National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

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Cross government

Managing budgeting in government

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.