National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

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Department for Environment, Food and Rural Affairs

Financial Management Report 2011

Key facts

£5.14bn

the Department's budget in 2010-11

40 per cent	the amount of this budget reimbursed by the European Union (EU) to support England to deliver the Common Agricultural Policy
£4 billion	or 80 per cent – the amount of the Department's budget spent by its arm's-length bodies in 2010-11
29 per cent	the real terms funding cut the Department will undergo by 2014-15

Summary

1 The Department for Environment, Food and Rural Affairs (the Department) develops and delivers policy on the environment; sustainable development and the green economy; food, farming and fisheries; animal health and welfare; environmental protection; and rural communities. The Department is also responsible for preparing for, and managing risk from, animal and plant diseases, flooding, and other environmental emergencies. It devolves delivery of most of its aims to arm's-length bodies, the largest of which are the Rural Payments Agency, the Environment Agency, Natural England and the Animal Health and Veterinary Laboratories Agency.

2 In 2010-11, the Department had a budget of £5.14 billion, the second smallest departmental budget across Government.[1] The 2010 spending review requires the Department to reduce its resource budget by 29 per cent between 2011 and 2015.

3 This report provides an overview of the Department's financial management against a model developed by the National Audit Office.[2] Our work focuses on the financial management of the Department. This includes how it manages its own finances and how it manages its arm's-length bodies to ensure their sound financial management. Our methodology is outlined in Appendix One and in more detail on our website.

4 Good financial management supports sound decision-making and accountability, improves planning and revision of plans, and helps an organisation to devise its strategy and manage risks to delivery. Failures in financial management can increase costs, reduce value for money and put service delivery at risk. Effective financial management has never been more important, with the Government requiring departments to achieve significant cost reductions.[3]

Key findings

The Department's financial governance and leadership

5 **The Department's new Accounting Officer has implemented a transformational change programme, which will look at the Department's operating model.** The principles of sound financial management should be embedded within the aims of the change programme so that progress made to date is not lost.

1 The smallest departmental budget is that of the Foreign and Commonwealth Office.
2 More information on the financial management maturity model is available at www.nao.org.uk/help_for_public_services/financial_management/fmmm.aspx
3 Comptroller and Auditor General, *HM Treasury: Progress in improving financial management in government*, Session 2010-11, HC 487, National Audit Office, March 2011.

6 **The Department has taken steps to improve its financial management since we reported in 2008, and its Accounting Officer understands the importance of good financial management. However, the Department has not measured the benefits of its finance improvement projects, so it does not know the extent of the improvements made.** The Department has undertaken a number of finance improvement projects designed to strengthen its financial management. These projects have resulted in some positive outcomes such as revised management reporting and greater finance involvement in approval panel processes for allocating and reallocating funds. Whilst the Department has taken some steps to monitor and evaluate these projects, it has not measured the benefits, so it does not know to what extent improvements have been made, or how effective these projects have been.

7 **A recent Cabinet Office benchmarking exercise highlighted that the Department has a higher than average ratio of finance staff, and a higher than average percentage of qualified staff when compared with similar organisations.** Given this level of finance resource, the Department should aim to achieve a more developed set of skills, and expertise in financial management.

8 **The Department has improved its financial capacity and capability, though weaknesses remain. Financial skills could be better integrated across the Department to embed a culture of strong financial management.** The non-executive directors bring extensive knowledge of major public and private sector bodies. The Department has increased the number of permanent qualified finance staff and also offers financial skills training courses for non-financial staff. Senior staff appraisals include an assessment of financial skills, and a consideration as to whether budget holders have contributed towards value for money. For these improvements to be sustained, the Department should ensure that non-finance staff who manage budgets are financially literate. In addition, the Department should focus on improving its commercial skills, such as contract management.

9 **The Department's internal control and risk management have improved, both across the Department and its arm's-length bodies.** It should now focus on building its oversight of these bodies. To continue to improve, the Department should focus on strengthening its understanding of risk across its arm's-length bodies. The 2009 capability review identified that the Department's management committee needed to better oversee strategic risks. The Department understands that it has weaknesses in this area and is taking steps to address them.

Planning, monitoring and performance reporting

10 In 2010-11, the Department has reduced its underspend against its departmental expenditure limit to £34 million, or 1 per cent. However, since 2002, the Department has consistently reported a significant underspend against its total Parliamentary estimate. In 2010-11, this underspend was £530 million, or 10.3 per cent. The details of the Department's underspends are explained in more detail in paragraphs 3.10 to 3.13. Managing expenditure against estimate is an indicator of how well departments are managing use of public funds. Budgets will be aligned to estimates in 2011-12 and the Department considers that this will lead to a significant reduction in underspend against estimate going forward. The Department needs to continue to challenge forecasts to ensure it can have greater confidence in their accuracy and reduce underspend against the estimate.

11 The Department has improved its processes for reallocating resources in-year. However, there remains, in some areas, a culture of budget holders keeping back surpluses. The Department has put in place local approval panels, which examine the portfolio of activities for each of the Department's Groups. It also has a central approval panel that makes budget allocation decisions, which are escalated to them from the local approval panels, and for budget allocation issues relating to programmes. These panels should assist the Department to overcome cultural barriers to reallocating funds.

12 The spending review has spurred the Department to work more closely with its arm's-length bodies. However, this collaboration and engagement needs to be more proactive, and integrated into 'business as usual'. The Department has improved how it engages with arm's-length bodies, for example, by establishing a minimum reporting requirement. However, there is no clear strategic model of engagement with arm's-length bodies. Without such a model, the Department cannot clearly understand both the risks and opportunities for it and its arm's-length bodies. The Department is developing a set of 'accountability systems statements' with its arm's-length bodies, which should help to build appropriate oversight.

13 Under the spending review, the Department has cut its spending in a targeted way and has challenged and altered its models for delivery. It instructed its arm's-length bodies to assess value for money of spending on activities and cost benefit analysis of different options was carried out. The Department should continue to focus on value for money going forward so its ability to make evidence-based strategic decisions is not hampered.

14 The Department faces a challenge in delivering the HM Treasury alignment project. The project aims to simplify financial reporting to Parliament. This means that, in 2011-12, departments will need to produce consolidated accounts that include departments' and arm's-length bodies' income, spending, assets and liabilities. The Department has established a project team, and has developed a project plan to deliver pre-recess consolidated accounts. It plans to review progress after a dry run exercise, and to monitor delivery against the project plan throughout 2011-12. The Department should ensure that plans are realistic, based on the timing of necessary information from its arm's-length bodies. The alignment project will also reinforce the need for the Department to work closely with its arm's-length bodies to achieve common objectives.

15 The Department has improved the quality of reports to the management committee, though not all relevant financial information is reported. The information reported to the committee is clearer and more consistent than when we reported in 2008. However, there are aspects that could be improved, for example, better links between performance and financial information.

16 The Department needs to better understand its own costs and cost drivers, and those of its arm's-length bodies, rather than just monitoring spending. The Department does not have an overview of cost drivers for the key work of its arm's-length bodies, or understand the costs of its policies or objectives. Some of these bodies themselves demonstrate progressively improving understanding of their own cost structures. The Department has started to collect better management information from its arm's-length bodies, but performance and cost information is not generally integrated. Without this information, the Department cannot make fully informed decisions on how best to manage its resources, or accurately assess the effectiveness of its activities.

Conclusion on value for money

17 The Department has taken a number of steps to address weaknesses in financial management since we reported in 2008. We cannot yet conclude that the Department is achieving value for money in its financial management activity, because we would have reasonably expected faster progress in improving performance and a higher level of financial management maturity today, given the focus and resources applied.

18 It is clear, nevertheless, that improvements have been made, and the Department understands that it needs to maintain momentum to further develop its financial management. Its recently launched change programme provides an opportunity to embed the principles of good financial management throughout the Department.

Recommendations

Financial governance and leadership

a The Department does not have a fully embedded culture of sound financial management across the Department and its arm's-length bodies. To achieve this it should:

- ensure that the aims of the change programme reflect the principles of good financial management;
- improve the financial management skills of non-financial staff by requiring budget managers to undertake financial training on forecasting and budgeting that it already offers on a voluntary basis; and
- make sure that business managers who deal with contracts undertake training in commercial skills, such as contract management, to support the Department to get the best value out of its contracts.

With its arm's-length bodies, the Department should, when developing accountability systems statements:

- establish an engagement model with each of its arm's-length bodies based on relative risk;
- ensure proportionate flows of information are in place between it and its arm's-length bodies that reflect the needs of the business; and
- build on its engagement with arm's-length bodies to develop realistic and achievable plans for the alignment project, which take into account relative size and track record in producing timely and accurate accounting information.

Planning, monitoring and performance reporting

b The Department's monitoring and forecasting is not always accurate or robust. To improve, it should:

- build on the accuracy and realism of its forecasts and budgets, by targeting those areas that consistently underspend and providing appropriate support and training in forecasting and budgeting;
- enhance its monitoring of forecasts and budgets, with appropriate triggers to give 'early warning' of potential problems; and
- increase the level of challenge from central finance and investment approval panels on all bids for funding and on in-year forecasts.

c The Department does not fully understand the costs of its activities or plan and monitor robustly. It should:

- develop a 'systems view' of its cost reductions, which clearly assesses how cuts in one area will impact other areas, to better understand costs and cost drivers within its delivery network;
- undertake more robust planning, for example, focus on costs rather than just spending, and embed this in 'business as usual' processes;
- implement a monitoring regime, which would build on the monthly reporting information already collected from arm's-length bodies. This would allow the Department to assess how well value for money is being preserved, in the light of spending reductions; and
- enhance monthly reporting to the committee to include relevant financial information, as well as robust data on performance against budgets and forecasts.