



National Audit Office

REPORT BY THE
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Cross-government

Financial management in government

Key facts

£720bn

total government
spending in 2013-14

15.4%

planned real terms
cuts to departmental
spending between
2009-10 and 2015-16

3.8%

annual departmental
spending cuts needed
in 2016-17 and 2017-18
implied by government
forecasts

£428.8 billion departmental spending in 2009-10 (2013-14 prices)

£381.0 billion planned departmental spending in 2013-14 (2013-14 prices)

£335.3 billion forecast departmental spending in 2017-18 (2013-14 prices)

Note: departmental spending comprises programme and administration spending. Total government spending also includes annually managed expenditure, such as pensions and benefits spending.

Summary

Introduction

1 The government is forecast to spend £720 billion in total in 2013-14. It is part way through a significant programme of fiscal consolidation, incorporating both spending reductions and tax increases. The progress of fiscal consolidation has been slower than expected, mainly because of the slow economic recovery. As a result, the consolidation programme is now expected to last longer than originally planned, with the government having set out an assumption of consolidation extending to 2017-18.

2 The financial situation is not the only pressure on public services. Demand for public services is expected to change substantially. The UK's demographic profile is forecast to create particular pressures on pensions, health and social care spending as the number of older people increases. Nationally, nearly a quarter of a million primary school places are needed by 2014-15 to accommodate a significant increase in the number of children.

3 Within this context, the government is implementing wide-ranging public service reforms. In many sectors, there are major long-term reform programmes, including Universal Credit, the Work Programme, pension reform, the defence transformation programme and the implementation of health reforms. More widely, there are opportunities to improve value for money, for example through the smarter use of technology and by better integrating services. However, government has tended to operate in a silo-based way, which limits such opportunities.

4 We have emphasised the importance of effective financial management in supporting sound decision-making, facilitating accountability, improving and refining planning, and enabling an organisation to devise its strategy and manage risks to its delivery. This report recognises that improvements have been made in the government's financial management in recent years. However, given the importance and urgency of the challenges presented by fiscal consolidation and public service reform, it cautions that further improvements in strategic financial management will be required if the delivery of public services with fewer resources is to be sustained over the longer term. It considers some of the strategic challenges finance professionals should engage with, including: cost reduction; strategic planning; prioritisation; and the funding of, and accountability for, local public services.

Key findings

Progress on financial management

5 There have been signs of improvement in financial management in government, as well as greater recognition of the strategic importance of the finance profession. There is positive progress in:

- leadership of the finance profession;
- significant financial management processes; and
- management information.

6 The Finance Leadership Group has established the Finance Transformation Programme to develop finance professionals' skills and capabilities, and to better incorporate financial management within broader strategic decision-making processes. The group leads on five work streams: value for money; finance profession talent management; financial and commercial awareness for non-finance professionals; the shared services agenda; and management information and financial reporting.

7 The finance profession has a greater senior presence in Whitehall. For example, the Head of the Civil Service and Permanent Secretary of the Department for Communities and Local Government, and the Permanent Under-Secretary in the Ministry of Defence, are both qualified accountants. More widely, finance directors have to be financially qualified and to be full members of departmental boards.

8 The government has made some significant financial management processes more coherent. The Clear Line of Sight initiative has aligned and simplified financial reporting at three stages: plans, estimates and expenditure outturns. HM Treasury has published two sets of Whole of Government Accounts (WGA). These offer an opportunity to better hold government to account for the money it spends and the activities it undertakes. The Committee of Public Accounts has welcomed publication of the WGA as an improvement in transparency and accountability.

9 The government has taken a number of steps to improve management information, including publishing departmental business plans and Quarterly Data Summaries of financial and performance information. However, the Cabinet Office acknowledges that it needs to make further improvements to reporting, and to consider behavioural issues that limit the use of management information in decision-making. Non-executive directors have also recognised the existing limitations of management information and are putting pressure on departments to improve.

10 Progress has therefore been made on aspects of financial management. However, none of the improvement processes are complete. On management information, for example, government remains a long way from ensuring that decision-making is routinely based on appropriate and robust information. Unit cost data are not systematically collected across government, and when efforts have been made to gather such data, for example in the 2010 Spending Review, the data were limited and inconsistent. The above progress does not mean that government is well placed to meet the forthcoming challenge of continued fiscal consolidation alongside substantial demand pressures.

Strategic challenges for financial management

Cost reduction

11 Departments and other public bodies have generally managed within reduced spending limits, but the savings realised have differing degrees of sustainability. Some initiatives are primarily geared towards controlling spending. Of these, reforms such as changes to pensions and higher education funding, can be expected to lead to long-term savings. However, others are less sustainable, such as pay freezes, controls on procurement spending and moratoria on the use of consultants and temporary staff.

12 In order to respond to financial and demand challenges, government needs to go further than controlling spending, by redesigning public services so that they operate permanently at lower cost. Recent NAO reports have identified that government needs to develop a clearer strategic approach to service redesign and transformation. Our report on NHS efficiency savings found that service transformation, such as expanding community-based care, is fundamental to making future savings but that only limited action has been taken so far. Similarly, we have found that the Efficiency and Reform Group in the Cabinet Office has helped departments to make savings, but that there has been less emphasis on the longer-term changes and improvements in efficiency needed to ensure that the savings are sustainable.

Strategic planning

13 Effective planning is critical to the success of cost reduction strategies. Departments often do not integrate financial management with strategic and operational planning. An absence of planning prevents departments from optimising the link between resources and outcomes. In 2012, we found that most departments had yet to develop a clear picture of their future state or a detailed plan based on a strategic view across the business.

14 A finance team should be a strategic partner in any organisation, helping the organisation to meet its objectives more effectively. Given the scale of the challenge, and the immediacy of the required response, financial management should be a key input in developing target operating models. These models can act as a roadmap for departments to set out in a coherent way their plans for transformation. Our work on financial management shows that this is not yet apparent in many departments.

Prioritisation

15 In an environment of limited resources, it is imperative that government is able to take an informed view when prioritising and allocating its resources, and that where possible it avoids short-term and incremental decision-making. However, our report on managing budgeting in government identified constraints on government's ability to prioritise spending effectively. The budgetary system addresses the Treasury's objectives for prioritisation and value for money, but less effectively than the objective for spending control. The budgetary system also lacks clear links to results and is insufficiently integrated with business planning. In the 2010 Spending Review, the Treasury's separate resource and capital exercises did not promote consideration of the links between these areas of spending, hindering the overall prioritisation of resources.

Local public services

16 More than half of the government's programme and administration spending is devolved to local public bodies. Local authorities and NHS trusts have generally absorbed central government funding reductions to date. However, they are facing increasing difficulties in absorbing further cost reductions. Successfully making financial savings while maintaining service delivery requires financial management capability in local public bodies. Central government needs to ensure that the effects of decisions about the funding it provides to local bodies are understood, and that accounting officers can provide assurance about system-wide value for money. Central government therefore needs to identify appropriate management information, and possess sufficient analytical capability, to fulfil these roles.

Skills and capability development

17 It is essential that a smaller civil service has the right balance of professional skills, and the finance profession should be a key part of this. We have found that government lacks some of the skills associated with effective financial management, such as commercial skills. The Finance Transformation Programme includes projects to improve the skills of both finance professionals and the wider civil service, and to measure improvements in financial awareness and culture. However, current data on finance skills in government are limited.

Conclusion

18 There are signs of improvement in financial management in government, as well as greater recognition of the strategic importance of the finance profession. The Finance Leadership Group has established the Finance Transformation Programme to position finance at the centre of decision-making. Qualified finance professionals are better represented at senior levels in Whitehall. There have been improvements in key financial processes, such as the Clear Line of Sight and WGA initiatives. While there is still much more to do, government is also taking positive steps with the aim of improving management information.

19 Despite these improvements, the scale of the challenge for finance managers in government is stark. While government has succeeded in a number of areas in controlling spending, it still faces a significant challenge in redesigning and transforming public services so that they operate sustainably in the context of further reductions to departmental spending, alongside increased demand.

20 The Treasury needs to provide more effective central leadership, to support public bodies in providing services at permanently lower cost. The chances of success will be much greater if financial managers are central to decision-making. Financial management should be integrated fully within processes to design and implement effective target operating models, and the financial impacts of all options should be a key factor in decision-making by finance and non-finance professionals alike.

Recommendations

21 Achieving effective financial management in the context of wider transformation will require a strategic and wide-ranging approach. The Treasury, working alongside the Cabinet Office, should provide more effective central leadership to better enable and incentivise the finance profession to confront the challenges it faces. This should include:

- strengthening the evidence base for key processes such as spending reviews, to better inform how resources are allocated and prioritised across government;
- considering the medium- and long-term effects of its resource allocation processes, to avoid incremental decision-making;
- identifying opportunities where early action or service integration can improve value for money;
- actively promoting a collaborative approach to financial management, for example by encouraging joint funding bids; and
- working to align financial accounting and reporting with initiatives to develop and improve management information, such as the Quarterly Data Summaries.

22 Government needs a ‘compact and competent’ finance profession. Alongside a more effective strategic role from the Treasury, the Finance Leadership Group should take responsibility for diagnosing the key current financial management challenges facing the finance profession and the wider civil service, and for addressing them quickly. This approach will support both operational decision-making and accountability to enable effective scrutiny of public spending. This should include:

- ensuring that a sound financial understanding is at the heart of target operating models for public services;
- actively seeking opportunities for transforming service transformation and coordination of both front-line and back-office services, to reduce spending in the long term (while recognising that this may also involve additional investment in the short term);
- applying rigorous financial analysis while innovative public service delivery models are implemented;
- equipping the wider civil service with a better understanding of the strategic importance of considering the financial implications of their work; and
- more active programme management for the Finance Transformation Programme, with milestones for anticipated progress and clear performance measures and expectations of success.