



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

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Ministry of Justice

Financial Management Report

Summary

1 This report examines the financial management of the Ministry of Justice (the Ministry), which in 2008-09 was responsible for some £10.1 billion of expenditure and administered £37 billion of grant payments to the Scottish and Welsh devolved administrations.

2 The Ministry was established in May 2007, through combining the criminal justice elements of the Home Office with the Department for Constitutional Affairs. The Ministry is made up of a small corporate and policymaking centre and a range of delivery bodies that constitute some 94 per cent of its expenditure. Since its inception, the Ministry has been subject to significant machinery of government changes, including the establishment of the National Offender Management Service agency in April 2008, which represented some 49 per cent of the Ministry's overall expenditure in 2008-09.

3 Effective financial management is crucial to strong corporate governance, ensuring an organisation's resources are directed and controlled to support its aims and objectives. 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 of its assets and use of resources.

4 The Ministry has wide ranging responsibilities across the justice sector and a nationally important remit, encompassing the courts, prisons and probation services. To deliver this remit, the Ministry has a range of interlinked arm's length bodies and delivery chains. In addition, the Ministry is operating under considerable financial pressure, due to the current spending environment. Strong, consistent and flexible financial management processes are, therefore, crucial in ensuring that these arm's length bodies are held to account and that the Ministry is able to monitor its financial and operational risks effectively, respond to problems quickly and deliver improvements in services within the constraints of available resources. This is particularly important following the recent Budget announcements.

5 This report presents the findings and recommendations from our examination of the Ministry's financial management in three parts:

- Part One – how the Ministry is organised and managed;
- Part Two – the financial performance of the Ministry; and
- Part Three – our assessment of financial management within the Ministry.

6 During our fieldwork for this study in late 2009, we met with the Ministry's senior executives and examined evidence underpinning the Ministry's financial management systems and 2008-09 reported performance, to conclude on its effectiveness.

7 The Ministry has a diverse structure, a nationally important delivery portfolio and a significant operational budget. In addition, the Ministry needs to ensure that it can deliver sustainable cost reductions to meet the demanding targets outlined in the recent Budget. To manage these challenges, the Ministry needs effective strategic and operational financial management capacity, supported by consistent integrated financial and operational management information and good quality financial reporting. We found that the Ministry is making progress in improving in its financial management. It has identified the main financial management challenges it is facing and has begun to address them. However, we have identified the following areas of weaknesses:

- the consistency of the Ministry's financial management approach;
- the Ministry's understanding of its costs;
- consolidation of the Ministry's financial management systems and processes; and
- the delivery of the Ministry's financial management improvement initiatives.

8 Our key findings in these areas are outlined below.

Key findings

The consistency of the Ministry's financial management approach

9 The Ministry has complex delivery mechanisms and accountability structures in its executive agencies. This makes it difficult for the Ministry to introduce consistent financial management processes, reducing their efficiency and increasing their cost. The Ministry has a range of financial management processes and accountability structures in its executive agencies, who are primarily responsible for delivering its challenging remit. The Ministry has yet to consolidate these processes, particularly in the National Offender Management Service, its largest executive agency, whose financial management has yet to be integrated with the Ministry's.

10 The Ministry's financial management and monitoring processes did not identify the emerging control issues in the Legal Services Commission, its largest Non-Departmental Public Body, in time for the Ministry's Board to address them and prevent their accounts being qualified. The Ministry and the Legal Services Commission have begun to address these control issues. In addition, the Ministry has announced its intention to convert the Legal Services Commission from a Non-Departmental Public Body to an executive agency. The Ministry's monitoring systems did not enable the Board to intervene in the Legal Services Commission's control environment quickly enough to enable its emerging control issues to be addressed.

The Ministry's understanding of its costs

11 The Ministry does not understand the costs of its activities within prisons, the probation service, and the courts in sufficient detail. This reduces the Ministry's ability to allocate resources on the basis of relative financial and operational performance of individual prisons, probation services and courts.

The Ministry has improved its understanding and control of the costs of its external goods and services by enhancing its procurement function. However, some 40 per cent of the Ministry's cost base relates to staff time. The Ministry has introduced two major costing programmes, Specification Benchmarking and Costing in the National Offender Management Service, and activity-based costing in HM Courts Service to improve its knowledge of its staff-based costs. These have the potential to generate significant savings and operational benefits, but the overall programme is not due to be completed until March 2012.

12 The Ministry's Finance Directorate does not have sufficient visibility of the costs of policy proposals, affecting its ability to monitor their financial implications centrally.

The Ministry has recognised the importance of producing fully costed policy initiatives and is improving the coordination of its policy proposals through its Policy Committee and economists embedded in local policy areas.

The Ministry's financial management systems and processes

13 The Ministry's multiple financial data systems impact on the Board's ability to monitor its overall budgetary position, emerging financial risks and staff numbers.

Due to machinery of government changes, the Ministry has been subject to significant revisions to its structure since it was established. This has resulted in a legacy of multiple data systems, which reduces the Board's ability to monitor its financial position; ensure the timely flow of financial and operation information; produce accurate month-end reports and monitor financial risks as they develop.

14 The Ministry currently does not produce combined financial and operating reports for the Board, and its financial reports include information on expenditure and income only. This reduces the Board's ability to monitor the Ministry's full range of assets, liabilities and future cash requirements.

The Ministry produces operational reports highlighting performance against its Departmental Strategic Objectives, which include information on the progress of major programmes. However, these reports are not integrated with the Ministry's financial reporting and the Board's financial reports do not include information on its balance sheet and cash flow position.

Delivery of the Ministry's financial management improvement initiatives

15 The Ministry has recently drawn together its financial management improvement projects. However, it is yet to define the importance of financial management in its future development or deliver its programme of improvements.

The Ministry's Board has made good progress in improving its financial management. It has identified that it needs to integrate its financial systems, deliver its future efficiency programme and improve its internal financial reporting. The Ministry has also introduced its Value for Money Improvement Committee to develop and oversee its financial plans and monitor their delivery. However, the Ministry is yet to commit to a clear, comprehensive action plan to deliver the projects within its financial management improvement programme.

16 The Ministry's Performance and Efficiency Programme has been effective in providing a clear direction for efficiency across its corporate centre and arm's length bodies. The Performance and Efficiency Programme has encouraged staff to engage in the process of delivering efficiency savings and, through this programme, the Ministry has started to spread existing effective operational practice. This focus has also helped the Ministry to live within its budget in recent years despite increasing cost pressures in courts, prisons and probation. The Ministry has reported that it is on track to delivery £1 billion of savings during the current Government Spending Review period. The Ministry will face further efficiency challenges in the coming Government Spending Review, to be completed in autumn of this year, but it is beginning to plan for the delivery of these efficiencies, building on the disciplines it established in the Performance and Efficiency Programme.

Overall Conclusion

17 The Ministry has recognised the need to improve its financial management. The Ministry has also introduced programmes to better understand its costs and integrate its financial systems, for example, by establishing its Value for Money Improvement Committee and enhancing its procurement function. The National Audit Office welcomes these initiatives, however, we view the Ministry's present financial management as below best practice in three significant areas:

- **The consistency of the Ministry's financial management approach.** The Ministry's differing financial management processes in its arm's length bodies reduce the efficiency of its financial management and affect the Board's ability to monitor its full range of financial and operational risks.
- **The Ministry's understanding of its costs.** The Ministry's incomplete knowledge of the costs of its activities and policy proposals reduces its ability to make decisions on the efficient allocation of resources.
- **The Ministry's financial management systems and processes.** The Ministry's multiple financial systems and incomplete financial reports affect the Board's ability to monitor its overall budgetary position and awareness of the full range of the Ministry's assets, liabilities and future cash requirements.

18 In the light of these findings, the National Audit Office believe there is a pressing need to ensure that the Ministry's financial management improvement programmes are delivered through a coherent, controlled and measurable change programme. We believe that this programme should be put in place within the next four months to ensure that the Ministry focuses on the delivery of its financial management initiatives and demonstrates its commitment to further improving its financial management.

Recommendations

19 The National Audit Office makes the following recommendations:

Delivery of the Ministry's financial management improvement initiatives

a **The Ministry has yet to commit to a clear plan for the delivery of its financial management improvement initiatives.** The Ministry should, within the next four months, articulate a strategy for the development of financial management across its span of control and set clear milestones and resource requirements for the delivery of its programme of financial management improvements.

The consistency of the Ministry's financial management approach

b **The Ministry's accountability structures and delivery model affects its ability to introduce consistent financial systems and processes across its remit and ensure the timely flow of financial and operational information.** In its review of its arm's length bodies, the Ministry should seek to streamline its financial systems and accountability structures to facilitate the introduction of consistent financial management processes.

c **The Ministry's financial management systems did not bring the control weaknesses within the Legal Services Commission to the Board's attention in time.** To improve its control framework for its Non-Departmental Public Bodies and ensure the Accounting Officer is able to gain sufficient assurance over their financial and operational risks, the Ministry should:

- clarify its monitoring remit with its Non-Departmental Public Bodies;
- determine the circumstances in which it would intervene to strengthen their control environment; and
- clarify the role of its Internal Audit function in relation to its arm's length bodies.

The Ministry's understanding of its costs

- d** **The Ministry does not understand the detailed costs of the delivery of its activities across its full range of arm's length bodies and activities.** To drive long term and sustainable efficiencies, and to enable it to make informed decisions on relative operational performance, the Ministry should, where resources permit, look to accelerate its Specification, Benchmarking and Costing programme in the National Offender Management Service, and activity-based costing work in HM Courts Service. It should also plan how it will use the outputs from these programmes to drive cost savings and should seek to expand these programmes to the Ministry's other delivery bodies.

- e** **The Ministry's Finance Directorate does not have sufficient visibility of the costs of its proposed policy initiatives reducing its ability to manage its forward policy programme within the constraints of its available resources.** The Ministry's Finance Directorate takes assurance from its Policy Committee and economists embedded in local policy areas for the costs of proposed policy. However, the Ministry should ensure that its Finance Directorate is able to monitor the likely costs of policy proposals centrally.

The Ministry's financial management systems and processes

- f** **The Ministry does not produce integrated operational and financial reports affecting the Board's ability to make decisions on the basis of the full range of relevant performance information.** The Ministry should build on the recent improvements it has made to its financial monitoring processes by:
 - producing a combined report for the Board including: all relevant financial information (covering income and expenditure, financial commitments, assets, liabilities, cash flows and staff numbers); operational performance and risk data; and
 - providing a clear commentary in the report describing the data, the potential implications and the decisions that are required by the Board.