National Audit Office

Financial Management in the Home Office

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SUMMARY

Scope of the NAO examination

1 The Home Office's stated purpose is "working together to protect the public". Protecting the public covers policing, crime reduction, counter terrorism, border control, and identity management. The Department delivers some front line services, such as immigration enforcement and the issuing of passports, directly through Executive Agencies. Other front line services, such as policing and crime reduction, are delivered through arms length partnership arrangements with other bodies, including six Non-Departmental Public Bodies and the 43 police forces in England and Wales.

2 For 2008-09, the Home Office has a gross budget of £11.8 billion. Around 71 per cent is passed on through grants to partner organisations, principally police authorities, which help deliver the Department's objectives. The remaining 29 per cent funds the Home Office's Executive Agencies which are the UK Border Agency (operating in shadow form until 31 March 2009)(£1.9 billion); the Identity and Passport Service (£0.5 billion) and the Criminal Records Bureau (£0.1 billion), plus its own running costs (£0.9 billion). The Department receives £1.4 billion in income, principally from fees and charges for public services.

3 Financial management is the system by which the resources of an organisation's business are directed and controlled to support the organisation's goals. Good financial management is an essential element of strong corporate governance. It forms part of the foundations of an organisation, underpinning service quality and improvement, and is the basis of accountability to stakeholders for the stewardship and use of resources. Effective financial management helps an organisation manage its budgets; allocate resources and make decisions supported by an understanding of the relationship between resource consumption and performance; and so deliver its services cost-effectively.

4 The Comptroller and Auditor General issued a disclaimed audit opinion on the Department's Resource Accounts for 2004-05. Following complications arising from the introduction of a new accounting system, the Department had failed to reconcile its cash records, was unable to provide an adequate audit trail to support accounting entries and, as a consequence, was unable to produce auditable Financial Statements. The Public Accounts Committee reported in July 2006 on the weaknesses in financial management at the Home Office that caused it to fail to produce proper accounts. The Committee recommended improvements in the Department's basic financial systems and processes, in the financial skills and capacity of staff and a greater emphasis on the corporate importance of financial management and accounting at senior levels of the Home Office. In response, the Home Office began a substantial programme of reform.

5 The Department initiated a programme of improvement more than two years ago, so this report examines:

- the Home Office's organisation and the progress made in delivering improvements in its financial management (Part 1);
- the recent financial performance of the Home Office (Part 2); and
- how far the Home Office has integrated good financial management into its business (Part 3).

Main findings

On the progress made in improving financial management

6 We found that the Home Office has made substantial improvements to its financial management since 2006. The Department recently commissioned IPF Ltd to independently moderate a self-assessment of its financial management. That review, conducted between July and November 2008, reinforces our findings. It concluded that "the Home Office has made huge strides within the past four years in improving the strength of financial management from what was a patently low base. Indeed we would be of the view that the Home Office is extremely well placed in meeting the Treasury and Head of the Accountancy Profession's aspirations in respect of financial management standards". While significant progress has been made, the Department recognises that there is still more to do to meet its aims for the financial management of its business, and the Treasury's ambition to embed "world class" financial management across central government. In order to meet this objective, the Department is in the process of refreshing its Finance Improvement Strategy.

On recent financial performance

Managing against budgets

7 The Home Office reported in its Autumn Performance Report 2008 that it met all of its Public Service Agreement targets for 2004 to 2007, exceeded its targets for efficiency savings, and did so within budget.

8 Over the five years to 31 March 2008, the Department has controlled its resource consumption effectively, managing it consistently between 96 and 100 per cent of the limits approved by Parliament. Over the same period, the Department has consistently underspent against its annual capital budgets, in one year by as much as 25 per cent, giving rise to a cumulative underspend of £725 million. The Department is improving its use of capital budgets and, in 2007-08, reduced the in-year underspend to £48 million (6 per cent) from £330 million in 2006-07 (25 per cent). The Department has not used its accumulated capital reserve, which has since been capped by the Treasury in the funding settlement covering 2008-09 to 2010-2011 at a maximum of £292 million.

9 In 2007, the National Audit Office reviewed the Home Office's data systems which it uses to measure performance against its Public Service Agreements. We found that three of the Home Office's data systems were fit for purpose, while the remaining seven were broadly appropriate but needed strengthening. Whilst we have not reviewed the Department's Comprehensive Spending Review 2004 efficiency savings outturn in full, in our review in February 2007, we considered £1,377 million of the Department's reported savings and assessed 32 per cent (£445 million) as fairly representing the efficiencies made and 68 per cent (£932 million) as representing efficiencies but raising some measurement issues. We have not yet reviewed the data systems underpinning the Department's more recent Public Service Agreement targets, nor the value for money savings under the Comprehensive Spending Review 2007. We will review each of these in due course.

Understanding links between resources and performance

10 The extent of the Department's understanding of its delivery costs varies across the range of activities and objectives for which it is responsible. The Department understands the direct costs of delivering specific services, such as issuing passports, relatively well, as the components of the service can often be individually costed. The Department examines in less depth the costs of activities which have less clearly defined outputs or activities which are delivered through partner bodies.

11 The Department does not yet, but is taking steps to more fully understand the impact of funding decisions on performance outcomes. At a national level, increases in funding for priority outcomes, such as reducing crime, have been accompanied by improved performance, but the causal links have not been established firmly. Similarly, the Department does not yet have a full understanding of how local variations in resourcing impact on outcomes. Establishing the links between the use of resources and delivery outcomes is undoubtedly challenging, because of the complex range of factors that impact on outcomes, and remains a challenge across the public sector. To assist in addressing this challenge, the Home Office is undertaking a project entitled "Matching Resource to Priorities". Complexity is greater where delivery is devolved to partner organisations. In 2008-09, over £8 billion will go in grants to delivery partners, including £5.4 billion to police forces through the main police grant. The forces are operationally independent and make spending decisions based on local priorities. The Home Office is improving its tools for monitoring devolved funding and is developing its understanding of the links between resource consumption and performance.

Charging for services

12 Accurate cost modelling for chargeable services remains a challenge in some areas. The Department is required to charge for some of the services it provides. It is allowed to make a surplus on some services to foreign nationals, but generally, like other government departments, where UK citizens pay for services, such as passports and criminal record checks, the Home Office is required to set fees and charges only to levels that cover the costs of providing the service. We found, however, that owing to changes in costs in 2007-08, fees charged for the provision of passports and criminal record checks gave rise to unplanned surpluses of £12 million and £10 million respectively. The main reason for the Criminal Records Bureau surplus was a favourable HM Revenue and Customs ruling on VAT, while at the Identity and Passport Service the principal factor was the delay to the roll-out of the Interview Office Network.

On managing the Home Office's business

13 We considered how far the Home Office has integrated five widely accepted aspects of good financial management into its business: financial governance and leadership; financial planning; financial decision making; financial monitoring and forecasting; and financial and operational reporting. Our findings are set out below.

Financial governance and leadership

14 An improved financial management culture is in place at the top of the Home Office. Strong, visible leadership from the top, focusing on risk management and improving the financial capability of senior managers, has improved the financial management culture at the top of the Department. The appointment of a qualified accountant to the Board in 2005 emphasised the corporate importance of finance. This appointment, together with the leadership of the Permanent Secretary, has been an important factor behind the Department's improvements to its financial management. Regular Operating Reviews of each business area, examining all aspects of performance including finance, led by the Permanent Secretary, have enhanced senior level accountability. The Department also took the initiative in expanding the scope of the existing internal audit programme to assess whether basic financial procedures were being followed.

15 This improved financial management culture, however, is not yet embedded throughout the organisation. Review work carried out by the Department's internal audit team during the last year found that there is significant scope for improvement in compliance with core financial management policies and procedures across a range of areas, including budget management, fixed asset and inventory management, the handling of pay and allowances and the use of procurement cards. The Home Office has over 24,000 employees and instilling lasting cultural change on this scale will, of course, take time. The ongoing support of senior management will also be important to continue promoting and embedding the Department's financial management improvement agenda throughout the business.

16 The recruitment and retention of key finance staff have been difficult at the Home Office, in common with much of the public sector. To enhance financial expertise and capacity, over the last 2 years, the Home Office has increased the number of professionally qualified finance staff in core finance roles. The Department is also piloting membership of a well established Government Finance Profession graduate trainee accountant scheme to develop a cadre of in-house finance professionals. Although trainees will be able to fill some gaps immediately, it will take time for the scheme to supply candidates capable of filling senior vacancies: some five years for manager grades, where external recruitment is most difficult. The Department recognises the need to develop staff with both professional finance skills and the acumen to use these skills to add value to the Department in areas where a generalist may be less well equipped to do so.

Financial planning

17 The Department has improved its financial planning and budgeting, but short term funding settlements are still affecting the delivery of objectives. Although its single largest element of funding, the distribution of grants to police authorities, has been on a multi-year basis since 2006-07, other recipients of grants from the Home Office rely on short term agreements, typically single year settlements underpinned by longer term indicative budgets. Single year funding agreements for local Crime and Disorder Reduction Partnerships meant that the Partnerships largely used these funds to help manage the consequences of violent crime, rather than tackling its root causes. Internally, budgets are now being delegated in advance of the financial year to all business areas and it is important that they are cascaded swiftly thereafter. For example, although all Non-Departmental Public Bodies were given indicative three year budget settlements, two major Non-Departmental Public Bodies told us that earlier firm annual budget delegation would help timely business planning.

18 New Home Office bodies have taken some time to establish their financial management on a firm footing. In recent years, the Home Office has set up important new business areas and bodies: the Office for Security and Counter Terrorism; the Serious Organised Crime Agency; the National Policing Improvement Agency; and the Independent Safeguarding Authority. Getting new organisations up and running effectively is challenging. We found instances where local financial management capacity was insufficient to deal with the initial challenges these bodies faced.

Financial decision making

19 Submissions to decision-makers for important policy and operational decisions are usually supported by appropriate financial analyses. The Department has put appropriate governance structures in place to monitor and provide advice to the business on the quality and completeness of financial information provided to decision makers.

Financial monitoring and forecasting

20 The quality of the Department's financial monitoring and forecasting has improved and its key financial systems are capable of supporting the Home Office's business needs, but staff find them difficult to use. Working round the systems reduces compliance, causes errors and hinders the production of timely, good quality financial information. To mitigate the risk of management receiving inaccurate information, finance staff need to spend substantial time making sure that financial data is reliable. The monthly Finance Report is therefore provided to the Board 16 to 20 working days after the month end, compared to the Treasury target of 10 days. The Department has plans in hand to address these issues and, in December 2008, completed the first phase of its Central Finance Process Improvement Review.

Financial and operational reporting

21 The Home Office has improved the accuracy and reliability of financial information reported internally and externally. We found that the Department has improved in-year budget management and reallocated resources to areas experiencing budgetary pressure or deemed to be high priority through its mid year review process. The Department's delivery of its Resource Accounts for 2007-08 with an unqualified audit opinion, before Parliament's summer recess, was an important symbol of the progress it has made.

Financial Management Conclusion

22 The Home Office has substantially improved its financial management, including its overall financial governance, its financial planning, budgeting, monitoring, forecasting and reporting, and its arrangements to support financial decision making. However, the Department has not reached the stage of maturity at which good financial management is part of "business as usual" operations. Continued effort and emphasis is required to consolidate the improvement which has been achieved, and to deliver the further improvements in financial management that will assist the Department in maximising the value for money it delivers to citizens and non-citizens alike. In particular, the importance of good financial management and financial management skills is not yet fully apprehended throughout the Department; the strategic management of its large capital programme has not been responsive enough to avoid large underspends; the Department does not have enough information on the relationship between resource requirements and outcomes; and financial management arrangements have not been sufficiently resilient in supporting organisational change. The Department recognises these issues and is updating its Finance Improvement Strategy accordingly. The following recommendations are intended to improve financial management across the Department.

Recommendations

23 Against the above background we recommend as follows:

a **The Home Office has made substantial improvements to its financial management in recent years, but has not reached the stage of maturity at which good financial management is part of "business as usual" operations**. Following on from this report and that of IPF Ltd, the Department should now set out a clear aspiration for its desired standard of financial management. To achieve this aspiration, the Department should set out an updated action plan to address the areas of improvement that are needed.

b **Newly established Home Office business areas and bodies have taken some time to establish their financial management on a firm footing**. The Department should identify how it can provide better financial management support to new bodies at inception and during their early years.

c **The Department has consistently underspent against its capital budgets, generating a cumulative underspend of £725 million over the last five years**. It should identify its capital expenditure priorities, and underpin its capital programme with robust project management and budgets that are taut yet realistic. The Department should also put arrangements in place to improve individual project deliveries so that it can identify and release funds that are no longer required so that they may be deployed elsewhere on the same timescale.

d **The forecasting of some costs remains challenging for the Department in areas where fees for services are required to be set to break-even levels, such as passports and criminal record checks. Demand and cost modelling may become more challenging in the uncertain financial environment**. The Department should carry out further analysis of forecast demand and costs for these services to improve their ability to set fees at levels that will more closely meet break-even targets.

e **Management of funding to partners has improved but short term funding settlements are still affecting the delivery of objectives**. Within the existing annuality restrictions, to help improve value for money, the Department could provide longer term stability of funding and increase lead times when delegating budgets to delivery partners.

f **The Department has increased the number of professionally qualified finance staff it employs and is rolling out programmes to enhance and build financial skills and capacity more widely, but it will be some time before the benefits are realised**. The Department should improve succession planning and recruitment to bridge the skills gap. The Department should evaluate the benefits derived from its finance professionalism programmes and use the results of this assessment to accurately match its financial management capacity levels to its specific business needs.