

MHS 2007/08 BUDGET – PROCESS, PREPARATION AND APPROVAL

Executive Summary

1. This paper provides information on the process, preparation and approval of the MHS 2007/08 Budget. Future MHS Budgets are intended to be submitted to the MHS Board for approval.
2. The MHS Board is asked to **note** the contents of this paper. No action is required. Questions on this paper can be addressed to either of the contacts below.

Sponsoring Director :

Kathryn Davies
Director of Corporate Services
Tel: 01904 456400

Contact :

Mike Dore
Finance Manager
Tel: 01904 455560

MHS 2007/08 BUDGET – PROCESS, PREPARATION AND APPROVAL**Issue**

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Process

- Using the forecast out-turn for 2006/07 as a starting point, a high-level budget for 2007/08 was prepared and submitted to the FSA's Director of Finance for approval. It was based on likely business activity, changes to major programmes, expected wage and cost inflation, the inclusion of efficiency savings and priorities identified in the business plan for the coming year. This was used as a basis for the calculation of proposed new charge-out rates to industry and Government customers. A consultation exercise was undertaken and the new charges implemented in the new budget year.
- An initial allocation of £35m had been indicated by the FSA in January 2007, and after a review by the MHS Senior Management Team (SMT), the MHS confirmed in late January 2007 that it would be able to meet its normal business operations within this allocation, assuming an amount of £14m for FSA programmes, predominantly SRM, would be confirmed.
- Also, additional bids totalling £3m for exceptional items were submitted for approval from its unallocated resource pot making a total bid of £38m, being £35m for normal operations and £3m for exceptional items. Following an initial review by the FSA, further information was sent in March 2007 for the exceptional items to enable a final decision to be made.
- Simultaneously, a provisional top-down internal allocation of the proposed budget to MHS Directorates, Regions and Departments was made with Directorate participation and agreed by the MHS SMT, in line with the indicative budget outlined by the FSA. A bottom-up

comprehensive budget exercise, detailed by cost and income lines and calculated from the major cost drivers, was undertaken from Area level, consolidated at Regional level and finally consolidated at Operations Directorate level. In addition, Head Office Departmental detailed budgets were prepared prior to consolidation at Directorate level.

- At budget challenge meetings at each level, budget numbers and assumptions were debated. Budgets were not allowed to exceed the allocated numbers, unless business cases had been prepared for consideration and resources switched within overall allocations. A consolidated MHS budget was prepared to check that the overall allocations had been adhered to.
- Detailed capital expenditure and cashflow budgets were also prepared for submission to the FSA.
- A process diagram is enclosed for assistance (**Annex B**).

Preparation

- The budget calculation set out in the table at **Annex A** outlined inflationary cost pressures, activity changes and efficiency savings. In total, the MHS forecasted that, after having taken into consideration the new programme, activity and inflationary changes, it would be able to operate normally within a net cost of operations of £35.0m subject to any unforeseen events, e.g. emergencies such as disease outbreak (FMD). However, the MHS required a total net cost of £38.0m to cover exceptional items.
- It was expected that cost inflation of £3.0m would be applied to gross expenditure. As a result, a recommendation was made to the FSA that hourly charge out rates for units of inspection be increased by 3.8% to cover this cost increase and reduced activity. Continuing the strategy of adding further to this base as in previous years, to recover a historic under recovery of costs, would result in a rate rise to industry customers of 4.8% and Government of 3.8%. The required consultation exercise with stakeholders on the proposed rates commenced in March 2007 for return by April 2007. After agreement, the new rates were implemented from 28 May 2007.
- Continued requests from the poultry industry to replace plant authorised slaughter staff with MHS staff were expected to increase costs by £0.7m and staff relocation costs would add £0.3m. A net income increase of

(£0.1m) would result from increased charge-out rates offsetting activity reductions, particularly in Defra programmes.

- These cost pressures were offset by major savings gained through efficiency, £3.0m, particularly through staff verification and restructure exercises.
- Exceptional items totalled £3.0m, including a full year effect of the 45% minimum industry charge rule abolition £2.2m, offset by increased income from increased industry throughput charges (£0.6m). Additional costs were identified for redundancy costs resulting from staff verification reductions, the development of new charging systems, continuation of the leadership development programme which commenced in 2006/07 and the rolling replacement of IT in plants equipment.

Approval

- The assumptions and results contained in the submitted budget to the FSA were discussed with the FSA Finance Director and responsible FSA Directors before approval by the FSA Chief Executive. However, it was decided that the MHS should only be allocated the initial £35m for net operating cost, with no approval of the exceptional items requested. The formal Delegation Letter was issued at the end of March 2007 confirming this.
- Subsequent approaches were made to the FSA to provide detailed business cases for these items, which were assessed alongside other FSA business cases before a confirmation was given of how much of the corporate unallocated pot would be made available. The FSA again declined to allocate any more funding to cover these bids.
- Significant cost adjustments to the internal MHS budget were then made to identify further savings to incorporate priority programmes. Particularly stringent was the decline of any support to meet regulatory changes to industry revenue reductions of £2.2m. This has simply been offset to cost. No allocation was made to meet early redundancy opportunities.
- Since the commencement of the new financial year, FSA policy Divisions (MHVD and TSED) have identified that they can now only afford to meet £13m of the initial £14m programme cost, largely applicable to SRM. This has resulted in a significant imbalance in the internal MHS/FSA budgets, effectively putting a retrospective pressure on the MHS to achieve its budget with £1m less income.

- **Transformation** – a revised delegation has been requested from the FSA to include an additional £7m operating cost and cash funding for 2007/08, particularly related to redundancies resulting from the Staff Verification exercise, to continue the Transformation programme agreed by the FSA Board at its July 2007 meeting. As yet, funding has not been secured from the Treasury by the FSA, neither has a revised delegation been received. This has stalled the process of commitment to redundancies and the resulting savings expected this financial year.

Future Approval

3. Prior to this year, the Budget has been submitted directly to the FSA for its review and approval, with the MHS Audit Committee being appraised of the process and the bid. In future, it has been requested that, subject to agreed governance arrangements, the MHS Board wish to review the Budget and approve it prior to its submission to the FSA. The submitted figures would be inclusive of the FSA programme for SRM which needs to be integral to the agreed delegated numbers for both the MHS and the FSA. It is therefore likely that a review will be necessary in December/January 2008 to meet the FSA timetable.

Sponsoring Director :	Kathryn Davies Director of Finance Tel: 01904 456400
Contact :	Mike Dore Finance Manager Tel: 01904 455560

Annex A

Proposed MHS Budget for 2007/08**£m**

2006/07 Budget Delegation from FSA	34.2
2006/07 Forecast Outturn	34.1
Efficiency Savings	(3.0)
Inflationary Cost Pressures : Contractor RPIX increase	1.1
Staff Pay Award	1.5
Overheads including increased PCSPS contributions	0.4
2007/08 Budget Based on Normal Operations including efficiencies	34.1
Move by Poultry Industry to Request MHS staff to replace plant authorised slaughter staff (net cost)	0.7
Staff relocation costs offset through increased income	0.3
Net Increase in Income (including reduced government income, increased chargeout rate)	(0.1)
2007/08 Budget Based on Normal Operations including normal business activity level changes	35.0
Exceptional Items (not approved)	
Leadership Development Programme	0.5
Redundancy Costs	0.4
New Charges System	0.3
Replacement of IT in Plants IT equipment	0.2
Removal of 45% Rule	2.2
Increased Income through increased throughput charges	(0.6)
2007/08 Budget Submission	38.0

Annex B

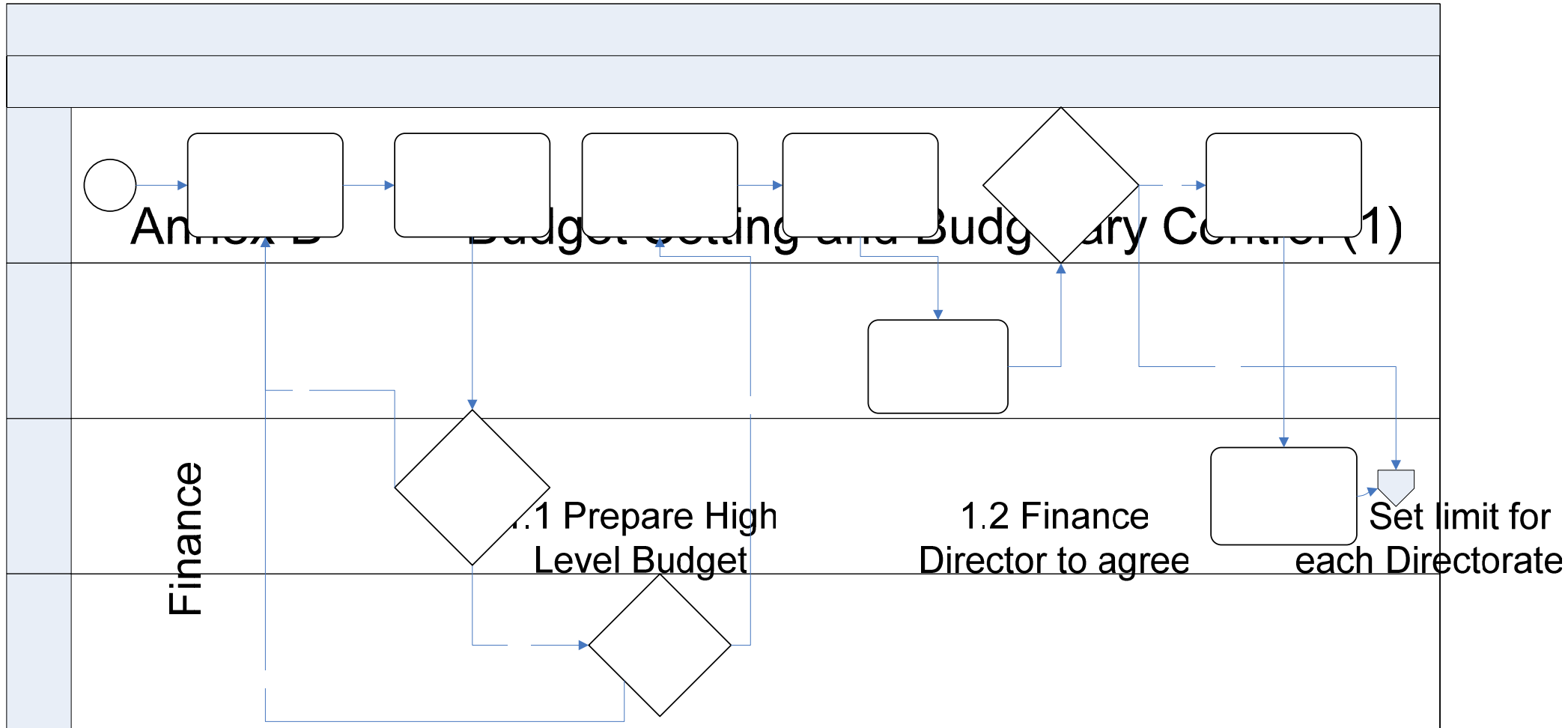
Delegated MHS Budget 2007/08**£m**

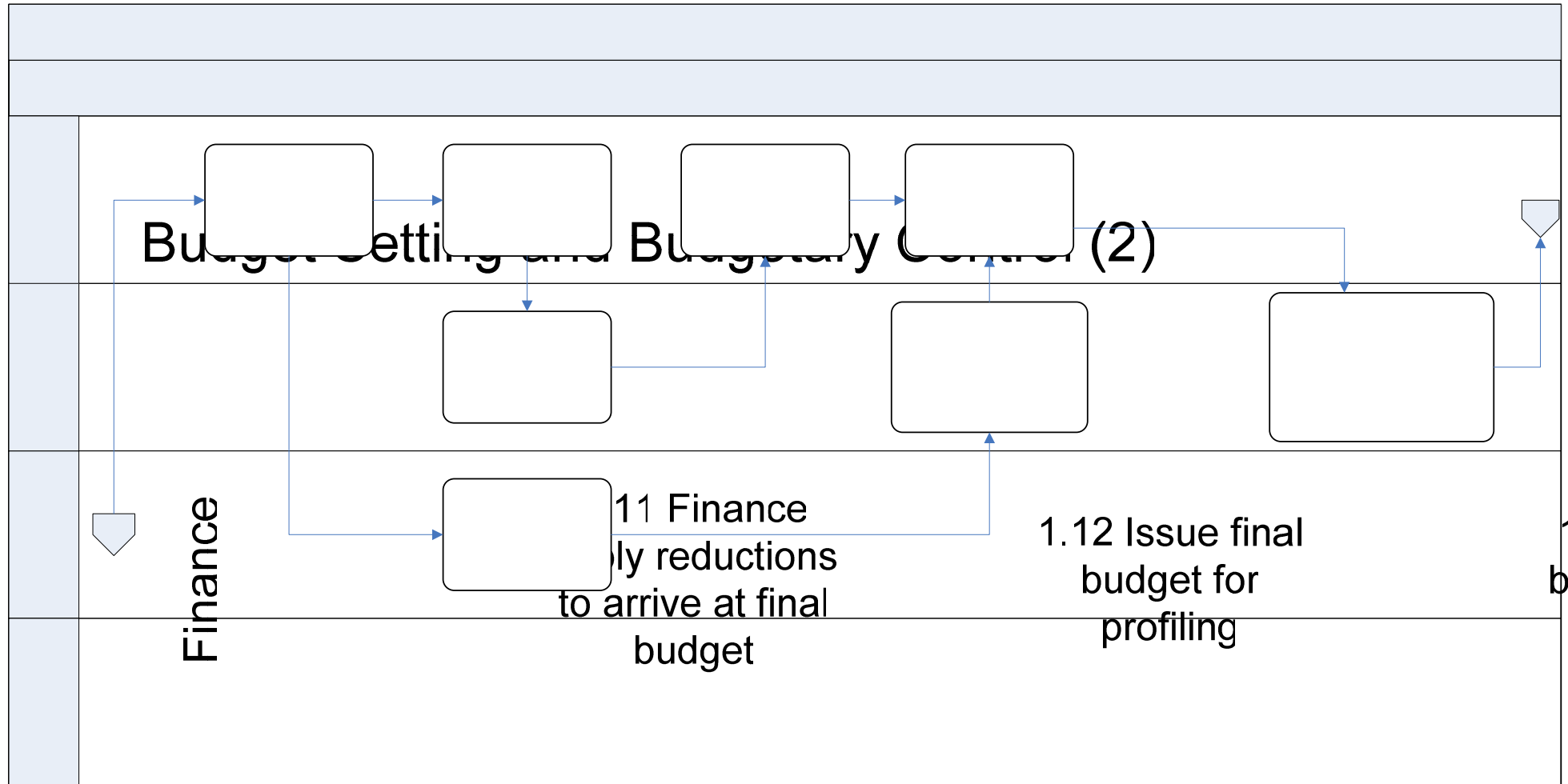
Approved and delegated by the FSA
(**NB** No Exceptional items were approved) 34.9

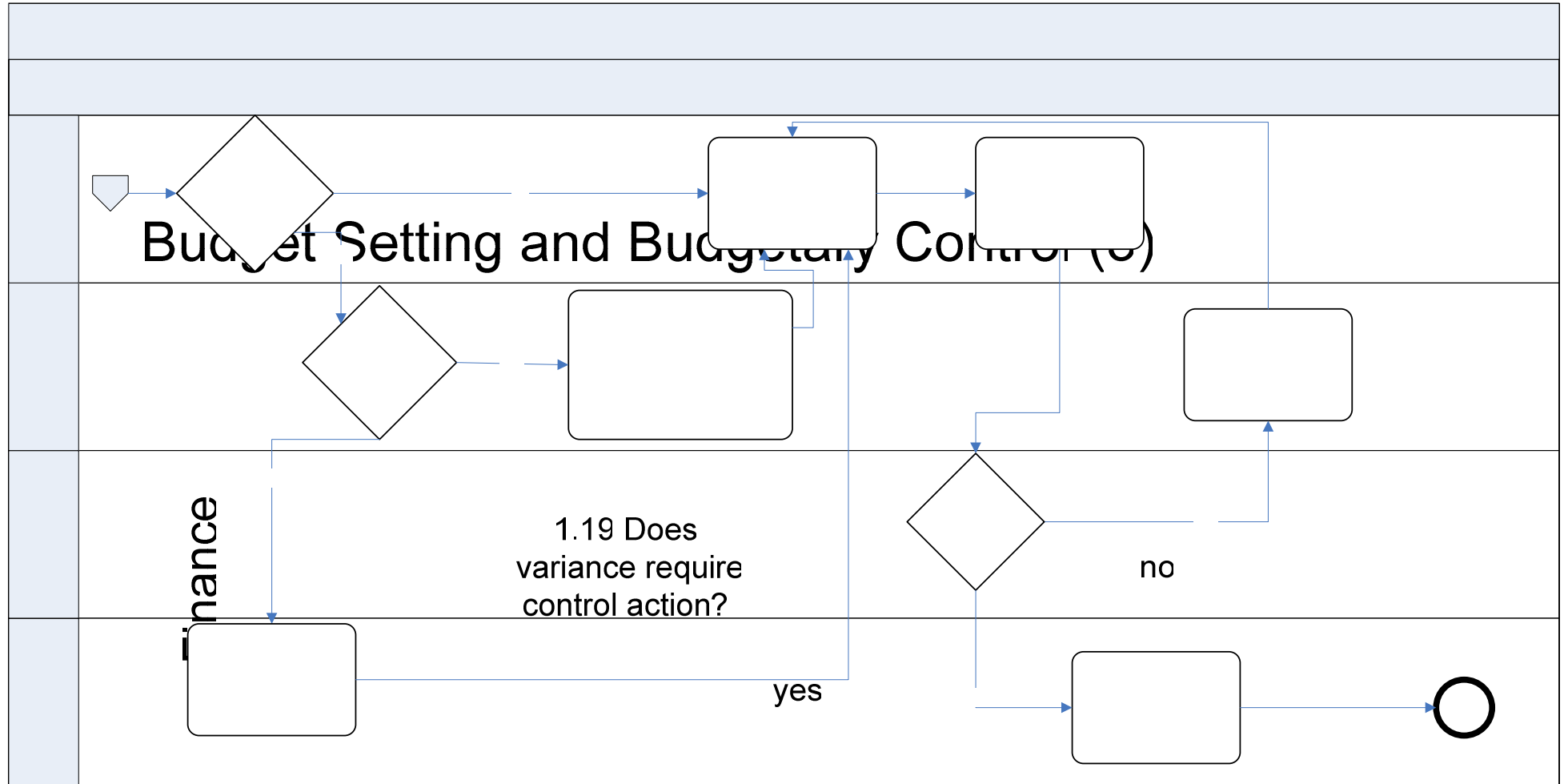
Transformation Costs requested –

Redundancy costs	3.2	
Enhanced severance costs	2.9	
Programme office (consultancy)	0.2	
Project Team (backfill)	0.3	
Corporate Services/Regional Office streamlining	0.3	
Establishment of Lead OV	<u>0.1</u>	
		7.0

Revised MHS Budget requested from the FSA	41.9
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Budget
Holders

1.20 Can action be
taken?

yes

1.22 Take action to
bring back in line with
agreed budget