National Audit Office

# DEPARTMENT FOR ENVIRONMENT, FOOD AND RURAL AFFAIRS
## Management of Expenditure

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 309 Session 2007-2008 | 6 March 2008

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Ordered by the
House of Commons
to be printed on 3 March 2008

LONDON: The Stationery Office
£13.90

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This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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**Comptroller and Auditor General**
**National Audit Office**

**28 February 2008**

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# SUMMARY


**1** The Department for Environment, Food and Rural Affairs (the Department) is responsible for tackling climate change, maintaining our natural environment and delivering a range of other services and operations. In 2006-07, 41 per cent of the Department's funding was used by the Department's 31 delivery bodies, such as the Environment Agency and Natural England. The Department and its delivery bodies were set a Departmental Expenditure Limit of £3,617 million by the Treasury in 2007-08.

**2** The Department has managed within its resources for each year since it was established in 2001, and reduced its level of underspending from £258 million in 2003-04 to just £1 million in 2005-06. In 2006-07, the Department identified a risk of overspending and cut its planned budgets by some £170 million mid year, including those of some of its delivery bodies. The Department secured £305 million in additional ring-fenced funding for potential CAP disallowance which enabled it to remain within the overall expenditure limit. It required £198 million to increase its provisions for disallowance, and as a consequence, the net difference of £107 million enabled it to underspend against its Departmental Expenditure Limit by £44 million.

**3** The quality of the Department's financial management has been questioned by a number of external stakeholders in the past, including the Environment, Food and Rural Affairs Select Committee[1] and the Cabinet Office's capability review.[2] Following the appointment of a new Accounting Officer in November 2005, the Department instigated a "Renew Defra" programme to improve its overall performance, and a change in Finance Director, in April 2007, has led to the development of a Financial Management Improvement Programme which aims to:

- **Ensure that only the resources available to the Department are allocated to budget holders.**
- **Improve the quality and timeliness of the Department's month-end financial reporting.**
- **Improve financial management capabilities across the Department.**
- **Achieve faster preparation and completion of its annual accounts.**

**4** The Financial Management Improvement Programme action plan defines a series of tasks needed to improve financial management within the Department and allocates responsibility for implementation to named individuals by specific dates. Introducing a culture of tighter financial management is likely to take time. This report looks at the reasons underlying the Department's difficulties in managing its expenditure, the actions it has taken and its plans to improve further its management of expenditure, and makes recommendations on areas requiring further attention by the Department.

## Overall conclusion

**5** Holding managers to account for the resources they have been allocated is key to improving financial management performance. This need has been recognised by the Department's Management Board and reflected in the action they have put in hand to improve financial management. For longer term success, this initiative will need to remain a top priority for senior officials in the Department and its delivery bodies, and managers throughout the organisation will need to produce reliable cost estimates of activities and objectives to justify resource bids and track the cost-effectiveness of work done. Without these key factors, resources will not be utilised in the most cost effective manner in support of the Department's strategic objectives, putting at risk the value for money of its services, projects and policy initiatives.

**6** Drawing on the Department's existing plans, the key elements of good practice for success in improving financial management and changing attitudes are as follows:

- **Allocate funds according to the strategic objectives of the organisation.**
- **Set budgets based on work plans and challenge them closely.**
- **Hold managers to account for the management of their resources.**
- **Raise the profile of financial management through rigorous scrutiny and debate at Management Board meetings enabling early corrective action to be taken to address emerging risks.**

### Allocate funds according to the strategic objectives of the organisation

**7** The Department and some delivery bodies have prepared business plans and corporate strategies by function and not by the Department's or their own organisation's corporate objectives. Under the 2007 Comprehensive Spending Review, the Department's overall budget will grow by 1.4 per cent in real terms[3] between the years 2008-09 and 2010-11, but the growth is largely restricted to capital projects such as flood defences and waste management facilities. These tight financial constraints will require difficult management decisions on where funds should be allocated, and such decisions will be better informed if financial resources are allocated by strategic objectives rather than by operations or functions alone. The Department is in the process of allocating its resources for 2008-09 to 2010-11 on this basis, but the methodology is new to the Department and it will be important for it to maintain focus on this key issue.

1 *Environment, Food and Rural Affairs Select Committee, 2nd report 2006-07*, HC 132, February 2007.
2 *Cabinet Office: Capability Review of the Department for Environment, Food and Rural Affairs*, March 2007.
3 This is based on a forecast annual inflation rate of 2.7 per cent.

## Set budgets based on work plans and challenge them closely

**8** Some of the Department's delivery bodies, such as the Environment Agency and Animal Health, build their budgets from their work plans but others set their budgets on the same basis as the prior year plus or minus any overall percentage change in the funding available. The latter approach fails to challenge the relevant organisation to demonstrate that it is improving its efficiency and its effectiveness in delivering its objectives and those of the Department. Just under two thirds of the budget holders we surveyed agreed that their budgets were challenged on a line by line basis but the remainder did not report a challenge of this kind. The structure and methods used by the Department to scrutinise delivery bodies' budgets could be enhanced by applying a framework, tailored to take account of each delivery body's size, independence and importance to the Department's strategic objectives. Such a framework would enable the Department to challenge discussions on the following lines:

- **Reviewing the realism of the budgets**. The review could include a comparison of overheads to operational costs, analysis of the costs per service delivered, and comparison of running costs with expenditure on assets. The results of this preliminary review could identify areas requiring more challenge using the methods below.
- **Prioritising spend between essential and desirable levels of performance.** By developing business plans based on a range of different levels of funding and activity levels, officials would be better placed to differentiate between essential and desirable levels of performance.
- **Analysing the risks to delivery.** By comparing the likelihood of the key risks to delivery being realised with their estimated impact on delivery, managers could better review each month whether the forecast spending for the remainder of the year is likely to be achieved.

**9** The Department has taken steps to focus resources on its key priorities through its Renew Defra change programme, and staff have reviewed the realism of budgets to reflect the tight financial constraints of the 2007 Comprehensive Spending Review settlement. The longer term success of the Department's initiatives to improve its resource allocations, however, will depend upon embedding such efforts into the budgeting process each year.

## Hold managers to account for the management of their resources

**10** The Department's Management Board agreed budgets at the start of 2006-07 and 2007-08 which exceeded the funds available, partly because budget holders had typically over-estimated their forecast spending in previous years, and the Board felt that the over-allocation would be recoverable before the end of the relevant year. The absence of realistic spending limits cascaded to each team and the mismatch with the total resources available to the Department made it difficult to agree budget revisions without lengthy discussions.

**11** Improving financial management within the Department will require the Management Board to take a corporate approach, based upon strategic objectives, to the allocation of available resources. Bids by their staff should be for a realistic level of resources required to deliver objectives. The Department reports that the process of allocating funds from the 2007 Comprehensive Spending Review period shows progress in this regard and that the Renew Defra change programme will embed this approach into the routine management of the Department.

### Raise the profile of financial management through rigorous scrutiny and debate at Management Board meetings enabling early corrective action to be taken to address emerging risks

**12** Without detailed budgets which profile plans on a month by month basis, and which match the total resources available, variations from plan are difficult to detect at a sufficiently early stage to enable corrective action. Our review of the Department's teams responsible for monitoring progress by delivery bodies found that while individuals asked intelligent questions, there was insufficient evidence of a methodical and structured approach to scrutinising plans and budgets. Effective monitoring of progress by the Department's Management Board had been hampered by delays in agreeing budgets, a lack of integration between the arrangements for monitoring performance delivery and financial expenditure, and then in profiling the expected expenditure. This was due in part to the failure of some of the Department's delivery bodies to provide timely data.

**13** The Department has taken steps to encourage better co-ordination between performance and financial control by appointing financially qualified Heads of Finance and Business Affairs within each Director General's Group. This is an important role and their contribution would be enhanced by closer working with policy colleagues to analyse and validate integrated financial and performance data for the Department's Management Board, as part of the monthly monitoring processes.

**14** Audit Committees provide support for better financial management and the Department's Audit and Risk Committee has a valuable role in scrutinising the Financial Management Improvement Programme instigated by the Interim Finance Director General. The Audit and Risk Committee has taken a keen interest in the preparation of the Department's annual Statements of Internal Control and the assurance these Statements provide to the Permanent Secretary. It was involved in the oversight and assurance of the Department's 2006-07 accounts and is playing a key role in seeking to ensure that the 2007-08 accounts are finalised on time.

## Recommendations

**15** Better management of expenditure across the Department depends upon further improvement in the application of the four good practices we identified in paragraph 6 above. More specifically, we recommend that the Department's Management Board:

- **i** Set budgets for 2008-09 onwards that balance with the funding from the 2007 Comprehensive Spending Review settlement.
- **ii** Ensures that its budgets and those of the delivery bodies accord with the Department's and the delivery bodies' strategic objectives each year.
- **iii** Develops a range of measures to benchmark forecast spending each year across its different activities, to enable senior officials to probe the rigour of the budgets set and to determine more methodically whether there are any resources that could be re-allocated to support the Department's strategic objectives.
- **iv** Incorporates the performance of budget holders in managing their resources into each staff appraisal and associated personal development plan, determining any skills gaps amongst budget holders so that suitable training courses can be developed.
- **v** From 2008-09, specifies the timing and information required in the monthly progress reports (to include integrated performance and finance data) from each delivery body to enable the sponsoring Directors General to engage more effectively with the delivery bodies and to respond to challenges at the Department's Management Board meetings.
- **vi** Tasks the Department's Audit and Risk Committee to continue to support and scrutinise improvements in financial management by following up the Interim Finance Director General's Financial Management Improvement Programme and the National Audit Office's recommendations with regular reviews of progress.

# PART ONE

# Introduction

## Background

**1.1** Departments rely upon taxpayers' money to deliver the services, projects and other initiatives required to achieve their strategic priorities. In 2006-07 the Department for Environment, Food and Rural Affairs (the Department) spent £3 billion on day to day activities and £0.9 billion on purchasing capital assets **(Figure 1)** for a range of government policies, including tackling climate change, and maintaining a healthy, resilient and productive environment **(Figure 2)**. In addition, the Department had to be ready to respond to potential emergencies such as flooding or outbreaks of animal disease. The delivery of services, projects and other initiatives rest with the core Department, its 31 delivery bodies, plus 27 advisory and tribunal non-executive non-departmental public bodies, (see Appendix 1 for an overview of the Department's delivery bodies).

**1** A summary of the Department's Budgets and Actual Expenditure in 2006-07

| **Budgets** | | **Actual Expenditure** | |
|---|---|---|---|
| Resource | £ | | £ |
| Budget for current expenditure | 2,917,643,000 | Actual current expenditure | 3,036,288,000 |
| Unspent funds carried forward from previous years drawn down in 2006-07 | 50,000,000 | | |
| Other net increases to resource budget during 2006-07[1] | 228,040,000 | | |
| Funds switched from resource to capital | (99,000,000) | | |
| **Total resource budget** | **3,156,683,000** | **Total resource expenditure** | **3,036,288,000** |
| | | Underspend[2] | 120,395,000 |
| Capital | | | |
| Budget for purchasing assets for long term use | 772,000,000 | Purchase of assets for long term use | 923,890,000 |
| Unspent funds carried forward from previous years drawn down in 2006-07 | 25,000,000 | | |
| Increases to capital budget during 2006-07 | 226,000 | | |
| Funds switched from resource to capital | 99,000,000 | | |
| **Total capital budget** | **896,226,000** | **Total capital expenditure** | **923,890,000** |
| | | Overspend | 27,664,000 |

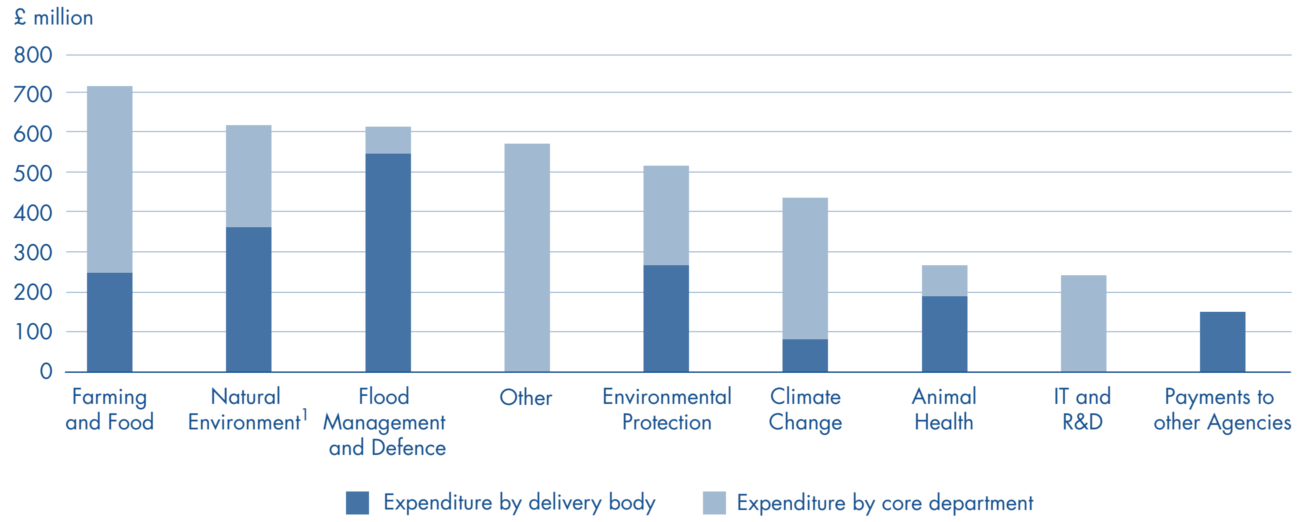
*Source: The Department for Environment Food and Rural Affairs*

NOTES

1 This includes £305 million ring-fenced funding to cover potential disallowance of Common Agricultural Policy expenditure by the European Commission.

2 When calculating total Departmental expenditure underspending £49 million of the resource underspend relating to depreciation is excluded to avoid double counting.

**2** Departmental Expenditure by major programme in 2006-07




*Source: National Audit Office analysis of March 2007 Finance Report to the Department's Management Board*

NOTE
1 The English Rural Development Programme falls in the Department's budget although it is administered by Natural England and the Rural Payments Agency.

**1.2** Each Department's expenditure limits are agreed with the Treasury as part of a Spending Review for a three year period. This longer time frame enables managers in the core Department to plan ahead with some certainty, and Departments are expected to prioritise accordingly to keep within the separate budgets set for current expenditure (the resource budget) and for investment in assets for continuing use by the organisation (the capital budget). Departments may draw down unspent Departmental Expenditure Limit provision from one year to another, subject to the Treasury's agreement. The Treasury may agree to increase the resources available where the Department is faced by an unforeseen or exceptional event.

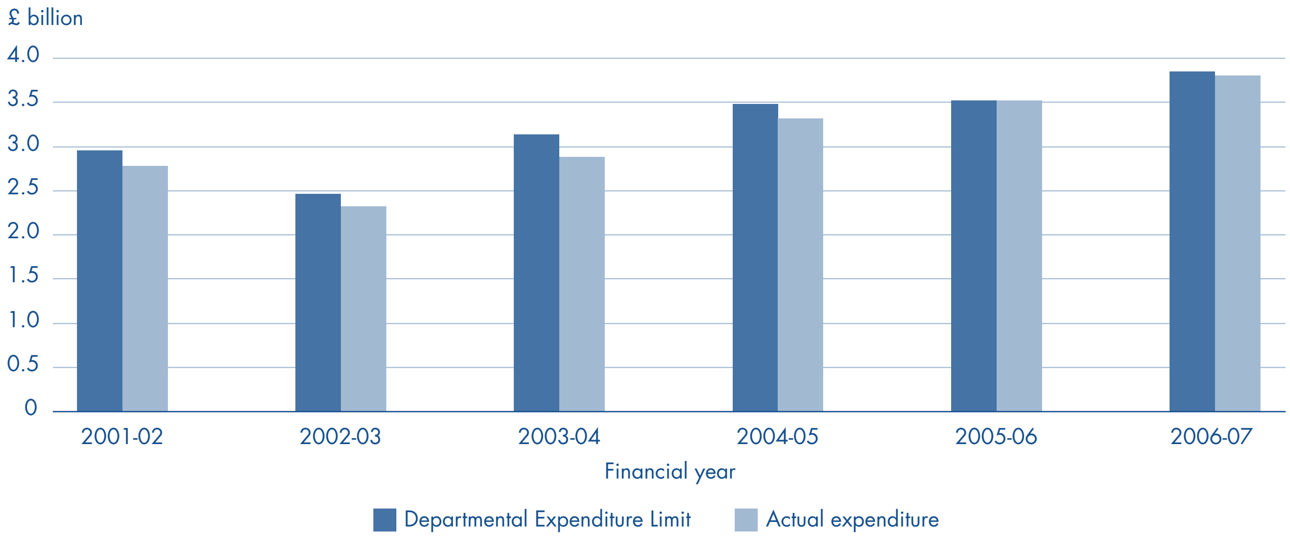
## The Department has recognised the need to improve its financial management

**1.3** Since it was established in 2001, the Department has kept spending within the Departmental Expenditure Limits agreed with the Treasury while reducing its level of underspending from £258 million in 2003-04 to just £1 million in 2005-06, equivalent to 0.03 per cent, see **Figure 3 overleaf**. There is greater pressure from Treasury and from Parliament on departments to avoid overspending than underspending. Our review of the extent to which departments had spent less than their resource budgets in 2006-07 confirmed that the Department's underspending, in percentage terms, was close to the average for all departments.

**1.4** In May 2006, the Department's Management Board recognised that the Department faced a significant risk that it would exceed its Departmental Expenditure Limit for its resource budget in 2006-07. The Department asked all areas of its business, including its delivery bodies to identify areas of expenditure where savings could be made. This generated savings of £170 million. The timing of the resulting budget reductions mid-way through the financial year had some adverse impacts on policy delivery (Appendix 2) and a subsequent investigation by the Environment, Food and Rural Affairs Select Committee[4] concluded that there had been a failure in financial management by the Department. The Department secured additional ring-fenced funding for potential CAP disallowance, which enabled it to remain within the overall expenditure limit.[5] Within the 2006-07 expenditure total the Department overspent against its capital limit by £27.7 million (three per cent). According to the Treasury it was the only department to overspend against its capital Departmental Expenditure Limit in 2006-07.[6]

4 *Environment, Food and Rural Affairs Select Committee, 2nd report 2006-07*, HC 132, February 2007.
5 The Department received an additional £305 million in 2006-07 to take account of the risk of disallowance by the European Commission of Common Agricultural Policy expenditure. The additional funding was ring-fenced and could not be spent elsewhere. In practice, the Department required £198 million to increase its provisions for disallowance and, as a consequence, the difference of £107 million enabled it to underspend against its Department Expenditure Limit by £44 million.
6 *Public Expenditure Outturn White Paper 2006-07*, pages 1 and 13. There were no breaches of resource Departmental Expenditure Limits in 2006-07.

**3** The Department's actual expenditure came close to its total Departmental Expenditure Limit[1] in 2005-06




*Source: The Department. The actual expenditure figures differ from the outturn figures in the Departmental Report, as those have been revised to take account of changes to Treasury rules that were not in force at the time*

NOTES

1 The total Departmental Expenditure Limit is the resource budget plus the capital budget less depreciation to avoid double counting.

2 The unspent funding in 2006-07 relates to penalties which may be imposed by the European Commission in respect of the single payment scheme. These funds were 'ring-fenced' and could not be spent on the Department's other activities.

**1.5** While the budget cuts made by the Department in 2006 were necessary to avoid the risk of overspending in 2006-07, the Accounting Officer recognised that longer term changes were necessary to improve financial management within the Department. Other reviews have also highlighted concerns over the Department's management of its finances:

- **Financial Management Review:** In 2005, the Treasury undertook a review which identified the need to embed financial awareness across the Department with fully trained and accountable budget holders. The review identified the need to ensure that finance staff were suitably involved in policy formulation; and the need to tackle the financial culture which had led to significant underspending in previous years.
- **Capability Review.** In March 2007, the Cabinet Office published its Capability Review on the Department. The Review concluded that the core Department needed a robust way of linking business objectives to the allocation of resources and people and reported that the Department's financial management capability needed to be addressed urgently.

**1.6** One indicator of financial management capability is whether a Department is able to lay its annual accounts before Parliament before the summer recess starts in July each year.[7] In 2002, the Treasury launched an initiative for all departments to achieve the summer deadline by 2006. In 2006, the Department laid its 2005-06 accounts on 30 October. In 2007, the Department laid its 2006-07 accounts on 29 October and was one of only three out of 56 Government organisations that failed to meet the July deadline.[8] The Department has put in place an action plan for its 2007-08 Resource Accounts which includes a clear timetable, arrangements for its consolidated interim accounts to be audited, and arrangements for senior officials to be consulted where applicable. The Department's Audit and Risk Committee has arranged regular meetings to review progress in the preparation of the 2007-08 Resource Accounts.

7 The NAO guide *Ready, Steady, Go… Faster Closing 2002-2003* states that the systems, processes and procedures required to achieve earlier finalisation of annual accounts help to ensure that a department has effective and efficient systems capable of monitoring and managing a departments expenditure and use of resources.

8 The other two organisations were the Home Office and the Department of Health which laid the NHS Pension Scheme Resource Account and its Departmental Resource Account late.

**1.7** In November 2006, the Accounting Officer instigated the Renew Defra programme **(Figure 4)** to improve the Department's overall performance, to make it more customer focused, to improve ways of working and to change the Department's size and shape. Part of the programme is the Corporate Performance Management Programme which is re-designing how the core department monitors and manages organisational performance including: designing a new annual business planning process; introducing agreed organisational performance measures and establishing roles and responsibilities for performance management.

**1.8** The Renew Defra programme is being managed as a formal change programme and so follows many of the principles of change management **(Figure 5)**.[9] In addition the Department's Management Board has introduced a Management Board Development Programme with the aim of enhancing the way the Board functions.

**4** Aims of the Renew Defra programme

The overarching aim of the Renew Defra programme is to transform the Department into an organisation that is more collaborative, flexible and effective in developing policies which deliver the right outcomes. The Renew Defra programme has five distinct work streams:

- Building a high performance culture.
- Seeing ourselves as customers see us.
- Defining the Defra way of doing things.
- Delivering the Right Size, Right Shape, Right Skills organisation.
- Managing the programme.

The Department expects the Renew Defra programme to deliver improvements in terms of both performance and value for money and to help in responding to the findings of the Capability Review.

*Source: National Audit Office summary of the Renew Defra Programme*

**5** Case Examples of how to bring about cultural and behavioural change

| **Example** | **Applicability to the Department** |
|---|---|
| In the National Audit Office report 'Achieving innovation in central government organisations', we identified that innovation does not flourish easily within strongly hierarchical or siloed structures. Useful suggestions from front-line staff need to be positively sought out, backed by clear leadership interest and supported by excellent internal communications.[1] | The 'Renew Defra' initiative to introduce more flexible working for staff at all levels should make a significant contribution to breaking down the silo structure.<br><br>The Financial Management Improvement Programme needs clear leadership from the highest levels to become fully embedded and its continued support from the Permanent Secretary and the Management Board will be vital for its successful implemetation. |
| Network Rail took positive steps to identify the extent of the culture change required within the old Railtrack company by using a survey to assess staff engagement in the change management process and measure job satisfaction.<br><br>Initial results, as expected, showed a very low level of commitment to Network Rail's change initiatives and indicated resistance to change in the organisation.<br><br>Network Rail used the survey programme to assist in measurement of the success of the change management process on a periodical basis.[2] | The Department has undertaken a staff survey to assess attitudes to the change programme.<br><br>The Department should continue to monitor staff attitudes, during the implementation phase of the change programme. |
| During this study we found that British Waterways and the Environment Agency use league tables successfully to encourage improvements by highlighting variations in performance between their waterways units and regions respectively.[3] | The 'Renew Defra' programme is introducing new programme and project management methods. Useful comparisons should be carried out across projects to identify staff who are particularly able to keep to time and budget. |

*Source: National Audit Office value for money reports and fieldwork*

NOTES

1 *Achieving innovation in central government organisations*, National Audit Office, HC 1447 2005-06, 2006.

2 *Network Rail – Making a Fresh Start*, National Audit Office HC 532 Session 2003-2004, 2004.

3 National Audit Office fieldwork.

9 The six key principles of change management identified by the National Audit Office are: Lead from the top; Address behaviour and culture; Engage your stakehlolders; Communicate, communicate; Design the Change Programme; and Manage the Change Process, *Change Management Toolkit*, National Audit Office, www.nao.org.uk/change_management_toolkit/index.htm.

**1.9** Following the appointment of a new Interim Finance Director General in April 2007, the Department's finance team has instigated a Financial Management Improvement Programme which aims to:

- Ensure that only the resources available to the Department are allocated to budget holders.
- Improve the quality and timeliness of the Department's month-end financial reporting.
- Improve financial management capabilities across the Department.
- Achieve faster preparation and completion of its annual accounts.

When implementing the Financial Management Improvement Programme the Department needs to place particular emphasis on leading from the top and addressing culture and behaviour.

**1.10** The Department has established a Financial Management Improvement Programme Board attended by the Permanent Secretary and the (non-executive) Chair of the Audit and Risk Committee as well as two Directors General. An action plan defines the tasks needed to improve financial management and allocates responsibility for implementation to named individuals by specific dates. The finance capacity of the Department has also been strengthened by the appointment of qualified accountants to be Heads of Finance and Business Affairs in each of the policy Groups. These posts form an important link between central finance and policy staff within the Department.

## The scope of our work

**1.11** This report aims to contribute to the business changes being developed by the Permanent Secretary by identifying the underlying reasons why the Department has found it difficult to manage its expenditure sufficiently in the past and how financial management can be improved. In particular, Part 2 examines the extent of the Department's oversight of its use of resources; and Part 3 examines the skills, processes and systems needed across the Department and its delivery bodies to ensure financial control and efficiency.

**1.12** In designing and conducting our examination we have had regard to the principles of 'World Class Financial Management' first published by the Audit Commission in its discussion paper in November 2005 and since developed by the Chartered Institute of Public Finance Accountancy and the National Audit Office. These include: finance for governance and leadership; financial planning; finance for decision making; financial monitoring and forecasting; and financial reporting. The examination has placed less emphasis on financial reporting as this is dealt with more fully in our financial audit of the Department's annual resource accounts.[10]

**1.13** We adopted a range of methods for this examination including:

- **three surveys (covering Finance Directors, budget holders at the level below the senior management team and Non-Executive Directors) across the Department's delivery bodies;**
- **visits to eight delivery bodies involving interviews with a range of staff including the Finance Director, accountants and budget holders, supplemented with a review of key documents and financial data; and**
- **interviews with key staff in the core department involved in budgeting, monitoring and financial decision-making, as well as within two of the Departmental Groups – the Natural Environment Group and the Service Transformation Group.**

Our methodology is set out in more detail in Appendix 3.

10 The Comptroller and Auditor General's report on the Department's 2006-07 resource accounts may be found at www.defra.gov.uk/corporate/finance/resource-accounts/accounts0607/index.htm.

# PART TWO

# The Departmental Management Board's oversight of the 'Defra family'

## The Defra family includes many delivery bodies

**2.1** The Department's Management Board has to prioritise policy activities and responsibilities, allocate funds accordingly, and monitor progress to confirm that resources are spent in accordance with their plans and kept within the financial constraints set by Parliament and the Treasury. The Management Board comprises the Accounting Officer, eight Directors General, the Chief Scientific Advisor and two non-Executive Directors **(Figure 6)**.

**6** The Department's Management Board

Permanent Secretary: Chair of the Management Board and Accounting Officer for the Department

→ Eight Directors General:

- Strategy and Evidence Group
- Natural Environment Group
- Food and Farming Group (two including the Chief Veterinary Officer)
- Climate Change Group
- Legal Services
- Service Transformation Group
- Finance

→ Chief Scientific Adviser

→ Two non-executive Directors

*Source: National Audit Office summary of the Department's organisational chart*

**2.2** Just over two fifths of the Department's activities are carried out by its delivery bodies. Lord Haskins' Rural Delivery Review, published in November 2003, recommended the separation of policy formulation from the delivery process to improve accountability. By October 2007, the Department had thirty one delivery bodies comprising:

- **Nine executive agencies.** These bodies are constitutionally part of the Department, but are run semi-independently. The Department's executive agencies include the Rural Payments Agency (whose responsibilities include making rural payments to farmers and carrying out rural inspections), and Animal Health, which is responsible for minimising the risk and impact of certain animal diseases. The Department provided £657 million in funding to its executive agencies in 2006-07. The Rural Payments Agency also received £1.9 billion in European Union Common Agricultural Policy funds for England.
- **Nine executive non-departmental public bodies.** These bodies are independent from the Department, employ their own staff and are accountable to Parliament. Their relationships with the Department are often complex, reflecting their independence and size. Such bodies include the Environment Agency, the largest of the Department's delivery bodies, responsible for protecting and improving the environment in England and Wales. Smaller executive non-departmental public bodies include the Consumer Council for Water, and the Commission for Rural Communities. The Department's funding of non-departmental public bodies was £985 million in 2006-07.

- **Six levy funded boards.** These boards have powers to collect levies to fund their activities. The Milk Development Council, for example, collects a levy from dairy farmers and the Meat and Livestock Commission collects levies on sheep, pigs and cattle. The levy boards are self-financing non-departmental public bodies and so fall outside the Department's Expenditure Limits. In September 2007, the Department announced that five of the boards would merge into a single body from April 2008.
- **Two public corporations.** British Waterways and the Covent Garden Market Authority are commercial enterprises that have a board whose members are appointed by Ministers. They employ their own staff and manage their own budgets. British Waterways manage over 2,200 miles of canals and rivers, while the Covent Garden Market Authority runs the New Covent Garden Market, the largest fresh produce market in the United Kingdom. In 2006-07 the Department provided a subsidy of £56 million for British Waterways. The Covent Garden Market Authority generated a surplus without any subsidy from the Department.
- **Five private sector companies.** These not-for-profit companies include the Carbon Trust, set up by government in response to the threat of climate change, and the British Wool Marketing Board. Total funding from the Department in 2006-07 was over £150 million.

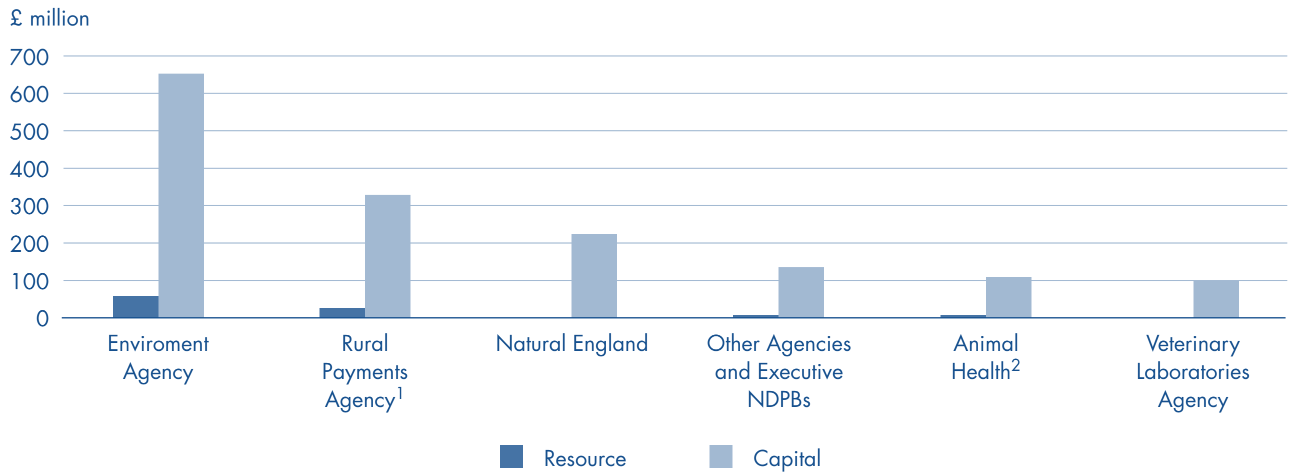
The Department also sponsors a further twenty seven advisory and tribunal non-executive non-departmental public bodies, most of which employ one or two people.

**2.3** The effective management of budgets and expenditure depends to a large degree upon sound financial management on the part of the core Department, and effective oversight of the 'Defra family' by the Department's Management Board. This part of the report highlights how:

- **Setting budgets that balance with the funds available will enable the Management Board to manage expenditure more effectively.**
- **The Department's scrutiny of budgets and the progress of work would benefit from a more rigorous approach.**
- **Maintaining the improvements made to the 2007-08 Management Board financial reports depends upon the timeliness and quality of the underpinning data.**

**2.4** The delivery bodies vary in size, amount of independence and in how important their activities are to achieving the Department's objectives and the Department has to tailor its oversight mechanisms and senior management focus accordingly. As **Figure 7** shows, the five largest delivery bodies each had resource expenditure of £100 million or more in 2006-07 and, therefore, have a much greater impact on the Department's financial management than many of its smaller bodies.

**7** The Department had five delivery bodies with resource expenditure of £100 million or more in 2006-07




*Source: The Department, final outturn against Departmental Expenditure Limits*

NOTES

1 Rural Payments Agency resource expenditure includes its own administration costs and expenditure on European Union schemes.

2 Animal Health was known as the State Veterinary Service until the 1st April 2007.

## Setting budgets that balance with the funds available will enable the Management Board to manage expenditure more effectively.

**2.5** The budgets agreed by the Management Board at the outset of the financial years 2006-07 and 2007-08 exceeded the funds available. For 2006-07, the budgets agreed with each Director General in March 2006 totalled £3,854 million, some £164 million (four per cent) more than available. Similarly for 2007-08, although the Department's Management Board examined the budgets submitted by Directors, the total cost of the business plans approved amounted to £66 million (two per cent) more than the total resources available. Our discussions with senior officials confirmed that the Management Board agreed to proceed with these over-allocations as the Department had historically overestimated how much it was likely to spend and therefore considered that there would be underspending in some areas during the year which would bring the budgets into balance by the end of the year.

**2.6** Bringing the 2006-07 budgets back into balance once the year had started took a long time to agree. In April and May 2006, increased spending to remedy difficulties with the single payment scheme led the Department to conclude that there was a risk of overspending in 2006-07, and it instigated a review which led to savings against the original budget for the remainder of the financial year of £170 million. Some of the Department's sponsored bodies were given their final budgets for 2006-07 in July 2006 while others were notified of the extent of the savings required from their budgets in September 2006 depending upon the amounts involved and the extent of the negotiations required.

**2.7** During April and May 2007, different Groups within the core Department declared further commitments above their agreed budget allocations which led the Management Board to conclude that the Department was at risk of exceeding its 2007-08 Departmental Expenditure Limit by £140 million. In July 2007, the Management Board instigated a 'Star Chamber' process of meetings of senior managers which identified some agreed reductions but this was not sufficient to balance the budget. Final budgets were not allocated to the Groups within the core Department until August 2007, impeding the Department's ability to manage and monitor its resources effectively, and in November 2007 the Department was projecting a programme overspend of £65 million due to the summer 2007 floods and disease outbreaks. (See Appendix 4 for a timeline of pressures on the Department's expenditure limits).

**2.8** Until April 2007, the post of Departmental Finance Director was line managed by the Director General of the Service Transformation Group. Since then the post has reported directly to the Permanent Secretary and has been upgraded to that of Director General. These changes in status have helped to empower the Finance Director to hold each part of the Department to account for their budgets. The post is currently held on an interim basis, however, and further progress will depend upon the appointment of a permanent Finance Director after March 2008.

**2.9** The Permanent Secretary has begun to instil better awareness of the importance of budgetary control by requiring budget holders to prepare zero-based budgets for each of the financial years 2008-09 to 2010-11 which agree in total to the resources available under the 2007 Comprehensive Spending Review and by linking those budgets to associated outcome-based business plans. Setting realistic budgets before the outset of each financial year, however, will depend upon the continuing commitment of the Permanent Secretary, the Department's Non-Executive Directors and the Finance Director to challenge assumptions and maintain focus on the need to reach a satisfactory agreement. The Finance Director reports that the Renew Defra programme includes a Management Board Development Programme, following which the Directors General have recognised the need to operate in a more corporate manner. The process adopted to allocate the Comprehensive Spending Review Settlement for 2008-09 to 2010-11 is evidence of the progress being made.

**2.10** A department's Audit and Risk Committee provides important scrutiny and oversight in improving financial management. The Department for Environment, Food and Rural Affairs' Audit and Risk Committee has taken a keen interest in the preparation of the Department's annual Statements of Internal Control and the assurance those Statements provide to the Permanent Secretary. It was involved in the oversight and assurance of the Department's 2006-07 accounts and is playing a key role in seeking to ensure that the 2007-08 accounts are finalised on time. The Chairman of the Department's Audit and Risk Committee is a member of the Management Board and also a member of the programme board for the Financial Management Improvement Programme.

## The Department's scrutiny of budgets and the progress of work would benefit from a more rigorous approach

**2.11** In our report on the difficulties in administering the 2005 Single Payment Scheme[11] we found that the governance structures between the Department and the Rural Payments Agency were overly complex and that there was a lack of appropriate management information with clear metrics. In response to that report, the Department recognised the need for greater clarity in its oversight of its delivery bodies. As a consequence, Executive Agency Chief Executives now report to their associated Directors General in the Department. The Department has also split its sponsorship role for the Executive Agencies from the policy teams who call on the services of each Agency:

- **Corporate Owner.** The corporate owner is responsible for the overall health of the Executive Agency, and for ensuring that it receives appropriate resource, support and strategic direction for the work it carries out for the Department. A main part of the corporate owner's role is to scrutinise the corporate and business planning.
- **Corporate Customer.** A number of Executive Agencies provide services to the Department, such as research results or technical advice. The relevant teams in the Department who commission the bulk of these services are designated as corporate customers. They focus on in-year reporting on the progress of specific programmes and projects which have been commissioned by the Department.

The distinction between corporate owners and corporate customers can result in complex relationships but should enable the Department's corporate owner teams to build more effective relationships with its Executive Agencies once it is fully in place. For the smaller Agencies, such as the Pesticides Safety Directorate, the corporate owner and the corporate customer are the same person. Other delivery bodies (those which are not Executive Agencies) have a single corporate sponsor team as their formal point of contact with the Department.

**2.12** Each Executive Agency prepares business plans, corporate strategies and agrees targets in consultation with its corporate owner in the Department according to a standard timetable:

- **November or December prior to the start of the financial year:** a review of the strategic fit and affordability of the Executive Agencies' outline business plans should be undertaken by their Corporate Owners.
- **February prior to the financial year:** detailed comments on the Executive Agencies' business plans and targets are provided by their Corporate Owners, along with confirmation of funding.
- **April, in the start of the financial year:** Executive Agencies' business plans are submitted for Ministerial approval.

**2.13** The Cabinet Office Capability Review noted that the Department needed to improve the co-development of business plans with its delivery partners and not allow this to be a 'tick-box' exercise.[12] Eight of the 17 Finance Directors of delivery bodies we surveyed (including the Environment Agency, Rural Payments Agency and Natural England) considered that they had a close working relationship with the Department. However nine other Finance Directors, typically from the Department's smaller delivery bodies, considered that they provided the Department with a lot of information but that it was often not clear how the data were used in making resource decisions.

11 Department for Environment, Food and Rural Affairs: *The Delays in Administering the 2005 Single Payment Scheme in England*, HC 1631 Session 2005-2006, 18 October 2006.
12 *Capability Review of the Department for Environment, Food and Rural Affairs*, Cabinet Office, March 2007.

**2.14** Our review of corporate owners in the Department found that while individuals ask intelligent questions of their delivery bodies, there was not sufficient evidence of a methodical and structured approach to scrutinising plans and budgets being used consistently by each team. By developing benchmarks to compare data over time and with other organisations, the Department could potentially reduce the range of information typically requested each year and improve the effectiveness of its scrutiny. Such a scrutiny framework might include:

- **Reviewing the realism of the proposed budgets.** Such a review would include a comparison of overheads to operational costs (more detailed analysis could include, for example, dividing the cost of a Human Resource department by the number of staff in post, or dividing the cost of accommodation and other facilities by the number of staff in post), analysis of the costs per service delivered (such as calculating the average cost of processing a claim or the average cost of an inspection), or comparison of the day to day running costs with expenditure on infrastructure (such as the proportion of expenditure on maintenance work compared to construction). The results of this preliminary review could identify areas requiring more challenge using the methods below.
- **The prioritisation of expenditure between essential and desirable levels of performance.** By developing business plans based on a range of different levels of funding (such as the delivery bodies estimation of the resources required, and the same level of resources, for example, minus five per cent) officials should be able to differentiate between essential and desirable levels of performance. While it can be difficult to persuade budget holders to accept that some activities may be less important than others, such information could assist the Management Board in their prioritisation of work.
- **Analysis of the risks to delivery.** Each Agency maintains a register of its key risks to delivery, but we found that the sponsor teams have not routinely drawn on this information to assess whether delivery bodies are likely to achieve the levels of performance specified in their business plans for the planned cost. By comparing the likelihood of these risks being realised with their estimated impact on delivery, sponsor teams could better review each month whether the forecast spending for the remainder of the year is likely to be achieved. Relating financial information to performance also helps to identify those activities that have been postponed without the concurrent savings having been made.

This framework would be applied on a risk basis tailored to take account of each delivery body's size, independence and importance to the Department's strategic objectives.

## Maintaining the improvements made to the 2007-08 Management Board financial reports depends upon the timeliness and quality of the underpinning data

**2.15** The current Interim Finance Director General has provided summary financial data and an overview report to the Management Board each month in 2007-08, highlighting the key issues to be considered. The finance reports use a traffic light system to summarise progress against Treasury Departmental Expenditure Limits and provides detailed analyses of budget, expenditure and forecast outturn broken down by major programme and business area in tabular and graphical forms. The actual and forecast expenditure are drawn from the Department's own finance system which is updated by submissions by Departmental Group and each delivery body.

**2.16** Our review of the minutes and associated papers from the Department's Management Board confirmed that its effective monitoring of progress had been hampered by delays in agreeing budgets, a lack of integration between financial monitoring and performance monitoring, and difficulties in obtaining realistic monthly profiles of expected expenditure on time from the delivery bodies. As **Figure 8** shows, only around half of the Department's delivery bodies met the timetable for submitting monthly finance templates for the first seven months of 2007-08. New improved arrangements were introduced in November 2007. Delivery bodies now submit monthly financial data direct to their sponsor teams in the Department and, in November and December 2007, 24 of the delivery bodies submitted their data on time.

**2.17** The Department has taken steps to encourage better co-ordination between performance management and financial control by appointing a qualified accountant as Head of Finance and Business Affairs in each of the policy Groups to advise the relevant Director General on the financial position of their part of the Department. Under the current Interim Finance Director General, the process has been developed so that Heads of Finance and Business Affairs review and comment on the finance data in cooperation with the Directors General. Each Group Head of Finance and Business Affairs is responsible for reviewing the monthly reports from their delivery bodies with the sponsor teams and providing the relevant Director General and the Finance Director with assurance that the data is up to date, reasonable and complete.

**8** An improving proportion of the delivery bodies now meet the Department's timetable for submitting monthly finance information

| | Apr 07 | May 07 | Jun 07 | Jul 07 | Aug 07 | Sep 07 | Oct 07 |
|---|---|---|---|---|---|---|---|
| Returns on Time | 13 | 12 | 13 | 13 | 15 | 13 | 14 |
| Returns Late | 7 | 13 | 14 | 14 | 12 | 13 | 11 |
| No Return | 4 | 2 | 0 | 0 | 0 | 1 | 2 |
| Total Returns | 24 | 27 | 27 | 27 | 27 | 27 | 27 |

*Source: National Audit Office summary of data from the Department*

# PART THREE

# How resources are managed in the delivery bodies and the Department

**3.1** The 2007 Comprehensive Spending Review indicated that, from April 2008, the Department's overall budget will grow by 1.4 per cent in real terms[13] between 2008-09 and 2010-11, but this growth is restricted largely to capital projects such as flood defences and waste management facilities. Discussions have yet to be concluded between the Department and each of its delivery bodies on how the resources will be allocated but the Department and its delivery bodies will have to operate within tight financial constraints throughout the 2007 Comprehensive Spending Review period. This part of the report, therefore, examines how:

- **Improvements in the way budgets are drawn up, scrutinised and monitored would enable the Department's delivery bodies to demonstrate the cost effectiveness of their activities.**
- **More regular and consistent oversight of financial risks would enable the Department to take any corrective actions earlier.**
- **Strengthening the culture of routine financial monitoring depends upon building the skills and experience of budget holders.**

## Improvements in the way budgets are drawn up, scrutinised and monitored would enable the Department's delivery bodies to demonstrate the cost effectiveness of their activities

**3.2** Effective budgeting depends upon a three stage process:

- **Operational planning and budget setting.** This process requires each budget holder to estimate the work required for the forthcoming financial year and the resources required.
- **Scenario planning and budget challenge.** Alternative budgets can be developed based upon different assumptions. Senior managers can then scrutinise and challenge the proposed budgets from across their organisation.
- **Profiling.** The agreed budgets are broken down to show the estimated expenditure each month to enable managers to monitor progress more effectively.

**3.3** Effective budget setting involves senior managers defining the strategic priorities of an organisation and the activities necessary to achieve them, and then encouraging teams to draw up detailed estimates of the resources required to deliver such work. The majority of the Department's delivery bodies have adopted such an approach, and reported that the budget setting process was always or largely aligned with their strategic objectives **(Box 1 overleaf)**.

**3.4** The Permanent Secretary instigated a zero based budgeting exercise to form the basis of the Department's bid for the three years of the 2007 Comprehensive Spending Review. After it received its settlement in October 2007 it embarked on setting detailed budget allocations for 2008-09 based on its new Departmental Strategic Objectives and current ministerial priorities. The Interim Finance Director General confirmed that the Department has also started to develop administration cost budgets to deliver a five per cent year on year reduction. The Department aimed to complete the budget setting process for 2008-09 before the start of the financial year.

**3.5** In practice, the core Department and six of the eight delivery bodies we visited had not fully categorised their budgets for 2007-08 by corporate objective, and the budgets generally reflected the functions of the organisation instead. The Department had manually categorised expenditure by objective after the year end.

13 This is based on a forecast inflation rate of 2.7 per cent a year.

## BOX 1

**The Environment Agency involves the Regions in Corporate Planning and the Directors give a high level 'steer' to the annual business planning process.**

The Environment Agency's seven English regions and Wales each have their own regional strategy units that look at long term strategic environmental planning in their local regional context. These local strategies contribute to an overarching national strategy "Creating a Better Place 2006-11".

Each year the Environment Agency's Directors brainstorm key budgetary issues and develop a strategic 'steer' based on assumptions around strategic priorities, increasing efficiencies, budget cuts and any changes to these. They attempt to predict the amount of money they will receive from the Department, utilising an optimism/pessimism spread.

The steer is disseminated to each of the Director's management and planning teams who translate it into priorities for each directorate. This is filtered down eventually to the areas via a service level process which drives operational work planning. Budgets are built up from work plans and are challenged by managers at regional and national level.

This culminates in a process known as 'commit to deliver' where each Director signs up to achieving the agreed objectives with the agreed resources. The Environment Agency tells us that they are striving for further integration between strategic planning and budgeting through their current Future Finance Programme.

*Source: National Audit Office fieldwork*

This was partly because its finance system continued to record expenditure each year against the departmental objectives as they stood at the beginning of 2004-05. The Interim Finance Director General confirmed that he planned to realign the finance system with its current objectives as part of the Financial Management Improvement Programme.

**3.6** When the Department reduced its overall funding in 2006-07 those organisations that set their budgets on the same basis as the previous year, plus or minus any overall percentage change in the total funds available, found it more difficult to re-prioritise their expenditure. At the Veterinary Laboratories Agency the science department budgets were based on current levels of activity by scientists, taking into account views from the Department on projected levels of activity (such as the increased likelihood of testing for avian influenza), and then multiplied by current charge-out rates to calculate a financial estimate. Other delivery bodies, such as the Environment Agency and British Waterways, adopt a zero based approach to planning their budgets whereby they build them up largely from scratch each year. While this approach is more time-consuming, it generates a better understanding of cost drivers and encourages teams to re-think whether their existing approaches are appropriate. At the Environment Agency the area offices' work plans form the basis of the regional and then national budgets, reflecting local priorities but shaped by the national priorities. We also found that Cefas[14] had a sophisticated and well-informed approach, assessing its activities according to the contribution they made to running costs. Cefas had also reviewed its asset base and was in the process of rationalising its land and buildings to fit its strategic needs.

**3.7** Challenging budgets is a key part of the budget process through which senior managers scrutinise the proposed budgets from across their organisation and identify any areas that may be over resourced or which may have underestimates of the costs they are likely to incur. At the Veterinary Laboratories Agency, for example, we found that costs for a research project commissioned by Health Canada – Canada's federal department for health – were underestimated and as a result the contract generated a £63,000 loss. Sixty per cent (114 of 189) of budget holders we surveyed reported that all their budgets were challenged on a line by line basis and that budget assumptions were assessed for reasonableness. Forty five per cent (74 of 165) of budget holders referred to budget reductions as a result of the budget challenge process.

**3.8** Each of the delivery bodies we visited had budget challenge processes in place, although some were more robust than others. At the Environment Agency, for example, there are several tiers of challenge. The budgets proposed by the area offices are challenged by the regional offices, which consolidate the budgets before sending them to head office for further challenge.

**3.9** One effective method of budget challenge is by inviting budget holders to use scenario planning. This is where alternative budgets are developed based on different assumptions to provide senior managers with information on the financial implications of budgetary decisions. Scenario planning depends upon having good quality data about the cost of existing and proposed activities. Nine out of 19 of the Finance Directors surveyed across the delivery bodies reported that their organisation had not used scenario planning to set any of their 2007-08 budgets as did 43 per cent (75 of 173) of budget holders.

14 The Centre for Environment, Fisheries and Aquaculture Science.

**3.10** Six of the organisations we visited had used scenario planning for all or most of their budgets, whereas the Marine and Fisheries Agency and Veterinary Laboratories Agency had not. British Waterways had developed a scenario planning tool called the 'Steady State Model' **(Box 2)**. In October 2006, the Environment Agency introduced a process whereby each of the Agency's central directorates had to show how they could cut 25 per cent of their budgets over three years. This target was revised for some directorates, but a cash reduction of nearly £24 million over three years was identified. The Environment Agency's Director of Operations in turn set the Agency's regions a similar challenge of a 15 per cent reduction over three years on staffing.

**3.11** Once budgets have been agreed, they should be profiled as accurately as possible over each month of the financial year to enable financial staff and budget holders to monitor progress effectively. Only five Finance Directors (out of the 22 surveyed) reported that all their 2007-08 budgets for expenditure, income, cash flow, and capital works for their organisation had been fully profiled. Six Finance Directors from the Department's smaller delivery bodies reported that, as a consequence of not profiling their budgets, they had experienced difficulties in monitoring variances between actual and budgeted figures. The Marine and Fisheries Agency, for example, had adopted a flat profile for most of its 2006-07 budgets by dividing the funds equally across 12 months rather than adjusting figures for seasonal variation **(Box 3)**. For 2007-08 the Agency has profiled more of its expenditure. The Veterinary Laboratories Agency also informed us that its budgets followed the same flat profile, although this reflected the nature of this agency whereby the majority of its expenditure is staff costs for which there is little seasonal variation. This contrasted with British Waterways and the Environment Agency, where the business units 'phase' their budget across the year.

## BOX 2

**The 'Steady State Model' developed by British Waterways has proved helpful in budgeting for future maintenance requirements**

British Waterways has a management tool called the 'Steady State Model'. This model is used to work out the level of routine works required to keep the waterways in a steady state of maintenance. It is an iterative process and the model is updated following inspection of assets and incorporation of the most up to date information on actual costs. The state of repair of British Waterways' assets is graded from A (meaning the asset is new and in repair) to E (meaning the asset has reached the end of its useful life and requires maintenance or replacement). The model was not originally intended to be used for budgeting, but has been adapted to this end as part of British Waterways' continuing commitment to increased efficiency and as a response to reduced funding. It is now embedded within the business planning and budgeting process.

*Source: National Audit Office fieldwork*

## BOX 3

**An example of how profiling could be improved**

The Marine and Fisheries Agency was established in October 2005 to bring together the service delivery, inspection and enforcement activities provided by the Government to the fishing industry. We found that budgets delegated by central finance to district offices were not profiled to reflect predictable seasonal variations in fishing. Local staff were keen to make the budgets more accurate by profiling them using their local knowledge but they had not been called on to do this as part of the budget setting process. These budgets make up a small part of the Agency's overall expenditure and the Agency intends to profile more of its budgets in the future.

*Source: National Audit Office fieldwork*

## More regular and consistent oversight of financial risks would enable the Department to take corrective actions earlier

**3.12** Failure to stay within the budgets agreed with the Department is a key risk that requires regular monitoring by the senior management team in each delivery body and in the core Department. Good financial management involves the regular monitoring of expenditure against budget and using this data to forecast whether the organisation is likely to remain within its financial constraints at the year end and is likely to use all the resources available. A good example of monitoring takes place at British Waterways where they produce a monthly financial monitoring report (the Blue Book) which contains a narrative against the major financial variances from plan and a bi-monthly Orange Book which contains financial information and broadly based Key Performance Indicators. The Orange Book is reported to each Board meeting and includes progress in achieving the Business Plan Milestones using narrative and a traffic light system. Each quarter, the Chief Executive and the Finance Director visit every General Manager to monitor achievement of the local Business Plan and seek explanations for variances. This covers not only the financial results but also risk and progress towards the Business Plan milestones.

**3.13** During our visits we found different approaches to challenging variances between budgets and actual income and expenditure. In particular defined thresholds for investigation were not always in place. The Veterinary Laboratories Agency had no formal threshold for investigating variances but monitored variances on a monthly basis. The Marine and Fisheries Agency also had no variance thresholds, although it reports that it is in the process of introducing formal thresholds. Given its relative size, the Royal Botanic Gardens, Kew generally reports on variances over £100,000, but had no formal threshold.

**3.14** We compared the actual expenditure against budgets in the eight organisations we visited and the budget holders were able to justify the sample of variances we identified. The reasons for variances from budget varied. At the Veterinary Laboratories Agency, for example, when avian influenza became a widespread concern in 2006 its virology group accrued a considerable amount of overtime. At the Royal Botanic Gardens, Kew changes to health and safety regulations led to unexpected expenditure to enable them to go ahead with an exhibition. These costs were not known at the time the budget was set. At the Marine and Fisheries Agency three of its seven major programmes needed attention as a result of variances that were identified and reported to the Management Board. Two of these were surveillance programmes where the variances were due to inaccurate profiling, and the third concerned a European Grants programme where variances were caused by problems in understanding the complexity of the programme compounded by the difficulties in forecasting a demand-led programme. We also found that the delivery bodies we visited carried out forecasts to estimate their financial position at the end of the year with varying frequency **(Figure 9)**. In-year forecasting is a key financial control. At the Veterinary Laboratories Agency, for example, regular meetings are held between senior science and finance staff where progress on projects is discussed together with likely impact on financial outcome.

**3.15** All the organisations we visited maintained a risk register and allocated the oversight of each risk to a senior manager in line with good practice across government **(Figure 10)**. In particular, Animal Health had a robust model in place for managing its corporate risks compared to some of the other delivery bodies. This model included both top down and bottom up mechanisms for identifying and recording risks, and its Corporate Management Team reviewed the Corporate Risk Register each month. In 2006, Animal Health also introduced an electronic risk register "4Risk" which collated the risks allocated to individual cost centres so that the Corporate Management Team could monitor progress as part of their risk management process. The Department's sponsor team for British Waterways considers the principal risks affecting achievement of its Business Plan as part of their quarterly performance reviews. Our review of risk management arrangements highlighted that the audit and risk committee in each of the eight organisations we visited monitored the effectiveness of the processes for identifying and monitoring risks.

**9** Examples of how delivery bodies forecast their end of year position

| Delivery Body | Approach to Forecasting |
|---|---|
| Cefas[1] | Has a project management system that enables them to forecast outturn on a monthly basis. |
| British Waterways | Re-forecasts the financial results every two months throughout the year to give greater control over expenditure planning and the year end results. |
| Environment Agency | Forecasting is well structured and it has been reiterated to budget holders and planners that forecasting is important. There is a soft deadline that accuracy by December is expected for the full year's expenditure and management accountants in Head Office are involved in the challenge process of forecasts and profiles. |
| Marine and Fisheries Agency | Aim to forecast outturn in monthly reports to the management team. Forecasts are based on spending to date, a view on profile to date (taking into account that profiling is flat, but spending is not), and information from budget holders' variance analysis and projections. |
| Royal Botanic Gardens, Kew | Produces two forecasts per year. These two forecasts are supported by information from each budget holder on progress to date and information as to what activities are likely to be carried out by the year end. |

*Source: National Audit Office fieldwork*

NOTE

1 Centre for Environment, Fisheries and Aquaculture Science.

**10** The management of **corporate** risks in the delivery bodies visited[1]

| Delivery body | Total gross expenditure 2006-07 (£ million) | The delivery body has a balanced scorecard or similar framework | Risks are reviewed regularly | Key risks are allocated to a senior named member of the management team | There is a risk management oversight process, such as a Risk Committee |
|---|---|---|---|---|---|
| Animal Health | 106 | Corporate risk register and electronic risk register for all cost centres and key projects | Risk register reviewed monthly by management team along with report on cost centres and project registers | Risks allocated to senior managers | Risk Management Committee meets bi-monthly and reports to Corporate Management Team |
| British Waterways | 189 | Corporate risk register underpinned by registers in each business unit. Risks are measured financially and potential opportunities are included as well as threats | Board regularly reviews process for identifying and managing risks | Risks allocated to Director and General Managers | The Audit Committee meet three times per year and receives reports on the risk management framework |
| CEFAS[2] | 43 | Cefas uses a balanced scorecard to manage risks and a risk and mitigations register | The Management Board reviews the risk register every two months and executive managers hold a risk workshop twice a year | All risks are allocated to board members | Audit and Risk Committee gives advice on risk management |
| Environment Agency | 1,065 | Scorecard and corporate risk plans | Reviewed monthly by Management Board | Directors are risk champions. Risk managers report to them | The Audit Committee meets quarterly and oversees corporate risk management |
| Marine and Fisheries Agency | 22 | Corporate risk register | Management Committee meets monthly to identify emerging risks and reviews risks | Risks are allocated to board members | Audit and Risk Committee gives advice on risk management to Chief Executive and Steering Board |
| Royal Botanic Gardens, Kew | 45 | Corporate risk register | Reviewed and updated quarterly. Risk is a standing agenda item for the fortnightly Executive Board meetings | Risks are allocated to members of the management team | Audit Committee scrutinises the corporate risk register three times a year |
| Veterinary Laboratories Agency | 111 | Corporate risk register, plus register for each division | Risk is a standard agenda item at each monthly Management Board meeting. Corporate risks reviewed quarterly, divisional risks monthly | Each risk is owned by a Director along with a named contact for day to day management | Audit and Risk Committee has two external members that provide independent cross-checks of the risk assessment |

*Source: National Audit Office analysis of governance documents*

NOTES

1 As an advisory non-departmental public body, the Sustainable Development Commission does not have its own risk strategy.

2 Centre for Environment, Fisheries and Aquaculture Science.

**3.16** Nine of twenty-three Finance Directors reported to us that their body's executive board used a balanced scorecard to manage the key risks to their organisation, and that financial risks were included in this list. Thirteen of the twenty-three Finance Directors reported their body had a financial risk register and thirteen also reported that financial risks were allocated to individual executive board members **(Figure 11)**.

**11** The management of **financial** risks in the delivery bodies surveyed

| Finance Directors' responses on behalf of following delivery bodies[1] | Total gross expenditure 2006-07 (£ million) | Executive Board uses a balanced scorecard to manage risks and financial risk is one element | Has a financial risk register | Financial risks are allocated to individual Executive Board members |
|---|---|---|---|---|
| Animal Health | 106 | | ✔ | ✔ |
| British Potato Council | 6 | ✔ | ✔ | ✔ |
| British Waterways | 189 | ✔ | | |
| Cefas[2] | 43 | ✔ | | ✔ |
| Central Science Laboratory | 48 | ✔ | ✔ | |
| Commission for Rural Communities | 9 | | ✔ | |
| Consumer Council for Water | 6 | | ✔ | ✔ |
| Energy Saving Trust | 75 | ✔ | | |
| Environment Agency | 1,065 | ✔ | ✔ | |
| Gangmasters Licensing Authority | 3 | ✔ | | |
| Government Decontamination Service | 2 | | | ✔ |
| Home Grown Cereals Authority | 11 | | ✔ | ✔ |
| Joint Nature Conservation Committee | 9 | | ✔ | ✔ |
| Marine and Fisheries Agency | 22 | | ✔ | ✔ |
| Natural England (created 1 October 2006) | 233 | ✔ | | |
| Pesticides Safety Directorate[3] | 13 | | ✔ | ✔ |
| Royal Botanic Gardens, Kew | 45 | | ✔ | ✔ |
| Rural Payments Agency | 228 | | ✔ | ✔ |
| Sea Fish Industry Authority | 13 | | ✔ | ✔ |
| Sustainable Development Commission | 3 | | | ✔ |
| Veterinary Laboratories Agency | 111 | ✔ | | |

*Source: Analysis of National Audit Office fieldwork and survey of Finance Directors*

NOTES

1 The other two delivery bodies did not report having any of these in place. These were the National Non-Food Crops Centre and the Meat and Livestock Commission.

2 Centre for Environment, Fisheries and Aquaculture Science.

3 The Pesticides Safety Directorate manages financial risk at Management Team level on a monthly basis and quarterly at Board level by: scanning for new risks; financial monitoring and reporting; and reviews of the risk register. All reports include financial implications.

**3.17** The Department's Audit and Risk Committee has a key role to play in encouraging senior officials to monitor and manage financial risks. We found that the members of the Committee understood their role and had the necessary skills and experience. We found that there had been positive initiatives, such as an exercise to map the assurances that exist in relation to the top risks faced by the Department and to identify areas where there is no regular assurance reporting. We encourage the Committee to continue this mapping exercise and to review key sources of assurance on a regular basis. The Committee has been fully briefed on the Financial Management Improvement Programme and the Chair of the Committee is a member of its programme board. The Financial Management Improvement Programme includes actions to ensure the Department meets the timetable for finalising its 2007-08 accounts before the summer recess **(Figure 12)**.

**12** The Department's Audit and Risk Committee's effectiveness could be enhanced

| Good Practice | Performance |
|---|---|
| Effectiveness in supporting the Board and the Accounting Officer – reviewing completeness, reliability and integrity of assurances | In Spring 2007, the Committee began (with Internal Audit and the Department's risk manager) to map the assurances the Permanent Secretary needs. We encourage the Committee to continue this mapping exercise and to review key sources of assurance on a regular basis.<br><br>The Committee has been fully briefed on the Financial Management Improvement Programme and the Chair of the Committee is a member of its programme board. |
| Independence and objectivity of members and their understanding of their role | Four of the five members are non-executives including the Chair. The Chair also sits on the Department's Management Board. All members are objective and understand their role.<br><br>The Permanent Secretary is invited to meetings of the Committee and attends as appropriate (to provide a balance between awareness of the work of the Committee and allowing the Committee to discharge its responsibilities drawing on the evidence supplied by the Department). |
| The mix of skills at the Committee's disposal | There is no specific training for members apart from an induction day which the two newest members have attended.<br><br>The members have an understanding of the Department's objectives and a broad understanding of its current initiatives and accountability structures. At least two members have recent relevant financial experience. |
| The scope of the Committee's work | The Committee takes a strong role with respect to the preparation of the annual statement on internal control.<br><br>The Committee provided oversight and assurance for the 2005-06 and 2006-07 accounts.<br><br>It reviews progress reports on the work of internal audit but does not consider individual internal audit reports.<br><br>The Committee has not reviewed management's internal controls in respect of fraud and has not been routinely informed of cases of actual, suspected or alleged fraud. The Committee recognises that this arrangement requires further consideration, and notes that losses from fraud in the Department have not been material. |
| The Committee's engagement with Financial and Performance Reporting issues, and its communication with the Accounting Officer, Board and other stakeholders | The Financial Management Improvement Programme includes actions to ensure the Department meets the timetable for finalising its 2007-08 accounts before the summer recess.<br><br>The Committee's Chair is a member of the programme board for the Financial Management Improvement Programme along with the Permanent Secretary. |
| The resourcing of the Committee and work planning | The Committee is setting meeting dates and agendas in advance covering the whole scope of its terms of reference over an annual cycle. |
| Support for the Committee from its Secretariat | Responsibility for this key role has been assigned to the Department's Financial Control Division. |

*Source: National Audit Office*

## Strengthening the culture of routine financial monitoring depends upon building the skills and experience of budget holders

**3.18** It is essential that the delivery bodies have staff with the relevant skills and training to effectively manage their resources. Our survey of Finance Directors found that a high proportion (18 out of the 20) who responded were qualified accountants.[15] During our visits to a sample of eight delivery bodies, we found a range of training for budget holders was on offer **(Figure 13)**. However, when asked to describe the overall financial management capability of budget holders in their organisation, none of the Finance Directors we surveyed chose the option "Almost all budgets holders have a high level of financial management expertise". Seven of the 20 (35 per cent) chose "A significant proportion of budget holders struggle to adequately monitor income and expenditure on an accruals basis and to provide meaningful explanations for variances from budget but, in the main, they are able to do so with assistance from others within their own business areas or the central finance team". Nine of the 20 Finance Directors (45 per cent), when asked what three factors would most improve resource management in their organisation, cited improving staff training and financial skills as a key issue.

**3.19** We asked budget holders about the nature of the training they had received and whether it was sufficient to support their role. Seventy-four per cent (145 of 196 who responded) of budget holders reported that they had been provided with either formal or informal training to support them in their role. Of those who had received training 79 per cent (112 of 142) considered that they had been provided with as much training as they needed to support their role as budget holder. The remaining 21 per cent (30 of 142) said that their training had been lacking in some areas.

**3.20** Not all delivery bodies routinely assess budget holders for their ability to manage their budgets as part of their performance appraisals. We found this was the case at the Marine and Fisheries Agency. At the Veterinary Laboratories Agency budget holders are appraised against a scorecard, which included whether or not they had worked within budget. The Environment Agency assesses their budget holders against a scorecard which includes an expenditure profile. Budget holders have performance objectives, one of which assesses their ability to keep within budgets. Pay bonuses are allocated depending on how well staff perform against these objectives. At Cefas,[16] budget holders are held to account for their performance as part of their performance appraisals. At the Marine and Fisheries Agency there should be relevant objectives within personal development plans, but these were not set at the time of our visit due to problems with the HR system, although delegation documents make it clear that budget holders are personally accountable.

**13** The extent of financial training in the delivery bodies varies

In 2007 the **Marine and Fisheries Agency** ran two series of seminars targeted at administrative staff who managed finance records and budget holders on how to interpret management reporting. At the time of our visit a 'training needs analysis' was underway to identify further training requirements. The Marine and Fisheries Agency also supports administrative staff in qualifying for the Association of Audit Technicians.

The **Environment Agency** had introduced a key initiative to train 1,000 budget managers in how to use Oracle and automated systems more effectively. The Environment Agency was also trying to increase the financial literacy of its managers. At the time of our visit a one to two day financial awareness course was being rolled out. One hundred and twenty managers in the Environment Agency have also attended a leadership development programme, which includes training in finance.

At the **Veterinary Laboratories Agency** there is no formal training for the Business Administration Managers (who monitor budgets for budget holders), but the Head of Finance runs a half-day "Financial Awareness in VLA" course, in which he explains the financial accounts, annual statutory accounts and project accounts, and how they all come together. There is also a finance contact group meeting between five and six times per year when any issues can be raised and discussed.

*Source: National Audit Office fieldwork*

15 The two Finance Directors who were not qualified accountants were based at the Commission for Rural Communities and the Joint Nature Conservation Committee.
16 Centre for Environment, Fisheries and Aquaculture Science.

# APPENDIX ONE

# Overview of the Department's delivery bodies

| Name of delivery body, by type | Main functions | Total gross expenditure 06-07 | Staff employed |
|---|---|---|---|
| Executive Agencies | | | |
| Animal Health (formerly the State Veterinary Service) | Responsible for minimising the risk and impact of notifiable animal diseases for the protection of public health and the economy throughout Great Britain | £106,452,000 | 1,427 |
| Central Science Laboratory | Research and information services on protecting environmental quality, developing sustainable land uses and safeguarding food chain safety | £48,489,000 | 680 |
| Centre for Environment, Fisheries and Aquaculture Science | Aquatic scientific research and consultancy centre | £43,342,000 | 533 |
| Government Decontamination Service | Provides advice and guidance (including access to specialist contractors) to those responsible for dealing with decontamination following a chemical, biological, radiological or nuclear terrorist incident or a major hazardous materials event | £2,204,000 | 24 |
| Marine and Fisheries Agency | Management, regulatory and enforcement role with regard to marine fisheries | £21,852,000 | 145 |
| Pesticides Safety Directorate | Aims to ensure the safe use of pesticides and detergents for people and the environment | £13,155,000 | 188 |
| Rural Payments Agency | Key services include making rural payments, carrying out rural inspections, and livestock tracing | £228,000,000[1] | 4,467 |
| Veterinary Laboratories Agency | Provides animal disease surveillance, diagnostic services and veterinary scientific research to the animal health industry | £110,885,000 | 1,233 |
| Veterinary Medicines Directorate | Aims to protect public health and animal health and promotes animal welfare by assuring the safety, quality and efficacy of veterinary medicines | £13,970,000 | 136 |
| Executive NDPBs | | | |
| Commission for Rural Communities | Provides independent advice to government and ensures policies reflect the real needs of people living and working in rural England, especially the disadvantaged | £9,274,000 | 84 |
| Consumer Council for Water | Provides a watchdog role that represents customers of water and sewerage companies in England and Wales | £5,841,000 | 74 |
| Environment Agency | The leading public body for protecting and improving the environment in England and Wales | £1,064,600,000 | 13,114 |
| Food from Britain | Provides a range of services to food and drink companies designed to help them to identify, win and grow business at home and overseas | £8,820,000 | 28 |

| Name of delivery body, by type | Main functions | Total gross expenditure 06-07 | Staff employed |
|---|---|---|---|
| Executive NDPBs *continued* | | | |
| Gangmasters Licensing Authority | Set up to curb the exploitation of workers in the agriculture, horticulture, forestry, shellfish gathering and associated processing industries | £2,910,000 | 44 |
| Joint Nature Conservation Committee | The statutory adviser to government on UK and international nature conservation | £8,955,000 | 123 |
| National Forest Company | Leads the creation of The National Forest, a new, wooded landscape across 200 square miles of central England | £4,475,000 | 18 |
| Natural England | Aims to conserve and enhance biodiversity, landscapes and wildlife in rural, urban, coastal and marine areas | £233,246,000 | 2,323 |
| Royal Botanic Gardens, Kew | Delivers science-based plant conservation | £45,381,000 | 717 |
| Levy Boards | | | |
| British Potato Council | Funds research and development, collects and disseminates market information and advertises potatoes to consumers (home and abroad) | £6,100,000 | 51 |
| Home Grown Cereals Authority | Supports the UK cereal and oilseeds industry in improving its competitiveness in UK and overseas markets | £11,218,000 | 70 |
| Horticultural Development Council | Provides horticultural research and development and the associated technology transfer | £6,255,000 | 15 |
| Meat and Livestock Commission | Works with the British meat and livestock industry to improve efficiency and competitiveness | £37,432,000 | 121 |
| Milk Development Council | Provides essential services that help dairy farmers run profitable businesses, such as consumer education to stimulate demand | £8,123,000 | 44 |
| Sea Fish Industry Authority | Aims to promote the marketing and consumption of sea fish in the UK; and advises on relevant research and development | £13,192,000 | 104 |
| Public Corporations | | | |
| British Waterways Board | Responsible for maintaining 2,200 miles of inland waterways | £189,000,000 | 1,963 |
| Covent Garden Market Authority | The statutory corporation responsible for the running of New Covent Garden Market, the largest fresh produce market in the UK | £12,826,000 | 49 |

| Name of delivery body, by type | Main functions | Total gross expenditure 06-07 | Staff employed |
|---|---|---|---|
| Local Bodies | | | |
| National Parks and Broads Authority (9 bodies in England) | Aims to conserve the natural beauty, wildlife and cultural heritage in the National Parks and promote public understanding and enjoyment of the National Parks | £43,120,000 | not known |
| Private Sector | | | |
| British Wool Marketing Board | Operates a central marketing system for UK fleece wool with the aim of achieving the best possible net returns for farmers | £11,321,000 | 198 |
| Carbon Trust | Accelerates the move to a low carbon economy by helping business and public sector organisations to reduce carbon emissions and develop commercial low carbon technologies | £100,424,000 | 133 |
| Energy Saving Trust | Set up to address the damaging effects of climate change and aims to cut emissions of carbon dioxide by promoting the sustainable use of energy by consumers | £74,530,000 | 142 |
| National Fallen Stock Company | Designed to help farmers and horse owners comply with regulations which prevent on-farm burial of fallen stock by providing a disposal scheme | £14,000,000 | 2 |
| National Non-Food Crops Centre | Provides independent advice and information to industry, government and the general public on renewable materials and technologies | £1,500,000 | 9 |
| Advisory and Tribunal NDPBS | | | |
| Sustainable Development Commission | Independent watchdog on sustainable development. Provides an advocacy role as well as offering advice and appraisal | £2,900,000 | 46 |

There are another 27 advisory and tribunal NDPBs who have on average two employees each.

*Sources: Agencies: each Agency's Annual Report and Accounts 2006-07. NDPBs and Public Corporations: "Public Bodies 2006" published by the Cabinet Office. Private sector bodies: The Department's web pages on the delivery landscape and each body's Annual Reports and Accounts 2006-07.*

NOTE

1 Rural Payments Agency gross expenditure is for its own costs only and does not include the European funds which it pays on behalf of the European Union.

# APPENDIX TWO

# The impacts of budget reductions on the delivery bodies we visited

## Five of the eight bodies we visited as part of our fieldwork had had their budgets reduced during 2006-07

- The Environment Agency reduced its programme of inspections and non-capital maintenance work of flood risk assets, by delaying the lowest priority items.
- British Waterways had responded to an initial cut in its funding from the Department from £62.6 million in 2005-06, to £55.5 million in 2006-07 by rationalising its workforce and introducing other efficiencies. When a further £3.9 million reduction was made during 2006-07 it postponed the lowest priority projects in its major works and repairs programme.
- The Marine and Fisheries Agency deferred a vessel decommissioning grants scheme which aimed to help trawler owners leave the fishing industry and so reduce overfishing.
- The Royal Botanic Gardens, Kew absorbed some of the impact of the cuts by using its reserves but it also deferred both recruitment and implementation of pay rises; and deferred updates of signage around the Gardens.
- The Veterinary Laboratories Agency reduced its scientific surveillance work and some research proposals did not go ahead.

*Source: National Audit Office fieldwork*

# APPENDIX THREE

# Study scope and methodology

**1** This appendix sets out the study scope for our examination of management of expenditure in the Department for Environment, Food and Rural Affairs and its delivery bodies. It also sets out the methodologies we employed.

## Scope of the study

**2** We focused our examination on three main issues:

- Does the Defra family need to improve the way it manages its resources?
- Does the Defra family have the ability to plan and to set budgets effectively?
- Does the Defra family have the appropriate structures to monitor its performance and its use of resources, and to take appropriate corrective action?

**3** Our scope included the core Department and most of its thirty-one delivery bodies comprising nine executive agencies, nine executive non-departmental public bodies, six levy funded boards, two public corporations, five private sector companies as well as the largest of its advisory non-departmental public bodies.

## Methodology

### Surveys of Finance Directors, budget holders and Non-Executive Directors in the delivery bodies

**4** We designed, piloted and sent out three different electronic questionnaires to the delivery bodies targeting the Finance Directors, budget holders below senior management level and Non-Executive Directors. **Figure 14 overleaf** summarises the main themes in each of the questionnaires and shows the response rates achieved. We did not survey budget holders in the Department because budgets had not been allocated to them at the time we carried out our fieldwork.

### Case studies involving visits to eight delivery bodies

**5** To validate responses to the questionnaires and to gain a deeper understanding of how delivery bodies manage their resources we visited eight of the delivery bodies. Details of the eight bodies can be found in **Figure 15 overleaf**. We chose delivery bodies according to type, level of gross annual expenditure and size.

**6** At each of the delivery bodies we conducted semi-structured interviews with the Finance Director, chief accountants, management accountants, and budget holders, plus other key staff involved in budgeting, monitoring and financial decision-making. These interviews were supplemented with a review of key documents and financial management data, which we gathered from each of the bodies both in advance and during our visits. Key documents reviewed included Corporate Plans, Business Plans, Annual Reports, senior management board minutes, and internal audit reports.

**7** In addition to the visits to the head office for each delivery body, we visited regional offices or local business units for the larger delivery bodies, such as the Environment Agency and British Waterways. This was in order to take a closer look at the level of alignment between business planning, resource allocation and measurement of performance throughout these larger organisations.

### Interviews with key Departmental staff including core finance team and sponsors

**8** We carried out semi-structured interviews with key staff in the core Department involved in budgeting, monitoring and financial decision-making. This included staff in the central finance team, the Business Analysis Division, Financial Control Division as well as the Interim Finance Director General and Deputy Finance Director. We asked about management accounting practices, allocation of money from the 2004 Spending Review to the Directors General, in-year controls for both the core Department and the delivery bodies.

**9** We also interviewed staff in the Natural Environment Group, one of the departmental Groups in order to get a clearer picture of how they function in terms of their own business planning, budgeting and monitoring processes. This formed our ninth case study. In addition we interviewed staff in the Service Transformation Group with responsibility for delivery relationships corporately.

**10** In order to get a better understanding of the relationships between the core Department and the delivery bodies we interviewed the 'sponsors' responsible for overseeing the performance of the eight delivery bodies we had visited. We asked them about their oversight of the delivery bodies, in particular about how they monitored their performance and use of resources. We also reviewed the main governance documents setting out the relationship and respective responsibilities of the core Department and the delivery bodies.

**14** Overview of questionnaire content and response rate

| Target respondent | Issues covered | Number of questionnaires sent | Number of responses |
|---|---|---|---|
| Finance Directors | Oversight and decision-making at Executive Board level | 32 | 20 (63%) |
| | Relationship with the core Department | | |
| | Planning and budget setting | | |
| | Budget monitoring | | |
| | Finance capacity | | |
| Budget holders | Integration of financial management | 273 | 200 (73%) |
| | Planning and budget setting | | |
| | Budget monitoring | | |
| Non-Executive Directors | Managing resources and risks | See note 1 | 20 responses across 14 delivery bodies |
| | Relationship with the core Department | | |

*Source: National Audit Office*

NOTE

1 Due to confidentiality issues around accessing personal contact details of the Non-Executive Directors, we asked Finance Directors to forward the questionnaire on to the Non-Executive Chairs of their Audit Committee and Finance Committee, if in post. Not all of the delivery bodies had Non-Executive Directors, for example the Veterinary Laboratories Agency. This resulted in 20 responses across 14 delivery bodies.

**15** Summary of delivery bodies we visited

| Type of delivery body | Name of delivery body | Average staff numbers |
|---|---|---|
| Executive Agency | Animal Health | 1,427 |
| | Centre for Environment, Fisheries and Aquaculture Science | 533 |
| | Marine and Fisheries Agency | 145 |
| | Veterinary Laboratories Agency | 1,233 |
| Executive Non-Departmental Public Body | Environment Agency | 13,114 |
| | Royal Botanic Gardens, Kew | 717 |
| Public Corporation | British Waterways | 1,963 |
| Advisory Non-Departmental Public Body | Sustainable Development Commission | 46 |

*Source: See Appendix 1*

# APPENDIX FOUR

# Timeline of pressures on the total Departmental Expenditure Limit

**Timeline of pressures on the total Departmental Expenditure Limit**

| | |
|---|---|
| **2004-05** | **Total Departmental Expenditure Limit £3,481 million** |
| 31 March 2005 | End of year position: £3,318 million |
| | The Department had underspent its total Departmental Expenditure Limit by £163 million. £120 million of this underspend was carried forward under the end of year flexibility arrangements to be drawn down in later financial years |
| **2005-06** | **Total Departmental Expenditure Limit £3,520 million** |
| July 2005 | Treasury restricted the Department to drawing down only £65 million of its £120 million end of year flexibility funds from 2004-05 leading to a shortfall of £55 million |
| Mid 2005 | £40 million extra spending pressures develop relating to TB, Foot and Mouth Disease, European structural funds and rent increases |
| August 2005 | Treasury informs all departments that they will need Treasury approval before switching more than £20 million a year between 'non-cash' and 'near cash'[1] |
| October 2005 | The Department wishes to transfer £85 million unspent 'non-cash' to 'near cash' but realises it will need Treasury approval |
| November 2005 | Treasury does not permit the Department to switch more than £20 million to 'near cash' leading to a £65 million shortfall |
| December 2005 | The Department decides to defer £150 million of expenditure from 2005-06 to 2006-07 |
| 31 March 2006 | End of year position: £3,519 million |
| | The Department had come within £1 million (0.03%) of its total Departmental Expenditure Limit |
| **2006-07** | **Total Departmental Expenditure Limit £3,848 million** |
| January 2006 | 2006-07 budgets do not cover the £150 million worth of activities deferred from 2005-06 into 2006-07 |
| April 2006 | Extra budget pressures: Rural Payments Agency £23 million, Avian Influenza £10 million, other pressures £15 million |
| May 2006 | Review initiated to identify £200 million budget cuts |
| September 2006 | £170 million reductions finalised. Department hopes remaining £30 million planned expenditure in excess of the limit will be balanced by underspends in some of its activities |
| January 2007 | The Department secured a £305 million ring-fenced increase in its resource Departmental Expenditure Limit in respect of potential disallowance by the European Commission |
| 31 March 2007 | End of year position: £3,804 million |
| | The Department underspent its total Departmental Expenditure Limit by £44 million (1.1%). It had overspent its capital limit by £28 million (3%). The resource underspending was due largely to the fact that the Department only required £198 million of the £305 million it had claimed in January 2007. These funds were not available for the Department to spend on its other activities. |

**Timeline of pressures on the total Departmental Expenditure Limit *continued***

| | |
|---|---|
| **2007-08** | **Total Departmental Expenditure Limit £3,617 million**[2] |
| January 2007 | The Department set provisional budgets which exceeded the total Departmental Expenditure Limit by £66 million |
| April – June 2007 | Extra budget pressures are identified bringing the over allocation to a total of £140 million. The Department freezes all discretionary expenditure |
| July 2007 | 'Star Chamber' exercise identifies cuts but there is still an expected £75 million overspend |
| November 2007 | The Department is projected to overspend its programme budget by £65 million due to Foot and Mouth Disease, Blue Tongue Disease, Avian Influenza and the summer floods. The Department's projections also show a forecast overspend of £50 million on its £286 million administration costs budget[3] |
| January 2008 | The Department's Interim Finance Director General reports that it is now on course to stay within its 2007-08 administration costs budget |

*Source: See as Appendix 1; 'Defra's Departmental Report 2006 and Defra's Budget' Second Report 2006-07 Environment, Food and Rural Affairs Committee, HC 132 February 2007; Departmental Management Board Finance Reports for May and June 2007; and the Permanent Secretary's evidence to the Environment, Food and Rural Affairs Committee on 21 November 2007.*

NOTES

1 'Near cash' is expenditure that needs to be paid for in the near future, such as staff salaries and suppliers' bills. 'Non-cash' is expenditure which although it is recorded as current year expenditure will only be paid in the long term, for example pension liabilities, or not at all, such as depreciation.

2 As stated in the Winter Supplementary Estimate. It may be increased in the Spring Supplementary Estimate.

3 Increased from £269 million to £286 million in the Department's Spring Supplementary Estimate.

Printed in the UK for the Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
5738275 03/08 77240

Design and Production by
NAO Marketing & Communications Team
DP Ref: 8294VB

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Management of Expenditure

A report by the Comptroller and Auditor General

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ISBN 978-0-10-295306-0

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