



National Audit Office

**REPORT BY THE  
COMPTROLLER AND  
AUDITOR GENERAL**

**HC 1279  
SESSION 2010–2012**

**22 JULY 2011**

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**Department for Environment, Food and Rural Affairs**

# Managing front line delivery costs

# 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.