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Managing financial resources to deliver better public services

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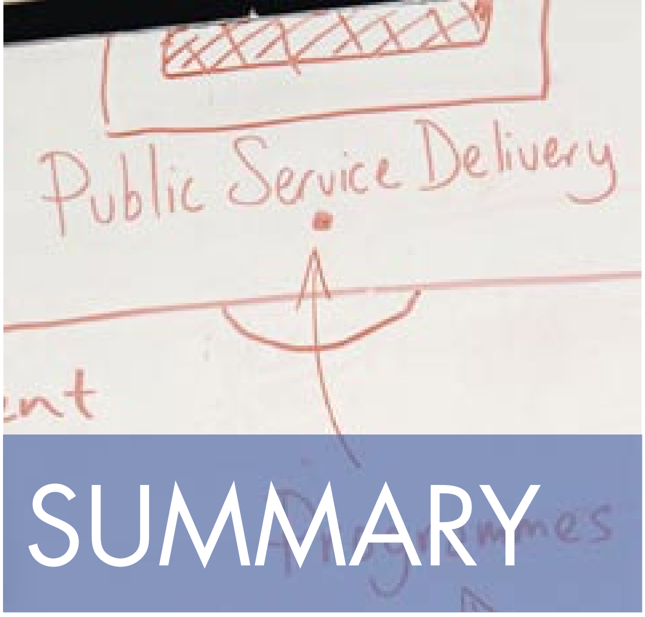

SUMMARY

1 By 2010-11, central government spending is forecast to grow to £678 billion per year.[1] This represents £11,000 for every person in the United Kingdom. It is the challenge for departments to convert these resources into public services that meet the expectations of service users, while also providing value for money for the taxpayer. Departments' capability to manage their financial resources effectively is crucial to whether they are able to succeed in meeting this challenge.

2 From the smallest transaction to the largest programme, financial resource management is relevant to every aspect of a department's business. At one extreme, the Department for Children, Schools and Families must understand how primary schools are using their budgets to raise standards of education. At the other, the Department must track the £45 billion allocated to its programme to rebuild or refurbish every secondary school in England.

3 In addition to their current activities, effective financial resource management can also help departments meet future challenges. For instance, our ageing population will radically change how financial resources will need to be allocated across the public sector. It is expected the NHS in England, for example, will need to provide dementia services to more than 750,000 by 2020, compared to 560,000 today.[2]

4 This report examines how capable departments are at managing their financial resources, and what impact efforts to improve capability have had on financial resource management performance **(Figure 1)**. It follows a report published by the Comptroller and Auditor General in 2003 and a related 2004 report by the Committee of Public Accounts.

5 Overall, departments have made visible progress in improving the management of their financial resources. We consider the three key areas where departments need to make further progress are:

- Improving the finance skills of staff outside of the finance department;
- Linking financial and operational performance information to improve service delivery and achieve better value for money; and
- Improving the reliability of forecasts of future resource needs.

1 Improving skills and awareness, and the use of techniques and practices can improve financial resource management performance

Skills and awareness		Techniques and practices		Impact of progress
Progress made in establishing financial resource management skills and awareness across departments – Part Two.	→	Progress made by departments in using advanced techniques and practices to manage their financial resources effectively – Part Three.	→	Impact of efforts to improve financial resource management across central government – Part Four.

Source: National Audit Office

Departments are more aware of the importance of sound management of financial resources, but ensuring staff are sufficiently skilled remains a challenge

6 The increased number of professional Finance Directors on departmental Boards has enhanced the focus on financial performance at senior management level. In some departments, such as the Department for Business, Enterprise and Regularity Reform, this has been accompanied by a department-wide culture which increasingly recognises the importance of sound management of financial resources. At present two departments[a] do not have a qualified Finance Director and a further four departments[b] do not have their Finance Director on the Board.

7 The lack of financial skills and awareness amongst many non-finance staff remains a significant barrier to improving financial resource management across government. With better skills, non-finance staff are able to manage their budgets and fulfil any necessary reporting requirements more effectively. HM Treasury, working with six major departments, has taken steps to fund the development of material enabling departments to improve financial skills and knowledge among non-finance staff. However, take up of the new learning opportunities on offer has been patchy and the Cabinet Office does not yet have a robust way of measuring the number of civil servants who now meet the Professional Skills for Government standard for financial management.

8 Most departments do not routinely incorporate objectives relating to the management of financial resources in the performance appraisal system for either Permanent Secretaries or senior civil servants. Those departments that regularly assess the financial resource management skills of their senior managers were found to be more able to nurture a culture in which the management of financial resources is of central importance.

Departments have implemented accruals-based systems but could do more to evaluate the cost-effectiveness of their programmes

9 Departments have made significant progress in using accruals-based accounting and budgeting systems since our previous study. This has allowed departments to better understand how they are using their financial resources, for example by offering more detailed information to manage their assets and liabilities. Departments have used this information to help identify under-utilised assets and to dispose of those no longer required. The public sector disposed of assets valued at £18.5 billion between 2004-05 and 2006-07 against its objective of realising £30 billion by 2010-11. Central government has contributed £4.7 billion to this total.

10 The use of accruals-based systems, together with the impact of HM Treasury's Faster Closing Initiative,[3] has helped departments to improve their external financial reporting. In 2007, only three departments and one department pension scheme failed to meet the summer recess target for presenting accounts to Parliament[c], whereas in 2003 only nine departments met the summer recess target and six departments failed even to present their accounts to the National Audit Office by the statutory November deadline.

a The two departments that do not currently have a qualified Finance Director are the Ministry of Defence and the Crown Prosecution Service. The Permanent Secretary of the Ministry of Defence stated to the Committee of Public Accounts on 3 December 2007 that the successor to the current Finance Director would be a professionally qualified accountant. The Finance Director of the Crown Prosecution Service is one year in to the Chartered Institute of Management Accountants' two-year accelerated route to qualification.

b The four departments who have a professionally qualified Finance Director without a place on the Board are the Department for International Development, and the regulators, the Office of Fair Trading, the Office of Gas and Electricity Markets and the Water Services Regulation Authority (OFWAT). The Department for International Development's Finance Director is represented on the Board by the Director-General for Corporate Services, although the Finance Director is generally present when the Board discusses financial issues. The Board also contains two qualified finance professionals. Although the Finance Directors of Office of Fair Trading, the Office of Gas and Electricity Markets and the Water Services Regulation Authority (OFWAT) do not have permanent seats on their departmental Boards, the relatively small expenditure of these departments is generally discussed at Board level with the Finance Director present. The Office of Gas and Electricity Markets Board also has a qualified Accounting Officer and Chief Executive.

c For 2006-07, the Home Office, the Department of Health, the Department of Health Pension Scheme and the Department for Environment, Food and Rural Affairs failed to meet the summer recess target for presenting their accounts to Parliament.

11 Internal reporting has also benefited. Nearly all departments now have accruals-based financial information systems, compared to around one in four at time of our last report. However, progress could be made in improving the timeliness and accuracy of internal reporting:

- Only 39 per cent of departments we surveyed said that their in-year reports were produced and forwarded to the Board within ten working days after the period end, the standard used by HM Treasury in assessing departments during their Financial Management Reviews. At the time of our survey, the Office of Fair Trading was able to produce limited in-year reports for its Board within three working days, although the Office now produces more sophisticated in-year reports eight days after the period to which they relate. At the Ministry of Defence, while financial reports are available within 17 working days after the period end, the Board prefers to receive reports that have been reviewed by the Finance Director accompanied by proposals for action where necessary. This extends to 43 working days after the period end, the average time taken to produce and forward to the Board in-year reports.
- Many departments reported problems with the accuracy and timeliness of primary data from which in-year reports on financial and operational performance are produced.

12 Departments could do more to link improved financial management information to information about the quality of public services being delivered. If departments know exactly what has been spent on what programmes and to what effect, they will be better able to assess whether they are achieving value for money and engage more intelligently with delivery partners. Most departments are not sufficiently well placed to do this as they have made limited progress in integrating financial and operational performance information. More than half of departments still report financial and operational performance information to the Board separately. Non-Executive Directors in our workshops expressed frustration that it is not routine for key decisions to be based on a comprehensive assessment of both financial management information and data on service performance.

Departments need to improve their forecasting capabilities

13 Departments are benefiting from using financial resource management techniques to improve how their businesses are preparing for future challenges. For example, almost all departments now have detailed business and capital investment plans.

14 However, departments could do more to improve their forecasting capabilities. Poor forecasting can lead to departments exceeding their Departmental Expenditure Limits or conversely, where unanticipated underspends are not identified sufficiently early, losing the opportunity for unspent funds to be reallocated to other key priorities. We interviewed several Finance Directors and budget holders who had concerns about how well departments forecast future resource needs. In addition, some departments continue to produce forecasts that vary significantly from the actual expenditure then incurred only a few months later. Typically, these departments significantly underspend against their forecasts.

15 Reforms to the end of year funding process may no longer incentivise departments to manage their budgets in a way that represents optimum value for money. In 1999-2000, under the End Year Flexibility initiative (EYF), departments were given the flexibility to carry forward unspent funds from one year to another (partial EYF was in place before this). This was intended to reduce the trend of departments spending their remaining budget wastefully in the fourth quarter of the financial year to safeguard their budget for subsequent years.

16 Drawdown of EYF has always been subject to the approval of HM Treasury. In light of the tighter fiscal environment, HM Treasury has exercised greater control over the amount departments can use from their balances of unspent funding brought forward from previous years. This has led to several departments losing confidence in the system. There is a risk that the system now offers departments insufficient incentives to avoid wasteful spending of excess funds towards the end of the financial year.

Recommendations

1 *Issue: The lack of financial skills and awareness amongst non-finance staff remains a significant barrier to improving the management of financial resources across government. If inadequately skilled, non-finance staff will be unable to manage their budgets effectively.* The Cabinet Office should work with departments to establish how many senior civil servants and staff at Grade 7 meet the standard for the financial management core skill, as laid out in the Professional Skills for Government framework. Departments should then use their staff appraisal processes to ensure that all staff at Grade 7 and above can demonstrate that they meet this standard. HM Treasury should continue to provide technical expertise in the design of training material.

2 *Issue: Some departments still do not have a qualified Finance Director at Board level despite HM Treasury's requirement that all departments have one by December 2006. In our view, this risks financial resource management being given insufficient professional leadership at the very top of departments.* As a matter of urgency, there should be a qualified Finance Director at Board level in every department.

3 *Issue: Senior managers in many departments are not provided with the incentives to promote sound management of financial resources. This makes it unlikely effective financial resource management will become embedded into departmental cultures.* Senior Managers should be properly accountable for their financial resources and incentivised to use them efficiently and effectively. As a first step, departments should include an assessment of their management of financial resources within the performance appraisal system for Permanent Secretaries and all senior civil servants.

4 *Issue: Departments could do more to improve their forecasting capabilities to ensure they are adequately prepared for future challenges to delivering public services*. HM Treasury spending teams should work with departments to reduce the number of departments whose final outturn varies by more than five per cent against their final resource Departmental Expenditure Limit and by ten per cent against their final capital Departmental Expenditure Limit.

5 *Issue: Some departments have lost confidence in HM Treasury allowing them to draw down resources carried forward from one year to the next. This might weaken incentives for departments to avoid wasteful spending of excess funds at the end of the financial year.* HM Treasury should review the system of End Year Flexibility to ensure that it provides the right incentives to improve departments' use of their financial resources. In particular, HM Treasury needs to communicate with departments earlier and more clearly about how much underspending from previous years departments can use.

6 *Issue: Departments are not sufficiently well placed to integrate financial and operational performance information, making it difficult to evaluate the value for money of their businesses.* Departments should present integrated financial and operational performance data to the Board to enable them to compare the cost of their principal outputs and to improve the evidence on which they base resource allocation decisions.

7 *Issue: Many departments do not always ensure that a full assessment of the financial implications of policy proposals is included in all submissions to Ministers and Board members.* In order to strengthen departments' focus on value for money, every policy proposal submitted to Ministers and Board members should include a full assessment of its financial implications.

8 *Issue: Departments do not always make best use of non-Executive Directors.* HM Treasury should assess how well departments have developed clearly defined roles for their non-Executive Directors on their Boards and consider how the Corporate Governance Code can be refreshed to enable non-Executive Directors to challenge and support departmental activity effectively.