fiscal year (the last quarter of the calendar year), a probable explanation for which is an increase in 'Net Social Benefits' paid in that quarter.

Table 2.1 Pattern of Capital Expenditure in UK Central and Local Government

Fiscal year	Quarter	Capital £m	% of Year in Quarter
1998/1999	Q1	2,613	17.3%
	Q2	3,071	20.3%
	Q3	3,720	24.6%
	Q4	5,702	37.7%
Total for fiscal year		**15,106**	**100%**
1999/2000	Q1	609	9.6%
	Q2	1,244	19.7%
	Q3	1,394	22.0%
	Q4	3,078	48.7%
Total for fiscal year		**6,325**	**100%**
2000/2001	Q1	325	4.8%
	Q2	1,238	18.4%
	Q3	1,832	27.3%
	Q4	3,325	49.5%
Total for fiscal year		**6,720**	**100%**
2001/2002	Q1	1,062	10.1%
	Q2	1,977	18.8%
	Q3	2,682	25.5%
	Q4	4,807	45.7%
Total for fiscal year		**10,528**	**100%**
2002/2003	Q1	1,217	10.0%
	Q2	2,366	19.5%
	Q3	2,426	20.0%
	Q4	6,129	50.5%
Total for fiscal year		**12,138**	**100%**
2003/2004	Q1	3,549	22.0%
	Q2	3,130	19.4%
	Q3	3,429	21.3%
	Q4	5,998	37.2%
Total for fiscal year		**16,106**	**100%**

Source: Economic Trends (Office for National Statistics, 2001 (Table 6.4), 2003 (Table 6.5) and 2004 (Table 6.5)).

A National Audit Office report (Comptroller and Auditor General, 2003, p. 32), using a Treasury source, although the original source is not further referenced, gives the 'percentage of annual budget spend' by quarter for the average of the fiscal years 1991/92-1997/98, and separately for 1998/99 through to 2001/02, for central government departments in total. These percentages, which appear to include capital and current spending, show a higher spend in the fourth quarters of the fiscal years and are presented by the report as such. However, in even the most extreme case, which was 2001/02, the pattern from the first quarter through to the fourth quarter was only 24.5%, 23.5%, 25.5% and 26.5%.

Specifically addressing capital expenditure, the report found (p. 32) what it calls 'some improvement': some 24% of capital spending occurred in the last two months of the fiscal years 2000/01 and 2001/02 compared to 35% in 1998/99. Although there are some similarities between these findings and the statistics derived from the Office of National Statistics in terms of the pattern of spending (for example 24% and 35%, respectively of the budget being spent in the last two months (17%) of the budget year), there are also some contradictions. Unfortunately, on the basis of the published information it is not possible to effect a reconciliation. The Treasury numbers are presumably based on accounting numbers whereas ours are clearly statistics; we would therefore expect the Treasury's accounting numbers to be more reliable. The ONS statistics include local government; the Treasury numbers do not. However, only a detailed reconciliation would resolve the contradiction.

2.2 The timing of spending

What literature there is on annuality tends to judge the disproportionate spending of the final quarter unfavourably: as spending that is uneconomic, inefficient, ineffective and/or of inappropriate quality (usually inappropriately high). This judgement is often reflected in the nicknames that have been given to this disproportionate spending.

The 'Grand Piano Syndrome' was the name given within the British Council to suggest that, whenever there was a grand piano in British Council offices around the world, it had been purchased in March. The importance of this name is not that pianos are inappropriate for British Council offices but that grand pianos may not have been bought if annuality had not applied. A name with a similar intonation is 'Christmas season', which has been used in the sense that the suppliers or contractors are the particular beneficiaries (US Senate Subcommittee, 1980, p.6), as well as in the sense that the government disproportionately increases its spending; this latter sense is also reflected in the expressions used by some of our interview respondents, such as 'Spring sale' (Interview J) and 'March madness' (Interviews K and N). More neutral terms that have been used are 'year-end rush' and 'hurry-up spending'.

In judging the effect of annuality, therefore, it is important to distinguish between the timing of spending and the economy, efficiency, effectiveness and quality of spending[iv]. What might be called the first-order effect of annuality is only of timing of spending: spending in the final quarter that might otherwise have taken place earlier in the year.

In which case and why, then, does annuality affect the timing of spending? In the first place, the timing and amount of the spending has to be discretionary, in the sense that the relevant budget-holder has the discretion. This is why most salaries budgets are unaffected. Setting these kinds of budgets aside, why are the remainder potentially affected by annuality?

It can be taken as given, however important it might be that budgets are spent, that there is an imperative not to overspend. In an uncertain world, in which the annual budgets may have been set months (perhaps even years) before the financial year, it is natural for budget-holders to want, if possible, to wait until the demands of the financial year are clearer before they spend their budgets. At its most innocuous, this is simply the passage of time reducing the period of uncertainty. This might discourage the dividing of a discretionary budget by twelve months and smoothing the spending over the year, and encourage the holding back of say, half of the annual budget, to be spent in the final quarter. If such a budget profile were planned, and executed as planned, it would be unfair to judge this even as a 'rush' of spending. But many budgets are, by their nature, difficult to profile so exactly, not least because three months, and especially since those three months are in the middle of the UK's winter, can be an uncertain time. Notwithstanding this uncertainty, the imperative remains not to overspend. It is easy to imagine how a planned increase in spending during the final quarter could become, by force of circumstances, a rush of spending.

This scenario is presented in neutral terms; it can be applied to any kind of discretionary spending. However, in some kinds of capital spending there can be a systematic factor that exacerbates this disproportionate spending in the final quarter. This factor relates to those capital projects that, by their nature, require many months from their initiation to their implementation, a lead-time that cannot easily be reduced. Such projects include, for example, those that require extensive discussion with the public or with pressure groups. Initiation is, at the earliest, approval of the budget; implementation is necessarily months into the financial year.

Another less systematic but pervasive phenomenon that can turn a planned increase of spending into a rush is the 'phone-call', received during the final quarter by a budget-holder from a higher authority (which during the financial year has typically taken the role of watchdog for overspending) telling the budget-holder to spend additional money quickly (Interview A). The higher authority might be a part of the European Commission, or of central government, or even within the same organisation as the budget holder. The point about this is that the 'cascade' of budgets within a country such as the UK can mean that a lower-level budget-holder's planned increase in spending can become a rush because of a higher-level's rush of spending (possibly because of the higher-level's awareness of underspendings elsewhere). In the US context, another cause of hurry-up spending has been suggested, namely delays in obtaining supplementary budgets (US Senate Subcommittee, 1980, p.9).

The crucial element of the above analysis is the imperative not to overspend. Of less, but still crucial, significance is that there are clear incentives for the budget-holder not to underspend either. In the first place, as surely as the budget is authorising spending for specific purposes (even if those purposes are expressed as only one budget for a whole department) the budget is requiring the spending to take place within a year. Under annuality, not underspending a budget is, in theory, as important as not overspending it. Yet it has long been recognised that, in practice, there are other possible reasons for not underspending;

> 'There is nearly always some balance, for every department has to keep within its vote, (increased if necessary by a supplementary vote,) and it is not possible to calculate the expenditure so nicely that every penny voted will be spent (except in the case of a vote confined to one or more grants of agreed and invariable amounts).'
> (Hawtrey, 1921, p. 54, cited in Jones (2001)).

One view derives from distinguishing between the budget holder's objectives and those of the budget holder's organisation as a whole:

> 'As the end of the year approached the condition of appropriation balances was carefully studied with the deliberate purpose of seeing how all the money available could be used. This was but human nature. Any money that had to be returned to the Treasury was a loss to the service for which it was originally appropriated.'
> (Willoughby et al., 1917, p. 85, cited in Jones (2001)).

Such a pessimistic view of human nature is, of course, not necessarily predominant:

> 'It is said that when a department has secured a certain amount of money from the Treasury and from Parliament for the financial year (perhaps not without a struggle) it will be reluctant to leave a part unspent, and will hasten, towards the close of the year, to devise means of using up any balance which would otherwise have to be surrendered. The criticism cannot be dismissed as trifling, based though it is on an abject misconception of the position alike of the Treasury and of all other departments. Human nature is frail, and official human nature does sometimes forget that the settlement of the expenditure to be incurred on a service is not a battle-ground for contending departments but a matter of public policy to be decided by the servants of the public in the public interest.' (Hawtrey, 1921, p. 55, cited in Jones (2001)).

Nevertheless, a view that politicians and officers have a stronger association with 'their own' service or portfolio of services than with the public interest as a whole can be safely said to be a common one.

Another view of the budget-holder involves interpreting spending against the budget as a signal of the budget-holder's 'need' to spend. This signal is especially strong, and is the norm, when there is no systematic profiling of the budget (that is, a formal, agreed pattern of spending the budget over the financial year) and when there is no overt, profiled relationship between spending and outputs and outcomes. Notwithstanding the original agreed need to spend the authorised budget, subsequent underspending signals that the authorised budget was not wholly needed and signals that subsequent budgets can be reduced:

> 'They're supposed to spend the public's money as carefully as possible, but if they plan effectively, budget prudently, spend less, and manage to return tax dollars to the Federal Treasury, they face the prospect of having their budgets slashed for the next year. There is simply no incentive for prudent management, no regard for the saving of tax dollars. The system is commonsense turned upside down'
> (Wildavsky, 1974, cited in US Senate Subcommittee, 1980, p.10).

In the UK central government, the signal that the authorised budget for the year is not wholly needed can be intensified by the workings of the cash management system which is embodied in that particular application of annuality. That is to say, cash is forwarded from the Consolidated Fund to the departments' bank accounts in tranches, before, during and after the financial year. If the interim tranches are not spent before further tranches become due, the signal intensifies: not only has a budget been authorised that appears too high but actual cash has been moved out of the Consolidated Fund that is not needed.

These signals depend on the absence of strong links between spending and outputs and outcomes. But, as important, this absence also raises serious questions about whether a rush of spending includes spending that is uneconomic, inefficient, ineffective and/or of inappropriate quality (usually inappropriately high).

2.3 The economy, efficiency, effectiveness and quality of spending

As pervasive as the concepts of economy, efficiency, effectiveness and quality are now in accounting and auditing, judgements concerning them remain difficult. Nevertheless, the literature does suggest deleterious effects that March madness can have. These are seen as two dimensions of the timing of spending: the time of year of the rush in spending and the speed with which spending has to take place, to ensure that budgets are spent.

The most straightforward view is that annuality leads to there being more spending than would otherwise be the case:

> 'all, or at least a very strong, incentive to economy is removed.'
> (Willoughby et al., 1917, p. 85, cited in Jones (2001)).

Osborne and Gaebler (1992, p.3) represent the wider view, which is that efficiency, effectiveness and quality are adversely affected:

> 'Normal government budgets encourage managers to waste money. If they don't spend their entire budget by the end of the fiscal year, three things happen: they lose the money they have saved; they get less next year; and the budget director scolds them for requesting too much last year. Hence the time-honored government rush to spend all funds by the end of fiscal year.'

In this context, there are two related difficulties with making judgements about economy. The first is that, in many services, it can be argued that there is insatiable demand; the second is that however quickly the budget is being spent at the year-end, the budget was authorised by the politicians to be spent.

Judgements about 'waste' are more difficult. One theme in the end-year rush is that spending, as well as being quick, is also discretionary. This may result in 'low-priority items of services' being bought (GAO, 1998, p.1). A more specific example of where this occurred in the US relates to the hiring of consultants (US Senate Subcommittee, 1980, p.5). As it happens, two of our interviews were with consultants to the public sector (Interviews E and O); in neither case did the interviewees recognise that their business was affected by this possibility, although Interviewee O was interested enough to want to look at their pattern of business again.

2.4 Proposals for reform

Although there is relatively limited literature on annuality, there have been proposals for reform aimed at preventing the surge of spending at the end-year or, failing that, ensuring that the surge is not wasteful spending. The traditional approach to the latter is to rely on improved systems of procurement. However, US evidence has suggested that 'systematic procurement reforms' have helped but not in all cases (GAO, 1998, p.2).

As to preventing the surge, improved systems have also been suggested particularly in providing better approaches to planning and therefore scheduling spending (e.g. US Senate Subcommittee, 1980, p.16).

Proposals have also been made for more direct control of budget-holders. For example, it has been suggested that pay and promotion policies should reward civil servants who save (US Senate Subcommittee, 1980, p.11). Another example is to set a limit on the amount that can be spent in the last two months of the year (US Senate Subcommittee, 1980, p.4, fn.11). The US evidence available suggests that this did even out spending but did not stop the rush (US Senate Subcommittee, 1980, pp.13-14).

Probably the most prominent suggestion for preventing the rush of spending is to retain (necessarily) annuality in accounting but to have some, or total, flexibility in carrying-forward unspent balances:

> 'By allowing departments to keep their savings, Visalia not only eliminated this rush, but encouraged managers to save money. The idea was to get them to think like owners: 'If this were my money, would I spend it this way?' '.
> (Osborne and Gaebler, 1992, p.3).

Others have added nuance, in which the carry-forward is subject to conditions:

> 'In principle, there is no reason why the end of March should have any special significance for spending programmes (particularly as spending no longer determines government grant) or why balances should not be carried forward. Certainly, there should be some way of allowing committees to carry forward significant sums earmarked for specific purposes. But it may make sense to carry out a thorough base-budget review to eliminate over-provision, and institute a system of resource allocation based on objectives, before widespread carry-forward is allowed. If it is allowed – and this is one of the main problems of delegation to schools – it should be closely monitored and senior management should intervene before the sums involved get out of hand.' (Audit Commission, 1989, p.10).

In recent years the UK government has introduced a number of major reforms to the budgeting process. These include setting departmental budgets on a three-year basis and end-year flexibility (Thain and Wright, 1995, chapter 19, provides a detailed discussion of end-year flexibility before the three-year budgets).

Setting firm budgets for departmental spending for a three-year period (known as 'departmental expenditure limits') permits longer term planning than is possible under a system of annual authorisations. Expenditure that cannot be sensibly managed over a three-year period, such as social security payments and debt interest, is separately managed as 'annually managed expenditure'. End-year flexibility has been introduced 'to avoid the wasteful end-year surges evident in the past' (HM Treasury, 2001(a), p.18) and permits departments to carry forward in full any underspendings of their department expenditure limits allocations in full. The amounts carried forward from 2000/1 into 2001/2 under the end-year flexibility scheme totalled almost £6.7 billion, which represented approximately 3.5% of all departmental expenditure limits expenditure for 2000/1 (HM Treasury 2001(b), Tables 1 and 6).

Although end-year flexibility was introduced at departmental level, the departments were left to themselves to decide how to cascade this flexibility down to lower levels within a department. However, a review by the Treasury of the extent of cascading (Treasury, 2000) revealed that in many departments cascading had not occurred and a working group was set up to carry out a survey of existing practices. This revealed that departments that had managed to cascade end-year flexibility reported a reduction in end-year surges and an improvement in the managing of capital projects which often involve 'lumpy' payment patterns. However, it was also recognised that restricting end-year flexibility to the central departmental level made it easier for departments to meet their responsibility for keeping overall spending within their departmental expenditure limit. This acted as a disincentive to cascading end-year flexibility to lower level budget holders. One suggestion that emerged from this survey was to require budget holders to identify possible underspendings well before the end of the financial year-end. Only amounts identified at this stage would be available for carryforward as end-year flexibility. To the extent that these identified underspendings were the result of slippage rather than an initial overprovision, or the abandoning of a programme, then 80% or more of the underspend could be carried forward. The remaining 20% would be available to allow some flexibility at central departmental level in meeting overspends elsewhere in the department. A strong counter-argument to the idea that end-year flexibility will endorse underspendings and therefore prevent end-year rush is the view that the flexibility only endorses the underspending in the current year and does not prevent the centre of the organisation cutting future budgets on the ground of this underspending (US Senate Subcommittee, 1980, p.12).

3. Method and results

3.1 Method

In spite of annuality being such a widely recognised and pervasive principle there has been relatively little research into the implementation and impact of annuality. In an attempt to explore the use of annuality in practice a number of interviews were held with budget holders, finance officers and consultants. Interviews were held in a total of 17 organisations situated in England, Wales and Northern Ireland over the period September 2001 to March 2003.

The interviews were semi-structured in nature and each interview lasted for approximately one hour. On five occasions two interviewees took part in the interviews and so the views and responses of a total of 22 interviewees were obtained. It was made clear to the interviewees that strict confidentiality would be observed and that neither they nor their organisation would be identified in any publication arising out of the research. All but four of the interviews were taped and, in addition, notes were taken by the interviewers during each interview. These notes were summarised within a few days of each interview. In order to preserve anonymity the 17 organisations at which interviews took place are referred to by the letters A to Q and summaries of the notes of each interview are produced in the appendix to this report. An analysis of the organisations visited, the job category of the interviews and the letter code for each interview is provided in Table 3.1. For presentational purposes the results are discussed under the following headings: how spending is managed; waste as a result of annuality; timing of expenditure; accounting boundaries and annuality; and end-year flexibility.

3.2 How spending is managed

Although the frustrations of having to operate within an annuality framework were evident from many of the responses, the overall impression was that because everyone was so aware of the problems that annuality might lead to, this resulted in it being managed in a way that minimised the adverse impacts.

Many of our finance officer respondents pointed to the systems in place for the early identification of possible underspending so that the planned expenditure could take place by the end of the year. The following comment expresses this.

> 'I'm not aware of a huge rush of spend that's done just to spend a budget. Certainly, last year we were on people's backs to get the budget spent throughout the year because, for the last few years, the department was underspent by quite a bit and that's not seen as a good thing for all sorts of reasons. So we had a big push to get people to spend their budgets. And it took an awful lot of effort but the results were brilliant with 99.5% of budgets spent, almost too brilliant. This was in comparison with a figure of 97.5% from the year before. By the same token, we have an accounting officer, so if this money was going out seriously in advance of need or on things that we didn't really need, then the accounting officer would have cried foul; we do have good checks and balances in the system. So, I wouldn't actually describe it as a rush of spending. What we have tried to do is to get people to proof up far better. I think we suffer from optimism, rather more than intrigue. You know, people hoping that they'll spend it by the end of the year and it's hard to get people nailed down, just to tell us their real forecast and work to it.'
> (Interview J)

Table 3.1 Analysis of interview responses[v]

Organisation visited			Job category of Interviewees (22)		
	No.	**Letter code**	**Finance Officer**	**Budget Holder**	**Consultant**
Government Departments	8	A,B,C,D,F,L,J,N	7	3	–
Local Administrative units	5	G,H,I,K,M	5	2	–
Consultancy Firms	2	E,O	–	–	3
NDPB	1	P	–	1	–
Voluntary sector charity	1	Q	–	1	–
Total	**17**		**12**	**7**	**3**

A further way of dealing with the constraint of annuality is to find a way of managing the constraint. One budget holder with responsibility for highway maintenance and development provided the following example of how annuality could be actively managed rather than it acting as a limiting factor:

> 'If we just talk historically about the cash budget base, what we would do to ensure that we could deliver the budget to a good level of accuracy is to make sure that we gave ourselves flexibility in the payments we have to make towards the end of the financial year and there are various ways to do that. Within the contract you can, for instance on a major capital scheme, have interim certificates as the contract runs through and as those become due they are payable over a particular period of time. If you engineer that period of time to cross the financial year then you have a degree of flexibility as to whether you pay the invoice in one financial year or the next.' (Interview N)

Further evidence of 'creative' ways of overcoming annuality is provided from interview Q who referred to the practice of 'parking' money with a service provider, often on a handshake deal, to ensure that money appears to have been spent by the end of the financial year. The service is therefore paid for in advance before the financial year end but provided in the following financial year.

In some interviews particular emphasis was placed on what was considered good management in having 'off the shelf' spending that is desirable and can usefully and easily be taken off the shelf during the final months of the year. Examples of this were furniture and IT equipment (Interview D). This was also referred to in the context of highway maintenance in Interview N as follows:

> 'Because the financial year ends on the 31 March and the winter period is at the end of the financial year, you have to make at the start of the financial year a reasonably prudent allocation for winter maintenance. Obviously if it transpires to be a very mild winter you may find yourself at the end of the financial year with unspent resources which you are looking to consume. Normally, in highway terms anyway, that isn't a major problem. If it had been a mild winter, you are able to do resurfacing works for instance, in March, which is a very effective means of spending the money, it isn't sort of abortive expenditure. And certainly most prudent managers would have a programme ready to pull off the shelf.' (Interview N)

Several respondents referred to the difficulties associated with 'slippage' money being made available, often very late in the financial year. Slippage occurs where a higher level in the control of spending realises that they are unlikely to spend their budget entitlement and therefore makes funding available to lower levels. A typical example of this is as follows:

> 'We find year-end is very problematic for us in some ways but, on the other hand, one of the advantages of annuality is that because we've got quite a bit of slippage out of the department this year where their expenditure has slipped, so we've been able to fund some things they wouldn't give us money for.' (Interview P)

The same interviewee explained that monies they had not been expecting and that they had originally been told they could not have were suddenly made available in the second week in March. Despite the late notice the interviewee was able to spend the additional money.

> 'Yes, we were able to spend it. We were lined up to take advantage of anything that came our way, so it does cut both ways doesn't it?' (Interview P)

The interviewee went on to explain that they had off the shelf schemes waiting for funding and pointed out that:

> '... it doesn't distort priorities quite to the extent that it would suggest because if you are planning for it what you actually do is bring things forward from the early part of the coming year, but it's a silly way to do business to be honest. I'm far from persuaded that the public purse gets best value as a consequence of the way it operates.' (Interview P)

Other examples of quick, discretionary spending were provided in our interviews: flipcharts etc (Interviewee A); IT equipment (Interviewee C); staff overtime (Interviewee C); repairs and maintenance (because repairs and maintenance is one of the first items to be cut when cost reductions are needed) (Interviews E and G); flag-pole painting (Interview F); vehicles (Interview G); filling potholes (Interview K); training courses, including sending more people on a course than would otherwise attend, sending them in March rather than April, or sending them on external courses rather than training them in-house (Interview O); equipment and general (Interview O).

3.3 Waste as a result of annuality

Turning to the matter of 'waste', the rush of spending can have an effect on the organisation's administrative costs because of the need to pay overtime or to employ temporary staff to deal with the short-term increase in the processing of orders and invoices etc. (Interview C; GAO, 1998, p.2; US Senate Subcommittee, 1980, p.6). Another effect on the organisation's costs can occur because contractors are able, or are required, to charge the organisation more than they otherwise would (because of the speed in which their services are needed) (GAO, 1998, p.2; US Senate Subcommittee, 1980, p.6).

One way of overcoming this has been to try to commit contractors to prices before the final quarter.

> '... the way local authorities generally used to get round that was by an annual tender process, whereby contractors would commit themselves to rates for those works for a whole year and if they were called upon to carry out these activities in March it would be at rates they had tendered for at the beginning of the year.' (Interview N)

However, the interviewee went on to point out that there could still be a situation whereby the contractors would be unable to meet the demand towards the end of the financial year. A similar point was made by Interviewee K.

> 'Yes, you do (end up paying over the odds for spending to get rid of money at short notice). There's two things – there are those (contractors) on our select list who have given us prices ... but you find in some years that none of them are willing to do it, as they are all fully committed and you end up paying over the odds ...' (Interview K)

One very specific example of 'waste' was provided by Interviewee A, who emphasised that, because of annuality, it had not been possible to keep a retention for some capital projects: retentions are in part used to mitigate the effects of wasteful spending by contractors. Specific examples of 'waste' cited in the US context are: spending without competition by suppliers; poorly defined statements of work; inadequately negotiated contracts; purchase of stock with short shelf-lives; unnecessary costs of warehousing (GAO, 1998, pp.1-2; US Senate Subcommittee, 1980, p.6).

3.4 The impact of the accounting basis

The timing of spending is obviously affected by the definition of spending. In other words, the accounting basis can affect the ability of a budget-holder to spend quickly enough to ensure that the budget is neither over-nor underspent. In the UK, because the full effects of accruals, budgeting and accounting had not been felt by budget-holders in central government, there was a range of bases in practice, from cash to forms of accrual accounting (in the financial accounts), and including commitment accounting in the management accounts. In addition, the two US studies cited here addressed the federal government, in which obligations accounting is used in the financial accounting.

There are different perspectives on these accounting bases. In one context, cash accounting is the hardest for the budget-holder who is buying goods and services to manage, or manipulate, because of the time lapse between order and cash payment, and the fact that the cash payment is usually out of the budget-holder's hands (Interview B). In such a context, an accrual basis is easier to manage; and the commitment and obligations bases are easiest. The shorter time between the order and the booking of the 'spending' makes transactions more predictable, and under the accrual, commitment and obligations bases, there may be direct contact between the budget-holder and the supplier. This latter point means that there are opportunities for budget-holders to make different judgements about when spending has been 'incurred'. For example, Interviewee A might not take as strict a view as an accountant might, and did feel happier about asking for a premature invoice from a known supplier.

However, in the case in which the budget-holder is managing a capital scheme, it was argued by Interviewee N that cash accounting is easier to manage and an accrual basis creates potentially many more difficulties. Three examples were cited. First, it is often easy to 'engineer' work within the contracts, and therefore the associated payments, under cash accounting. In addition, when dealing with the budget-holder's own agencies, it is easy to requisition funds in advance or in arrear to smooth cash flow (which is lost when dealing with private sector contractors). Another technique used in major capital schemes may be to establish a cap on spending in an early year but to allow the contractor to accelerate work (but not the reimbursement). These possibilities for 'managing annuality' would be a great deal more difficult under accrual accounting.

In the context of an organisation as a whole, all accounting bases have their weaknesses, in terms of their manipulability. Cash flows are very easy to manage; payments can easily be postponed or advanced by a few days (Interview B). Under accrual accounting, manipulating cash flows will not help; on the other hand, the non-monetary accrual adjustments can be manipulated because they are pure matters of judgement (Interview O). At the organisation level, a commitment accounting system is an irrelevance, since commitments entered into for which goods or services have not been received ought not to be included in the financial accounts. However, the obligations accounting system used, for example, by the US federal government is a financial accounting system, and is the easiest of all systems to manipulate, simply because of the ease of entering into obligations with willing contractors or suppliers.

3.5 Accounting boundaries and annuality

Whichever accounting basis is used by an organisation, the complexity of organisations within the public sector (and in their relationships with the private sector) means that paying money to another organisation, in the form of grant of subsidy, is an easy way to ensure that budgets are spent (Interview M). This is particularly easy under cash accounting but is perhaps not much more difficult under accrual accounting, given that the definition of anything other than the timing of the cash payment is subjective. It is also important to realise, and not parenthetically, that such rushed year-end payments can significantly add to the pressures that annuality may impose on the recipient public sector organisation.

An issue that emerged from our interviews was that there were a number of ways of changing the budgets, rather than the accounting, to make sure that underspendings or overspendings were not shown. Interview D explained the incentive for underspending units to offer their projected underspendings to overspending units, obviously not to avoid losing the underspending but to avoid the charge that any underspending would justify a cut in next year's budget.

Another accounting issue emerged in the context of grants. Interviewees H and I explained that there had been grants to which spending that had been incurred before the grant was announced could be charged. The effect of annuality was particularly marked when the organisation making the grant had a different financial year from the recipient. Commitment accounting systems were rarely mentioned in our interviews but in two cases the point was made that because annuality ultimately refers to the financial accounting it was to the financial accounting basis that budget-holders looked for their definitions of underspending (Interviews H and K). In one case, Interviewee M judged the effect of annuality as being merely 'cosmetic' because the interviewee's unit was consolidated with other units to produce the annual financial statements. Overall, these financial statements tended to show neither over- nor underspending but the over- and underspendings of each unit were restored to them in the new financial year.

3.6 End-year flexibility

The position with end-year flexibility at government department level is that there was little evidence of this being cascaded down to lower levels of budget holder within the department. End-year flexibility existed between the departments and the Treasury but was not automatically cascaded to lower levels. The three central controllers in government departments (see endnote v) offered different reasons for the lack of cascading. In Interview F it was explained that end-year flexibility at the central departmental level was not cascaded to lower levels because historically there had been an allocation to lower levels that was less than optimal and which inevitably led to under- and overspendings. If these anomalies could ever be overcome so that the baseline budget for each lower level was a realistic estimate of spending need, then end-year flexibility might be introduced. The response from Interview J pointed out that the politicians in charge of his department were insistent that the budget should be as close to 100% spent as possible. In other words the department was not going to make use of end-year flexibility and so this could not be cascaded to lower levels because of the need to ensure that overspendings were matched by underspendings. This need to use underspendings to finance any overspendings was also referred to by the third central controller (Interview B).

Even in local administrative units, where there was evidence of limited end-year flexibility (see endnote v), two of the interviewees (Interviews J and K) indicated that they knew of the possibility of carrying underspendings forward but they were unsure of the precise rules. In another it was explained that underspends had to be surrendered to the centre and then bid for:

> '... year-end flexibility is available though you have to apply for it...effectively you've got to yield the money back to the centre and then try to secure it again for next year...' (Interview G)

4. Conclusions

Annuality is a widespread and pervasive phenomenon. It affects public budgeting throughout the world. It has obvious benefits for those at the centre of organisations who wish to impose traditional central control. The literature suggests that it is likely to lead to wasteful and extravagant spending and there is much anecdotal evidence to support this. A scramble to spend as the end of the financial year draws near gives rise to such expressions as 'March madness' or 'silly season'. The UK Treasury's stated rationale for introducing end-year flexibility was 'to avoid the wasteful end-year surges evident in the past' (HM Treasury 2001, p.19). It is against this backdrop that this exploratory study of annuality was undertaken.

The first point to note is that attitudes to annuality across the very complex web of entities that form the public sector were always likely to vary quite widely. Even so, it was interesting to note that all of the 13 interviews that were conducted with controllers or budget holders fundamentally supported annuality implicitly or explicitly. In addition, each recognised the need for sensitivity, of one form or another, in implementing it. Examples are as follows:

- Interviewee A, when asked to make a judgement about annuality, felt that it was a good compromise between a longer period of control (where tight control would be lost) and a shorter period of control (where there would not be enough time for managers to do their job).

- Interviewee B made the point that it was often easier to see the waste from the year-end rush than it was to see the improved productivity from having year-end carry-overs.

- Interview C said that 'annuality in one year is not the same as annuality in the next year'. In other words, though there were defined rules, budgeting was always a matter for negotiation and that the nature of those negotiations would often change.

- Interviewees I and K did not know the 'rule' about carry-forward but knew carry-forward was possible.

- Interviewee F offered an argument for end-year flexibility to the higher level but annuality for the lower levels based on the view that end-year flexibility is new and could not be applied to the lower levels because history has culminated in a misallocation of resources between services. Once this has been corrected, perhaps end-year flexibility will be introduced.

- Interview H recognised that, probably since 1997, more money was available. In this environment, modifications of annuality had been easier to manage. In the interviewee's opinion, however, it was when resources were tight that the real benefits of the modifications are felt. An additional point was that, although the greater resources did benefit services with a high political profile (e.g. social services, education), many important services with a low political profile (e.g. street lighting, repair and maintenance of roads), were still working with tight budgets.

- Interviewee L explained that budget-holders had often argued that end-year flexibility to carry forward underspendings should be matched by end-year flexibility to carry forward overspendings, but the interviewee felt strongly that it is much less easy to persuade budget-holders to make a necessary reduction in future spending than it is to persuade them to increase future spending.

- Interviewee N acknowledged that politicians do find annuality useful because it helps in balancing the tensions that inevitably arise between different portfolios.

- Interview I even went so far as to say 'annuality is a useful mechanism because, to be blunt, I don't know any other… it's the culture I work in, I haven't had any experience of any other culture…it's difficult for me because I can't really compare it.'

All of these interview respondents were fully aware of annuality's potential for wasteful and unnecessary spending and yet they felt that the systems and procedures that operated in their organisations minimised any adverse impacts.

The respondent from the NDPB (Interview P) and the voluntary sector charity (Interview Q) and to a lesser extent one of the consultants (Interview D) were, however, more critical of annuality even though both Interviewees P and Q acknowledged that they benefited from slippage money in their funding departments being made available late in the financial year. Our interviews with government departments revealed that end-year flexibility was enjoyed by the centre of the department in its dealings with the Treasury but this end-year flexibility was not passed down to lower levels in the organisation. One obvious reason for this is that it enabled the government department to utilise underspendings by some budget holders to offset overspendings elsewhere and so ensure that actual spending for the year was very close to budget.

4.1 Further research

Although it was useful to explore how annuality affects a range of different organisations and to explore the procedures in place for managing and minimising the impact of annuality, there are a number of ways in which this study might be extended. One possibility would be to undertake a substantial case study in a large spending department. Each of the departments and organisations that we visited had its own systems and procedures, its own specific problem areas and its own culture. In a 60-minute interview it was not possible to understand fully and appreciate fully the significance of these different variables, which affected our ability to compare responses. A case study within one large department would mean that these background variables would, for the most part, be common, which would be helpful when analysing and discussing the responses and findings. It would also be important for the case study to involve interviews and discussions with budget holders at every level in the organisation. One of the limitations of our exploratory study is that, notwithstanding the frankness of many of the interviewees, their seniority tended to mean that discussions took place within a context in which the organisations were said to be, or were implicitly assumed to be, well managed; thus serious inefficiency or ineffectiveness was not discussed. Also, the seniority of the interviewees tended to mean that the voice of the budget holder who actually buys goods and services was rarely heard.

A particular focus of such a study might be on the ways in which approaches to annuality have been affected by changes in other aspects of budgetary control, for example the way in which a more flexible approach to annuality may have been accompanied sometimes by more flexibility (eg, greater use of virement, more opportunities to spend additional income) sometimes by less flexibility (e.g. more severe penalties for overspending) in other matters of central control. A pervasive aspect of central control throughout the public sector now is the use of measurable targets and performance measurement against those targets; how this form of central control affects or is affected by annuality is of special interest.

In addition, the statistics used in this report are only indicative, and very broadly indicative at that, particularly because they are highly aggregated. Tentative explanations have been offered but these can only be tentative. To understand fully the effects of annuality would require access to one organisation's budgeting and accounting system, which would be able to segregate the effects on capital and revenue spending separately, for example. The detailed patterns of spending could then be understood in the context of the wider managerial and political issues of the organisation, including the relationship of the budget cycle with the political cycle. Ideally, this would then be supplemented by access to other organisations' systems, in order to make the results more generalisable; on the other hand, the costs associated with deriving such comparative data may be prohibitive.

A further way in which the study could be extended would be to examine the impact of resource budgeting on annuality. During the period the research was undertaken resource budgeting in government departments was clearly something that was beginning to have an impact but the full effect had not been felt by the interviewees, not least because it was only when the 2002 Spending Review became effective in 2003/4 that significant amounts of non-cash accrual amounts were moved from annually managed expenditure into departmental expenditure limits.

(i) In the UK, there is no use of the wider system of accounting for obligations that is adopted, for example, by the US federal government; nor is there use of 'budgetary accounting' in which budget numbers are an intrinsic part of the accounting (even to the point of their being included in the double-entry), which is common in continental Europe and the US.

(ii) In many undeveloped budgeting systems around the world, the financial management system simply provides cash to spend: in such systems, it is strictly not possible to overspend. In a financial management system in which individual spending decisions are divorced from their financing, it is quite possible of course that budgets can be overspent.

(iii) For example, Government Accounting 2000 states that Estimates (short for Supply Estimates) are subject to annuality…that is, money voted in any given financial year can only be spent during that year (para 11.1.6). Similarly, para 12.2.6 states that the appropriation account of a Parliamentary grant is a single non-cumulative account – i.e. any surplus at the end of the year must be surrendered to the Consolidated Fund – it cannot be carried forward. This is the annuality principle.

(iv) This research is not concerned with fraud or other irregularities that may be induced by annuality, although issues to do with the accounting bases are discussed in Chapter 3.

(v) In three of the government departments (organisations B, F and J) the interviewees were central controllers for their entire departmental budget and at this level there was complete end-year flexibility. The interviewees from the remaining five government departments (organisations A, C, D, L and N) were lower level budget- holders and subject to the traditional rules of annuality. In three of the local administrative units (organisations H, I and K) the interviewees stated that under certain circumstances limited provision for the carry-forward of underspendings (end-year flexibility) was permitted. Annuality was strictly imposed in the remaining two local administrative units.

Appendix

Summary of each of the interviews – key points

Interview A

The interviewee was a budget-holder (of both revenue and capital; in total £1m-£10m). The interviewee was not an accountant but (though middle-aged) had been taking a professional accounting qualification by correspondence course, and had formal qualifications in strategic planning.

A central point the interviewee made related to the fact that the revenue budget did have a x% carry-forward. The point was that this carry-forward helps militate against the rush of spending (in the sense that you know you will not lose all of the underspending) but does not help in the sense that the centre may still want to cut next year's budget because you underspent.

The interviewee's imperative was for tight control of the budget, informed by experience of human nature in relation to money. The interviewee made sure that the accounting system provided the timely information needed.

The interviewee's approach to profiling a budget was to spend up to budget for the first nine months and then to re-assess. Since the interviewee had tight control, the interviewee did not want spending curbed in the first nine months followed by the rush, which the interviewee knew produced undesirable effects. The interviewee's approach was helped by having the carry-forward on revenue, which presumably meant there were reserves to finance any overspendings that might result.

The interviewee made the point that the rush of spending pushes you into particular kinds of spending because other kinds of spending have tight rules about procedure that involve long lead-times. In extremis, bids were often made for 'flipcharts etc.'

The interviewee was reluctant to manipulate 'spending' at the year-end but did recognise that the interviewee might not take quite as strict a line as an accountant might. The interviewee did feel happier about asking for a premature invoice from a known supplier.

Before the interview, the interviewers had discussed the 'phone-call', which is the pervasive phenomenon in which budget-holders who are subject to a higher authority that spends most of the year telling the budget-holder that there is not enough money suddenly calls to rush spending through. Unprompted, the interviewee mentioned the 'phone-call'. In the interviewee's case of tight control this often meant that the interviewee could not spend quickly enough. The interviewee made the point that, while the maker of the phone call would not care so much about how the money was spent, the interviewee's auditor would.

The interviewee developed the discussion into the similar situation of windfalls: if they came towards the end of the year, annuality meant that you often could not spend them and they would be lost to the centre.

When asked about the effect of annuality on capital budgets, the interviewee made the point that the interviewee had at times been unable to keep a retention for a capital project. The crux of this point depended on the interviewee's view that the capital budget was a one-year budget.
At the end when asked to sum up the interviewee's view of annuality, the summary offered was that it was a good compromise between a longer period (tight control would be lost) and shorter (not enough time for managers to do their job).

A central implication of this interview was that the interviewee was a planner with good control and that the main villain was the centre (of the civil service). This implies that those at the centre are not good planners and do not have good control (in the interviewee's sense).

Interview B

The interviewee is a central controller of a number of budget-holders, each of which is also a controller of many different kinds of budget-holders. The interviewee is not an accountant and drew distinctions between budgeters and accountants that were important to the interviewee.

The interviewee's central axiom is that annuality is a bad thing because it encourages a rush of spending. Hence, the interviewee's organisation has allowed 100% carry-over since 1998. There are, however, a number of necessary associated constraints. First, the annual flexibility is in the context of a three-year budget (negotiated every two years). Second, the annual flexibility is asymmetrical: money cannot be drawn down from future years' budgets. Third, when underspending in the year follows having taken money from reserves earlier in the year, the latter amount must be repaid.

On the other hand, the interviewee could understand why the first level of budget-holders below him would impose annuality: they would want to claim the underspendings to finance any overspendings, because of the imperative of not overspending their budget as a whole. (Perhaps the reason why this was less of an imperative for the interviewee was because experience had demonstrated net underspending since the 100% carry-over had been introduced.) Indeed, although as a central controller the interviewee could have done more to insist that budget-holders adopt 100% carry-over, the interviewee did not, because this factor could outweigh the benefits from giving the incentive not to have the year-end rush.

The interviewee's accounting data confirmed that there has continued to be a year-end rush, most marked for capital spending. Moreover, the new system had not noticeably reduced the year-end rush.

When asked about the effect of Resource Accounting and Budgeting on the year-end rush, the interviewee's argument was that under cash accounting it was too easy to advance or postpone cash flows. The interviewee implicitly agreed with our point, however, that in another sense it is easier to manipulate accrual accounting (and easier still, commitment accounting) because the cash flow can be a long way away from the issuance of an order, and the cash flow may have to be processed through accountants.

Since introduction of the new system, there had been net underspending in each year and there was concern that this trend would continue.

On the overall judgement of annuality, the interviewee made the point that it was easier to see the waste from the year-end rush than it was to see the improved productivity from having year-end carry-overs.

Interview C

The two interviewees (chief executive and finance director) were budget-holders (of both revenue and capital; in total £130m). They considered themselves 'large' and, even though a significant proportion of their budget was for staff, they felt that this size meant that their organisation was easier to manage, in the sense that issues raised by annuality were easier to deal with. They were essentially an organisation of office staff working in office buildings.

They had recent experience of a regime in which their annual budget was being cut every year but were now in a regime in which budgets had been stable and in which there was greater perceived security that they would be stable in the near term. On a number of occasions, this point was used to emphasise what they saw as the biggest problem with annuality when resources were scarce: that it did not allow them to plan beyond one year. One significant effect, for example, was the employment of temporary staff during such times.

Their budget derived from a (much larger) budget that had full end-year flexibility but their own budget did not. They were subject to annuality rules and they perceived that their relationship to the body that enforced annuality rules was one in which the enforcement agency was very strong. They subjected their 'divisional' budgets to the same rules.

When asked what their most obvious examples of year-end spending were they instantly said 'staff overtime' and 'IT equipment'. They did say that in some it was not unknown for them to receive invoices before taking delivery of equipment. In the same context, they talked of the need to tell 'white lies' but not 'whoppers'.

A summary comment by the director of finance was that 'annuality in one year is not the same as annuality in the next year'. In other words, though there were defined rules, budgeting was always a matter for negotiation and that the nature of those negotiations would often change.

Worries about resource budgeting often overshadowed concerns about annuality. This was because, although resource budgeting was a fact for them, comparisons between resource budgets and resource actuals had not yet been produced, and their effect on the next major budgeting cycle had not yet been felt.

Interview D

The interviewee was a budget-holder (of both revenue and capital; in total £4bn). The interviewee's budget derived from a larger budget that had full end-year flexibility but the interviewee's own budget did not. The interviewee was subject to annuality rules and perceived that the interviewee's relationship to the body that enforced annuality rules was one in which the enforcement agency was very strong. The interviewee subjected 'divisional' budgets to the same rules.

However, the interviewee's service was one that often benefited from the underspendings in parallel services. The organisation as a whole was one in which there was continual central monitoring of spending and one in which there was a history of some services offering up expected underspendings (say, in December) so that they could be re-allocated to other services. The service of Interviewee D was one of the beneficiaries.

There was agreement that this 'offering up' was part of the culture. On the other hand, wider discussion suggested that there were often cases in which the services offering the underspendings up were simply not able to spend the money and this was a way of adjusting their budgets so that at the year-end they did not report underspendings. No one wants to report underspendings to those at the higher levels because they provide prima facie evidence that subsequent budgets can be cut. The 'divisional' budgets of Interviewee D, for the same reason, often yielded underspendings up to Interviewee D's department.

When asked for the most obvious examples of year-end spending the interviewee said 'furniture' and 'IT equipment'. The interviewee added that the interviewee's service always had capital and semi-capital (i.e. repair and maintenance) schemes waiting for the possibility of year-end spending.

An important part of the interviewee's service was the use of private, voluntary organisations to which the interviewee's service made grants of one sort or another. A number of these voluntary bodies only survived on the basis that grants would be made to them during the year-end rush of spending.

Interview E

The two interviewees were management consultants. They tended to emphasise that the public sector environment in which they worked was one in which there was always a shortage of money, and in which there were many audit controls.

One point they raised was that annuality is more complex when the fiscal year is different from the effective management year (e.g. in schools, the academic year) or different from the fiscal year of an associated government, such as the EU institutions.

Another point was that because repair and maintenance is one of the first parts of budgets to be cut, it is one of the easiest items on which to spend money quickly.

Interview F

The interviewee is a central controller (an economist by background) of a very large budget, who is, however, answerable for this budget to a higher level. There is complete end-year flexibility for this budget. But this budget is then split into lower-level budget-holders, each of which is also a controller of many different kinds of budget-holders. Annuality is applied to all these lower-level budget-holders and there are strict rules about virement.

One characteristic that these lower-level budget-holders have is that they are strongly politicised.

The basic argument (supported by wider discussion) for end-year flexibility to the higher level but annuality for the lower levels is that end-year flexibility is new and could not be applied to the lower levels because history has culminated in a misallocation of resources between services. Once this has been corrected, perhaps end-year flexibility will be introduced.

Within the regime of annuality, requests for effective carry-forward of capital spending are stronger than for revenue because it is often clear (by the nature of many capital projects) that the money is needed.

The interviewee's view of the end-year rush was that to approve of capital and maintenance spending. The interviewee's pejorative term for consumption spending was 'flag-pole painting'.

Although the interviewee was responsible for implementing resource budgeting, the interviewee had serious concerns about it, particularly that such important resource allocation decisions were in effect being driven by 'the more technical people'.

Interview G

The interviewees were the budget-holders (chief executive and director of finance) of a 'division' of Interviewee D's service. Their budget was of both revenue and capital; in total £xxm.

They confirmed the relevant parts of Interview D but emphasised how good they were at spending money quickly at the end of the year. They put particular emphasis on capital (including vehicles) and semi-capital (repair and maintenance).

Interview H

The interviewee is a central controller of many different kinds of budget-holders, in a large local government. The interviewee is an accountant for whom annuality is a central issue in his work.

The interviewee's starting-point was that the Spending Review has significantly helped the interviewee's organisation predict future resources. For a major element of their annual finance (the Revenue Support Grant), this predictability is dependent on the formula that allocates the grants to individual local governments not fundamentally changing. The interviewee's perceived success in prediction was helped by the role that the interviewee's immediate superior played in, including observing, central negotiations in London. The interviewee confirmed that the RSG is a grant that is non-returnable to central government (except in extremis).

The place where annuality had major impact on the finance of the interviewee's organisation was the ever-growing number of specific grants from central government. Many of these had straightforward annuality constraints; some of them would be announced at times in the year that made it difficult to spend quickly enough. In addition, major specific grants could be defined over a five-year period, say, but have annuality constraints within the five years.

For 2001/02, the interviewee's perception was that the Treasury had itself encouraged a rush of spending at the year-end, because of the political heat that had been brought to bear in the previous year when it was announced that central government was underspending on budgets.

There was a suggestion that, notwithstanding accrual accounting, central government booked some of these grants when they were paid to the local government not when the local government spent the grant.

EU money, though significant to this local government, was not as affected by annuality. Many big programmes were defined over a number of years. These did produce problems at the beginning and end of the defined periods (at the beginning, the projects can be very flexible in allowing spending that has already been incurred to be brought into the project period but at the end, spending that had not been incurred could not be charged to the project). However, there are some initiatives that are annual. The problems of annuality are exacerbated because of the EU's use of the calendar year (which necessitated keeping, in effect, a separate set of accounts for EU money).

Within the interviewee's local government, annuality is modified by their being the possibility of a 2% carry-forward. This works at Cabinet level and the members of the Cabinet cover more than one department, so individual departments did not necessarily have a direct claim on the 2% carry-forward. The interviewee did not think in the interviewee's local government that there was a rush of spending anywhere; a major reason is that he felt that a department was quite capable of spending 98% of the budget without the rush. Accounting for the carry-forwards meant, in effect, the designation of reserves.

But the point about the amount of money in the system had a number of nuances. Overall, the interviewee recognised that, probably since 1997, more money was available. In this environment, modifications of annuality had been easier to manage. In the interviewee's opinion, however, it was when resources were tight that the real benefits of the modifications are felt. An additional point was that, although the greater resources did benefit services with a high political profile (e.g. social services, education), many important services with a low political profile (e.g. street lighting, repair and maintenance of roads), were still working with tight budgets.

The interviewee's feeling was (supported by a Best Value exercise) that, though the situation was mixed, the budgetary control information was quite good in providing timely information. Online information was available to budget-holders but there is a tendency for them to use the monthly hard-copies. There is a formal system of commitment accounting but the implication is that there is not yet a culture of using it to the full.

Interview I

The interviewee is an accountant in a big spending department (in big local authority) with responsibility for all technical accounting functions within the department. The interviewee is employed by the spending department but the interviewee's immediate superior in the department has 'dotted line' responsibility to the authority's director of finance. The department's budget is around £600m. However, much of the responsibility for this spending is delegated; the spending department itself is directly responsible for about £100m. For this £100m, there are 40-50 budget-holders. In recent years, the department has, especially in comparison with other services within the authority, been well-financed.

There is a close relationship between the interviewee's delegated finance function and the central directorate of finance, including a monthly budgetary monitoring system by the centre. Although this monthly monitoring sometimes took place without detailed knowledge of what was happening on the ground (because a monthly monitoring is demanding in a big department) in general there was a close control. Important elements of this were that projected underspendings (as well, of course, as overspendings) were known in advance. The typical recent year witnessed no under (or over) spending.

However, the immediately preceding year had had a projected underspending of about £1m on the revenue budget. The interviewee acknowledged that the authority allowed carry-forward of underspending up to a specified percentage of the budget. The interviewee was unsure of the percentage but was sure of the practice. This involved agreeing with the central finance directorate that the underspending had been controllable, that there was necessary work that could be financed by this underspending, and that the necessary work could only be done in May/June of the new financial year. The work was building maintenance on the spending department's offices. The underspending did not show in overall budgetary control of the authority because carry-forwards are put through the accounts (presumably only in the management accounts).

The spending department had recently reverted to a policy of applying annuality to its own budget-holders. There had been a system in which there had been a 50/50 split of controllable underspendings but this had fallen into disuse. The interviewee recognised that annuality might encourage budget-holders to make sure they did not underspend. The first example he cited was of the budget-holder that provided IT equipment for the department.

Another example, with an added dimension, was of the budget-holder that by the nature of the unit earned substantial revenues (by providing services to other units within the authority). Because budgets increasingly emphasised the 'bottom line', by being relatively relaxed about virement and about the spending of earned revenues, this unit was likely to ensure that there was no underspending or to want to carry forward any underspending, particularly because of the unit's perception that otherwise it was earning the money that others were spending.

The essential reason cited for wanting to impose annuality was that there were always 'demand-led units' that would overspend and the underspendings were used to finance these.

The interviewee knew of grants that imposed annuality on the spending department, and of cases in which the 'phone call' required rushed spending. One anomaly cited was where spending that had already been incurred by a unit, but which qualified for the grant, was brought into the grant account. What made this even more interesting was that the unit had total year-end flexibility so that the grant for the spending that had already been incurred benefited the unit not the spending department itself (which, however, managed the process of receiving the grant).

The interviewee acknowledged the importance of the government's biennial Spending Review. However, while recognising that the authority as a whole did benefit from greater predictability in future planning of resources, the interviewee emphasised that this did not materially improve predictability in the spending department. The department was experimenting with business plans (which necessarily emphasise future years) but the uncertainty beyond the current year's budget was hampering this development.

Interview J

The two interviewees are central controllers of a very large (revenue and capital) budget, who are, however, answerable for this budget to higher levels. There is complete end-year flexibility for this budget as far as the higher levels are concerned. There are approximately 350 lower-level budget-holders. Strict annuality is applied to all these lower-level budget-holders and there are strict rules about virement. The major relaxation of traditional controls appeared to be in relation to income: the lower level budget-holders are to a considerable extent free to spend excess revenues.

The interviewees were very clear about the importance of strict annuality for lower-level budget holders. Their environment had recently changed radically to one in which politicians now require detailed scrutiny of finance (and one, therefore, in which there is a significant increase in openness in budgeting). This environment, while the budget is very large, is small in terms of the numbers of people involved, largely because much of the budget is 'spent' in the form of transfer payments to other public sector and voluntary sector bodies. More specifically, the politicians and the central controllers need annuality because they know that some budgets are, because of matters outside of budget-holders' control, overspent and the underspendings are needed to finance these.

Their view is that there is little evidence of a 'rush of spending' at the year-end (no 'Spring Sale'), notwithstanding the strict annuality. In addition to monthly budgetary control (on an accrual basis, from a single management information system), there are two high-level budgetary control exercises (in September and January) whose purpose is to identify potential over- and under-spending, so that resources could be moved between budget heads. They did recognise that there were cases in which these exercises may still not detect potential underspending. They were conscious of the use of 'projects on the shelf', for example in relation to roads programmes, which might be used to ensure that such underspending did not in fact occur. They also suggested that underspending is more likely to occur because of optimism in budget-holders rather than intrigue, given the culture of the organisation.

They explained how successful they had been, as central controllers, in responding to a 'push' from higher levels to ensure that in the immediately-preceding financial year there was much less of an underspending in the budget as a whole, than there had been in the past.

Interview K

The interviewee is a senior policy manager in a spending department in a big local authority, with overall responsibility for a revenue budget of about £50m and a capital budget of about £40m. The latter, in the past two years, has risen from about £10m (though the interviewee remembers when it was last at current levels). The authority has procedures that allow carry-forward of underspending but the interviewee did not cite a specified maximum and did not dwell on the procedures. Currently, the spending department is being asked to make savings. The interviewee called the year-end rush of spending 'March madness'.

A significant element of the revenue budget is divided into 'planned' and 'unplanned' work. The unplanned work, as its name suggests, is demand-led, therefore difficult to cut back, and less susceptible to an end-year rush of spending. However, the planned work did include a 'holdback' of planned spending to be used in January, February and March (notwithstanding the procedures for carry-forward of underspendings). The interviewers raised the point about some spending being difficult in the winter months; the interviewee agreed and added that contractors were often difficult to get in March, which might add to pressures to increase prices. The interviewee did point out that for some work their Direct Labour Organisation could more easily be contracted in March.

The department has a commitment accounting sub-system but the interviewee explained the potential contradiction involved in managing budgets using such a system, when the financial accounting is on an accrual basis. The authority sometimes had kept the accounts open until as late as September but the interviewee still felt that commitment accounting did not give the best numbers for budgetary control. The interviewee preferred using the accrual accounts even though they did not pick up outstanding orders. In this part of the discussion the example of issuing orders late in the financial year for filling potholes was cited.

When asked whether the interviewee recognised the 'phone call', the response was immediate and positive. The first examples offered related to European money. One fund, although the terms of awards were over four years, did produce requests to spend money at the end of the Commission's financial year (which is the calendar year).

The major concerns the interviewee had about annuality related to the capital budget. 60% of the capital budget is spent in the last three months. The concerns were complicated by a number of factors: a big increase in the past two years, a change in the way that capital is allocated within the authority (now requiring more negotiation between spending departments), and a further layer of budgetary control (because the local authority had a formal arrangement with contiguous authorities to plan and manage capital spending). In addition, the authority is committed to a formal process of consultation with community groups, obviously involving politicians.

Interview L

The interviewee is a senior financial manager in a large spending department, responsible for a particularly large number, and complexity, of budget-holders. Some of the budget is managed directly in the centre of the department, but even here with a large number of budget-holders. There has been a lot of money available in recent years and this shows no signs of changing in the near future. The overriding concern of the interviewee is that the overall budget, for which accountability is due to the higher level, is not overspent. At the same time, underspending is undesirable, especially given the demands by service recipients on the department. The interviewee emphasised the success achieved in the previous financial year in having a small percentage underspending. This was in part put down to the ability, in a complex setting, to find offsetting savings to cover inevitable overspendings.

In this accountability to the higher level, the department has total flexibility to move underspendings from one year into the next. For the budget-holders within the department who are not managed directly, there is a system of brokerage (sometimes referred to as 'loans') in which, in one financial year, the underspending of one budget-holder can be used by another to cover its overspending; but both the original underspending and the overspending are then returned to the originating budget-holders in the new financial year. The system depends on the potential under/overspendings being identified early enough in the financial year so that the budget-holders to gain from the brokerage have time to spend the money: December is the typical trigger-point. This brokerage system, however, because the budget-holders are not directly managed by the department, depends on accounting information being provided to the department: there is not just one information system.

As to the budget-holders that are directly managed at the centre, the interviewee takes a harder view of carry-forward of underspending.

The interviewee stressed the importance of planning in mitigating adverse effects of annuality. For example, plans of what was to be achieved by annual budgets provide a way of holding budget-holders to account that is not purely based on money. Also, capital spending used to be particularly prone to an end-year rush of spending, because the cycle of capital approvals was too long, leaving little time within the financial year to spend the capital allocation. Very recently, as a direct result of the 'certainty' felt to be given by the Spending Review, the approval process begins earlier and covers a longer period. Finally, the interviewee emphasised the undesirability of windfalls being provided, especially within financial years: they are hard to spend efficiently and effectively, and they undermine financial discipline.

Budget-holders had often argued that end-year flexibility to carry forward underspendings should be matched by end-year flexibility to carry forward overspendings but the interviewee felt strongly that it is much less easy to persuade budget-holders to make a necessary reduction in future spending than it is to persuade them to increase future spending.

In summary, the interviewee felt that annuality is a necessary discipline: there has to be a shorter-term reckoning (and a year is a good interval). But when this is within a longer-term planning framework, strict annuality (i.e. surrender of underspendings) is not desirable.

Interview M

The two interviewees are senior financial managers in a large NHS Trust, with a large number of budget-holders. This trust has a history, because of the environment in which it works, of overspending (which is typically referred to by the interviewees as having deficits on income and expenditure). There are very significant increases of money in the system but the interviewees were also able to identify significant commitments that are building up which will make their task hard in the next few years.

In accounting to the higher levels, there is a system in which in a given year underspendings in one trust can be used to finance overspendings in another, while in the new financial year the original balances are restored. In practice, however, there are factors that militate against the cooperation that this system requires. One problem is the traditional one of cross-border business, which sometimes encourages competition rather than cooperation. The recent creation of Primary Care Trusts has increased the likelihood of competition simply because they have taken the place of only one body, the Health Authority. It is not yet clear if the new structure will receive the kind of intervention needed from the Strategic Authority to 'encourage' cooperation.

The interviewees' equivalent to the 'phone-call' (the interview did not use this term) was the 'dumping' of money by Primary Care Trusts during the final three months of the financial year. This was felt to be, in part, a function of the newness of these Primary Care Trusts, which tends to add to their 'prudence' in not wanting to overspend. It was suggested that this dumping of money would be recorded in the accounts of the Primary Care Trusts as an expense. In contrast, the money was a problem for the interviewees' trust to spend (because of its lateness and unplanned nature) and it undermined the culture of restraint (more especially needed in an organisation with a history of deficits).

Their experience with capital spending is that the cycle of approval is too long and begins too late, so that there has been a rush of spending in the final quarter. They recognised, however, that this might be changing.

When asked what practical effect the end-year flexibility has had on them (given that the trust has a history of overspending) the response was that the effect was 'cosmetic'. The annual financial statements did not now record a big annual deficit (because of the use of other trusts' underspendings) but the big deficit was then immediately restored on April 1.

In managing the budget-holders within the trust there is a greater emphasis on the use of annuality. The interviewees emphasised that their essential problems were that the overspenders always had very good excuses for overspending (excuses that would work well in a public debate) while the underspenders had many ways of making sure that what appeared to be an annual underspend must be carried forward (specially-designated money for high-profile diseases was one such). In addition, because the budget-holders have much to do with each other in the operation of the trust, there are other issues on which the budget-holders are arguing against each other: agreement to finance the overspending of one with the underspending of another does not take place in a vacuum.

The interviewees knew that revenue spending (other than on employees) tended to increase in the final three months and so they implemented a policy that forbade such spending in the final quarter.

Interview N

The interviewee is a senior financial manager in a spending department with a budget of approximately £200m a year, of which £30m is revenue and another £30m is for renewals (sometimes called structural capital). Of the remaining, a significant proportion is in the form of grants etc for other bodies to spend. The department is essentially one of engineers. There is strict monthly control of budgets, with a meeting of senior officers four times a year to review budgets (which the interviewee chairs). The accounting information system is a bespoke one and, in addition to providing relevant information about current spending, is especially good at forecasting future spending. The department is currently being told to adopt a system developed for the whole of the organisation; this is bringing tension because the new software is not as good at forecasting.

There is strict annuality in this department and in all other departments. The interviewee did not see this as a result, primarily anyway, of political desire but rather saw it as part of the maintenance of traditional budgetary controls. The interviewee acknowledged that politicians do find annuality useful because it helps in balancing the tensions that inevitably arise between different portfolios. In theory, the organisation as a whole has complete end-year flexibility in dealing with the higher authority. However, the interviewee felt that, in practice, this flexibility was constrained. Although the organisation's budget does, in total, have flexibility, the period-by-period management of cash in the organisation requires a 'drawing-down' of cash from the higher authority to the organisation, in tranches. There are incentives in the system for these tranches, in practice, to be spent, because they are a strong signal to the higher authority about whether the overall budgets have slack in them. Thus, it is hard for the organisation to argue during the financial year that the overall budget needs increasing (for example, in an emergency) if the tranches already drawn down have not been spent.

The interviewee is an expert in working with annuality, in local and central government. He knows the rush of spending as 'March madness'. The particular issue for this department is in predicting the effect of the winter climate, the difficulty of which requires detailed management of spending in the last quarter. In mild winters, there are always projects on the shelf that can be carried out during that quarter to ensure that budgets are spent. This approach was what the interviewer considered to be 'prudent' management. An associated problem, however, is that if many managers in the same business are doing the same thing, contractors are too busy during that quarter and prices go up. One response to this that the interviewee was familiar with was to have an annual tender process that committed contractors to prices long before the fourth quarter.

The interviewee recalled serious discussion in similar departments in local government to move the financial year-end from 31 March to 30 June, and that some individual authorities had implemented budgetary control systems that, in effect, had a 30 June year-end.

A central tool for managing annuality related to capital schemes. Within these, it is often easy to 'engineer' (the interviewee's word) work within the contracts and therefore the associated payments. In addition, when dealing with the department's own agencies, it is easy to requisition funds in advance or in arrear to smooth cash flow (which is lost when dealing with private sector contractors). Another technique is in a major capital scheme to establish a cap on spending in an early year but to allow the contractor to accelerate work (but not the reimbursement).

The interviewee emphasised the concerns that many had in moving from cash accounting to resource accounting, in that this engineering of cash flow would be a great deal more difficult under resource accounting. One major hope was that retaining material parts of the budget for which the time of cash payments was not materially different from the recognition under resource accounting would enable the department to handle the relative lack of flexibility for the other parts of the budget.

The organisation had been strongly encouraged in the previous financial year to ensure there was no material underspending (on the cash basis). The interviewee, in a department which was always very good at spending the budget (and not overspending), found that the department had unpaid invoices in March that could not be paid until the new year because an 'underspending' in this department had been used to finance overspendings elsewhere.

The interviewee felt overall that annuality is a good discipline but that it should be implemented sensibly.

Interview O

The interviewee is a consultant with current experience of financial management in public sector bodies, as well as having previous experience as a senior financial manager in a health service trust. Two sets of questions were put: first, relating to the consultant's own operations; and second, relating to perceptions about annuality in the current environment in which the public sector operates.

The consultancy did not recognise that January-March significantly affected their business, though the interviewee did think that a further look at their statistics might yield patterns that had not heretofore been identified. Specific examples of how a rush of spending might have affected the consultancy business were perhaps where a client would send six-seven people on a course rather than three, perhaps sending them in March rather than April, and perhaps sending people on courses rather than training them in-house.

On the interviewee's perceptions about annuality, the interviewee felt that the end-year flexibility of the Spending Review did not cascade down below the level of the government department, because the financial controllers were too traditional and did not trust the budget-holders at the lower levels.

The interviewee's experience with annuality was that the best managed operations would always have orders on the shelf waiting to be used to rush through spending, not least because money did often emerge in February/March to be spent by the year-end. The essence of these orders was that (in an accrual accounting environment) the goods and services were easy to push through the system quickly: IT, equipment, stocks (of items that could be ordered and received quickly). In this, the interviewee distinguished between 'hard' and 'soft' spending, the latter being the orders waiting on the shelf.

The interviewee emphasised the ease with which accrual accounting could be manipulated to spend budgets, especially the non-cash items.

The interviewee did not approve of annuality, at least the strict version in which no carry-forwards were allowed. As a consultant, the interviewee felt that the really big problem was in finance staff wanting to retain control of anything to do with money, leaving the managers to manage everything other than money. Further, the interviewee felt that annuality leads to managers being financially illiterate, which is a serious problem under the current situation in which (as the interviewee sees it) the centre is pressing for managers to manage according to outputs (public service agreements etc).

Interview P

The interviewee is the chief executive of a non-departmental public body (NDPB), with a budget (revenue and capital of approximately £30m). The NDPB's activities are funded in more or less equal measure by a grant from a single government department and the National Lottery. The funding from the government department is subject to annuality rules with a 2% carry-forward provision. The National Lottery funding is not subject to annuality and the NDPB does carry forward large balances. This is because of the timing differences between the NDPB's receipt of funding from the National Lottery and the drawing down of the funding from the NDPB by the charities and other organisations for whom the funding is committed.

The interviewee was critical of the concept of annuality, both from his experience in his current post and from previous public sector experience because of the incentives to spend immediately rather than attempt to achieve best value. However he did point out that his organisation regularly benefited from annuality rules. The interview took place on the 19th March and he and his senior colleagues were busy putting in place plans to spend money that had recently been made available by the funding department. The government department had experienced slippage in its spending and so had notified the NDPB that funding was available to meet a request to replace IT equipment that had been turned down earlier in the year. The NDPB benefited most years from 'slippage' in the funding department's spending and the amounts involved could be up to £1m. Occasionally the NDPB did have to make a request to carry forward funding in excess of the 2% tolerance and one example was the receipt in March of 'slippage' funding from the funding department which was to be used to clear the outstanding debts of one of the charities funded by the NDPB. It proved impossible to ensure that the legal agreements were in place with all of this charity's creditors by 31 March and so a special request for carry-forward was approved. The interviewee made the point that had the funding department practiced end-year flexibility then slippage would not have been an issue and the NDPB would not have benefited from these additional amounts of end-year funding.

Interview Q

The interviewee was the chief executive of a voluntary sector charitable organisation. The total budget of this organisation was approximately £1.5m. About 66% of this came from a government department, with the balance from a local authority. In addition the charity received some EU funding.

The interviewee felt that the funding should be regarded as a fee for a contract entered into between the charity and the funding organisation. The 'contract' was for the charity to provide an agreed level of service, with the funding being the fee for providing the service. This would mean that annuality should not apply. However the funding organisations insisted that the funding was a grant and the rules of annuality should apply. This created tension at the end of the year with the charity resisting requests from the funding organisations for repayment of underspendings.

Without prompting and at a very early stage in the interview the interviewee mentioned the 'telephone call' notifying him of 'slippage' money that was available. Only about £7,000 had been received this year but in some years the amounts had been as high as £150,000. Often the time scale to spend 'slippage' money was impossible to meet but the interviewee was extremely candid in his description of the ways of securing invoices for services that had not been provided by 31 March (31 December in the case of EU funding) but for which a verbal or email agreement existed with the service provider for the service to be provided soon after the year-end. He indicated that this practice was fairly widespread and he felt that it was an acceptable way of ensuring that funding available late in the financial year was put to the best use possible to meet the intended aims of the provider of the funds and satisfy the accounting requirements of annuality.

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