National Audit Office

REPORT BY THE
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Department for Business,
Innovation and Skills

Financial management report

Summary

1 The Department for Business, Innovation and Skills (the Department) is focused on delivering the Government's goal of sustained and balanced economic growth. It is responsible for a broad range of policy areas including: science and research; innovation; enterprise and business; fair markets; better regulation; universities and skills; and regional economic development. The Department was created in June 2009, following the merger of two predecessor departments.

2 The Department devolves the majority of its delivery aims to its network of 42 partner organisations. These vary significantly in their size, function and legal status.

3 In 2010-11, the Department had an operating cost, net of income, of £22.5 billion of which 78 per cent was spent by its partner organisations. The nature of the Department's business, with its focus on investment and loan activities, means it has a complex and substantial balance sheet.

4 This report reviews the Department's financial management against a model developed by the National Audit Office. The main features of good financial management that the model covers are:

- financial monitoring and forecasting;
- financial planning;
- financial and performance reporting;
- finance for decision-making; and
- financial governance and leadership.

5 This report focuses on the Department's financial management, including how it oversees its partner organisations to ensure their sound financial management. Our methodology is set out in Appendices One and Two.

Key findings

The scale of the challenge for the Department

6 **The Department has developed financial management processes and capacity that are effective for stable circumstances.** The Department has been through successive machinery of government changes in recent years and now covers a broad span of policy areas. It sponsors 42 partner organisations, most of whom have their own finance systems. Despite this, the Department's resource accounts have historically been published to time and received true and fair audit certificates. The Department has a number of high-quality capable finance staff. It typically produces management accounts within 10–12 working days of month end; a time frame that compares well across government. It has also taken steps to develop its finance function further.

7 **The Department will have to manage a much tighter financial position following the 2010 spending review announcement.** In particular it will:

- need to reduce its administration budget by 42 per cent, once inflation is taken into account;
- have less flexibility to manage its resources due to the growth of hard-to-predict budgets such as maintenance grants and increased ring-fencing of monies; and
- implement a substantial reform programme which includes replacing the higher education teaching grant with student loans, attracting private investment into Royal Mail and establishing the Green Investment Bank.

The core resources covered by the 2010 spending review announcement are forecast to reduce by 27 per cent, after inflation, between 2010-11 and 2014-15. However, this does not include a rise in student loan payments, much of which the Department expects will be repaid sometime after 2014-15. Once these financial transactions are included, total departmental spending is forecast to reduce by 6 per cent, after inflation, between 2010-11 and 2014-15.

8 **The Department recognises that its current financial management capacity and skills will not be sufficient if it is to manage the substantial challenges ahead.** It is implementing a number of change programmes aimed at integrating financial management across the Department and its partner organisations. The outcomes of this are as yet unclear and our work has identified a number of areas where the Department will need to make further changes to financial management.

9 The Department has managed itself and its partners effectively in its efforts to produce consolidated accounts for the first time as part of HM Treasury's 'clear line of sight' programme. The 'clear line of sight' programme requires the Department to produce a more complex set of accounts that includes the Department's non-departmental public bodies as well as the core department and executive agencies. The Department has 33 additional bodies to include as a result of this programme, making it a far more significant undertaking for them than for most other departments. The additional bodies include six which had delayed accounts in 2010-11 and the eight regional development agencies that were closing down in 2011-12. The Department has devoted significant management effort to the programme and is beginning to realise wider benefits such as improved communication between itself and its partners. At the time of publication of this report, the Department does not expect to meet the summer parliamentary recess target for producing these accounts but this does not detract from its overall effective management of the programme.

Informed decision-making

10 The Department is on a different financial reporting system than many of its partner organisations, making management reporting complex and resource intensive and leading to incomplete reporting. In May 2011, 12 per cent of partner organisations provided data to the Department on a timely basis for inclusion in monthly management accounts. This improved in the second half of the financial year and, in February 2012, 53 per cent of partner organisations provided sufficiently timely data. However, even with these improvements the overall accuracy of management accounts was weakened by the significant percentage of partners unable to provide timely data. The Department is planning to bring its partners together on one system, by a phased move to a shared service centre. In October 2011, we found that there had been problems with establishing the shared service centre and that substantial work was required before any expansion took place.

11 The Department needs to take further actions to improve its forecasting accuracy. In 2011-12 it underspent, based on provisional figures, its final approved parliamentary expenditure limit by 9.2 per cent. A significant element of the underspend was attributable to difficulty forecasting the value of the student loan book and the associated impact of any changes in value on operating costs. Such valuations are sensitive to changes in economic forecasts. The Department has undertaken a series of actions to improve its forecasting accuracy, for example developing better financial models to support its preparation of forecasts for key activities. Further work is needed, however, to improve in-year monitoring and forecasting performance.

12 The Department has developed an innovative framework for reporting its non-financial performance but, as yet, this does not clearly link to its spending. In September 2011, the Department developed a new performance management framework. This new framework has helped the Department to better understand the link between its activities and its objectives. However, the Department still has some way to go before it understands the link between cost and performance. For example, it reports financial performance differently and so overall performance monitoring and reporting is not yet integrated. When the Department, in November 2011, reviewed the financial position for 2012-13 to 2014-15, it decided to apply uniform cuts of 1 per cent rather than, if better information had been available, targeting areas that were inefficient or over-performing.

13 The Department does not sufficiently consider how to manage its overall finances in the medium and longer term. The Department considers future years infrequently and does not include a monthly profile of future spending in its management accounts. The balance sheet is critically important to the Department, particularly due to the cash flow management implications of student debt recovery and the wider policy potential of selling the student loan book. We would therefore expect the balance sheet to be routinely reviewed by one of its governance committees but this does not occur. Further, the Department does not typically agree operational plans until three months after the financial year has begun.

14 The Department needs a more structured approach to making decisions with significant financial implications, as the current approach risks weakening the financial scrutiny of key decisions. The Department is responsible for some major areas of spending and reform. It has taken steps to improve the information available to aid decision-making. However, it currently takes a case-by-case approach to key decisions meaning they are not all subject to the same scrutiny before approval. In some instances, the Department completed business cases after making decisions. There is no consistent quality assurance process for scrutinising the financial elements of business cases.

Financial capability

15 The Department has raised and strengthened the profile of its finance function, but governance changes mean there is a risk that this focus will not be maintained. Since mid 2011, the main forum for financial oversight was the Department's executive finance board, chaired by the Permanent Secretary. Compared with previous arrangements, evidence suggests the top management team has been more closely engaged in the financial performance of the organisation. Changes to governance from March 2012 mean that some of the board's financial decision-making will now be delegated to a new performance, finance and risk committee, chaired by the Director General, Finance and Commercial. There is, in our view, a risk that financial management issues will be seen within the Department to have been downgraded just as the challenges are increasing. The Department has recently decided to invite non-executives to join its performance, finance and risk committee.

16 The Department's finance function has a number of high-quality, capable staff but relies on a small number of key individuals to effect change. Feedback from Department staff, its partner organisations and external parties about senior finance officials was positive. However, the role of group finance staff, who support managers in making spending decisions, needs to keep developing so that they can secure further change and deliver the Department's ambitious financial management plans effectively.

17 The Department has taken steps to improve its sponsorship arrangements with partner bodies but this has yet to lead to lasting change. In early 2011, the Department put in place a number of measures to improve sponsorship including establishing a sponsorship advisory board and developing guidance to help oversee partner bodies. The Department also initiated reviews of its major partners, to assess the inherent risks faced and overall capabilities. We found little evidence that the assessments had yet impacted on how the Department sponsors organisations. Despite the steps the Department has taken there are still gaps in communication, especially with audit committee chairs.

Conclusion on value for money

18 The Department has worked hard over the last 18 months to improve the prominence and quality of its financial management. Its current financial management practices have enabled it to keep its day-to-day financial management on track, during a period of substantial organisational change.

19 The Department is facing substantial financial challenges in the medium term, largely as a result of the 2010 spending review settlement. To meet these challenges the Department needs to refocus efforts from procedural to strategic financial management. Until it does so, the Department will not achieve the value for money it needs from its financial management activities. Key areas for action include: improving the quality of information available to support decision-making; strengthening cross-department arrangements for scrutinising investment proposals; and improving its sponsorship of partner organisations.

Recommendations

a **The Department's management team needs a wider range of data available to it to improve its management of the business.** There are a number of gaps in the financial and non-financial performance information routinely available to the Department. In particular the Department needs to:

- integrate financial and non-financial data so that it is better informed on cost drivers and relative efficiencies;
- allow for greater scrutiny of non-financial performance by more clearly quantifying the information provided to the management team and being clearer on what constitutes good performance; and
- include a wider range of data in management accounts so that financial performance is better understood and the management of financial risk more widely shared.

b **The Department should establish a common framework across the organisation for reviewing all decisions with significant financial implications.** The Department needs a more structured approach to making decisions with significant financial implications. A common framework could, for example, take the form of a single investment board with clear delegations for those decisions not subject to its oversight. For a new approach to work effectively, the Department will need to develop a more consistent way of appraising and presenting the information used in such decisions.

c **The Department needs to guard against the risk that its new governance arrangements reduce the focus devoted at board level to financial management issues.** The new governance arrangements carry a risk that financial management issues do not receive sufficient coverage at top-management level and receive limited non-executive scrutiny.

d **The Department needs to build the capacity and capability within its sponsorship function and better prioritise the resources it devotes to this activity.** The Department's risk assessment processes are not used to facilitate differentiation in the Department's approach to sponsoring partners who are considered to be high or low risk. The Department is also not communicating effectively with audit committee chairs meaning that a valuable resource for improving partner organisation performance is not used fully.