National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

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Financial management in the Home Office

Key facts

£12.2bn	£6.5bn	23%
spent by the Home Office in 2010-11	granted to police forces in England and Wales in 2010-11	funding cut, in real terms, that the Home Office expects by 2014-15

6,500	estimated Home Office staff reduction by the end of the Spending Review period (2014-15), a fall of around one-fifth
70 per cent	proportion of Home Office expenditure on grants to other bodies, including £6.5 billion to police forces
£7.1 billion	whole-life cost of major projects being delivered by the Home Office as at January 2012
£1.68 billion	Home Office income in 2010-11, from activities carried out by the Criminal Records Bureau, the Identity and Passport Service, and the UK Border Agency

Summary

The Home Office

1 The Home Office (the Department) oversees government policy and delivery for counter-terrorism, policing, crime reduction, borders and immigration, identity and passports, and equalities. It is headed by the Home Secretary, who sets its agenda and goals. The Home Secretary is supported by a supervisory board, which formulates strategic objectives and monitors the Department's performance against its business plan, and an executive management board which oversees the day-to-day running of the Department.

2 The Department spends just over £12 billion each year. The core Department is relatively small, spending just over £1 billion each year, and primarily delivers its objectives through other entities. It provides annual funding of around £6.5 billion to cover crime and policing locally. It has four executive agencies, which receive almost £3 billion of funding in total: the Criminal Records Bureau, Identity and Passport Service, National Fraud Authority and UK Border Agency, which is the Department's largest delivery body. Its two most significant arm's-length bodies, the National Policing Improvement Agency and Serious Organised Crime Agency, together receive over £800 million. Given this range of sponsored bodies, and the autonomy exercised by police forces, it is challenging for the Department to achieve high quality financial management across all of its funding streams.

The Department's financial management

3 The National Audit Office (NAO) last evaluated the Department's financial management capability in May 2009.[1] The report concluded that the Department had made substantial improvements since its accounts were disclaimed in 2005-06. Improvements included overall financial governance, financial planning, monitoring and reporting. However, the report also found that good financial management was not established across the whole organisation.

4 The Committee of Public Accounts took evidence on the subject in October 2009,[2] and recognised that the Department had made considerable progress in its financial management capability and processes. Nevertheless, the Committee made 11 recommendations: actions taken against these are set out at Appendix Two.

1 Comptroller and Auditor General, *Financial Management in the Home Office*, Session 2008-09, HC 299, National Audit Office, May 2009.
2 HC Committee of Public Accounts, *Financial Management in the Home Office*, Forty-sixth Report of Session 2008-09, HC 640, October 2009.

Our review

5 Good financial management supports sound decision-making and accountability, and improves planning. It 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 is increasingly important, with the Government requiring departments to make significant cost reductions.

6 This report examines the Department's progress in embedding financial management practices since our 2009 report. We also examine how the Department has responded to changes in the landscape in which it operates. We aimed to evaluate whether:

- financial management is sufficiently strong and embedded within the Department to inform strategic decision-making; and
- the Department is able to tackle current business challenges, such as making sustainable cost reductions, deal with revised police accountability arrangements and implement machinery of government changes.

7 The main focus of our work is the core Department (especially governance structures and the control exercised by its central finance function) and its agencies. We also comment on how the Department oversees police forces, and on key organisational changes in its sponsored bodies.

Key findings

Core financial management practices

8 The Department is starting to benefit from its new governance structures. There is finance expertise at senior levels on the supervisory board and executive management board, and finance matters are discussed routinely. Board material is of high quality, and contains an appropriate level of detail. The Department uses the expertise of its non-executives well, both within board meetings and more widely on specific risk areas. Nevertheless, there is scope for the supervisory board to improve its discussion of strategic priorities, and for the executive management board to focus more clearly on operational matters. It should also ensure that issues within the agencies and arm's-length bodies are appropriately escalated.

9 The Department has a strong culture of centralised risk management, and senior staff actively manage the risk management process. The Home Office risk committee includes representatives from all business areas, and the boards discuss key items from the corporate risk register at each meeting. They approve major changes suggested by the risk committee, including scope and priority rankings. While the Department is good at identifying its key risks, risk management at an operational level is less well embedded. Failure to embed risk management at an operational level makes it less likely that key issues will be captured, for the purpose of local management and for appropriate escalation.

10 The Department carries out the key elements of financial control – planning, monitoring and reporting – well. However, it needs a more integrated business and financial planning process throughout the Department. The Department regularly reviews spending, reporting to the boards on out-turn and forecasts. The Permanent Secretary supplements these activities with operating reviews on individual areas. These activities help the Department make informed decisions about how to deploy available resources. However, much of the business still conducts budgeting separately from operational planning. This restricts the Department's understanding of the relationship between funding and outcomes, and thereby its ability to make informed strategic decisions as to the optimal deployment of resources to maximise impact.

11 The Department has enhanced how it manages capital investment, which was identified as a weakness in our 2009 report. We recommended that the Department should identify its capital spending priorities, and underpin its programme with robust project management and more realistic budgets. In 2011, it introduced a capital portfolio management board, which monitors spending against profile, and reallocates resources to priority projects. The new board works in tandem with the group investment board which deals with the largest projects. This structure has introduced stronger control mechanisms and provides clearer information for senior management. Major capital projects are therefore being managed well.

12 The Department has taken some positive steps to professionalise its staff, although formal classroom training is now less common. There is an increasing proportion of staff across the Department and its principal agencies with a formal finance qualification, even though the number of staff in the finance function has fallen. The Department has delivered financial management workshops to the majority of senior civil service grade staff. However, it has scaled back classroom training, and now relies on e-learning modules, whose take-up has been low. This is in line with the civil service's 'Next Generation HR' programme. Succession planning remains a challenge, especially when the Department is cutting staff and business areas are reluctant to lose high-performing individuals.

13 The Department has improved its cost recovery against targets, despite difficulties in managing income because of fluctuating levels of demand. While the Criminal Records Bureau and Identity and Passport Service aim to recover full costs, the UK Border Agency is permitted to over-recover. Income collected by the Criminal Records Bureau and UK Border Agency was closer to their respective targets in 2010-11 than the previous year, while the Identity and Passport Service moved from under- to over-recovery.

14 The Department has significantly improved how it manages cash balances, but there is scope for further progress to be made. Since 2006-07, the Department has reduced the variance between cash flow forecast and out-turn from 20 per cent to 7.5 per cent. However, this still falls short of HM Treasury's 5 per cent target, placing its performance in the bottom quartile of government departments. The Department recognises that the forecasting of cash receipts needs improvement.

Current challenges to financial management

15 The Department has clear plans to reduce costs in core activity, but should do more to increase confidence that savings are being made in the right areas. The Department is accountable for savings of £664 million per annum by 2014-15, but has identified potential savings of over £1 billion because it expects additional spending pressures in other areas in the latter years of the settlement. It has a well-established system of financial monitoring, which projects annual savings from each business area. However, around half of these savings are uncertain, and business areas have not fully considered efficiency and effectiveness when evaluating where cuts should be made.

16 Devolved accountability arrangements make it more difficult for the Department to predict whether police forces will make the required cost reductions. Forces must make around £1.5 billion of savings through efficiency improvements. But in 2011, around two-thirds of forces had shortfalls in their cost reduction plans, amounting to around £500 million in total. Her Majesty's Inspectorate of Constabulary is due to examine whether these shortfalls have been addressed later in 2012. The Department must produce an accountability system statement for Parliament, describing how it will oversee policing in the context of increasing local autonomy, including the introduction of Police and Crime Commissioners in late 2012. This statement has been through various iterations since 2011, and several elements are not due to be finalised until mid-2012.

17 There are risks to the successful delivery of the Department's change programmes. Programmes to develop the National Crime Agency (NCA) and the Disclosure and Barring Service (DBS), and to phase out the National Policing Improvement Agency (NPIA), started slowly and were initially under-resourced. While this has largely been addressed for the NCA programme, the NPIA and DBS programmes have lacked continuity in management, with insufficient access to finance skills. As a result, the Department has not established organisational structures sufficiently early, and outputs such as full business cases have been delayed. The NCA programme benefits from a longer time frame and will import many functions from the Serious Organised Crime Agency. But time frames for the DBS and NPIA programmes are much more challenging. The Department needs to control costs, especially transition costs, more strongly and explicitly.

Conclusion on value for money

18 Since our last report, the Department has made good progress. It has further enhanced its ability to plan, monitor and report on its financial position, and to control income, cash balances and capital spend. These aspects are well led from the top of the organisation, and supported by the new governance arrangements. It is now achieving clear benefits from these improvements, and is doing so while cutting staff in the finance function. The Department is therefore delivering value for money in terms of exercising financial control over its core business activities.

19 However, there is more to be done. The Department could do more to integrate financial and operational planning, and thereby understand better the link between resources and performance. While it has clear plans for reducing costs in its core activity, it needs to establish whether it could maintain the overall effectiveness of its spend better by making alternative savings in other areas. In addition, many of the strengths which it demonstrates in its core business are much less apparent in its change programmes. There are risks that these programmes will fail to deliver the proposed benefits if the Department does not manage them more effectively.

Recommendations

a **While the Department's governance arrangements are strong, and finance is well represented at board level, the supervisory board is relatively new, and the Department is still developing the role of the non-executives.** The Department should distinguish further the functions of the boards so that the supervisory board focuses clearly on delivering strategic priorities, leaving the executive management board to cover operational matters.

b **Financial control is good, but there is a need to integrate financial and business planning further to ensure that there is better information, and therefore understanding, of the link between resource allocation and performance.** The Department should, as a priority, make sure that financial and operational plans are fully aligned to the strategy at all levels. The Department has introduced stronger control over its capital spending, allowing it to reallocate funds to priority projects and make faster decisions. There is scope to develop its control over revenue spending in the same way.

c **In 2010-11, the difference between cash flow forecast and out-turn was outside HM Treasury's 5 per cent target, and higher than most government departments.** The Department believes that this is largely due to unforecast cash receipts. It should take action to meet the target in future years.

d **The Department's plans for making savings in core activity appear sound, but there is more work to be done.** The Department should assess whether:

- additional savings could be found by taking an approach which is more cross-cutting; and
- the areas of spend to be cut are the right ones with regard to overall efficiency and effectiveness.

e **The success of key change programmes is at risk because of poor continuity in personnel, insufficient resourcing, and weak elements of financial and project management.** The programmes are being managed by specific local teams. However, the Department should transfer more of the key skills demonstrated at the centre – strong governance, clear risk management and control over costs – to these programmes.