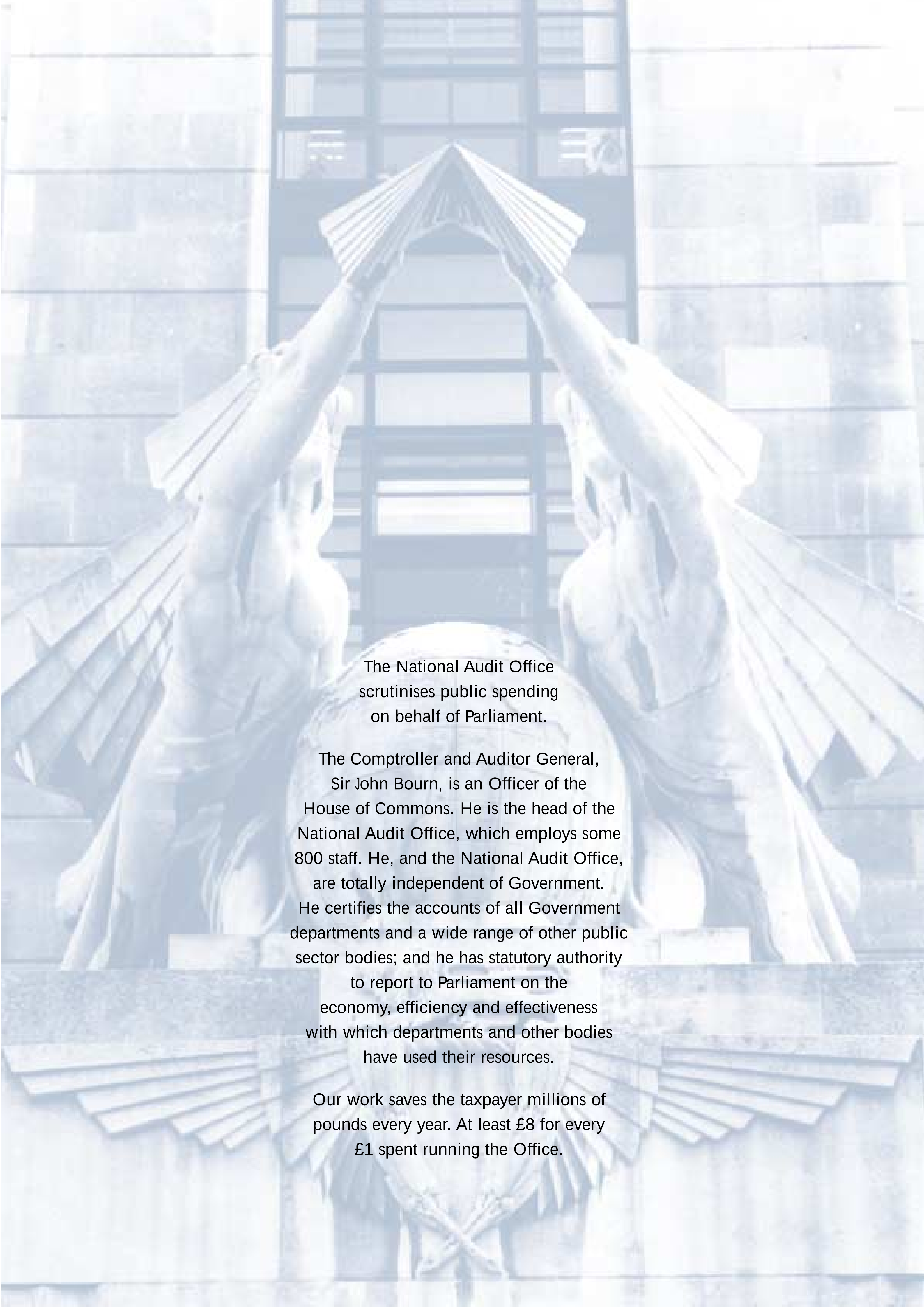
NATIONAL AUDIT OFFICE

Managing resources to deliver better public services

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HC 61-I Session 2003-2004: 12 December 2003



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John Bourn
Comptroller and Auditor General

National Audit Office
25 November 2003

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Photograph on page 13 has been supplied courtesy of the Ministry of Defence.

Preface

by the Comptroller and Auditor General

1 Departments and their agencies currently spend some £421 billion a year, a significant proportion of which is used to deliver key services to the public. Since 1995 a number of important changes, led by Treasury, have been introduced to improve how departments manage resources of this magnitude to convert them into high quality public services while also ensuring value for money. This report assesses the progress which departments have made in improving their resource management.

2 Public Service Agreements are ensuring that resources are better allocated to key priorities and aligned to targets to improve public services. Just over a quarter of departments and agencies we examined have made good progress in implementing accruals-based accounting, following generally accepted accounting practice in the private sector subject to adaptation, to improve the information they have on their use of resources and consumption of assets and other departments are investing in new systems to achieve more consistent progress. The complexity of the changes particularly the introduction of accruals accounting means that the full benefits of the new approaches to improve resource management will take some time to be realised but departments need to focus more on:

- **Adopting a strategic approach to resource management.** A critical consideration should be down grading those activities which are peripheral to core services and achieving greater consistency in investment strategies that are sufficiently long term to develop the capability of infrastructure, equipment and staff to deliver and sustain good quality services.
- **Having a well developed capability to convert resources into services that meet people's needs.** A key factor is identifying the weakest links in the service delivery chain and strengthening their capability to contribute to high quality services.
- **Allowing appropriate flexibility to encourage innovation.** This requires ensuring that how resources are allocated both within departments and to partner organisations encourage sensible and well managed risk taking.
- **Using management information to make better use of resources and improve efficiency.** As yet the potential of better resource information to help improve efficiency has to be fully realised. Just a one per cent improvement in the utilisation of the £1,447 billion resources allocated to departments over the next three years would release some £14.5 billion to redeploy to front line services.

executive summary

1 Departments and their agencies currently spend around £421 billion[1] annually and are responsible for assets and liabilities[2] of some £334 billion and £112 billion respectively. How well these resources are managed to convert them into staff with appropriate skills, infrastructure and equipment, and IT has a significant influence on the delivery of better public services **(Figure 1 and 2)**.

2 From 1998 a number of fundamental changes in how resources are allocated and should be managed have been introduced. These changes include Public Service Agreements to concentrate departments' efforts on achieving sustainable improvements in services; a public spending and control regime which allocates resources to departments over a three year period and gives more flexibility to carry forward unspent resources; and in keeping with generally accepted accounting practice in the private sector subject to adaptation, full resource accounting and budgeting which came into effect for departments from 2001-02.

3 The developments underpinning each of these changes, as well the practical guidance on their implementation has been led by HM Treasury. The changes were intended to address some long standing inherent weaknesses in the way resources in the public sector were managed in the past. Departments tended to focus more on the management of inputs - staff and goods and services - than on the benefits to people which inputs are intended to deliver. Funding departments on an annual cash basis with any unspent money usually having to be given back at the year end provided little incentive to plan for the longer term and invest in capabilities to deliver better services. With cash accounting assets such as equipment were usually treated as free goods by departments and limited account was made for the consumption of assets in delivering services and that they would eventually have to be replaced. This meant that there was little incentive to use resources efficiently.

1 HM Treasury estimate for aggregate outturn in 2002-03.

2 Liabilities typically include amounts owed for goods and services provided but not yet paid for by departments (creditors).

4 Using the new tools and in particular accounting for the use of resources on an accruals[3] basis is requiring departments to make a step change. To do so they are investing in new IT systems and training to equip staff with more advanced financial accounting and management skills. While the costs are likely to be significant, we found that departments do not have precise information on the cost of IT investments specifically in relation to resource accounting and budgeting since they are being phased over a number of years as part of the normal replacement cycle for IT systems in departments. Implementing changes of this scale and complexity will take some time.

5 The need for reliable resource management is brought into sharp focus by the allocation of an additional £61 billion over the next three years to deliver better public services particularly in the key areas of health, education, transport and criminal justice. Without careful planning and management there is a risk that resources are not all used as intended or efficiently with the result that the full potential to improve services is not realised. In a separate report[4] we have assessed the arrangements which the relevant departments have in place to ensure that these additional resources are used to deliver improved services.

1 **Resource management can improve both public service delivery and efficiency**

Resource Management Requirement	Benefits	
	Service delivery	*Efficiency*
Targets and objectives are clearly defined and underpin the way resources are allocated.	Resource can be directed at achieving key outcomes such as raising educational standards rather than simply putting money into an activity.	Non core activities can be identified providing opportunities to shift unproductive resources to front line delivery.
Resources can be used flexibly and expenditure is not constrained by short term annual cycles.	Expenditure can be better matched to service needs ensuring more consistent delivery throughout the year. Unspent resources are not lost but available to redeploy to other priorities.	Risks associated with the rush to spend all money at the year end are reduced such as nugatory expenditure and poor value for money because of limited time to confirm that expenditure is justified and to determine the most cost effective procurement approach.
Full cost information on an accruals basis is available and used to monitor and review performance and influence the allocation of resources.	The full cost of delivering a service is known including its consumption of assets. Costs can be assessed to determine whether they are reasonable for the level and quality of outputs delivered. Information on the consumption of assets can inform future investment.	■ Inefficient use of assets can be more easily identified and remedied. ■ High cost, inefficient processes and working practices can be eliminated. ■ Resources tied up in unproductive and inefficient activities can be more easily identified and redeployed.
Resource allocation and management are aligned throughout the service delivery chain.	If all the key organisations contributing to a service have targets which are mutually supportive and underpinned by resources that are allocated on a consistent basis the potential to deliver higher quality services is increased.	Supporting activities which involve duplication or are delivered out of sequence or late or are over or under resourced can be identified and addressed.
Performance and resource utilisation is regularly reviewed at a senior level and informs future resource allocation.	Reliable performance information allows shortfalls in service quality to be identified sufficiently early for remedial action to be taken.	Trends in the unit costs and the overheads of delivering services can be monitored and where practicable benchmarked to identify poor use of resources.

Source: NAO identification of good practice

3 *Accruals accounting shows departments' expenditure and income as it is incurred or earned rather than when amounts are paid or received (as was the case with cash accounting). This provides an appreciation of the real costs involved in providing a service rather than what is simply paid out in cash. Financial statements as in the private sector now show departments assets and liabilities as well as the effect of depreciation and a capital charge.*

4 *'Departments' preparations to use increased resources to improve public services,' to be published in 2004.*

2 Responsibilities for resource management

Parliament - Votes (approves) public expenditure

Treasury - approves the allocation to specific programmes at departmental level and delegates flexibilities to departments for resource allocation within and between programmes. Treasury provides advice on the way departments should manage their resources and those managed by agencies. It has over riding responsibility for expenditure control.

Departments - allocate resources to meet their strategic priorities and are responsible for day to day control of expenditure. Departments may allocate resources to a range of public, private and voluntary organisations in what is effectively a "delivery chain". Our examination covered this level of responsibility.

Source: Treasury and NAO

6 This report assesses the progress which departments have made in improving their resource management. The report is intended to be constructive by highlighting good practice drawn from the Highways Agency, the Teacher Training Agency, the Housing Corporation and the Serious Fraud Office and from the private sector and internationally which other organisations can learn from.

Resource management has a number of features

7 Sound resource management requires:

- **Planning and decision making** which allocates resources to achieve clearly defined outputs and outcomes and minimises unproductive effort; it takes a longer term view so as to invest in enhancing and sustaining capability to deliver high quality public services; reviews performance and learns from it.
- **Reliable and complete information** routinely available on performance and the consumption of resources used in delivering services. This should cover not only cash expenditure but how the investment in assets and work in progress is used to provide assurance that resources are not deployed inefficiently or on unproductive activities.
- **A clearly demonstratable impact**. Resource management should achieve improvements in the way resources are used to deliver better public services. Such improvements should be clearly visible so that public confidence is increased.

Findings

8 **On planning and decision making.** Public Service Agreements are ensuring that resources are better allocated to key priorities and aligned to targets to improve public services. More could be done, however, to ensure that these targets are used to influence resource allocation at lower operational levels in departments and in other organisations on which departments depend to deliver public services. Eight of the 46[5] departments and agencies which we examined did this in full. Just under half of departments still allocated resources to programmes on a cash basis and by omitting non cash costs such as depreciation the full cost of a programme or service is understated. This increases the risk that poor value for money may go undetected or future investment needed for services or key delivery capabilities may be underestimated. More generally departments have been more successful making small year on year incremental changes in resource allocations than major changes. Larger shifts of resources from one set of priorities to another or from support functions such as corporate overheads to front line service delivery may therefore, be difficult to achieve without other incentives or mechanisms. Around half of the departments and agencies examined consider that for smaller organisations the arrangements under resource accounting and budgeting for requesting resources has created a level of administrative effort disproportionate to their size and the focus of their work.

9 **On using better information to manage resources.** Just over a quarter of the 46 departments and agencies we examined had made good progress in implementing accruals based accounting and were using it effectively to manage resources. Benefits included identifying inefficient assets, better scheduling of expenditure to match service needs and more reliable data on the value of assets and their contribution to service delivery. Just over a third of departments (37 per cent) examined are progressing towards accruals reporting but management information on this basis is produced only periodically and budgetary control is based on a hybrid of cash and accruals. Around 16 departments and agencies (35 per cent) still rely mainly on cash based management information and the preparation of accruals financial statements was a separate one-off exercise at the year end to meet external reporting requirements. These departments have so far derived limited benefit from the new information. They attributed slower progress to insufficient financial expertise; operational staffs' lack of understanding and financial awareness; and old or incompatible IT systems.

5 *Our examination covered 30 of the 56 central government departments, including all of the major departments and the majority of government spending; plus 16 executive agencies and non-departmental public bodies.*

10 **Impact.** Seventeen of the departments (37 per cent) examined had made use of the new flexibilities and secured Treasury approval to carry forward underspends. Seventeen had given similar end of year flexibilities to their partner organisations. This had helped in ensuring that expenditure met clear service delivery needs. There was, however, little change in the profile of annual expenditure with a continuing bias to a higher proportion of both revenue and capital spending in the last two months of the year. Some departments lacked sufficiently complete information to ensure that expenditure was spent in a measured way throughout the year.

11 In contrast in 2001-02 four departments overspent their cash, resource and administrative budgets by £1.5 billion. Departments considered that their capability to manage resources and avoid either significant over or underspends was influenced by a number of factors. These included not enough senior management responsibility for the delivery of programmes made more difficult by poor monitoring and the need for greater accountability to Departmental Management Boards; a record of not sufficiently reliable expenditure forecasting possibly made worse by inexperience in forecasting on a resource accounting basis and unrealistic budget assumptions; and not enough understanding of the capacity of partner organisations to deliver services and manage resources competently. In addition departments considered that the multiplicity of budgets and programmes each with its own rules for redeploying resources, a significant amount of ring fencing, and current year end flexibility arrangements not being sufficiently developed made it more difficult to get the best out of resources.

12 **Managing assets and liabilities.** Under resource accounting there is a requirement for departments to prepare an annual balance sheet, identifying a body's assets and liabilities and their associated value. This provides a wealth of information to departments, providing them with the means to make better use of their existing resources and also to identify and manage important risks to service delivery. In particular it imposes a discipline on departments to make sure that assets are properly identified and accounted for, that the cost of holding assets is fully understood and that, as a consequence, there is an incentive to make sure they are put to good use. Similarly, a balance sheet requires that departments identify and manage their liabilities. These are obligations arising out of a transaction or other event that has already occurred and for which departments will have to make a payment or payments at some point in the future. If these liabilities are not identified and anticipated, with adequate provision made in advance for their settlement, they will arise unexpectedly, reduce available resources and have an adverse affect on service delivery.

13 While there is progress in improving resource management particularly in setting strategic targets, developing departmental investment strategies and using more complete cost information progress is not consistent. This may in part be explained by departments and their staff not as yet being sufficiently skilled or experienced in the new approaches. However, the good practice which we found in the four organisations which we examined in more detail **(Figure 3)** and in the private sector and internationally suggests there are four aspects of resource management which departments need to develop further.

14 **Adopt a more strategic approach.** This requires simplifying planning and monitoring to focus on key service delivery priorities and the resources needed to achieve them. A critical consideration should be down grading those activities that are peripheral to core services. Better communication between departments, their agencies and other partner organisations is needed so that there is a greater alignment of key targets, and greater consistency in investment strategies that are sufficiently long term to develop the capability of infrastructure, equipment and staff to deliver and sustain good quality services. Departmental Boards need also to consider their longer term liabilities and be sure that where appropriate they have contingency arrangements to maintain services.

15 **Have a well developed capability to convert resources into services that meet people's needs.** Our examination suggested three aspects which require further progress **(i)** While departments are concentrating more on identifying the key organisations which are critical to service delivery the extent to which all are consulted and contribute to key decisions which could influence service quality is more limited. **(ii)** One of the most significant risks to improving public services is the capability of all organisations involved in the delivery of a service. If just one underperforms or encounters difficulties a whole service may be put at risk. Departments need to seek regular assurance about their delivery partners' resource management and other capabilities and where necessary seek to strengthen them. **(iii)** Initiatives to strengthen resource management skills will take time to have an effect. Departments need, therefore, to find other ways, possibly through partnering with other organisations, of strengthening their operational teams involved in designing and delivering services so that they have access to sufficient financial and resource management expertise.

16 **Allow appropriate flexibility to encourage innovation.** How resources are allocated can significantly influence how willing organisations are to be innovative. For example, greater certainty over future funding is more likely to encourage investment and sensible well managed risk taking to develop key service delivery capabilities. Unnecessarily prescribed and rigid regulatory regimes with harsh penalties for underperformance can have the opposite effect to that intended and contribute to poor performance and stifle innovation.

17 **Use management information to make better use of resources and improve efficiency.** Departments are investing in new IT systems which should provide information on a full resource basis. The potential of such information to help improve efficiency and performance has however yet to be fully realised. This is particularly the case in ensuring that public assets are utilised to their full extent in contributing to services; the full cost of programmes is known and justified in terms of the level and quality of the contribution they make to public services; ensuring that activities which do not directly contribute to services are kept to a minimum; and managing expenditure, so that it better meets service needs. In the private sector there is a greater expectation that management information will be reliable, provided quickly and assist decision making. A key focus of departments' resource management should be delivering better services but it can also help to identify and realise opportunities to improve efficiency - just a one per cent efficiency improvement in the utilisation of the £1,447 billion of resources allocated to departments over the next three years would release just under £14.5 billion to redeploy to front line services.

3 **The four case study bodies examined in this report have responsibilities for managing resources in transport, education, social housing and criminal justice and demonstrate good practice in resource management**

HIGHWAYS AGENCY

The Highways Agency

Annual expenditure: £5,082 million (including £3.7 billion cost of capital)
Value of assets: £63.6 billion

An executive agency of the Department of Transport managing the second largest asset base of any Government body, while delivering a programme of strategic road building and developing a wider role as traffic manager, at a time when there has been a loss of capacity in the civil engineering industry.

Key lessons include:

- Using longer term planning and budgeting to improve the allocation and management of resources.
- A strategic planning process designed to ensure resources are allocated to achieve targets throughout the whole organisation.
- Implementing new procurement and project management practices to encourage greater partnership and innovation with delivery partners such as construction firms.
- Implementing an integrated financial and management information system to improve monitoring and decision making on resources.
- Using accruals based management information to better match expenditure to need and reduce costs.

teacher training agency

The Teacher Training Agency

Annual expenditure: £417 million. Value of assets: £2.2 million

A non-departmental public body sponsored by the Department for Education and Skills, responsible for recruiting and training new teachers (one of the largest recruitment and training programmes in the UK). It has tackled under-performance in the supply of good quality newly qualified school teachers, a major risk to improved educational standards, by developing partnerships to create the right conditions for effective use of resources and successful delivery.

Key lessons include:

- Implementing clear and effective board planning and monitoring arrangements that focus on core priorities and targets and involve those in the delivery chain.
- Collaborating with the sponsoring department to inform decisions on methods of delivery, allocation of resources and targets, to ensure targets are likely to be achievable by those in the wider delivery chain.
- The value of market research, including drawing on best practice in private sector recruitment, in understanding the needs of potential trainees and implementing innovative publicity and recruitment campaigns and new training 'products'.
- Implementing arrangements to understand and develop the capabilities and capacity of training providers and promote partnership.
- Incentives to achieve targets and quality standards, such as greater certainty over funding, used to encourage innovation and improved performance.

3 **The four case study bodies examined in this report have responsibilities for managing resources in transport, education, social housing and criminal justice and demonstrate good practice in resource management**

HOUSING CORPORATION

The Housing Corporation

Annual expenditure: £1,749 million. Value of assets: £11 million

A non-departmental public body sponsored by the Office of the Deputy Prime Minister, responsible for ensuring the supply of affordable social housing. It is working with partners to build affordable homes to address the overheated property market in the south-east and the abandonment of northern cities, while meeting the wider demands of economic development and the creation of sustainable communities.

Key lessons include:

- Working with stakeholders to develop a strategic planning and resource allocation process to reconcile national and regional priorities.
- Developing a better understanding of the capacity of registered social landlords to deliver the required level and quality of investment, and targeting its investment accordingly.
- Creating a supportive regulatory regime and incentives to encourage growth in priority areas and the use of innovative construction methods.
- Developing management information systems with delivery partners to actively monitor performance and support a flexible and transparent approach to the use of resources.

Serious Fraud Office

The Serious Fraud Office

Annual expenditure: £23 million. Value of assets: £1.2 million

A small department that helps maintain confidence in UK business and financial institutions by investigating and prosecuting serious fraud. It is taking action to tackle improved performance and resource management, including completing more cases in a shorter average time despite the withdrawal of police support.

Key lessons include:

- Setting up multi-disciplinary review groups to identify ways of improving efficiency.
- Seeking to control administrative support costs, for example by reducing the number of non-operational staff as a proportion of total staff.
- Working within wider public and private sector networks to generate early intelligence on likely workload and decide on which organisation is best placed to investigate any individual fraud case.
- Using technology to improve efficiency and support partner organisations within the criminal justice system.

NOTE

Detailed findings are set out in case studies 1-4 in seperate associated volume.

Source: National Audit Office case studies

Recommendations

18 To assist departments in their drive to improve resource management we make the following recommendations:

1 **More focused leadership is needed to ensure that reliable resource management exists at all levels in departments.** If Departmental Boards do not clearly demonstrate the importance they attach to better resource management and actively use the improved information and flexibilities to help deliver better services staff throughout the organisation will not be encouraged to do the same.

2 **All departments need to have in place strategies for developing integrated accounting and management information systems supported by finance staff with appropriate professional training and expertise.** Progress in improving resource management is constrained in some departments by insufficient IT system capability and not enough financial expertise. These constraints need to be addressed.

3 **Greater alignment of the targets and resource allocations of key organisations involved in delivering specific services is needed to ensure that they are mutually supportive in working to a common good.** Most departments depend on a number of organisations in a delivery chain to provide public services. Delivery is put at risk however if the targets and underlying resource allocations of organisations providing complementary or supporting elements of a public service are not comparable or consistent.

4 **Departments need to recognise and actively manage their assets and liabilities, including contingent liabilities.** The inefficient use of resources or the emergence of unforeseen liabilities can have serious consequences for service delivery. Departments need to make sure that these are properly recorded in their balance sheets, and that, in the case of liabilities in particular, there is adequate provision to meet these when they occur.

5 **Drawing on the better resource information and the greater flexibilities departments should do more to invest in longer term capacity building.** Better information on how assets such as infrastructure, equipment and IT are consumed to deliver services should be used to influence longer term capacity building so that improvements in service delivery can be sustained.

6 **Departments should seek regular assurance about the capability, including competence in resource and project management, of the public and private sector organisations on which they rely to deliver services.** Failure or under performance by any one organisation involved in delivering a service can put the whole service at risk or seriously effect its quality. Departments need to engage regularly with the organisations on which they rely to ensure they have appropriate delivery capabilities and where these are deficient seek to strengthen them.

7 **Greater use should be made of resource based information to improve efficiency to release resources for front line service delivery.** Accruals based information in providing more comprehensive and complete cost and performance information is a powerful tool to identify scope to improve efficiency and make better use of resources. As yet it is not widely used in this way by departments but it is important that they draw on the more comprehensive information to help make the best use of taxpayers' money. A relatively small improvement in efficiency would release significant resources to deploy on front line service delivery. In part 3 we highlight six indicators of efficiency which Management Boards should routinely monitor.

19 To support the implementation and use of the new arrangements for public spending planning and control HM Treasury have produced various technical and general guides on resource management, including the 'rainbow guides' in the Managing Resources series, setting out how departments can make best use of the information contained in resource accounts (available at www.hm-treasury.gov.uk). In the Annex to this summary we set out a self assessment questionnaire which departmental boards might use to assess the reliability of their resource management.

Annex

Self assessment questionnaire for departments to use to gauge the reliability of their resource management

High level self assessment questions to assist departments and agencies in developing effective arrangements for using resources to deliver better public services:

Characteristic	Question
1 Developing a strategic approach to resource management	
Boards resource allocation decisions are based on the achievement of key targets and objectives to deliver better public services	Are all resource decisions considered in terms of the contribution they will make to achieving key targets to improve service delivery?
Boards have the appropriate skills and experience	Do boards have the appropriate skills, expertise and experience or access to them in finance, IT, human resources as well as project implementation and management?
Management Boards are sufficiently focused on core activities	Does the Board regularly review activities to determine those that are peripheral to core services and down grade them or ensure that only resources appropriate to their status are allocated to them?
Boards take a sufficiently long term perspective to develop service delivery capabilities	Does the Board identify and keep under regular review long term requirements (skills and infrastructure) to maintain and enhance service delivery capabilities?
Boards consider wider issues of policy, priorities and opportunity costs when considering how to deploy resources	Do Boards fully consider the full resource allocation implications of policy decisions both in the short and longer term?
The effects of new programmes or activities on existing services are assessed before their implementation	Does the department assess the potential impact of new programmes or initiatives on existing services, and have appropriate strategies to manage the risks associated with their implementation?
Resource allocation takes account of the priorities and capabilities of partners and other organisations essential to delivering a service	Does board membership reflect, where appropriate, the department's partners and other stakeholders, or have they been offered observer status? Has the department established appropriate arrangements to allow delivery partners and other stakeholders to contribute to the development of the basis and priorities for resource allocation?
The basis or criteria for allocating resources is transparent to the wider delivery chain and other stakeholders	Has the department ensured that its partners in the wider delivery chain understand its targets and priorities and how resource allocation is designed to meet these?
Appropriate contingency arrangements are in place to maintain services in the event of the unexpected	Has the department established contingency arrangements appropriate to its circumstances and the risks associated with its activities?

Characteristic	Question
2 Ensuring that the department and its partners are capable of converting resources into services	
Programmes and activities, and the allocation of resources, are based on a good understanding of customers' needs	Has the department taken adequate steps, including surveys and market research, to understand their customers' needs and used this information to inform the design of services and the allocation of resources?
The delivery capability of departments and their partner organisations is reliable and kept under review	Has the department identified the key skills and capabilities needed to deliver its core activities and services and where these are insufficient has a strategy to improve them? Are key organisations involved in delivery chain consulted to determine their capabilities including the strength of their resource management? Does the department provide support to develop partner organisations' delivery capabilities which need strengthening? Does the department promote effective partnerships throughout the delivery chain both directly and by identifying and promoting good practice?
Resource management skills are reliable and available in sufficient quantities	Has the department determined the level of resource management skills required for the effective delivery of its core services and to ensure that resources are used efficiently? Is remedial action being taken where these skills are deficient?
3 Providing flexibility to those responsible for service delivery to encourage innovation	
Resource allocation encourages risk taking and innovation within the organisation and by delivery partners	Does the department's methods for allocating resources promote innovation and well managed risk?
Regulatory frameworks are flexible and do not unduly stifle risk taking and innovation	Has the department ensured that its regulatory frameworks reward performance and encourage innovation?
Effective incentives exist for delivery and achievement	Does the department's resource allocation system provide incentives for improved performance and the delivery of targets?
Appropriate authority and flexibilities have been devolved internally and to delivery partners.	Has the department delegated appropriate flexibility to plan and utilise resources (including end of year flexibility to carry forward funds) both internally and to delivery partners? Are appropriate arrangements in place to manage risks associated with greater delegation of responsibility?

Characteristic	Question
4 Using financial and management information to make better use of resources	
Management information is complete, timely and reflects the full use of the department's resources	Does the department use accruals based management information that enables timely monitoring of resource consumption linked to performance and service delivery? Is information required to produce annual resource statements and for internal resource management generated from the same system?
Information produced by all key organisations in a service delivery train should be compatible and consistently reliable	Does the department obtain and provide regular and timely information from, and to, delivery partners on performance and resources consumption?
Management information is used to monitor and improve both service delivery and the efficiency with which resources are used	Does the Board use information to monitor routinely: ■ asset utilisation ■ work in progress ■ the full cost of programmes ■ productivity ■ the balance between direct work and overheads ■ staff productivity

Part 1

Why resource management is important

1.1 Departments and their agencies are responsible for managing large scale programmes and assets that compare in size with those managed by some of the largest private sector companies. The challenge which departments face is ensuring that the resources which they are accountable for are managed effectively to deliver high quality public services. This part of the report covers:

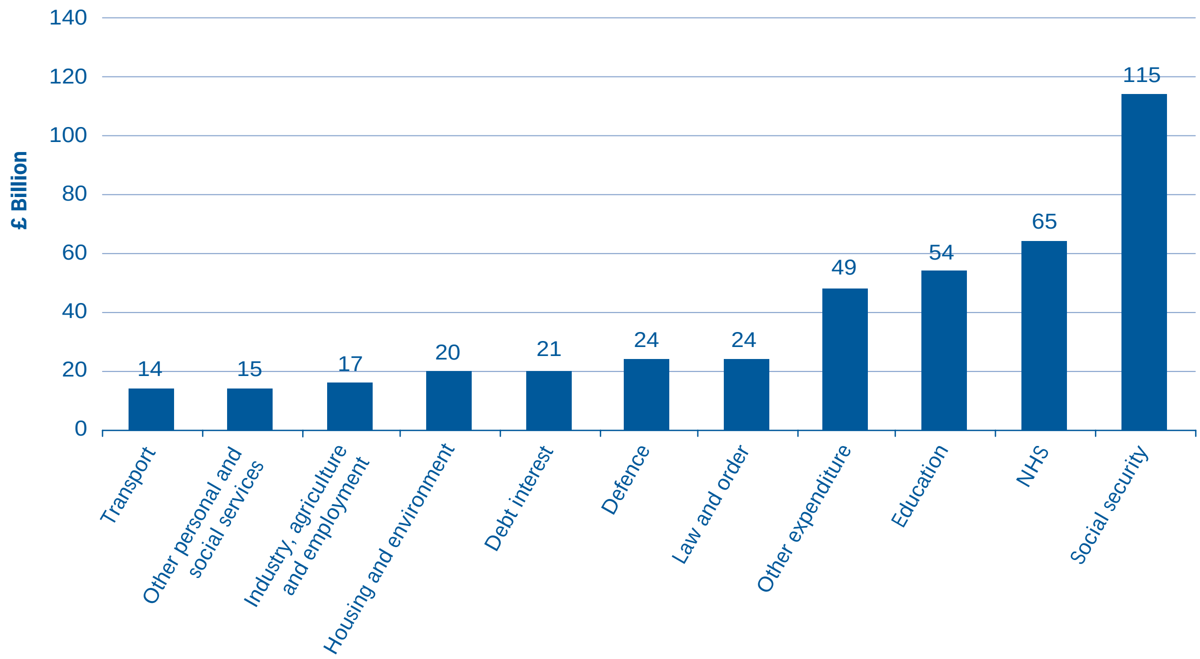
- the scale of Government resources;
- the increasing complexity in the way public services are delivered;
- the consequences of poor resource management and action being taken to improve it.

The scale of Government resources

1.2 In 2002-03 departments and their agencies, including non-departmental bodies (hereafter referred to as 'departments and agencies'), planned to spend an estimated £418 billion (just under 40 per cent of Gross Domestic Product[6]) on programmes or in new capital investment for a range of services or activities to benefit citizens **(Figure 4)**. At any one time they also manage assets and liabilities valued at £334 and £112 billion respectively **(Figure 5 overleaf)**, with just under half of the assets concentrated in two sectors - defence (mainly equipment) and transport (mainly roads). The July 2002 spending review allocated departmental budgets and assigned delivery targets for 2003-04 to 2005-06[7]. Over

4 Planned Government spending in 2002-2003

Total managed expenditure

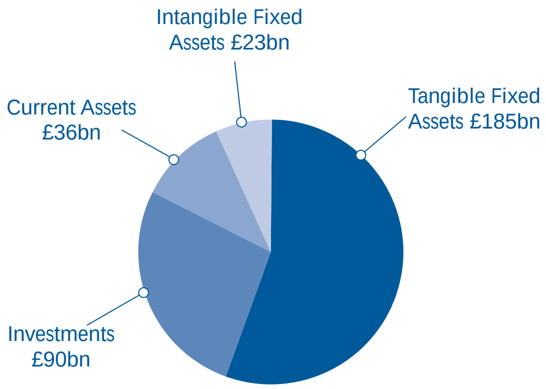


Source: HM Treasury, Budget 2002

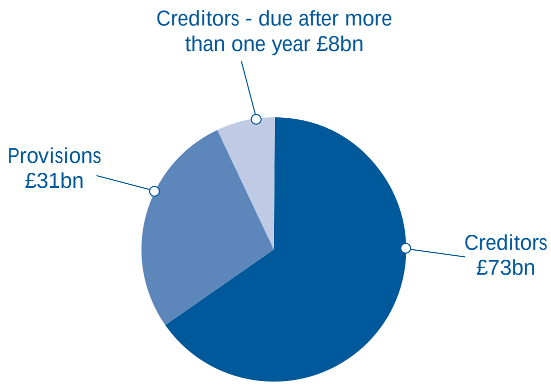
6 *Office for National Statistics.*
7 *Biennial spending reviews set out the budgets to be managed by departments for the next three years.*

5 Government assets and liabilites

Government assets of £334 billion



Government liabilities of £112 billion



NOTE

Tangible fixed assets include land and buildings. Intangible fixed assets include patents and intellectual property rights. Other current assets include debtors under one year and stock and work-in-progress. Provisions are for liabilities and charges or valuation adjustments. Figures exclude assets and liabilities in relation to centrally controlled funds such as the National Loans Fund and Consolidated Fund.

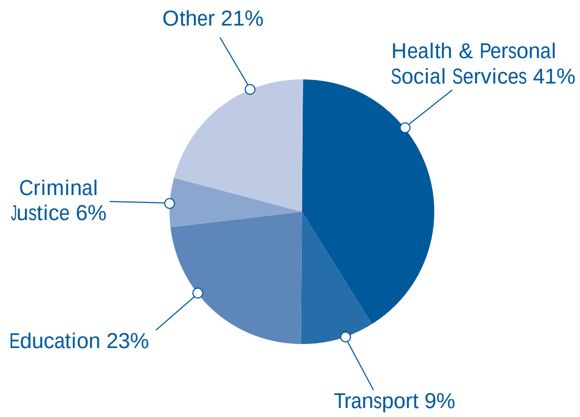
Source: Aggregate figures from departments' published resource accounts for 2001-02 including assets and liabilities owed and due between departments

this three year period departments have been allocated a total of £1,447 billion in resources, £454 billion and £482 billion in the first two years respectively, rising to £511 billion for 2005-06.

1.3 Over the period covered by the 2002 Spending Review the Government has committed an additional £61 billion, over and above previous levels of spending, targeted at improving public services, particularly in health, education, transport and criminal justice **(Figure 6)**. Managing resources of this scale requires that departments have highly developed skills, robust systems and comprehensive and reliable management information to ensure that resources are used effectively and efficiently to deliver better public services.

6 Where the £61 billion additional resources are being targeted to improve services

Other includes a 7 per cent combined increase in spending on defence and international development with 14 per cent distributed across the remaining areas of government spending



Source: HM Treasury

Increasing complexity in the way public services are delivered

1.4 Public services are increasingly delivered in many different ways which have implications for the way resources are managed. Some services such as issuing passports or the payment of benefits and tax credits are delivered directly to citizens *(For example, substantial sums of public money are disbursed as benefit payments the demand for which can be forecast and the flow of payments monitored. Information on the full cost including overheads of administering benefits is also needed, however, to monitor and assess the efficiency of service delivery to the public)*. For other services citizens can benefit indirectly such as from investment to promote urban regeneration and so reduce social deprivation or from the establishment of regulatory frameworks to protect the public and promote minimum standards of service delivery *(full costs can be less easy to identify because of the range of service providers and benefits can be more difficult to quantify and measure)* **(Figure 7)**. Good information is essential to reach consistent, reliable judgements about priorities and different ways of delivering services.

1.5 The delivery of public services is also often not the sole responsibility of a single department. Increasingly there is a delivery chain **(Figure 8)** of public, private and voluntary organisations who provide different but complimentary aspects of a service. For example, many bodies contribute to the provision of criminal justice including the Police, the Crown Prosecution Service, the Forensic Science Service and the Courts. In addition, many new programmes intended to improve service delivery are funded from multiple sources requiring complex inter-departmental and inter-agency working.

7 Different forms of Service Delivery

Examples of different types of public services

1 Direct Service delivery

Payment of benefits and tax credits

Issuing prescriptions and National Insurance numbers

Processing of student loans

Access to heritage, museums and galleries

2 Services which provide indirect benefits

Public Health protects the public by preventing the spread of diseases

Defence by the armed forces provides security to all of society

Investment in Science facilitates industrial progress

Criminal Justice system protects the public from criminal offences

3 Developing frameworks for other service providers

Regulation of educational standards, teacher training and social housing

Promoting business opportunities abroad

Transport **integration**

Frameworks for purchasing Information Technology systems and professional services

4 Services which provide direct and indirect benefits

National Savings and Investments provides tax efficient savings facilities for individuals and helps fund the Government

Road building benefits individuals by providing easier access and provides transport links for the economy

Source: National Audit Office

8 The service delivery chain

Services delivered directly by departments involving the direct management and control of their own resources including staff resources and capital and other assets.

Services delivered by 127 executive agencies and 244 other public bodies*. Agencies and non-departmental public bodies may deliver services themselves, or they may channel resources to other service providers or intermediary bodies. For example, the Higher Education Funding Council for England channels funds from the Department for Education and Skills to Higher Education Institutions. Departments do not have direct control over these resources, but do have oversight responsibilities to monitor how well resources are being managed.

Services delivered by other public sector bodies in receipt of government funds, such as those delivered by local authorities, schools, universities and NHS Trusts. Resources may be provided direct from departments, via intermediary bodies, or from multiple sources creating a complex network of accountabilities and responsibilities. For example, the funding of Higher Education Institutions comes not only from Higher Education Funding Councils but also from sources such as the Teacher Training Agency, Research Councils, private sector bodies, commercial activities, the European Union, and private donations.

Services delivered by private and voluntary bodies. Such bodies may be funded directly or be involved in contractual and sub-contractual arrangements of varying complexity. For example, National Savings and Investments in 1999 transferred responsibility for the delivery of its services to Siemens Business Services. At the other end of the scale higher education institutions may sub-contract some educational provision to private sector training bodies. Others will be involved in a less direct manner, for example, the voluntary sector plays a large part in making pensioners aware of the benefits to which they are entitled.

The actions of Departments and their agencies will also affect the resources of citizens, business and other stakeholders. For example, road maintenance can lead to delays, inconvenience and higher costs for private and commercial road users.

** Public bodies comprise three nationalised industries, 12 public corporation, 23 National Health Service bodies and 206 executive non-departmental public bodies.*

Source: National Audit Office

For example, tackling street crime has implications for the resources needed by a range of criminal justice agencies.

1.6 The capability of all organisations in the delivery chain to allocate resources to meet priorities, to convert them into staff with appropriate skills, equipment, IT and other inputs required to deliver services; and to review regularly how resources are used so as to tackle any underperformance is essential for the delivery of high quality public services. Failure or underperformance by any one organisation or weakest link in the delivery chain can put the quality of the whole service at risk.

1.7 The demand for public services can change significantly in response to new economic conditions or unexpected events. For example, the volume and value of benefit payments made by Job Centre Plus can increase as a result of sudden rises in unemployment while the work of the Land Registry increases during periods of buoyant property sales. Similarly, the impact of the unforeseen foot and mouth crisis on the general public and business required resources to be quickly deployed to meet the need to test and dispose of infected cattle. The ability of departments to respond effectively to such developments will be influenced by the quality of their resource management. Reliable information on the cost of services directly provided by departments or the overhead costs of administering major departmental activities such as the payment of benefits should enable departments to determine the resource implications of responding to the changing circumstances and well developed allocation systems should make it easier to switch resources to other priorities quickly.

The consequences of poor resource management and action being taken to improve it

1.8 Until fairly recently resource management in the public sector had a number of long standing inherent weaknesses.

- **Insufficient focus on delivery.** Departments tended to focus more on the management of inputs - staff, equipment and goods and services rather than on the outputs and outcomes - improvements in services and benefits to people which inputs are intended to deliver. This increased the risk of resources being used ineffectively and inefficiently and not realising the full potential to improve public services.

- **Short termism.** Departments were funded on an annual cash basis and, with some exceptions such as the Department of Health, any unspent money usually had to be given back at the year end. There was uncertainty as to whether funding would stay the same, increase or reduce in future years. Managing a cash budget on an annual basis meant that there was no incentive for departments to plan for the longer term in the way the private sector, having the certainty of longer term financing, will invest to develop its capacity to deliver better services or new products. This increased the risk of under investment in public services throughout the delivery chain because other organisations which depended on departments to allocate resources to them had limited certainty of future financing and were therefore reluctant to put in place the long term capacity required to deliver services at more optimal levels of efficiency. Perhaps, for example a new IT system, the introduction of which would offer faster, cheaper and more responsive services to the citizen.

- **Perverse incentives.** The requirement to spend cash budgets before the year end or have to surrender unspent sums contributed to an uneven pattern of expenditure. A well known phenomenon was established with a high proportion of budgets being spent in the last three months of the financial year to avoid losing the money. This increased the risk of nugatory expenditure which did not necessarily match service needs or priorities and poor value for money as departments had limited time to confirm that expenditure was fully justified and to determine the best procurement approach.

- **Incomplete cost information.** With cash accounting the assets of a department such as equipment, land and buildings and stores once purchased were considered free goods. In analysing the cost of services no account was made, for the consumption of assets which would eventually have to be replaced. There was no incentive, unlike in the private sector, for assets to be used efficiently or for inefficient assets to be disposed of to release funds to allocate to other priorities. Incomplete cost information meant that departments often did not know how much it really cost to deliver a service or to make the investment required to improve it.

- **Insufficient performance measurement.** Insufficiently reliable and timely information on resource utilisation and what it has achieved in terms of service delivery increased the risk of opportunities to use resources more effectively and efficiently being missed. For example, unproductive overheads may increase at the expense of services which directly benefit citizens or the reverse may be true - arbitrary cuts in administration might adversely impact upon services.

- **Poor project management.** Often weak project management is the result of incomplete or unreliable information which is not sufficiently up to date so that managers fail to act quickly enough to tackle poor performance.

1.9 Other aspects of resource management requiring improvement have been highlighted in reports by the Committee of Public Accounts and the National Audit Office **(Figure 9 overleaf)**.

1.10 In response a number of fundamental changes were introduced (i) to improve departments' resource management and in particular to remove the bias against long term investment inherent in cash based planning; (ii) provide a better measure of the full cost of providing public services; and (iii) switch the focus of public expenditure planning from inputs to outcomes **(Figure 10 overleaf)**. The main changes were:

- **Public Service Agreements** introduced in 1998, setting out for each department the aims, objectives and quantified targets they need to achieve over the spending review period, and closely linked to department's spending plans. Objectives and targets focus on what the resources should produce, such as raising educational standards in schools, rather than simply the money to be put into an activity. The aim is to concentrate the minds of departments and their agencies on what they are trying to achieve and how they can do so with improved efficiency. The better matching of resources to key objectives should help avoid the allocation of resources to low priority activities.

- **New public spending and control regime** introduced in 1998. It includes a three year comprehensive spending review period and the allocation of a three year resources budget for departments, plus flexibility to carry forward unspent funds across years. The aim is to provide greater stability and certainty in departments' financial planning, with increased freedom to use resources flexibly over the three year period to address the risk of wasteful use of resources associated with end of year increases in expenditure.

- **Full resource accounting and budgeting** which came into effect for departments from 2001-02 onwards. Departments' accounts and budgets are now drawn up on an accruals accounting basis to show the full cost of their activities and to provide better information on how resources are being used, including the cost of owning assets such as buildings and to provide an appreciation of the real costs involved in providing a service rather than what is simply paid out in cash. This is intended to provide Parliament with better information on the full cost of departmental activity and how resources are used to meet objectives, and a better indication of whether taxpayers are receiving value for money.

  Resource accounting provides departments with a powerful tool to manage public expenditure better. For example, providing more complete and earlier information on the extent to which projects or activities are likely to be over or under spent. The benefits depend, however, on departments being able to generate a regular flow of accruals and performance based management information that enables resource consumption to be recognised and managed in real-time, and ensuring that this information is understood and used by all managers.

1.11 These new flexibilities and changes in the way resources can be managed if used effectively should make an important contribution to improving public services. The importance of them being applied consistently by departments is critical at a time when expenditure is increasing by £61 billion above previous levels over the next three years. Without reliable management there is a risk that resources will be misdirected and planned improvements in public services not achieved.

1.12 In the private sector the most powerful pressures for efficiency come from competition. In the public sector these pressures do not generally apply and departments have to rely on other incentives and disciplines. A key focus of resource management should therefore be to identify and realise opportunities to improve efficiency - just a one per cent efficiency improvement in the utilisation of the £1,447 billion of resources allocated to departments in the next three years would release just under £14.5 billion to redeploy to front line services.

1.13 We assessed (i) the progress departments have made so far in improving resource management; and (ii) what more needs to be done to realise the full benefits to achieve better public services. Our detailed methodology is set out in Appendix one.

9 Examples of weak resource management leading to poor value for money

Risk to value for money	Example
Poor targeting of resources can lead to sub-optimal performance.	The Agency could make better use of its resources by carrying out fewer but more comprehensive and in-depth inspections of waste operators and improving its detection of illegal waste activities, such as fly tipping. In 2001-02, the Agency planned to visit licensed sites 15 times on average. There is no evidence that this high frequency of inspections, covering all licensed sites, is needed to deliver effective regulation. *Environment Agency: Protecting the Public from Waste (HC 156 2002-03)*
Weak corporate governance with board members not having the appropriate skills and experience can lead to ineffective management and safeguarding of resources.	The Teeside Development Corporation wound up its affairs in March 1998 with a potential deficit valued at £23 million in February 2002. Governance at the Corporation could have been more robust. Not all Board members had a clear understanding of their responsibilities or of the public sector financial framework within which the Corporation operated. *The operation and wind up of Teeside Development Corporation (HC 640 2001-02)*
Failure to identify and dispose of surplus assets is an unnecessary resource and opportunity cost.	A third of NHS trusts did not review their property portfolio to identify surplus property and report it to the trust board annually. NHS trusts need to do more to identify property they no longer need and dispose of it more quickly and effectively. Better management could bring forward some sales and release significant sums for use elsewhere in the NHS. *The management of surplus Property by Trusts in the NHS in England (HC 687 2001-2002)*
Failure to understand customer requirements and deploy and use resources flexibly can lead to lower levels of service delivery.	Some centres at certain times cannot cope with the number of calls they receive. For example, although 94 per cent of callers to the Child Benefit Centre Enquiry Line are satisfied with the service they receive, over twice as many calls are met with an engaged tone as are answered. Ways in which demand can be better managed include better deployment of staff, encouraging callers to use quiet times and improved IT support. *Using call centres to deliver public services (HC 134, 2002-03)*
Failure to take account of and exploit the capacity of industrial suppliers leads to missed opportunities to maximise the benefits to resource management.	The Department needs to be smarter in the management of its stock and work more closely with industrial suppliers. Better information on its stock holdings will allow the Department to identify which parts of its inventory can be managed by industry, for example through 'just in time' direct delivery to military units and 'contractorisation' of storage functions. At a local level, the Department needs to exploit the arrangements being put in place by the Non-Project Procurement Office and extend its use of the Government Procurement Card. *Ministry of Defence: Progress in Reducing Stocks (Committee of Public Accounts - Thirteenth Report 2002-03, HC 566 2002-2003)*
Failure to recognise the role that can be played by wider stakeholders can result in ineffective use of resources and gaps in service delivery.	Although two million pensioners live in low-income households, many tens of thousand miss out on benefit entitlements annually - with up to £1.9 billion in income-related benefits lying unclaimed, according to latest estimates. Many low-income pensioners have little knowledge about the benefits available to them and tend to find out about them from relatives and friends, rather than official sources. Certain groups, such as pensioners in rural areas, those with sensory impairments, and pensioners from ethnic minorities, face additional barriers. There is scope to make details of pensions and other benefits available to older people better known among a wider audience, including the range of professionals who deal with pensioners. *Tackling pensioner poverty: Encouraging take-up of entitlements (HC 37 2001-02)*
Inadequate information on resource availability prevents effective planning of resource use and leads to less than optimal use of assets.	Good information systems that provide real time information on current and planned use of key resources are essential in helping bed managers and other hospital staff to plan patient admissions effectively. Some trusts have succeeded in developing good systems, for example at Shrewsbury. However, in many trusts systems are inadequate and adapting existing systems can be complex. *Inpatient Admission, Bed Management and Patient Discharge in NHS Acute Hospitals (Committee of Public Accounts, First Report 2000-01, HC 135 2000-01)*
Failure to set appropriate performance measures for resource use prevents monitoring and identification of areas where improvement is necessary.	Some three years after its inception, the Department has not set appropriate performance measures for Smart Acquisition. The Department needs to address this shortcoming and set robust and challenging performance measures against which to monitor the achievement of the principles underlying Smart Acquisition. *Ministry of Defence: Major Projects Report 2000 (Committee of Public Accounts - Fifth Report 2001- 02, HC 368 2001-2002)*

10 Managing Public Expenditure

The Fiscal Framework

The Treasury establishes the overall level of public expenditure and borrowing.

Spending Review

The Treasury leads the biennial spending reviews of departments' expenditure plans for the next three years. The most recent Spending Review in July 2002 set out departmental budgets for the three years 2003-04 to 2005-06. The next spending review will be in the summer of 2004.

The spending review results in an allocation of budgets to departments, Public Service Agreements setting out the objectives and targets that departments are committed to achieve, and any delegated flexibilities for the use of resources.

Departmental Budgets

Departments receive a three year budget (Departmental Expenditure Limits), with the exception of expenditure that is difficult to forecast beyond one year which is provided on an annual basis (Annually Managed Expenditure).

Budgets are divided between resource (current) and capital budgets.

Public Service Agreements

For each department the **Public Service Agreement** set out the objectives and quantified targets it must achieve.

These are supported by **Service Delivery Agreements** setting out the key steps that departments will take to achieve their objectives, including their work with partners, and a wider range of performance indicators.

Supply Estimates

These are the means by which the Government seeks Parliamentary authority for its spending each year.

Following the introduction of resource accounting, Parliament approves the resources the department will consume as well as the cash it spends. These estimates are granted for one financial year at a time.

Departmental Investment Strategies

These set out how the capital assets and investment required to deliver services are to be managed.

End of Year Flexibility

Departments can carry forward into the next financial year unused resources from the current financial year's estimates (subject to Treasury authorisation).

Departmental Reports

Each department produces an autumn Performance Report and a spring Annual Report which sets out progress in meeting the Public Service Agreements.

Resource Accounts

These are prepared annually by departments and present the financial outcome for the relevant year.

Resource accounts are prepared according to generally accepted accounting standards used in the private sector.

Planning Cycle

The information in the Departments' resource accounts and reports is used to inform the next biennial spending review.

Source: National Audit Office and Treasury

Part 2

Progress in improving resource management

2.1 This part of the report considers the progress which departments have made in improving their resource management focusing on: (i) departments' planning and decision making; (ii) the availability and use of better information to manage resources; and (iii) the impact the new arrangements are having on the way resources are managed.

2.2 Our findings are based on **four case examinations** of the Highways Agency, Teacher Training Agency, the Housing Corporation and the Serious Fraud Office, **structured interviews with six organisations** - the Cabinet Office, the Office of the Deputy Prime Minister, Foreign and Commonwealth Office, Department of Trade and Industry, the Lord Chancellor's Department and National Savings and Investment - and **36 other departments and agencies** where we drew on our work as their financial auditors. We also considered good practice in the private sector **(Figure 11 overleaf)** and internationally.

Departments' planning and decision making

To be effective departments' planning should allocate resources to achieve clearly defined outputs and outcomes and minimise unproductive effort; it should take a longer term view so as to invest in enhancing and sustaining departments' capability to deliver high quality public services; it should ensure that reliable risk management is in place and in particular contingency arrangements to maintain services should unforeseen circumstances arise; and it should learn from past performance so that a culture of continuous improvement through out the organisation is promoted.

2.3 The 1998 Spending Review changed the basis on which departments are allocated resources **(Figure 12 overleaf)**. In contrast to resources being allocated on a cash basis each year departments now receive a budget for a three year period and a separate budget for expenditure that has to be managed on an annual basis:

- The three year budget **(or Departmental Expenditure Limit)** includes two separate allocations of resources. One to meet the cost of departments' activities and administration, including provision for accruals based items such as the cost of capital, and a separate allocation of resources for capital expenditure.
- The one year budget **(or Annually Managed Expenditure)** covers activities where it is less easy to estimate the level of resources that might be required over a three year period, particularly activities subject to short-term fluctuations in demand such as benefit payments. For these activities resources are still allocated on an annual basis, with separate allocations to cover the costs of departments' activities and capital spending.

The total of resources allocated to a department in any one year is known as **Total Managed Expenditure**. In 2002-03, of the total £421 billion planned to be spent by departments, 58 per cent (£244 billion) were allocated on a three year basis and 42 per cent (£177 billion) annually.

2.4 The allocation of three year resource budgets to departments is intended to promote greater stability in financial planning to encourage longer term investment in resources and assets to deliver better services. Departments and agencies which already have strong planning arrangements in place such as the Highways Agency were able to adapt fairly quickly to the new planning timescales. Other organisations are also taking advantage of the new arrangements. For example, the Teacher Training Agency has used the greater flexibility made possible by three year financing to set more realistic targets for the organisations which it uses to provide initial teacher training. Greater funding certainty has enabled the training providers to be more innovative and invest, which has contributed to the achievement of targets for newly qualified teachers **(Case study 2)**.

11 While the corporate objectives of private and public sector organizations may vary the principles of good resource management apply to both

Key principle	Private Sector Objectives Retaining or enhancing market share, maximising return and maintaining share price	Public Sector Objectives Delivering responsive and high quality services efficiently and effectively
Meeting customer need	Companies will not survive if they fail to deliver consistently what their customers want on time at competitive prices.	Departments will never improve services if they do not have an outward, customer-facing focus.
A clear planning process	A failure to link corporate objectives to a clear business plan will result in poorly focussed activity, wasted resources, and a loss of competitiveness.	Poor planning will cause confusion and unfocussed activity, creating waste and threatening the achievement of targets. Without clear planning, there is a risk that any extra resources provided for improved services will become diluted, and will not create the improvements intended.
Understanding what resources are required	Mis-directed resources reduce productive capacity, and may lead to failure to meet customer demand, resulting in a lower level of return.	Accurate information on what it costs to deliver different public services is essential to make reliable allocation decisions. Failure to do so will result in mis-directed resources that make it even harder to achieve improvements in service delivery with whatever remains.
Flexibility and the ability to deal with the unexpected	To remain viable, companies must identify and actively manage risk, and be able to respond quickly to changing conditions, whether in their marketplace or in other areas of their activities.	The ability to identify risk to service delivery, to manage those risks and have mechanisms in place to respond quickly when they threaten is essential to avoid breakdowns in service delivery, or the need for expensive remedial action.
Establishing effective partnerships	Continued success and growth is often dependent on new or innovative ways of delivering products or services, and gaining access to new skills, technologies and markets through working with others, is a key part of this. But in complex delivery chains it is essential to understand and actively manage the capacities and competencies of delivery partners.	Departments are increasingly dependent on other public, private and voluntary organisations to deliver public services, who often have greater expertise and a better understanding of citizens' needs and how these can best be met. As with any complex delivery chain, success or failure depends on these partners and departments must ensure that they are reliable and clearly focussed.
Good project management	With scarce capital to invest, companies make careful analyses of the business cases for different options and projects. This is to be clear about why certain projects should go ahead and why other should not, the value they are expected to produce, and how they will be managed to meet targets for time, cost and specification.	Significant investment is made each year in large scale infrastructure projects designed to improve public services. Even small delays or shortfalls against intended levels of performance can have a big impact on citizens. With much at stake, good project management is vital for the improvement of public services.
Active performance measurement using complete cost information	Failure to identify loss making areas, cost escalations, inefficiency or under performance can quickly erode competitiveness and threaten viability. Incomplete, untimely or inaccurate information, or measures simply focussed on the wrong thing will degrade management's ability to identify and deal with such problems.	Having systems to monitor and measure the efficiency and outputs of departments is an essential pre-requisite to good resource management and in turn represents an important means to maintain and improve quality of services.

12 How the three year public spending, planning and control regime operates

- **The Treasury conducts spending reviews on a two year (biennial) basis**. Every second year it sets out the budgets to be managed by departments for the next three years. For example, the most recent spending review in July 2002 set out departmental budgets for the three years 2003-04 to 2005-06.
- The three year budgets include a separate allocation for resources (to be spent on administration and activities) and for capital expenditure. Collectively these determine a department's **Departmental Expenditure Limit**.
- Spending plans should provide a clear framework within which **departments establish three-year funding agreements with their agencies** which in turn enable three year business plans to be prepared by agencies.
- **Departments have flexibility to carry forward from one year to the next all unused provision from their Departmental Expenditure Limit**. The annual carry forward of unused provision is subject to Treasury approval. The Treasury may decide to not allow carry forward of all unutilised resources if new priorities emerge elsewhere. Departments can determine the extent of flexibilities for their executive agencies and non-departmental public bodies.
- Departmental activities that are difficult to predict or are demand-led, such as benefit payments, are still managed on an annual basis. In this case the department is allocated annual resource and capital budgets for these activities. Collectively these determine a department's **Annually Managed Expenditure**.
- Departmental Expenditure Limits and Annually Managed Expenditure equal a department's **Total Managed Expenditure**.
- **Parliament still approves department's supply estimates on an annual basis**. The supply estimate sets out the resources to be used that year, differentiating between those that have been provided on a three year basis and an annual basis.
- Treasury requires departments to set out targets for how resources will be used in **Public Service Agreements**. The Treasury requires that similarly agencies have key targets covering their financial and operating performance. Departments also have to set out plans and targets for the use of funding for capital expenditure in Departmental Investment Strategies.

2.5 Public Service Agreements, introduced in 1998, require departments to agree with the Treasury quantifiable targets covering the delivery of their main objectives and the overall efficiency of their operations. The agreements are revised on a biennial basis as part of the spending review process. The purpose of the targets is to focus departments on using their resources to achieve sustainable improvements in service delivery. The Home Office, for example, currently has a Public Service Agreement which sets out seven objectives each of which is measured by the achievement of one or more targets. Its third objective of delivering effective custodial and community sentences has, as one of its four targets, a 5 per cent reduction of re-offending by young offenders.

2.6 There are currently 20 Public Service Agreements with a total of 101 objectives measured by 141 targets. Where programmes are cross-cutting targets may be the joint responsibility of two or more departments or agencies (50 targets are currently established on this basis). For example, the target for enhancing the take up of sporting activities by children is a joint target of the Department for Education and Skills and the Department for Culture, Media and Sport. We found that in general Public Service Agreements were having some impact in better focusing resources towards key priorities.

2.7 There is some evidence that the public spending planning and control regime has raised the importance of financial considerations in senior decision making in departments. In all 10 departments and agencies we examined in more detail, issues of financial management and how resources are deployed to achieve targets are now more regularly considered by senior management usually at board level together. The Department for Trade and Industry's improved management information has for example, led it to investigate in more depth the reasons for underspending and how this could be best remedied. An under spend in 2001-02 of £58 million in Venture Capital Funds (used to provide guarantees to banks for loans to small businesses) prompted a review of why take-up was so low and has led to a more realistic view of what is achievable and the level of resources required for future years. The link between under spending and what the Venture Capital Funds were achieving had not been clearly identified previously.

2.8 Nevertheless we found aspects of departments' planning which required further enhancement if resources are to be used effectively:

- While Public Service Agreement targets were influencing how resources were allocated at a strategic level there was less evidence that targets were used to determine the best way to utilise resources at operational levels. Only 15 per cent (7 out of 46) of departments clearly demonstrated that target achievement influenced resource decisions at all key points in the service delivery chain. *If resources allocated to key support services and functions are not consistent with strategic targets overall performance can be put at risk including the efficiency with which resources are used.*
- Departments generally find it easier to adopt a strategic approach when allocating resources to new programmes. For on-going activities there is a tendency to make small year on year incremental changes. *This increases the risk that major shifts in resources for example, from one set of priorities to another or from support functions such as corporate overheads to front line service delivery may be slow to happen.*

- Some 43 per cent (20 out of 46) of departments and agencies allocated resources to programmes on a cash basis. By omitting non-cash costs such as depreciation and cost of capital the full cost of a programme or service is understated. *This means that departments are less well placed to determine the level of resources which a service is consuming; to assess whether these are justified in terms of the level of outputs produced and their quality; and to determine the right level of investment needed to maintain or enhance the service in the future.*
- Around half of the departments and agencies which we examined considered that the administrative effort involved in making requests for resources to the Treasury every second year was still onerous for smaller organisations. Departments consider that there is something of a "one size fits all" approach. For example, the Serious Fraud Office is a small department with relatively few assets, but size has no bearing on what it is required to prepare to demonstrate its plans and proposals as part of its request for resources. It has to provide the same information in support of the requirements of the Parliamentary Supply procedure in the same way as a much larger department such as the Ministry of Defence. While it is important that Parliament receives the right information, there may be merit in further consideration of the administrative burdens placed on smaller departments. The Treasury is currently completing an internal study of the burdens placed on smaller departments.

Use of better information to manage resources

To make the best use of public money departments need to have complete information on their consumption of resources involved in delivering services. This covers not only cash expenditure but how the investment in assets and work in progress is used to provide assurance that resources are not deployed on unproductive activities.

2.9 Departments and agencies are now required in accordance with best practice in the private sector to prepare their accounts on an accruals basis. The main benefit of this is that departments' performance can be measured in terms of resources (for example, medical equipment, and investment in computers) consumed in the process of delivering a service, and revenues earned in a period rather than cash paid and received. Accruals accounting provides a fuller picture of a department's performance than a simple cash statement because assets and liabilities and their performance have to be accounted for **(Figure 13)**.

13 Departments' Resource Accounts include:

A Summary of Resource Outturn

Showing the total resources used in the financial period including variations against budgets

Operating Cost Statement

Showing resources consumed during the year by the department in providing its services, broken down by activities and administrative costs

Balance Sheet

Showing the value of assets and liabilities owned at the end of the financial period

Cash Flow Statement

Showing the receipt and use of cash in the period

Schedule of Resources by departmental aim and objective

Showing how resources have been used against the department's objectives

2.10 Further benefits become evident when the accruals basis is used for internal management information: costing can be based on resources consumed rather than those purchased; assets may be better managed because they are recorded and their use monitored; and investment decisions can be more soundly based as they have to reflect the contribution they will make to improved performance. Such disciplines mean that the costs of different activities are prepared on the basis of a consistent set of principles and standards, allowing the merits of different courses of action to be compared on an equal footing. Accruals accounting is, however, complex and requires more resources both financial and people to operate and many of the necessary skills are still being developed in departments.

2.11 In 2002 the Public Audit Forum consisting of the six national audit agencies of the United Kingdom developed five criteria[8] to assess the extent to which full accruals accounting had been introduced in the public sector and has been used as an effective resource management tool. In summary the criteria are:

Criteria		Potential to improve resource management
1	Accounting and budgetary systems remain cash based.	Nil
2	Accounting and budgets remain cash based and a separate process exists to draw up financial statements for external consumption.	Nil
3	Systems are moving towards accruals reporting but management information on this basis is produced only periodically and budgetary control is a hybrid of cash and accruals.	Low
4	Monthly accrual based management information and annual financial statements are produced by the same process. The focus of control is shifting to accruals based targets and there is good use of financial and performance data in decision making.	Medium
5	Accrual based and cash flow information are fully integrated both for internal management and external reporting. Information on departments' activity is reliable, regularly produced and underpins decision making and future investment strategy.	High

2.12 We assessed 46 departments' and agencies' performance against these criteria as at March 2003 **(Figure 14)**.

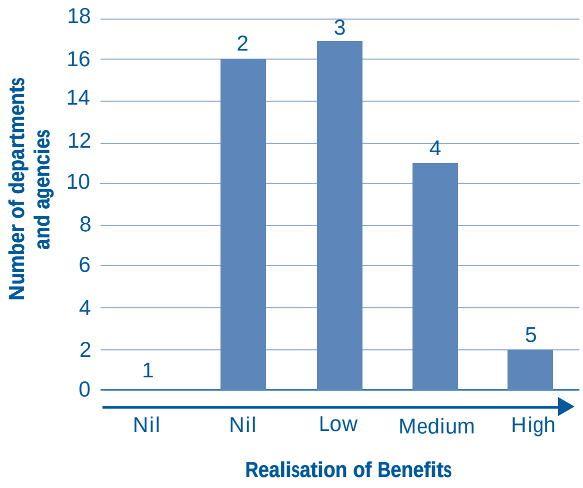
2.13 Our main findings were:

- Some 28 per cent (13 departments) have made good progress implementing accruals based accounting
- Around 35 per cent (16 departments) still rely mainly on cash based budgets and management information and the preparation of accruals based financial statements is a separate one-off exercise at the year end to meet external reporting and accounting requirements. As such these departments have so far derived no or limited benefits.

2.14 If the production of accruals-based financial statements is treated as a separate annual exercise the benefits of more comprehensive information on resource utilisation and performance in promoting better management will not be achieved. This will have consequences for delivering better public services because departmental managers' information to make both resource decisions, assess the contribution which resources are making and so tackle inefficiency and unproductive effort will remain deficient. At a general level accruals accounting is methodologically more complicated than cash accounting and some departments have encountered difficulties through their failure to implement full accruals accounting **(Figure 15 overleaf)**.

14 Progress by departments in realising the full potential of accruals accounting to improve resource management

The analysis covers 46 departments and agencies



Source: National Audit Office examination and results of financial audit

2.15 Departments identified a number of barriers which they considered explained why progress has not been more uniform or achieved more quickly. These were:

- **Insufficient financial expertise**. Some 63 per cent (29 departments) considered that this was a barrier though many are making good progress in addressing this.
- **Understanding and awareness**. Some 39 per cent (18 departments) consider that the main barrier to changing the focus of control from cash to accruals was raising awareness and understanding among operational managers who often lacked the necessary financial expertise.
- **IT systems' capability**. Some 11 per cent (5 departments) consider that their existing IT systems were not capable or not sophisticated enough to produce integrated financial and output performance information.

8 *Public Audit Forum report 'The Whole Truth: or Why Accruals Accounting Means Better Management' (November 2002).*

15 **Examples of the difficulties departments have encountered through their failure to implement full accruals accounting**

Failure to keep track of monies owed to suppliers

- Under cash accounting departments only needed to account for payments to suppliers at the point they were made regardless of when the related goods and services were received. Accruals accounting, however, requires departments to match the amounts owed for goods and services to the financial year in which they are obtained. Otherwise there is a risk that Departments fail to identify the liabilities for which they are accountable, and a distorted picture of their financial position is created. The introduction of accruals accounting exposed deficiencies in a department's systems and procedures for in-year monitoring of expenditure. While payments were recorded as before under cash accounting there was an absence of regular updated information on the amounts owed to suppliers. This masked the real trend in expenditure until after the year end, by which time the department had exceeded their budget. Failure to monitor these balances in a timely manner meant that an overspend was incurred with the department requiring extra money from the public purse in the form of an excess vote.

Lack of adequate information on stock holdings

- Under accruals accounting departments are required to account for stocks of spares and equipment components held on their behalf by contractors. In one case a department failed to establish arrangements for obtaining timely information on changes in the levels of these stocks, and therefore had no way of identifying whether it had too few or too many items, or how this impacted on its activities and finances. Its failure to account for stock changes led to qualification of its resource account.

Inability to distinguishing between capital and current expenditure

- Under accruals accounting departments are required to differentiate between capital and current expenditure. In some cases department's financial systems have been unable to budget, monitor and account for the items separately resulting in an overspend on, for example, maintenance (current expenditure) and an underspend on construction (capital expenditure), and resulting in departments requiring resources in excess of those originally provided to them by Parliament. If unresolved this could potentially distort future allocation of resources and put delivery of important services at risk.

Source: National Audit Office examination

2.16 The implementation of resource (accruals) based budgeting and accounting has been phased over a number of years **(Figure 16)**. This was to provide sufficient time to allow departments to plan their expenditure on new accounting systems to coincide with planned enhancements of existing and financial management systems. This was intended to contain additional costs by allowing any extra expenditure to be absorbed where possible within departments' existing budgets. Similarly training costs associated with the introduction of resource based financial management have been absorbed over a number of years within existing departmental budgets. The result is that the cost associated with introducing resource accounting and budgeting cannot be readily distinguished from departments' expenditure on systems development. The costs are, however, likely to be significant. The Highways Agency's existing financial systems for example, were not designed for the production of resource accounts. Its first set of resource accounts in 1990-2000, were produced by consultants and temporary staff. This was an expensive process, costing more than £2.5 million or around three per cent of its total administrative budget. Since then the cost of producing resources accounts has been reduced by moving the work in-house, resolving policy issues and streamlining processes to reduce costs. The Agency envisages further cost reductions as financial and management accounting become fully integrated to provide better information for managers.

16 **Timetable for implementing resource budgeting and accounting**

The Government's White Paper *Better Accounting for the Taxpayer's Money (Cm2929)*, 1995 set out the timetable for implementation of resource accounting and budgeting by departments.

Government Resources and Accounts Act 2000 leading to the first:

- partial resource based Spending Review in 2000*;
- audited resource accounts for 1999-2000 and 2000-01 (preceded by trial 'dry run' resource accounts for 1998-99);
- full resource based supply and accounts in 2001-02;
- full resource based Spending Review in 2002.

* Full accruals information not available until the production of the first full resource accounts

Source: Treasury

2.17 In most cases it is too soon to identify any discernable benefits from better resource management in terms of contributing to improved public services from for example, enhanced efficiency. There is, however, some early evidence of better resource management arising from reviews of stock holdings, the use of accommodation and from the disposal of obsolete assets **(Figures 17 and 18)**. Some departments have also improved their cash flow management. For example, organisations making large annual grants have been able to match the dispersal of funds more closely to service needs enabling them to stage payments rather than transferring funds too soon thereby maximising the interest earned on public monies.

17 The Teacher Training Agency. How better information can improve the utilisation of resources

In 2001-02 the Teacher Training Agency was allocated an additional £100 million (32 per cent increase) to train the increased number of teachers. At the end of the year the Agency underspent £9.8 million (some 2.4 per cent of its total budget) including £6 million on lower than forecast student bursaries. If the likelihood of an underspend had been identified earlier the resources could have been redeployed to other priorities. The Agency determined that late awareness of the underspend was due to two factors:

- **Budgetary control**. Senior managers responsible for resource management were not in post and the finance department had a high staff turnover. At the start of 2001-02 all but one of the central finance team had been in post for less than a year. Oversight of budgets and support for budget managers was therefore weak.
- **Financial awareness**. End of year flexibility rules previously permitted the Agency to carry forward two per cent of its grant-in-aid to the next year. The rules changed in 2001-02 allowing a fixed amount of £3 million to be carried forward. The implications of this change were not understood until too late in the year.

The Agency has tackled these issues by (i) ensuring that posts were filled and improving the retention of staff through flexible working; (ii) adopting zero based budgeting underpinned by budget management awareness workshops for budget holders; (iii) emphasising to all staff the importance of quickly identifying and redeploying resources that are not likely to be utilised as planned; and (iv) having electronically produced monthly reports and variance analysis to identify opportunities to redeploy funds that become surplus to requirements. The Agency did not incur any unauthorised underspend in 2002-03.

Source: Teacher Training Agency (More detail is provided in case study 2)

18 The Defence Evaluation and Research Agency: The importance of having reliable asset valuations

The Defence Evaluation and Research Agency, a former trading fund of the Ministry of Defence, moved in 1995-96 from cash to accruals accounting. Accruals accounting required the Agency for the first time to conduct regular revaluations of its assets, such as its tank testing range site at Chertsey.

In 2001-02, the Ministry transferred a substantial part of the Agency into the private sector, and based the selling price, in part, on the value of the assets. The National Audit Office was asked by the Ministry to examine the sale price. The availability of reliable information on the value of the Agency's assets, and the knowledge derived from auditing the Agency's accounts, enabled the National Audit Office to identify a substantial understatement in the valuation of the business. As a result the Ministry was able to recover an additional amount of over £50 million from the private sector company that had purchased the business.

Source: National Audit Ofice examination

Impact on the way resources are managed

Better, more flexible planning and more complete and comprehensive information should not be ends in themselves. They should deliver improvements in the way resources are used to deliver better public services. Such improvements should be clearly visible and communicated to all staff so that they are encouraged to adopt the new approaches.

2.18 Departments' capability to deliver better public services has historically been affected by two phenomena:

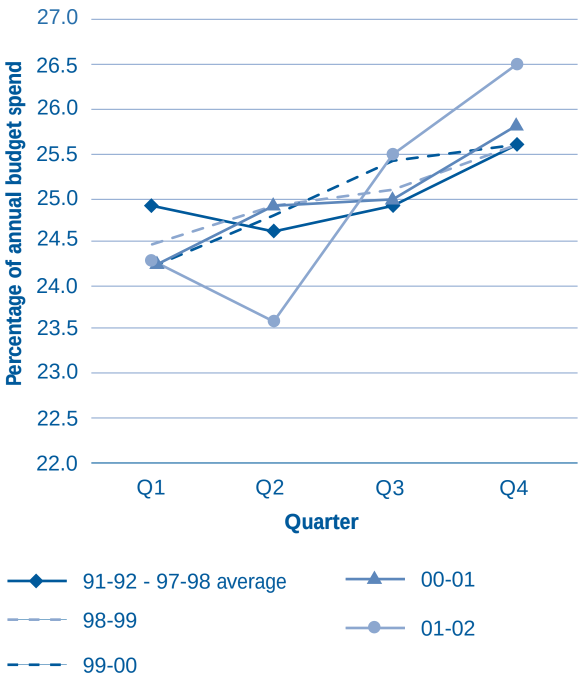
- An uneven pattern of spending with a higher proportion of expenditure made in the last quarter of the year *(the risk to public service delivery is that a rush to utilise unspent monies results in expenditure that is not sufficiently well planned to meet service needs with an increased risk of poor value for money). In some cases there may also be negative distributional effect in that those who use a public service towards the end of the year may benefit from the increased expenditure for example, more patients may be treated compared to those who use the service at other times. Conversely, if spending is heavily biased towards the earlier parts of the year this may mean that less money is available to provide services to people who need them towards the year end.*
- Significant under and overspends of allocated funds *(underspending of planned expenditure may suggest under delivery of services while an overspend may suggest weak project management increasing the risk of poor value for money). There is also an opportunity cost in that unspent funds if identified earlier might have been utilised on other priorities.*

We assessed the impact which the intended improvements in resource management are having in tackling these two issues. We also considered improvements in the way assets are managed and liabilities identified together with the action taken to minimise, in particular, the risk of contingent liabilities impacting on service delivery.

Matching expenditure more closely to service needs

2.19 Historically, the combined spending profile of all departments reflected a tendency for expenditure to reduce in the second quarter of the financial year and then rise to a peak in the last quarter **(Figure 19)**. Since the introduction of the new flexibilities we found there was no discernible difference as yet in the annual spending profile in 74 per cent of the 46 departments which we examined. In three cases, levels of expenditure in the last two months of 2002-03 increased in comparison with previous years. This may be explained by the time it is taking departments to understand how best to use the new flexibilities and cascade these down to their managers and partner organisations. For example, some departments had not given corresponding end of year flexibilities to their executive agencies or non-departmental public bodies often because they considered the partner organisation to have a poor delivery track record.

19 Departments have a history of increased spending in the last three months of the financial year



Source: Treasury

2.20 Our more general findings are summarised in **Figure 20**:

20 The extent to which departments are using the new flexibilities to plan and manage their expenditure

We found:

- in 74 per cent (34 departments) there was no change in the profile of annual expenditure with a continuing bias towards spending in the last two months
- 37 per cent (17 departments) could demonstrate that under spends had been carried forward and reallocated to other priorities
- 37 per cent (17 departments) who deliver services through other organisations in a delivery chain had given similar end of year flexibilities to their partners
- 13 per cent (6 departments) did not have sufficiently complete information to ensure expenditure was spent in a measured way throughout the year

Source: National Audit Office examination of 46 departments and agencies

2.21 With capital expenditure there was evidence of some improvement in achieving a more even pattern of expenditure. Some 24 per cent of spending occurred in the last two months of 2000-01 and 2001-02 compared to 35 per cent in 1998-99. In some instances departments may be accounting for their capital spending in the last quarter of the financial year because they do not have fully integrated accruals based accounting systems to identify and address under or over spending earlier in the year.

2.22 In some cases year end flexibility had been used constructively for example, to carry forward international aid projects where timetables slipped in developing countries. At the Highways Agency **(Case study 1)** end year flexibility combined with resource accounting has improved budget monitoring and promoted a smoother annual expenditure profile, unlike the end year peaks of previous years. It has discouraged managers from making poor procurement decisions and purchasing expensive items in advance of need to avoid under spending.

2.23 To ensure that resources are used for their intended purpose the Treasury will in certain cases limit ("ring fence") departments' flexibility to transfer funds between programme or activities. Many departments considered that the ring fencing of programmes and activities, could prevent the best alignment of resources to priorities especially where these change in-year. The Office of the Deputy Prime Minister, for example, considered that ring fencing was only useful to protect new programmes at an early stage of their development. As a consequence it had sought successfully to reduce ring fencing and have the flexibility to re-allocate resources to meet new priorities. In contrast, over three quarters of the Department for Trade and Industry's budgets were "ring fenced", which can increase the potential for under spending since it reduces the scope to reallocate resources. Greater flexibility, however, must be balanced against the need to ensure that all programmes and activities are managed well in the first place and that significant reallocations between programmes are fully accounted for.

Avoiding significant over and underspends

2.24 In 2001-02 aggregate Departmental Expenditure Limits of £193 billion were underspent by around £5 billion (2.7 per cent) with under spending unevenly spread across departments **(Figure 21 overleaf)**. In May 2003, however, the House of Commons Treasury Select Committee noted, as part of their examination of the 2003 budget that estimated aggregate current spending for 2002-03 was above planned totals (£421 billion compared with £418 billion)[9].

2.25 Our examination of departments' capability to utilise resources as intended found that:

- 46 per cent (21 departments) incurred significant over spending for individual programmes and 17 per cent (8 departments) had identified significant underspending in recent years.
- 78 per cent (36 departments) considered the main causes of over and under spends were related to poor quality project management. No department or agency was fully confident that they and their partners had adequate arrangements to avoid over or underspending in the future.
- All departments and agencies considered that the move to accruals based accounting had created additional short-term risks of over and underspending given their lack of experience on managing on an accruals accounting basis.
- In the longer term, all departments and agencies saw the potential benefits to improved managerial control that accruals accounting could provide by enabling them to better understand and forecast expenditure they have committed themselves to rather than simply what they have already paid.

2.26 The Committee of Public Accounts report on Excess Votes 2001-02 drew attention to a considerable increase in overspending against departments' cash, resource and administrative budgets in 2001-02, the first year of resource accounting, compared to 2000-01. There were eight excesses totalling £1.5 billion including:

- **Ministry of Defence:** excess of £602 million arising from decisions to withdraw certain defence assets from service taken very near the end of the financial year and reassessment of the operational capability of other defence assets.
- **Department for Transport, Local Government and the Regions:** excess of £562 million, including £456 million overspending on roads due to failures to distinguish properly between current and capital expenditure or allow fully for non-cash expenditure in its Estimates and in subsequent monitoring of outturn.

2.27 While the Committee recognised that 2001-02 was the first full year of preparing departmental accounts on a resource basis it concluded that Excesses could have been avoided if more had been done to address a number of weaknesses. These included:

- failure to implement full accruals accounting undermining the ability of departments to monitor and forecast their performance properly during the year;
- insufficient skilled and trained finance staff;
- estimates that included errors in the classification between resource and capital expenditure, or were constructed on the basis of inappropriate accounting polices;
- failure to fully consider or realise the financial consequences of operational developments or decisions.

2.28 In 2002 the Treasury carried out a review of Departmental Investment Strategies in response to concerns about the levels of capital under spending in 1999-2000 and 2000-01. The review concluded that there was a need for better management by Departments to reduce under spending and that the new arrangements provided them with a range of tools for doing so **(Figure 22 overleaf)**.

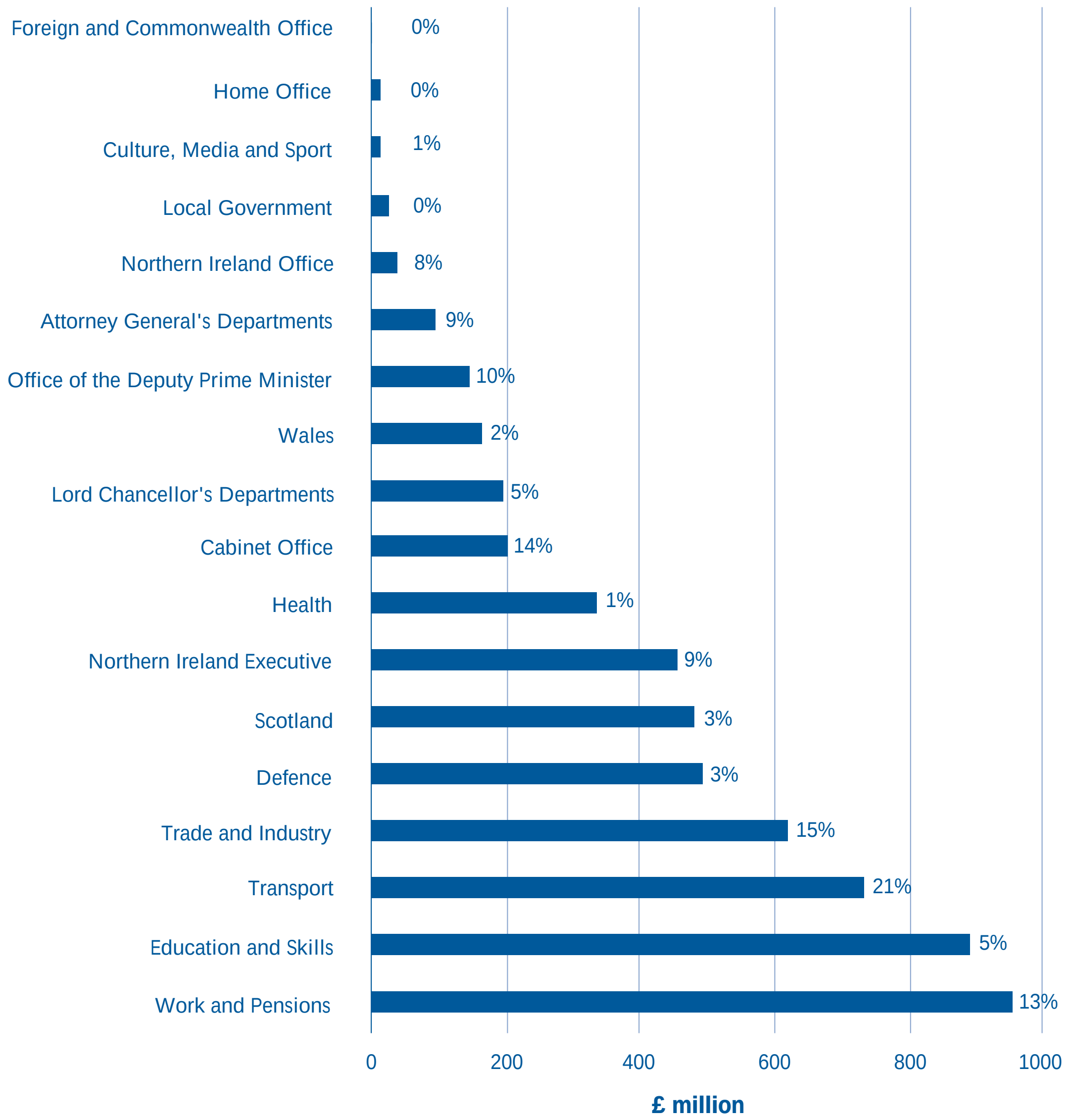
2.29 In 2001-02, however, capital under spending was even more marked with a total under spend of £2.3 billion out of £26 billion (8.7 per cent), including high levels of under spending in:

- the Department for Education and Skills (£417 million or 14 per cent);
- the Department for Transport (£348 million or 7.5 per cent);
- the Home Office (£230 million or 22 per cent).

In 2002-03 estimated out-turn is again below the planned total. The House of Commons Treasury Select Committee in May 2003 concluded that dramatic fluctuations in public sector investment militate against the efficient delivery of a sound public sector infrastructure and called for further investigation into the reasons for the inability to adhere to investment programmes[10].

9 *House of Commons Treasury Select Committee report The 2003 Budget, seventh report session 2002-03 (HC 652-1).*
10 *House of Commons Treasury Select Committee report The 2003 Budget, seventh report session 2002-03 (HC 652-1).*

21 **Departments' under spending 2001-02**



NOTE

The figure shows the amount of underspending by departments against their authorised resources in absolute and percentage terms.

Source: HM Treasury

22 Main conclusions of the Treasury review of capital under spends

- There needs to be an overview of investment strategy within departments, with Board-level involvement to ensure that allocations are made in accordance with the overall strategy. 'Over-programming' should be more widely used to deliver investment plans.
- **Three-year budgets and End Year Flexibility** should usually be delegated to delivery bodies and departments need to make sure that their impact is well understood. There should be room for more flexibility within departmental systems for example, indicative budgets beyond three years and 'reverse' end year flexibility.
- **Allocations processes need to be timely and focused**, so that those who will actually commit funding are aware of their budget in good time before the beginning of the financial year. Asset management plans, containing specific asset utilisation and disposal targets, are increasingly seen as a useful tool to manage assets, or make investment priorities explicit to local partners.
- **Full use needs to be made of resource accounting and budgeting** for example, by delegating capital charges to budget-holders.
- 'Senior Responsible Owners' and 'Project Owners' in construction projects need to play a more active role in managing investment projects, with the help of appropriate training.

2.30 Departments considered that the risk of significant under or over spends had often increased because of:

Management:

- failure to assign sufficient senior management ownership and responsibility for the delivery of programmes or activities linked to poor monitoring and holding to account by Departmental Management Boards;
- a record of poor forecasting, possibly made worse by inexperience in forecasting in resource accounting and budgeting terms, leading to unrealistic initial budgeting assumptions;
- increased programme resources not matched by an increase in administrative resources to manage them;
- poor understanding of the capacity of partners to deliver (including their external constraints, business priorities and programme management skills);
- insufficient skills and capacity in finance resulting in poor support for budget holders;
- failure to identify and monitor the link between resource usage and service delivery and a failure to act to stop inefficient or ineffective programmes and use these resources elsewhere; and poor management information on resource usage linked to service delivery.

Structural:

- a multiplicity of budgets and programmes, each with its own rules and conditions for deployment or redeployment of resources, and the involvement of large numbers of agencies and non-departmental and other bodies making budget and performance management overly complex;
- significant degree of ring fencing of programme budgets limiting the scope to transfer over and under spends between programmes and activities or refocus resources on new priorities;
- current year end flexibility arrangements not allowing expenditure to be brought forward from future years, and the penalties attached to overspending can create a bias towards under spending.

External factors such as:

- delays in decisions by external bodies such as the European Commission or delivery partners.

Management of assets and liabilities

2.31 Under resource accounting departments now produce an annual balance sheet setting out the value of all their assets and liabilities **(Figure 23 overleaf)**. The balance sheet and its accompanying notes provide a valuable source of information to assist departments in analysing their performance in using resources to deliver services. For example, using information contained within the accounts of registered social landlords, the Housing Corporation has developed a range of financial indicators, to help measure the efficiency of the different providers, and to determine which ones are best able to convert resources into social housing. To fully realise the value of the information contained in balance sheets, however, it is essential that there is full and proper recognition by departments of the assets and liabilities that make up those statements.

23 **Departments' balance sheets include information on:**

Fixed assets:

- Intangible assets (such as trade marks, patents, intellectual property rights and copyrights)
- Tangible Assets (such as land and buildings)
- Investments (over one year)

Plus: current assets

- Stocks
- Debtors
- Investments *(under one year)*
- Cash

Less: liabilities

- Creditors and other known commitments

= Taxpayer's Equity *(what the taxpayer owns)*

A great deal more detailed information on these categories will be available in the notes to the accounts, including on contingent assets and liabilities.

Source: NAO and Treasury

Recognition of assets

2.32 *If departments do not fully recognise all their assets and their associated costs they cannot know how they are contributing to the delivery of services.* A department holds assets in order to deliver services. These will typically include land, buildings, stock and equipment, as well as cash held in the bank or monies owed to departments. Over one third of departments and agencies we examined stated that the main benefit of resource accounting and budgeting has been the complete identification and subsequent better management of their assets, in particular fixed assets and stock. The Serious Fraud Office, for example, when preparing its first set of resource accounts identified previously unaccounted for assets worth £4 million relating to uncollected debts, which in turn have highlighted a more widespread problem with debt collection across the civil and criminal justice systems **(Figure 24)**.

24 **The move to resource accounting has increased awareness about the extent of previously unrecognised assets**

The introduction of resource accounting led for the first time to the Serious Fraud Office identifying the full value of its debtors. It revealed £4 million in debts stemming from uncollected cost awards made against convicted fraudsters. The £4 million in uncollected debt, equivalent to almost 20 per cent of the Office's annual resource budget, are resources that should have been available to the Government. The identification of this issue highlighted a wider failure on the part of the Court Service to collect fines and cost awards throughout the criminal justice system, not only reducing the resources available for services, but undermining the deterrent effect of successful convictions.

2.33 Resource accounting has also encouraged departments to identify as assets less typical items such as databases, trademarks, copyrights and intellectual property rights. Such assets represent past investment in the business and a valuable source of present and future income to it. At times, however, the classification of such items as assets requires careful and considered accounting judgements. For example the Comptroller and Auditor General has qualified the Ordnance Survey Accounts from 1999-2000 to 2002-03 because the department have not accounted for the National Topographic Database as an asset in their Balance Sheet. The decision to qualify the accounts was based on the fact that the National Topographic Database was developed by past investment of public funds. The Ordnance Survey, however, sets out in its Annual Report and Accounts each year an explanation for the treatment it has adopted which it believes is appropriate and in accordance with the relevant accounting and reporting standards[11].

2.34 Under resource accounting, Government as a whole incurs an interest cost (the cost of capital) representing the cost of borrowing or using taxpayers' money to finance departments' assets, that could otherwise be used for alternative purposes. To ensure the full cost of services is reflected in departments' accounts this financing cost has been devolved to departments providing an incentive to make better use of the assets at their disposal. If a department's assets are unused, under utilised or incorrectly valued then they may be incurring unnecessarily high costs of capital as well as other unnecessary costs such as maintenance, reducing the resources available for services **(Figure 25)**.

11 *While the Ordnance Survey does treat the database management system and the hardware as capital assets, it considers that the data contained in its National Topographical Database should not be treated as a capital asset because it is akin to intellectual property, being developed internally by its staff and without a readily ascertainable market value in similar assets. The Ordnance Survey continues to monitor relevant accounting developments.*

Recognition of liabilities

2.35 *If departments do not recognise the full extent of their liabilities they cannot know the level of resource that they can safely commit to the delivery of public services.* As well as assets, resource accounting requires departments to identify liabilities in their balance sheets. Liabilities typically represent obligations arising from a transaction or other event that has already occurred but has not yet involved the department in any payment.

2.36 Departments have always been responsible for liabilities but, under cash accounting, they were not required to fully account for them or take responsibility for managing all the associated costs and risks. This meant that there was no anticipation of a liability until it actually manifested itself and payment was required. This created unexpected reductions in the resources available for service delivery.

2.37 An example of a major liability is that faced by the Department of Health in respect of charges against its future resources as a result of cases of clinical negligence. The Department has recognised the need to determine the full scale of future clinical negligence costs and to set aside funds - in the form of a provision on the balance sheet - to meet this liability[12]. Otherwise resources could be committed to health services that subsequently have to be withdrawn to meet clinical negligence costs. Better understanding and reporting of the scale of clinical negligence liabilities has stimulated action to both prevent and better manage the risks at local and national level, including the increased use of mediation and faster processing of claims to reduce legal and other costs in response to recommendations of the Committee of Public Accounts[13].

The recognition and management of contingent liabilities

2.38 A contingent liability, as distinct from a liability, is a potential risk of a future call on a department's resources where the timing and value of its realisation are uncertain. Under cash accounting departments had to provide a note to the accounts about any contingent liability, but its definition was narrowly drawn making departments less inclined to consider or report the wider risks to services. Under resource accounting the definition of what comprises a contingent liability is much wider and the reporting requirement more explicit making it more important that departments are rigorous in identifying and reporting their contingent liabilities, particularly where they may affect the future delivery of services.

25 The Court Service: Using reliable information to identify inefficient use of assets

The Court Service undertook a rolling programme of revaluations of their land and buildings of both the Court Service and Magistrates' Court Service. With a "combined" estate valued at £2.7 billion this meant an annual cost of capital charge of some £175 million, which has to be recovered from court fees (in 2002-03 total costs of the Court Service exceeded court fees by £73 million). The scale of capital charges promoted a joint Treasury and Court Service review of the court estates. This identified spare capacity of between 200-600* courtrooms, and indicated that if whole buildings could be released this could generate a capital receipt of between £35 million to £215 million, considerably reduce the maintenance backlog of around £145 million, and result in an estimated £5 million to £24 million reduction in cost of capital charges. For example, the Royal Court of Justice, valued at £272 million, is substantially under used for court hearings with only 12 per cent of the floor space taken up by courtrooms, and potential for better utilisation of the 92 courtrooms by transferring work from elsewhere and better scheduling of cases. Even if part of this space could be released, and better use made of courtroom capacity, this could result in substantial savings.

The Court Service have developed a performance management framework for the better management of the estate involving targets for co-location of courts and offices, accommodation use and improved efficiency through property benchmarking, with the aim of reducing the cost of capital charge.

** Crown, county, magistrates and Royal Courts of Justice*

Source: The Court Service

2.39 In the case of clinical negligence, described in paragraph 2.36 above, a distinction is drawn between claims where the Department is confident about the size and value of the claims (accounted for as a liability), and the body of further claims where it is more difficult to determine value and likely incidence. For the latter it is still important to report this potential liability by making an estimate of its value, and disclosing this as a "contingent liability" in a note to the balance sheet[14]. By so doing the Department is better placed to understand and manage these potential obligations and, in turn, their potential impact on future service delivery.

12 *The National Health Service (England) Summarised Accounts 2001-02 has a provision of £5.2 billion in respect of clinical negligence.*

13 *Committee of Public Accounts' report on 'Handling Clinical Negligence Claims in England' (thirty seventh report, 2001-2002).*

14 *A contingent liability of £3.1 billion in respect of potential future claims for clinical negligence is noted in the National Health Service (England) Summarised Accounts 2001-02.*

Accounting for complex transactions such as the Private Finance Initiative

2.40 In recent years government bodies have developed a range of different means by which to procure or provide services or capital assets such as hospitals and schools. Chief amongst these has been the development of the Private Finance Initiative (PFI). In accounting for assets and liabilities created through the PFI or similar deals, it is important that departments follow the range of guidance available to them to ensure the resulting assets and liabilities are correctly recorded. In some cases the National Audit Office has found that property assets built under PFI deals are not accounted for anywhere - neither on the balance sheet of a department nor on the 'special purpose vehicle' of the consortium delivering the project. In some cases there can be valid reasons for this. This is, however, an important issue since it raises questions about departments' responsibilities for the stewardship of assets which have been paid for by the taxpayer, and the risk that in some cases departments may have incomplete information on the assets being used, what they cost and how they are contributing to the overall delivery of public services.

2.41 Similarly, under the PFI, departments have entered into long-term contracts with private sector organisations for the delivery of public services. Under the terms of the deals departments are required to make payments over the life of the projects which can be for 20 or 30 years. The total value of such payments is large - estimated in April 2003 at over £105 billion. Though not directly addressed in this report it is important that, where appropriate, such obligations are fully considered by departments so that any effect they have on spending and resourcing decisions are fully understood.

Part 3

What more needs to be done

3.1 Drawing on good practice in the private sector and internationally this part sets out four key aspects of resource management which departments need to develop further:

- **Adopt a more strategic approach** - with a clear focus on achieving better public services.
- **Have a well developed capability to convert resources into services that meet people's needs**.
- **Give appropriate flexibility to those responsible for delivery to encourage innovation**.
- **Use management information to make better use of resources and improve efficiency**.

A strategic approach to resource management

This typically requires:

- Simple planning and monitoring processes at board level, providing a clear focus on targets and priorities, ensuring targets and objectives are fully aligned at all levels of the organisation and the delivery chain, taking a longer term perspective and having well understood arrangements for dealing with the unexpected.
- Ensuring the Board includes the main delivery partners and other organisations that can either influence or be effected by resource decisions.
- Ensuring the Board has the appropriate skills, experience and support.
- Decision and resource allocation making processes that are transparent to organisations in the wider service delivery chain.
- Assessing the potential impact of new delivery mechanisms on existing activities before their implementation and planning for potential changes (sensitivity analysis and contingency planning).

3.2 A strategic approach to resource management has a number of key characteristics.

3.3 **Simplicity**. A strategic approach does not necessarily require over elaborate planning and monitoring systems at Management Board level. Simplified arrangements can help create a clearer focus on key goals and objectives. A critical consideration should be how to rationalise activities and in particular eliminating or down grading those that are peripheral to core services **(Figure 26)**. Successful private sector companies are usually those that have slimmed down in size and concentrate only on those activities that add most value to their business. *While many departments often have to deal with many issues in designing and delivering services their planning processes can be too complex becoming an end in themselves - which can increase the level of resources consumed by overheads which might be more productively applied to front line service delivery*.

26 Adopting a simplified planning approach and focusing on core responsibilities

The Department for Education and Skills transferred a number of the Teacher Training Agency's peripheral tasks to other organisations. This enabled the Agency to simplify its board level planning processes concentrating on core priorities and targets, and to promote greater involvement by its own staff and other stakeholders. The model adopted by the Agency is simple and it is clear where the sponsoring Department's and its own responsibilities start and finish, with the Department setting and agreeing with Ministers the policy context for resource allocation and the Board setting strategic priorities, approving operational plans and providing clear and quantifiable objectives for the Agency. The arrangements have engendered a sound governance relationship between the Board and officers, through which the Board provides a challenge function but also advises on policy development to promote better delivery.

Source: NAO examination of the Teacher Training Agency (more detail is provided in case study 2)

3.4 **Clarity and commitment**. While departments are now much better at setting objectives and targets the extent to which these are understood and accepted by all those organisations in the service delivery chain is more variable. A KPMG study of American and European senior private sector executives found that they rated 'getting everyone aligned around strategies and vision' as the most important issue they face in seeking to improve their performance[15]. The study found that companies deliver best results when they operate an integrated planning process with a strategic plan establishing clear goals which can be cascaded down through the organisation. For example, multi-national corporations use performance management systems to align objectives throughout the organisation, providing a clear link between the activities of individual employees and strategic objectives. The Highways Agency has developed a planning framework along similar lines linking the strategic goals of the organisation through operational plans to staff personal development goals **(Figure 27)**. *More generally communication between departments, their agencies and other partner organisations is less well developed with the risk that all those in the service delivery chain are not sufficiently focused on common or complementary objectives*.

27 The Highways Agency: Aligning objectives throughout the organisation

Delivery of a major road scheme can take up to ten years. The Highways Agency uses a comprehensive set of planning and monitoring arrangements to control and link its organisational targets, varied activities, and the personal development of staff to the Government's '10 Year Plan for Transport'. The main features are:

- ***10 Year National Roads Strategy*** detailing how the Agency will meet each of the Government's aspirations for the strategic road network as set out in the 10 Year Transport Plan.
- ***Corporate Plan*** setting out how the Agency needs to change and develop over a five year period in order to deliver improvements in service quality.
- ***Business Plans*** setting out the Agency's role as Network Operator, key deliverables over a three year period to meet the outcomes of the 10 Year Plan and Ministerial targets for the coming year.
- ***The Management Plan*** providing the detail and setting out specific roles and responsibilities for all directorates within the Agency.
- ***Team Plans***, the fundamental building block in the annual management planning process. The high level targets set out at Directorate level are broken down in detail into team plans for action and tracking at individual project or scheme level.
- ***Performance and Development Plans*** managing individual performance and development needs, and define the purposes of jobs and their main functions.

Source: NAO examination of the Highways Agency (more detail is provided in case study 1)

3.5 **Longer term perspective**. In the private sector while annual performance is critically important more recognition is given to longer term investment and capacity building. The tendency is to move away from budgeting and resource allocation processes that involve small year on year changes. The aim is to give more prominence to resource allocation over three to five years. With multi-national companies this requires resources to be more closely aligned to corporate and group objectives. The Department of Trade and Industry in its allocation of resources to the seven research councils is adopting a similar more integrated and longer term approach to get the best out of the science budget **(Figure 28)**. *While meeting key targets is influencing the allocation of resources departments need to adopt a longer term perspective to resource allocation involving key organisations in the delivery chain*.

28 The Science budget: Taking a longer term more integrated approach to resource allocation

Since 2000-01 the science budget has grown annually by 10 per cent and is set to continue at this rate to 2005-06 when the budget will exceed £2.9 billion. The Department for Trade and Industry is responsible for managing delivery from the science budget and provides grant-in-aid to seven Research Councils to deliver research through their own institutes or fund research programmes in higher education institutions. Up to 2002 resources were allocated to each Council based on approved programmes within their specialist fields, but there were concerns that the science budget was underperforming. Structural barriers limited the use of the budget flexibly and prevented it from responding to new opportunities through cross boundary multi disciplinary work.

Working in partnership the DTI and the Research Councils established Research Council's UK (RCUK) which was tasked with putting together a single integrated research programme and resource allocation plan for all the Councils. The allocation of the science budget is now a joint DTI and RCUK process involving extensive consultation with stakeholders such as industry and research charities. Through RCUK the Department has been able to identify new national strategic priorities, break down the barriers between the Councils, and encourage the development of roots-up multi-disciplinary research programmes. For example, the e-science programme is researching the utilisation of world wide spare computer capacity to assist with data rich research programmes in fields as diverse as particle physics and human genetics. The UK is developing a lead in this work which may lead to the next generation World Wide Web. One Council does the lead core work with other Councils receiving resources to develop specific applications.

Growth in resources has also increased the pressure to demonstrate tangible benefits from the science budget. In response work is being carried out on developing international comparators, and using a technological consultancy company to develop a comprehensive set of metrics across a balanced scorecard which will be used to demonstrate results and inform future resource allocation.

Source: Department of Trade and Industry

15 *Achieving Measurable Performance in a Changing World, KPMG Assurance and Advisory Services (2001).*

3.6 **Leadership**. Effective leadership is difficult to define but it should ensure that resources are directed to clearly articulated priorities and secure staff's commitment to achieving results. Renewed emphasis on resource management is leading departments to review the role of their management boards to strengthen leadership. For example, some have:

- **Consolidated separate specialist boards into one** with responsibility for oversight of all activities - this has included merging separate policy and management boards to ensure that the resource implications of policy initiatives are fully considered.
- **Specific committees to address specific resource allocation issues**. The board of the Housing Corporation has separate committees for regulation, investment and organisational effectiveness that allow its members to deal in more detail with each core aspect of its role.
- **Expanded the role of audit committees**. Both departments and their partner organisations' Audit Committees consider the arrangements for allocating and managing resources as part of the annual assurance they give about internal controls.
- **Recruited staff with more experience in financial management**. Many departments cited the benefits they have derived from having board members with relevant private sector experience in developing their approach to, and scrutiny of resource management.
- **Ensured that Board membership, where appropriate or practical reflects key partners** in delivering services or at least give them observer status.
- **Broadened membership of their boards** to include not only finance but human resource management and IT expertise.

3.7 **An ability to deal with the unexpected**. A key capability is being able to deal with something unexpected which if a department could not respond quickly and appropriately would seriously affect the delivery of services. Some departments retain a contingency to fund any unexpected expenditure while others use contingencies to avoid possible overspends. Some departments meet unexpected expenditure through reallocation during the year either instead of, or in addition to, a contingency fund. The Foreign and Commonwealth Office for example, review their allocation of resources halfway through the year and retain a contingency fund, while the Teacher Training Agency and the Department of Trade and Industry undertake quarterly and monthly reviews respectively to identify resources which are unlikely to be utilised as intended. *While having well developed arrangements for dealing with the unexpected is an essential requirement, large financial contingences can tie up significant resources that might be better allocated to specific programmes. Much depends, however, on the extent to which departments can rely on the preparedness of all organisations in the delivery chain to deal with the unexpected. Where services are much more demand led and unpredictable arrangements do need to be in place, however, to meet sudden increases in expenditure. A strategic approach requires the risk of such circumstances to be clearly assessed and managed.*

A well developed capability to convert resources into services that meet peoples' needs

This requires:

- Understanding customers' needs and responding effectively to them.
- Active consultation with all key organisations involved in delivery so that all are focused on improving services.
- Determining the best structure and method of delivery for the organisation and the wider delivery chain to ensure that resources are allocated and used to best effect.
- Understanding the capability of partner organisations to deliver what is expected of them and providing support early enough where capability is at risk.
- Ensuring that project and programme and resource management skills are reliable.

3.8 We focused on three aspects which, while there is evidence of good practice, further progress is needed.

(i) Involving those responsible for delivery in decision making

3.9 The successful conversion of resources into services is put at serious risk where all key organisations contributing to the delivery of a service are not involved in important decisions concerning customer needs, how they can be best met and the associated resource implications. Often organisations depend on others to provide supporting or complementary services or infrastructure. For example,

- The Highways Agency is responsible for the delivery of the major road projects as part of the 10 Year Plan for Transport. The Agency does not, however, itself decide which schemes are to be constructed. This is a matter for the Department for Transport which in turn depends on the outcome of studies carried out by government offices for the regions.

- The Housing Corporation is responsible for promoting the delivery of social housing by housing associations. Establishing new sustainable communities also requires better roads, schools and other infrastructure which are the responsibility of local authorities and other agencies. The Housing Corporation has planning arrangements designed to reconcile its own local and national priorities, but it also has to seek to influence those providing supporting services.

3.10 In contrast the Teacher Training Agency is now actively involved in the Department for Education and Skills' modelling of the future supply of teachers and whether this is likely to meet demand. This increased collaboration reflects the need for reliable information on the capacity of training providers to handle increases in teacher recruitment.

3.11 Even if they are not directly participating in decision making it is important that all delivery partners are aware of the basis for allocating resources as early as possible. This should enable them to plan their own activities in a timely and effective manner. To this end the Teacher Training Agency has recently started to publish its board meeting papers to promote a wider understanding of the decisions behind its policies and programmes.

3.12 Departments can also benefit from participation in wider networks of organisations with shared interests. The Serious Fraud Office is, for example, a member of the Financial Fraud Information Network which brings together regulatory and law enforcement agencies and other bodies with public functions. The objective of the network is to encourage the exchange of information between its members on actual or suspected criminal activity that makes use of or impacts on the UK financial system. The Office also participates in a Joint Vetting Committee with the Crown Prosecution Service (who are responsible for the prosecution of criminal cases investigated by the police in England and Wales) and the police. These liaison arrangements, to differing degrees, help ensure that cases are dealt with by the most appropriate organisation and that participants are aware as soon as possible of any changes in their potential case load.

3.13 *While departments are focusing more on identifying the key organisations which are critical to service delivery the extent to which all are regularly consulted and contribute to key decisions which could influence service quality is more variable. It is usually, however, those organisations most involved in delivering services to the public who are best placed to advise on how resources can be deployed most effectively*.

(i) Providing support to delivery partners

3.14 To maximise the potential to deliver better services departments often need to provide support to develop the capability of those organisations on which they depend. In the seven years before 2000-01 the Teacher Training Agency failed to achieve target numbers of newly qualified teachers. The Agency addressed this through better and more targeted advertising and recruitment but it also changed how resources were allocated to training providers to give them greater financial stability as an incentive to encourage investment and growth **(Figure 29)**. This approach required not only a better understanding of the graduate recruitment market but also the capability of key organisations in the delivery chain. The latter led to the recognition that more needed to be done to strengthen the capability of training providers.

29 The Teacher Training Agency: Developing the capability of delivery partners

Action taken in response to meet teacher recruitment targets included:

Better understanding of the recruitment market

- Using market research better and developing new or expanding existing ways of recruiting teachers such as the Graduate Recruitments Programme, an innovative employment based route to teacher training.
- Developing an integrated advertising and recruitment campaign and through careful monitoring of its success refining and targeting priority areas.
- Developing better communication with potential recruits to respond to enquiries and direct them to training providers.

Understanding capacity constraints of delivery partners and helping to address them

- Annual meetings with training providers to identify problems and practical solutions and consult on the criteria for allocating intake targets and funding.
- Refocusing the allocation methodology to secure financial stability for training providers as an encouragement for investment, while providing incentives for achieving targets.
- Streamlined sector regulation to increase efficiency, reward higher quality providers with fewer full inspections and provide greater support to under-achievers.
- Supporting the development of sector capacity and flexibility through workshops to improve recruitment and customer care strategies, and implementing support mechanisms and financial incentives for partnerships.

Source: NAO examination of the Teacher Treasury Agency (more details are provided in case study 2)

3.15 The Highways Agency depends heavily on civil engineering skills which are nationally in short supply. To address this the Agency has developed strategic partnerships to encourage contractors to invest in their long term engineering capacity. The Serious Fraud Office has some of the longest and most resource intensive cases that go before the courts. The Office depends on the Court Service to ensure that delays in hearings are kept to a minimum. To achieve this it has invested in better co-ordination so that a court room is booked well in advanced, only judges experienced in fraud cases are assigned and the special arrangements for jury selection are progressed quickly.

3.16 *One of the most significant risks to improving public services is the capability of all organisations involved in the delivery of a service. If just one organisation underperforms or encounters some difficulties a whole service may be put at risk. Departments need to seek regular assurance about their delivery partners' resource management and other capabilities and where necessary seek to strengthen them*.

(ii) Developing resource management skills

3.17 Resource and project management that delivers programmes to cost, time and quality standards are essential. The Office of Government Commerce has initiatives underway to strengthen project management skills. But high quality resource management skills are likely to be in limited supply for some time in many departments. The best use must therefore be made of those skills that are already available. The Department of Trade and Industry and the former Lord Chancellor's Department for example, assign financial specialists to each of their key activities. This is similar to private sector experience where financial managers often have dual responsibilities reporting both to the finance director to ensure consistent professional standards and to operational directors to provide resource management advice in the delivery of services.

3.18 The experience of National Savings and Investments is a good example of initiatives to improve resource management capabilities. These included greater involvement of the private sector, more emphasis on commercial skills, commensurate with the main function of the Agency and closer links between staff experienced in financial and project management **(Figure 30)**.

30 National Savings and Investments: Developing capabilities

The National Savings and Investments Agency helps to finance government borrowing by offering saving products such as income bonds and saving certificates directly to the public. In response to out of date IT systems some of which were 15 years old, limited project management capacity, a lack of sufficient financial expertise, and high staffing levels the Agency took action on a number of fronts.

Strategic partnership: In 1999 the Agency transferred its operations, the bulk of its staff and the 11 product delivery systems to Siemens Business Services. The contract required Siemens to develop and operate modern systems and capabilities to deliver service improvements. Together the Agency and Siemens developed an operational strategy programme to encourage joint working in building a low cost high productivity service and to re-shape the business to reduce costs and improve customer service. These arrangements have halved staffing levels to about 2,000 at a time when business has grown.

Project Management: A new project management process was established introducing more rigour and reducing the number of projects, with staff no longer having both project management and operational responsibilities. This change is intended to increase the quality of financial and project management by making it more professional and focussed.

Emphasis on commercial skills: Staff with proven commercial skills have been recruited to manage projects such as the new Easy Access Savings Account.

Embedding financial disciplines throughout the organisations: Qualified finance staff are now assigned to each operational directorate to promote more informed consideration of the financial implications of decisions.

Source: NAO examination of National Savings and Investments

Appropriate flexibility to encourage innovation

This typically requires:

- Ensuring that how resources are allocated both within departments and to partner organisations encourages sensible and well managed risk taking.
- Ensuring regulatory frameworks are flexible and do not unduly stifle risk taking and innovation.
- Providing incentives to achieve key deliveries.
- Delegating appropriate authority and flexibilities internally and to delivery partners.

3.19 Challenging long established ways of working, harnessing advances in technology and learning from other organisations are all key to improving public services and value for money. How resources are allocated can significantly influence how willing organisations and their staff are to be innovative. For example, certainty about funding over a number of years is more likely to encourage investment to develop key capabilities. Rewarding good performance with additional funds together with increased flexibilities and freedoms to take decisions can also be a major incentive. In the social housing sector for example, housing associations' tendency to rely on traditional, and potentially less effective onsite methods of construction could impede progress in tackling the housing shortage. The Housing Corporation is therefore using its allocation of grants to encourage delivery partners to rethink their approach. For example, the Corporation has set up a Challenge Fund to encourage housing associations to have longer term construction partnerships that adopt more efficient working practices such as building homes for later assembly onsite.

3.20 Unnecessarily prescribed and rigid regulatory regimes with harsh penalties for underperformance can have the opposite effect to that intended and contribute to poor performance - they can also stifle innovation. Two of the organisations which we examined in some depth have some regulatory responsibility and both have recognised that better performance requires a more flexible approach.

- The Teacher Training Agency is responsible for regulating providers of Initial Teacher Training and works closely with the Office for Standards in Education. The Agency has streamlined its regulatory framework to focus on consistent underperformers. Training providers which achieve good quality grades are given higher levels of guaranteed funding and potentially fewer full inspections. If quality standards are not achieved the training organisations are given time and support to remedy the underperformance. Any decision on a financial penalty is deferred until reinspection results are known.

- A new Regulatory Code has been established setting out standards to be met by housing associations. The Code was strengthened in response to the wider range of organisations and individuals becoming registered social landlords. The code has the dual purpose of **(i)** giving the Housing Corporation more confidence in the capacity of the housing associations to which it allocates resource to maintain high standards while **(ii)** also promoting private sector support for social housing by giving assurance about the security of investments.

3.21 There are of course risks involved in providing greater freedom to take decisions but this can be managed. For example, the Highway Agency manages the risks associated with a greater delegation of responsibility to its contractors and other delivery partners through a programme of financial review and audit to provide assurance that agents are complying with agency agreements, implementing best practice and delivering value for money. The emphasis on partnership is being enhanced by using Performance Review Improvement Delivery groups to support operational teams to develop quality and compliance systems covering the new contractual arrangements. An incentive to promote innovation is still retained by setting performance targets that are benchmarked against the best industry standards.

3.22 *Departments are increasingly recognising the importance of innovation and are considering ways in which resources can be allocated to support it. Delegating greater freedom to take decisions can help* **(Figure 31)**. *Determining the level of delegation that is appropriate requires that departments assess the risks inherent in the service delivery chain and ensure that authority to take decisions is commensurate with the risks involved*.

31 The Dutch education sector: Allowing greater flexibility to improve performance

There is a growing shortage of primary teachers in the Netherlands with an estimated extra 28,000 required between 2003 and 2006 to replace those nearing retirement. Dutch schools are funded by the Centrale Financiele instelligen (CFi), an agency of the Ministry of Education, and traditionally have had little discretion over the salaries paid to their teachers.

To provide greater flexibility in the use of teaching resources and encourage innovation, the Ministry of Education introduced a number of initiatives including:

- A scheme in 2002 to test the effectiveness of allowing schools to create new teaching roles such as assistant teachers (`Functional Differentiation'), and to introduce team teaching. For example, in a middle sized town four classes from the top years of primary schools were merged and split into three mixed classes with pupils from both years. Each of these classes was assigned a full time teacher, supported by two part time assistant teachers.

- The 'Sideways Inflow' scheme in 2000-01 to allow graduates who have pursued other careers to transfer to teaching by training for a year mostly in a school. The scheme is administered by an agency responsible for teacher training, but the training and costs are borne by the school where the training is undertaken. In the first year uptake was very low as schools had insufficient funds to cover training costs and due to initial resistance to the concept amongst existing teachers. In 2001-02 schools were allocated more resources to fund the scheme resulting in greater uptake.

Source: Research carried out by RAND Europe for the NAO

Using management information to make better use of resources and improve efficiency

This requires:

- timely information to the Board and managers that links performance and resource utilisation to targets and is used to inform decisions on resource allocation and service delivery
- information systems that meet the needs of the organisation
- reliable information being used to influence resource allocation and review performance

3.23 Most departments and agencies have underway projects to improve their management information usually to link resource utilisation to measures of performance. In the private sector there is usually, however, a greater expectation that management information will be reliable, provided quickly and assist decision making. The main motivation for this is that failure to identify cost escalations, inefficiency or underperformance quickly can have an impact on profits. But even in the private sector there remain concerns that information is often not sufficiently focused on key performance issues[16]. In particular too much reliance on traditional accounting measures such as return on investment can provide a too narrow point in time assessment with as a result insufficient effort being given to continuous improvement.

3.24 The move to resource budgeting and supply has been a major incentive for departments to improve their management information. While this is beginning to have a beneficial impact in improving resource deployment and assessing performance more widely spread progress is needed in a number of areas:

- **Better integration**. Information generated to produce annual financial statements and that on the cost of services should be more routinely integrated and whenever practicable produced from the same resource information system. In this way the full cost of programmes including their use of public assets as measured by a depreciation charge can be identified and monitored.
- **Monitoring commitments**. Most departments enter into major expenditure commitments against which payments may be made over many months or years. If information on commitments is not available and regularly reconciled with actual payments expenditure cannot be managed effectively to avoid under or over spending.
- **Completeness**. Departments now produce a range of information on performance for example, covering the time it takes to deliver services, number of people receiving a grant or other assistance, productivity in delivering services and quality measures. Cost is also an essential component. In assessing performance departments need a portfolio of measures but these should be fully integrated with information on cost and resource utilisation.
- **Consistency**. An accurate assessment of services delivery will be deficient unless all those organisations contributing to service delivery produce compatible information to monitor performance and do so on a consistent basis **(Figure 32)**. The former Lord Chancellor's Department for example, concluded that better resource management would be achieved by sharing the same financial systems as the Court Service, the Public Guardianship Office and the Legal Services Commission.

32 The Housing Corporation: information provided on a consistent basis throughout the delivery chain

The Housing Corporation's new management information system contains data directly input by housing associations. This has led to two important benefits:

- Housing Associations can calculate for themselves the level of grant to which each of their schemes may be entitled, and can monitor the progress of their schemes through the Corporation's approval processes; and
- the Housing Corporation has access to up to date information on Housing Associations' performance that can be used in allocating resources.

Source: NAO examination of the Housing Corporation (more detail is provided in case study 3)

- **Achieving efficiency**. In the private sector sound financial performance necessitates careful monitoring of operating costs, the efficiency with which assets are used and levels of work in progress. Failure to do so could put profits at risk. Accruals based information is a key tool which companies rely on. While financial performance is not such a key factor in the public sector the efficiency with which assets are used can significantly influence service delivery. As yet, however, resource based information is not generally widely used by departments as a means to monitor and improve efficiency. **Figure 33** illustrates how resource information can be used to improve efficiency.

16 *A report by KPMG - 'Achieving measurable performance improvement in a changing world' 2001 found that some 49 per cent of private sector managers were not satisfied with the information they received.*

33 Six key aspects of performance which departments' management boards should routinely consider to ensure that resources are being used efficiently

Asset utilisation	Departments have assets ranging from land and buildings, equipment, vehicles, IT and computer software including licenses. **How assets are utilised should be regularly reviewed by Boards to assess their contribution to the departments' core activities; to identify any spare capacity; and to dispose of assets surplus to needs**.
Full resource cost of programmes	Boards should have regular reports on the full resource costs of key services and activities with costs attributed to outputs. Such information should include all overheads and depreciation. In this way Boards can monitor the full resource cost of services including the consumption of assets. **Such information should be used by Boards to question regularly whether resource costs are justified in terms of the level and quality of outputs/services delivered**.
Balance between direct costs and overheads	Without close monitoring overheads which do not directly contribute to a service or activity can increase and consume significant resources which would be better deployed on frontline services. **Boards should clearly define what is an acceptable overhead including expenditure on corporate support activities; they should have regular information on resources consumed by overheads; and frequently question whether the balance between direct work contributing to core activities and indirect work remains justified. There is a tendency to forget cinderella services such as utilities and maintenance which because they may be less routinely monitored become inefficient or uneconomic**.
Stock and work in progress	Stock is a resource held as part of the means of meeting present and future demand for services. For example, the Highway Agency's holding of grit to spread on icy roads, or holdings of non-issued driving licences, passports and applications for benefits. 'Work in Progress' represents resources consumed by services or assets yet to be delivered such as military equipment under construction. **Boards need to monitor stock and work in progress because consistently high levels may suggest that resources are being used inefficiently**.
Productivity	Departments and agencies employ considerable numbers of staff who should be deployed cost effectively. **Boards need to monitor the productivity achieved by their staff in delivering core activities. Using internal and external benchmarks Boards should be able to identify unproductive staffing requiring action**.
Cash management	Expenditure should be well planned and spent in a way that reflects service and business needs. **Boards require frequent information on expenditure profiles and how these compare with planned spending patterns. This should enable Boards to identify likely underspends in sufficient time to reallocate funds to other priorities**.

Source: National Audit Office

Appendix 1 Methodology

Our methodology consisted of:

Case study examination	Highways Agency Teacher Training Agency Housing Corporation Serious Fraud Office
Structured interviews focusing on how departments and agencies manage their resources	Cabinet Office Office of the Deputy Prime Minister Department for Trade and Industry Foreign and Commonwealth Office Lord Chancellor's Department National Savings and Investments (an executive agency of the Chancellor of the Exchequer)
Evidence from the National Audit Office's financial audit of departments and agencies	The NAO are the external financial auditors of all departments and agencies and we drew on the results of this work specifically on progress in implementing new resource management arrangements, the barriers to further improvements and examples of good practice.
International comparisons	We commissioned RAND Europe, a non-profit independent policy research institution with extensive worldwide contacts to prepare a report on the approach used by public bodies overseas to convert resources into improved services. RAND focused on examples in three countries the Netherlands, Germany and the United States.
Private sector comparisons	We engaged professional business advisers KPMG to prepare a report, supported by examples of good practice of how private sector organisations use: ■ business planning, budgeting, forecasting and other mechanisms to allocate resources to activities; ■ performance management tools and techniques to monitor and review the allocation of resources; ■ post-programme reviews to inform future decisions on investments.
Local authority comparisons	We sought information on local authorities' approach to resource management from a London Borough (Westminster); and a Metropolitan District (Wigan MBC). Each local authority had received an excellent overall Comprehensive Audit Assessment from the Audit Commission and the highest score for the component covering resource management.

Glossary

Accruals accounting
Accruals accounting shows departments' expenditure and income as it is incurred or earned rather than when amounts are paid or received (as was the case with cash accounting).

Annually Managed Expenditure
Public expenditure that is managed annually because it is less able to be estimated or controlled by the department over a longer period. For example, expenditure on benefits is highly demand-led and budgeted for on annual basis.

Balance sheet
A financial statement, which shows the assets, liabilities and capital of an organization on a particular date, normally the end of the accounting period.

Capital spending
Expenditure on fixed assets.

Cash accounting
A method of accounting which records cash payments and cash receipts as they occur within an accounting period.

Cost of Capital
The government as a whole incurs an interest cost for borrowing to finance investments by departments. This is also described as the Government's cost of capital. To improve transparency and to ensure the full cost of services is reflected in departmental accounts, this borrowing cost has been devolved to departments as a 'capital charge'. In general terms, the capital charge is calculated as a percentage of the department's net assets (assets less liabilities) and is charged to the Revenue section of its Resource Account.

Departmental Expenditure Limit
The three year budget provided to departments on a biennial basis covering activities where it is possible to forecast the level of demand and resource three years in advance. Departmental Expenditure Limits identify separate elements for capital and current spending. A separate budget may be provided on annual basis (see Annually Managed Expenditure).

Departmental Investment Strategy
Departmental Investment Strategy sets out the department's plan to deliver the scale and quality of capital needed to underpin the Government's proposed improvements in public services. Each Departmental Investment Strategy sets out: a strategic policy context; current asset base; new investment plans; and systems and processes.

Departmental Reports
In spring of each year, departments publish their departmental reports. The reports are one of the main vehicles for presentation of Government spending plans and information about progress against departmental objectives and performance targets. They provide context for Parliamentary consideration of the Estimates and are an important part of the process by which departments publicly account for themselves. In addition to producing printed copies, departments must make versions of their reports available on their public websites.

Depreciation
A measure of the wearing out, consumption or other reduction in the useful life of a fixed asset whether arising from use, passage of time or obsolescence through technological or market changes. The cost is charged to the revenue section of the Resource Account, in other words is a charge against current expenditure.

Direct work All work that can be identified with delivering a service as opposed to an overhead.

Efficiency The rate at which inputs are turned into outputs. A department can be said to be more efficient if it is achieving the same quality and quantity of outputs at lower cost; or getting more output at the same cost.

End year flexibility A mechanism to allow unspent provision in the Departmental Expenditure Limit in one year to be carried forward to the next to encourage good financial management.

Excess vote If circumstances lead to an excess of expenditure above that allowed in the Departmental Expenditure Limit the necessary additional provision is sought in an Excess Vote and is usually presented by the Treasury at the time of the Spring Supplementary Estimates in the following financial year.

Generally Accepted Accounting Practice The practice adopted by United Kingdom companies in preparing accounts to give a true and fair view as required under the Companies Act.

Investment Purchase of assets to deliver services or produce goods over several, usually at least three, years. The opposite of revenue expenditure or spending to deliver services in the current year.

Nugatory expenditure Expenditure that fails to produce the intended output.

Overheads Expenses other than the costs of labour and materials directly used to deliver a service or produce a good, for example the cost of senior management or of the building where the service is delivered.

Parliamentary Supply Procedure The arrangements for control of expenditure where Parliament approves departments' requests for resources.

Public Service Agreement Public Service Agreements describe what a department will deliver in the form of measurable targets over the public expenditure review period, in return for its resource budget.

Resource accounting A method of recording expenditure as it is incurred and income as it is earned during an accounting period based on accruals method of accounting in accordance with generally accepted accounting practice. Resource accounting replaced cash accounting which recorded payments and receipts when they were paid or received. Resource Accounts are prepared annually and present the financial results of a department for the relevant financial year.

Resource budgeting Resource budgeting involves using resource accounting information as the basis for planning and controlling public expenditure. Unlike the previous cash based approach, it requires departments to consider the costs of capital consumption, and to match their costs to the time of the related service delivery activity.

Revenue expenditure Expenditure that is charged completely to the Resource Account in the accounting period in which it is spent, for example salaries and wages.

Reverse end year flexibility	A mechanism to allow Departments to bring forward the next year's expenditure into the current year.
Service Delivery Agreement	The Service Delivery Agreements set out in broad terms how a department's Public Service Agreement (what a department will deliver in the form of measurable targets in return for its resource budget) targets will be achieved.
Spending reviews	Spending reviews set out the budgets to be managed by departments for the next three years. The first spending review in 1998 was called the Comprehensive Spending Review. Since then they are referred to as Spending Reviews. They are currently conducted on a biennial basis with the 2002 Spending Review setting budgets for 2003-04, 2004-05 and 2005-06.
Supply Estimates	The means by which departments seek Parliamentary authority for their spending each year. Following the introduction of resource accounting, Parliament approves the resources the department will consume as well as the cash it spends. Supply Estimates are granted for one financial year at a time.
Total Managed Expenditure	The total of resources allocated to a department in any one year is known as Total Managed Expenditure, comprising the Departmental Expenditure Limit plus Annually Managed Expenditure.

Reports by the Comptroller and Auditor General, Session 2003-2004

The Comptroller and Auditor General has to date, in Session 2003-2004, presented to the House of Commons the following reports under Section 9 of the National Audit Act, 1983:

			Publication date
Cross-government			
Managing resources to deliver better public services	- Report	HC 61-I	12 December 2003
	- Case studies	HC 61-II	12 December 2003
Defence			
Operation TELIC - United Kingdom Military Operations in Iraq		HC 60	11 December 2003

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