National Audit Office

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

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Cross government

Managing budgeting in government

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Report by the Comptroller and Auditor General

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National Audit Office

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This report examines how the Treasury has designed and implemented the budgetary process, as well as how departments responded to central guidance, and developed their budgets. It assesses the processes and information behind the decisions, but does not question judgements on the budgetary decisions themselves.

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Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/managing-budget-2012

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Key facts

£2,601bn
total spending envelope for spending review 2010, covering the period 2011-12 to 2014-15

£203bn
cumulative value of the government's planned spending cuts for the period 2011-12 to 2014-15

0.2%
proportion of total departmental settlements in spending review 2010 for which departments made joint submissions

10,000	finance professionals, accounting technicians and trainees working in government
£20 million	our estimate of the costs of running spending review 2010
6 per cent	the proportion of the total of spending review 2010's departmental expenditure limits allocated by the capital ranking exercise
£683 billion	forecast total managed expenditure for 2012-13 in budget 2012
-6.9 to 133.5	the range of net present value per pound for capital projects approved in spending review 2010's capital ranking exercise
8 out of 52	staff in the Treasury's spending teams for our case study departments were still in place 20 months after spending review 2010

Summary

Introduction

1 In 2012-13, the government expects to spend £683 billion. The Treasury designs and manages the budgetary system to enable it to allocate and control this spending. The Treasury has two main objectives for this system:

- "to support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the Government's fiscal framework"; and
- to provide "…good incentives for departments…to prioritise across programmes…" and "…to manage spending well so as to provide high quality public services that offer value for money to the tax-payer".

2 Spending reviews determine how to allocate resources between departments, looking forward three to four years. These reviews set the expected spending limits to which departments should adhere when requesting resources from Parliament through the annual budgetary process. Departments manage their spending within rules the Treasury sets.

3 Departmental spending falls into three main categories:

- **Resource spending:** Current expenditure, comprising programmes and administration.
- **Capital spending:** For example, investing in roads or buildings.
- **Annually managed expenditure (AME):** Volatile spending, such as welfare payments.

4 The political and economic context is a significant factor in the application of the budgetary process. Spending review 2010 (SR10) and subsequent annual budgets have focused on reducing public spending to tackle the fiscal deficit. Government priorities had already been set in the Coalition Programme – such as protection of health spending in real terms and commitment to spend 0.7 per cent of Gross National Income on overseas aid. Against this background, most departments were asked to make cuts of 25 to 40 per cent to programme spending and 33 to 50 per cent to administration. The government also asked departments to identify efficiency savings, to minimise impacts on frontline services. We conservatively estimate that the spending review itself cost departments and the Treasury around £20 million to administer.

5 There are, however, challenges for government in prioritising and allocating resources in the most cost-effective way. It is difficult for government to compare benefits from very different service areas. It also faces behavioural challenges in getting fair consideration of options that might radically change existing patterns of allocation. Good budgetary systems help departments to identify credible options, provide good information on their service implications and aid informed decisions.

6 This report examines how the Treasury has designed and implemented the budgetary process, as well as how departments responded to central guidance, and developed their budgets. It assesses the processes and information behind the decisions, but does not question judgements on the budgetary decisions themselves.

7 Part One describes the Treasury's budgetary process and assesses how well it relates to the Treasury's budgetary objectives and to good budgetary practice in the public and private sector. In Part Two we examine how government allocates budgets to departments and in Part Three we review how departments turn their allocation into operational budgets. Our methodology is summarised in Appendices One and Two.

Key findings

Design of the budgetary system

8 Many aspects of government budgeting compare well with good budgetary practice – particularly in support of its spending control objective (paragraphs 1.18 to 1.19). Treasury's guidance clearly establishes governance and delegation; spend is considered in the short- and medium-term; and the system promotes budgetary control across resource, capital and annually managed expenditure (AME). SR10 was the first review to consider AME in a significant way, providing fuller coverage of overall spending and prompting greater focus than before on the relationship between AME and resource spending in areas such as welfare.

9 The budgetary system addresses the Treasury's objectives for prioritisation and value for money, but less effectively than the objective for spending control (paragraphs 1.22 and 1.25 to 1.26). Budgeting is a crucial first step in securing value for money. The system, however, does not require 'performance budgeting', where resource allocation is explicitly linked to past and expected performance levels. Budgetary consideration of priorities is usually focused on individual projects or programmes, and the system does not require consistent assessment of the value from proposed spending, or promote cross-departmental comparisons.

10 The budgetary system lacks clear links to results and is insufficiently integrated with business planning (paragraphs 1.22 and 3.7). The most recent budgeting guidance does not mention departmental business plans or structural reform priorities. Departments only weakly integrate budgets with their corporate operational plans – with the latter not clearly corresponding to allocations proposed at SR10 or to business plan priorities, and rarely describing the level of services expected.

Informed decision-making

11 **The data required to inform decision-makers on optimal resource allocation was not readily available and in some places did not exist (paragraphs 2.2 to 2.7).** For SR10, the Treasury requested 70 pieces of information, half of which were required of all departments. However, there was no prior common view on the sort of management information needed to support spending allocation. Our case study departments varied in their preparedness for the spending review. They did not initially supply some of the required data and, in line with the Treasury's requirements, their responses were largely qualitative and lacked cost–benefit assessments. The Treasury asked for, but did not mandate, data key to assessing value for money, such as unit costs. None of our case study departments initially supplied these data.

12 **Information on the value of resource spending was patchy and often hard to compare (paragraphs 2.9 to 2.16).** Resource spending represents nearly 90 per cent of all controllable spending. Information on expected results from individual programmes was stronger, but often remained at departmental level and did not facilitate comparisons between programmes. The Treasury asked departments to split programme spending into a maximum of five areas and provide only high-level information on proposed savings. It asked departments to address nine key questions in their funding bids, but did not oblige them to answer those questions. Treasury guidance did not ask departments to give details of proposed resource spending, its results or value, or quantify the impact of savings on services. While the Treasury made efforts to close information gaps during the review, departments' data provision and quality varied. Analysis was typically ad hoc, rather than systematic to enable cross-policy comparisons.

Challenge and cross-cutting issues

13 **The Treasury's exercise in SR10 to compare and rank potential capital spending across government was a step forward (paragraphs 2.19 to 2.20).** The Treasury allocated capital budgets after comparing the value that different investment options would deliver, although it also considered other factors. This exercise had limitations in the availability and quality of evidence, but helped challenge pre-existing patterns of resource allocation across government. Such an exercise offers the prospect of better-informed judgement about the most valuable portfolio of capital projects to fund.

14 **The Treasury's approach to prioritising resource spending was less structured (paragraphs 2.8 to 2.18 and 2.24 to 2.25).** In SR10, the Treasury settled with departments individually, in phases. Prioritisation was based on a mix of discussion and analysis, with differing levels of attention given to individual policy areas based on differing types of information. The service implications of budget changes were considered, but not always quantified. Information on the value of resource spending was patchy, and where present, often not comparable. We found examples of the consideration of interactions between resource, capital and annually managed spending options in specific programme areas. However, the Treasury's separate resource and capital exercises did not promote consideration of the links between these areas of spending. These practices hinder the assessment and allocation of resources according to greatest overall value.

15 Treasury spending teams' challenge approach lacks consistency and their capacity could be strengthened (paragraphs 2.28 to 2.29). The Treasury's main contact with departments comes through relatively small spending teams which suffer high staff turnover, and whose experience, skill base and knowledge of their departments vary. The teams for each of our case study departments made valuable contributions to tighter departmental budgets, but their ability to challenge proposals was hampered by information limitations and short timescales. The teams did not formally judge how far departments had met all information requirements or assess comparatively whether proposals represented good value for money.

16 The Treasury improved other challenge processes for SR10, but there were some limitations (paragraphs 2.30 to 2.32). There was some external challenge in the form of six members from outside public service in a 39-strong Independent Challenge Group. This Group, set up by the Treasury, offered some innovative thinking, but was not directly involved in interactions between departments and the Treasury. Wider external review was limited – for example, Parliament had no formal opportunity to review budgetary proposals during SR10.

17 The budgetary system does not incentivise departments to collaborate (paragraphs 2.21 to 2.23). The budgetary system encourages departments to bid for funds based on their specific needs. It does not promote cross-government working to tackle issues that do not fall neatly into the remit of one department. SR10 drew on coordinated submissions in just three areas – strategic defence and security, overseas development and local government.

18 There are some promising developments in departments, which could be built on (paragraphs 3.10 to 3.16). In our case studies, we found examples of substantial preparations for the spending review, innovative methods of internal challenge, greater portfolio management from the centre and strengthened links between performance and spending. The centre of government could play a greater role in helping departments to learn from others' experiences.

Conclusion on value for money

19 Good budgeting is crucial to resourcing those programmes and projects that offer the most value and is particularly important to minimising the impact of budget cuts on public services. We assessed budgetary design and implementation against good practice and found that the current budgeting system addresses the Treasury's objective to control government spending. However, the system is less effective at meeting its objective to support informed prioritisation and value for money. In particular, there are gaps in the information available – especially cost–benefit assessments – which hinder informed decision-making. Moreover, mechanisms to compare the relative value of spending between departments, or between service areas within departments, are weak. While government should not make decisions on the basis of cost–benefit information alone, its patchy availability and quality limit how far the Treasury and departments can compare the value from different resource allocation options. We conclude that information failings in the budgetary system hinder the government's ability to demonstrate that resource allocation optimises value for money.

Recommendations

20 This government faces the substantial challenge of providing good quality public services with less money. It needs to strengthen its budgeting processes to emphasise value for money in allocating resources.

a **To ensure the budgetary system incentivises departments to achieve and show value for money in allocating resources:**

The Treasury should:

- require departments' budgetary submissions to state what level of service and value will be delivered and how performance will be measured, so that performance informs future spending decisions;
- build on external challenge arrangements by increasing external review capacity, permitting a more direct consideration of departmental proposals and adding a specific remit to comment on the quality of information provided and risks to implementation; and
- ensure greater consistency in budgetary approaches across government, and between the requirements of budgetary, planning and reporting systems.

Departments should:

- ensure that programme monitoring and evaluation systems provide sufficient, up-to-date data on service results and value to inform comparative judgements on resource allocation.

b **To make better use of information to inform decisions and improve the alignment between budgeting and business processes:**

The Treasury should:

- work with the Efficiency and Reform Group and departments to identify weaknesses in current information and define management information (such as unit cost data) to inform budgeting, planning, monitoring and review activity; and
- identify the information most critical to budgetary decision-making and mandate its inclusion in budgetary submissions.

Departments should:

- improve information on the results and value of spending, and use it as a common core to feed budgeting, planning and review processes;
- ensure budgeting uses the management information (needs, resources, expected and actual performance, risks) needed to secure value for money;
- align budgets with strategy, performance and operational planning and ensure departmental boards oversee progress against budgets and associated results; and
- adhere to the Treasury's information requests.

c **To support better-informed consideration of resource allocation and prioritisation across government:**

The Treasury should:

- develop the capital ranking exercise to support ranking and prioritisation, addressing weaknesses in the quality of information and the framework for comparing non-monetised factors that would influence ranking;
- work with departments and analytical professions to identify ways to improve the evidence base and management information; and develop an approach to prioritising resource spending on the basis of value, starting with the largest programmes in the next spending review;
- promote portfolio management which requires departments to set the cost, results and risks of individual projects and programmes in the context of their full portfolio of spending; and
- require spending teams to identify opportunities for departments to gain from working together and encourage them to do so.

Departments should:

- involve boards, non-executive directors and investment committees in reviewing portfolios against strategy, not just individual proposals.

Part One

Budgetary design

The Treasury's aims

1.1 The Treasury designs and manages the government's budgetary system, for which it has two main objectives:[1]

- "to support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the Government's fiscal framework"; and
- to provide "…good incentives for departments…to prioritise across programmes…" and "…to manage spending well so as to provide high quality public services that offer value for money to the tax-payer".

Good budgetary practice

1.2 Our review of budgetary literature identified some common elements of good practice – in particular:

- clarity in the rules and relationships, which enables the agreement of sustainable budgets and supports budgetary control;
- integration between spending, strategy and performance;
- informed decision-making and challenge; and
- organisation-wide spending prioritisation and effective allocation.

1.3 In 2012-13, the government expects to spend £683 billion. Budgetary processes to allocate such a sum between departments, and then to projects and programmes, consume significant administrative resources involving many staff across government. There are, for example, 10,000 finance professionals, accounting technicians and trainees working in government. We conservatively estimate the total costs of spending review 2010 (SR10) to have been around £20 million. It is important that the budgetary process itself is effective and delivers value for money.

1 HM Treasury, *Consolidated Budgeting Guidance from 2012-13*, March 2012. Available at: www.hm-treasury.gov.uk/d/consolidated_budgeting_guidance_201213.pdf

1.4 This report considers government budgetary practices against the Treasury's aims for the system, as well as good budgetary practice. We examined the design and operation by the Treasury of this system and reviewed the budgetary approaches in five case study departments:

- Department for Work and Pensions;
- Department for International Development;
- Department for Transport;
- Department for Communities and Local Government; and
- Department of Energy and Climate Change.

1.5 This part considers budgetary design centrally and within departments.

Budgets and spending reviews

The key budgetary components

1.6 At each annual budget, the Chancellor sets out how taxpayers' money is to be spent and updates Parliament on the state of the economy and progress with economic objectives. The system has evolved significantly in the last 15 years – in particular with the addition in 1998 of spending reviews.

1.7 Treasury-led spending reviews set multi-year budgets for departments in line with the government's policy priorities. The June 2010 budget set a four-year total for public spending, as well as totals for its main components (**Figure 1**). SR10 was the process by which the Treasury then allocated these amounts across government.

Figure 1
Types of spending

Budgets are set by the Treasury for the spending review period, with limits for the following types of spending:

a DEL (departmental expenditure limit) for general running costs – split into the following (often referred to as 'control totals'):

- Resource DEL (RDEL), such as pay or procurement, further split between:
  - administrative budget (support functions); and
  - programme budget (frontline activities).
- Capital DEL (CDEL) relating to investment in assets, such as buildings, equipment and land.

b AME (annually managed expenditure) which reflects volatile spending such as benefits payments. This is further split into resource AME and capital AME.

Source: HM Treasury

1.8 Departments decide how best to manage and distribute their allocated budget. However, they can finance planned activities only if Parliament votes the necessary money through an 'estimates' process. If a department spends more than the amounts authorised by Parliament, it must seek Parliamentary approval through the Treasury, for an 'excess vote'.

1.9 Alongside SR10, the government established a new performance framework, centred on published departmental business plans setting out the efficiency measures, structural reforms and resources they would put in place. Draft business plans were published in November 2010. The plans were finalised in May 2011 and updated in May 2012. **Figure 2** overleaf sets out the relationship between the SR10, budgets, the estimates process and business planning.

1.10 At the end of a spending review, the Treasury sends each department a settlement letter, which sets out a high-level breakdown of agreed DEL and AME. Departments may spend against their DEL without seeking further Treasury consent, subject to a requirement for approval for any novel or contentious streams of expenditure or projects above a given value – their 'delegated authority'.

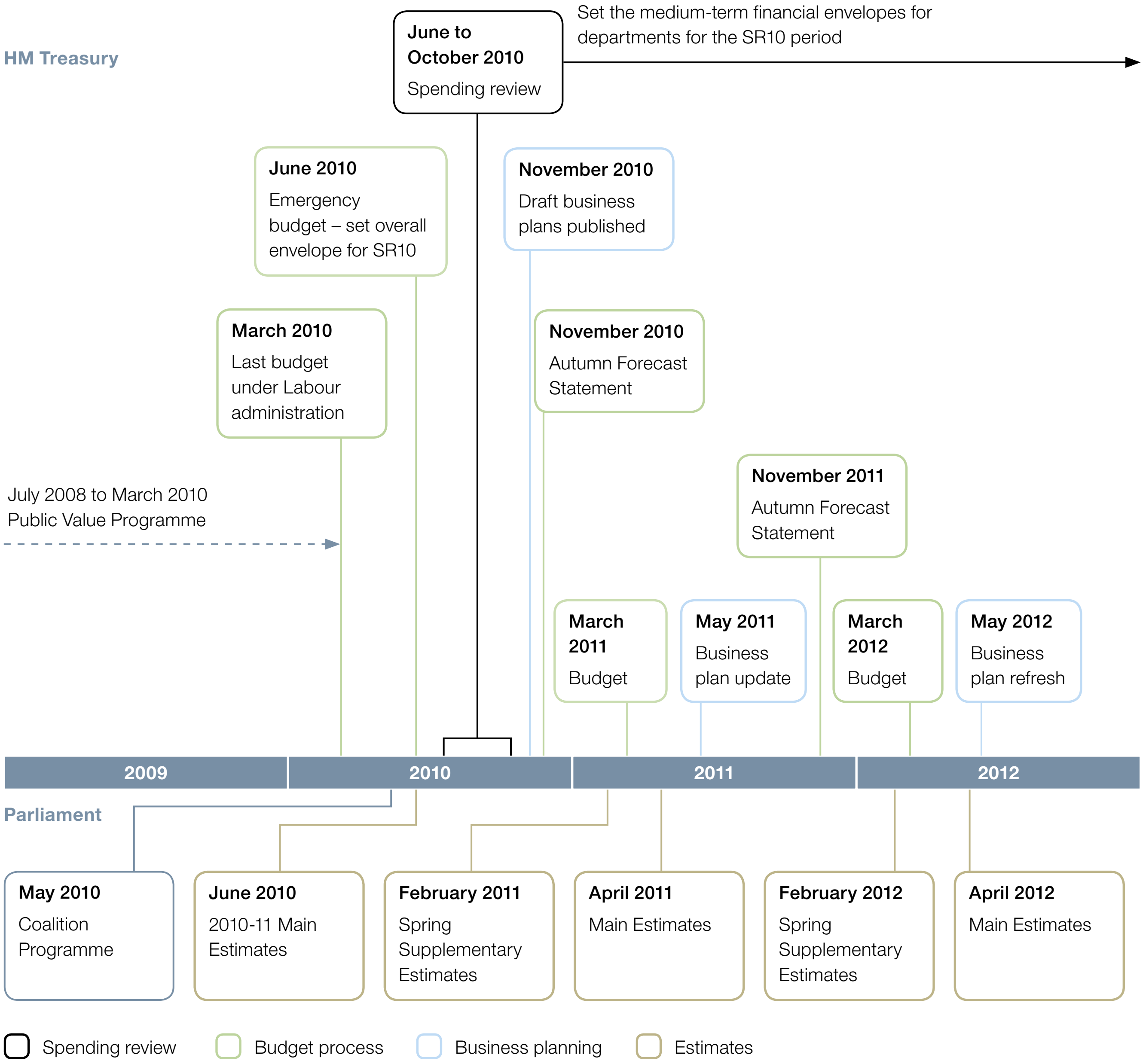
1.11 The Treasury monitors departments' adherence to these agreed spending limits and budgetary rules. It uses several mechanisms, including monthly reviews of departmental spending returns; approvals for large projects; ring-fencing; and restrictions on carrying money forward and on switching between different types of spending.

Spending review 2010

1.12 In October 2010, the government set DEL at £1,478 billion for the four-year period from 2011-12 to 2014-15. This was split between £1,313 billion resource (excluding depreciation) and £165 billion capital. SR10 included significant changes to most areas of AME, such as welfare spending and environmental levies. In autumn 2010, the Office for Budget Responsibility (OBR) forecast total AME spending of £1,319 billion over the spending review period.

1.13 The fiscal and political environment for SR10 was very different to that of previous reviews, with a new government committed to spending cuts totalling £203 billion over the period. In July 2010, most unprotected departments were asked to plan for 25 to 40 per cent real term cuts to resource spending with 33 to 50 per cent cuts to administration. They were also asked to identify ways to reduce AME against the OBR's forecast baselines. The Treasury requested submissions in a common format, and asked departments to use its 'VFM toolkit' to identify ways to reduce spend and transform service delivery (although it has not since promoted it).

Figure 2
Spending reviews, budgets, estimates and business planning



Source: National Audit Office

1.14 The SR10 process fell broadly into three phases (**Figure 3** overleaf). In **phase 1**, departments prepared submissions to the Treasury using its guidance and planning assumptions. This asked them to provide a short ministerial covering letter and to complete templates setting out:

- how they had split resource into up to five areas (with administration shown separately) and their proposed savings for each. Treasury asked departments to consider nine key questions, including "Is the activity essential to meet Government priorities?", "Does [it] provide substantial economic value?" and "Can [it] be provided by a non-State provider or citizens?";
- their expected capital spending, to be considered as part of a cross-government review;
- tailored information on capital and resource AME; and
- pay and workforce data.

1.15 In **phase 2**, the Treasury engaged with departments to fill data gaps and challenge assertions on proposed resource savings. It also oversaw a cross-government examination of capital spending.

1.16 In **phase 3**, the Treasury and departments held bilateral negotiations, overseen by Ministers and the Public Expenditure Committee (PEX). This led to settlements between September and October 2010.

UK budgetary design and good practice

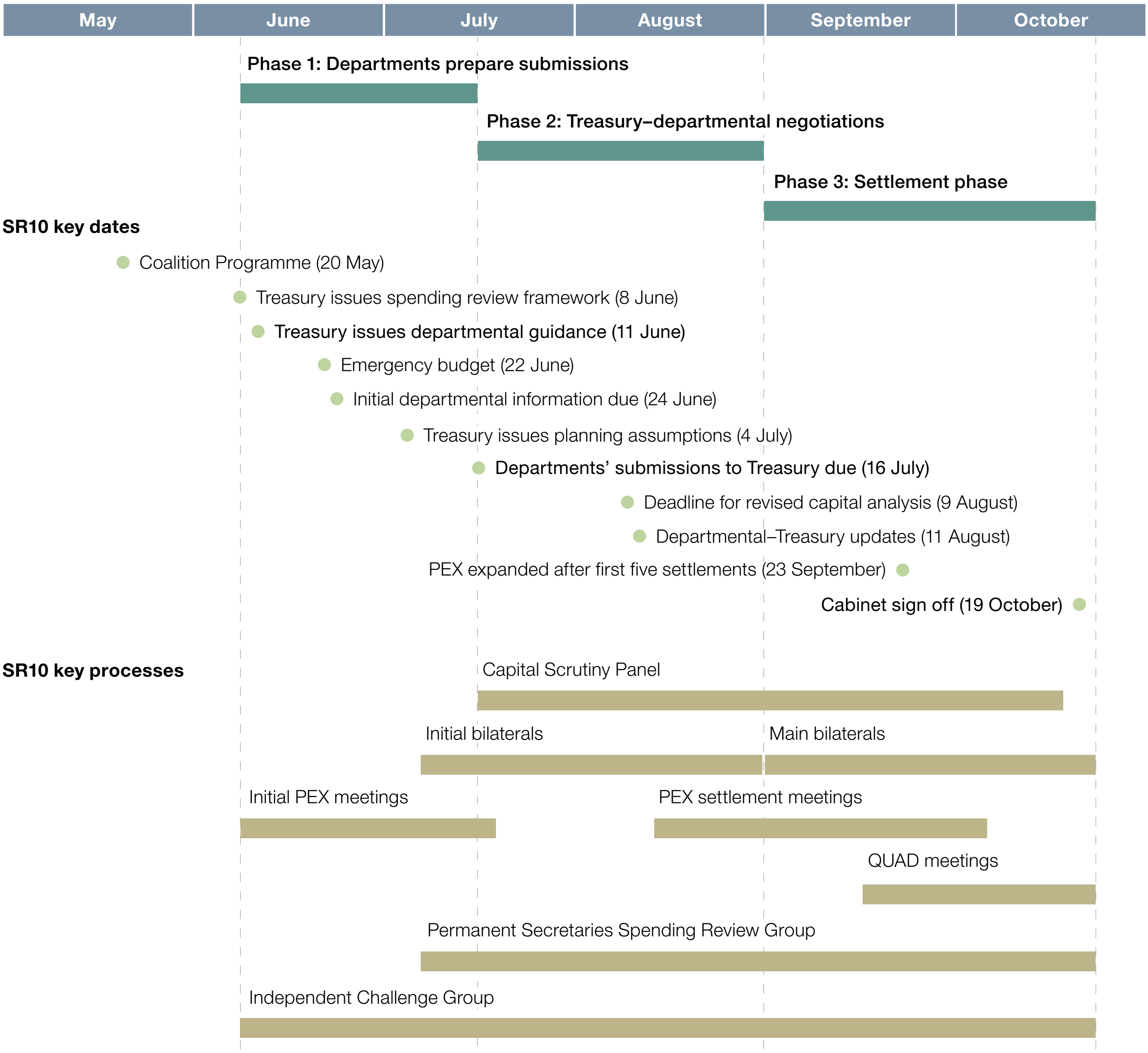
The design of the UK budgetary system compares well against many good budgeting practices

1.17 The design of the budgetary system is described in Treasury guidance – particularly *Managing Public Money*[2] and *Consolidated Budgeting Guidance*[3]. This is supplemented by Treasury guidance to departments for each spending review, and more specific advice – for example, its *Green Book*[4] and guidance on business cases,[5] which set out how departments should develop and consider spending proposals. Also relevant is the Cabinet Office's guidance on *Management of Portfolios*.[6]

2 HM Treasury, *Managing Public Money*, October 2007. Available at: www.hm-treasury.gov.uk/d/mpm_whole.pdf
3 HM Treasury, *Consolidated Budgeting Guidance from 2012-13*, March 2012. Available at: www.hm-treasury.gov.uk/d/consolidated_budgeting_guidance_201213.pdf
4 HM Treasury, *Green Book*, 2003. Available at: www.hm-treasury.gov.uk/d/green_book_complete.pdf
5 HM Treasury, *Public Sector Business Cases using the Five Case Model: a Toolkit*, 2007. Available at: www.hm-treasury.gov.uk/d/greenbook_toolkitguide170707.pdf
6 Cabinet Office, *Management of Portfolios*, 2011.

Figure 3
Spending review 2010: Key dates, processes and players

Spending review published on 20 October 2010



NOTES

Key players in the spending review process:

1 PEX: the Public Expenditure Committee (or 'Star Chamber'). PEX agreed the planning assumptions; considered papers on departmental returns; discussed cross-cutting strategic issues and oversaw bilateral discussions.

2 QUAD: meetings between the Prime Minister, Deputy Prime Minister, Chancellor and Chief Secretary to the Treasury.

3 Permanent Secretaries Spending Review Group: the Group discussed cross-cutting issues but had no decision-making role.

4 Independent Challenge Group: a group of 39 experts from the civil service, local authorities, and the financial and voluntary sectors. Their role was to "…think innovatively about the options for reducing public expenditure and balancing priorities to minimise the impact on public services".

5 Capital Scrutiny Panel: a group of senior Whitehall economists convened by the Treasury to quality assure departments' capital analyses.

Source: National Audit Office

1.18 In many aspects the UK budgetary system compares well with good practice (**Figure 4** overleaf). The system is well established and the relationships between Parliament and government and between budgets and spending reviews are clear. The Treasury's main guidance is strong in addressing budgetary governance; sustainability; delegation; and control. This is consistent with our finding in 2011 that "…the system as operated works towards the [Treasury's] first objective".[7] The Treasury's SR10 guidance clearly set out the timescales, roles and information requirements and was largely welcomed for its clarity by our case study departments.

1.19 There have also been developments in the design of the system in recent years, which have improved its position in relation to good practice:

- The government's introduction of spending reviews supports sustainability and budgetary control because it enables government to review all spending and gives greater medium-term certainty and transparency.
- AME is a key component of public spending. In SR10, departments were encouraged to consider the relationship between DEL and AME more than they had previously.

Matching budgetary approach to service circumstances

1.20 Our research[8] identified the importance of budgetary processes being able to respond to the needs of the business, rather than following traditional systems or structures. Current budgetary processes cover the short- and medium-term. However, public services often have spending implications well beyond a four-year horizon.

1.21 The UK budgetary process does not include the sort of longer-term vision seen in other countries and could help inform strategic decision-making. The OBR publishes an annual *Fiscal Sustainability Report*,[9] which provides detailed fiscal projections for the next 50 years assuming there is no change in government policies. However, there is currently no comprehensive government response on the policy implications of these projections. Countries such as Australia, New Zealand and Norway combine fiscal projections, considering high-level policy responses to likely long-term budgetary developments. This can help to avoid complex long-term issues being repeatedly postponed. A longer-term focus is also more conducive to the development of spend-to-save initiatives, which require a willingness to accept short-term costs in return for later benefits. Other than for the Department for Work and Pensions, we found little evidence of planned spend-to-save initiatives of significant magnitude.

7 National Audit Office, *Progress in improving financial management in government*, March 2011. Available at: www.nao.org.uk/idoc.ashx?docId=E9303518-921A-49CD-BF46-5C74B1AB8552&version=-1

8 PricewaterhouseCoopers, *Good budgetary processes: comparators – case studies from the public and private sector*, October 2012.

9 Available at: cdn.budgetresponsibility.independent.gov.uk/FSR2012WEB.pdf

Figure 4
UK budgetary design and good practice

Central government's key guidance provides for strong budgetary control, but is weaker in supporting informed decisions and challenge as well as how budgeting integrates with other key processes

Guidance clearly encourages or supports or addresses...	Directly related to budgetary process or management, or both			Relevant to budgetary process or management, or both		
	Managing Public Money (2007)	Consolidated Budgeting Guidance from 2012-13 (2012)	Treasury guidance to departments for SR10 (2010)	Green Book (2003)	Public Sector Business Cases using the Five Case Model (2007)	Management of Portfolios (2011)
Clarity in budgetary rules and relationships	Green	Green	Yellow	Grey	Grey	Grey
Creation or maintenance, or both, of sustainable financial envelope	Green/Yellow	Green	Green	Grey	Grey	Grey
Budgetary control or delegation, or both	Green	Green	Yellow	Grey	Grey	Grey
Integration with guidance on spending, strategy and business planning	Red	Red	Yellow	Red	Red	Green/Yellow
Informed budgetary decision-making	Yellow	Yellow	Yellow	Yellow	Yellow	Green
Informed challenge of budgetary decision-making	Red	Red	Yellow	Yellow	Yellow	Green
Organisation-wide spending prioritisation	Yellow	Red	Yellow	Red	Red	Green
Allocative efficiency across spend portfolios	Yellow	Red	Yellow	Red	Red	Green

- Green: Covered explicitly in guidance
- Yellow: Some, or limited, references within guidance
- Green/Yellow: Implicit within guidance, or because of guidance
- Red: Absent from guidance
- Grey: Issue not relevant to this guidance

Source: National Audit Office assessment of HM Treasury and Cabinet Office guidance

Integrating budgeting with strategy and planning

1.22 The Treasury's budgetary guidance is not well integrated with business planning guidance. For example, its latest budgetary guidance does not refer to business plans. While central government's business plan guidance asked departments to reflect SR10 outcomes, the relationship is not explicit. The *Green Book* and the Treasury's guidance on preparing business cases provide detailed advice on considering spending options, but focus on individual items rather than best allocation across competing areas. The Cabinet Office's portfolio guidance[10] is less well disseminated, but offers the most directly relevant advice on how departments can weigh up the relative merits of competing areas of spending.

1.23 For SR10, the Treasury did not require departments to accompany bids with a detailed strategy, but asked for coverage of how they would:

- drive down the costs of operational delivery;
- meet the needs of the disadvantaged;
- address long-run demographic, social, environmental and economic challenges; and
- drive fundamental changes in how services would be delivered.

1.24 The initial submissions from our case study departments addressed these questions at a high level. They provided a strategic backdrop to the bids but, in line with the Treasury's request, this was not at the level of precision that made clear the 'strategic fit' of their proposals with government policy.

The design supports the Treasury's objectives for spending control better than those for value for money

1.25 The budgetary process leads to spending limits and projections that give a sound basis for spending control. In the five-year period from 2006-7 to 2010-11, Parliament was asked to vote excess funds to only ten bodies, with total requests for resources and cash each less than 0.1 per cent of the respective total voted funds for all years, except for 2008-09.[11]

10 Cabinet Office, *Management of Portfolios*, 2011. This describes a portfolio as "…the totality of an organisation's investment in the changes required to achieve its strategic objectives". Portfolio management ensures that "…programmes and projects…are prioritised in terms of their contribution to the organisation's strategic objectives and overall level of risk…", with "...benefits realisation maximised to provide the greatest return".

11 In 2008-09, Parliament was asked to vote resource excess of £23.8 billion to the Treasury to cover its obligations under the government's Asset Protection Scheme following the banking crisis.

1.26 However, the design is weaker in supporting objectives for:

- **Incentives:** The Treasury's recent announcement[12] on budgetary controls stated that the system should reward good spending control and discourage poor control. It suggested that departments demonstrating excellent financial management would receive greater freedoms such as higher delegated authorities. However, the Treasury does not have such a clearly defined approach to how it incentivises high-quality services, prioritisation and value for money.
- **Prioritisation:** The Treasury does not require the weighing-up by departments of allocation across competing areas of spending on the basis of value or promote the Cabinet Office's guidance on portfolio management.
- **Value for money:** The Treasury's guidance requires departments to secure value for money, but does not set out how departments should monitor and report achievement.

12 HM Treasury, *Improving Spending Control*, April 2012. Available at: www.hm-treasury.gov.uk/d/improving_spending_control.pdf

Part Two

Informed allocation

2.1 In this part we focus on how far the budgetary system supports informed decision-making by departments and the Treasury, as well as organisation-wide prioritisation and informed challenge.

Informed decision-making

The Treasury's information requests for SR10

2.2 The Treasury requested a significant volume of data for the spending review – some as requirements, some 'where available'. None of our case studies fully met all the Treasury's data requirements initially (**Figure 5** overleaf), and their returns varied in depth. The Department of Energy and Climate Change acknowledged that it was only able to provide much of the information later in the review. In line with the Treasury's request, departments also provided only limited explanations of their proposed spending. The Treasury described departments' initial submissions as "…patchy, with particular gaps in relation to workforce data".

2.3 Departments' submission of non-mandatory information was weaker. For example, they were asked to select a key output from each of their five areas of resource spending and submit volumes and unit costs data. Such information can assist understanding of spending options, but none of our case study departments initially supplied it.

2.4 The Treasury did not request information on all the issues that it had asked departments to consider:

- it asked departments to review resource spending against nine key questions, but did not ask them to share these assessments;
- it asked departments to set out high-level resource savings, but did not ask them to break down how they proposed to allocate resource spending; and
- although it requested distributional and equality impacts, its guidance did not ask departments to identify how spending reductions would affect service quality.

Figure 5
Departments' initial response to the Treasury's data requests

Departments varied in their initial responses to the Treasury's request for data to inform SR10: none supplied all the data required and none provided data on unit costs

We identified **70** distinct information requests in the Treasury's SR10 guidance to departments...

...**35** items appeared to be required of all departments...

...and for these, our case studies initially provided most items, but with some variations and omissions:

Department[2]	Clearly supplied in full
DWP	29
DFID	29[3]
DfT	28
DCLG	27
DECC	13

...**26** items may have been required from departments depending on their circumstances...

...for these our case study departments varied in their initial provision of information, but this may have reflected their circumstances:[1]

Department[2]	Clearly supplied in full
DfT	18
DCLG	8
DECC	7
DWP	5
DFID	4

...**9** items appeared to be optional for all departments...

...in particular, departments were asked to supply, where available, the following data for one key output for each of their five resource spending areas:

Item

- volumes since 2000
- unit costs since 2000
- estimated volumes 2011–2015
- estimated unit costs 2011–2015
- international comparisons
- private sector comparators
- public sector comparators

No case studies supplied these data in their initial submissions.

NOTES

1 In a small number of cases, it is unclear whether a request was fully or partially met.

2 DWP = Department for Work and Pensions, DFID = Department for International Development, DfT = Department for Transport, DCLG = Department for Communities and Local Government, DECC = Department of Energy and Climate Change.

3 The Treasury agreed that DFID need not supply two of the items required in its guidance.

Source: National Audit Office

2.5 Four of our case studies said that they had adopted an open-book policy with the Treasury. However, submissions varied in depth and information was presented to support preferred positions, rather than explore options. The Department of Energy and Climate Change, for example, considered the information it presented as part of a negotiating strategy. The Treasury's Capital Scrutiny Panel had concerns about much of the capital analysis and identified 'game playing' on the part of four departments.

2.6 During the spending review process, the Treasury's spending teams chased missing data and requested further information, such as policy-specific analysis or how bigger cuts could be delivered. The Treasury acknowledged that, in the timescales, it proved difficult to get much of the information it would have liked from departments.

2.7 The information available on unit costs illustrates this situation. Such data are potentially useful to assess trends in efficiency, comparisons with benchmarks or internal variations in units' performance, and so prospects for further improvement. Recognising their potential value, ahead of SR10 the Treasury collated examples of departmental unit costs data it held. This exercise directly identified 170 metrics, noting differences in the extent to which departments themselves produced or used unit costs. Coverage varied substantially, with no metrics presented for seven departments – and addressing only two of our five case study departments in any depth. Twenty-nine per cent of the metrics included some form of historic comparator; and five per cent included some form of external benchmark. Individual spending teams then probed departmental submissions, which did not initially provide indication of unit cost out-turns or projections, with varying degrees of focus on efficiency. There was, however, no summarised identification or analysis of any projected changes in unit costs associated with departmental resource bids.

Resource prioritisation

2.8 Although SR10 treated resource and capital separately, departments' internal analyses applied the same tools and techniques to all spending when developing their first submissions. Typically, departmental centres asked divisions to answer a set of tailored key questions which, in some cases, included the Treasury's nine questions.

2.9 **Figure 6** on pages 24 and 25 assesses departments' initial approaches to considering and comparing spending options across programmes against key factors in the *Green Book*, such as economic, environmental and social impacts and risk. Only one department covered all bases and the pattern of analysis was very varied. More consistent analysis could have aided cross-government comparisons.

Figure 6

Departments' internal analytical processes to inform initial consideration of SR10 resource allocation

Departments varied in how they considered resource spending priorities[1]

	Description of method	Reviewed according to the Treasury's nine questions	Quantified economic assessment	Social or distributional impacts (or both)
Department for Transport	Divisions completed standard template. Submissions considered individually.	Yes	Yes	Yes
Department for International Development[2]	Standard template completed by country teams for BAR exercise.	No	Yes	Yes
Department of Energy and Climate Change[3]	Standard template prepared by departmental divisions for all policies.	No	No	Yes
Department for Work and Pensions[4]	Template completed by departmental divisions for AME cuts options.	No	No	Yes
Department for Communities and Local Government	Guidance on format of papers supporting discussion for internal challenge exercise.	Yes	Yes	Yes

NOTES

1 This table assesses the types of information requested by departmental centres to compare options across areas of spending. It is not an assessment of the quality of resulting responses. Subsequent analysis of specific spending options may have considered more factors. For example, the Department for Communities and Local Government and Department for International Development considered issues such as risks and environmental impacts through business cases for specific policies developed during and after SR10.

2 To determine its allocation of SR10 resources, the Department for International Development conducted reviews of its bilateral and multilateral aid spending. The Bilateral Aid Review (BAR), between May 2010 and March 2011, sought to allocate direct spending in developing countries on the basis of expected results. We have only considered here the template which DFID country offices used to submit initial BAR offers.

3 The Department of Energy and Climate Change conducted another exercise in August and September 2010 to inform programme and administrative priorities.

4 The Department for Work and Pensions was unable to evidence its process for considering DEL options.

Source: National Audit Office assessment of departmental processes

Environmental impacts	Assessment of deliverability	Consideration of risk	Cross-government interests	Assessment of evidential quality	Examples of other factors considered
Yes	Yes	Yes	Yes	Yes	Carbon impact; political impact; reduction of regulatory burdens.
No	Country-level	Country-level	Country-level	Yes	Scalability; VFM comparators; unit costs.
Yes	Yes	Yes	No	No	International implications; UK emissions; energy security.
No	Yes	Yes	No	No	Policy rationale; legislative requirement; compatibility with Universal Credit.
No	Partially	Partially	No	No	Could policy better meet localism principles?

2.10 The Treasury did not require departments to assess the value delivered by their proposed spending portfolio. In the same way that the Treasury primarily considered departments individually, departmental centres typically assessed SR10 options along organisational lines and within programme areas.

2.11 Departments typically maintained central tallies of proposals and presented ministers with combined assessments of the monetary trade-offs from proposed departmental spending and options for savings. However, we found little evidence that decision-makers were considering potential trade-offs in terms of the comparative benefits and impacts of spending in one area against another and the best value combination of spending.

2.12 Government priorities had already been set in the Coalition Programme – such as protection of health spending in real terms and commitment to spend 0.7 per cent of Gross National Income on overseas aid. Within these existing constraints, the process of prioritisation was based on a mixture of discussion and analysis and agreed through correspondence and bilateral negotiations between departments and the Treasury (see **Figure 7**).

2.13 Communications between the Treasury and departments showed they focused primarily on cuts. For example, Treasury spending teams measured the gaps between departmental offers and their planning assumptions, and developed options for discussion with departments on how to close these gaps. Initial departmental returns proposed only £31 billion of total savings in 2014-15, against a target of £66 billion. There was no similar focus in the process on efficiency or productivity.

2.14 To counter the risk of making cuts based on ease of cutting rather than relative service value, decision-makers need to know the impact of cuts on services. In some cases, departments assessed these impacts for SR10, but the Treasury guidance did not request this information and the analysis was typically high level and qualitative.

Figure 7
Prioritising resource spending

Although it was not required by the Treasury, the Department for Communities and Local Government included in its SR10 submission further details of spending proposals for its five main areas of spending – including a high-level discussion of the benefits and the impact of cuts. This information varied in nature, hindering straightforward comparisons.

	DCLG submission on 16 July 2010	
	VFM benefits	**Impact of cuts**
1 Housing		
Housing growth	Qualitative	No reference
Supporting people	Qualitative £ Net benefit	£ Net cost
Affordable housing	Qualitative Quantitative	No reference
Improving existing housing	Qualitative NPV/£	No reference
2 Economic development	Qualitative Quantitative £ Net benefit	No reference
3 Fire	Qualitative Quantitative NPV/£	Qualitative
4 Planning	Qualitative	No reference
5 Communities	Qualitative Quantitative £ Net benefit	No reference

In late July 2010, the Treasury responded with requests for over 120 further items of information. These varied significantly by nature and volume for the different policy areas and included requests for missing data, spend breakdowns, modelling, and clarifications of rationale, intent and assumptions. In many cases the Treasury requested further information on the quantified benefits of proposals, but not in a consistent or comprehensive way. In response to this and further requests, throughout August 2010 the Department provided a substantial volume of further information, including more quantified value-for-money assessments.

Treasury officials submitted a proposed resource settlement to Ministers in early September 2010, setting out a combination of savings to hit the savings target and qualitative reasoning to varying degrees of depth for each separate policy area.

Source: Department for Communities and Local Government and HM Treasury

2.15 The Treasury did not ask departments to rank proposed resource spending by priority (except additional spending), although it did ask them to undertake cost–benefit analysis on key areas of resource spending in the same way as it proposed for capital. However, information on the value of resource spending was patchy, and where present, often not comparable across policy areas. In practice, submissions contained little cost–benefit assessment of resource spending. Nevertheless, there were some examples in departments, illustrating its feasibility. For instance:

- The Department for Transport acknowledged that for SR10 it had net present value per pound (NPV/£)[13] data for less than half its resource spending. We considered its 11 largest resource spend items (accounting for 76 per cent of its resource settlement) and found evidence of NPVs/£ being cited for five of these.
- Submissions to the Department for Communities and Local Government's Ministers included cost–benefit assessments for three of its four largest revenue programmes (accounting for 76 per cent of the relevant resource eventually allocated).
- The Department for Work and Pensions was the only one of our departments to complete the table that the Treasury requested for new resource spending prioritised by NPV/£. This covered, however, only 1 per cent of its resource settlement.

2.16 These examples also illustrated a wide range of NPVs/£, with values from minus 38 to 701. The Treasury did not consider some of the largest claimed NPV/£ figures for SR10 to be credible.

2.17 The volume of most annually managed expenditure (AME) is driven by external factors. For SR10, Treasury spending teams addressed AME cuts bilaterally with the relevant departments. For example, the Department of Energy and Climate Change was asked to identify 10 per cent savings. The exercise revealed weak central government understanding of this type of spending, with the Treasury finding that "In many cases, spending teams had little understanding of their Departments' AME".

2.18 The Department for Work and Pensions has the largest AME spending in government, and therefore focused on benefits and welfare changes and associated spending forecasts. Its submission highlighted how departmental expenditure limit (DEL) spending can help control AME, for example, identifying nearly £4 of savings for every £1 of DEL spent on debt recovery.

13 Net present value (NPV) describes the difference between the present value of future costs and of future benefits for an investment. By dividing the NPV of an investment by its cost (and thus generating an NPV/£ figure), decision-makers can compare the net economic value per pound of investment for different investment options.

Capital prioritisation

2.19 The Treasury's capital ranking exercise (**Figure 8**) approved only 6 per cent of total DEL allocated in SR10, but it was a step forward in cross-government comparative analysis and prioritisation.

2.20 There were, however, some weaknesses which would need to be addressed in future exercises:

- Departments did not present NPV/£ data for 35 per cent of the 260 ranked projects and programmes. The Treasury did not press for NPVs/£ for some projects because they were politically or legally committed, even when they represented large amounts of spending.
- The range of NPVs/£ was substantial (from -6.9 to 133.5) and the Treasury's Capital Scrutiny Panel disputed many of the figures. Although the Treasury found some analysis impressive, it concluded that "…the NPV analysis was not of high enough quality to inform robust policymaking conclusions". In some cases "…this was because of game-playing: the numbers were obviously inflated and flimsy evidence was used if it supported the funding bid…".
- Despite the emphasis on NPV/£ data, the final rankings did not fully reflect this information (**Figure 9** overleaf). For example, the Treasury approved projects despite their having a negative NPV/£ and rejected many with a positive NPV/£. Final prioritisation also reflected other factors, including the government's political and strategic priorities, deliverability, commitments and regional distribution.

Figure 8
Capital ranking exercise

The Treasury asked departments to provide spend data for all capital projects, using the *Green Book* methodology to rank them on a measure of net present value per pound spent (NPV/£). It then worked with departments to adjust rankings on the basis of other factors, such as regional fit. The £90 billion allocated in the ranking exercise was split into:

- 196 stand-alone projects of which 125 were 'approved' (59 per cent by value); and
- 64 scalable programmes (41 per cent by value), where the ranking played a direct part in calculating spending allocated (with some exceptions).

On the provision of NPV/£ data:

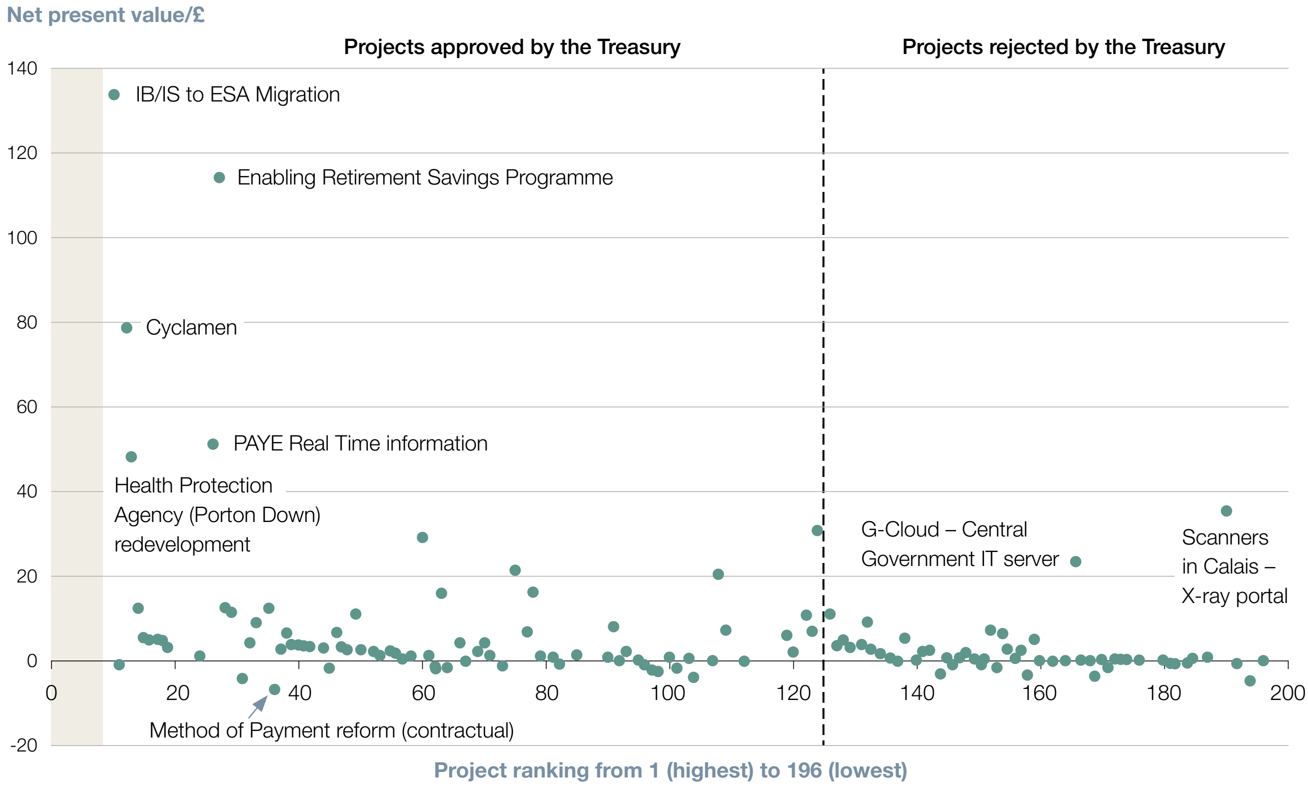
- 67 per cent of all projects ranked had NPVs/£ attached (ranging from -6.9 to 133.5), but only 46 per cent of approved spending had NPV/£ data; and
- 58 per cent of programmes had NPVs/£ attached (ranging from -0.9 to 16), but 83 per cent of all allocated spending had NPV/£ data.

Source: HM Treasury

Figure 9

Relationship between project ranking and net present value per pound (NPV/£)

There was only a weak relationship between the NPV/£ for capital projects and how they were ranked[1]



Projects approved and rejected by their NPV/£[2]

	Negative NPV/£	Neutral/positive NPV/£
Spend approved	14 projects £810m	64 projects £23,549m
Spend rejected	12 projects £257m	42 projects £18,408m

NOTES

1 This analysis relates to the 132 projects for which there were NPV/£ data. The first nine ranked projects (i.e. from 1st to 9th) had no NPVs/£ attached. The Treasury explained that these were contractually committed. These projects were worth £22.7 billion (43 per cent of the £53.4 billion approved spend on capital projects).

2 This analysis relates to the 132 projects for which there were NPV/£ data.

Source: National Audit Office analysis of HM Treasury data

Central support for cross-government working and prioritisation

2.21 SR10 emphasised cross-government approaches less than its 2007 predecessor, which established cross-government public service agreements. The Treasury conducted prior reviews of some priority cross-government themes, such as growth and the environment, to form a backdrop for SR10. However, it is unclear how these reviews were used in SR10 to assess the implications of departmental bids.

2.22 SR10 drew on coordinated submissions in just three areas – strategic defence and security, overseas development and local government. The Treasury's SR10 guidance invited departments to submit joint submissions. However, the Treasury did not actively identify or coordinate spending on services between departments and received only two joint submissions (representing only 0.2 per cent of all controllable spending settled).

2.23 The budgetary process provides an opportunity to facilitate and incentivise cross-government work to cut costs. However, the Treasury did not direct departments to identify cross-departmental savings through joint working. The Cabinet Office's Efficiency and Reform Group (ERG) has now taken the lead on cross-government reform and efficiency by, for instance, centralising procurement and establishing spending controls for some common areas of spending. However, ERG does not influence all spending and we have previously recommended that to support longer-term structured cost reduction the Treasury and Cabinet Office should develop mechanisms to challenge, intervene or provide more support for weaker departments.[14]

2.24 SR10 represented an opportunity to compare spending options across government. The Treasury created a 'scorecard', which collated and modelled AME, capital, resource, ring-fences, administration and depreciation based on departmental submissions. However, it was primarily a position tally rather than an allocative tool to enable comparisons and potential trade-offs across government.

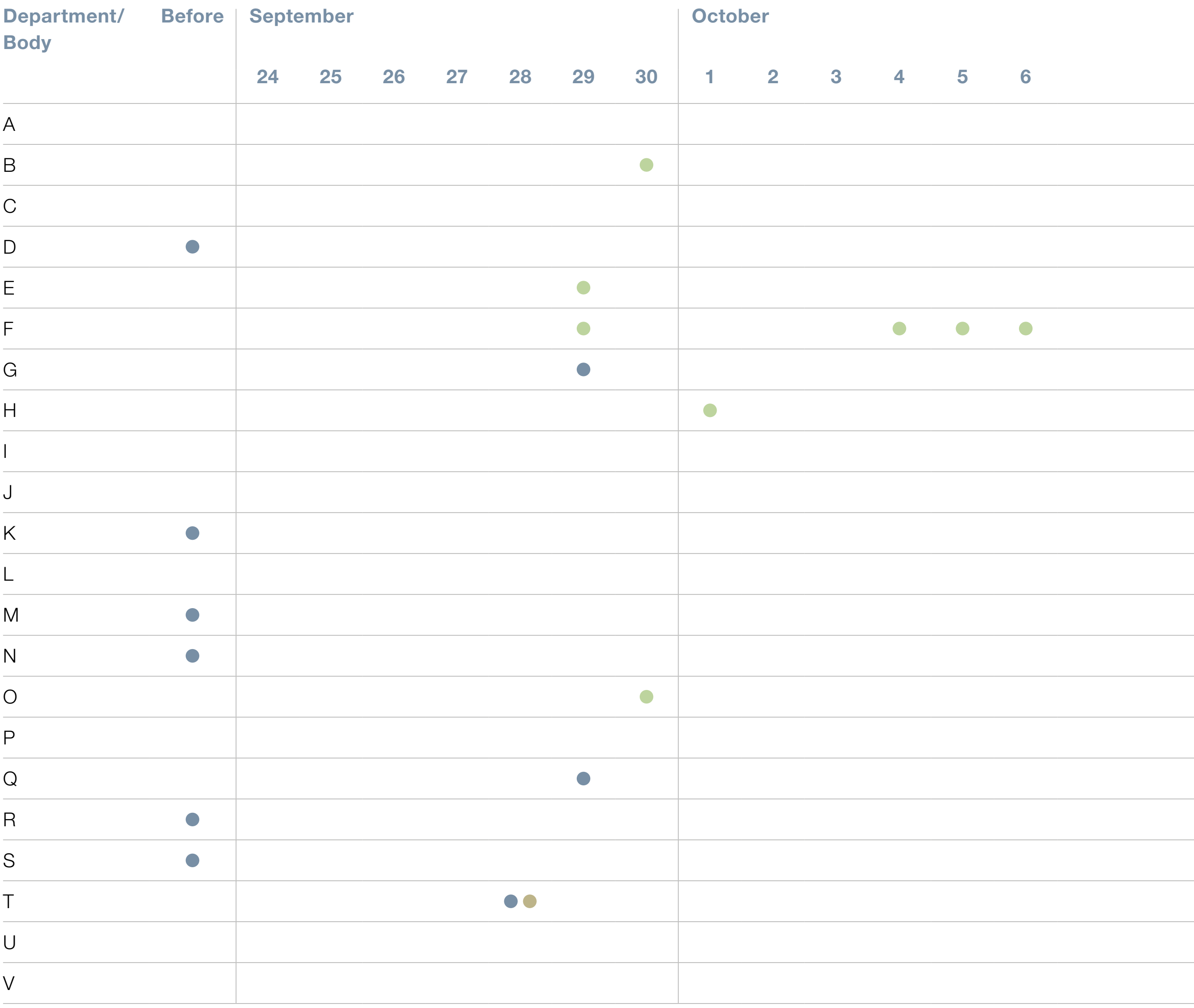
2.25 The SR10 process did not support integrated cross-government allocation of spending. The Treasury:

- conducted different exercises to allocate resource, capital and AME, despite their codependencies; and
- settled with departments individually in three stages – in 16 cases it settled resource and capital at different times (**Figure 10** on pages 32 and 33).

14 National Audit Office, *Cost reduction in central government: summary of progress*, February 2012. Available at: www.nao.org.uk//idoc.ashx?docId=544ae39c-7dac-4d85-8f75-0f30db473ba9&version=-1

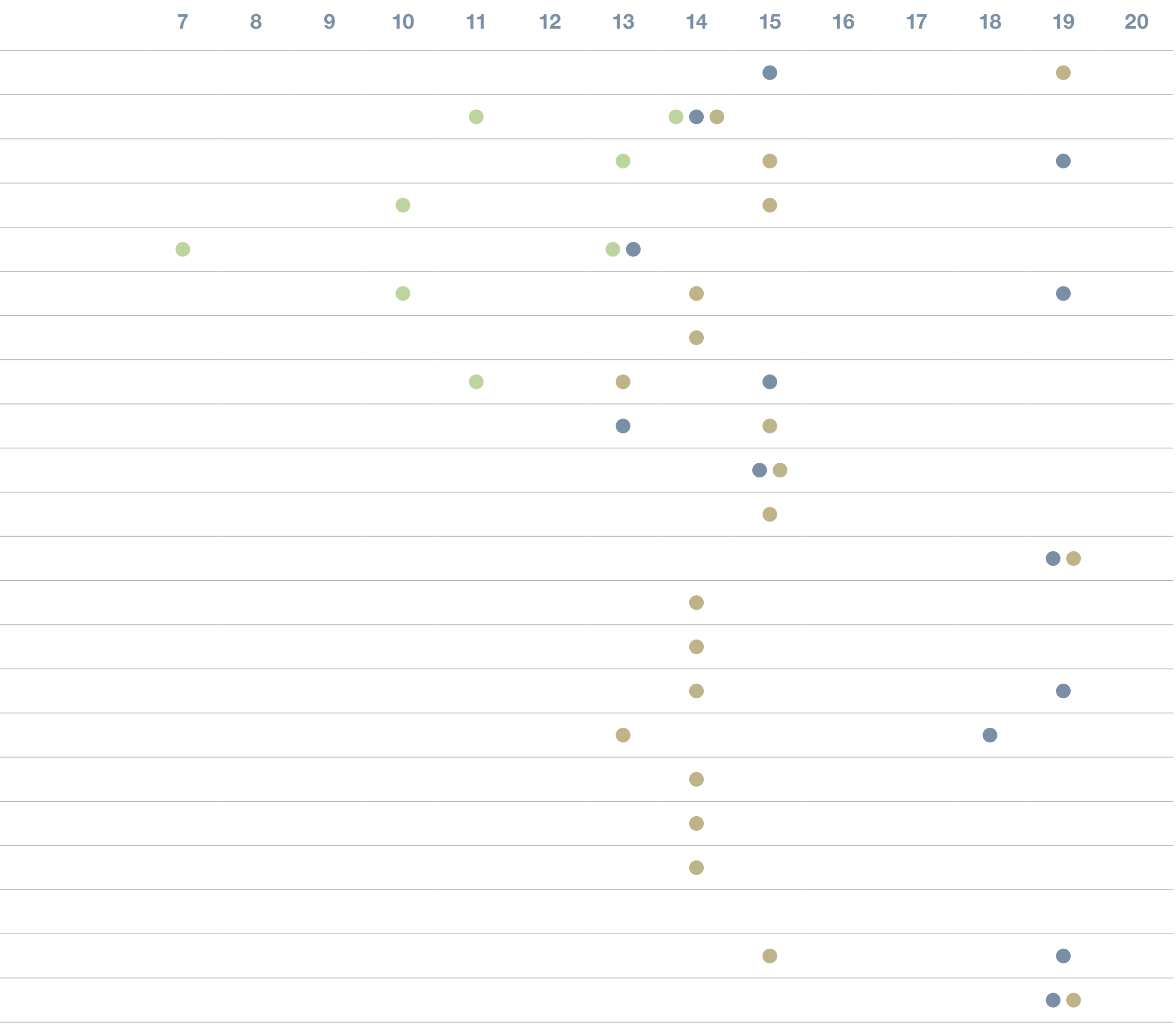
Figure 10
Fragmented phasing of settlements in the last month of SR10

The Treasury settled with departments individually in three stages and in 16 out of 22 cases it settled resource and capital on different days



- Resource settlement agreed
- Capital settlement agreed
- Bilateral between the Secretary of State and Chief Secretary to the Treasury

Source: HM Treasury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Informed challenge

Departmental challenge for SR10

2.26 Methods of internal challenge for SR10 varied for our case studies. The Department for Communities and Local Government adopted an innovative challenge process (**Figure 11**). In the Department for International Development, anonymous technical reviewers and scrutiny panels, which included external members, assessed country offers for its Bilateral Aid Review.

2.27 We found that departments were developing some radical options and their submissions referred at a high level to plans for fundamental reforms. However, only three of our case studies initially proposed savings from fundamental reforms ('category 2' savings)[15] and accounted for no more than 5 per cent of their combined SR10 resource settlements (**Figure 12** on pages 35 and 36). The most radical changes may have occurred elsewhere, such as health and education, but transformational proposals were less evident in our case studies.

The Treasury's challenge role

2.28 There were examples of spending teams prompting some significant allocative changes during SR10. However, with no ongoing central information store in place, Treasury spending teams spent much time gathering, chasing and seeking explanations for information from departments. For example, the Capital Scrutiny Panel ran out of time to resolve concerns about departments' analyses. The Equality and Human Rights Commission[16] also noted that some returns on equality impacts were significantly late and that this may have meant that there was limited time for the data to inform decision-making.

Figure 11
Challenge in the Department for Communities and Local Government

The Department conducted an exercise for SR10 in which two competing teams (red and blue) developed counter propositions on their five major spending areas. Each blue team completed summary papers for spending proposals, including arguments based on questions similar to the Treasury's nine questions. This assessment was challenged by a red team. Both assessments were moderated by a 'home team' who provided a final verdict. Ministers then considered the arguments for each area and made final decisions on where to invest or cut, using a live spreadsheet showing the latest position.

Source: Department for Communities and Local Government

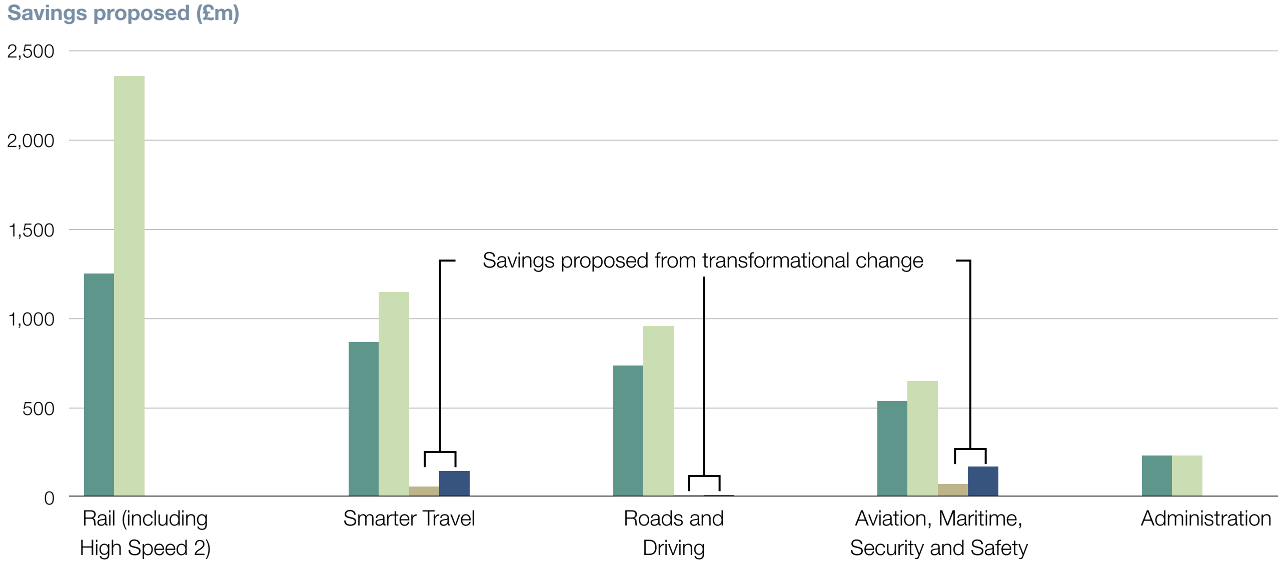
15 The Treasury's SR10 guidance described 'category 2' savings as "…approaches which change or reduce the existing role of the state to release savings".

16 Equality and Human Rights Commission, *Making fair financial decisions – An assessment of HM Treasury's 2010 Spending Review conducted under Section 31 of the 2006 Equality Act*, May 2012. Available at: www.equalityhumanrights.com/uploaded_files/Inquiries/s31_final.pdf

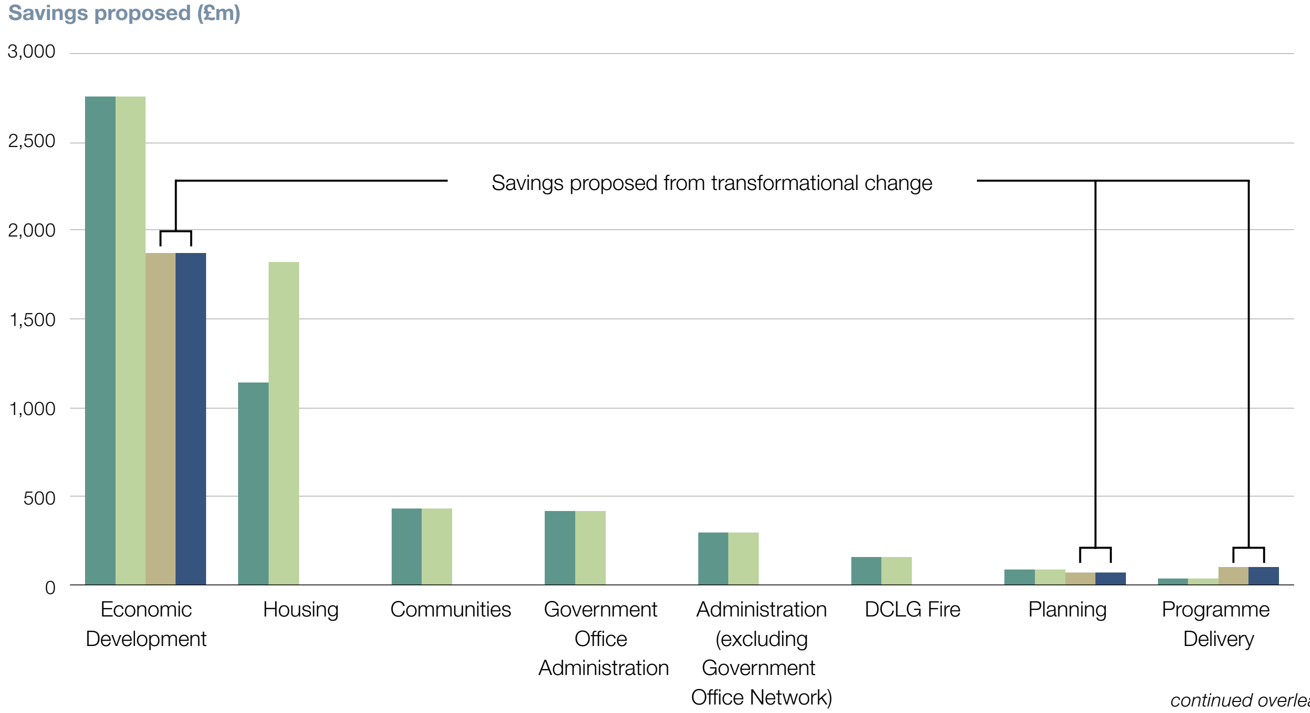
Figure 12
Transformational resource spending proposals in SR10 submissions

Departments proposed only small savings from transformational changes in resource spending

Department for Transport



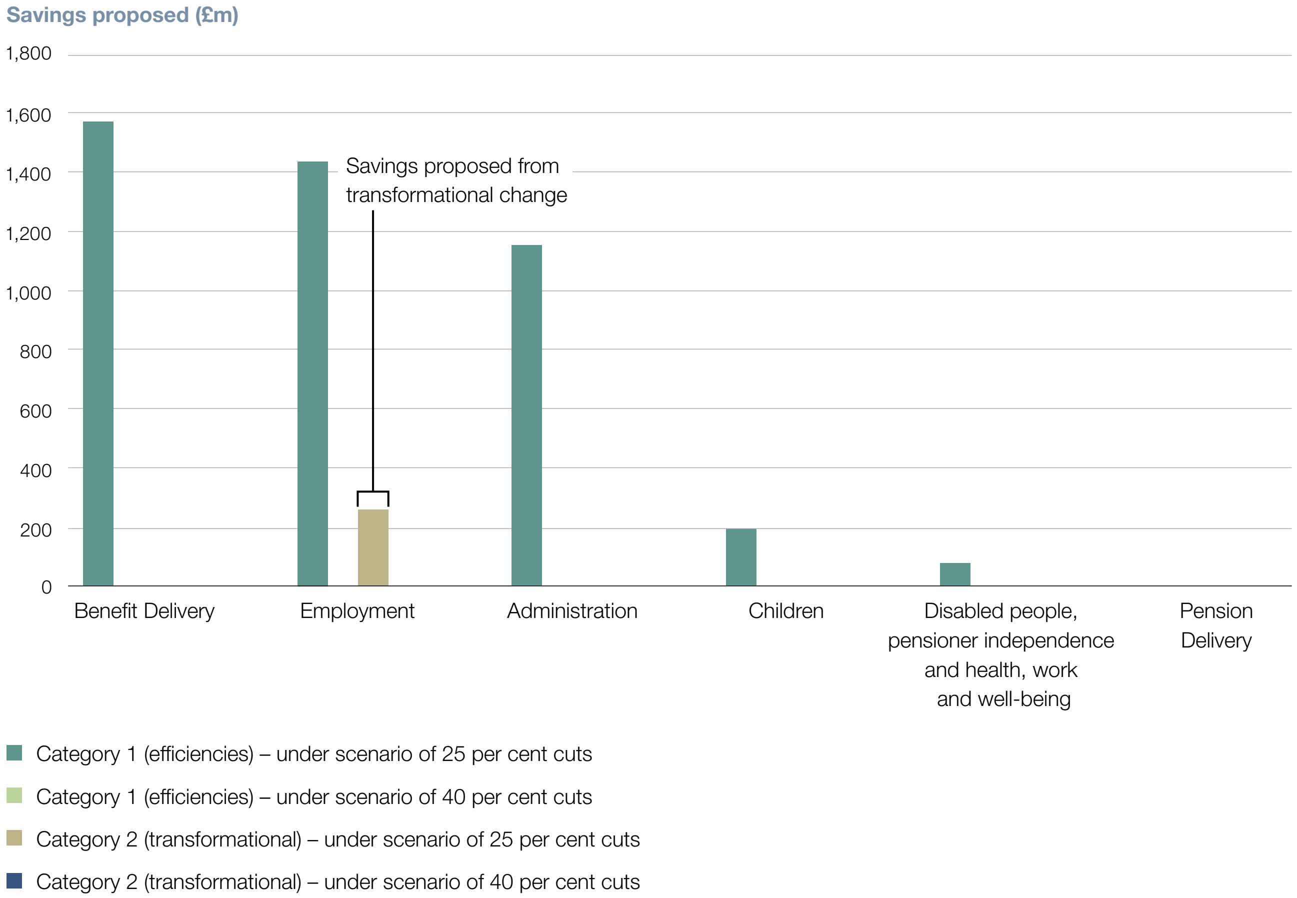
Department for Communities and Local Government (DCLG)



continued overleaf

Figure 12 *continued*
Transformational resource spending proposals in SR10 submissions

Department for Work and Pensions



Source: National Audit Office analysis of departments' SR10 submissions

2.29 Spending teams considered that they have the capacity and capability to provide sufficient challenge. However, staff churn is a significant risk to knowledge retention. A recent Treasury report[17] noted that its staff turnover was "…three times higher than the UK civil service average". Out of the 52 staff in the spending teams for our case study departments, only eight were still in place 20 months after SR10 (**Figure 13**). Interviewees in three case study departments cited this as a specific problem and one department had raised it with the Chief Secretary to the Treasury. Three departments also considered that the Treasury was insufficiently joined-up.

17 HM Treasury, *Review of HM Treasury's management response to the financial crisis*, March 2012. Available at: www.hm-treasury.gov.uk/d/review_fincrisis_response_290312.pdf

Figure 13
Treasury spending teams

Treasury spending teams have experienced significant turnover since SR10

	SR10 – Total DEL settlement (£bn)[1]	Department's current staff numbers[2]	Size of spending team for SR10	Current size of spending team	SR10 'survivors'
Department for Transport	51	16,900	10	10	3
Department for Work and Pensions	31	105,500	13	15	1
Department of Energy and Climate Change	14	2,800	13	11	1
Department for Communities and Local Government	16	3,900	11	8	2
Department for International Development	40	2,500[3]	5	4	1
Total			**52**	**48**	**8**

NOTES
1 Rounded to nearest £1 billion. Excludes AME.
2 Departmental family full-time employees, from departments' quarterly returns to the Cabinet Office in April 2012. Rounded to the nearest one hundred.
3 Includes staff appointed in other countries.

Source: HM Treasury

External challenge

2.30 For SR10, the Treasury established an Independent Challenge Group (ICG) whose 39 members included six from outside the public sector. While it provided a different perspective and thematic thinking, the ICG was not actively involved in interactions between departments and the Treasury; and was disbanded after SR10.

2.31 The UK budgetary system has been praised internationally for its openness in published information – scoring highly in the 2010 International Budget Partnership Open Budget Survey.[18] However, its legislative oversight was rated as only 'moderate' – below France, Germany and the United States. Commentators have criticised the Westminster system for limitations in how government provides information and the legislature's capacity to examine it in depth.

2.32 In Scotland, budgets are published first in draft to enable public scrutiny and challenge, and in June 2011 the Scottish Finance Committee appointed a specialist budget adviser to scrutinise proposals. OECD research[19] has concluded that legislatures in countries such as the USA, Germany, Switzerland and New Zealand have greater powers to amend budgets and longer to review them than the UK Parliament.

18 International Budget Partnership, *The Open Budget Survey 2010*. Available at: www.internationalbudget.org/wp-content/uploads/2011/06/2010_Full_Report-English.pdf
19 The Organisation for Economic Cooperation and Development, *International Budget Practices and Procedures*, 2007. Available at: www.oecd.org/governance/budgetingandpublicexpenditures/internationalbudgetpracticesandproceduresdatabase.htm

Part Three

Operational budgeting

3.1 Departments have varying budgetary processes, but typically their operational features include:

- Finance professionals, reporting to a finance director, typically manage budgets. These officials monitor spending, provide updates to the board or executive team and liaise with Treasury spending teams.
- A central strategy unit or equivalent leads on overall medium- to long-term policy development in liaison with policy leads and finance colleagues.
- Policy leads develop business cases for new spending, and proposals for changes to spending. An investment committee or equivalent, typically comprising strategic, policy, economics and finance leads, considers the business cases before they are put to the board or executive.

3.2 This part examines how departments prepare and use their budgets and considers how they have developed their allocative approaches since SR10.

Preparations for SR10

3.3 Local budgeting models reflect departmental history as well as differing policy fields and spending types. These variations are reflected in how our case studies prepared for SR10 (**Figure 14**) and budgeting since (**Figure 15**). Despite the value of prior analysis, departments had to amass disparate evidence from across the organisation to inform decisions. None of our case studies readily held such information in a format, such as a central database, that would make future exercises easier, or operated an information strategy to meet the needs of budgetary decisions.

Figure 14
Preparative work in the Department for Transport

In early 2010, the Department's Alternative Planning Assumptions Framework (APAF) exercise identified cost reduction options and assessed their impacts against high-level objectives. Nine 'discovery projects' considered the scope for fundamentally different delivery models that could lead to reduced spending consistent with these objectives. This work provided the basis for judgements about potential areas for savings.

Source: Department for Transport

Figure 15
Departments have adopted varying approaches to budgeting

	Pre-SR10	During SR10	Immediately after SR10	To present day
Department for Transport	Public value programme (PVP),[1] Alternative Planning Assumptions Framework and discovery projects.	All parts of the Department were asked to complete templates setting out proposed savings. Templates collated into a central database to support iterative discussions with Ministers. Multi-criteria analysis conducted to examine relative merits of different capital projects, in terms of their economic benefits, deliverability, strategic fit and other impacts.	Budgets allocated to directors based on the position reached at settlement.	Board Investment Committee considers new spending. Now addressing £1.7 billion unexpected funds for infrastructure. Pipeline Management Group considers funding new programmes, taking account of their value.
Department for International Development	PVP exercise covering key policy areas. Adopted new allocative approach, based on bottom-up proposals to deliver results in five priority development areas.	Initiated Multilateral and Bilateral Aid Reviews intended to generate good value proposals to deliver development results. Offers reviewed by scrutiny panels, including external members.	Aggregated offers into the five areas to assess them against policy priorities, their level of ambition and value for money. Business Units issued with settlement letters setting out their resources and expected development results.	Local Operational Plans published, setting out budgets and expected results. Business cases prepared for all new programmes. Annual cycle to review budget allocations and expected results.
Department for Communities and Local Government	PVP exercise covering key policy areas. New analytical work commissioned where not already covered.	Submissions to Ministers on key spend areas addressing standard questions. Challenge exercise, involving Ministers, to identify the effect of different combinations of savings.	The Finance Director and Investment Subcommittee reviewed business cases for all policy proposals to refine them and reallocate any resulting funding.	The Investment Subcommittee considers business cases for new spend above £1 million. The Department has received an extra £2.4 billion, for specific programmes since the spending review.
Department for Work and Pensions	PVP exercise covering key policy areas. Development work on Universal Credit and Work Programme.	All parts of the Department completed templates setting out proposed AME savings. Engaged Ministers and senior officials on the allocation and prioritisation of spend.	The Department developed a four-year plan with envelopes for each area. It then asked each area to detail its planned spend over the period. It established continuous planning, with multi-year budgets.	Allocation of all budgets is reviewed at three points each year. The Portfolio Management Unit oversees allocation of new investment spend based on a range of factors.
Department of Energy and Climate Change	PVP for Nuclear Decommissioning Agency. The Department also led PVPs on fuel poverty and public sector emissions and conducted internal review of metrics on spend.	The Department split its analysis into legacy and future spending. It conducted an exercise, chaired by a junior Minister, to consider savings options for future spend; and subsequent prioritisation for programme and administration spend.	Ran departmental 'future' exercise to allocate resources to priority activities.	Established an approvals committee to consider business cases for major spend items. Considering how to develop a more structured approach to portfolio management.

NOTE

1 PVPs were reviews of major areas of spending conducted between 2008 and 2010 to identify value-for-money improvements.

Source: National Audit Office

Budgeting since SR10

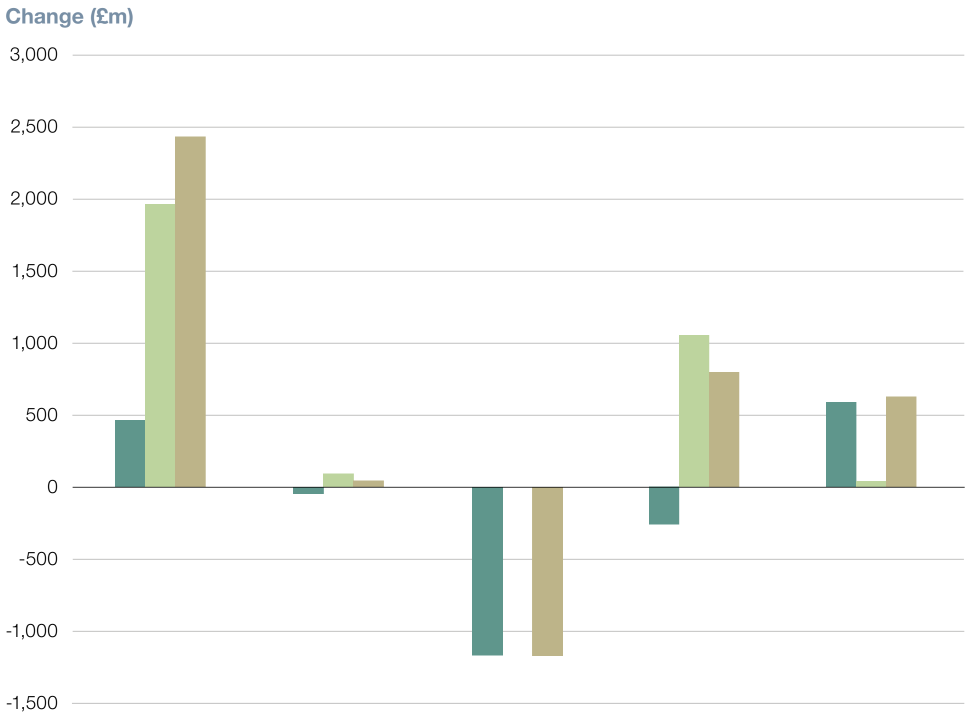
Budget allocations

3.4 Spending limits can change to reflect new circumstances (**Figure 16**). In SR10, the Treasury's settlement letters to our case study departments did not detail how the Treasury expected them to spend their allocation, beyond some specific agreed items and ring-fenced policies. For instance, the settlement letter for one department referred to specific areas of spending accounting for only 38 per cent of its £50.5 billion settlement and these references were at a high level (**Figure 17**).

Figure 16

Changes to case study departmental expenditure limits (DELs) for the SR10 period since SR10

Medium-term spending totals can be varied to reflect changed circumstances



	Department for Communities and Local Government	Department of Energy and Climate Change	Department for International Development	Department for Transport	Department for Work and Pensions
Resource DEL	465	-43	-1,164	-257	589
Capital DEL	1,966	91	0	1,056	39
Total DEL	2,431	48	-1,164	800	628

NOTE

1 Figures show nominal changes. Resource DEL figures exclude depreciation.

Source: National Audit Office analysis of departments' data

Figure 17
Allocative detail in the Department for Transport's SR10 settlement

The Treasury's settlement letters for SR10 did not contain detailed expectations for how departments would spend the total amounts allocated to them

£19.0 billion

Specifically allocated in the Treasury's SR10 settlement letter to the Department for Transport

£31.5 billion

Source: National Audit Office analysis

3.5 Departments therefore have considerable freedom, within budgetary rules and ring-fencing, to decide how they allocate funding to programme areas. While some departments allocated budgets on a similar basis to the pattern developed during the review, others conducted further allocative work.

3.6 Departments can continue flexing allocations during the spending review period. For example, the Department for Communities and Local Government's calculations show that, in the ten months to January 2012, it had moved between programme budget heads 40 per cent of its resource and 13 per cent of its capital allocation.

Linking budgets to operational plans

3.7 Four of our case study departments maintain 'operational' plans setting out their strategy and policy priorities for the year. They primarily focus on staff allocations and, where they include financial breakdowns these are to divisions rather than to policies and activities. All publish business plans setting out reform actions, and input, back-office and impact indicators. The business plans reflect capital, resource and AME totals disaggregated at a high level, but otherwise focus on priority areas, not the full span of departmental business. Difficulties in linking resources with results are consistent with concerns we have previously raised[20] about weak links between departments' strategic planning and financial management.

Control of budgets

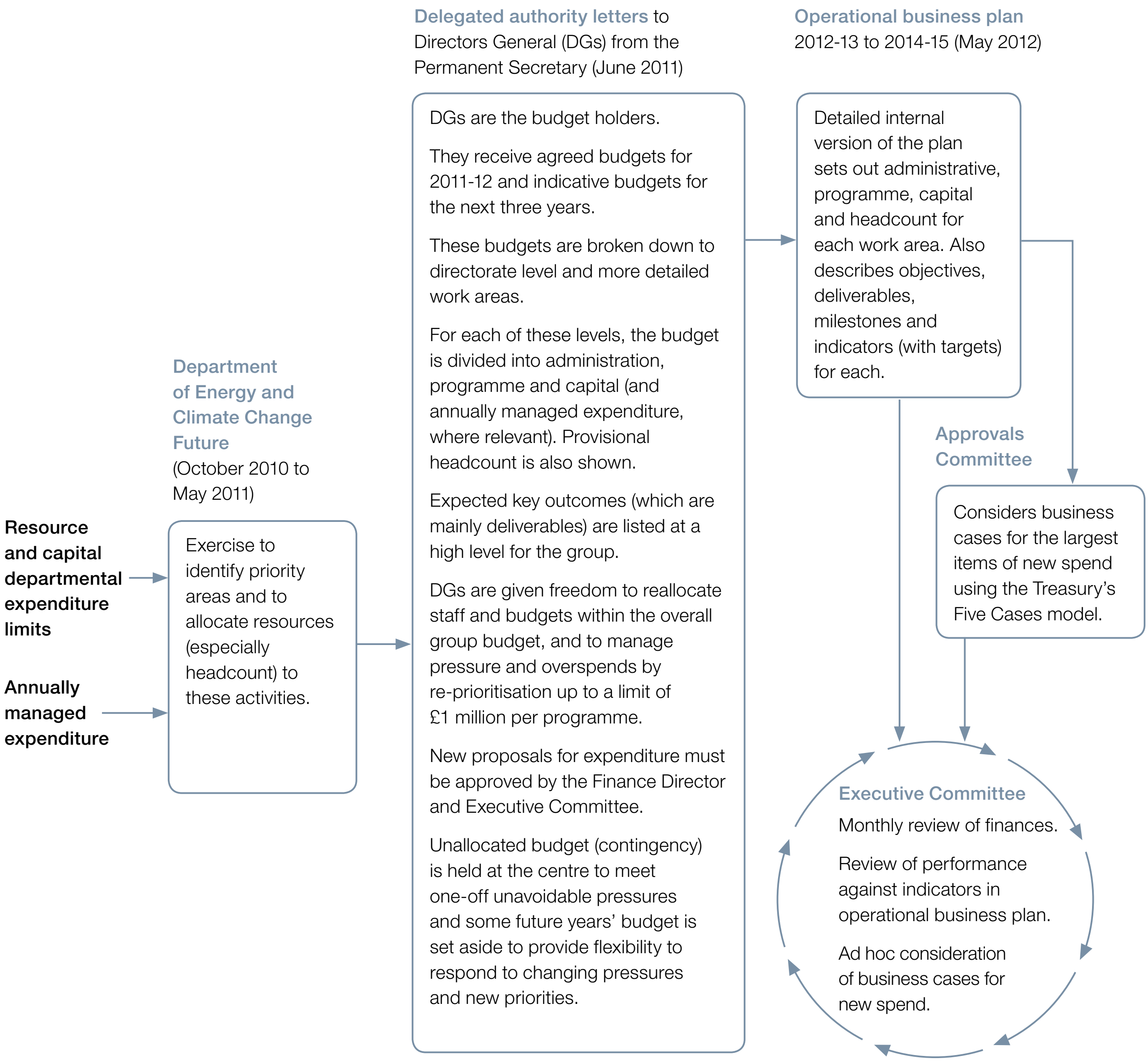
3.8 Departments typically delegate budgets to directorate and divisional levels, with agreed deliverables and milestones. Budget holders report actual and forecast spending to the finance directorate, which in turn keeps the board informed of developments and risks. Budget holders also report to management on performance against agreed indicators. **Figure 18** illustrates one department's approach to operational budgeting.

3.9 The Treasury maintains an ongoing challenge role through its monitoring and control functions. For example, spending teams maintain regular contact with departments to monitor spending; officials attend departments' Investment Committees and review business cases for major projects and spending above delegated limits. The Treasury also requires departments to share risk assessments submitted to their boards.

20 National Audit Office, *Progress in improving financial management in government*, March 2011. Available at: www.nao.org.uk/idoc.ashx?docId=E9303518-921A-49CD-BF46-5C74B1AB8552&version=-1

Figure 18
Budgeting process in the Department of Energy and Climate Change

An example of how one department has put its budgetary allocation for SR10 into operation



Source: Department of Energy and Climate Change

Managing spend portfolios

3.10 Portfolio management remains in its infancy. The Department for Transport acknowledges that budgeting focuses on specific transport modes, although it has set up a Pipeline Management Group which receives combined high-level assessments of deliverability and value for money for possible new spending on different transport modes. The Department for Communities and Local Government's Investment Subcommittee considers business cases for new spending on an individual basis, with its Finance Subcommittee considering financial issues across the department. The Department of Energy and Climate Change envisaged a portfolio management role for its new approvals committee.

3.11 After SR10, the Department for Work and Pensions also concluded that it needed to evolve its portfolio management (**Figure 19**). It focused on the most volatile areas of spending. This is in keeping with an example in our review of external comparators[21] of an organisation focusing particular effort on spending with the greatest impact and volatility.

3.12 The need for a rational and planned approach to budget allocation has been given further impetus by the Treasury's new requirement for departments to identify 5 per cent of allocated DEL for contingency. The Department for Work and Pensions, with no unallocated provision, acknowledges that it cannot make equal cuts from all budgets, but needs to prioritise where the savings will be found. Restrictions, such as fixed costs, have prompted a focus on areas where its spending is most discretionary – such as the most flexible elements of its change programme (which were worth 3 per cent of total DEL in 2012-13).

Figure 19
The Department for Work and Pensions' portfolio management

The Department's new portfolio management unit maintains a single portfolio of change projects (worth £4.3 billion, or 14 per cent of its DEL settlement). The unit advises management on prioritisation, capacity and interdependencies. It monitors spending and provides monthly dashboard reports to management, covering the financial position, milestones and top risks.

In autumn 2011, the Department reviewed all its spending as part of its new continuous planning process. For the change portfolio, teams completed a template, which included ratings from zero to ten against nine criteria addressing strategic intent, value for money, affordability and successful delivery. It is clear, however, that investment was driven more by some factors than others: some of the largest projects are funded despite scoring below the average score of 57. The Department explained that while factors such as cost–benefit assessments were important, political priorities were a major driver.

Source: Department for Work and Pensions

21 PricewaterhouseCoopers, *Good budgetary processes: comparators – case studies from the public and private sector*, October 2012.

3.13 Budgeting decisions can be restricted by long-term spending commitments. For example, we recently noted how for the Department for Transport,[22] the Network Rail grant (£10.7 billion, 28 per cent of its budget) was largely excluded from consideration in SR10, having already been determined for the five years up to 2013-14. Likewise, for its centralised capital ranking exercise, the Treasury identified 25 per cent of approved spending as contractually committed.

Linking budgets and performance

3.14 Departmental settlements do not define the economic or social value expected from funding allocations. Departments vary in the extent to which finance and performance reporting are brought together and any performance indicators are often milestones and deliverables rather than outcomes. We have previously commented that there are few examples of departments with systems that link costs to performance.[23] Not understanding the factors driving cost and the consequences of spending cuts makes it difficult to forecast spending.

3.15 All public sector participants in our external comparators work,[24] as well as our case study departments, acknowledged that the links between performance and budgeting could be improved. The Department for Transport, for instance, acknowledged that more could be done to draw on performance monitoring and evaluations to inform budgeting; and the Department for International Development had recently sought to enhance its use of performance information in budgeting decisions (**Figure 20** overleaf).

Maintaining budget relevance

3.16 Keeping budgets up to date in a changing world is a common theme in budget literature. The Department for Work and Pensions' recent adoption of continuous planning is one example of a department introducing links between annual and medium-term budgeting, and providing for budgetary review at several points in a year (**Figure 21** on page 47).

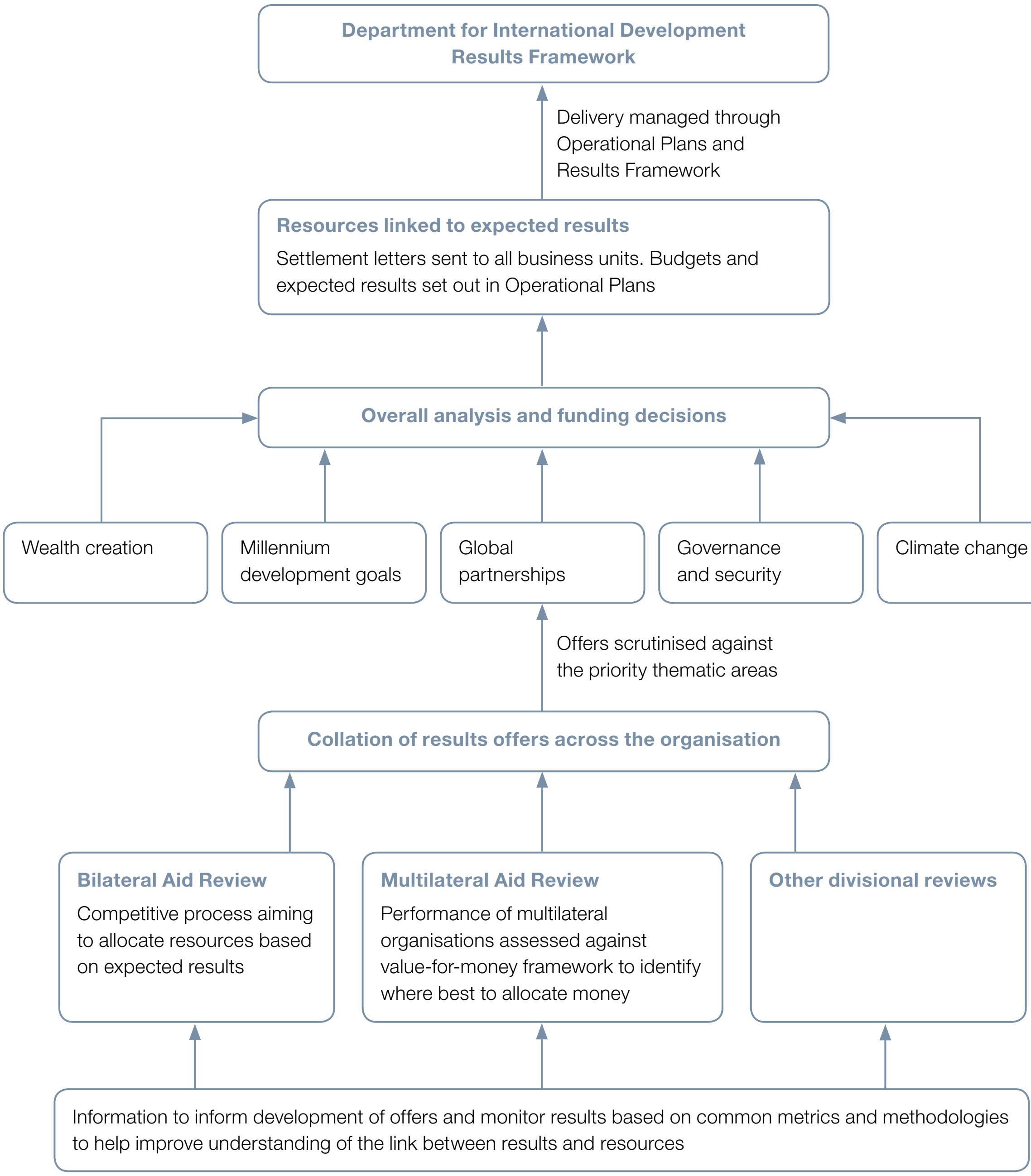
22 National Audit Office, *Reducing costs in the Department for Transport*, December 2011. Available at: www.nao.org.uk//idoc.ashx?docId=a5919424-db59-402b-be22-b3c261be53a4&version=-1

23 National Audit Office, *Cost reduction in central government: summary of progress*, February 2012. Available at: www.nao.org.uk//idoc.ashx?docId=544ae39c-7dac-4d85-8f75-0f30db473ba9&version=-1

24 PricewaterhouseCoopers, *Good budgetary processes: comparators – case studies from the public and private sector*, October 2012.

Figure 20
Performance information and budgeting in the Department for International Development

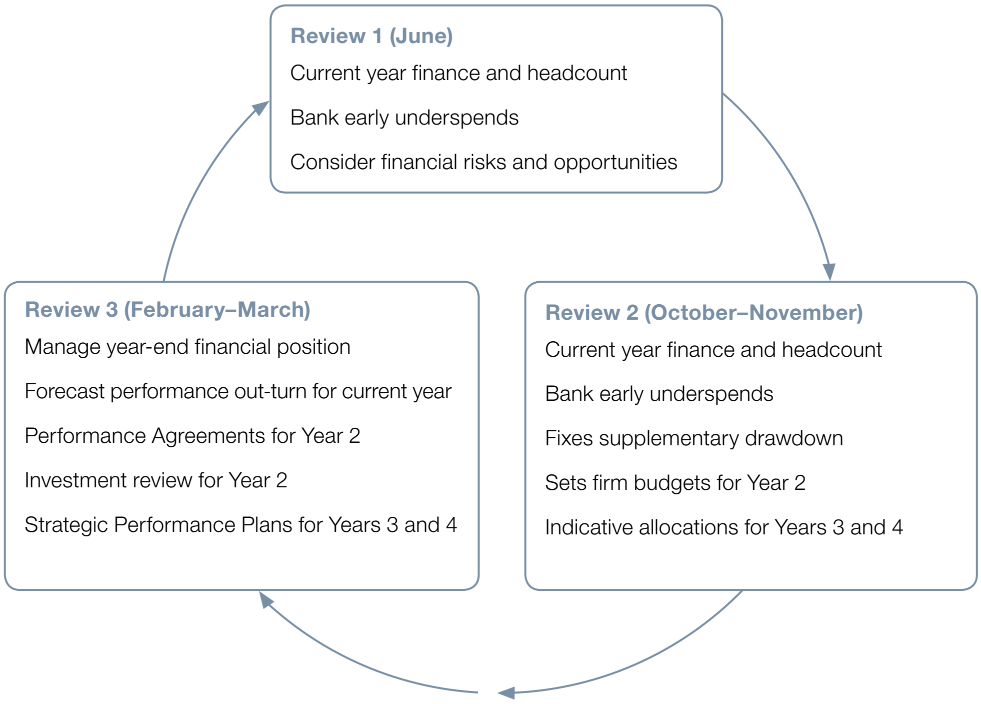
For SR10, the Department sought to link resources to delivery and assessed initial offers to deliver results within five priority thematic areas. It now manages delivery of results through local Operational Plans and its Results Framework. Business cases and its new Annual Project Scoring System are intended to provide a better basis for approving and monitoring programmes to deliver value for money. The Department has developed a Portfolio Quality Index (aggregating project scores) and is considering approaches to diversifying risk across its portfolio.



Source: Department for International Development

Figure 21
Continuous planning in the Department for Work and Pensions

The Department has a new medium-term planning cycle to monitor actual spending but also plans and forecasts for the next four years



Source: Department for Work and Pensions

Appendix One

Our audit approach

1 This report reviews the government's budgetary processes to assess whether the method for allocating resources enables it to optimise value for money.

2 Our work focuses on the Treasury's design, implementation and management of the budgetary system and examines how departments manage budgets. The study addresses the current budgeting process – including the spending review; the annual budgetary process; and how departments prioritise spending between budgets. It also addresses the extent of cross-cutting spending decisions and nature of integration with other key strategic processes, such as business plans.

3 We considered the design of the system against international good practice in budgeting in both the public and private sector. We also compared the budgetary process against the Treasury's stated objectives for the budgeting system.

4 We focused on a sample of five departments:

- Department for Work and Pensions;
- Department for International Development;
- Department for Transport;
- Department for Communities and Local Government; and
- Department of Energy and Climate Change.

5 These were selected to reflect a wide range of circumstances to allow us to draw generalisable lessons. Our audit approach is summarised in **Figure 22**. Our evidence base is described in Appendix Two.

Figure 22
Our audit approach

The objective of government

The Treasury has two main objectives for the budgetary system: "To support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the Government's fiscal framework"; and

To provide "…good incentives for departments…to prioritise across programmes…" and "…to manage spending well so as to provide high quality public services that offer value for money to the tax-payer".

How this will be achieved

The Treasury designs and manages the government's budgetary system, including how money is allocated between departments. Parliament looks to the Treasury to ensure that revenues are raised and resources spent only within the limits agreed by it. The government looks to the Treasury to ensure that the system enables ministers to implement its policies.

Our study

This report examines UK budgetary practices against the Treasury's aims for the system, as well as good budgetary practice. It assesses the design and operation of the system; and the budgetary approaches in five case study departments.

Our evaluative criteria

- Clarity in the rules and relationships, which enables the agreement of sustainable budgets and supports budgetary control.
- Informed decision-making and challenge.
- Organisation-wide spending prioritisation and effective allocation.
- Integration between spending, strategy and performance.

Our evidence

(see Appendix Two for details)

We assessed budgetary control by:

- Drawing on our **previous work** in this area
- Conducting a **literature review** to identify good budgetary practice
- Drawing on our **external comparators work**
- Reviewing **key documents** on the design of the budgetary system and comparing it with best practice
- Conducting **semi-structured interviews** with relevant officials in the case study departments and Treasury spending teams
- Analysing **data** on estimates and excess votes.

We evaluated information provision and the challenge processes used in government by:

- Drawing on our **previous work** in this area
- Conducting **semi-structured interviews** with relevant officials in the case study departments and Treasury spending teams
- Analysing **documents and data** supplied by the departments and the Treasury.

We examined the budgetary allocation process by:

- Drawing on our **previous work** in this area
- Conducting **semi-structured interviews** with relevant officials in the case study departments and Treasury spending teams
- Analysing **documents and data** supplied by the departments and the Treasury.

We reviewed the links between spend, strategy and performance by:

- Drawing on our **previous work** in this area
- Conducting **semi-structured interviews** with relevant officials in the case study departments and Treasury spending teams
- Reviewing **documentary evidence** from our case study departments.

Our conclusions

The current budgeting system addresses the Treasury's objective to control government spending. However, the system is less effective at meeting its objective to support informed prioritisation and value for money. In particular, there are gaps in the information available – especially cost–benefit assessments – which hinder informed decision-making. Moreover, mechanisms to compare the relative value of spending between departments, or between service areas within departments, are weak. While government should not make decisions on the basis of cost–benefit information alone, its patchy availability and quality limit how far the Treasury and departments can compare the value from different resource allocation options. **We conclude that information failings in the budgetary system hinder the government's ability to demonstrate that resource allocation optimises value for money.**

Appendix Two

Our evidence base

1 We reached our independent conclusions on whether the budgetary system helps to optimise value for money following our analysis of evidence collected between January and June 2012.

2 We developed an evaluative framework to consider existing arrangements against good budgetary practice as well as the Treasury's stated intentions for the budgetary system it has designed.

3 It would not be feasible to review the budgetary experiences of all departments. We therefore focused on a sample of departments to draw generalisable lessons. In sampling, we considered a range of factors, including size of their total managed expenditure (TME) and the split between types of spend (capital, resource and AME). On this basis, we selected five departments, representing 31 per cent of all spending covered by the spending review:

- Department for Work and Pensions;
- Department for International Development;
- Department for Transport;
- Department for Communities and Local Government; and
- Department of Energy and Climate Change.

4 To understand the Treasury's and departments' activities and experiences, we requested key documents and conducted semi-structured interviews with:

- thirty-five officials in the case study departments, working in finance, strategy and policy areas; and
- fifteen officials from five Treasury spending teams, as well as with officials from the Treasury's General Expenditure Policy team.

5 To assess how the UK's budgetary system compares with good practice worldwide we reviewed good budgetary practice literature. This identified a wide range of relevant literature, including academic texts and papers from the World Bank, Organisation for Economic Cooperation and Development, Chartered Institute of Public Finance and Accountancy, Chartered Institute of Management Accountants, International Monetary Fund and Audit Commission.

6 Our analysis identified the following key elements of effective budgeting:

- clarity in the rules and relationships, which enable the agreement of sustainable budgets and support budgetary control;
- integration between spending, strategy and performance;
- informed decision-making and challenge; and
- organisation-wide spending prioritisation and effective allocation.

7 We assessed the **effectiveness of budgetary control** by doing the following:

- We reviewed key documents on the design of the budgetary system and compared it with the best practice identified in our literature review. In particular, we examined guidance issued by central government, including:
  - the *Consolidated Budgeting Guidance*;[25]
  - *Managing Public Money;*[26] and
  - the guidance issued by the Treasury to departments for SR10.
- We drew on the findings from work we commissioned PricewaterhouseCoopers to undertake, identifying good budgetary practice and lessons learned from case studies in three sectors:
  - central government in Canada, Australia and Germany;
  - three UK local authorities; and
  - three large private sector companies in the UK.
- We analysed data in supply estimates and statement of excesses between 2006-07 and 2010-11, to identify the prevalence and extent of the Treasury's requests to Parliament for additional funds.
- We estimated the costs of the SR10 process using Treasury and departmental information on the level of staff involvement and a set of assumptions on staff costs.
- We conducted semi-structured interviews with key officials in our case study departments and the Treasury.
- We reviewed relevant previous reports published by the National Audit Office.

25 HM Treasury, *Consolidated Budgeting Guidance from 2012-13*, March 2012. Available at: www.hm-treasury.gov.uk/d/consolidated_budgeting_guidance_201213.pdf
26 HM Treasury, *Managing Public Money*, October 2007. Available at: www.hm-treasury.gov.uk/d/mpm_whole.pdf

8 We evaluated **information provision and the challenge processes** used in government by doing the following:

- We examined examples of departments' internal guidance and submissions to senior officials and ministers for SR10, including the use of departmental centre templates to coordinate data collection.
- We reviewed key documents from the SR10 process, including:
  - SR10 submissions – ministerial covering letters, associated papers and completed templates from the case study departments;
  - example correspondence between the Treasury and the case study departments during SR10;
  - examples of key internal Treasury and departmental papers during the SR10 process, including Public Expenditure Committee (PEX) papers; and
  - the settlement letters issued by the Treasury to departments at the conclusion of the review.
- We reviewed key documents from the Treasury on the SR10 process – including papers from the Capital Scrutiny Panel and the results of the Treasury's lesson learning exercise.
- We assessed departments' SR10 submissions to the Treasury for how they initially met the information requirements in the Treasury's guidance for the exercise.
- We identified the capacity of the Treasury's spending teams for the case study departments for SR10 and currently.
- We reviewed examples of the papers produced by the Independent Challenge Group (ICG) for SR10.
- We conducted semi-structured interviews with key officials in our case study departments and the Treasury.
- We reviewed relevant previous reports published by the National Audit Office.

9 We **examined the allocation process** by doing the following:

- examining the submissions and subsequent correspondence between departments and the Treasury during SR10;
- analysing the results of the Treasury's capital exercise – including an analysis of the inputs to, and results of, its capital ranking exercise;
- reviewing examples of proposals relating to resource spending, to identify the approach taken to prioritisation – including the application of cost–benefit analysis;
- reviewing key papers supplied by the case study departments on their allocative processes since SR10;
- analysing changes to the spending totals envelopes and budget allocations for the case study departments on the basis of SR10 settlement letters and business plans 2012-13, as well as data supplied by the departments;
- conducting semi-structured interviews with key officials in our case study departments and the Treasury; and
- reviewing relevant previous reports published by the National Audit Office.

10 We **reviewed the links between spending, strategy and performance** by doing the following:

- examining example departmental papers and submissions developed during SR10;
- reviewing the contents of departments' latest business plans and their most recent corporate plans;
- conducting semi-structured interviews with key officials in our case study departments and the Treasury; and
- reviewing relevant previous reports published by the National Audit Office.

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