



National Audit Office

Report

by the Comptroller
and Auditor General

**Department for Business, Innovation & Skills, Ministry of Justice,
Department for Environment, Food & Rural Affairs,
Department for Culture, Media & Sport and Cabinet Office**

Departments' oversight of arm's-length bodies: a comparative study

Key facts

£25bn

National Audit Office (NAO) estimate of the funding provided by the four departments to the 116 arm's-length bodies (ALBs) covered by this report, in 2014-15

144,000

NAO estimate of the number of staff employed by the 116 ALBs covered by this report, in 2014-15

9,200

staff employed in the four core departments in 2014-15

- 24** NAO qualifications of ALBs' accounts between 2010 and 2015 in the four departments covered by this report (40 across all departments)
- 355** public appointments, including reappointments, made by the four departments to ALBs in 2014-15
- 28%** percentage of ALBs that were partially clear or not clear about their department's objectives in relation to their organisation's area of work
- 80%** percentage of ALBs in our survey who reported that the current relationship with their department was very or moderately effective in helping them to deliver their objectives, compared to 69% 18 months ago
- 52%** percentage of ALBs reporting that oversight of their organisation has increased in the past 18 months

Summary

1 This report is about how departments oversee and manage the relationship with their arm's-length bodies (ALBs). ALB is a commonly used term covering a wide range of public bodies, including non-ministerial departments, non-departmental public bodies (NDPBs), executive agencies and other bodies, such as public corporations. The scale and role of ALBs vary hugely. ALBs range from large executive agencies, like HM Courts & Tribunals Service, to smaller non-departmental public bodies, such as the Gambling Commission.

2 There has been considerable debate about what is and what is not an ALB, and there is no single list of all the ALBs across government. Both the Office for National Statistics (ONS) and the Cabinet Office classify central government public bodies. The ONS determines how a body should be classified for the national accounts, including whether it sits in central government; the Cabinet Office further classifies central government bodies for administrative purposes. The Cabinet Office oversees the public bodies' landscape, and provides support and guidance to departments in relation to the creation, governance and oversight of ALBs. It also leads on the process for reviewing whether ALBs should continue to exist. Since 2010, the Cabinet Office has led the Public Bodies Reform Programme, which we have previously reported on. Through this it has successfully reduced the number of ALBs across government, bringing some services back into departments, and moving others outside of government. Our December 2015 report *Companies in government* identified that, since 2010, there has been an increase in the number of companies in government at the same time as a reduction in the number of public bodies.

3 In 2014, the Public Administration Select Committee (PASC) reviewed the state of accountability for arm's-length bodies. It found inconsistency, overlaps, confusion and clutter. Since 2015, the Cabinet Office has focused on streamlining and reforming the ALB landscape. It has reviewed the classification of arm's-length bodies, publishing recommendations in April 2016 together with new guidance on classifying ALBs. It has also expanded its triennial review programme which has focused previously on just one form of ALB, the non-departmental public body, but since February 2016, covers a broader range of bodies.

4 The Cabinet Office reported in *Public Bodies 2015* that there were more than 450 ALBs, (executive agencies, NDPBs and non-ministerial departments) spending a total of some £205 billion, (including NHS England but excluding HM Revenue & Customs and public corporations). Bodies that have been identified as ALBs typically meet at least one of the following three Cabinet Office tests: (i) they perform a technical function; (ii) their activities require political impartiality; or (iii) they need to act independently to establish facts.

5 Departments rely on ALBs to carry out a range of important functions, many of which are vital to delivering against departments' strategic objectives. ALBs often play a critical role in delivering services, regulating or inspecting others, and giving technical advice to and on behalf of departments. Nearly all departments oversee ALBs, and their specific roles mean they often need to operate with varying degrees of independence. But departmental accounting officers remain ultimately accountable to Parliament for the ALBs they oversee.

6 As a general observation, getting the best from ALBs means balancing assurance and control with an appropriate degree of independence consistent with an ALB's function, for example freedom to form impartial judgements and apply technical or operational expertise. This is, in itself, not an easy balance to strike. But there are other contextual pressures on departments, such as the need to reduce costs, which may encourage departments to make decisions that are based on factors other than balancing necessary independence and control. And if independence reduces too far, the benefits which ALBs are intended to bring might be restricted, and the very point of having an ALB compromised. Effective and proportionate oversight arrangements are therefore critical in enabling ALBs to deliver value for money.

Scope of the report

7 This report builds on our earlier work, and that of PASC, and others, on how to get the best from ALBs. It considers four departments that oversee large numbers of ALBs:

- Department for Business, Innovation & Skills (BIS);
- Ministry of Justice (MoJ);
- Department for Environment, Food & Rural Affairs (DEFRA); and
- Department for Culture, Media & Sport (DCMS).

8 These departments, including their ALBs, spent around £40 billion in 2014-15, with ALBs receiving funding of around £25 billion. We compared and contrasted how the four departments oversee their ALBs, drawing out comparative insights rather than comparing the departments directly on every aspect of their oversight. We also considered the role of the Cabinet Office in overseeing the public bodies landscape and providing advice and guidance to departments. We examine three areas critical to effective oversight of ALBs, namely:

- clarity about the purpose and accountabilities of ALBs;
- taking a proportionate approach to the oversight of ALBs; and
- maximising value from ALBs.

9 Our methodology included interviews with officials and non-executive directors from the four departments and 12 case study ALBs; focus groups with ALB staff; a survey of 116 ALBs overseen by the four departments; review of relevant documents and data; and interviews with the Cabinet Office.

Key findings

On being clear about purpose and accountabilities

10 There is no collective understanding of what type of oversight is appropriate and cost effective for different types of bodies. Interpretation of what an ALB is differs between the four departments and there is no single list of ALBs across government. The Cabinet Office's Public Bodies directory has been extended to cover a broader range of ALBs, but still excludes some public bodies. The prevailing confusion hampers a consistent approach to understanding what oversight approaches are most appropriate in different circumstances. The four departments have evolved their oversight arrangements in response to pressures such as increasing financial constraint, initiatives to improve transparency and wider public service reforms. While there have been gradual improvements in approach, a lack of data means there is limited understanding of the costs and benefits of the different approaches (paragraphs 1.2, 1.4, 2.3, 2.4 and 3.16).

11 Accountabilities, roles and responsibilities for ALBs are not always clear, risking confusion and tensions. Given the varying degrees of independence that different ALBs have, it is essential that both departments and ALBs are clear about who is responsible for what. Framework documents between departments and ALBs should clearly set out the terms of the relationship and be updated regularly. Nine of the framework documents for our 12 case study ALBs had been updated in the last three years, as suggested by HM Treasury and Cabinet Office. Only one had been updated in the past year, and two ALBs, Kew and the Environment Agency, did not have one. These two DEFRA ALBs had draft framework documents with supporting management statements and financial memoranda in place. The relationships between departments and ALBs were also not adequately described by accountability system statements, which we have previously recommended all departments should have to provide clarity to Parliament. Only DEFRA has an accountability system statement covering its ALBs (paragraphs 2.5 to 2.8).

12 The public appointments process is a time-consuming challenge for departments and ALBs, and delays create risks for the effective governance of ALBs. The power to appoint and remove board members of ALBs is a key lever in departments' oversight arrangements. But ALBs find the appointments process burdensome and lengthy. This creates a risk that capable individuals may be put off by the bureaucracy involved and increases the risks of vacancies impacting on ALBs decision-making. Departments are keenly aware that appointments present an issue for ALBs. Across the ALBs we surveyed, 44% reported that departments' day-to-day oversight of appointments had increased; this was 67% for DCMS ALBs. While decisions are ultimately made by ministers, with some appointments reviewed by the Prime Minister, the departments have taken steps to better coordinate appointments through central teams to help minimise delays (paragraphs 2.13 to 2.15).

On taking a proportionate approach to oversight

13 All four departments consider the scale of risk in overseeing their ALBs, though approaches vary, and the capability of ALBs to manage risks is not considered systematically. ALBs operate at a distance from departments and different types of ALB may present different risks. While most ALBs have their own governance arrangements, which can provide assurance, departments must make an informed judgement about the extent of oversight that is necessary. BIS, MoJ and DCMS all use a structured risk-based approach, informed by an overall assessment of risk in each of their ALBs, although they interpret and assess risk differently and don't systematically consider the capability of ALBs to manage those risks. DCMS takes a light-touch approach to oversight, placing less emphasis on process and more on developing relationships at a senior level. BIS is the only department that includes 'opportunities' as a category in its risk assessment, identifying where ALBs may have potential to have greater impact. DEFRA is developing its approach to oversight through its transformation programme, seeking to integrate DEFRA strategic risks with ALBs' operations (paragraphs 2.10, 2.12, 3.2 to 3.5 and 3.11).

14 Departments can undermine good relationships with ALBs by frequent, often duplicated, requests for information. Although 87% of the ALBs we surveyed felt the frequency of contact with departments was 'the right amount', 52% felt oversight had increased in the last 18 months. We heard concerns that departments often contacted ALBs to request information that was already held by the department, or available in published documents such as annual reports. Other common concerns included poor coordination between different parts of the department, a lack of clarity about why departments were requesting information or how it had been used, and departments not recognising the cost of responding to requests (paragraphs 3.8 and 3.9).

15 Increasingly, oversight is focused on financial and administrative issues rather than the quality of services delivered, which risks missing opportunities to deliver greater value. While an increased focus on financial oversight is understandable when budgets are pressured, this may mean oversight is not focused on the areas of greatest strategic risk to the ALB. This was particularly stark in MoJ following the introduction of emergency spending controls in October 2015. These have required ALBs to submit detailed weekly returns on spending, consuming significant senior management time and implying a lack of trust in existing ALB governance arrangements. By better balancing attention across other areas departments could be able to extract greater value from ALBs (paragraphs 3.14 and 3.15).

On maximising value

16 Departments are missing opportunities to exploit the skills and expertise that exist within ALBs. ALBs are often at the front line of delivering policy and therefore have deep expertise and understanding that could be exploited in both designing and implementing policy. Despite this, ALBs felt they were not sufficiently involved in policy discussions, though there were some exceptions. The considerable skills and experience of non-executive directors within ALBs are also not routinely exploited across ALBs and departments. Secondments between ALBs and departments are another way to help develop mutual understanding, but they are only used sporadically (paragraphs 4.4 to 4.6).

17 Many ALBs do not fully understand how their work aligns with departments' objectives, which risks limiting the contribution they can make. A quarter of surveyed ALBs were only partially clear what departments' objectives were relating to their area of work, and a further 3% were not clear. This was most pronounced in MoJ where 42% were partially or not clear. Recently published single departmental plans do not adequately reflect the contribution of ALBs to departmental objectives. BIS and DEFRA are currently undertaking transformation programmes: BIS is discussing the impact of this with its ALBs, while DEFRA is developing its programme in partnership with its ALBs. This may help to explain why all of DEFRA's ALBs considered they had been helped to understand the Department's strategic direction in the last 18 months, compared with only 53% of MoJ ALBs. Overall, 36% of ALBs surveyed wanted to better understand their department's strategic direction (paragraphs 2.9, 4.2 and 4.3).

18 While departments have established mechanisms to encourage collaboration across ALBs, these are still developing. All four departments bring together senior staff from ALBs to consider current issues. These meetings have focused mostly on departments giving information and encouraging networking, and views on their value were mixed. All four departments are seeking to make engagement more discussion-based, with more focus on sharing ideas and promoting collaboration. We also saw some good examples of departments encouraging collaboration on specific issues in a targeted way and DEFRA is building closer relationships with its ALBs as part of its transformation programme. While 64% of ALBs surveyed had been supported in sharing good practice and working collaboratively, 30% had not, and 47% wanted more support from departments in this area (paragraphs 4.8 to 4.11).

19 The Cabinet Office has more to do to develop greater coherence and consistency in the oversight of ALBs. It is welcome that the Cabinet Office has recently published guidance on the classification of ALBs and developed a new, more inclusive and strategic, programme of reviews of public bodies. Over time this has the potential to bring greater coherence and consistency to the ALB landscape. The Cabinet Office has developed a 'sponsorship specialism competency framework', supported by a training programme. It has also established a peer network of 'sponsors' across Whitehall to address the low profile of sponsorship skills in the civil service. But as our findings show, there are still areas where greater central support is needed to both identify and disseminate effective practice (paragraph 4.13).

Conclusion

20 The arm's-length body landscape remains confused and incoherent. There is no single list of all ALBs across government nor a common understanding of when ALBs should be used or what type of ALB is most appropriate for particular circumstances. Different departments define ALBs in different ways and some ALBs are uncertain about how they relate to their department's objectives. While the Cabinet Office is building on its Public Bodies Reform Programme and taking further steps to address this, the prevailing inconsistency hampers a coherent approach to overseeing ALBs that is consistent with their purpose.

21 Across the four departments, approaches to oversight of ALBs have evolved in response to internal and external pressures. All four departments use different approaches, but without a consistent overarching framework that draws on learning from departments' experience. While we are not arguing for a 'one size fits all' approach, it seems clear that the broad range of approaches cannot all be equally good at getting value from ALBs. The one consistent feature is the extent to which oversight is focusing on compliance and control, as opposed to achieving greater value from the relationship. There are, however, examples of departments adopting a more strategic approach through greater involvement of more senior staff and selective, targeted collaboration with and between ALBs. There is also a real appetite to learn and adapt approaches to oversight. The Cabinet Office needs to work collectively with departments to build on this momentum. It should take the lead in drawing together existing work, and identifying the most effective approaches and under what circumstances they can best be applied, to ensure oversight improves value for money.

Recommendations

22 Although our findings are based on an analysis of the oversight approaches used across four departments, they have wider relevance to all departments that oversee ALBs. Differing circumstances within individual departments and across ALBs precludes a one size fits all approach, but the Cabinet Office should:

- a** review the effectiveness of existing mechanisms for sharing good practice and developing capability in the oversight of ALBs; and
- b** work with departments to better understand the costs and benefits of different approaches, and develop and implement a guiding framework for effective oversight based on the following principles:
 - **clarity of purpose** and an appropriate form and structure to reflect that purpose;
 - **clear alignment of objectives** between single departmental plans, through framework documents and performance frameworks, to those of ALBs; these objectives should be central to oversight arrangements;

- **a balanced approach** that focuses effort on the wider risks to achieving departmental and ALB objectives as well as financial risk;
- **a proportionate and transparent approach** to oversight based on the role and purpose of the ALB, their contribution to departmental objectives, a thorough understanding of risk, and a consideration of the ALB's capability to manage this;
- **streamlined processes** that avoid overlap with ALBs' own governance arrangements, do not duplicate requests and recognise the costs of reporting arrangements for ALBs; and
- **maximise opportunities** to provide greater value by involving ALBs in policy development and operational decision-making where relevant, identifying where targeted support is most in demand and facilitating targeted links between ALBs to exploit their skills and knowledge, and leveraging the experience and expertise of non-executive directors.