



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

**HC 1279
SESSION 2010–2012**

22 JULY 2011

Department for Environment, Food and Rural Affairs

Managing front line delivery costs

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National Audit Office

Department for Environment, Food and Rural Affairs

Managing front line delivery costs

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

19 July 2011

In 2009-10, the Department for Environment, Food and Rural Affairs reported that it channelled £4.2 billion through the arm's length bodies it commissions to deliver the vast majority of its front line services.

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This report can be found on the
National Audit Office website at
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Key facts

£4.2bn

the amount of money the Department reported it channelled through its arm's length bodies in 2009-10

80%

of the Department's total spending passed through arm's length bodies

30%

overall reduction in the Department's budget by 2014-15

- £4.2 billion** the amount of money, including European Union Common Agricultural Policy funds, the Department reported in its Resource Account it channelled through delivery bodies in 2009-10.
- 80 per cent** of the Department's total spending is passed through its network of delivery bodies. In 2009-10, £2.3 billion of this related to the management of European Union funds.
- 30 per cent** the overall reduction in the Department's budget over the period 2010-11 to 2014-15.
- 53** the number of arm's length bodies the Department has announced it will no longer fund. The Department will continue to fund 39 bodies, accounting for the majority of the Department's expenditure.
- £1.7 million** the extent to which costs exceeded income calculated by Animal Health; and
- £2.4 million** the Food and Environment Research Agency on the statutory work they charged for in 2009-10.
- 400 per cent** the increase in charges that the Food and Environment Research Agency have calculated will be required to match the cost of undertaking some activities.

Summary

1 In 2009-10, the Department for Environment, Food and Rural Affairs (the Department) reported that it channelled £4.2 billion through the arm's length bodies it commissions to deliver the vast majority of its front line services. All of them operate with considerable autonomy but, because ministers remain accountable to Parliament for the way arm's length bodies spend public money, the Department needs robust financial and performance data from them.

2 The National Audit Office, the Committee of Public Accounts and HM Treasury have all previously emphasised the need for robust cost data to be linked to activity and performance information. Without such data, departments are unable to assess the cost-effectiveness of the activities they fund or make evidence-based decisions when prioritising resources. Measuring expenditure does not, taken by itself, show whether money is being spent well. Across government, we reported in May 2010 that few indicators used by delivery bodies linked cost and performance information, and that arrangements to secure assurance over information reported by delivery bodies were often underdeveloped.

3 The Department's budget will reduce by 30 per cent, including the effect of inflation, by 2014-15. Prompted by the requirements of the 2010 Spending Review the Department carried out an exercise to identify specific and targeted savings across its delivery network. However, to deliver savings of the scale required over the next four years, the Department will need a good understanding of its arm's length bodies' costs in order to exercise scrutiny and challenge.

4 In previous reports, the National Audit Office has found that some of the Department's delivery bodies are not able to measure the full cost of front line activities accurately. We have also reported that inconsistencies in the way different delivery bodies measure costs make it very difficult for the Department to calculate the full cost of measures, for example, to tackle animal diseases, when several bodies' work is involved.

5 This report takes as case studies four of the Department's larger delivery bodies: Animal Health; the Centre for Environment, Fisheries and Aquaculture Science (CEFAS); the Environment Agency; and, the Food and Environment Research Agency (FERA). The activities for which they are responsible include working with farmers to prevent and control diseases among farm animals, protecting animal welfare, protecting and carrying out research into the marine and farmed environment, managing water resources and protecting communities from the risk of flooding. The activities they undertake are very

diverse, and for some activities the costs and benefits are more accessible and easier to measure than others. The decisions these bodies make about how to prioritise resources, and where to achieve efficiency savings, affect farmers, fishermen and rural communities. We examine:

- the extent to which the Department requires delivery bodies to accurately measure the full cost of carrying out front line activities;
- whether cost and performance data are linked sufficiently to measure the value for money of achieving impacts and outcomes; and
- whether cost data is used to drive value for money improvement.

6 The Environment Agency is a non-departmental public body, and has different governance arrangements to the other three bodies, which are executive agencies. Across government, non-departmental public bodies have a greater degree of autonomy. Ultimately departmental accounting officers are accountable to Parliament, but the Chief Executives of non-departmental public bodies, as Accounting Officers in their own right, also have that accountability. In addition to the sponsoring department, the board of a non-departmental public body have the responsibility of holding the body to account and ensuring value for money.

Key findings

The Department has begun to develop mechanisms to collect more systematically financial management information from arm's length bodies

7 The Department allows arm's length bodies considerable operational autonomy and it does not seek to micro-manage them. It has, however, needed to tighten its relationship with bodies across its delivery network, in part to meet the challenges of the 2010 Spending Review, which has required closer working between departments and their delivery bodies. The Department has also been required by HM Treasury to establish closer monitoring of its arm's length bodies' expenditure to meet new Government financial reporting requirements.

8 The Department has recently introduced a template to standardise the financial information it receives from its delivery network. Following a 2010 review of the financial information it regularly receives from delivery bodies, the Department trialed a new monthly reporting template in January 2011. This was used by all arm's length bodies for the first time from May 2011. Whilst for the Department's larger arm's length bodies the template consolidates information already reported, it has helped establish minimum reporting requirements across all delivery bodies.

9 The template represents a step forward in financial reporting, but it does not include data on the costs of front line delivery. That is because it focuses on the monitoring of expenditure against high level budgets. Tracking expenditure in this way may help the Department to pursue efficiency savings, but it does not show whether the full costs of front line activities are accurately measured and well managed by arm's length bodies. HM Treasury has issued guidance to improve the quality of cost data across government, but the Department has not yet implemented this among its arm's length bodies.

10 Better integration between cost and performance data would strengthen the Department's ability to assess value for money. The Department does not obtain routine systematic analyses combining expenditure, cost and performance data for the delivery of front line work. Arm's length bodies do not have to routinely report to the Department indicators which are specifically relevant to costs, such as cost comparisons or unit cost information. More sophisticated integration of financial and performance data would help the Department to more effectively monitor cost and performance through analysis of the relationships between expenditure, outputs and outcomes, and cost, quality, time and volume.

The Department has few indicators to assess whether costs of activities in delivery bodies are high or low

11 All four bodies we reviewed have started to assess front line costs against internal benchmarks. For example, Animal Health benchmarked across its 15 regions the cost of activities such as welfare visits to farms, statutory inspections and tests for diseases such as bovine tuberculosis. The exercise shows where there may be scope to bring relatively high costs closer to the average. At the time of our fieldwork, the Department had not requested such benchmarking data, even though this would help it to assess the reasonableness of front line costs.

12 The Department takes some assurance that bodies such as the Centre for Environment, Fisheries and Aquaculture Science and the Food and Environment Research Agency are competitive because they secure significant amounts of income from work in the commercial market. A number of arm's length bodies operate on an increasingly commercial footing, securing work from private sector customers and other government departments through open competition. The Department takes some assurance from this that arm's length bodies, such as CEFAS and FERA, are providing value for money. To obtain a more complete picture and assess the reliability of these benchmarks the Department – as both a sponsor and a customer – needs a more thorough understanding of the cost base of its arm's length bodies and of the competitiveness of the markets in which they operate.

13 Arm's length bodies have struggled to identify external cost benchmarks.

For back office functions, such as human resources, estates or finance, arm's length bodies rely on an annual external benchmarking exercise coordinated by HM Treasury. For other costs there are fewer suitable comparators. As described above, some arm's length bodies, including CEFAS and FERA, use their ability to win work in commercial markets as one indicator of good cost performance. With some 39 bodies sponsored by the Department there is also some opportunity to explore cross-agency benchmarking of front line costs. Bodies such as, for example, CEFAS and FERA have similar project-based business models, are similar in size and face similar practical financial management pressures. The Department recognises that it has a central role to play as a knowledge hub. Whilst external benchmarking has proven difficult for government bodies, the Department has not so far exploited opportunities for cost benchmarking across its delivery bodies by centrally facilitating knowledge collection and sharing. The Department is supporting an exercise to benchmark the quality of financial management against the National Audit Office's financial management maturity model, a project which was initiated in June 2011 by Finance Directors in arm's length bodies.

The Department needs to better understand the different approaches delivery bodies have adopted to allocate and apportion costs to front line activities

14 The Department has not required arm's length bodies to explain the basis upon which costs are attributed to front line activities. Delivery bodies calculate the full cost of activities in different ways because they have adopted alternative approaches, for example, to matching indirect costs to front line work. CEFAS and FERA, for example, have made different choices about the detail with which they apportion overheads to different parts of the business, which influences the costs attributed to specific front line activities. Alternative costing methodologies may be appropriate to the needs of individual bodies and the Department has placed reliance on governance arrangements in arm's length bodies and internal audit work that costing methodologies are reasonable. The Department has not asked them, however, to explain what impact these decisions have on the costs they report for different activities.

15 Manual analyses may be needed to match costs to all front line activities.

Arm's length bodies have made independent judgements about what they consider an appropriate level of detail to monitor the cost of activities. Several have reduced, for example, the number of separate cost codes with the aim of making the analysis more meaningful to the business. Manual calculations have, therefore, sometimes been needed to break down costs in greater detail. Additionally, to calculate unit costs Animal Health, for example, has used spreadsheets to combine financial data with information about the volume of work drawn from other databases.

16 The Department needs to have access to good information, and make effective use of it, to be confident about where to allocate scarce resources. This requires good information from each of its arm's length bodies explaining the relationship between costs, activities and outcomes. The Environment Agency, for example, used an assessment of how activities contribute to key outcomes to agree internal budgets, focusing on activities with the greatest impact. More generally, we found little evidence that arm's length bodies routinely draw on cost and volume data to model the impact on outcomes of changes to the budgets available for individual activities.

More accurate cost data has helped delivery bodies identify where fees and charges do not cover costs

17 Fees and charges do not always match the full cost of activities. Improved cost data, however, has allowed arm's length bodies to identify more accurately under-recoveries. HM Treasury rules require bodies to recover the full cost for services. Amending charges can be a lengthy process, because of the legislative time needed to prepare statutory instruments, and because of policy decisions which might, for example, restrict the scale of increases imposed at any one time. Costs and fees need to be monitored closely so that the balance between public funding and fees is properly understood and, where recoverable, fees can be brought into line with costs. For example:

- The Food and Environment Research Agency reported a loss of £2.4 million on some of the statutory work for which it charges. In reviewing the losses for individual activities, the Agency found that some charges, the fees for which were set by predecessor organisations, would need to be four times as much in order to recover costs.
- Animal Health reviewed fees and found that it had been unable to recover the full cost of some activities through the fees charged, to an estimated value of £1.7 million.

Conclusion on value for money

18 The arm's length bodies we examined understand their costs reasonably well and are taking steps where necessary to improve the data available to them. To oversee cost reductions with minimal impact on front line services, however, the Department will need to engage arm's length bodies in robust scrutiny and challenge. That dialogue needs to be informed by high quality integrated cost, expenditure and performance data. The Department has started to address this by collecting financial and performance data from arm's length bodies in a more systematic way. The Department still has more to do to fully understand the relationships between cost, outputs and outcomes needed to be confident that it is securing value for money.

Recommendations

19 Arm's length bodies operate with a good deal of autonomy, but sponsoring departments remain ultimately accountable to Parliament and the taxpayer for the value for money with which they use public funds. The current climate of public spending restraint makes it essential that departments have confidence that local governance arrangements are sufficient to promote effective cost control within delivery bodies, and that there are effective and consistent reporting arrangements to give them a strong grasp on the costs of delivery bodies' activities.

- a** **To act as an intelligent commissioner of services, the Department needs to assure itself that the data and information delivery bodies supply enables it to measure and track cost-performance.** The Department should establish what key cost data, reported in a consistent and transparent way, it requires to better scrutinise arm's length bodies and make decisions about the allocation of resources. This should include agreed measures to help assess value for money, such as unit costs tracked over time and linked to relevant performance measures.
- b** **The Department needs to understand the different approaches to costing across its delivery network.** The Department cannot adequately interrogate and challenge the data and information it receives without better understanding how its delivery bodies calculate their costs. The Department should ask its delivery bodies to justify how they measure and monitor costs.
- c** **There is a balance to be struck between obtaining adequate information to monitor costs and overburdening delivery bodies with increased reporting requirements.** The Department monitors the performance of delivery bodies. The Department should carry out a gap analysis between the information it routinely receives from delivery bodies and what is required to monitor performance and assess value for money. Data requirements should be rationalised and standardised.
- d** **Resource allocation decisions need to be informed by a good understanding of the relationships between costs, outputs and outcomes.** Transparency of front line delivery costs is increasingly important where budget reductions have to be carefully targeted to protect services. In line with the good practice in this respect we found, for example, in the Environment Agency, the Department and all its arm's length bodies should model the impact on front line services of budget reductions, and prioritise resources accordingly.
- e** **The Department has very little evidence by which to assess whether unit costs in its delivery bodies are as low as they might be.** The Department should promote existing good practice provided by arm's length bodies which have carried out internal benchmarking exercises, and challenge all arm's length bodies to use internal and external benchmarking data as a way to drive down average costs and better evidence value for money.

Part One

The Department's oversight of costs in delivery bodies

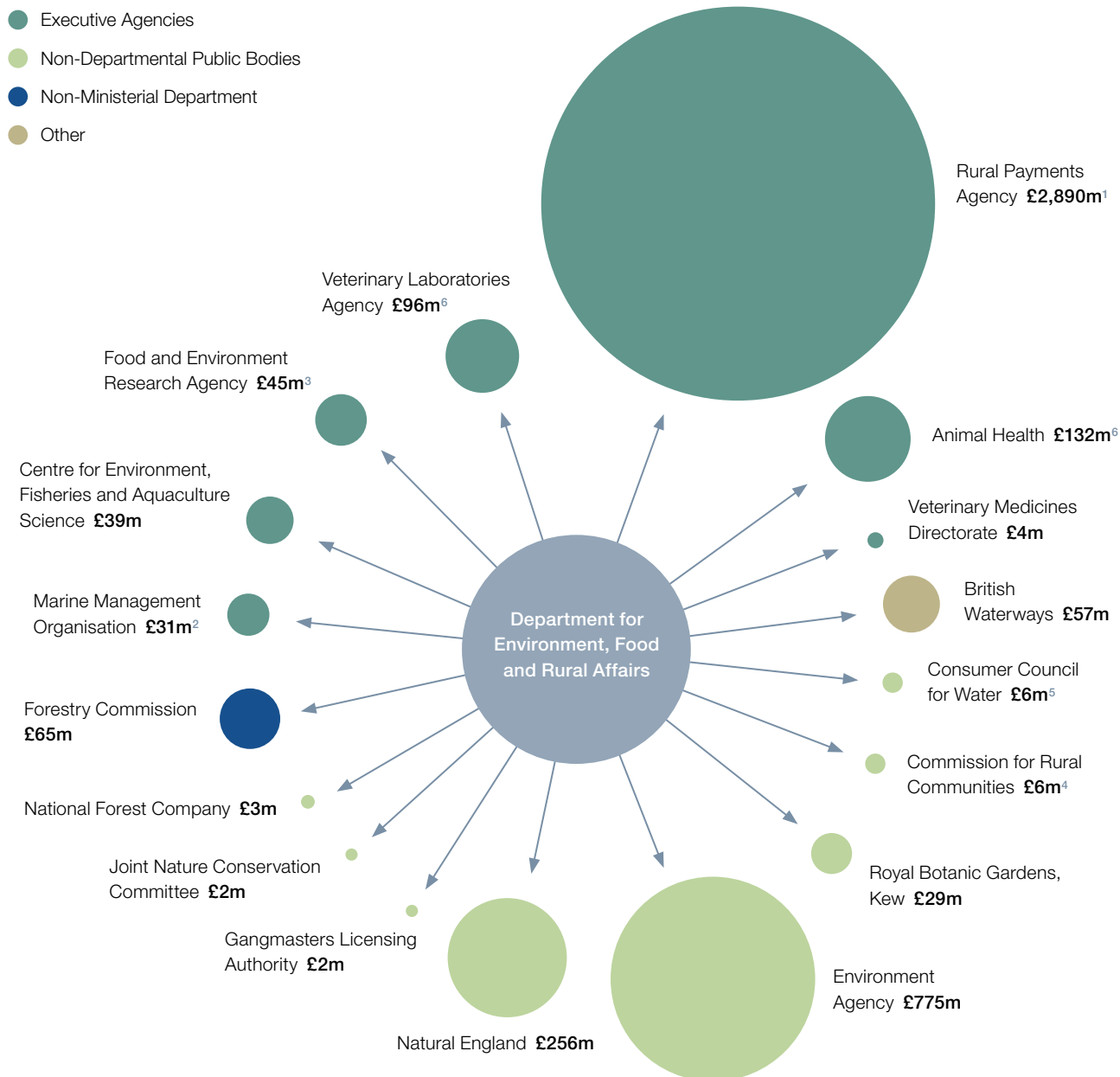
1.1 The Department for Environment, Food and Rural Affairs (the Department) is responsible for delivering the Government's policy on the natural environment, sustainable development, food, farming and fisheries, animal health and welfare, environmental protection and rural issues. The Department delivers the majority of its front line services through arm's length bodies. Their responsibilities include research, surveillance, provision of advice, regulation and enforcement, and processing payments under United Kingdom and European Union agricultural and environmental support schemes.

1.2 **Figure 1** overleaf shows the Department's key arm's length bodies in 2009-10, which together accounted for some 80 per cent of the Department's total expenditure. In 2010, the Department announced its intention to reduce the number of arm's length bodies it funds from 92 to 39. Those abolished include some reconstituted as expert committees, such as the Advisory Committee on Hazardous Substances, and others whose functions the Department considered were no longer required, such as the 15 Agricultural Wage Committees and 16 Agricultural Dwelling House Advisory Committees. The remaining bodies will continue to account for the majority of the Department's expenditure.

Scope of the report

1.3 This study uses four of the Department's larger delivery bodies as case studies to illustrate what has been done to measure the full cost of front line services, and how these bodies have shared this information with the Department. **Figure 2** on page 13 provides an overview of the roles and responsibilities of the four bodies. The Environment Agency, as a non-departmental public body, has greater autonomy than the three executive agencies.

Figure 1
The Department's funding of key delivery bodies 2009-10



NOTES

- 1 The bulk of expenditure by the Rural Payments Agency represents grants to farmers and landowners under the Single Payment Scheme, within the European Union Common Agricultural Policy.
- 2 On 1 April 2010, the Marine Fisheries Agency ceased to exist as an Executive Agency of the Department, and most of its functions and responsibilities transferred to a new non-departmental public body, the Marine Management Organisation.
- 3 The Food and Environment Research Agency was formerly the Central Science Laboratory and Government Decontamination Service.
- 4 The Commission for Rural Communities is to be abolished.
- 5 The Consumer Council for Water is under consideration for abolition.
- 6 Animal Health and the Veterinary Laboratories Agency merged in April 2011.

Source: National Audit Office analysis

Figure 2
The four case study delivery bodies

	Animal Health	Centre for Environment, Fisheries and Aquaculture Science	Environment Agency	Food and Environment Research Agency
Type of delivery body	Executive Agency	Executive Agency	Executive Non-Departmental Public Body	Executive Agency
Gross Expenditure 2009-10	£140m	£57m	£1,276m	£69m
Of which funding from the Department	£132m (94%)	£39m (68%)	£775m (61%)	£45m (65%)
Key role	Prevention of exotic disease outbreak in farmed animals; testing for and responding to notifiable animal disease; ensuring high standards of farm animal welfare.	Providing marine and aquatic evidence and advice.	Protecting and improving the environment of England and Wales; protecting communities from the risk of flooding; managing water resources.	Research, inspectorate and response functions for plant health, bee health and seeds.
Main responsibilities				
Research		✓		✓
Advice and good practice	✓	✓	✓	✓
Inspection and compliance	✓	✓	✓	✓
Issue licences	✓		✓	
Enforce legislation	✓		✓	✓

Source: National Audit Office

1.4 Compared with the Department's other arm's length bodies, the Rural Payments Agency is a medium-sized body, but it has the largest total expenditure due to the value of European Union funds it distributes to farmers. In relation to the budget it receives directly from the Department it is a medium-sized arm's length body. We reported on the Agency in October 2006, December 2007 and October 2009, and continue to monitor its progress in implementing recommendations previously made by both the National Audit Office and the Committee of Public Accounts. For this reason, we have excluded the Agency from the scope of this report.

The assurance the Department needs about arm's length bodies' use of resources

1.5 The Department's arm's length bodies operate with considerable autonomy but Ministers remain ultimately accountable to Parliament for their efficiency and effectiveness. The Department therefore needs reliable, complete and timely data linking cost and performance in its arm's length bodies. Across government, we reported in May 2010 that few indicators used by arm's length bodies linked cost and performance information, and that arrangements to secure assurance over information reported by delivery bodies were often underdeveloped.¹

How good quality cost data can support cost reduction

1.6 The National Audit Office,² the Committee of Public Accounts³ and HM Treasury⁴ have all emphasised the need for robust cost data to be linked to activity and performance information. The Department has to make savings of 30 per cent in real terms by 2014-15, equivalent to a reduction in non-capital spend from £2.3 billion in 2010-11 to £1.8 billion in 2014-15 (**Figure 3**).

1 Comptroller and Auditor General, *Non-Departmental Public Bodies Performance Reporting to Departments*, National Audit Office, May 2010. We recently reported that the Department for Culture, Media and Sport faces challenges in providing effective oversight of its arm's length bodies, which differ substantially in size, influence and risk. Comptroller and Auditor General, *Department for Culture, Media and Sport: Financial Management*, Session 2010-11, HC 821, National Audit Office, March 2011.

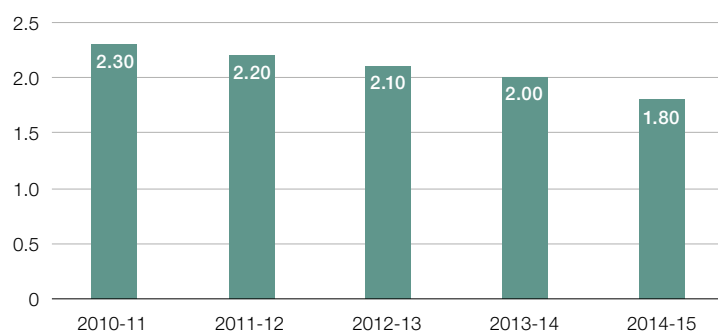
2 Comptroller and Auditor General, *Department for Environment, Food and Rural Affairs: Management of Expenditure*, Session 2007-08, HC 309, National Audit Office, March 2008. Comptroller and Auditor General, *Defra's organic agri-environment scheme*, Session 2009-10, HC 513, National Audit Office, March 2010, also found, for example, that Natural England did not separately account for the cost of processing an application for organic stewardship schemes.

3 HC Committee of Public Accounts, *Managing financial resources to deliver better public services*, Forty-third Report of Session 2008-09, HC 519, September 2008.

4 *Managing taxpayers' money wisely: a commitment to action*, HM Treasury, January 2011.

Figure 3

The Department's non-capital budget, 2010-11 to 2014-15

Cash resource budget (£bn)**NOTE**

1 All figures are in cash terms.

Source: Comprehensive Spending Review, 2010

1.7 In September 2010, HM Treasury circulated guidance from the Government Finance Profession to help departments improve their understanding of the unit costs of activities.⁵ The unit cost is the total cost divided by the total number of units of service provided, producing a flat rate for a single unit. Unit cost information can be used to construct budgets based on varying volume or activity levels. Unit costs can also be used to measure efficiencies, by tracking reductions in the average cost of carrying out a piece of work. The guidance reflects the expectation that departments will cascade reporting requirements to arm's length bodies, which would allow data to be viewed across the delivery network and inform decision-making.

⁵ *Unit cost guidance, Correspondence to Finance Directors*, MS FD (10) 40, HM Treasury, September 2010. See also *Managing taxpayers' money wisely: a commitment to action*, HM Treasury, January 2011.

The Department has not clearly set out the cost and performance information it requires from delivery bodies

1.8 The Department's finance and performance teams are responsible for scrutinising delivery bodies' expenditure and activities. There is no central oversight of the robustness of cost management and quality of costing data across the Department's delivery bodies. This lack of a systematic approach means that the Department will be unaware of the extent of good practice as much as weaknesses in cost management.

1.9 The Department collects monthly expenditure data from its delivery bodies, but until very recently has given little direction as to what additional financial and performance information it needs to understand business performance. In the absence of such direction, arm's length bodies have shared with the Department the internal management reports they developed to meet their reporting and monitoring requirements. The arm's length bodies we interviewed believed the Department would find this information useful in understanding their business.

1.10 The Department has introduced a template for the reporting of financial information from delivery bodies. In 2010, the Department undertook a review of the routine submissions received from delivery bodies. The Department trialled a new monthly reporting template in January 2011, which standardises the format in which it receives information, and, following the trial, introduced the template across its delivery network from May 2011.

1.11 The template represents an improvement in the reporting of financial information to the Department and may help it meet new Government financial reporting requirements. While the report focuses on the monitoring of expenditure, arm's length bodies must also provide a quarterly narrative on performance. The Department does not, however, require them to report data on the cost of front line delivery. The Department has yet to carry out a review to establish the cost and performance data it requires.

1.12 The absence of efficient mechanisms to collate data means that substantial manual work is required to measure routinely the full cost of activities, particularly where this depends on collating data from more than one agency.⁶

⁶ We highlighted this issue in *Assessing the cost to public funds of animal diseases. Commentary on cost data provided by the Department for Environment, Food and Rural Affairs to the Advisory Group on Responsibility and Cost Sharing*, National Audit Office, October 2010.

Assessing the reasonableness of front line delivery costs

1.13 The Department has not asked delivery bodies for internal benchmarking data that would allow it to drive improvements in cost effectiveness, make comparisons of front line delivery costs, or collate and share good practice examples. There is evidence that, locally, delivery bodies have started to assess performance by establishing internal benchmarks. It remains early days, and to date this work focuses on simple cost comparisons rather than being able to identify reasons for inefficiency or areas of good practice.

1.14 The Department takes some assurance that delivery bodies are competitive where they secure income from work in the commercial market. There are a number of arm's length bodies that operate commercially, securing work from private sector customers and other government departments through open competition. The Department takes some assurance from this that those bodies' costs are reasonable and that they are providing value for money. The Department has not sought to assess the reliability of this as a benchmark through a more detailed analysis of the cost base of its arm's length bodies and of the competitiveness of the markets in which they operate.

1.15 Arm's length bodies have found it difficult to identify comparable organisations and obtain relevant data suitable for external benchmarking. In the absence of external benchmarks, the Department has little evidence on which to judge whether the cost of work it commissions from its delivery bodies is high or low, although for indirect cost comparisons the Department contributes to, and can draw on, an annual exercise across government led by HM Treasury.⁷ This is based on self-reported data from a range of public sector bodies on key metrics such as finance and human resources, but does not measure front line delivery costs.

1.16 Parts Two to Five of the report examine, for each of the four case studies, how delivery bodies: have used cost data to measure the cost of front line activities; make well informed decisions about how resources are used; and, demonstrate effective cost control. Our methodology is summarised in Appendix One.

⁷ *Benchmarking the back office: central government*, HM Treasury, 2009.

Part Two

Animal Health

2.1 Animal Health is the national agency which manages risks from notifiable diseases affecting kept animals across Great Britain, although responsibility for animal health is devolved to the administrations in Wales and Scotland. In 2009-10, the Department funded 94 per cent of Animal Health's total expenditure of £140 million. Service level agreements with other government bodies such as the Food Standards Agency, and commercial customers, generated income of £6 million. On 1 April 2011, Animal Health merged with the Veterinary Laboratories Agency to become the Animal Health and Veterinary Laboratories Agency.

2.2 Animal Health's formal governance structures involve a senior official from the Department, alongside the Chief Executive and other members of the leadership team. Information available to senior managers includes monthly variances between expenditure and budget, and quarterly performance reports for 133 operational indicators that measure performance against standards such as the time taken to respond to incidents. Our review of the regular monthly and quarterly reports found that both cost and performance data were available to oversight boards, but reports did not analyse and interpret the combined data to help understand relationships between costs and outputs.

Using cost data to allocate resources

2.3 The way the Department funds Animal Health's work in England, Scotland and Wales does not match the different activity levels in each of the three administrations, and results in Animal Health setting different prices for carrying out similar work. For 2010-11, the Department allocated resources to fund direct costs in proportion to historic outturn in England, Scotland and Wales, and funded indirect costs in proportion to the number of animals in each country. For some of Animal Health's work, particularly in preventive or animal welfare interventions, this approach is likely to correlate reasonably well with actual cost, because activity levels for this work relate closely to animal numbers. It does not necessarily correlate well, however, with the amount of work needed to tackle endemic disease, which is the largest area of work by value. Bovine tuberculosis, in particular, is prevalent in Wales and the south west of England, but is rare among Scottish herds.

2.4 Animal Health attempted to model the impact of prospective funding reductions in 2011-12 by matching the estimated cost to volumes of work (such as the number of tests or inspections carried out) for 42 key activities, but it would need to collect new monitoring data to increase the accuracy of the analysis. Drawing on information recorded in internal databases, Animal Health found that robust volume data was only available for 17 of the 42 activities. For 15 activities reasonable estimates of volume data could be made, but for the remaining 10 activities volume data are not available.

2.5 Faced with budget reductions in 2011-12, the Department has prioritised funding such as for the bovine tuberculosis programme and some exotic disease risks. The Department had access to Animal Health's cost analysis but did not ask for detail of the underlying cost drivers, or challenge whether efficiency savings would allow costs to be reduced while maintaining some or all activities at their previous levels.

Measuring the full cost of activities

2.6 Animal Health breaks its work into seven core functions. The full cost of delivering this work is made up of direct costs (mainly staff salaries), the agency's back office costs (such as finance and human resources), and services such as estates and common IT costs recharged to Animal Health by the Department and over which it has little control (**Figure 4**). Indirect costs, including common services, are apportioned to functions in proportion to the direct staff costs or, where more appropriate, to the volume of work carried out.

Figure 4

Estimated breakdown of Animal Health costs in England, 2009-10

Work area	Direct costs (£m)	Indirect costs (£m)	Defra common services (£m)	Total cost (£m)
Endemic disease	37.7	10.5	13.3	61.5
Border controls	7.0	2.1	2.6	11.7
Disease risk reduction	4.9	2.0	4.0	10.8
Protecting the food chain	3.7	1.6	2.3	7.6
Animal welfare	2.8	1.1	2.2	6.2
Exotic disease	1.6	0.6	1.1	3.3
Reportable diseases and other zoonoses	0.3	0.2	0.2	0.8

NOTE

1 Totals may not sum due to rounding.

Source: National Audit Office analysis of data provided by Animal Health

2.7 Animal Health estimates that the fees and charges it raises, some £2.8 million a year, under-recover full costs by some £1.7 million. Under existing legislation Animal Health charges customers for services such as testing animals imported into the country, and issuing licences. Updating fees and charges, which are set by statutory instrument, is not a quick or simple process and relies on accurate cost data. Animal Health has been actively working on a project to raise charges and carried out a systematic review of the way it calculates the cost of activities in support of cost and responsibility sharing proposals in 2010. In recent years Animal Health has been better able to assemble the full cost of activities after the Department started supplying up to date information on the shared service costs relevant to these activities.

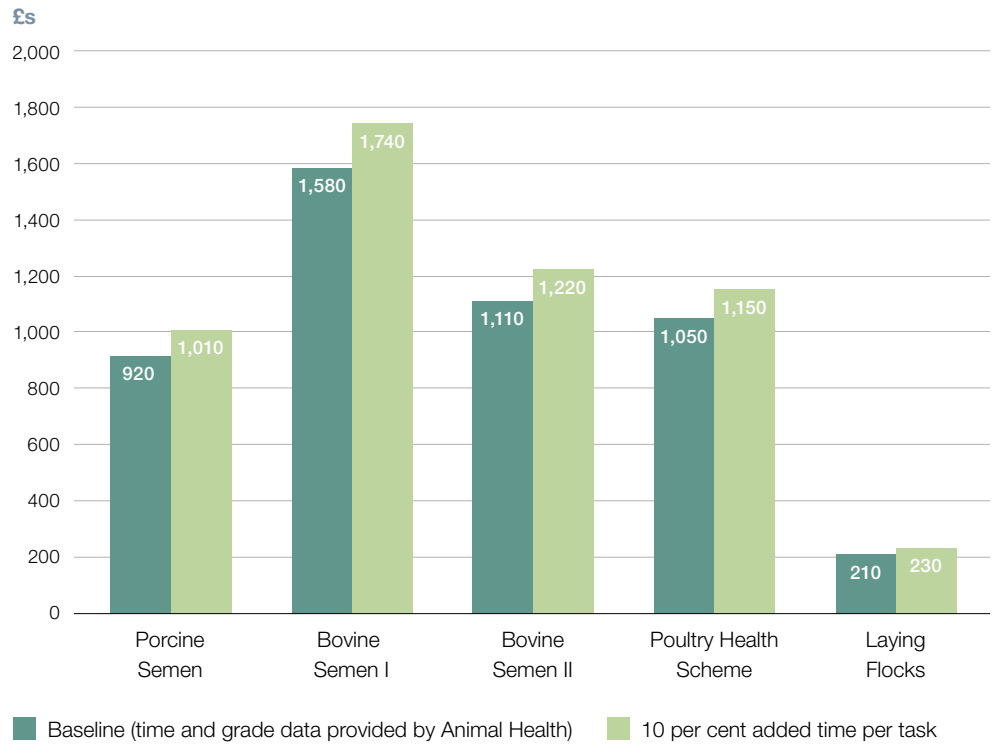
2.8 Animal Health will need more robust measures to invoice the Department accurately for front line work. Animal Health is making rapid progress towards this goal, through for example, mapping the processes involved and estimating the time taken to carry out key tasks. This exercise covers some 347 separate field tasks (such as carrying out bovine tuberculosis skin tests, site visits to check that animal welfare legislation is being complied with, or investigating suspected incidence of exotic diseases such as African horse sickness or avian influenza), and over 800 supporting administrative tasks and sub-tasks. There are, for example, 20 separate tasks involved in processing an application for an artificial insemination licence under Porcine Semen Regulations. Calculations have proved complex and labour intensive, and are heavily reliant on estimates which reduce their accuracy. **Figure 5** shows, for an illustrative sample of five activities, that small changes in the assumptions made can make a considerable impact on the unit cost of carrying out a single activity. The differences are substantial when multiplied by the total volume of work.

Benchmarking

2.9 Animal Health aims to use internal benchmarks to help drive costs down towards the average across all regions. It began an internal benchmarking exercise in 2010, drawing on data for the last five years to compare typical costs for key activities between all 15 of the agency's regions in England, Scotland and Wales. At the time of our fieldwork internal benchmarks had been completed for bovine tuberculosis, animal welfare, animal by-products, and measures to protect the food chain, including the Egg Marketing Inspectorate and dairy hygiene inspections. **Figure 6** on page 22 shows, for example, that the average time taken to conduct a test for bovine tuberculosis varies markedly. Discounting the outliers, for which there may be local reasons for variations, there is scope for efficiency saving among regions handling similar volumes of work at very different unit costs. Animal Health is developing similar benchmarks for disease control and prevention and for border controls.

Figure 5

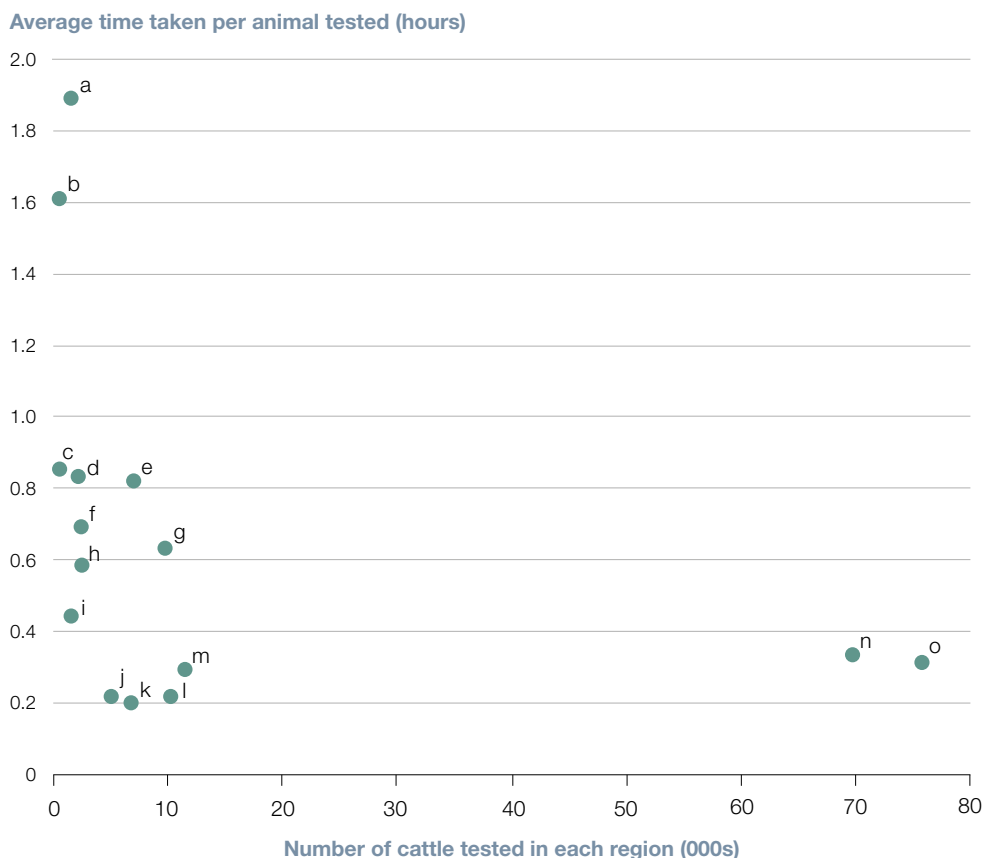
The sensitivity of activity costs to estimates for the time needed for tasks



Source: National Audit Office analysis of Animal Health data

Figure 6

Illustrative benchmarks for the average time it took vets to carry out bovine tuberculosis tests, by region, in 2009-10



● Time taken for sampling and testing (average time per animal) in each region

- | | | |
|----------------|------------------------|-----------------|
| a East England | f Yorkshire and Humber | k East Midlands |
| b North East | g West Midlands | l North Wales |
| c Perth | h Ayr | m South East |
| d Inverurie | i Inverness | n South Wales |
| e North West | j Galashiels | o South West |

Source: Animal Health

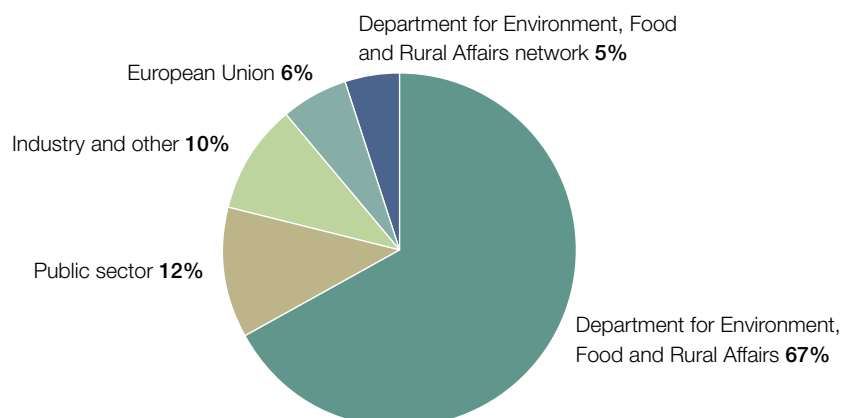
Part Three

Centre for Environment, Fisheries and Aquaculture Science (CEFAS)

3.1 CEFAS undertakes marine science research. Its business plan, approved by the Department, describes it as the Government's foremost source of marine evidence, applied science and impartial expert advice. The Agency sees its impact as contributing to ensuring good environmental status for United Kingdom seas, supporting sustainable economic growth and providing healthy, secure food supplies. It undertakes directly commissioned work and contracts won in open competition for customers including the Department, other arm's length delivery bodies, the wider public sector and private industry. In 2009-10, CEFAS's income was £57 million, of which around two thirds was funding from the Department (**Figure 7**).

3.2 Oversight by the Department is led by the CEFAS Owner's Advisory Board, which is chaired by a member of the Department's management board, in their capacity as owner. CEFAS senior managers also attend the Owner's Advisory Board, which reviews CEFAS's performance at a strategic level, including issues such as revenue growth, forward planning and major investment decisions and provides support and advice. Most of the Department's work in CEFAS is managed through a High Level Agreement, which makes a funding commitment over ten years, and related service level agreements. The Department agrees with CEFAS an annual programme of projects.

Figure 7
Centre for Environment, Fisheries and Aquaculture Science income sources in 2009-10



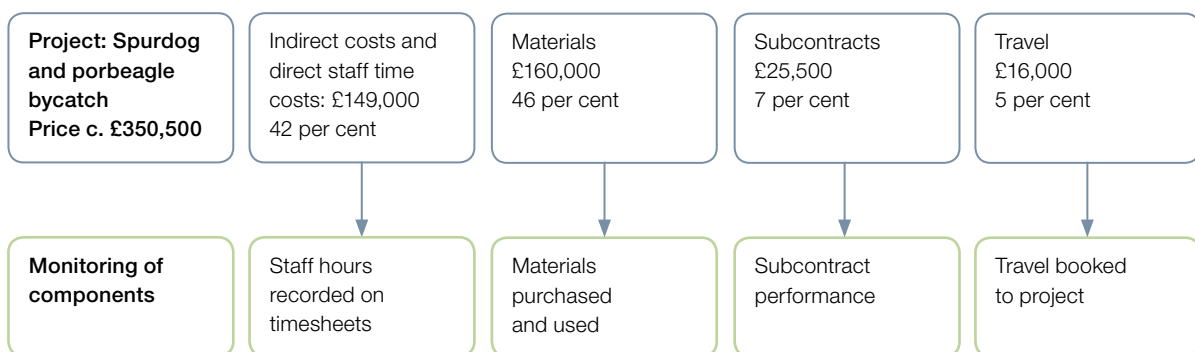
Measuring the cost of front line work

3.3 CEFAS has broad responsibilities including issues such as marine planning and environmental licensing, fisheries, marine biodiversity and habitats, fish and health and hygiene and emergency response. It manages each separate piece of work as a project and there are between 500 and 600 projects running in any year. Examples of projects include tracking fish within specific rivers and testing shellfish for bacteria and viruses.

3.4 **Figure 8** shows how CEFAS uses forecast costs to calculate the price of a typical project, in this case one assessing the movement patterns of porbeagle and spurdog sharks and their survivability when accidentally caught. The calculation is based on components including staff time and other resources needed for the work. CEFAS undertakes work for the Department at a fixed price. If forecast costs are not captured correctly, there is a risk that either CEFAS will have to absorb any cost overruns or the Department is charged more than necessary.

3.5 CEFAS sets charges for individual projects at a level that recovers direct costs and, when all projects are taken together, is sufficient to cover total indirect costs. Some expensive resources, such as laboratories, support a large number of different projects. CEFAS collects all the direct and related costs of these assets into single cost centres, and recharges the total cost to projects on the principle that these should be in proportion to the amount of resources used. The cost to projects of an expensive asset such as the agency’s research vessel, for example, is captured as a charge per day’s use. Project managers’ ability to control the costs of their projects depends on them actively managing the volume and mix of resources they require for their project.

Figure 8
The components underpinning the price of a project the Centre for Environment, Fisheries and Aquaculture Science delivers for the Department



Source: National Audit Office analysis of Centre for Environment, Fisheries and Aquaculture Science data

3.6 Overhead costs including, for example, general accommodation costs and corporate services, are charged to projects through the hourly rates for different grades of staff. Until 2007-08, CEFAS used different hourly rates for staff based at different sites, as a way of reflecting the general accommodation costs specific to where they were working. One consequence was that similar work, such as advice, was priced at a different hourly rate depending on where the staff doing the work were based. CEFAS concluded that this method of apportioning cost increased complexity and hampered internal collaboration because it acted as a disincentive to cross-site working. As a result, the extent to which relatively expensive accommodation impacts on the cost of specific projects is now less clear.

3.7 Other than in 2010-11, when there was no increase in staff charge rates, CEFAS has maintained a 3 per cent increase to charge rate for different grades of staff since 2006. CEFAS set rates in their business planning forecasts through considering average cost inflation, cost forecasts, efficiencies, sales volumes and the risks anticipated over the medium term. CEFAS has adopted this approach aiming for stability in charge out rates. Over the long term, if not periodically rebased, taking into account efficiency savings achieved, divergence between the charge out rates used and actual underlying cost base could have a substantial impact. This is because costs based on the staff charge out rates can account for between 40 per cent and 86 per cent of the total cost for each of the projects we reviewed, with the balance being made up of materials, subcontracts and travel costs.

Demonstrating effective cost control

3.8 CEFAS has increased the value of private sector work it undertakes each year – by around £3.5 million between 2006-07 and 2009-10 – so that it now accounts for around 10 per cent of total income. The increase over the same period in the value of work for the wider Department for Environment, Food and Rural Affairs' network and the public sector was around £3.2 million, accounting in 2009-10 for 17 per cent of total income. Income from work for the European Union increased from £1.8 million to £3.3 million (6 per cent of total income in 2009-10). The balance of income arises from work carried out for the core Department. Fixed costs have not increased to the same extent and are now spread across more customers. CEFAS has not reflected this in reduced staff rates used to charge the Department, but has not passed on exceptional charges arising in the year, for example, from the relocation of a site.

3.9 In response to reduced funding from the Department in 2010-11, CEFAS challenged project managers to achieve a savings target of a 3 per cent efficiency saving. For around 200 projects, managers identified efficiency savings that could be made without impacting adversely on the quality of service to customers. Of these, projects forecasting gains of greater than 5 per cent contributed around 30 per cent of the efficiency target.

3.10 CEFAS benchmarks fees to five commercial rates as one way of testing its competitiveness. As part of the exercise, CEFAS found that one comparator achieved an 8 per cent margin despite lower charges for staff time. That organisation is not an exact comparator in that it does not undertake the full range of work CEFAS performs, and CEFAS concluded that, looking at the organisation as a whole, their own commercial rates are competitive. CEFAS examines the reasons for the success or failure of individual project bids looking for opportunities to enhance its competitiveness. CEFAS also seeks to benchmark the efficiency with which resources are used. It routinely monitors the relative proportions of staff time booked to project work and overhead activity, and considers that these levels compare well against competitors.

3.11 The Department requires CEFAS to break even, which means that it is not permitted to incur losses and must return surplus income to the Department. Where a fee is charged for access to public goods or services, there are some specific rules about how the charge should be determined.⁸ Treasury guidance requires CEFAS to set prices for private sector work at commercial rates. In 2009-10, from an income of £57.3 million CEFAS returned £0.2 million to the Department (0.3 per cent), after exceptional charges of £2.5 million. The Department endorses CEFAS's annual targets for the return of surplus income by approving the annual business plan which includes assumptions about income, forecast expenditure including investment in research and development, and the risks being managed.

⁸ Set out in *Managing Public Money*, HM Treasury, chapter six.

Part Four

The Environment Agency

4.1 The Environment Agency undertakes a wide range of work including: flood and coastal risk management; acting to reduce climate change and its consequences; protecting and improving water, land and air; working with people and communities to create better places; and, working with businesses and other organisations to use natural resources wisely.

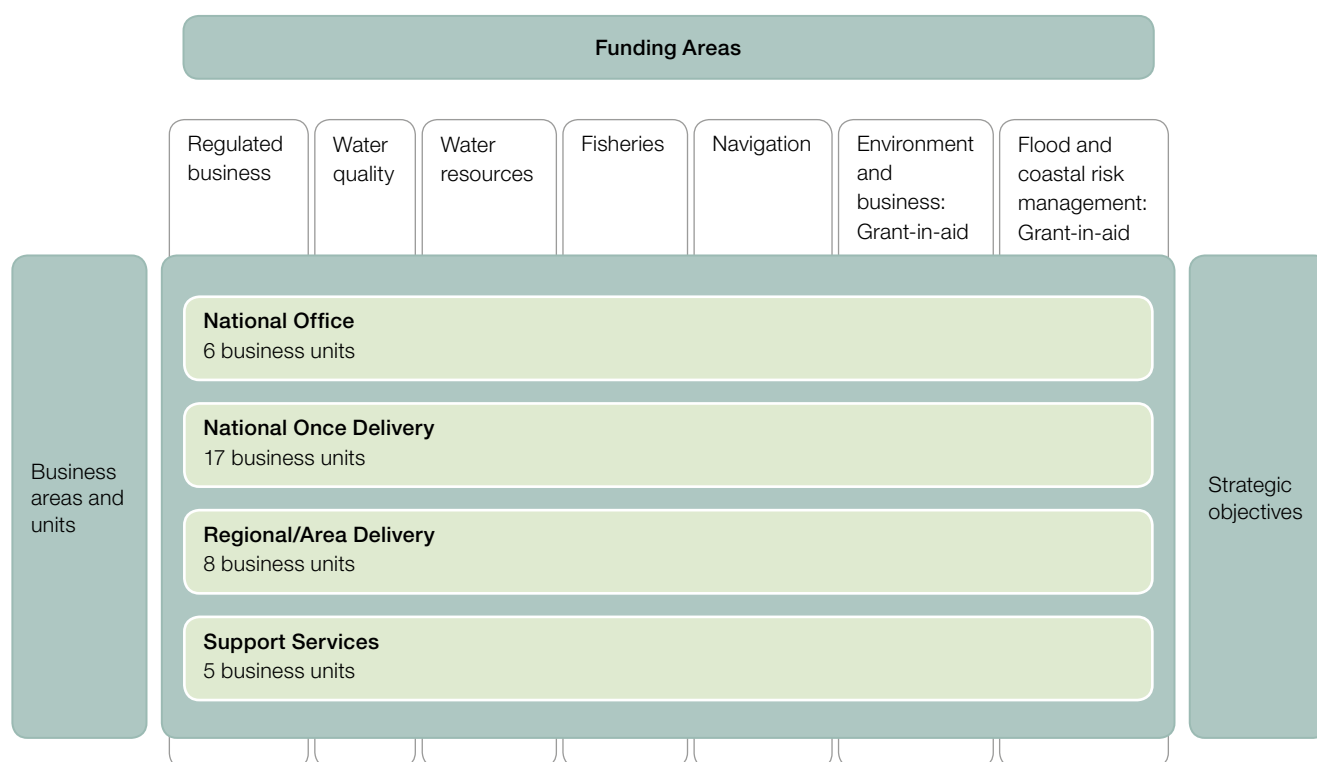
4.2 In 2009-10, the Environment Agency managed a budget of £1,276 million, 61 per cent of which came from the Department, 5 per cent from the Welsh Assembly Government and the remainder primarily from 20 different charging schemes for regulating individuals' and businesses' impacts on the environment.

4.3 The Environment Agency is a non-departmental public body. The Agency's Board is responsible for scrutinising the work of the organisation and is responsible to Parliament through Government Ministers.

4.4 The Environment Agency matched the funding it receives in seven broad areas to 36 business units organised in four groups (**Figure 9** overleaf). It structures its management information around this model of the business.

4.5 Reflecting the size and complexity of the Environment Agency there are many lines of communication with the Department. Corporate performance information is included in a corporate scorecard which forms part of a twice yearly Ministerial review of the Agency. Most of the scorecard's 41 indicators measure outcomes, such as reduced pollution or flood protection. One indicator relates to cost management, tracking cash savings delivered. There are monthly sponsorship meetings between the Environment Agency and the Department, and more frequent informal working level contact. Within the Agency all 41 scorecard indicators are linked to directorate level business plans. These match spending to each indicator, and are subject to quarterly review led by the Chief Executive.

Figure 9
The Environment Agency's model of its business



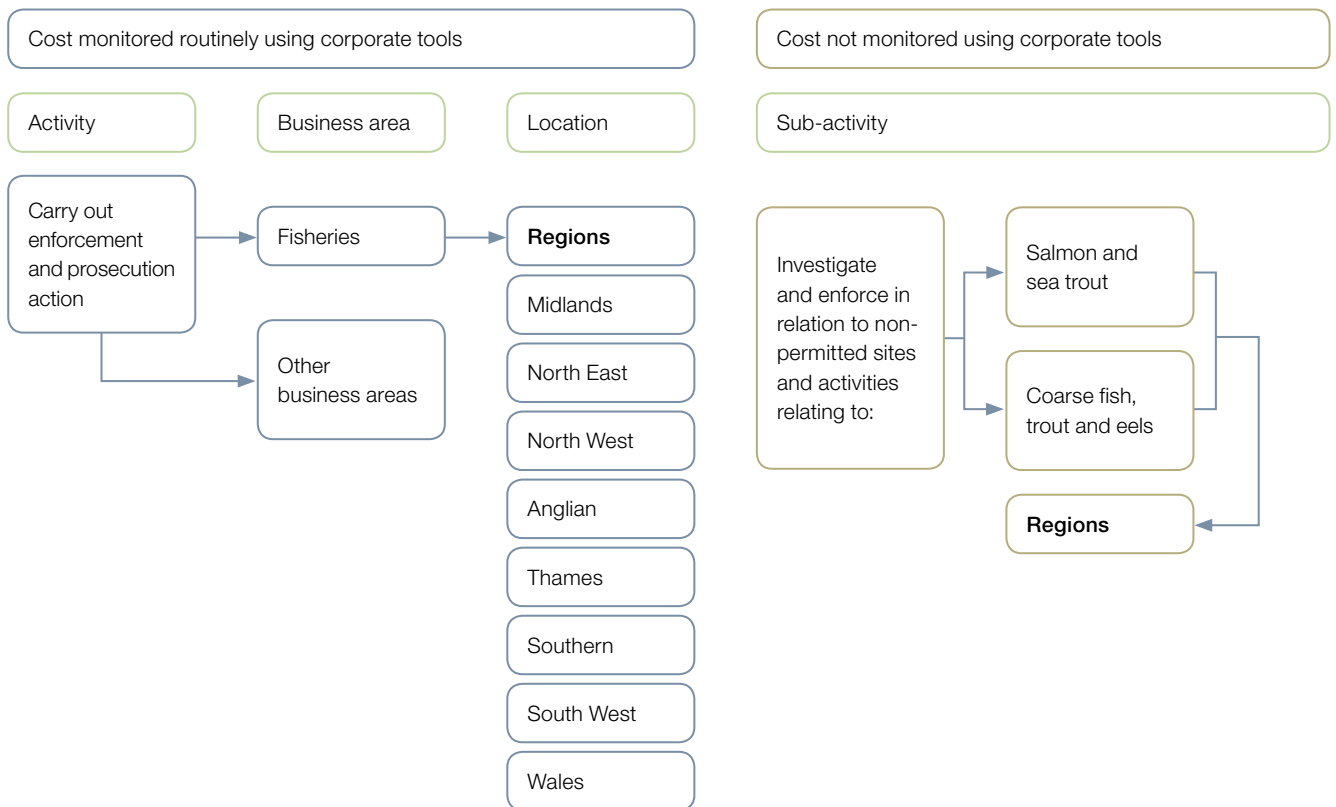
Source: National Audit Office analysis

Measuring the cost of front line work

4.6 The Environment Agency measures the cost of front line work by category, rather than attempting to track the cost of every activity. Its time recording system is linked to charge out rates for different grades, and measures the direct staff cost of some 900 distinct activities. For example, within the Fisheries area of the business, the activity to 'carry out enforcement and prosecution action' includes a mixture of activities for which the cost is separately measured and other costs which are not individually captured (**Figure 10**). In this example, the Environment Agency allocated budgets of approximately £1.8 million for salmon and sea trout and £1.1 million for coarse fish, trout and eels, to each of the eight regions based on factors including the number and size of sites and planned enforcement activities.

Figure 10

An example of how the cost of an activity is monitored in one area of the business



Source: National Audit Office analysis of Environment Agency data

4.7 The Environment Agency has simplified its time recording system, from more than 3,000 codes in 2007, to around 900 currently. The Agency found that the higher figure yielded too much detail, which was not helpful for practical decision-making. The choice of 900 activity codes has nonetheless involved some compromises, but local managers are able to break down the high level costs into more detail, and to make use of estimates derived from workloads to do this. The Environment Agency has periodically made use of some of the defunct activity codes for short periods of time to confirm that estimates are in line with actual staff activities.

4.8 The central finance team apportion indirect costs in similar proportions across the whole business, and plan to use a single flat rate in the future. The Environment Agency recognises that indirect costs could be apportioned to more accurately reflect the way different parts of the business actually use central services to differing extents, but has concluded that variations are not significant.

Using cost data to set accurate budgets, fees and charges

4.9 The Environment Agency has developed tools to help minimise the risk that planned activities do not match the available resources. Budget holders' initial business plans are collated into a single resource allocation model, which allows senior management to identify areas of potential overspend and duplication of work. This allows budget revisions based on reducing particular activities, rather than through arbitrary cuts. To help identify if resources are used as planned, the Agency uses a cost allocation model to check whether the actual costs of completed activities align with what was planned.

4.10 In 2009-10, the cost of activities for which charges were levied totalled £362 million, creating a shortfall of £19.8 million between costs and charges raised. This relates primarily to work within Fisheries and Navigation. The Environment Agency agrees with the Department the total amount to be spent in these areas each year. This includes general work to improve the environment which the Department has decided should not be fully recovered through charges to individuals. The Department funds the difference through grant-in-aid.

4.11 The Environment Agency has, nevertheless, sought to reduce the difference between total costs and income from users and has done so in part for Navigation, for example, by increasing total contributions from users. These have risen from £4.9 million in 2006-07 to £6.1 million in 2009-10. Our 2009-10 financial audit work found that while the Environment Agency complies with requirements under HM Treasury fees and charges guidelines, the Agency has recognised there are areas where improvements can be made. For example, the Environment Agency has in 2011-12 plotted expected costs against funding streams using more accurate estimates of how long it will take staff to complete particular pieces of work.

4.12 The Agency apportions indirect costs as a proportion of the direct costs for each charging scheme. Over the course of its 2011-15 business planning period the Agency is seeking to make greater reductions in back office costs than front line activities.

Demonstrating effective cost control

4.13 As part of the 2011-12 budgeting process, each business unit within the Environment Agency was required to plot the importance of their activities to customers against the extent to which they were uniquely deliverable by the Agency. This highlighted activities that could be reduced or stopped with minimal impact on outcomes. The Environment Agency is considering how it can build on this work by using cost data to make efficiencies in activities which add less value, but which under current legislation the Agency has an obligation to maintain.

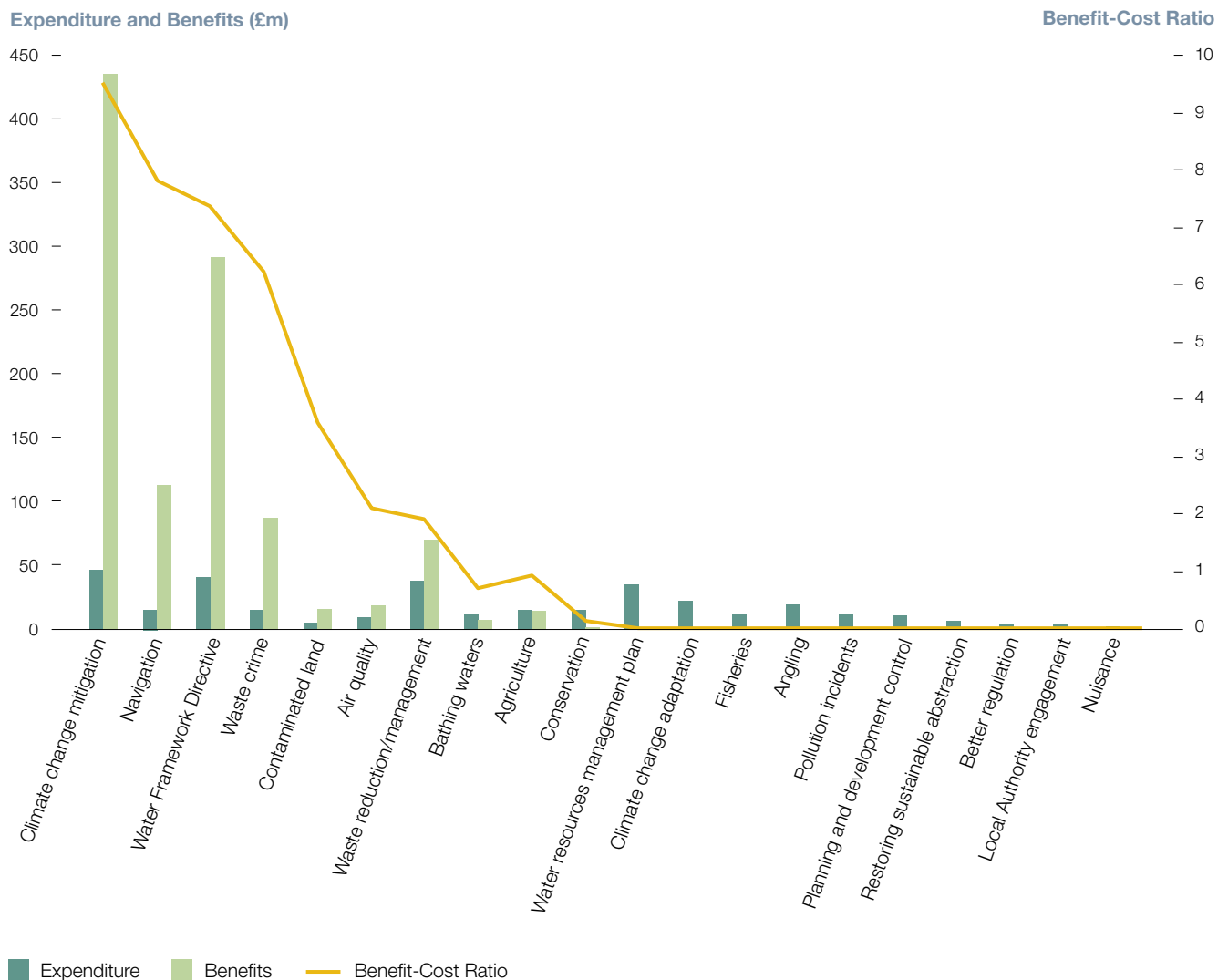
4.14 The Environment Agency has centralised back office functions, such as human resources and finance and also delivers some customer facing services centrally. The Agency has, for example, established a National Customer Contact Centre and a National Permitting Centre. The Environment Agency has not yet assessed if the approach of delivering services centrally would deliver better value for money for other customer facing services that are replicated in each region.

4.15 Reviewing costs and processes together has led to savings. As an example, a review of the tasks the Agency follows to respond to customer queries led to process redesign resulting, the Agency has estimated, in cost savings of 8 per cent, as well as improvements in response time. It has also allowed a previously planned IT project to be scrapped at a saving of £150,000.

4.16 The Environment Agency is taking steps to make more use of cost data to assess where savings could be made. It has recently undertaken a cost benefit assessment of 20 key activities (**Figure 11** overleaf) concluding that for seven of them the quantified benefits were likely to outweigh costs. The remaining 13 benefits remain difficult to analyse and assess. This data has been shared with the Department and HM Treasury, and the Environment Agency is working on improving the comprehensiveness and robustness of the calculations used in the analysis. More robust cost analyses will be needed because, while cost and benefit assessments provide an indicator that the benefit of an activity is greater than its cost, they do not indicate that costs as they stand are no higher than they need to be. Nevertheless, while this exercise remains work-in-progress, the Agency was the only delivery body we reviewed that had attempted an exercise of this kind and scale.

4.17 The Environment Agency calculates internal benchmarks for its top 20 activities measured by staff costs and top 20 other costs. The Agency compares the cost of items such as travel and subsistence, lease cars, use of consultants and mobile phone costs across its eight regions and against an internal average figure. This information is provided to regional directors to act upon, although the Agency has not assessed how the information has been used. The Environment Agency has explored identifying European comparator bodies to provide benchmarks for activity costs, but has found suitable external benchmarks difficult to identify.

Figure 11
Cost benefit analysis presented to HM Treasury



Source: Environment Agency presentation to HM Treasury

Part Five

Food and Environment Research Agency (FERA)

5.1 FERA delivers policy and inspection functions relating to plant and bee health, undertaking scientific research and emergency responses to serious contamination incidents, and provides professional advice to government, international organisations and the private sector. It managed a budget of £68.2 million in 2009-10, around two thirds of which came from the Department (**Figure 12**).

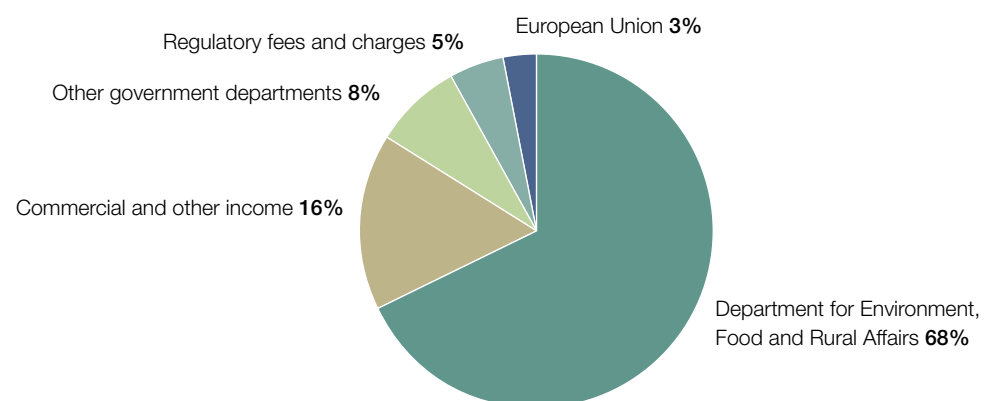
5.2 The Agency Chief Executive has responsibility for day-to-day management, but is supported by a Strategic Advisory Board which is chaired by a senior Departmental official. The Board also includes non-executive members drawn from the wider scientific community and the private sector. The Agency must seek the Department's approval for any material change to strategic corporate and business plans, changes to strategic investments, or changes likely to impact on its relationship with other bodies.

Measuring the full cost of front line work

5.3 FERA, like CEFAS, manages its front line work as projects and monitors them individually, as well as collectively within business units. There are around 500 live projects underway at any one time. FERA prepares monthly performance reports, which it shares with the Department, tracking progress for agreed projects.

Figure 12

Food and Environment Research Agency income sources in 2009-10



Source: Food and Environment Research Agency Annual Accounts 2009-10

5.4 The total costs in each business area are used to calculate staff charge out rates. Costs relating to accommodation are particularly important to FERA because laboratory space is more expensive than office space. For example, splitting FERA's total annual energy costs of £3 million equally across the business would overestimate the true cost of projects that do not use laboratories. **Figure 13** shows how different assumptions about how overhead costs should be attributed makes a substantial difference to the total cost of individual projects and, consequently, to the fee charged to public or private sector customers. In this example, a project relating to phytophthora disease, FERA charges less for an hour of staff time than for a molecular based technology project. If both projects had charged the higher rate, the phytophthora project would have been calculated as costing 24 per cent more. If a flat rate had been used one project would have cost more and the other less, but neither would have accurately reflected the full costs of undertaking the work.

Figure 13

The apportionment of indirect costs has an impact on the full cost of activities

	Project A: Molecular Based Technology	Project B: Phytophthora Disease Management	Cost of Project B if Project A staff charge rates were used
Staff days required	119	307	307
Number of staff	3	9	9
Different staff grades required	3	4	4
Total staff time driven costs	£60,000	£97,000	£123,000 27 per cent increase
Other costs	£193,000	£10,000	£10,000
Total project cost	£253,000	£107,000	£133,000 24 per cent increase in full cost of project

Source: National Audit Office analysis

5.5 FERA is in the process of better understanding its costs. In 2010, it undertook a detailed manual exercise to apportion indirect costs more accurately to each area of the business according to accommodation size or, where more applicable, in proportion to staff numbers.

5.6 FERA will need to increase its fees to recover the full costs for statutory work inherited from predecessor bodies. Fees charged for this work have historically been set at the lowest permissible rate and have not subsequently been revised. In 2009-10, FERA identified that the costs of some statutory work exceeded the fees recovered by £2.4 million, as shown in **Figure 14**. FERA is assessing the level at which charges would have to be set to recover costs, informed by the re-examination of how indirect costs should most accurately be apportioned. These calculations indicate that no charges are above cost, and that in some instances prices should be 400 per cent higher than current levels.

Figure 14

FERA does not recover the full costs of its regulatory work



Source: Food and Environment Research Agency Annual Accounts 2009-10

Demonstrating effective cost control

5.7 FERA has introduced a process improvement programme designed to save £4.7 million by December 2011, although it had only achieved small cost savings through the programme by December 2010. FERA tests around 35,000 samples a year as part of its chemical safety work, for example, and estimates that every minute by which a test could be reduced would save some £25,000 a year. Following slow initial progress towards the savings target from identifying areas where there was greatest potential for efficiencies, however, FERA adopted a practical, albeit less forensic, approach and allocated the £4.7 million savings target across each business area in proportion to their expenditure.

5.8 FERA bids competitively for work it undertakes for the Department, other government departments and commercial sectors. For the commercial sector work, the Agency charges a margin over the same services offered to government customers. This gives some assurance that its charges are in line with market rates. FERA does not benchmark the costs of its activities internally or externally. It reported that it has not found suitable comparator bodies with which to undertake benchmarking.

Appendix One

Methodology

Delivery body selection

We identified a long list of 19 non-departmental public bodies and executive agencies. We excluded those bodies that receive less than £30 million in annual funding from the Department. The eight remaining bodies represented over 95 per cent of the Department's funding to arm's length bodies. The short list of four was chosen based on discussions with the Department to ensure the selection encompassed a range of activities, sizes and funding, and that delivery bodies had capacity to take part in the study.

The four bodies reviewed are:

- Animal Health;
- Centre for Fisheries and Aquaculture Science (CEFAS);
- Environment Agency; and
- Food and Environment Research Agency (FERA).

Detailed methods

Methods	Purpose
<p>Semi-structured Interviews</p> <p>Staff interviewed varied between delivery body but included:</p> <ul style="list-style-type: none"> ● Senior management ● Finance staff ● Operational staff <p>We followed up the visits to the delivery bodies with interviews with several key officials in the Department</p>	<p>To develop an understanding of:</p> <ul style="list-style-type: none"> ● How costs are monitored and what costing methodologies are used ● How inefficiencies are identified and addressed ● To what extent an understanding of costs informs the budgeting and fee setting process ● What routine management information is produced and the extent to which this includes information on costs ● The volume and quality of cost information reported to the Department ● How the Department used the information provided by delivery bodies to assess value for money
<p>Document Review</p> <p>We reviewed the following published and unpublished documentation:</p> <ul style="list-style-type: none"> ● Internal management information ● Performance assessments ● Board papers and minutes ● Budgets, and internal process documentation ● Annual Reports ● Corporate and Business Plans ● Internal audit reports 	<p>To develop an understanding of:</p> <ul style="list-style-type: none"> ● The routine cost information available to decision-makers and how this was produced ● The relationship with the Department ● The strategic objectives and activities of the delivery bodies ● Recent financial performance ● How activities are costed and managed
<p>Quantitative Analysis</p> <p>We performed numerical analysis using the following data sources:</p> <ul style="list-style-type: none"> ● Budgeting data ● Fees and charges data ● Performance data ● Department for Environment, Food and Rural Affairs Resource Accounts ● Delivery bodies' annual accounts 	<p>To assess and understand how cost data is used to:</p> <ul style="list-style-type: none"> ● Allocate resources ● Monitor and make changes to fees and charges ● Assess performance of activities



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