HM Treasury

Strengthening financial management capability in government

June 2013

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Any enquiries regarding this publication should be sent to us at public.enquiries@hm-treasury.gov.uk.

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Foreword

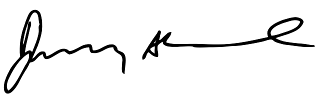
In this Spending Round we have made choices about the investment and reforms we want to pursue which build on the announcements made in Spending Review 2010. But creating robust, responsible and fair spending plans is only part of the challenge: government must now implement these plans, operating within reduced budgets, and ensuring that when we spend taxpayers' money day-to-day we secure value for money on their behalf.

To do this, we need a continual improvement in control over public spending and financial capability in government. This has been a priority for us since we took office in 2010. In April last year, I set out a new framework for spending control which emphasised the importance of financial discipline in managing budgets across government. As well as enforcing this new framework, we've taken action to improve the Government's knowledge of where money is spent and dramatically increased transparency. We want to see a cultural shift, and now, as we set out plans to 2015-16, is a good time to consider where we can step up the pace of that change.

I am clear, having considered reports from the National Audit Office and others on our progress, that what we most need is stronger, more effective leadership from the centre to support and strengthen the finance profession across Whitehall for the challenging period ahead. This is in line with our Civil Service reform plan and its call for stronger functional leadership in Whitehall.

We need to complement, rather than replace, the long-established accounting officer regime, where Parliament can call official heads of departments to account for the stewardship of resources under their control. However, within a system of delegated authorities and earned autonomy, there remains scope for us to modernise our approach and sharpen our game in government, learning from the operation of the best strategic central finance functions in the corporate world.

So today, the Chancellor and I are launching a review to help us to decide how to strengthen financial management further within central government. This document provides the backdrop for that review, setting out how the UK's system of spending control has evolved through time, the steps we've taken to strengthen it so far, and areas where we want to the review team to consider improvements.



Rt. Hon Danny Alexander MP

Chief Secretary to the Treasury

June 2013

1 Introduction

Context

1.1 High quality financial management is key to ensuring that the Government meets its spending plans and spends taxpayers' money as efficiently and effectively as possible within them.

1.2 HM Treasury, acting on behalf of Parliament, is the historic guardian of financial management in government and serves as the Government's central finance function. The Treasury allocates funds, creates and oversees the financial framework, controls and scrutinises spending, manages macroeconomic policy, and reports on the overall fiscal position and how money is spent.

1.3 Given the scope of government activity, the Treasury formally appoints and works alongside accounting officers – usually the heads of government departments – who provide a single point of accountability to Parliament for the stewardship of the resources placed within their control. They are responsible for ensuring their organisation meets specific standards, set out by the Treasury in *Managing Public Money*[1]. These accounting officers, supported by their finance directors, oversee the day-to-day delivery of value for money and probity in departments' spending, make sure they live within the budget allocations set by the Treasury, and produce resource accounts for Parliament and for taxpayers.

1.4 The Government has introduced a series of reforms to strengthen financial management across government. These include reforms to the budgeting and spending framework such as the introduction of Budget Exchange to reward good financial forecasting. There has also been a focus on improvements to spending control – the approach to monitoring, managing and providing oversight and scrutiny of public spending – such as tighter conditions for access to the Reserve, checking excessive spending at year end, the Finance Transformation Programme to improve financial capability in central government departments, and a strengthening of departmental boards. As part of this the Government has applied increased scrutiny to spending in discrete areas (e.g. marketing, consultancy, property and IT) via a system of new controls operated by the Efficiency and Reform Group in the Cabinet Office on behalf of the Treasury.

Strengthening financial management capability in government

1.5 As the Government sets out spending plans for 2015-16, now is a good time to consider how the Treasury, working with departments, can further improve financial standards, the quality of management information and wider financial capability for a period of continued spending restraint.

1.6 The Chancellor and Chief Secretary have therefore asked Richard Douglas, Head of the Government Finance Profession, and Sharon White, Director General, Public Spending at HM Treasury, to lead jointly a review on financial management in central government. The Chancellor has also asked Lord Sainsbury to act as external advisor to the review.

[1] Managing Public Money https://www.gov.uk/government/publications/managing-public-money

1.7 The review will build on recent improvements in spending control and financial management. It will particularly examine how the Treasury can, within existing budgets, and while preserving the single point of accountability to Parliament for financial stewardship that the accounting officer regime provides:

- Improve the quality and consistency of management information flows between the Treasury and departments to ensure these are of the right quality to enable effective risk-management and decision making across Government;
- Strengthen the role of the Head of the Government Finance Profession in promoting and assuring improved financial capability – skills, systems and processes – across government and the interaction of this role with the Treasury;
- Ensure that the right levels of delegated authorities and approvals are in place to ensure both tight spending control and appropriate flexibility for those departments with proven financial management capability;
- Create a more streamlined, coherent set of central appraisal and approval processes for projects and programmes outside those delegations.

1.8 The review will make recommendations about ways to achieve further improvements in these areas. It will report to the Chancellor and Chief Secretary by the end of the year.

1.9 This document looks at the evolution of the Treasury's role within the history of increasing public accountability for how taxpayers' money is spent; and sets out how the current framework operates, including recent developments. It provides the backdrop to the review.

2 Evolution of spending control

2.1 HM Treasury, acting on behalf of Parliament, is the guardian of financial standards in government and serves as the Government's central finance function.

2.2 The history of the Treasury's role in public spending is a story of increasing public accountability for spending taxpayers' money and the development over time of the Treasury's broader policy responsibilities as the UK's economic and finance ministry.

Spending approval begins

2.3 Prior to the 1660s all public spending was controlled by the Crown, with no significant internal controls. The defeat by the Dutch at the Battle of Medway was seen to be caused in part by poor financial controls. This led to the establishment of the Treasury Commission who authorised all petitions and money warrants – which had to be accompanied by an estimate of costs. This was an early form of business case approval, which finds its modern day equivalent in the requirement for Treasury ministers' approval for all significant expenditure (though most routine spending approvals are delegated to departments) and *The Green Book*[1] which the Treasury produces to guide departments on project appraisal. The establishment of the Treasury Commission was initially about the Crown getting a better grip over its own finances, but over time the Treasury Commission became increasingly accountable to Parliament for the prudent spending of taxpayers' money.

Parliamentary approval and oversight

2.4 The 1660s also marked the beginning of Parliamentary control over public spending, as areas of public spending – and the associated tax funding – had to be specifically authorised by Parliament. Initially this was for the costs of war, but over time Parliamentary authorisation of expenditure (or appropriation of supply) progressively increased to cover more areas of public spending.

2.5 The process of increased Parliamentary control was strengthened through the creation of the Consolidated Fund in 1787 which could only be used for spending specifically approved by Parliament. This was strengthened by the Concordat of 1932 in which the Treasury, on behalf of the Crown, agreed not to use contingency funding for expenditure with continuing costs. Acting on behalf of Parliament, the Treasury requires that all expenditure for significant or lasting public activities is specifically authorised in legislation. In addition, Parliament approves funding through an annual Estimates process year by year.

Accountability decentralised and sharpened

2.6 In the 1870s the principle of aligning accountability for policy and expenditure was introduced. The heads of government departments were made accounting officers, personally accountable for their department's spending to the Public Accounts Committee. This alignment of policy and financial responsibility was designed to improve the quality of administration and

[1] *The Green Book* https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

deliver better value for money. It became increasingly important as government activity became larger and more complex in scope. As Sir Warren Fisher, then Permanent Secretary to the Treasury and Head of the Home Civil Service put it in the 1920s "*it should not be open to any permanent head…to say 'please, sir, it wasn't me'…Pin it on him in the last resort and you have got him as an ally for economy"*[2].

Planning alongside control

2.7 The second half of the 20th century saw significant changes in the planning of public spending, in the context of increased calls on the resources of the state, international trends in macro-economic policymaking that emphasised active government management, and market demand for government data and reporting.

2.8 From the 1960s the Government started using multi-year budgets based on three to five year expenditure surveys. Following IMF intervention in 1976 this was strengthened by moving from surveys – which sought to budget in volume and inflation-adjusted spending power – to multi-year cash budgets.

2.9 The 1990s saw a deliberate move to a more strategic approach, where the Treasury agreed three-year budgets and let departments manage within their limits. From the late 1990s budgets were accompanied by extensive discussion on what priority outputs and outcomes departments would pursue with their funding allocation.

The Treasury's role established

2.10 The Treasury's role in public spending and financial control is now well established:

- To provide scrutiny and approvals, as the ultimate guardians of affordability and value for money in public spending, for which accounting officers are the day-to-day stewards.
- To ensure that funds provided by Parliament on behalf of taxpayers are used for their intended purposes. There is a long standing understanding that the Treasury looks after Parliament's interests in Government and sets the framework to ensure that money is only spent as Parliament intended.
- To allocate budgets between departments.
- To support macroeconomic policy, including making in-year adjustments. The Treasury's control of overall public spending allows it to adjust public spending in response to fiscal, economic or political events, in accordance with the macroeconomic policy framework of the Government of the day.
- To report to Parliament, the markets and the public on the overall fiscal position and on how public money is spent at a high level. The Treasury consolidates and publishes all the government's fiscal reporting into overall headline figures and a single set of consolidated accounts.

[2] https://www.gov.uk/government/speeches/speech-by-the-permanent-secretary-to-the-treasury-sir-nicholas-macpherson-the-origins-of-treasury-control

3 Current approach to spending control

3.1 The Government has introduced a series of reforms to strengthen financial management and raise standards across government within the operating framework of the Treasury's historic role in spending and financial control.

3.2 The key elements in the operation of the historic framework for spending and financial control are:

- Parliament delegates authority to the Treasury to lead on spending control policy, subject to obtaining Parliament's annual authority to spend money through the Estimates process;
- The Treasury allocates budgets to departments. The spending round sets budgets out to 2015/16;
- Spending allocations are reflected in the Estimates – an annual Parliamentary process of approval. They can be amended at subsequent fiscal events – i.e. the Budget and the Autumn Statement;
- In turn the Treasury delegates spending authority to departments, subject to limits based on the amount of spend on a particular project or programme, or whether it is novel or contentious, and requiring the Chief Secretary to approve pay remits;
- Accounting officers are formally accountable for the value for money and probity of their departments' spend, for producing the resource accounts and living within their budget allocations, based on the principle of keeping accountability where the spending decisions are taken. Beyond the controls described above, the Treasury does not seek to micromanage or second guess departments' spending decisions;
- The Treasury sets the standards which determine the criteria against which accounting officers take their decisions. These are set out in *Managing Public Money*[1], which is a public document.
- The Treasury works with departments to ensure that they manage spending within their allocated budgets and understand the macroeconomic context and outlook for public spending. Departments report monthly to the Treasury on their spending plans. They also undergo the major projects approval process for significant projects that fall outside their delegated authorities;
- Departments set out their priorities and the outputs they aim to deliver with their allocated budgets in their business plans and report progress against them;
- The National Audit Office audits departmental accounts and conducts value for money reviews on behalf of Parliament, to safeguard the interests of taxpayers;

[1] *Managing Public Money* https://www.gov.uk/government/publications/managing-public-money

- The Treasury holds back a modest reserve for significant unanticipated spending pressures, but departments may access it only after they have demonstrated they cannot manage those risks in part or in total by reallocating within their overall budgets, and only then with explicit Treasury approval;
- A Head of Finance Profession leads the Finance Leadership Group, and, through that group, helps drives up standards of financial management across government. The Head of Finance profession role is supported by, but currently separate from, the Treasury – instead filled by one of the network of departmental finance directors.
- The Public Accounts Committee holds individual accounting officers to account in Parliament.

3.3 Building on this foundation, the Government has reformed the budgeting framework to improve incentives to manage public money well; improved management information and financial control; sought to build financial management capability; and improved governance, scrutiny and transparency.

The budgeting framework

3.4 At Budget 2011, the Government announced that it was abolishing the End Year Flexibility system and replacing it with a new Budget Exchange system. The new system, introduced from 2011-12, provides flexibility for departments to deal with slippage in expenditure but does not lead to significant accumulation of liabilities to the Exchequer. The system also encourages more accurate forecasting, since access to the scheme is tied more closely to in-year forecasts.

3.5 The Government has also introduced tighter controls on Annually Managed Expenditure which sits outside Departments' fixed spending limits, including further steps announced as part of the spending round.

Improving spending control

3.6 The Treasury set out a new framework for spending control in *Improving spending control* (April 2012)[2] – the approach to monitoring, managing and providing oversight and scrutiny of public spending.

3.7 Departments, devolved administrations, and their arms length bodies are expected to monitor and manage information about spending effectively, including improving the skills needed, to help them deliver their spending plans. The degree of central Treasury control depends on a department's performance, with incentives to reward those with a record of good financial management.

3.8 As set out in *Improving spending control*, departments and devolved administrations must provide robust forecasts of full year spend, and a breakdown of monthly spend, every month from the beginning of the financial year, which reconciles with their internal management information. Accounting officers, supported by their departmental boards, are responsible for ensuring that the data provided to the Treasury is consistent with the information used internally.

3.9 To support the management of public spending, the Government introduced tighter control over access to the Reserve, and higher expectations for risk management and contingency planning. This has included asking all major departments to identify around five per cent of their

[2] *Improving spending control* https://www.gov.uk/government/publications/improving-spending-control

allocated Departmental Expenditure Limits that could be reprioritised if needed to fund unforeseen pressures in their area of responsibility and to discuss these plans with the Treasury.

3.10 There has also been a focus on reducing wasteful end-of-year spending. Budget 2013 set out how a strengthened cross-government effort to scrutinise end-of-year spending helped to address a long-standing trend of departmental spending rising in the final few months of the year in 2012-13.

Financial management capability

3.11 A key further part of support for improved management of public spending has been an emphasis on skills and capability. The Finance Transformation Programme is strengthening financial discipline and delivering a fundamental shift in public sector culture to become more commercial, adaptable and innovative – putting finance at the centre of decision making. This includes better leadership, professionalism, expertise, information, technology and structures. The Treasury has also required departments to produce financial management improvement plans.

Governance, scrutiny and oversight

3.12 The Government has strengthened departmental boards and applied increased scrutiny to spending in discrete areas. The Efficiency and Reform Group, using powers delegated by the Treasury, has implemented a tight set of controls on IT (over £5 million), property (over £100,000) and marketing and advertising (over £100,000).

3.13 The Efficiency and Reform Group also provides a cross government centre of expertise to focus on cross government efficiencies in areas such as procurement and shared services.

3.14 Further supporting this are a number of measures to increase transparency.

- The Clear Line of Sight project. This has improved transparency by aligning planning, control and accounting for public spending i.e. budgets, Parliamentary Estimates and accounts.
- Creating the first ever Whole of Government Accounts in 2011[3]. This provides a consolidated set of financial statements for the UK public sector, covering over 15,000 public bodies, showing the liabilities built up in the past and the financial pressures the Government faces in the future.
- Since June 2010 the Treasury has published the raw data from its public spending database. The new OSCAR database[4] provides departments' financial data to the Treasury in a systematic and consistent way; and provides Treasury and departments with a single version of the truth when discussing and taking decisions based on departmental spending data.

3.15 *Managing Public Money*, the manual for accounting officers, is also being refreshed in 2013. This sets out guidance on for handling public funds properly to improve effective control and value for money.

[3] https://www.gov.uk/government/publications/whole-of-government-accounts-2010-to-2011
[4] http://data.gov.uk/dataset/oscar

4 Next steps

4.1 Since 2010 the Government has focused on improving spending control through adjustments to the budgeting and spending framework, enhanced accountabilities for enabling effective monitoring of public spending and improving its management, a drive on financial capability and strengthened governance and oversight supported by increased transparency. All this has strengthened effective control.

4.2 The next stage is to examine how the Treasury, working with departments, can further improve financial standards, the quality of management information and wider financial capability, while retaining the single point of accountability that the accounting officer system provides for Parliament.

Improving financial standards

4.3 Much has been done to improve the robustness, relevance, consistency and timeliness of spending data to support effective monitoring of public spending by the centre of government. But this is a work in progress and will need to be stepped up to meet the challenges of the period ahead. This issue is highlighted in the Read Report[1].

4.4 In line with the Civil Service Reform plan we need to look at how we can go further, faster at improving financial capability – skills, processes, and systems – across government.

Improving financial controls

4.5 While increased transparency, accountability and scrutiny can strengthen value for money, they can also add rigidities and reduce value for money if they prevent the running of public bodies in the most efficient way. There is a balance to be struck and this requires continuous review. The Treasury's aim is for Government operations to meet private sector best practice in this respect.

4.6 The Treasury routinely reviews the framework of delegated authorities and approvals. A more root and branch review is now called for to ensure that tighter central constraints to promote efficiency, affordability and value for money are calibrated and applied to support efficient decision making and risk management, and that there is appropriate earned autonomy available to accounting officers who are managing departments with strong financial management.

4.7 There is currently wide variation in the level at which the Treasury requires projects to be approved. This tends to be correlated with the size of the department concerned rather than risk to the Government (delegated limits vary from the low millions for a small department to the hundreds of millions in others) and some ERG controls operate between £100,000 and £5 million for all Departments regardless of size. This also needs to be reviewed.

[1] Practical Steps to Improve Management Information in Government https://www.gov.uk/government/publications/improving-management-information-the-read-report

4.8 The Government also needs to ensure that the process for approving major projects and programmes which sit outside of these delegations can ensure effective control and assurance, without compromising accountability or effective decision-making.

Review of financial management

4.9 The Chancellor and Chief Secretary have asked Richard Douglas, Head of the Government Finance Profession, and Sharon White, Director General, Public Spending at the Treasury, to lead jointly a review on financial management in central government. Lord Sainsbury will act as external advisor to the review.

4.10 The review will particularly examine how the Treasury can, within existing budgets, and while preserving the single point of accountability to Parliament for financial stewardship that the accounting officer regime provides:

- Improve the quality and consistency of management information flows between the Treasury and departments to ensure these are of the right quality to enable effective risk-management and decision making across Government;
- Strengthen the role of the Head of the Government Finance Profession in promoting and assuring improved financial capability – skills, systems and processes – across government (considering also the interaction of this role with the Treasury);
- Ensure that the right levels of delegated authorities and approvals are in place to ensure both tight spending control and appropriate flexibility for those departments with proven financial management capability;
- Create a more streamlined, coherent set of central appraisal and approval processes for projects and programmes outside those delegations.

4.11 The review will make recommendations about ways to achieve further improvement in these areas. It will report to the Chancellor and Chief Secretary by the end of the year.

HM Treasury contacts

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If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

E-mail: public.enquiries@hm-treasury.gov.uk

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