



National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

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Cross-government

Financial management in government

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Financial management in government

Report by the Comptroller and Auditor General

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Amyas Morse
Comptroller and Auditor General
National Audit Office

7 June 2013

This report examines how far finance is at the heart of decision-making in government. It also considers the important role of financial management and the pressing need for improvement across central government in the face of current and future challenges.

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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.

Part One

Pressures on public finances

The financial context

1.1 The government is forecast to spend £720 billion in 2013-14.¹ 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 economic recovery has been much slower than forecast, based on the trajectory of previous significant downturns. Five years after the start of the recession, output remains well below its pre-recession level.²

1.2 As a result, the government has already announced deeper spending cuts within the current spending review period (2011-12 to 2014-15) in order to meet its existing fiscal consolidation commitments, and it expects the consolidation programme to last significantly longer than originally expected.

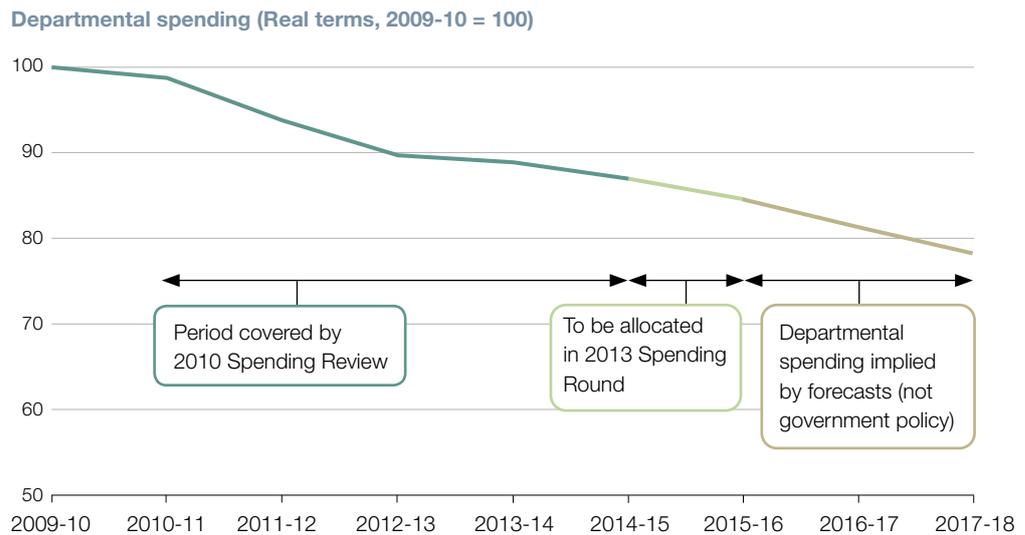
1.3 **Figure 1** overleaf sets out the Treasury's expected trajectory of departmental spending from 2009-10 to 2015-16. This shows that the government plans for departmental spending to reduce in real terms from £428.8 billion in 2009-10 to £362.6 billion in 2015-16, a reduction of 15.4 per cent. Departmental spending in 2015-16 will be allocated between departments in the 2013 Spending Round.

1.4 While departmental spending beyond 2015-16 has yet to be decided, the government has set out implied forecasts for 2016-17 and 2017-18, based on its overall assumptions about the continuation of fiscal consolidation and Office for Budget Responsibility forecasts for non-departmental spending. These forecasts imply that cuts in departmental spending will increase in the latter part of the period from 2009-10 to 2017-18. The reduction in departmental spending in the two years from 2015-16 to 2017-18 is forecast to be 3.8 per cent per year in real terms. This compares with an average 2.9 per cent reduction for the period between 2009-10 and 2013-14.

Figure 1

Forecast reduction in departmental spending, 2009-10 to 2017-18

Between 2009-10 and 2015-16, departmental spending is planned to reduce by 15.4 per cent



Departmental expenditure limits (2013-14 prices, £bn)	428.8	423.4	402.1	384.5	381.0	372.8	362.6	348.6	335.3
Year on year change (%)	-	-1.3	-5.0	-4.4	-0.9	-2.1	-2.8	-3.8	-3.8
Cumulative change (from 2009-10) (%)	-	-1.3	-6.2	-10.3	-11.1	-13.1	-15.4	-18.7	-21.8

NOTES

- 1 The chart and table are based on departmental expenditure limits, and therefore include departmental resource and capital spending, but do not include annually managed expenditure, for example pensions and benefits spending.
- 2 Data from 2009-10 to 2011-12 are outturn data. Data from 2012-13 to 2017-18 are forecasts. Figures for departmental spending in 2015-16 and beyond are based on forecasts published in Table 2.3 of the Treasury's March 2013 Budget. The data are not presented on an identical basis but represent the best available data covering the whole period.
- 3 Spending in 2012-13 was lower than originally planned, primarily due to unusually large departmental under-spends.

Source: National Audit Office analysis of HM Treasury data

Other pressures on public services

1.5 The financial situation is not the only pressure on public services. Demand for public services is expected to change substantially, with challenges including:

- **Providing services for a rapidly ageing population.** A recent inquiry by the House of Lords Select Committee on Public Service and Demographic Change cautioned about the preparedness of health and social care services to meet the additional expected demands from older people. Evidence received by the Committee forecast a greater than 50 per cent increase in the number of people with arthritis, coronary disease or strokes, and a more than 80 per cent increase in people with dementia expected, by 2030. The report also raised concerns about the sustainability of current arrangements for pensions and other benefits for older people.³
- **Providing school places and other services for increased numbers of children.** Our recent report on capital funding for new school places found that nearly a quarter of a million primary school places still need to be provided by 2014-15 to meet increased need, and that more than one-fifth of all schools were full or over-capacity in May 2012. The 22 per cent increase in live births between 2001 and 2011 referred to in the report can also be expected to place additional pressure on other children's services.⁴ There has already been a 13 per cent increase in the number of 'looked-after' children between 2008 and 2012.⁵

Opportunities to improve value for money

1.6 Although public services face a range of challenging financial and demand pressures, there is also a range of opportunities to provide services in different ways that can contribute to higher quality and reduced cost.

1.7 Smarter use of technology can be expected to lead to productivity gains and for many services to deliver more with less. Automating and streamlining processes can lead to significant savings for high-volume administrative services. The government's Digital Strategy estimates total potential savings of £1.7 billion to £1.8 billion from its 'digital by default' strategy, whereby a much greater proportion of services would be offered routinely through digital channels.⁶

1.8 We have found in recent reports that government recognises the potential benefits of early action and that different forms of integration offer potential value-for-money improvements (**Figure 2** overleaf). Early action involves preventative or other interventions that avoid the need to provide costlier services further down the line.⁷ We have also reported that there are substantial opportunities for services to be integrated, for example through Whole Place Community Budgets. This has the potential to both reduce costs and improve service effectiveness.⁸

Figure 2

Different forms of integration offer opportunities to improve value for money

Horizontal integration

Activities between organisations involved in a jointly delivered service or programme, or with a shared interest in a particular client group such as the elderly.

Vertical integration

Activities where there is a coordinated delivery chain for a service or programme, for example administration of student finance payments.

Back-office integration

Joint functions or management processes which support frontline services or programmes, for example shared services or procurement.

Strategic integration

Measures which encourage integration or apply a coordinated approach across government, for example cross-cutting mechanisms such as shared government-wide objectives, or central support for common functions such as recruitment.

Source: National Audit Office

1.9 However, government tends to operate in a silo-based way, which can lead to poorly coordinated services or programmes.⁹ In addition, key established processes do not incentivise departments to collaborate. For example, the overall budgetary system encourages departments to bid for funds based on their specific needs rather than promoting cross-government activities that do not fall exclusively within the remit of one department. The 2010 Spending Review drew on coordinated submissions in just three areas: strategic defence and security; overseas development; and local government.¹⁰

1.10 The government has also stated that the culture of the civil service can be cautious and slow-moving, and that this impedes government from acting quickly. It considers that there are too few incentives for civil servants to seek out and implement cost savings or service improvements. It is addressing the culture and behaviours of the civil service as part of its Civil Service Reform Plan.¹¹

Part Two

Progress on financial management

2.1 Financial management covers a broad range of skills and disciplines that are essential for a business or service to operate successfully. Among other things, effective financial management enables an organisation to:

- monitor and control planned expenditure;
- identify links between resources, outputs and outcomes to understand and improve value for money;
- manage risk effectively, to support innovation and mitigate service failure; and
- ensure that complex decisions on transforming service delivery are underpinned by robust financial analysis.

2.2 In the past, we have found that good financial management is not sufficiently embedded within the civil service, and that robust consideration of financial effects has not been at the heart of strategic decision-making.¹² Given the scale and breadth of the next phase of spending cuts and other pressures on public services, it is essential that finance profession leaders confront these challenges.

2.3 This part of the report acknowledges that government has made progress on financial management. The Finance Leadership Group has brought greater oversight and support to the finance profession, and has developed the Finance Transformation Programme to develop financial management presence, capability and processes. There have been improvements to significant financial management processes, such as the Clear Line of Sight initiative and the Whole of Government Accounts (WGA). Finally, while challenges remain, government has begun to confront some of the problems of poor management information.

Leadership of the finance profession

2.4 Finance has been given greater recognition at the most strategic level of government by being included in the Civil Service Reform Plan. The plan states that “financial management needs to be further strengthened and the finance functions in departments and agencies should be given greater authority. The Finance Transformation Programme has been set up to accomplish this.”¹³

2.5 In the past, finance professionals have often been on the fringes of decision-making within Whitehall.¹⁴ However, the finance profession now has a greater senior presence in government, with qualified accountants occupying a range of senior posts. 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.

2.6 More widely, government policy is that finance directors should be professionally qualified, report to their permanent secretaries and be on their boards, participating in decision-making and the oversight and monitoring of departmental activity. Both the corporate governance code¹⁵ and *Managing Public Money*¹⁶ emphasise the importance of securing the engagement and influence of finance directors on strategic decision-making.

The Finance Leadership Group

2.7 The Finance Leadership Group, originally formed in early 2005 and established in its current form since May 2012, leads the Government Finance Profession and works to promote and strengthen financial management. The Group is chaired by the Head of the Government Finance Profession and its membership includes finance directors from the ten largest spending departments, and representation from the smaller departments.

The Finance Transformation Programme

2.8 The Finance Leadership Group oversees implementation of the Finance Transformation Programme, which was launched in January 2011. The programme comprises a range of initiatives that aim to achieve a fundamental shift in public sector culture so that it is more commercial, adaptable and innovative, with financial consideration at the heart of strategic decision-making. Its vision, published in November 2011, is set out in **Figure 3**.

2.9 The Finance Leadership Group is developing five initiatives, each one led by a departmental finance director general:

- value for money;
- finance profession talent management;
- financial and commercial awareness for non-finance professionals;
- the shared services agenda to deliver efficient, high-quality corporate service functions; and
- management information and financial reporting.

Figure 3

The government's vision for the Finance Transformation Programme

	Effective leadership	Cost-conscious culture	Professionalism	Expert central functions
People	Ministers, boards and senior civil servants demand the highest standards of financial management.	All staff understand they are responsible for cost-effective delivery – and are appropriately trained and incentivised.	Finance professionals have the range of skills and experience needed to support the business.	The centre aligns with finance departments to provide consistent and coherent messaging.
Process	Finance is an integral part of strategy and business planning.	Processes promote a value-for-money and continuous-improvement culture.	Finance processes are economic, efficient and effective.	Central processes support and incentivise good financial management.
Information and technology	Senior management has expertise to use and analyse information effectively.	Systems provide relevant and timely information that staff need to exercise their responsibilities.	Systems provide access to clear, consistent and well understood information.	The centre draws on information that is used by and useful to departments.
Structures	The finance director is a key member of the senior leadership team, positioned to influence all material business decisions.	Departments' internal structures and governance support and incentivise a cost-conscious and risk-aware culture.	The finance department is structured and resourced to provide the business with the support it needs.	There is clarity between the respective roles and responsibilities of the centre and departments.

Finance at the centre of decision-making*Source: HM Treasury*

2.10 Alongside these cross-government initiatives, the Treasury has also set a requirement for all departments to develop and report their own financial improvement plans.¹⁷ The plans should address challenges identified by the department and concerns raised by the Treasury that are specific to the department's own financial management.

2.11 Although it is too early to conclude whether the above initiatives have been successful, they focus on some of the important issues facing financial managers in government. It is therefore critical that they are implemented well, and with sufficient urgency, to ensure that positive progress continues.

Significant financial management processes

2.12 A number of ongoing initiatives to improve significant financial management processes are now included within the Finance Transformation Programme. These include the Clear Line of Sight initiative (which simplifies and aligns government's financial reporting to Parliament), the WGA, and Project OSCAR (a new financial accounting system to report the government's spending).

Clear Line of Sight

2.13 The government has brought greater alignment and coherence to its key financial data and the processes supporting the management of public finances as part of the Clear Line of Sight initiative. This has involved introducing greater consistency across the key financial processes for planning, authorising and reporting government expenditure. Prior to Clear Line of Sight, there were different frameworks for each of these processes, making it complex to understand, manage and scrutinise public spending. It was also burdensome and inefficient, with only two-thirds of government spending aligned across all frameworks, meaning that numerous reconciliations were needed.

2.14 The Clear Line of Sight initiative sought to address this challenge in three main ways:

- It has aligned budgets, estimates and accounts as far as practicable.
- The number of publication events has been reduced.
- The publication of the combined departmental report and accounts has been accelerated.

Whole of Government Accounts

2.15 The Treasury published the Whole of Government Accounts (WGA) for the first time in November 2011; this covered the 2009-10 financial year. The WGA offer an unprecedented overview of the financial position of the entire public sector, including what government owes, owns, spends and receives. They combine the financial position of some 1,500 public sector bodies to provide the most complete picture available of government finances.

2.16 The Treasury has published two sets of WGA, most recently in October 2012 for the 2010-11 financial year. In the second year of publication, there were improvements in how the WGA were presented, such as the inclusion of the Bank of England, greater consistency of approach to reporting between local and central government, and the addition of comparative data.

2.17 The WGA offer an opportunity for Parliament and the public to hold government to account for the money it spends and the activities it undertakes. In time, it has the potential to provide the Treasury with the means to identify key risks to the government's financial position and, with others, to act to mitigate those risks.

2.18 The Committee of Public Accounts has welcomed publication of the WGA as a step forward in improving transparency and accountability. Its report highlighted the significance of key public finance issues, such as the scale of the public service pensions liability, the present value of future Private Finance Initiative commitments and the value of unpaid taxes written-off by government. The Committee noted that the WGA offer the Treasury the potential to strengthen the management of public finances if they are used to identify factors influencing the government's financial position, including where it is most exposed, and if the Treasury uses the WGA to better anticipate risks.¹⁸

Project OSCAR

2.19 The government recognises that it needs good financial information to monitor departmental progress in reducing spending. Project OSCAR (Online System for Central Accounting and Reporting) is designed to provide a robust and user-friendly system to equip the Treasury with key management information and data for public reporting. It will replace the previous system, COINS (Combined Online Information System), which had reached the end of its expected life and required considerable manual intervention and significant maintenance costs. The new OSCAR system is expected to provide a range of benefits, including:

- improving data quality;
- reducing the need for alternative and ad hoc analysis;
- developing more efficient and effective processes to reduce reporting burdens; and
- enabling users to better understand the detail behind aggregate figures.

Developments in management information

2.20 The government is also attempting to improve management information to aid better financial decision-making. It has included important initiatives within its Civil Service Reform Plan, which outlines the urgency with which government needs to improve management information. It also makes an explicit link between the availability of high-quality information and its use in driving better decision-making. In the plan, the government states that "successful implementation of objectives depends on robust, timely and consistent management information. Informed decision making is impossible without meaningful management information, and the Civil Service urgently needs to produce much better management information to increase accountability and track progress, so that it is more robust, timely and consistent."¹⁹

2.21 The government has taken a number of initial steps to improve the provision of management information, but it acknowledges that there is still much to do. The Cabinet Office commissioned a review of management information: the July 2012 report stated that poor quality management information in government had been a recurrent theme over many years.²⁰ The report's suggestions for improvement included: strengthening and simplifying departmental Quarterly Data Summaries; setting rigorous, clear data standards; making each senior finance officer accountable for departmental management information; and introducing a data quality assurance regime.

2.22 The main focus at the centre of government has been on:

- developing and publishing departmental business plans;
- developing a template for consistent reporting of financial and performance data within departmental Quarterly Data Summaries; and
- improving financial and performance reporting to departmental boards, with stronger challenge from non-executive directors.

Departmental business plans

2.23 The Cabinet Office leads on developing and publishing departmental business plans. The plans set out: the priorities of each department; specific actions they will take in support of their objectives; milestones for when those actions are expected to take place; and a range of financial and performance indicators. The business plans are intended to serve as the basis on which the public and Parliament can hold departments to account for implementing the government's reform programme.

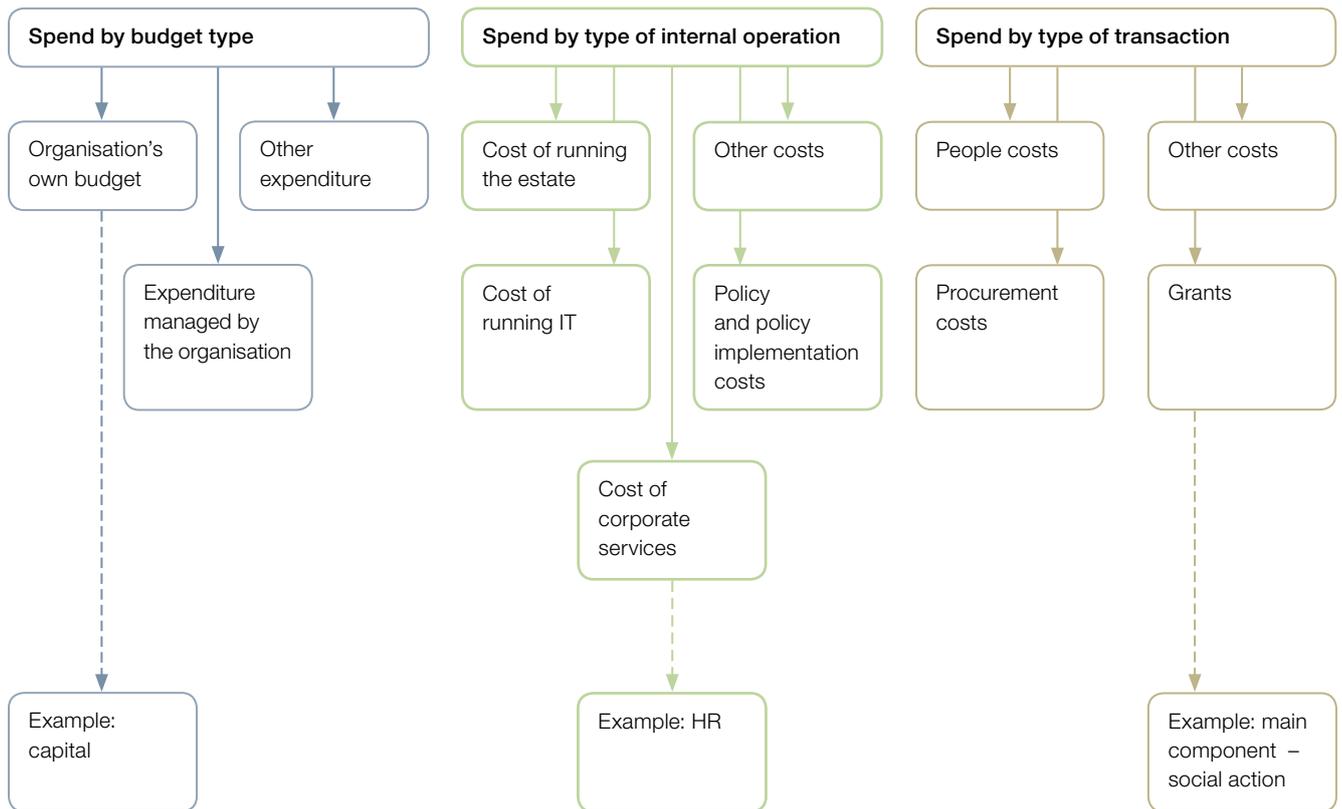
2.24 The Cabinet Office's Implementation Unit is also developing thinking about departmental performance reporting, although these arrangements have not yet been clarified. The business plans vary in their coverage and comprehensiveness, and do not always provide a clear alignment of inputs, outputs and outcomes so that value for money can be assessed.

Quarterly Data Summaries

2.25 Quarterly Data Summaries are a set of data designed to report how each department is spending its budget. The summaries are designed to make greater use of the management information currently held by government departments, and to make the information more consistent and accessible. The main types of information contained in the summaries are set out in **Figure 4**.

Figure 4
Information in departmental Quarterly Data Summaries

Quarterly Data Summaries set out information on spending across the different areas of a department's operations



Source: National Audit Office analysis of Quarterly Data Summaries

2.26 While the development of Quarterly Data Summaries is a positive step, the Finance Leadership Group and the Cabinet Office team recognise that implementing this requires a phased approach, and that it is still relatively early in the process. Their initial efforts have been on setting up the data systems and publishing data. They are now focusing on improving the quality of the data, and setting up automated processes to improve the efficiency of reporting. Currently, processes supporting production of Quarterly Data Summaries are not linked directly to OSCAR reporting (see paragraph 2.19).

2.27 The Finance Leadership Group and the Cabinet Office team consider that these improvements will support its objective that the Quarterly Data Summaries support and drive managerial decision-making. However, there are two key areas where further work on management information can be expected to lead to better strategic decision-making, in line with the government's objectives:

- **Scope:** The initial focus of Quarterly Data Summaries has been on management information for back-office services. They do not capture management information on the vast majority of departmental programme and administrative spending in a way that enables detailed scrutiny of financial and service performance.
- **Behavioural barriers to use:** The Finance Leadership Group and Cabinet Office team recognise that they need to address behavioural barriers to their use, and to consider capability and incentives. A recent Institute for Government report also noted the behavioural obstacles to improving management information more widely across government, including low levels of demand for good-quality information and a low priority given to continuous improvement in value for money.²¹

The role of departmental boards

2.28 In our last report on the government's financial management, we found that departmental management information was generally poor.²² We recommended that accounting officers worked with their boards and finance directors to improve the timeliness, clarity, quality and usefulness of financial management information. The government considered that our recommendations had been addressed through: a revised version of the corporate governance code in June 2011; new non-executive board members bringing more effective management techniques; and an aspiration for board reporting to highlight all essential performance data on a single page.²³

2.29 The government appointed 59 non-executive members to departmental boards to provide more effective support and challenge. Lord Browne of Madingley was appointed as the lead non-executive. His annual report covering the 2011-12 financial year identifies improvement in management information as being a key priority. It notes the improvement that non-executive members have observed in some departments, including the Ministry of Justice, the Department for Transport, and the Home Office. However, the report also challenges government to continuously improve its approach to management information. It notes that government could learn more from the corporate sector, carry out better benchmarking and improve its sharing of, and learning from, best practice.²⁴

2.30 The National Audit Office is currently reviewing specific aspects of information availability and use across government, including information on costing and forecasting, and will report on these later this year.

Part Three

Strategic challenges for financial management

3.1 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.²⁵ While there has been progress on the aspects of financial management described in Part Two, financial matters should be incorporated more effectively within strategic decision-making. Many strategies, business plans, and resource allocation and performance reporting frameworks do not link together clearly. Finance managers should support their organisations to confront a range of strategic challenges in the delivery of public services (**Figure 5** overleaf).

3.2 This part of the report considers the range of strategic challenges facing government as it introduces leading-edge financial management practices that will allow it to anticipate challenges and opportunities, and to optimise performance. The challenges include:

- successfully managing further **cost reduction**, given that the majority of spending cuts required still need to be realised;
- undertaking effective **strategic planning**, to align cost reduction with target operating models;
- clear **prioritisation** and allocation of resources, to avoid short-term and incremental decision-making;
- understanding how central government can support and monitor the successful delivery of savings by **local public services**;
- developing the **skills and capability** that finance professionals need in the context of fiscal consolidation and reform; and
- **developing a financial management mindset throughout the organisation**, so that all decisions are taken considering the financial effects.

Figure 5
Strategic challenges for financial management

Strategic challenge	From	To
Cost reduction	<p>Government generally managing within reduced spending limits, but the savings realised have differing degrees of sustainability.</p> <p>Limited understanding of the link between costs and public service outcomes.</p>	Sophisticated approach to deliver more sustainable cost reductions through business transformation.
Strategic planning	Competent finance function, but lacking a routine role in strategic decision-making.	Finance function at the centre of strategic decision-making, with a core role in developing and implementing target operating models to provide high-quality public services at permanently lower cost.
Prioritisation	<p>System designed to support spending control more effectively than optimising value for money.</p> <p>Incremental decision-making on the basis of poor information about trade-offs.</p>	Informed prioritisation of spending commitments, based on robust understanding of returns on investment in the form of public spending.
Local public services	<p>Local bodies absorbing cuts in central government funding through short-term efficiency savings with limited evidence of more sustainable, long-term approaches.</p> <p>Limited central government understanding of effects on local service provision.</p>	<p>Better understanding in central government about effects of decision-making on resource allocation.</p> <p>Improvements in management information and analytical capability in central government to provide robust assurance of system-wide value for money.</p>
Skills and capability	<p>Lack of skills in important areas of financial management, e.g. commercial skills.</p> <p>Limited data to form a government-wide view on progress of skills and capability.</p>	<p>Increasing emphasis on skills requirements in the longer term, based on a clear anticipated future state.</p> <p>Better management information to understand the presence of, or need for, particular skills and capabilities.</p>

Source: National Audit Office

Cost reduction

3.3 Departments and other public bodies have generally managed within the reduced spending limits announced following the 2010 election, 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.

3.4 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 a 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.²⁶ 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.²⁷

Strategic planning

3.5 A department's finance team does not only process payments, control spending and produce the annual accounts. A finance team should also be a strategic partner within the organisation, helping it to meet its objectives more effectively. This would include helping the organisation to: anticipate and respond to changing circumstances; deliver policies, programmes and projects on time, within budget and of the required quality; seek efficiencies and improve service provision; and have a sophisticated understanding of costs. Our reviews of financial management in departments, including interviews with senior staff, found that finance teams often play a fairly narrow role, and are not consistently central to a department's decision-making or strategic direction.

3.6 Effective planning is critical to the success of cost reduction strategies. An absence of planning prevents departments from optimising the link between resources and outcomes. In our February 2012 report on progress in cost reduction across government, 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 of the whole business.²⁸ Among our recommendations, we noted that departments would need a clear vision about how to provide services with significantly reduced resources, and a leadership commitment to that vision.

3.7 Given the scale of the financial and other pressures on public services, and the immediacy of the response needed, financial management should play a critical part 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, within the context of rapid and large-scale change. Transformation must take place in most parts of the public sector so that services can continue to operate sustainably and within limited budgets. Our work on financial management suggests that this support does not yet exist in all departments.

3.8 While some government bodies have drawn up target operating models, the process of developing them has demonstrated some of the challenges and complexities for which the finance profession should provide support:

- The UK Border Agency drew up a 2015 target operating model, but it lacked detail on exactly how case working processes and workforce resourcing would change, and therefore how such changes would be likely to affect costs and performance. Despite progress being slower on immigration case work than expected, the Agency reduced its staff levels more quickly than planned, with 2,100 full-time equivalent staff leaving during 2011-12. This resulted in a need to hire new staff to deal with spikes in demand.²⁹
- In our February 2013 report on progress on cost reduction in HM Revenue & Customs (HMRC), we found that the department is moving from making tactical efficiency savings and quick wins to a more strategic approach to managing its resources. We did, however, find that HMRC has some way to go in understanding interdependencies of its projects. It has identified the key projects which enable cost reduction activities and has identified and apportioned costs to its key, organisation-wide processes. While HMRC continues to strengthen its analysis, its understanding in these areas remains immature considering that it is halfway through the spending review period. HMRC is also uncertain about the impact of introducing Real Time Information and Universal Credit on customer contact, which may impact on its ability to make savings in personal tax administration.³⁰
- In our report on managing change in the defence workforce, we found that redundancy programmes were underway, but that the Ministry of Defence did not have a detailed plan for its overall change programme to transform how the department would work. Without real changes to ways of working, cutting headcount may result in the department either doing less with fewer people or trying to do the same with greater risk.³¹

3.9 Some government departments, such as the Home Office, have responded to our recommendations on improving the link between resources and performance.³² The Home Office is now better integrating the roles of the finance and operational planning teams to further embed finance in strategic planning.

Prioritisation

3.10 In an environment of limited resources, it is imperative that government is able to take an informed view when prioritising and allocating its resources. Where possible, it should also avoid short-term and incremental decision-making. However, our report on managing budgeting in government identified constraints on the government's ability to prioritise spending effectively:

- The design of the budgetary system addresses the Treasury's objective for prioritisation and value for money, but less effectively than the objective for spending control.
- The budgetary system lacks clear links to results and is insufficiently integrated with business planning.
- The data to inform decision-makers on optimal resource allocation was not readily available and in some places did not exist.
- Information on the value of resource spending was patchy and often hard to compare. While the Treasury made efforts to close information gaps during the review, departments' data provision and quality varied.
- Although the Treasury's exercise to compare and rank potential capital spending across government was a step forward, its approach to prioritising resource spending was less structured. The separation of the two exercises did not promote the consideration of links between the two areas of spending, hindering the overall prioritisation of resources.³³

Local public services

3.11 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. In local government, the majority of local authorities have not drawn on financial reserves to make up for the loss of income, but there is some evidence of services being reduced.³⁴

3.12 The Department of Health has reported that the NHS made £5.8 billion of savings in 2011-12. Most of the reported savings were generated through contractual levers applied by the department. To help support the delivery of savings, the department reduced the national prices (tariffs) that primary care trusts pay to NHS trusts and NHS foundation trusts for healthcare by 1.5 per cent (4 per cent in real terms). NHS staff were also subject to the government's two-year pay freeze for public sector workers from April 2011.³⁵

3.13 However, while local authorities and NHS trusts have made short-term efficiency savings, they are facing increasing difficulties in absorbing further cost reductions. We estimated in January 2013 that local authorities still need to find about half of the savings they need to make before March 2015. At the same time, demand is increasing and the scope to absorb cost pressures by reducing other services is decreased as authorities have already reduced spending on these services.³⁶ In the NHS, we found that service transformation is key to making future savings, but only limited action has been taken so far. Opportunities to make further savings include integrating care and expanding community-based care, but there is no evidence of a shift in staff from the acute to the community sector.³⁷

3.14 The successful delivery of financial savings, while maintaining service delivery, requires financial management capability in local public bodies. However, 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. This may not mean requiring more information, but understanding what information is fit for purpose.

Skills and capability

3.15 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 reported that government lacks some of the skills required for successful financial management. In 2013, for example, our report on the *Civil Service Reform Plan* noted the lack of commercial and commissioning skills: these skills will be needed as government plans to commission more services from private and third sector providers. The report noted that departments have often failed to consider the full range of business options for delivery, or omitted to pilot or test key assumptions. There has also been a lack of rigorous, data-led monitoring of performance to ensure that contractors are providing what they are being paid for.³⁸ The Finance Transformation Programme includes a work stream on finance and commercial awareness for non-finance professionals, to address these skills gaps.

3.16 The Finance Leadership Group believes that some finance staff need training so that they can add greater value, and it has set up a talent management work stream in response. This focuses on senior civil servant leadership development, talent management of finance staff in lower grades, departmental workshops on finance and professional training for graduate entrants. This approach is still in the development phase and it is too early to assess its effectiveness. The Treasury is also implementing initiatives to strengthen financial management and reporting within its public expenditure and control functions.

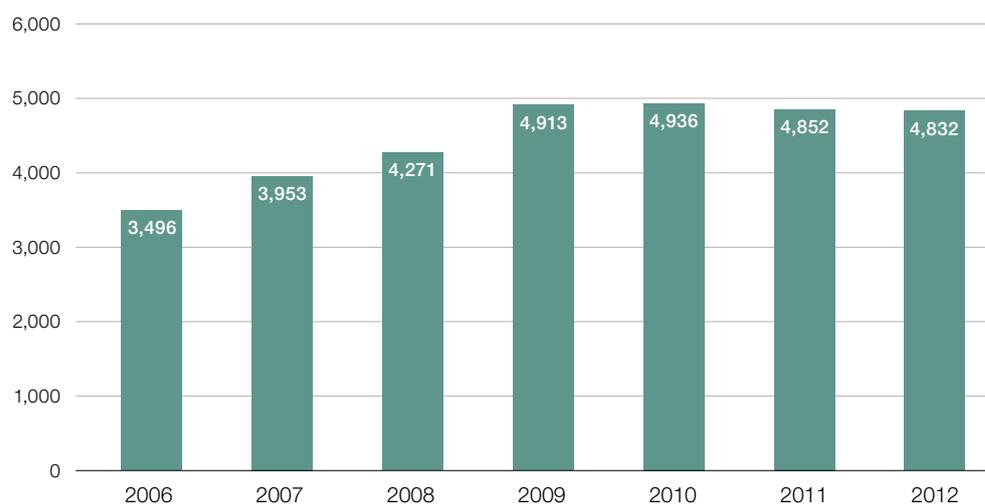
3.17 We found that the Finance Leadership Group has limited information it can use to assess how much financial management skills have improved across government. The data held demonstrate that there has been a substantial increase since 2006 in the number of qualified finance staff in departments' finance functions (**Figure 6**). However, the data are limited. They do not record finance professionals' more specific skills, how these might be matched to departments' needs for specific capabilities, or the presence of qualified finance staff within other functions. The Finance Leadership Group should therefore improve the data that it has access to on skills and capabilities so that it can match skills to needs, and track progress over time more effectively.

Figure 6

Total qualified staff in the finance function, 2006 to 2012

There was a substantial increase in the number of qualified finance staff between 2006 and 2009, though the number has reduced since then

Number of staff



Source: Finance Leadership Group

Developing a financial management mindset throughout the organisation

3.18 The Treasury has required departments to develop financial improvement plans to strengthen and raise awareness of financial management across their organisation.³⁹ Our analysis of these plans found that they varied in style, content and quality, and were often insufficiently well developed. Some plans, however, acknowledged the importance of leadership, clarity of purpose and promoting financial skills for all staff. The Department for International Development's plan, for example, is written as a personal address from the Permanent Secretary, to encourage a collective recognition of financial importance. The Department for Transport's plan sets out the links between financial improvement and the departmental strategy. It clearly articulates the impact for all staff on the front line.

3.19 Senior leaders outside finance teams need to champion the importance of financial management. This is reflected in the requirement for all senior civil servants to have at least one financial or efficiency measure in their performance objectives from 2012 onwards.

Appendix One

Our audit approach

1 This report examines how far finance is at the heart of decision-making in government. It also considers the important role of financial management and the pressing need for improvement across central government in the face of current and future challenges. We assessed:

- the need for good financial management;
- whether financial management is integrated into departments' business and culture;
- whether financial management is joined up across government; and
- how far initiatives to improve financial management across government focus on the right issues and are working.

2 Our audit approach is summarised in **Figure 7** overleaf. Our evidence base is described in Appendix Two.

Figure 7

Our audit approach

The objective of government

In the face of challenging economic conditions, the government has committed to improve financial management and bring finance to the heart of decision-making. *Managing taxpayers' money wisely*, published in January 2011, set out the Treasury's intention to change how public money is managed.

How this will be achieved

The Finance Transformation Programme was launched to address the areas identified for improvement. Success will require a fundamental shift in public sector culture. Individual departments are addressing their specific financial management challenges through their own change programmes.

Our study

This report examines how far finance is at the heart of decision-making in government. It also considers the important role of financial management and the pressing need for improvement across central government in the face of current and future challenges.

Our evaluative criteria

Departments require good financial management.

Financial management is integrated into departments' business and culture.

Initiatives for improvement are focused on the right issues and are working.

Financial management is joined up across government.

Our evidence
(see Appendix Two for details)

We assessed this by:

- reviewing central government documents;
- reviewing reports by industry experts, academics and think tanks; and
- analysing expenditure and forecast data to understand the current position and the scale of the challenges.

We assessed this by:

- analysing our departmental assessments;
- interviewing a selection of NAO client directors; and
- reviewing, summarising and collating the key findings from our past reports.

We assessed this by:

- interviewing the leads and working groups of the programme's work streams;
- analysing the programme's work stream documents and minutes;
- consulting the Finance Leadership Group, which is responsible for governance of the programme; and
- reviewing departmental financial improvement plans.

We assessed this by:

- interviewing director generals of finance and finance directors;
- reviewing third-party material on cross-government working; and
- reviewing, summarising and collating the key findings from our past reports.

Our conclusions

There are signs of improvement in financial management in government, and the strategic importance of the finance profession is receiving greater recognition. The scale of the challenge is stark, not least in ensuring public services are able to deliver sustainably in the context of further spending reductions and increased demand. Government needs to address the strategic challenges facing financial management quickly.

Appendix Two

Our evidence base

- 1 Our independent conclusions on financial management in government were reached following an analysis of evidence collected between August 2012 and March 2013.
- 2 We applied an analytical framework, with evaluative criteria that consider what arrangements are required for financial management in government. Our audit approach is outlined in Appendix One.
- 3 Our judgements about what represents good financial management are made primarily against the expectations summarised in **Figure 8**.

Figure 8

What is good financial management?

Our expectation of good financial management is set out in a maturity model

Attainment level	What we would expect to see: ¹
Enterprise	The organisation has leading-edge financial management practices that allow it to anticipate challenges and opportunities, to optimise performance.
Enhanced	The organisation has professional financial management practices to cope in challenging times and will identify some opportunities to improve performance.
Core competence	The organisation has adequate financial management practices to support and develop the business under stable circumstances, but these will not be sufficient in challenging times.
Basic	The organisation has basic financial management practices that allow it to function day-to-day but do not support the organisation to develop.
Inadequate	The organisation has some financial management practices but they are inadequate as there are many gaps that affect the day-to-day running of the organisation.

NOTE

¹ Assessments based on the framework in our financial management maturity model.

Source: National Audit Office

4 We assessed why good financial management is important.

- We **reviewed central government documents**, to assess the scale and urgency of the challenges it is facing. Source documentation included *Budget 2013*,⁴⁰ *Spending Review 2010*,⁴¹ *Autumn Statement 2012*⁴² and *Civil Service Reform Plan*.⁴³
- We **reviewed reports produced by industry experts, academics and think tanks** to draw together a range of views on the economic context and the challenges facing government.
- We **analysed government and third-party data** on central government's income, expenditure and spending reductions, to understand the government's current financial position and performance, and the size of the future financial challenge.

5 We assessed whether financial management was integrated into departments' business and culture.

- We **analysed our departmental assessments**, including results from assessments against our financial management maturity model, information maturity assessments and performance metrics. We summarised and collated findings to represent the common themes, challenges and strengths of financial management across government. The exercise also gave an indication of departmental financial management capability.
- We **reviewed financial management reports** to conclude on the level of financial management in departments. We reviewed those already published and those due for publication in spring 2013. This review demonstrated the capability and capacity of departmental finance functions.
- We **interviewed a selection of NAO client directors** to confirm what they saw as the main financial management challenges facing their department and to understand how their department was addressing the challenges in their business.
- We **interviewed director generals of finance in central government departments** as well as **directors from a private sector accountancy firm**, to understand how the perception of the finance function differs between the private and the public sector.
- We **analysed and compared departmental board performance packs**. This gave us an insight into the quality of information presented to departmental boards, from which decisions are taken for the governance of the department.

- We **interviewed non-executive directors** from a range of central government departments. This gave us an insight into the difference in attitudes between the private sector and the public sector towards the role of finance and finance teams. The interviews helped us to understand the functions of departmental boards, of the quality of information that they receive, and of their means of challenging information that is presented to them.
- We **reviewed governance statements** to further our understanding of the quality of top-level governance in central departments. These statements provided us with more detailed information about how departments are run, in terms of structure, management and risk.
- We **reviewed, summarised and collated the key findings** from the value-for-money reports published since our last report on financial management in government.⁴⁴ This enabled us to draw out the most prevalent issues and areas of strength in financial management across government. We identified case study examples of good and poor practice in financial management, which we used to illustrate key points in the report. This also included review of the key findings from our published cross-government work, which focused on specific areas of financial management, for example budgeting processes, cost reduction and shared services.

6 We assessed whether initiatives for improvement are focused on the right issues and whether they are working.

- We **reviewed departmental financial improvement plans** to assess the state of financial management and the adequacy of departmental attempts to improve it. We received plans and supporting documents from eight departments, but our ability to compare the plans was limited by the lack of a standardised approach to documentation and the varying maturity of the documents in each department.
- We **analysed Finance Transformation Programme documents and reviewed Finance Leadership Group meeting minutes** to gauge progress and sufficiency against the commitments in *Managing taxpayers' money wisely*⁴⁵ and recommendations from our previous study on financial management. Our fieldwork was organised around the programme's work streams:
 - Better value for money and efficiency in government spend.
 - Finance and commercial skills for non-finance professionals.
 - Cost-effective finance and shared services.
 - Improving management information.
 - Finance professionalism.
 - Demonstrating improvements to financial management – benchmarking and measurement.

- We **conducted semi-structured interviews with the leads and members of the working groups of each programme work stream** to assess the objectives, initiatives and progress made. We also attended the Government Finance Professionals conference in Brighton to understand the programme's activities.
- We **consulted the senior responsible owner for the programme and members of the Finance Leadership Group** to ensure that we were up to date with the latest governance arrangements, structure, timings and progress of the programme.
- 7 We assessed whether financial management was joined up across government.**
- We **held semi-structured interviews with director generals of finance and finance directors** to confirm what they see as the main financial management challenges facing departments and whether they think the programme is capable of addressing these challenges.
- We **triangulated our conclusions with relevant third-party material** to ensure consensus and consistency in assessing government financial management. We reviewed reports from a selection of accountancy bodies, larger accountancy firms and think tanks.
- We **undertook peer reviews** to test our analytical approaches and conclusions with independent experts.

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