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REPORT BY THE
COMPTROLLER AND
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Department for International Development

Financial Management Report

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.

Post publication this page was found to contain an error which has been corrected
[Please find Published Correction Slip]

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.