



PRIME MINISTER

FINANCIAL MANAGEMENT

I sent you a note about the Treasury's proposed initiative on financial management on 5 March.

2. Since then my officials have held extensive consultations with the MPO, a selection of major departments and Sir Derek Rayner about the memorandum with which this initiative is to be launched. You asked to see the memorandum before issue, ... and I now attach a copy. It has Janet Young's full support.

3. To mark the close links between the improvement of financial management and the improvement of management more generally, the memorandum is presented by the Treasury and MPO jointly, and the MPO will be closely associated with the Treasury in carrying out the programme it proposes.

4. As the meeting planned for 27 April had to be cancelled, I hope that you will feel able to approve the memorandum without a meeting since it asks departments to undertake a major programme of work to a tight timetable, and the sooner they can get going, the better. If you would like to discuss co-ordination, we could of course still do so a little later on.

5. The programme will involve departments in a large effort. When carried through, it will also mean big changes in the way they manage their affairs and, probably, in both the form and the amount of the information that is published and presented to Parliament. It is therefore a major development, which Ministers in charge of departments should back and in which they should take an interest. I suggest therefore that it would give the initiative the best possible start if you

were to circulate the memorandum to all Cabinet colleagues
yourself and ask them to put their weight behind the work.
If you approve the memorandum and agree with this suggestion,
I will provide a draft covering minute for you to consider.

A copy of this minute and its enclosure goes to the Lord Privy
Seal, Sir Robert Armstrong and Sir Derek Rayner.

L.B.

LEON BRITTAN
28 April 1982

FINANCIAL MANAGEMENT

Note by the Treasury and MPO

Introduction

The time has come for a general and co-ordinated drive to improve financial management in Government departments.

2. This paper sets out the objectives, places them in the wider context of management and organisation, and invites the departments listed at Annex A to work up programmes of action and discuss them with the Treasury and MPO.

3. Programmes of action should build upon the work done recently in a number of individual departments, in several cases with help from consultants; and the further work already planned for 1982. Departmental reviews which have pointed the way include the major reviews of financial management in MAFF, the Department of Industry and the Ministry of Defence; the institution of the MINIS system in the DOE; the studies of a budgetary system for the control of administrative costs and of management responsibilities in the network of Social Security offices in DHSS; and the review of support services in R&D establishments in six departments. In 1982, reviews are planned of the arrangements for controlling running costs in the FCO, MPO, Department of Trade, Department of Employment, Department of Energy and DES; of resource control in certain executive operations in the Home Office, Scottish Office, Ministry of Defence, Department of Trade, PSA and the Royal Mint; and of personnel management practices in nine departments.

4. The need now is:

- to keep in focus the fundamental objectives;
- to sustain the impetus towards them, translating the recommendations of reviews into action fitted to the tasks and priorities of each department;
- to identify and take action on any changes needed in Service-wide arrangements or requirements of central departments;

- to help departments to draw on the lessons of each others' experience.

The Objective

5. The main objective is to promote in each department an organisation and a system in which managers at all levels have

(i) a clear view of their objectives; and assess and wherever possible measure outputs or performance in relation to these objectives;

(ii) well-defined responsibility for making the best use of their resources including a critical scrutiny of output and value for money;

(iii) the information (including particularly about costs), training and access to expert advice which they need to exercise their responsibilities effectively.

6. There are obstacles to the application of these principles in the public service. The yardstick of profitability is lacking. Many Government objectives are generalised, and the test of their success is often acceptability rather than a quantified measure of output. In some areas, final measures of output are elusive and only partial indicators of performance can be devised. The task of applying the principles will therefore take time, and complete success in every particular is not to be looked for. Nevertheless, the principles are fundamental to good management and the effective use of resources. They should be applied to the maximum practicable extent.

7. A manager is anybody who has to take managerial decisions, ie decisions about the deployment and use of money and staff. The lowest level at which such decisions are taken varies. In some policy divisions they may normally be taken at Principal or Assistant Secretary level; in some operational areas they may be taken by Higher Executive or even Executive Officers. But the principles set out above apply to all areas of a department's work, whether it is advice on policy, the execution of policy or a specialist or staff function.

8. Good management thus goes wider than the good systems of financial control and the information needed to support them, which are the primary subject of this memorandum. The achievement of the objective requires a managerial structure within which the system of financial management can operate effectively. It will be necessary to consider the implications of financial plans for the management and organisation of each department as a whole and for the allocation of responsibilities within it.

The contribution of management accounting

9. The development and use of management accounting, linked as appropriate to other information systems, can make a central contribution both to the managerial structure and to the management of resources within that structure. It is not the accounting system itself that is crucial, but the discipline of breaking down a department's activity between managers, whose responsibilities can thus be more clearly distinguished and objectives more clearly defined; whose costs and outputs can be more clearly assessed; and to whom greater authority can then be delegated to choose the best way of using the resources allocated to them in pursuit of the defined objectives. The process of setting up and using a management accounting system, if properly planned and carried through, imposes that discipline. A more detailed note on management accounting is at Annex B, and notes on a suggested approach to implementation at Annex C.

10. The wide variety of work in Government departments and the different kinds of expenditure they incur mean, however, that the approach adopted to pursue the objective in paragraph 5 - and in particular the extent to which a full management accounting system will be apposite - will differ from one area to another. For example:

(a) In some executive operations, like the running of prisons and R&D establishments or the support of the Armed Forces, where the resources are consumed directly by the Government, the costs of procedures and activities can be measured and indicators of performance or measures of output can in

principle be devised, the potential of the management accounting approach can and should be fully exploited. Comparisons between establishments, or between alternative means of securing an objective, should then help to improve decisions.

(b) Where the activity involves the procurement of goods and services from other agencies, eg in the building of roads or the procurement of defence equipment, the Treasury has issued fresh guidance in the last year or so both on public purchasing policy and on the use of investment appraisal. The tasks of specifying objectives, assessing alternative means of achieving them (in terms of quantity, quality, cost, time etc) and monitoring results against expenditure will be helped by the application of the management accounting approach and the better information it generates.

(c) In executive operations like the paying of benefits or the collection of taxes, the rates of taxes and benefits and the rules governing their application are laid down by statute and the final outputs are therefore largely outside the responsibility of the managers who administer them. But the principles of good management summarised above apply to the administration of benefits and taxes, and the information derived from that process should be used not only to control costs and improve efficiency but also to throw light on the effectiveness of the policy decisions made elsewhere in the department. Departmental systems should clarify the respective responsibilities of those who manage the operation and those who formulate the schemes and monitor their effectiveness, and provide the information needed by each.

(d) Where a department pays out grants to other agencies which themselves carry the direct responsibility for how the money is spent, the department will require an information system and the appropriate techniques (eg of investment appraisal) which enable it to make a good job of its responsibilities for the funds in question. The nature of the

system will vary with the department's relationship with the spending agency. In the case of local authorities, due regard must be paid to their independence and accountability to their own electorates. The department may want to encourage the use of management accounting in the bodies it finances (a good example is DHSS's concern with management accounting by health authorities), partly as a source of information to help both formulation of policies and priorities and monitoring; and partly to encourage efficiency in the spending agencies. As far as the department's own operations are concerned, its system will focus on the effectiveness and efficiency of the grant-paying process.

(e) Where the activity is to provide an internal service, eg finance, establishments, legal advice, Ministers' private offices, outputs are not generally measurable. The same is true of some, but not all, policy work. It is still right, however, that those in charge of them should know their costs and be given as much responsibility as possible for controlling them.

11. Each department should work out its own best pattern of managerial responsibility, financial accounting and control. But the following points apply generally and should be reflected in the plans of all departments:

(a) Each department should construct an outline plan of development which will in time cover the whole of its activities. The plan should ensure that the most urgent priorities are tackled first, and that constituent parts of the department's system, as they are constructed, will be compatible.

(b) In most cases it will be well to advance in planned stages. These may include pilot projects. In large departments with a wide variety of functions, the task of filling in the initial outline may take several years and may need modifying if functions and responsibilities are changed.

(c) The system should not only meet the needs of higher management for aggregated information for estimating and control, but should also provide managers at successive levels down the line with the information about their resources which, together with information about performance and outputs, will help them to do their job properly. Unless the system meets the second criterion as well as the first, managers will not use it and its accuracy will degenerate.

(d) The responsibilities of managers should be specified systematically for the control of the resources they consume and, wherever feasible, the results they achieve. Each department should therefore examine the scope for breaking its structure down into cost-centres or responsibility-centres to which resource costs can be allocated and for which, where appropriate, measures of output can be devised and monitored.

(e) Whatever the pattern of their other expenditures, all departments incur the costs of their own administration. All departmental plans should include a system for the budgeting and control of administrative costs. Where outputs are difficult to assess, the identification of costs will still pose questions of value for money.

(f) The management accounting system should be used within the department for the purposes of planning and control. If it is relegated to the status of an optional extra for the display of information only, again the information fed into it will not be accurate and the system will not be used. The Treasury will review with departments, as the need arises, how their management accounting systems and their existing systems for the public expenditure survey, estimates and appropriation accounts can best be related.

(g) The development of performance indicators and output measures which can be used to assess success in achieving objectives is no less important than the accurate attribution and monitoring of costs. The question to be addressed is "where is the money going and what are we getting for it?"

Systems should be devised to provide answers to both sides of the question wherever and to the extent that it is possible to do so. Relevant information on performance and (where possible) outputs will often be non-financial in character.

(h) Attention should be paid to the costs and cost-effectiveness of the proposed system. In principle, costs can be allocated in different ways: to units of the organisation, to programmes of activity, to objectives. Computerised systems make much elaboration possible, and some of it is necessary. Equally, they can be expensive. In general, therefore, systems should not be more elaborate than the objective essentially requires.

Constraints on Cash and Manpower

12. All activity must continue to be managed within the limit of the total resources allocated annually to each department, both cash and manpower. That discipline can only be maintained effectively if the managers to whom authority is delegated are also subject to it.

13. Good financial management requires, however, that the manager should be concerned with his total costs and not simply with his annual cash flow. Notional costs, such as the accruing liability for superannuation, are relevant to decisions which involve a choice between staff and other resources. In some areas the manager uses resources which include capital items like buildings and stocks acquired in the past, and these can be a major factor in the costs of his operation. Where this applies, the accounting system which provides the information to help him take decisions should be constructed accordingly.

14. Cash control, though essential, has to be complemented by systems and techniques that encourage intelligent reaction to changes in prices and enable departments to assess levels of service or outputs as well as total costs so that optimum use can be made of the cash and manpower available in each period.

Other Constraints

15. Centrally devised rules govern the form of Government accounts and the presentation of information to the Treasury and Parliament. The Treasury will be ready to review departments' needs (see para 11 f above) and where changes in the existing requirements seem desirable, will be ready to make proposals to Parliament accordingly.

16. Similarly, central rules govern the pay, grading and conditions of service of civil servants; many of them are the subject of negotiation and agreement with the Civil Service Trade Unions. Within departments those arrangements limit the extent to which the individual manager can change the pattern of his resources to provide an exact fit with what he perceives as the needs of his particular job from time to time. Such constraints are common in large organisations, both public and private. They will continue to be needed in the Civil Service. But departments are encouraged to make maximum use of the scope for delegation which those constraints allow, coupled with the development of a management information system by which the use of more delegated authority can be monitored. In addition, the Treasury and MPO will be ready to consider and consult about specific proposals from departments which are aimed at introducing greater flexibility in the civil service management régime and at improving the incentives for managers to manage well.

Techniques and Training

17. The main needs are:

- (a) to spread cost-consciousness and a wider readiness to identify and try to measure costs and results, and to act in the light of this information;
- (b) to develop and apply techniques of measuring and appraising which the relatively junior managers who take most decisions will recognise as sensible and will use;
- (c) to assemble and use the specialised skills relevant to the work of each department;

(d) to give senior managers sufficient understanding of the relevant disciplines to know when they need specialised advice, and to assess and use the advice given.

18. Action is in hand to increase the supply of qualified accountants, and to improve and expand training in financial management. Training in internal audit is being expanded. A finance course for senior administrators will be mounted in 1982. The Financial Management Co-ordination Group is about to review training in financial management as a whole and will shortly consult departments about further plans.

Action

19. In the light of this paper, and taking into account the work already done and in hand, the departments listed at Annex A are invited to develop and define a programme of work for the improvement of financial management, and to discuss their programmes with the Treasury and MPO before the end of January, 1983. For this purpose, departments should regard the relevant Treasury Expenditure Division as the central point of contact. Programmes should be divided into stages as appropriate, with target dates specified.

20. In drawing up their plans, departments are invited to consider:

(a) their arrangements for carrying this work forward, including the allocation of responsibility for first formulating and then carrying out the plan, terms of reference, the deployment of suitably qualified and experienced staff, and any external help they may require;

(b) how far their existing systems, and plans already in hand, will meet their requirements and the criteria set out in this paper; and the size and scope of what remains to be done;

(c) whether their existing organisation is compatible with an effective structure of responsibility for management - both of programmes executed outside the department and of departments' own operations; and what changes may be needed;

(d) the scope for developing cost and responsibility centres and the creation of budgets for their managers; what additional authority could be delegated to managers; what that implies for any changes in the respective responsibilities of line managers and of finance and establishments divisions; or in requirements now laid down by the Treasury and MPO;

(e) what parts of the department's activity, within the outline comprehensive plan, should have priority in the development of management accounting;

(f) what work is needed for the development of output measures, what areas should have priority and how those and other indicators of performance can best be built into the management system;

(g) how their management accounts, as they develop, can best be related to the Vote accounting system, and any implications for possible changes in the latter;

(h) the implications of their plans for staffing and training, both in finance work and in line management;

(i) whether computerised systems would be desirable and if so how best to obtain them economically, bearing in mind the large extent to which the same basic needs recur in individual departments;

(j) how the management information produced can be used to keep Parliament better informed about the progress of departmental programmes.

21. Departmental Trade Union Sides have a legitimate interest in the development of departmental systems. Departments will wish to discuss their plans as appropriate with their Trade Union Sides (see Annex C to paragraph 5078 of the Establishment Officers' Guide).

22. The Treasury and MPO will keep in touch with departments as their plans develop; inform themselves of the results of the work already in hand (see paragraph 3) with the aim that any general lessons that emerge are made known through the appropriate machinery; encourage the common use of computerised systems; and circulate any guidance as necessary on central requirements or service-wide issues generally.

23. In addition to the normal working contacts outlined in paragraph 22, departments may find it helpful to draw on help and advice in tackling the application of the principles in this paper to their particular circumstances. To this end, a small MPO/Treasury unit is being established, which will report to the joint Heads of the Civil Service. This will consist of up to 6 members (both civil servants mainly drawn from the divisions with the relevant experience and knowledge in MPO and Treasury and senior consultants) and will have a limited life (probably twelve months). It will mainly work in departments, responsible to and subject to the direction of the Permanent Secretary concerned, to help the senior management of the department, in the light of the experience of other departments and the private sector, how best to approach the task and to fit it into the wider context of the organisation and managerial effectiveness of the department as a whole. The unit will pay particular attention to considering with departments how implementation of change can be facilitated including changes flowing from recommendations of scrutinies, reviews and other studies already complete. The unit will also report on any opportunities or problems which it finds to be common to departments and on any changes in existing practices and rules which it believes would enlarge the opportunities or help to resolve the problems. This should help the Treasury and MPO not only to see how best they can contribute to the working out of departmental programmes but also in developing their approach to management and efficiency in the longer term.

AGRICULTURE, FISHERIES AND FOOD

Ministry of Agriculture, Fisheries and Food
Intervention Board for Agricultural Produce

CHANCELLOR OF THE EXCHEQUER

Treasury
Central Office of Information
Customs and Excise
Inland Revenue
Department for National Savings

DEFENCE

Ministry of Defence

EDUCATION AND SCIENCE

Department of Education and Science

EMPLOYMENT

Department of Employment
Manpower Services Commission
Health and Safety Commission/Executive

ENERGY

Department of Energy

ENVIRONMENT

Department of the Environment (including
Property Services Agency)
Ordnance Survey

FOREIGN AND COMMONWEALTH

Foreign and Commonwealth Office
Overseas Development Administration

HOME

Home Office

INDUSTRY

Department of Industry

LORD CHANCELLOR

Lord Chancellor's Department
Land Registry

LORD PRIVY SEAL

Management and Personnel Office

NORTHERN IRELAND

Northern Ireland Office

PAYMASTER GENERAL

Paymaster General's Office

SCOTLAND

Scottish Office (including DAFS, SDD, SED,
SEPD, SHHD)

SOCIAL SERVICES

Department of Health and Social Security
Office of Population Censuses and Surveys

TRADE

Department of Trade
Export Credits Guarantee Department

TRANSPORT

Department of Transport (including DVLC)

WALES

Welsh Office



28 APR 1982