# 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.