National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 820
SESSION 2010–2012

6 APRIL 2011

Department for International Development

Financial Management Report

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Department for International Development

Financial Management Report

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

4 April 2011

This report provides an overview of the Department for International Development's financial management. It examines the strength of its current practice and the related information used by the business and provides a high level initial review of the design of new processes it is putting in place, particularly its revised approach to allocating resources, the results of which have recently been announced.

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This report can be found on the National Audit Office website at www.nao.org.uk/dfid-financial-management-2011

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Summary

Scope of the examination

1 This report provides an overview of the Department for International Development's financial management. It examines the strength of its current practice and the related information used by the business and provides a high level initial review of the design of new processes it is putting in place, particularly its revised approach to allocating resources, the results of which have recently been announced. We have assessed the Department's current financial management capability and future plans against a matrix developed by the National Audit Office, drawn from best practice and previously applied elsewhere in central government. This enables us to provide Parliament with our view of the Department's current capacity for effective financial management, and to make an early assessment of how this will change under its new processes. We have not examined the value for money of specific allocation decisions or aid programmes.

2 Our work focused on the Department itself. Its two sponsored bodies – CDC Group plc and the Commonwealth Scholarship Commission – fall outside the scope of this review (see paragraph 1.3).

The Department's operating context

3 The Department spent £6.63 billion in 2009-10, almost all of which was classed as Official Development Assistance. It employed 2,362 staff as at September 2010, of whom the majority, 1,304 (55 per cent), worked overseas. The Department has a high reputation throughout the world, as evidenced by feedback from the Organisation for Economic Co-operation and Development.

4 The Department's objectives are largely drawn from the goals agreed within the United Nation's Millennium Declaration of 2000. To achieve these objectives, the Department provides funding both on a bilateral basis (£3.96 billion; 60 per cent of its spending in 2009-10) and a multilateral basis (£2.44 billion; 37 per cent in 2009-10).[1]

5 A significant amount of funding is committed via high level governmental agreements with multinational organisations and, for this funding, the Department has limited input into financial management at an operational level. At the other extreme, the Department directly supports a number of projects via its country offices.

1 Bilateral aid is provided to countries direct. Multilateral aid is channelled via an international organisation active in development. The Department's remaining spending of £0.23 billion in 2009-10 went to meet its running costs.

6 From a baseline of 0.56 per cent in 2010, the UK has a target of devoting 0.7 per cent of its Gross National Income to Official Development Assistance from 2013.[2] The Department bears most of the responsibility for meeting this target and, over the next four years, its programme budget will grow by £3.7 billion (35 per cent in real terms). At the same time, its administration budget will reduce by one third. This reduction will, to some extent, be offset by an increase in the Department's programme support budget, albeit subject to an annual cap. In 2014-15, the cap will limit administration and programme support to around 2 per cent of the Department's total budget. The Department will therefore face significant financial and operational challenges, making sound financial management essential.

7 Increased funding comes at a time when other departments are having their budgets reduced. As a result, the Department will come under intense scrutiny from Parliament as well as the new Independent Commission for Aid Impact. It must be able to demonstrate that it is achieving value for money across all its programmes.

Key findings

The Department has improved core financial management but key weaknesses remain

8 **The Department has recognised the need to improve its financial management and has carried out a number of initiatives.** The Department introduced the 'Making It Happen' change programme in 2008 which included a finance strand – the 'Money Action Plan'. Progress has been made on a number of elements. Progress against the plan was formally monitored by the DFID Management Board until April 2010. Since then, the Board has continued to review key finance indicators, but actions in the plan have not been consistently and comprehensively followed through due to the plan's lower priority compared to other change initiatives introduced by the Department.

9 **The number of finance professionals has increased but this expertise needs to be used more effectively across the business.** A review of financial skills carried out in 2009 highlighted that the Department had a comparative lack of skilled and qualified finance staff. In response, at a time of pressure on administration costs, the Department recruited a number of additional qualified staff. While this initiative increased financial capacity, sound financial management is not yet embedded throughout the organisation and the Department does not have a full understanding of the financial skills and expertise of staff outside the central finance function.

2 0.56 per cent is a provisional value for 2010. The Department plans to finalise the value in autumn 2011.

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10 The Department has introduced a new information system, but it does not yet provide integrated financial and performance data to support well-founded decisions. While data on costs and performance held outside this core system are used for decision-making, coverage and quality remains variable. The Department introduced a new financial management and information system in 2008. We found a number of limitations to its reporting capabilities, and problems resulting from the Department not changing its business processes to match effectively the system's functionality for accruals and forecasts. While some system development work is ongoing, the Department's original plan to address these limitations has been suspended due to the Government's moratorium on new IT projects costing over £1 million, but some elements are being taken forward. The primary focus of the Department's financial monitoring has been on actual spend against forecast, and the Department has not to-date tracked outputs or unit costs against project plans through its core systems. At present, financial and performance systems are not fully integrated.

11 While improving, there is a significant recognised weakness in financial forecasting. The Department has historically managed its outturn close to budget – in large part through its ability to delay or bring forward payments to partner organisations rather than through effective forecasting. Forecasts are often inaccurate and both skills and system capabilities need improvement. The Department is aware of the limitations to its forecasting, and that this leads to additional work for finance staff to manage the impact. More recent management accounts show improvement. To achieve the necessary level of accuracy in forecasting will require more than system improvements; it will also require cultural change.

The Department has a broader ambitious change programme under way, to focus on value for money and results from aid spending

12 Initiatives to increase the focus on value for money in aid projects are under way but not yet embedded. The Department has, since 2008, been working on improving the link between financial and performance data at project level including through greater use of standard output and outcome indicators and the use of more rigorous economic appraisal. The Department's most recent internal review in 2010 showed significant improvement in defining measures, although there were still key weaknesses in around one quarter of projects. Improvement in the use of economic appraisals was more mixed. We found that evaluation of costs had not consistently influenced country-level decisions on the design of projects. The Department is now seeking to improve the value for money assessments for new interventions by further development of standard measures, and through the introduction in January 2011 of a new approach to business cases.

13 **The Department has significantly changed its approach to the strategic allocation of resources, which has the potential to drive a much stronger focus on aid results and value for money.** Since July 2010, the Department has been undertaking two major internal initiatives – the Bilateral and Multilateral Aid Reviews – as part of a fundamental change to the way it allocates resources.[3] The results of these Reviews were announced in March 2011 and final resource allocations for the four-year Spending Review period will be made after completion of operational planning. The new allocation process aims to better align budgets with objectives and to allocate resources based more on the results and value for money to be delivered, rather than primarily on the basis of the assessed needs of recipient countries or the level of resources previously given through multilateral arrangements. In particular:

- The Bilateral Aid Review comprised a bottom-up approach, with the Department's country teams making evidence-based 'results offers' to generate outputs with a given level of resource and detailing how those outputs lead to overall development impacts. This has been accompanied by a top-down review – including consultation with Ministers – to ensure overall programme affordability and that strategic priorities are being met.
- The Multilateral Aid Review assessed the value for money of the Department's funding of multilateral organisations. The assessment framework included criteria about the focus and impact of each organisation on the Department's objectives, and criteria about organisational strengths. The Department assessed value for money against both sets of criteria when allocating resources.

The Department has yet to design its processes for tracking 'results offers' made under the Bilateral Aid Review, although country offices are required to provide results frameworks in their operational plans against which the Department intends to measure progress, including against recommended indicators. These results frameworks should enhance the Department's ability to report aggregated results.

The Department needs to bring greater coherence to its change agenda and address key risks to the effective management of increased spending

14 **Having conducted a thorough review of where and how it spends, the Department now has a high level plan allocating its resources on the basis of the results it aims to achieve. This has now been implemented but a number of key risks need to be managed.** The Department has, through its Bilateral and Multilateral Aid Reviews and associated allocation processes, set out how at a high level it will use its resources over the next four years. Operational plans, currently in draft, will confirm initial allocations. There are, however, a number of key risks associated with the increased resources. In particular:

- Within a very tight time frame, the Department is seeking to grow its front-line capacity, including increasing its front-line staff by at least 150 in 2011-12, while reducing its relative spend on running costs.

3 A further independent review of Humanitarian Emergency Response was published on 28 March 2011.

- The Department will have to balance the pressure to commit resources with greater value for money scrutiny which could delay or prevent project approval.
- The percentage of future spending relating to projects already approved, or existing commitments to multilaterals, falls over the Spending Review period, from around 80 per cent in 2011-12 to around 40 per cent in 2014-15. This reflects the Department moving into less well developed sectors and countries to address new policy priorities and the particularly rapid growth in its budget in 2013-14. The Department needs to actively manage its evolving 'pipeline' of projects to develop enough well-designed projects to meet its spending commitments.
- Lags between spending and results mean it will be some time before the Department can fully assess its trajectory and have confidence that the processes it has put in place are driving improved value for money.

15 Effective risk management is not fully embedded, and the Department has yet to define fully the strategic risks it faces in delivering on its new high level plan. The Department is good at identifying and mitigating certain types of risk, such as the security risk present in the fragile states in which it operates, and risk assessments take place at project, country, directorate and corporate level. The Department is also currently revising its corporate risk process and its Board approved in February, subject to refinement, changes to its risk framework to be implemented in spring 2011. It aims to better identify its strategic risks, more clearly articulate its risk appetite, and apply a new system of 'flash reporting' to quickly escalate risks through the organisation. However, we found that risk management is not yet fully embedded; nor is it consistently applied across the organisation. Importantly, it is not always clear how the various risk management systems are integrated in order to ensure that risk is managed at an appropriate level within the Department. The Department has yet to identify the strategic risks it faces in implementing its revised resource allocations. Through its operational planning process, the Department is seeking to assess the level of risk country-by-country including some limited assessment of its own capacity to deliver. These assessments have yet to be aggregated and reflected in the Department's overall risk register. The Department is currently revising its corporate risk process and will update its risk register in spring 2011.

16 With greater spending in higher risk locations, the Department must do more to assure itself that it minimises fraud and corruption risks. The value of actual fraud reported in the Department's accounts is low (£459,000 for 2009-10; 0.01 per cent of spend). The Department's future plans involve channelling increased funding into more fragile states, with the most significant increases in countries with relatively low scores in the Transparency International index. The Department's prevention of fraud is underpinned by its Fiduciary Risk Assessments process, primarily at country-level. Assessments consider the leakage through fraud and corruption, and detail safeguards needed to mitigate identified risks – informing the Department's choice of aid method – but do not draw conclusions about the residual risk that remains. The Department does not attempt to quantify its estimated likely losses. Where specific frauds or losses have been identified, we found that the Department's Counter-Fraud Unit is effective in investigating and recovering losses. The investigation of fraud is reactive, although there are signs that the Department is enhancing its approach in this area. The Department will need to articulate clearly how it will manage the potential increased risk of leakage and needs to develop approaches which are more proactive in identifying, and responding to, fraud and corruption.

17 The agenda for improving financial management and value for money should be fully integrated. The absence of integrated, complete and aggregated information on costs and results undermines the Department's ability to prove it has achieved value for money. Since mid-2010, the Department's main focus has been on changes to how it allocates resources and its value for money initiatives, but more recently it has returned to updating its finance reform plan that will progress the different elements of the Money Action Plan. We found no evidence of a current integrated strategy to bind these two key priorities together, as well as identify, and manage, the risks associated with the changes under way at the Department.

Conclusion on value for money

18 We recognise that the Department has been improving its core financial management and has also been strengthening its focus on value for money at all levels of the organisation, including through a step change in its approach to the strategic allocation of resources based on expected results. Important building blocks have been put in place, but key gaps in financial management maturity remain. The changes the Department has introduced to-date are positive, and provide a platform to address the challenges that will come with its increased spending.

19 At present, however, the Department's financial management is not mature. The Department's forecasting remains inaccurate and its risk management is not yet fully embedded. Weaknesses in the measurement of value for money at project level, variability in the quality and coverage of data, and lack of integration in core systems, mean that the Department cannot assess important aspects of value for money of the aid it has delivered, at an aggregated level. The Department now needs to develop a coherent single strategy to address the weaknesses identified and the key risks to meeting its objectives.

Recommendations

20 We make the following recommendations:

At the strategic level

a **The Department has developed high level plans for allocating its increased spend.** The Department should develop an explicit risk mitigation strategy to support the transition from its current spending profile to one where spending increases by a third in real terms. This strategy should enable the Management Board to monitor progress against agreed action points and milestones and manage risks that could develop.

b **The Department does not yet have robust procedures for tracking results and agreeing revisions to operational plans.** The Department will need good quality periodic information on what results have been delivered, and what results are due to be delivered split by the maturity of projects and their likelihood of progressing to the required timetable. Plans will need to be flexed to reflect changing circumstances over the Spending Review period. However, clear rules should govern what changes can be made by divisions and what decisions might affect the achievement of the Department's objectives and thus need to be escalated for further approval.

c **The Department needs to improve the timeliness and quality of data provided by its partners.** Shifting the results focus in operational plans from outcomes to outputs should make it easier for the Department to collect timely data. However, data quality is likely to remain a significant challenge and teams will need to review data quality, develop clear plans to manage weaknesses, and ensure users of reported data are aware of data quality issues. The Department should continue to measure progress in development outcomes as well as its often more output focused results offers.

d **More focus on improving value for money is needed, through strengthening the links between inputs and outputs, extending unit cost data and establishing minimum thresholds which if not achieved would trigger the requirement for re-approval of projects.** The new business case requirements should add rigour to the project approval process, but there is a risk that the increased budget and desire to make early progress on delivering promised results could encourage acceptance of poorer quality projects. An important feature of the Department's model is to give flexibility to country offices to determine how to deliver their results. The Department should, however, seek to formulate clear value for money thresholds which set triggers for project re-approval or cancellation should results, costs or timescales be significantly different from those expected.

e **Fraud and corruption present a risk to the reputation of the Department and are threats to development impact.** The Department is too reactive and cannot provide Parliament and the taxpayer with a clear picture of the extent, nature and impact of leakage. The risk of leakage will potentially increase as the spending increases for those countries with less developed controls and capability. The Department should do more to establish the impact on its business, by corralling the knowledge it already has and through research. Efforts to spread lessons learned in the identification and investigation of fraud should be extended.

At the operational level

f **The Department recognises the need to continue to improve financial management.** Plans should be firmed up urgently, with specified action points and milestones and clear accountabilities. The new plan should be kept under active review. The strategies for improving financial management and value for money need to be fully integrated.

g **The Department has increased its financial skills capability, but expertise needs to be used more effectively across the business.** The Department needs to continue to grow its finance capability. Despite the current pressure on training budgets, the Department should prioritise training for all staff with financial management responsibilities throughout the organisation, to ensure financial management and reporting is an integral part of project management within all business units and country offices.

h **Weaknesses remain in financial management and information systems introduced in the past two years, and nor is the Department able to demonstrate important aspects of cost-effectiveness at an aggregate level.** The Department's current focus is on system functionality, including reporting. It needs to stand back and consider its longer-term strategy for aligning its systems and business processes. In particular, it should assess the further enhancements required to support improved financial and wider performance management, including more extensive unit costing.

i **Financial reports provided to the Management Board need to improve to support decision-making.** The Board should review their content particularly as the business grows and the operational context evolves, with financial forecasts and progress against results offers being key areas of focus.

j **Risk management is not fully embedded nor consistently applied.** Risk management should be fully aligned with other management activities, with appropriate risk registers maintained by business units and country offices. Procedures should be implemented to escalate risks appropriately. The Department needs to finalise its current work on risk appetite, so it has an explicit and realistic assessment of this, which should be fully visible to, and owned by, the Board.

Part One

Organisation, activity and accountability

Introducing the Department

1.1 The Department for International Development (the Department) was set up in 1997. It aims to reduce poverty and create wealth in poor countries, strengthen governance and security in these countries, and tackle climate change (**Figure 1**).[4] It pursues the eight global Millennium Development Goals set by the United Nations in 2000.[5] The Department has a high reputation throughout the world for the work it does, as evidenced by feedback from the Organisation for Economic Co-operation and Development.[6]

1.2 In 2009-10, the Department was responsible for £6.63 billion of UK public expenditure.[7] It has two UK headquarters, in London and East Kilbride, as well as around 40 country offices.[8] It employed 2,362 staff as at September 2010, of whom the majority, 1,304 (55 per cent), worked overseas in the Country Programmes Directorate.

1.3 The Department owns and sets the overall framework for CDC Group plc, the UK's development finance partner.[9] At the time of preparing this report, the Department is conducting a wide-ranging review of CDC; we have therefore not considered it in this report.[10] Because of its small size, we have also not considered the Department's only Non-Departmental Public Body, the Commonwealth Scholarship Commission. The Department has introduced a number of changes in parallel with our review, particularly the revised allocation processes under the Bilateral and Multilateral Aid Reviews. Therefore, our review of some elements has been necessarily high level; we will examine these changes further in our forward programme of work.

4 DFID, Business Plan, November 2010. http://www.dfid.gov.uk/Documents/DFID-business-plan.pdf
5 Department for International Development Resource Accounts 2009-10, July 2010. http://www.dfid.gov.uk/Documents/publications1/departmental-report/2010/rsce-accts-09-10.pdf
6 Development Assistance Committee, Peer Review: United Kingdom, 2010.
7 DFID, Statistics on International Development 2010, October 2010. http://www.dfid.gov.uk/Documents/publications1/sid2010/SID-2010-Statistical-Release.pdf. National Statistics publication produced by the Department was published on 7 October 2010 according to the arrangements approved by the UK Statistics Authority.
8 Department for International Development Resource Accounts 2009-10, July 2010. http://www.dfid.gov.uk/Documents/publications1/departmental-report/2010/rsce-accts-09-10.pdf
9 Department for International Development Resource Accounts 2009-10, July 2010. http://www.dfid.gov.uk/Documents/publications1/departmental-report/2010/rsce-accts-09-10.pdf
10 Ministerial statement dated 13 October 2010, column 14WS, Hansard.

Accountability and governance

1.4 The Department's Permanent Secretary, in her role as Principal Accounting Officer, is responsible for the Department's organisation and performance, as well as the propriety and regularity of its expenditure. At the time of our review, the Department's Management Board included the Permanent Secretary (as Chair), three Directors-General and two non-Executive Directors. The Management Board meets monthly and, amongst other responsibilities, it monitors the Department's performance to ensure that its financial resources and staff are allocated and managed effectively. An 'enhanced' Board, chaired by the Secretary of State, is expected to begin operating in 2011.

Objectives and responsibilities

Structural Reform Priorities

1.5 The Department is responsible for meeting its Structural Reform Priorities, as set out in its Business Plan 2011-15.[11] In addition, the Government has reaffirmed the UK's commitment to the Millennium Development Goals, to be met by 2015.

Figure 1
The Department's objectives and responsibilities

1 Structural Reform Priorities

- Honour international commitments
- Introduce transparency in aid
- Boost wealth creation
- Strengthen governance and security in fragile and conflict-affected countries
- Lead international action to improve the lives of girls and women
- Combat climate change

2 Driven by Millennium Development Goals

- Eradicate extreme poverty and hunger
- Achieve universal primary education
- Promote gender equality and empower women
- Reduce child mortality
- Improve maternal health
- Combat HIV and AIDS, malaria and other diseases
- Ensure environmental sustainability
- Develop a global partnership for development

3 Supplemented by other responsibilities

- Respond to humanitarian disasters
- Deliver on obligations to the Overseas Territories
- Influence the global development system

Source: http://www.dfid.gov.uk/Documents/DFID-business-plan.pdf, Business Plan 2011-15, Department for International Development, November 2010

11 DFID, Business Plan, November 2010. http://www.dfid.gov.uk/Documents/DFID-business-plan.pdf

The United Nation's Official Development Assistance target

1.6 The Government is committed to achieve from 2013 the United Nations' target for donor countries to devote 0.7 per cent of their Gross National Income to Official Development Assistance.[12] Official Development Assistance is measured in terms of calendar years and, in 2010, the UK's Official Development Assistance to Gross National Income ratio was 0.56 per cent (up from 0.51 per cent in 2009).

1.7 The Department leads the Government's efforts on this commitment. It is the UK's main funder of Official Development Assistance, contributing £7,356 million or 88 per cent of the UK's total in 2010. It is also responsible for reporting other qualifying contributions, which include equity investments made through CDC, debt relief and spend by other government departments.[13] Other departments account for around 7 per cent of Official Development Assistance, much of which is subject to joint governance arrangements (**Figure 2**).

Figure 2
Official Development Assistance as a percentage of Gross National Income

	2009 outturn[1]	2010 outturn[2]	2011 forecast	2012 forecast	2013 forecast	2014 forecast
Department for International Development departmental expenditure (£m)	6,292	7,356	7,810	8,145	10,834	11,491
Other government departments (£m)	541	609	497	608	777	608
Non-departmental (£m)	391	388	398	365	400	547
Total (£m)	7,223	8,354	8,705	9,117	12,011	12,646
Total as a percentage of Gross National Income	0.51	0.56	0. 56	0.56	0.7	0.7
Percentage accounted for by Government Departments other than DFID	7.5	7.3	5.7	6.7	6.5	4.8

NOTES

1 2009 values are revised figures issued by the Department in March 2011. The ratio of Official Development Assistance to Gross National Income was revised downwards from 0.52 per cent to 0.51 per cent in March 2011.

2 2010 values are provisional figures issued by the Department in March 2011. The Department plans to finalise the 2010 figures in autumn 2011.

3 All values are in terms of calendar rather than financial years and in cash terms.

4 Individual values may not sum to totals due to rounding.

Source: DFID, including Department for International Development Statistical Release, Provisional UK Official Development Assistance as a proportion of Gross National Income 2010, March 2010

12 DFID, Business Plan, November 2010. http://www.dfid.gov.uk/Documents/DFID-business-plan.pdf

13 DFID, Statistics on International Development 2010, October 2010. http://www.dfid.gov.uk/Documents/publications1/sid2010/SID-2010-Statistical-Release.pdf. National Statistics publication produced by the Department was published on 7 October 2010 according to the arrangements approved by the UK Statistics Authority.

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Spending Review period 2011-15

1.8 The Department takes the lead on achieving the UK's target expenditure on aid. In support of this, the Department's own spending will increase by 35 per cent, in real terms, over the Spending Review period.

1.9 The Department also leads on managing the increasing spend on supporting fragile states and conflict-affected states – from 22 per cent to 30 per cent of total UK Official Development Assistance by 2014-15 (**Figure 3** overleaf).[14] Under the International Climate Finance Initiative – for which the Department is one of the joint leads – it plans to spend £1.8 billion of the £2.9 billion committed to low carbon growth and adaptation in developing countries.[15]

1.10 Despite the significant increase in its funding, the Department's administration budget will be reduced by 33 per cent over the Spending Review period. The impact of this will be partly mitigated by an increase in its programme support budget which, together with administration spending, will be capped. In 2014-15, the cap will be £233 million, the equivalent of 2.09 per cent of the Department's total budget – down from the current 2.64 per cent.[16]

The Department's delivery network, multilateral partners and bilateral aid recipients

1.11 The Department is largely decentralised, with 40 country offices responsible for delivering its programmes.[17] It mainly funds its programmes via delivery partners, using a variety of channels. It chiefly provides funds to individual organisations in the countries in which it operates or multilateral organisations which themselves have a worldwide aid distribution function.

1.12 In 2009-10, the Department worked bilaterally with partners to distribute £3,959 million – 60 per cent of its spending – to around 90 countries. The bilateral programme primarily involves funding specific development projects, providing emergency aid, financial aid, funding non-government organisations active in development work, or funding multilateral organisations for specific purposes or to undertake work in specific countries.

1.13 A full analysis of the Department's spend is at **Figure 4** on page 17.

14 HM Treasury, Spending Review 2010, October 2010. http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf
15 HM Treasury, Spending Review 2010, October 2010. http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf
16 For the purposes of the cap, the Department's budget is defined as its total Departmental Expenditure Limit less its allocation to the conflict pool which is also funded by the Ministry of Defence and the Foreign and Commonwealth Office.
17 Development Assistance Committee, Peer Review: United Kingdom, 2010, page 50.

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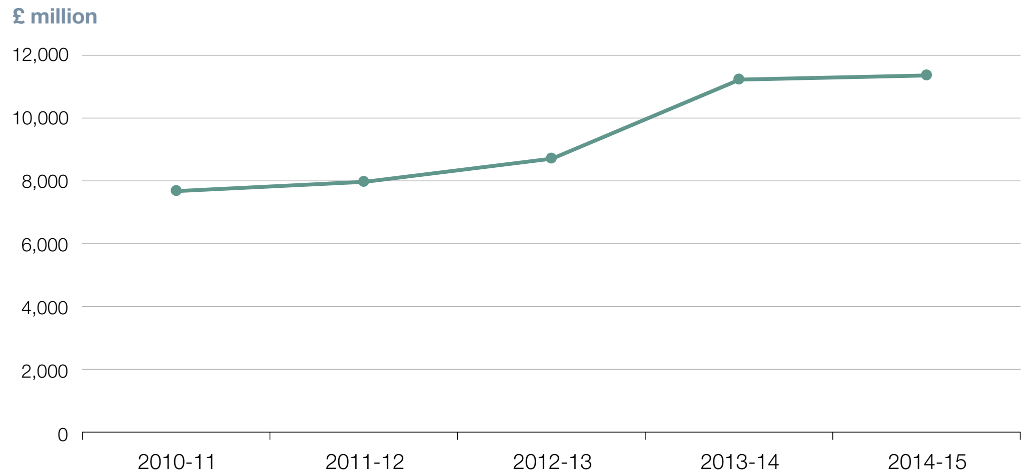
Figure 3
The Department's spending for 2010-11 to 2014-15

The Department's total budget will increase to £11,477 million by 2014-15, comprising £11,362 million for programme expenditure, £94 million for administration costs, and £21 million for depreciation. The Department's running costs, which comprise administration costs and programme support costs, will increase but will be capped at £233 million in 2014-15.

Programme expenditure

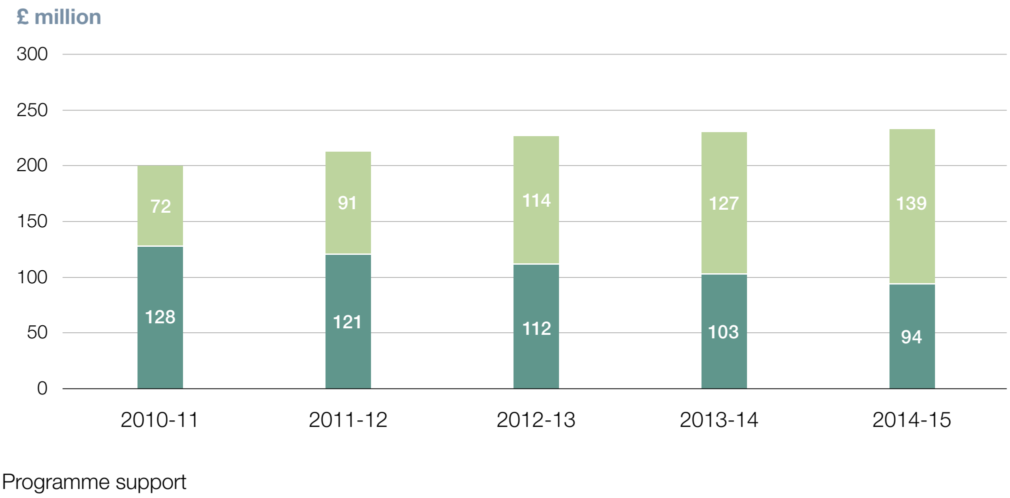


	2010-11	2011-12	2012-13	2013-14	2014-15
Programme expenditure (£m)	7,684	7,973	8,720	11,216	11,362

NOTES

1 All values in cash terms.

Running costs



NOTES

1 Programme support costs are funded from the Department's programme expenditure budget. They include the cost of staff who manage development programmes or deliver advice directly to recipient countries.

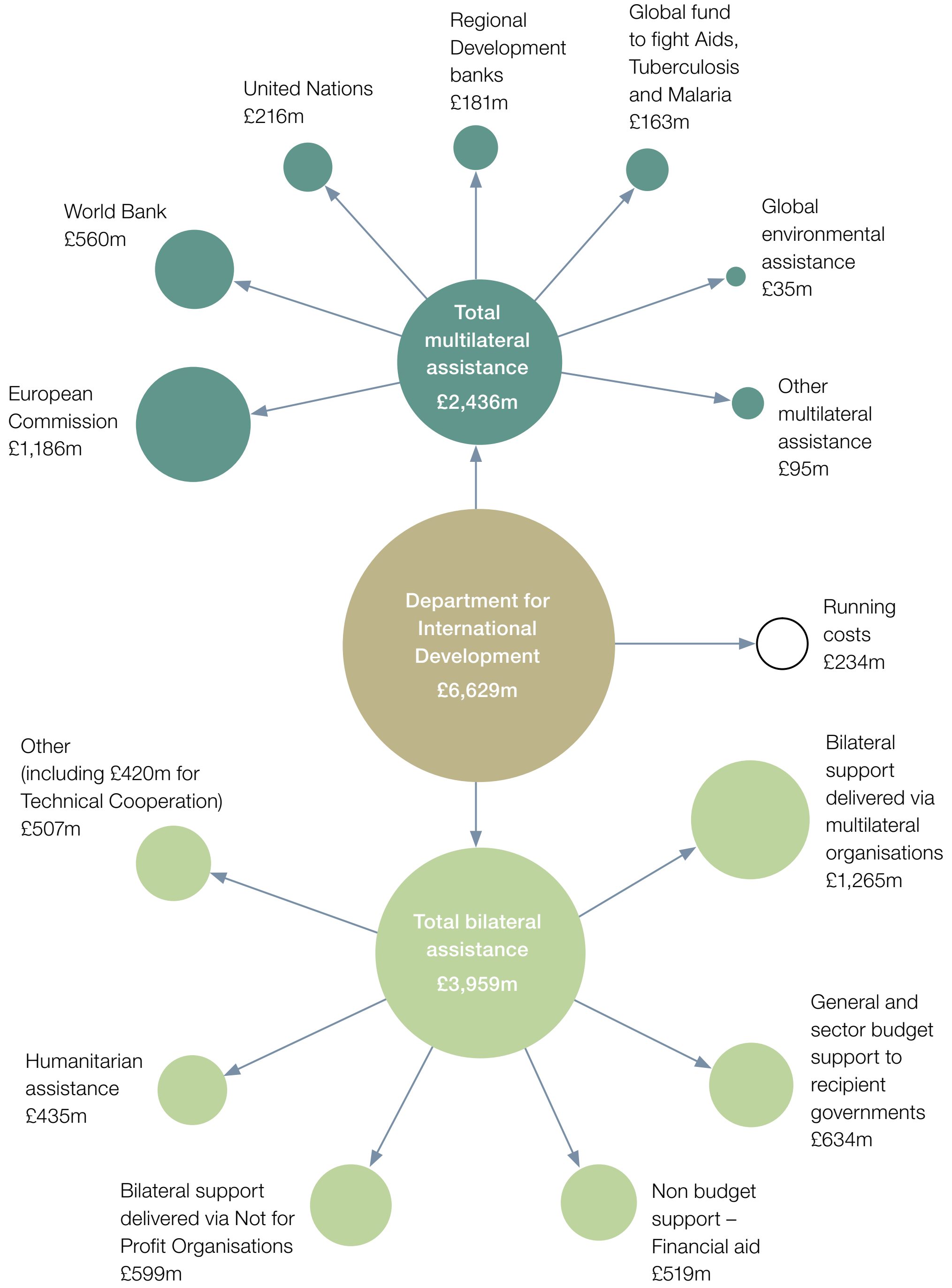
2 The Department's spending review settlement sets out a running cost cap for each year of the Spending Review period. The cap is equal to 2.70 per cent of DFID's total Departmental Expenditure Limit (less its allocation to the conflict pool) in 2011-12, 2.63 per cent in 2012-13, 2.08 per cent in 2013-14 and 2.09 per cent in 2014-15. The equivalent figure for 2010-11 was 2.64 per cent.

3 All values in cash terms.

Source: Department for International Development

Figure 4

The Department's cash flows and use of resources classed as Gross Public Expenditure on Development in 2009-10



NOTE

1 Running costs comprise administration costs and programme support costs.

Source: DFID Statistics on International Development 2010

Part Two

Current financial management and systems

2.1 In this part of the report, we evaluate the Department's existing financial management and financial systems. In particular, we examine the Department's financial management strategy, data collection and decision-making processes, risk management and the capacity and capabilities of financial staff.[18] The Department has a devolved operating model with country offices having delegated authority to approve projects up to a value of £40 million. This model allows country offices the flexibility to manage their programmes in a way that is appropriate to their context, whilst still following core business processes.

Early attempts to improve financial management

2.2 The Department's senior management recognised the need to strengthen financial management and have undertaken a number of initiatives including:

- The Money Action Plan, within the Making It Happen Value for Money corporate change agenda
- Recruitment of accountants at both the central and divisional level
- Implementing ARIES, a new financial IT application[19]

2.3 The Department introduced the Making It Happen change programme in 2008. This has been refreshed each year to produce a detailed plan for reform. For 2010, the finance strand – the Money Action Plan – included milestones for introducing a continuous professional development strategy, improving the quality of forecasting and making progress with the AXIS programme, which was designed to realise further benefit from ARIES. Progress against the Money Action Plan was formally monitored by the DFID Management Board until April 2010. The Department told us that, since then, it has continued to review key finance indicators, for example on the accuracy of forecasting, but it has deliberately stopped its separate reporting process for the Money Action plan. As a result, the accountability arrangements in place for the Plan's implementation are currently unclear. The Department has focused on undertaking a more fundamental review of how it secures impact and value for money from aid, and has also recently begun to develop an updated finance reform plan that will progress the different elements of the Money Action Plan.

18 DFID, DFID's Guide to Rules and Tools. http://www.dfid.gov.uk/About-DFID/Finance-and-performance/blue-book/Blue-Book-index-A-to-C/B7/
19 ARIES is the Department's financial management system, standing for Activity Reporting Information E-system.

2.4 Our interviews with the professional finance network of qualified finance staff – including the divisional accountants and others in the Finance and Corporate Performance Division – revealed that, more recently, they have developed a number of work-streams to take forward the Plan, as well as creating further local initiatives for developing financial management, all of which complements other initiatives being introduced by management. Examples of areas of improvement activity include the introduction of:

- a defined month end reporting timetable from June 2010;
- profiled budgets from December 2010; and
- greater automation of accruals and pre-payments to Administration budgets from March 2011.

2.5 Our investigations showed that the various initiatives are not being fully coordinated. Our experience shows that it is very difficult to deliver cultural change without a clear plan, or without senior ownership and responsibility for delivery of that plan. There is a risk that, without an overall strategy, the Department will not develop its financial management to the required standard.

Data for decision-making

2.6 The Department manages around 3,000 complex projects, working with a range of partners.[20] Sufficient, timely and accurate data, presented in a format to provide meaningful management information, is needed to inform effective resource allocation decisions.

Appropriateness of management information

2.7 The Management Board only began to receive dedicated finance reports in 2008, during the implementation of ARIES, the Department's new financial and management information system. From June 2010, the Management Board has received detailed monthly management accounts. The format and content of these reports continues to evolve.

20 *A Short Guide: The NAO's work on the Department for International Development*, National Audit Office, June 2010. http://www.nao.org.uk/publications/1011/short_guide_dfid.aspx

2.8 ARIES was fully rolled out by April 2009, replacing a number of legacy systems. It is primarily an off-the-shelf financial management system, customised to fit existing project management business processes. Our interviews with staff highlighted a range of views across the Department on the usefulness and effectiveness of ARIES. Key areas of concern are:

a The Department manages its resources largely on a cash basis throughout the year, with adjustments at year-end for resource accounting purposes. Finance staff indicated that non-finance colleagues do not always fully understand this process. As a result, the entries that non-finance staff process in ARIES increase the propensity for errors to be introduced into the Department's financial statements, which then need correction. The Department has committed to moving to automated full monthly accruals in 2011-12.

b Business units are frustrated that the system does not have the range of reporting functionality that they need and were expecting. There is a relatively small cadre of staff who can extract bespoke reports from ARIES which might address some of these concerns. However, this is not a core part of their role and they do not have the capacity to meet demand.

c It is not possible to reconcile the in-year spend on projects lasting over a number of years against the Department's aggregate annual resource budget. This complicates overall financial control of programme spending, and weakens central oversight over project progress.

2.9 To address these concerns and to fully realise the benefits of the system, the Department began the AXIS project soon after completing the ARIES roll-out. While development work on ARIES continues, the AXIS project has been partly suspended following the cross-government IT moratorium.[21] The Department does not anticipate that this will have any impact on its ability to fully realise the potential of ARIES, as work is now being undertaken by relevant business owners.

2.10 ARIES is used to track the Department's financial performance and also holds information on project 'scores' which provide a single summarised measure for each project; forecasting whether the project's outputs and objectives are likely to be achieved. It supports the Department's devolved model by giving access to real-time data, but reporting by country offices is limited to a comparison of actual spend against budget, with no commentary accompanying the financial data, and thus no means of assessing value for money. Separate systems are used to collect information on results and unit costs, such as the cost of a child educated. The absence of integrated financial and results information makes it difficult for the Department to demonstrate that it has achieved value for money at an aggregate level.

21 The AXIS project had three sub-projects: reporting and business intelligence; process and operational enhancement; and system upgrades. Following the government ICT review the Department is continuing with the second part of AXIS, while work on the other two has stopped.

Costing information

2.11 The Department has not in the past analysed costs at the aggregate level, but has begun to attempt to do so as part of its portfolio reviews. There is more information at the project level and recording of this information is expanding, but targets for recording this information are generally low. Metrics are being developed in some areas such as education and health, but these sectors still have weaknesses. For example, our recent report on bilateral support to primary education found that the Department has fragmentary information on whether inputs such as pay and school infrastructure costs have been minimised and on whether outputs, such as lessons taught, have been maximised. Improvements in these areas are necessary for the Department to demonstrate value for money.[22]

2.12 Work has started on developing a comprehensive costing approach, although there have been a number of obstacles and challenges, most notably:

- **a** There are a large number of disparate activities, resulting in difficulties with aggregating deliverables into a suitable framework.
- **b** The Department finds it difficult to collect unit costs for all projects and programmes, given the diversity of projects and delivery mechanisms.
- **c** The most significant internal cost driver is staff. There is no formal mechanism within ARIES or the human resources systems to maintain detailed timesheets or equivalent records.

Risk management

2.13 Risk management is integral to the work of the Department, with assessments taking place at project, country, directorate and corporate level. We found evidence that the Department is good at identifying and mitigating certain types of risk, for example, its assessment of the security risk present in the fragile states in which it operates.

2.14 The Department mitigates much of its risk primarily through its choice of aid instrument and operating partner, as well as by piloting projects in some cases. During our country office visits, we found that risk assessments were primarily used as a way to manage risk, rather than inform decisions on resource allocation. We also have some concerns about the effectiveness of the Department's risk registers, in practice. There have been no significant changes to the Department's Corporate Risk Register in the past 18 months, supporting our view that it is not being used as effectively as it should be. An internal review of the risk register identified that more work is needed to tie risks to the Department's financial objectives. The Department is seeking to address this by commissioning a comprehensive review of the Corporate Risk Register. This will need to address the risks that the Department faces in securing value for money from programme budget increases during 2011 to 2015.

22 *DFID: Bilateral Support to Primary Education*, www.nao.org.uk/publications/1011/dfid_support_to_education.aspx

2.15 During our overseas visits, we found that risk registers at a country and project level were not consistently reviewed and updated and we therefore question the efficacy of risk escalation within the Department.

2.16 The Department has started work to integrate its various risk assessment activities more fully and expects to embed this during 2011-12. Of particular importance is the need to clearly set out its appetite for risk, something which the Department is beginning to address. In February, the Department's Management Board considered a number of changes to its risk framework and, subject to some further refinement, approved their implementation from July. The Department aims to better identify its strategic risks, more clearly articulate its risk appetite, and apply a new system of 'flash reporting' to quickly escalate risks through the organisation.

Financial skills capacity across the organisation

2.17 The Department collects details of finance professionals across the organisation to inform its central government returns, and collected information on basic financial literacy of staff across the organisation through its 2009 staff survey. The Department examined its financial capacity across the organisation as part of its internal review of its finance operating model in August 2010. The Review concluded that there is insufficient understanding of financial matters generally across the Department and that there is insufficient financial management capacity and inconsistent use of internal financial resources. The Department is not atypical in having had a relatively low base of qualified finance staff. The Review considered the likely impact of changes in the operating model on staffing costs but noted that further work would need to be done on whether the Department had the appropriate skills.

2.18 The Department told us that there has been a tendency for corporate functions, such as Finance and Human Resources, to be viewed as solely responsible for delivery of their corporate functions rather than as support to operational managers in the delivery of the business. Corporate functions have been working to realign expectations. Since mid-2009, in support of this, the Department has recruited 11 qualified finance staff to fulfil roles both within the centre and within operational divisions. This increased the number of fully qualified finance professionals to 15, around 23 per cent of all staff in the Finance and Corporate Performance Division. All divisions now have a divisional accountant.

2.19 In August 2010, the Department completed an internal review of its finance operating model. This review recognised both the progress made in improving financial management and the need to improve compliance with best practice. A central tenet of the review's proposals is that financial accountability must rest firmly with programme staff.

2.20 Departmental management consider that divisional accountants have played an important role in improving communication between the centre and the front line, as they are responsible for collating financial and other information reported to Directors and above. Although recruited with the same core role, they were provided with limited guidance on specific roles and expectations. This has resulted in varying responsibilities between divisions and concern amongst staff that the Department is not making the best use of their expertise. All of the divisional accountants meet regularly with the central finance team to try and maintain coherence and share knowledge across the finance network.

2.21 Each divisional accountant is supported by a number of departmental finance officers and there is one departmental finance officer in each country office. Our interviews with finance staff show that, as with the divisional accountant role, there is a lack of clarity about what the departmental finance officer role comprises and the competencies required.

2.22 There is a view internally that, beyond the divisional accountants, the Department as a whole is still short of finance skills. Not only is there a shortage of finance skills in direct support of the Department's operations, but the central financial reporting function has also suffered from a shortage of qualified staff.

2.23 We are concerned that the Department may struggle to retain its financial management expertise if there are limited opportunities for professional development, combined with stagnation in the Department's culture in respect of financial management. To mitigate this, it is important that the Department uses its qualified finance staff effectively. Continued financial management reform, with clear organisational buy-in, will be important for retaining and motivating finance staff at all levels.

Financial management at a project level

2.24 We found that while the Department's senior management have recognised the need for strengthening financial management, it is less clear this is reflected in its project portfolio management. Our interviews with operational staff showed they are very clear about their objectives; there is total commitment to reduction of poverty through delivery of Official Development Assistance. However, we found no evidence that the supporting role of the finance function has been seen as critical to delivery of this objective.

2.25 Our work at the Department's country offices showed that the evaluation of costs has not consistently influenced investment decisions and operational staff do not expect to be challenged on costs. Furthermore, we found little evidence of analysis at country level of the relative efficiency and effectiveness of different aid mechanisms. The Department's Investment Committee has undertaken some higher level work on this over the last two years, carrying out portfolio reviews that feed in to investment decisions. In the examples we reviewed, the Department's primary control has been the open tendering process used to identify project partners. In reviewing project progress, there is a reliance on programme staff to review financial reports, without necessarily having the experience or training to do this effectively. Although country offices can theoretically call on the services of a divisional accountant to provide support, there is limited resource. For example, the Department has one divisional accountant covering the Africa division, with 16 field offices.[23]

2.26 The Department is trying to demonstrate more actively that it is achieving value for money, as well as to increase value for money. It is introducing a new business case model that requires cost benefit or other value for money analysis and specific financial and commercial cases for all new approvals, thereby encouraging more focused analysis of how project inputs translate into poverty reduction impact. However, to achieve the desired improvements, operational staff managing projects and resources need to be adequately equipped with the skills to use this model and to be fully aware of their obligations for effective financial management.

The Department's forecasting

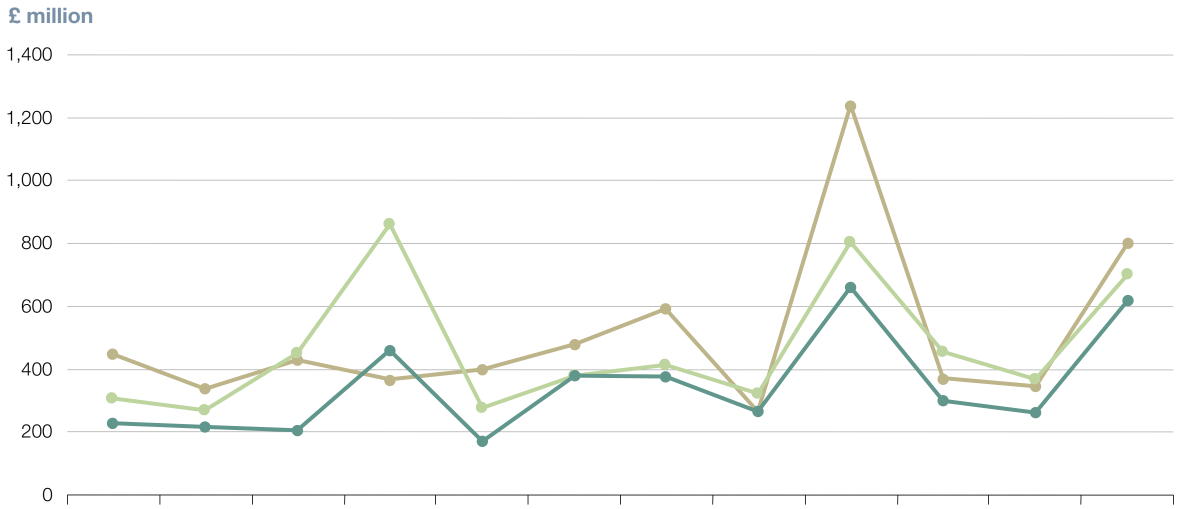
2.27 Within the Department, the financial reporting framework has not placed particular emphasis on the need for strong financial management. Grants, which are pooled, are deemed to be spent when the cash is transferred to partner organisations. Accruals have not generally been required, as no liability is deemed to have occurred until the Department agrees to make payment. Our annual audit has shown that, while financial treatment of such transactions has been appropriate, the Department has accurately managed achievement of spending targets by judicious cash management, choosing when it makes payments.

2.28 In addition, large elements of Official Development Assistance-classified spend are predictable. For example, the UK contributes a share of the European Commission's aid budget, which is recorded in December each year and is around £800 million. The variable funding requirements are smaller and, if required to adjust the level of spend at short notice, the Department has been able to delay or bring forward quite substantial payments.

2.29 The Department has a history of spending peaks at the end of the calendar year. **Figure 5** shows these peaks are getting more extreme with time.

23 DFID web site, http://www.dfid.gov.uk/About-DFID/Our-organisation1/DFID-Directory/Country-Programmes/Africa-Division/, accessed 1 April 2011.

Figure 5
The Department's cash payments from April 2008 to March 2011



	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
2010	449	338	431	366	397	477	593	266	1,236	367	343	800
2009	308	269	452	860	276	378	415	321	805	454	367	701
2008	228	218	206	458	171	380	375	264	658	298	264	620

NOTE

1 The value for March 2011 is the Department's forecast. All values are in cash terms.

Source: Department for International Development

The Department's monthly cash flow forecasts

2.30 Our 2009 report on Government Cash Management identified that the Department for International Development was one of the least accurate forecasters in Whitehall. The Department acknowledged that cash management had not previously been a priority, but that there has been a much greater focus on this in 2010-11.

2.31 As yet unpublished figures show that the average monthly variance between forecast cash flow and actual cash flow, while still variable, has reduced to just under 8 per cent for the first 10 months of 2010-11. The Department accepts that project managers need to be better at forecasting. The difficulties in forecasting are partly due to the nature of the Department's spending, with it being difficult to estimate demand, and therefore funding requirements, in the countries in which the Department is active. However, our visits to the Department's overseas offices have identified that they frequently fail to supply appropriate cash flow forecasts to the central finance team. The Department is able to meet its annual, rather than monthly, forecasts more easily, though this is achieved through year-end activity rather than effective cash management throughout the year.

2.32 Staff acknowledge that forecasts have been compromised by a reluctance to forecast underspends, because of concerns that unspent funds will be withdrawn. The bottom-up nature of the forecasting process has also meant that senior managers have not engaged sufficiently in the process and there remains a lack of transparency in the forecasting process and therefore a lack of trust in the numbers generated. For forecasts to support financial management, staff need to have confidence in the process and be open and honest in forecasting.

Changes to the forecasting process

2.33 We consider that the appointment of divisional accountants has resulted in improvements to forecasting, but this has not yet been fully embedded across the Department, mainly because of the varied working practices adopted locally. The revised process, introduced in 2010, requires that budgets are agreed in April and used as the baseline for forecasting spend for the rest of the year. Monthly reports are produced to monitor and record variations against this baseline. The Department told us that limitations in forecasting accuracy were leading to additional work by finance staff to manage the impact.

2.34 Despite the changes that have been made, there remain major issues with the robustness of the data. Fully profiled budgets were not loaded onto ARIES in 2010-11 and there were inconsistencies between project information and the control totals for each business unit. This has limited the usefulness of ARIES as a financial management information tool. Our analysis of the data held in ARIES showed that, in 2009-10, over £3 billion in payments were made for which no project forecasts had been entered onto the system. The Department has, however, used a separate system for generating fully-profiled budgets in 2010-11.

2.35 We recognise that the Department will need to adapt to the new circumstances in which it is operating. It will be managing a significantly increased portfolio and level of funding. If predictable spending modes are used less, in favour of more unpredictable project and programme spending, then this will increase the volatility of forecasting both cash requirements and expected outturn against budgets. This, combined with pressure to reduce administration costs, means that expenditure management and forecasting needs to be more sophisticated, to ensure that:

- the options for funding are properly assessed as there may be a better solution in a different country, partner or project;
- value for money is not compromised as a result of end of year pressure to spend; and
- funding is only provided where there is a need.

Part Three

The Department's strategic control of development aid

3.1 In this part of the report, we evaluate the Department's strategic and operational systems and processes for controlling the aid it provides. In particular, we examine the systems in place and under development to secure value for money from the increasing programme budget and the approach to identifying and preventing fraud.

The Multilateral and Bilateral Aid Reviews

3.2 At the start of March 2011, the Department announced the results of two strategic internal reviews undertaken to improve the focus of its aid programmes: the Bilateral and Multilateral Aid Reviews. A further independent review of Humanitarian Emergency Response, which was under way at the time of our work, was published on 28 March 2011. These reviews are informing the Department's development of its spending plans to 2015.

3.3 The Bilateral Aid Review aimed to improve the Department's targeting of aid and ensure those countries with the greatest need would continue to be supported. Country teams made evidence-based 'results offers' under five 'pillars' which reflect the Department's priorities and objectives: wealth creation, direct delivery of the Millennium Development Goals, governance and security, climate change and global partnerships. Each offer set out the results that would be delivered with a given level of resource and articulated how those outputs would lead to overall development impacts. They also specified how value for money would be achieved. Individual offers were subject to formal scrutiny before being reviewed by Ministers. The overall set of country offers, along with proposals from the Multilateral Aid Review, were checked to ensure they were affordable and adequately addressed Departmental priorities.

3.4 The Department announced in March 2011 that it would focus its bilateral aid on 27 countries, closing programmes in 16 countries.[24] By reference to an index which ranks developing countries according to their need, and the effectiveness of aid spending, the Department judges that these changes will improve targeting of its bilateral programme. Over the period 2011-15, the Department expects that around 80 per cent of its aid will go to countries ranked in the top quartile of the index; up around 10 percentage points on the period 2004-09.[25]

24 DFID web site, March 2011. http://www.dfid.gov.uk/Media-Room/News-Stories/2011/The-future-of-UK-aid/, accessed 1 April 2011.

25 The index was developed by the Department as part of the Multilateral Aid Review. Of the remaining 20 per cent of expenditure in 2011-15, the Department predicts around half will go to regional programmes that cover groups of countries.

3.5 The Multilateral Aid Review assessed the value for money of the Department's funding of multilateral organisations. In 2010-11, the Department provided core funding to over 40 organisations, including the World Bank, the European Commission's external assistance programme, United Nations organisations and development banks.[26] The Review used a single set of criteria to assess each organisation's contribution to UK development objectives and organisational strengths. The Department drew on a range of evidence, including 10 country visits and submissions from multilaterals, to make its assessments; these were then subject to scrutiny and discussion with Ministers.

3.6 Multilaterals were categorised into four groupings ranging from offering very good to poor value for money. These assessments have informed decisions about future funding levels, including any conditions that should be attached to that funding, and the Department's plans for engaging with organisations. For example, the Department has decided to withdraw funding from four smaller multilaterals which it rated as offering poor value for money. It has said this should save £50 million, which would be redirected to the top performing agencies.[27]

Strategic allocation process

3.7 The Bilateral and Multilateral Aid Reviews, and the findings of the Humanitarian Emergency Response Review, underpin the Department's revised strategic resource allocation process. A fundamental principle of the new process is to better align budgets with objectives, and allocate resources on the basis of results – at an aggregated level – rather than primarily on the basis of need or past funding levels.

3.8 By February 2011, the Department's divisions had been allocated initial budgets and had prepared draft operational plans providing more detail of what they would deliver, what staff were required and what risks they would need to manage. As at March 2011, the Department was reviewing these plans, including checking variations with offers made during the Bilateral and Multilateral Aid Reviews. It was also using the plans to identify the type and number of additional frontline staff to manage its increasing aid programme. The Department estimates it will need at least 150 extra front-line staff in 2011-12, with more staff required in the following years. Through its operational planning process, the Department is seeking to assess the level of risk country by country including some limited assessment of its own capacity to deliver.

3.9 When finalised, the operational plans will be published, providing further detail on what the Department expects to deliver over the Spending Review period. The Department is currently designing the framework for tracking performance against these plans, and making any necessary changes to planned results and resources during the Spending Review period. It is important that the Department determines the extent of changes to plans which can be made at country and corporate levels. The decision-making process will be at risk if there is no materiality level assigned, based on funding requirements and development impact of the options available.

26 The Department also channels some of its bilateral programme through multilaterals in specific countries and for specific purposes. This expenditure was addressed by the Bilateral Aid Review.

27 DFID, Multilateral Aid Review, *Taking Forward the findings of the UK Multilateral Aid Review*, March 2011. http://www.dfid.gov.uk/Documents/publications1/mar/Taking-forward.pdf

3.10 The Department has introduced a suite of recommended indicators to be included in divisional operational plans. In our view, this should enhance the Department's ability to report aggregated results. However, overall value for money could be threatened if country offices concentrate their efforts on delivering specified results at the expense of other important areas that are not explicitly covered by indicators in their operational plans.

3.11 To monitor progress against operational plans, the Department will need to draw on data from multilateral organisations and developing countries. We have previously reported that a lack of timely and reliable data has made it difficult for the Department to measure progress being made by developing countries towards the outcome-focused Millennium Development Goals.[28] Shifting the results focus in operational plans from outcomes to outputs should make it easier for the Department to collect timely data. However, teams will need to review data quality, and manage any weaknesses.

3.12 The new allocation process has introduced a clearly structured rationale for developing and approving plans, with an emphasis on linking resourcing and results. Lags between spending and results mean it will be some time before it is clear whether this new process, and its supporting monitoring arrangements, are securing value for money. The Department must now develop a strategy to support the effective implementation and management of its plans. A coherent strategy would help ensure that all key initiatives are brought together, and risks to securing value for money from its increasing programme spend are identified and managed.

Improving the focus on value for money at a project level

3.13 The Cabinet Office's 2007 Capability Review of the Department identified that it needed to strengthen its consideration of value for money.[29] In response, the Department established the Investment Committee – a sub-committee of the Management Board – to, amongst other things, ensure that the Department's investment appraisal procedures were fit for purpose and to champion the use of evidence and the quantification of costs. In 2008, the Department established a supporting programme which included developing standard output and outcome indicators to be incorporated into project logframes.[30] The Department continues to develop indicators, as well as cost and other benchmarking information, to inform project design and selection.

28 National Audit Office, *The work of the Department for International Development in 2009-10 and its priorities for reform*, November 2010. http://www.nao.org.uk/publications/1011/international_dev_committee.aspx
29 The Cabinet Office undertook a programme of reviews to examine whether Whitehall departments had the underlying capability to meet delivery challenges.
30 Logframes set out the key features of aid projects, including project objectives, inputs, performance measures and the planned results.

3.14 A 2010 internal review by the Department found a fairly significant improvement in the quality of logframes between 2008 and 2009. However, it also showed that a quarter of logframes prepared in 2009 did not set out clearly the project's logic, and some logframe indicators were not well-defined (36 per cent) and did not have clear targets (39 per cent). The same review also found that the quality of economic appraisals had risen since 2008, although the Department concluded that there was still much scope for improvement. The Department's findings indicated that appraisals were often carried out retrospectively and thus did not inform the design of proposals or the selection of options.

3.15 The Investment Committee has overseen the development of a new business case which is being implemented for all projects seeking approval from January 2011. As part of increasing the focus on value for money, the new business case requires teams to compare a number of alternative options for delivering the proposed outcome and to specify clearly the actual, rather than desired, outputs and outcome they expect the project to achieve. The rigour of business cases for new projects which are over £40 million, or which are novel or contentious, will for the first time be reviewed by a central quality assurance team, headed by the Department's chief economist.

3.16 The spending levels and results offers set out in operational plans will be delivered by bilateral projects which are already approved, ongoing multilateral commitments, and new projects which will be subject to the new business case procedures. The Department's assessment is that the proportion of spending that will be delivered by existing approved projects and planned multilateral commitments is around 80 per cent of programme expenditure in 2011-12, falling to around 40 per cent by 2014-15. The Department therefore needs to develop a substantial pipeline of good quality projects if it is to deliver its planned level of expenditure. The Department has not assessed what proportion of the results offers relate to expenditure that is already approved or committed.

The Department's approach to identifying and preventing fraud

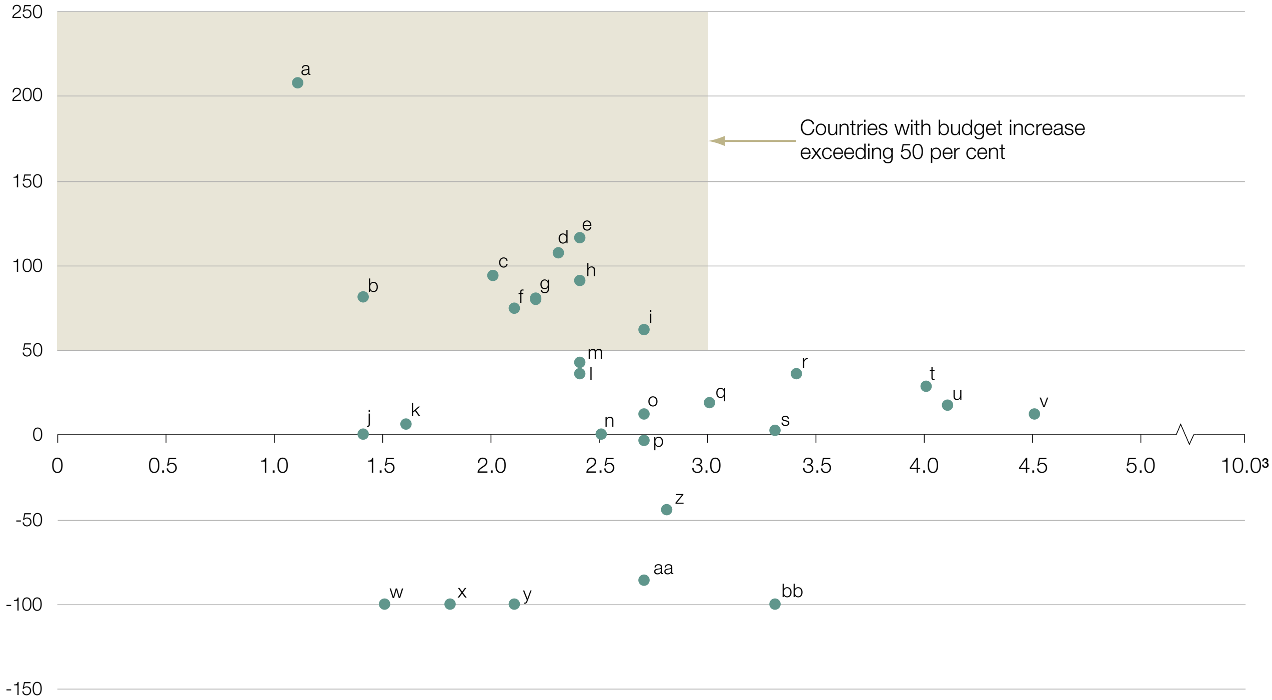
3.17 In those countries which are major recipients of aid, governance structures and delivery mechanisms are often underdeveloped and the risks of fraud and corruption, which erode the amounts available to intended aid beneficiaries and jeopardise the efficiency of aid, are considerable. Transparency International, a non-governmental anti-corruption organisation, publishes a review of the perceived extent of public sector corruption in 178 countries around the world.[31] The Department's future plans involve channelling increased funding into more fragile states that have high levels of deprivation but also weaker governance. **Figure 6** shows that all nine of the countries where the Department plans to increase its spending by more than 50 per cent over the next four years have a score lower than 3.0 in the Transparency International index (from zero which represents 'highly corrupt' to 10.0 which represents 'very clean'). Whilst the Department's actual risk exposure depends on how it spends and the controls it puts in place, operating in high risk environments necessarily means the potential for increased risk of leakage through fraud and corruption.

31 Transparency International Corrupt index 2010 http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results, published online October 2010.

Figure 6

The Department's spending plans for countries compared with the Transparency International corruption perceptions index 2010

Bilateral aid budget for 2014-15 as percentage of planned bilateral spend in 2010-11



a	Somalia	h	Bangladesh	p	Mozambique	x	Burundi
b	Burma	i	Ethiopia	q	Zambia	y	Cambodia
c	Democratic Republic of Congo	j	Afghanistan	r	Malawi	z	Indonesia
d	Pakistan	k	Sudan	s	India	aa	Vietnam
e	Nigeria	l	Zimbabwe	t	Rwanda	bb	Liberia
f	Kenya	m	Sierra Leone	u	Ghana		
g	Yemen, Nepal	n	Uganda	v	South Africa		
		o	Tanzania	w	Iraq		

NOTE

1 Tajikistan (score 2.1) and Kyrgyzstan (score 2.0) are excluded as the Department has not yet published its forward spending plans for these two countries.

2 The figure includes countries that DFID plans to withdraw from by the end of 2014-15.

3 The scale runs from zero, which represents 'highly corrupt', to 10.0 which represents 'very clean'.

Source: National Audit Office analysis, based on the Department's spending allocations announced in the Bilateral Aid Review and the Transparency International corruption perceptions index 2010

3.18 Despite knowledge of the potential for loss, the development sector, including the Department, has no systematic or comprehensive approach to quantifying the extent of fraud and corruption. Some significant donor organisations have attempted to perform analysis but the obstacles to obtaining reliable estimates are significant, not least because much corrupt activity is hidden.[32]

3.19 This context places a significant responsibility on the Department to safeguard its resources and to use aid instruments that minimise loss. Therefore, for each country where financial aid is provided or under consideration, the Department undertakes a Fiduciary Risk Assessment. Where the risk of loss is high, a mixed approach can then be used, for example to assist the country to strengthen governance and finance systems and funding of specific programmes routed through channels which are considered less prone to loss.

3.20 Our review of a sample of these assessments showed that they consider the risk that funds are not properly accounted for, are not used for the intended purpose or represent poor value for money. They also look at the likelihood of leakage through fraud and corruption. The assessment includes details of actions or safeguards needed to mitigate identified risks but there is no conclusion about any residual risk that remains. The Department's staff are required to update these assessments annually although they may be reliant on data which is several years old.

3.21 The Department believes that loss rates from its programmes are lower than those suffered by other donors, but we have found that there are no reliable, independent sources of evidence to estimate fraud levels. Even so, the Department's Internal Audit Department considers that it significantly under-captures incidences of fraud. This could be for a variety of reasons, including the failure to detect fraud or partners failing to notify the Department of losses.

3.22 The Department's current approach is largely reactive – it doesn't attempt to quantify its actual and estimated losses. Undertaking an exercise to obtain reliable data on the level of leakage could require significant resources and may need joint-funding with other donors and partners. However, benefits would include better evaluation of the Department's performance and plans and whether reported and expected levels of loss are minimised. In addition, the exercise would inform an assessment of the need for, and nature of, counter-fraud measures, give a better understanding of the risks, inform the choice of funding mechanisms, target anti-fraud activities and inform responses to stakeholder scrutiny. More widely, the exercise should highlight fraud patterns and types, locally and worldwide, allowing the Department to adapt its approach. The Department is currently undertaking the first stage of a study on fraud risk, through which it aims to better estimate likely losses through different funding routes and in different operating environments. The Department intends that this exercise will identify fraud patterns and types by country allowing it to adapt its counter-fraud approaches accordingly.

32 For Example, see the World Bank's study: *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level*, http://go.worldbank.org/OZLE95YA50, April 2007.

3.23 Key stakeholders have raised questions about judgements reached on the management of risk. In its recent report on support to primary education, the Committee of Public Accounts noted that the Department had assessed the risk of investing in Kenya's education system as manageable, but serious frauds have arisen.[33] This is not the first time that the Committee has made recommendations in relation to this topic.[34]

3.24 The Committee recommended that the Department should evaluate the wider implications for its risk assessment processes and the controls it relies on when delivering through other governments' systems, not just in Kenya. The Department recognises that it needs a more systematic approach towards leakage and Internal Audit has commenced a review of fraud risk from financial aid to government as a first step.

3.25 In specific instances where fraud or losses have been identified, we found that the Department's Counter-Fraud Unit has a good record of investigating and recovering losses, although this can be a lengthy process. For 2009-10, the Department detected gross losses due to fraud of £459,000 or around 0.01 per cent of overall expenditure. Of this, £199,000 has so far been recovered.

3.26 The Department's Counter-Fraud Unit leads the Department's response to the risk of fraud by:

- acting as the point of notification of suspected fraud;
- ensuring that investigations are carried out, either by their own staff, by consultants whom they have commissioned or by local deliverers or partners, where they deem this appropriate; and
- taking remedial action.

In 2009-10, the Unit received 96 cases to investigate, up by nine per cent from 2008-09. For the first nine months of 2010-11, the number of cases received is 76 compared to 56 in the same period last year, an increase of 36 per cent.

3.27 We found little evidence to show sharing of fraud intelligence, lessons learnt or successful practices within the Department. Individual directorates may make information available internally, but are unlikely to share with other Divisions. The Counter-Fraud Unit has provided Fraud Awareness training to several offices and the number of reported frauds has increased. However, it is not possible to say whether the increase is due to an increased prevalence of fraud or greater awareness of the reporting process by local offices.

3.28 Externally, the Department, through Internal Audit and the Counter-Fraud Unit, liaises with multilateral partners and other development and donor organisations and government agencies, to collect and share information on fraud. This should help develop its understanding of occurrences and build better communication and networks.

33 HC Committee of Public Accounts, Department for International Development: Bilateral Support to Primary Education,Thirteenth Report of Session 2010-11, HC 594, December 2010.
34 HC Committee of Public Accounts, Department for International Development: Providing budget support for developing countries, Twenty–seventh Report of Session 2007–08, HC 395, June 2008.

Appendix One

Methodology

1 The National Audit Office developed a model of maturity in financial management, based on published methodologies, which was used in this assessment. The approach followed the principles set out in the Audit Commission Discussion Paper *World Class Financial Management* published in 2005 and broadly accepted by HM Treasury and other commentators. Key areas covered include:

- Financial governance and leadership
- Financial planning
- Finance for decision making
- Financial monitoring and forecasting
- Financial and performance reporting

2 The toolkit identified a series of key statements on good financial management under each of the five key areas. We adopted the following methods to make our assessment against these statements.

Semi-structured interviews

3 We interviewed 35 members of staff from across the Department. The interviews included all of the executive and non-executive Board members, including the Permanent Secretary, as well as those with responsibility for aspects of financial management, including the Department's new strategic allocation process. Interviews also took place with the Independent Commissioner for Aid Impact, HM Treasury spending team and a consultant from the Chartered Institute of Public Finance and Accountancy (in 2008 the Department commissioned the Institute to review its financial management performance). We followed a semi-structured interview approach, which we used to inform the findings throughout the report.

Analysis of financial data

4 We reviewed financial data published by the Department, the Office for National Statistics, and the Organisation for Economic Cooperation and Development to analyse the Department's expenditure over the years 2005-06 to 2009-10. We also reviewed HM Treasury Spending Review 2010 figures, and the Department's own data, to examine and analyse the Department's budgeted expenditure over the period 2011-15.

Analysis of Departmental papers

5 We examined Departmental Board meeting papers and minutes, and internal reviews. We also examined a selection of other Departmental documents, including undertaking a high-level review of papers covering the Department's systems for allocating resources for 2011-15, including its Multilateral and Bilateral Aid Reviews. We did not examine the value for money of specific allocation decisions or aid programmes.

Analysis of reports on the Department

6 We reviewed the following to identify best practice, future plans, and strategies:

- Reports prepared by the Chartered Institute of Public Finance and Accountancy
- Reports prepared by PricewaterhouseCoopers on risk management
- Reports by Moore Stephens on risk management, costing of processes and outputs/outcomes, financial management, financial management in the Department's overseas offices and internal controls of ARIES
- Data obtained during our statutory and value for money audits of the Department in the period 2005-10
- Public Accounts Committee papers
- International Development Select Committee papers

Report by the Comptroller and Auditor General

Department for International Development Financial Management Report

HC 820 Session 2010-2012

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CORRECTION

Paragraph 6 (p 5) of the report incorrectly states that over the next four years the Department for International Development's programme budget will grow by £3.3 billion (34 per cent in real terms). The correct values are £3.7 billion (35 per cent in real terms).

Paragraph 1.8 (p 15) of the report also states that the Department's spending will increase by 34 per cent in real terms over the Spending Review period. The correct value is 35 per cent.

Figure 2 (p 14) of the report incorrectly shows that Other government departments Official Development Assistance in 2010 was £618 million, Non-departmental Official Development Assistance in 2010 was £377 million and the Percentage of Official Development Assistance in 2010 accounted for by Government Departments other than DFID was 7.4 per cent. The correct values are £609 million for Other government departments Official Development Assistance, £388 million for Non-departmental Official Development Assistance and 7.3 per cent for the Percentage of Official Development Assistance accounted for by Government Departments other than DFID.

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