



National Audit Office

Financial Management in the Foreign and Commonwealth Office

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SUMMARY

1 The role of the Foreign and Commonwealth Office (the Department) is to run a global network for the whole of the British government, deliver services to British citizens and pursue foreign policy priorities. The Department manages a budget of nearly £2 billion. Alongside its UK presence, the Department runs a network of 278 overseas posts, provides substantial funding to the British Council and the BBC World Service, and works closely with a range of other UK Government Departments.

2 Effective financial management helps an organisation manage its budgets, allocate resources, and make decisions supported by an understanding of the relationships between costs and performance. When the resources of an organisation's business are directed and controlled to support the organisation's goals, it is better able to deliver its services cost-effectively. In the same way, good corporate governance relies on sound financial management to underpin service quality and improvement, and to provide the information to account to stakeholders for its stewardship of assets and use of resources.

3 This report presents the findings and recommendations from our examination of financial management within the Foreign and Commonwealth Office (FCO). It examines:

- the management of the Foreign and Commonwealth Office's financial performance (Part 1); and
- how far the FCO uses five widely accepted aspects of financial management to manage its business (Part 2).

Main Findings

On the progress made in improving financial management

4 We have found that the FCO has made significant progress in developing its financial management capability. The focus of this effort has been a change project – 'Five Star Finance' – setting out a suite of milestones to be achieved in order for the Department to establish itself as one of the best in Whitehall. The Department currently rates itself at 'three and a half stars', which we consider to be a reasonable and soundly based assessment against the targets set within the original project plan. There is, however, still much to do to reach the five star standard, as the Department recognises.

5 The Department takes financial management seriously. In its review conducted in the final six months of 2008, the Institute of Public Finance Ltd (IPF) concluded that the building blocks of financial management are largely in place, to secure effective stewardship of resources. It identified that the FCO still has work to do to ensure that core financial competencies are present throughout the organisation to support performance and enable transformation. The FCO is establishing an Action Plan to respond to the main issues raised by the IPF review.

Financial Governance and Leadership

6 **There is a strong financial management culture in place at the top of the Foreign and Commonwealth Office.** The Accounting Officer and the Board have provided a strong lead to the mission to improve the standards of financial management throughout the Department. The external recruitment of a qualified Finance Director, and his promotion to the Board as Director General, Finance, provides a strong signal of the corporate importance of finance. The Board is also supported by a Non-executive director who is a senior member of the accountancy profession and the Chair of the Department's Audit and Risk Committee.

7 **In terms of financial management skills, the proportion of qualified staff within the Finance function is below the average for central government.**

As at October 2008, eight per cent of staff working in Finance were professionally qualified, against a central government average of 14 per cent. The Department has launched a professional finance training programme to build its numbers of professionally qualified staff. It has also introduced training programmes to improve skills for non-finance staff, but needs to do more to ensure widespread take-up of these programmes.

Financial Planning

8 **The Department has well-developed resource allocation procedures, but there is scope for better linkages to business planning processes.** Business plans, developed to outline how Departmental Strategic Objectives are to be achieved, are lacking in detailed financial information. The Department aims, through enhanced staff activity recording, to map resource utilisation more effectively in to business plans and to inform future resource allocation decisions.

Finance for Decision Making

9 **There is a structure of sub-committees of the Board (particularly the Finance Committee and Investment Committee) in place to manage decisions on resourcing commitments and future investments.** Monthly meetings of both Committees are informed increasingly by financial analyses, though there is scope to develop additional sensitivity analysis in options papers.

Financial Monitoring and Forecasting

10 **The Department underspent significantly against its 2007-08 budget, in spite of requesting additional funds part way through the financial year.** The underspend of £128 million (resource and capital) was attributable to both operational underspends and accounting entries relating to asset impairments, but it was not anticipated during the financial year and hence the Department was not able to re-prioritise activity in a planned way.

11 **There is more to do to achieve reliable in-year financial information, as a basis for holding budget holders to account for their financial management.** The Department is working to enhance its financial systems and staff skills so that reliable and timely financial information is available to budget holders. Staff are increasingly held accountable for their own financial management performance in performance appraisals and consideration of forward posting discussions.

12 Going forward, the Department has taken action to avoid future unanticipated underspends. The Department has introduced additional challenges to in-year financial forecasting with detailed scrutiny of quarterly financial forecasts at Director General level. Evidence of budget re-forecasts in the early part of the year indicates that this scrutiny has proved effective. Financial forecasting for 2008-09 has been made more challenging by significant exchange rate fluctuations. The Accounting Officer has set a target for expenditure to fall within one per cent of the budget. In working to meet this target, the Department will also need to guard against the risk of inappropriate or poorly conceived expenditure towards the year end.

Financial and Operational Reporting

13 The Department has improved the accuracy, reliability and timeliness of financial information reported both externally and internally. The Department's 2007-08 Resource Accounts were laid in Parliament on 30 June 2008, the earliest date yet achieved after the 31 March year-end, and amongst the first of the major Whitehall departments. Internal management information (in the form of the "Key Performance Report" produced for the Board each month) has improved significantly over time. The Department aims to speed up the production of the report to within seven working days of the month-end. In so doing, the Department should balance the need for timely information with the demands of accuracy and quality of accompanying commentary.

14 The Department is working to align financial and operational reporting. Enhanced staff activity recording should provide a basis for inclusion of a financial element in operational reporting against Departmental Strategic Objectives. This is an important step in order for the Department to be able to identify the true cost of seeking to meet its various objectives, requiring the understanding and buy-in of operational staff so that information is soundly-based.

Conclusion on Financial Management

15 The Department has shown strong leadership in raising the profile of good financial management across the organisation. Its main driver for improvement is a change programme, called Five Star Finance, established in July 2007 to improve processes, IT systems, collection of monthly management information and financial skills for staff. Some early successes have been achieved, the programme is ongoing, and the Department has established a sound financial management framework, but against a background of consistent underspending

against budget in recent years. The Department is working to strengthen the link between its business planning and resource allocation, and has introduced a system of staff activity recording as a basis for providing a clearer picture of the real cost of pursuing each of its Departmental Strategic Objectives.

Recommendations

16 Against this background, we recommend as follows:

- a The Department's Five Star Finance project will have run its course by July 2010, and the Department is currently considering how to consolidate the project's achievements.** In managing within increasingly constrained resources, the Department will need to use the capability created through the project to budget more rigorously and utilise all available resources to best effect.
- b The Department is working to extend Financial Skills training across the broader Department, but data on take-up of training is not complete, and there is scope to develop further tailored training for particular roles.** The Department should develop comprehensive data on the take-up of the training, use it to maximise participation, and develop further tailored finance training for Directors and for Senior Management Officers.
- c Historically, the Department has employed a large number of consultants and contractors in the Finance Directorate.** Progress on recruiting and training additional professionally qualified accountants should reduce the extent to which the Department needs to employ contractors or consultants in Finance roles. The Department should set targets for the reduction in use of contractors and consultants and monitor progress against them.
- d We noted some evidence of delays in delegating budgets to budget holders.** Directors General should delegate budgets at the beginning of the financial year to encourage accountability for the use of resources for the entirety of the financial year.

- e The system of staff activity recording introduced in 2008-09 is beginning to provide a better picture of the real cost of pursuing each of its Departmental Strategic Objectives. **The Department recognises that it has more to do to obtain regular and accurate activity data, as a basis for longer term resource allocation to DSOs.** It should operate a proportionate system of staff activity recording as a routine management tool, taking care to ensure the buy-in and understanding of staff of the process so that information is soundly-based.
- f The Finance Committee is increasingly drawing upon financial information to take decisions on financial risks arising from operational activities, and also for investment decisions. **The Committee has yet to make full use of sensitivity analysis in reaching its decisions.** The Department should review the form and content of submissions to the Committee so that adequate sensitivity analyses are included.
- g The Investment Committee considers business cases in support of capital investment decisions, and monitors capital expenditure and project progress through the year. **The Committee does not, however, have a role either in the scrutiny of longer term capital expenditure strategies or in post-project appraisal.** The Department should assess the scope for the Committee to take on a role in the scrutiny of longer term capital expenditure strategies. It should also consider whether existing arrangements for scrutiny of major projects and post-project appraisal best meet its needs.
- h **Some major projects which the Department has undertaken report in to a number of different Boards.** The Department should rationalise project scrutiny arrangements to minimise duplication of effort.
- i From 2008-09 onwards, the Department has taken over from the Treasury the responsibility for managing the impact on its budgets of movements in exchange rates. **Large recent shifts in exchange rates pose significant challenges to the Department's ability to manage its resources.** The Department should ensure that it has the technical skills in place within the Finance Team to deal with forward exchange rate fluctuations in order to manage this complex issue.
- j The Department has improved the accuracy and timeliness of the production of its Key Performance Report (KPR) for the Board. **It aims to build upon this improvement by producing the report within seven working days of the month end, but needs to manage the risk that the quality both of the core data and accompanying commentary could be reduced.** The Department should seek feedback from the Board on the KPR on an ongoing basis, to ensure that it balances the need for presenting management information on a timely basis with ensuring the accuracy of information and commentary provided.
- k **Programme teams report progress and performance to a number of different stakeholders in the Department (e.g. Programme Boards, Financial Management Group, Directorate Resource Management Units).** The Department should rationalise reporting arrangements to minimise unnecessary duplication.