



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

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Department for Culture, Media and Sport

Financial Management

Summary

Scope of the National Audit Office examination

- 1** Although a small department, the Department for Culture, Media and Sport (the Department) is responsible for £5.7 billion of expenditure across a wide-ranging sector. It delivers its objectives largely through arm's-length bodies. The Department's core Finance team consists of 22 staff, led by a qualified Director of Finance.
- 2** We assessed the maturity of the Department's financial management against a model developed by the National Audit Office (NAO) drawn from best practice (see Appendix One). We have examined "business as usual", the Department's response to the Spending Review 2010, and its review of arm's-length bodies.
- 3** The Department is the lead department for the London 2012 Olympic and Paralympic Games. The Olympic programme is overseen by the Government Olympic Executive, a separate directorate within the Department with its own Finance Director and Finance team. The NAO has a separate programme of work examining the Department's preparations for the Games. The work of the Olympic Executive and the financial management of the Olympic programme is accommodated within this wider work programme, and as it is distinct from the financial management of the Department as a whole, it has not been examined as part of this study.¹
- 4** Our wider body of work examining the Olympic programme has concluded that: responsibilities for costs have recently been clarified, putting preparations for the Games on a firmer financial footing; on current assumptions the Public Sector Funding Package should be sufficient; and the Olympic Executive has improved its understanding of the financial position of the London Organising Committee of the Olympic Games and Paralympic Games for which the Government is the guarantor. However, this study concludes that the commitment to financial management shown on the Olympic programme needs to be replicated across the Department's wider responsibilities.

¹ http://www.nao.org.uk/our_work_by_sector/culture,_media_and_leisure.aspx

Key findings

On the effectiveness and influence of the Finance function

5 The Department's Finance team has improved the standard of its financial management. Its external financial reporting meets the standards set by HM Treasury and it has received unqualified audit opinions on its Resource Accounts since the transition to Resource Accounting. There have been improvements to the controls over capital funding, where bids for funding must be based on fully developed and costed business cases, and put to a new Investment Committee for approval. Internal administrative budgeting has also improved, with budget holders facing direct challenge from the Director-General and Finance Director, while the Finance team has applied rigorous challenge to the set-up costs of a new arm's-length body.

6 The Finance team, however, still needs to improve its performance in a number of areas, in particular in strengthening the role it plays in support of key policy decisions and in providing information to the Board. To drive through these improvements, the Department's leadership needs to place greater emphasis on good financial management. This reflects wider concerns expressed in the 2009 Capability Review² highlighting the lack of influence the Finance team has within the Department. Our report on the Foreign and Commonwealth Office³ has demonstrated how strong leadership from the Accounting Officer and the Board can contribute to embedding a culture of sound financial management.

On performance, financial and risk reporting to the Board

7 The Department has adopted the Cabinet Office's new protocol for Departmental Boards. The Board is now chaired by the Secretary of State and three new non-executive members have been appointed. The Board is supported by five sub-committees. Between July and December 2010, the governance structure was in a transitional stage with the first full meeting of the Board taking place in January 2011.

8 In September 2010, the Department produced a new format of performance report, based on the Department's Business Plan that focuses on the Secretary of State's eight priorities. The Business Plan, however, does not cover several ongoing activities of the Department, including the activities of arm's-length bodies and high-value capital projects. Consequently, we consider that the Department does not provide the Board with sufficient information on the wider aspects of its performance.

9 The Board now receives financial information in a consistent format, including additional finance reports when requested. In our view, there are some gaps in the information reported, in that there is no reporting of performance against Parliamentary supply control totals, nor is information provided on outturn to date. This prevents the Board from examining the Department's financial position in full.

² *Capability Review: the Department for Culture, Media and Sport, progress and next steps*, March 2009.

³ Comptroller and Auditor General's report, *Financial Management in the Foreign and Commonwealth Office*, June 2009.

10 In its new structure, the Board intends to rely on its Policy Committee to provide assurance on finance and performance across the Department. While the Committee is still in a transitional phase, there is as yet no established mechanism to escalate these issues up to the Board.

11 The Department has improved risk management at an operational level. While the Audit Committee Chair provides an update on risk at Board meetings, the Board has not yet included any formal discussion of strategic risks on its agenda. It is also unclear how the escalation of operational risks to the Strategic Risk Register is working in practice. The Strategic Risk Register itself has significant omissions and does not focus on controls mitigation or the financial impact of risks.

On the Department's relationship with its arm's-length bodies

12 The Department faces a substantial challenge in providing effective financial oversight of its arm's-length bodies which differ substantially in size, influence and risk. In line with other departments with devolved delivery chains, the Department faces the challenge of determining the appropriate level of oversight it can commit to its arm's-length bodies commensurate with the resources that it has.

13 The Department has developed risk assessments of its arm's-length bodies to inform the level and nature of its relationship with them. Whilst recently enhanced, however, these assessments have not been incorporated into the Department's monitoring activities and have not been used to inform the level of sponsorship engagement. Applying a targeted approach to monitoring will be increasingly important as the Department adapts to its significant staff reductions announced in the Spending Review in October 2010.

14 The Department does not have an information strategy that defines sufficiently the financial information it needs to apply appropriate management of its arm's-length bodies. Financial data obtained does not provide data about spending on particular projects or a cost breakdown beyond overhead and programme activities. This weakens the Department's ability to make more informed decisions on budget allocations. Until December 2010, the Department had incomplete information on arm's-length bodies' cash balances leading to grant-in-aid being awarded in advance of need. There are also weaknesses in the Department's oversight of arm's-length bodies' compliance with framework documents, many of which are out of date.

15 The Department has a history of over-committing its budget allocations across its arm's-length bodies. In April 2009, initial forecasts for 2009-10 showed capital budgets had been over-committed by £95 million, and in 2010-11 by £110 million. The Department had to negotiate with HM Treasury for access to an additional £120 million of budgetary cover and find £72 million of reductions in planned expenditure in order to reduce the forecast deficit. The impact of over-programming budgets can be significant and can lead to situations where areas of spend may need to be reduced, regardless of their strategic importance.

On the Department's management of cost reduction in its arm's-length bodies

16 The Department faced a substantial challenge in preparing for the Government's Spending Review. It prepared thoroughly, by developing an understanding of the impact of reductions in funding through scenario planning based on information provided by its arm's-length bodies and preparing targeted options. It was also able to inform its bodies of the outcome of the Spending Review on the same day as the HM Treasury announcement.

17 The Department applied specific graduated reductions across a number of its bodies. However, the budgets of the arts and culture sector were cut by a standard flat rate, albeit moderated by differential budgets for capital spending and as yet unallocated access to self-generated reserves and to restructuring funds. The Department also made a 50 per cent cut in its own administration costs and those of a number of larger bodies. While the Department was influenced by the desire to make quick decisions, the use of standard flat rates does not differentiate sufficiently between the existing cost bases of the different bodies, although access to reserves and restructuring funds may address this going forward. However, the level of cuts imposed, combined with the fact that funds for restructuring and use of accumulated reserves have not yet been allocated, means that the Department cannot yet know the ultimate impact on frontline delivery. This followed a decision to apply a 3 per cent cut to the majority of bodies' budgets to meet the new Government's target to reduce spending in 2010-11. Undifferentiated top-slicing of budgets can leave organisations exposed and unprepared for the future, and can lead to higher overall costs or the displacement of costs elsewhere.⁴

18 The Department's decision in 2010 to close and merge a number of its arm's-length bodies was not informed by a financial analysis of the costs and benefits of the decision. The Department did not obtain sufficient financial data about the bodies and based its decisions on estimates that did not take account of the full costs of closure such as lease cancellation, redundancy and pension crystallisation costs. The decision was also not informed by an estimation of future savings or of what the pay-back period would be. In responding to the new Government's review of recent spending decisions, the Department cancelled seven projects with a total value of £73 million, without ascertaining the financial penalties that might be incurred.

⁴ National Audit Office, *A short guide to structured cost reduction*, 2010
http://www.nao.org.uk/publications/1011/structured_cost_reduction.aspx

Conclusion on value for money

19 The Department has improved the maturity of its financial management in specific areas, both within its Finance function and more broadly across its sponsor teams. Our previous studies have acknowledged evidence of good financial management within the Olympic programme. However, this review of financial management across the Department as a whole has found that it is not possible to conclude that the Department is achieving value for money as the following features are absent:

- Senior sponsorship to develop finance to an appropriate level of maturity and influence throughout the organisation.
- A commitment to take decisions based upon appropriate and accurate information that fully analyses underlying costs and understands the consequences of reductions.
- Deployment of a coherent, graduated approach to the challenging task of managing its arm's-length bodies.

Recommendations

20 We make the following recommendations:

a **The Board is not giving sufficient attention to performance, financial and risk management across the Department and its arm's-length bodies.**

The Department should:

- provide the Board with more comprehensive performance and financial information, and facilitate the Board taking ownership of risk management; and
- enhance the Strategic Risk Register so that there is increased focus on control mitigation, the financial implications of risks are defined, and the escalation of operational risks operates appropriately.

b **The Department does not have a consistent approach to overseeing its arm's-length bodies.** The Department should:

- determine the appropriate level of oversight it can commit to arm's-length bodies commensurate with the level of resources it has; and
- use its revised risk ratings to inform this relationship, and keep these ratings up to date.

- c The Department does not consistently obtain information on the financial activities of its arm's-length bodies.** The Department should establish a coherent information strategy that:
- defines the information it needs to hold on its arm's-length bodies to inform decisions on budget allocations and facilitate effective monitoring;
 - defines the quality assurance process that should be in place to challenge the information received from its sponsored bodies; and
 - sets the minimum level of financial and performance information that will be reported to its Board and senior management.
- d The Department over-commits its budget allocations to arm's-length bodies.** It should cease its practice of planning to overspend. If it chooses to over-programme, then it should have a clear plan of action should the over-programming crystallise, supported by accurate and timely monitoring.
- e The Department has made decisions based on insufficient financial information and analysis.** In making future decisions, the Department should:
- stop applying standard flat rate cuts to budgets and make awards to arm's-length bodies that take further account of their differing cost bases and the differing impact that cuts may have on frontline delivery; and
 - use a full analysis of costs, future savings, and pay-back periods when making decisions to merge or close arm's-length bodies and to cancel projects.