

Annex C - 3rd PAC Report Financial Management in the FCO (Unaudited)

3rd PAC Report Financial Management in the Foreign and Commonwealth Office Progress against recommendations:

Recommendation 1: The Department has a history of significant under-spending in recent years, exposing a culture of weak financial stewardship, a lack of financial skills to monitor budgets effectively and a lack of trust in its financial information. It recognised the need to take action and set up its 'Five Star Finance' project with a series of targets and milestones to measure improvement. The Department has made significant progress in the last two years towards having reliable high level financial oversight of its business. Monthly produced Key Performance Reports now highlight variations in spending and enable FCO to take prompt action. The Committee notes the assurances made by FCO that following completion of the Project, all the processes and practices will then be embedded into 'business as usual' activities.

Progress: The FCO accepts in recent years there were underspends. Improved financial management has been established through the creation of a 'Five Star Finance' programme. It has introduced a raft of measures to improve processes and practices. The NAO will independently assess whether we have reached 4½ stars in the Autumn of 2010.

Recommendation 2: The Committee is pleased to note that the Department has acted upon previous recommendations made by our predecessors on this Committee and has recruited a qualified finance director to sit on the Board, which has had a number of positive impacts on the Department. The benefits include driving up skills, increasing the understanding across the organisation of the importance of good financial management, improving confidence in the numbers leading to better informed decisions, and the ability to manage budgets actively and produce better quality annual accounts on a more timely basis. The Department should increase further the level of qualified finance staff and monitor its progress in increasing financial awareness throughout the organisation, especially across its global network.

Progress: The FCO accepts and welcomes acknowledgement that through senior leadership it has acted on previous recommendations by recruiting a qualified Financial Director General onto the Board with positive impact. Financial skills have improved with a marked increase in qualified accountants, trainee accountants and widespread financial training within and outside the UK.

Recommendation 3: The Department has improved its financial management by allocating budgets before the start of the year, with budget holders reviewing costs allocated to them and challenging unfamiliar items. The Department should aim to move to the next level of good practice, where mispostings are rare and its staff becomes more confident in the financial forecasts they produce.

Progress: The FCO accepts and welcomes the Committee's recognition of its improved financial practices such as more timely budgets' allocation to allow sound resource planning and robust quarterly reviews to rebalance allocations. The FCO has introduced new financial Management Information tools in the UK and is extending them to the overseas network.

Recommendation 4: The Department has not yet made effective use of activity recording to ensure that its operations and policies are fully costed. Although the Department has made some progress, it should take further action to implement a workable and effective system of costing activity in all locations to enable it to make informed decisions about its operational priorities in a very tight fiscal situation. The Department should also benchmark costs and identify regional variations to help drive efficiency, and should make its charges to other government departments for the use of its facilities more transparent and understandable to help encourage joined-up working overseas.

Progress: The FCO accepts more progress needs to be made on effective use of activity recording and providing more visibility to PAGs on platform. The FCO is examining a more workable costing system that includes use of DSOs to make informed decisions about operational priorities in a tight fiscal environment. Improved MI data quality on management support costs on behalf of Partners Across Government (PAGs) will lead to a charging framework in line with Treasury guidance, as well as providing value for money to PAGs.

Recommendation 5: The Department has a history of poor forecasting of its expected spend and also of under-spending against its budget. After incurring a significant under-spend in 2007–08, the Department exerted better in-year control of spending in 2008–09, so that it spent within 1% of its budget for ‘controllable’ costs. Although the Department appears now to have a good level of financial discipline over the spending it controls within each financial year, it needs to improve the accuracy with which it forecasts expenditure which is harder to control, such as changes in the value of its estate. It should identify what practical actions it could take, such as moving forward the dates for valuation of fixed assets, so that appropriate provision for cost movements can be made in time for the Spring Supplementary Estimates.

Progress: The FCO accepts the Committee's conclusion that it had a prior record of underspending and welcomes the acknowledgement of the good levels of financial discipline it now exerts over spending. It agrees that greater accuracy and improvements in forecasts are still needed. The FCO's continual improvement of financial management is through the Five Star Programme. HMT's Clear Line of Sight programme will help align Parliamentary and HMT Control Totals in future. Predicting the impact of exchange rate movements will remain difficult.

Recommendation 6: The relative weakness of sterling in the last year or so against foreign currencies has significantly reduced the Department's purchasing power. The Department has had to re-prioritise expenditure and make further efficiency savings to stay within budget. In all, the Department is exposed to the effects of currency fluctuations against over 120 currencies, including the US dollar, euro and yen. This is not an issue peculiar to the Foreign and Commonwealth Office and, with input from the Treasury, it should work alongside other departments, such as the Ministry of Defence and Department for International Development, to identify the most effective way to manage exchange rate risk for the government as a whole.

Progress: The FCO accepts and welcomes the acknowledgement of difficulties faced managing the effect on purchasing power of currency movements from within its own resources in this CSR period. The FCO continues to work with HMT, and PAGs similarly affected to share best practises and identify possible solutions.

Recommendation 7: The Committee is of the opinion that historic residences, which are national assets, should not be sold off for money saving reasons and was pleased to note that the Department has no plans to do so. The Department confirmed that it was its standard practice to make best use of its assets, exploiting opportunities for commercial use of properties where available. The Committee welcomes the appointment of a professionally qualified Estates Director and looks forward to the forthcoming C&AG's report on the Department's Estates, which is expected to be published early in 2010.

Progress: The FCO accepts and welcomes the policy endorsement not to sell historic residences to make budget savings. The FCO continues to try and manage the estate according to best asset management practice.

Recommendation 8: The level of fraud uncovered at overseas posts has reduced to a relatively low level because of improvements made in the Department's financial management procedures and practices. The Department needs to continually test the adequacy of its processes for preventing and identifying fraud against its assessment of the risk, recognising that the types of fraud may change over time.

Progress: The FCO accepts the need to maintain a robust and effective control framework to mitigate against the risk of fraud. Improvements introduced in 2009 effectively manage the risk whilst maximising benefits for the Department and have reduced the levels of fraud.

Recommendation 9: The Department recognises that it has not always had a workforce that reflected the diversity of the population of the United Kingdom. It aims through its current recruitment policy to create a workforce which is representative of modern Britain and monitors the diversity of its staff by gender, ethnicity and disability. It should identify what other data it could gather to monitor the extent to which the social background of its employees is representative of the wider population.

Progress: The FCO accepts the importance of representing and reflecting the diversity of modern Britain. At present data is not held on employees' social background. The FCO is working with the Cabinet Office as they consider this question of monitoring this and other aspects of diversity.

Recommendation 10: Robust challenge provided by suitably experienced non-executive directors has made a positive difference to the Department's financial management capacity. The Department has valued the contribution that a financially qualified nonexecutive director can make and, importantly, has created a receptive environment. The Treasury should work with all departments in encouraging them to recruit nonexecutive directors with the right mix of skills to fit the needs of their business.

Progress: The FCO accepts that non-executive directors have made a positive difference to the Department's financial management capacity. Treasury agrees that it will continue to promote the practice more widely, including in a revised code of corporate governance in central government departments.

Recommendation 11: Government has not always learnt lessons systematically by disseminating examples of good practice on financial management across all government departments and agencies. As part of the 'Five Star Finance' project, the Department has demonstrated that it is keen to share good practice through the Director General Finance's membership of the cross-Government Finance Leadership Group, and by the Director of Finance's cross-Whitehall Business Improvement Group. Treasury should adopt a firm leadership role, identifying the key success factors of the Department's programme-based approach and disseminating this good practice across Whitehall.

Progress: The FCO welcomes the conclusion that it has demonstrated a willingness to pro-actively share best working practises in both the cross-Government Finance Leadership Group and the cross-Whitehall Business Improvement Group. The Treasury agrees with the conclusion it needs to adopt a firm leadership role across Whitehall and share best practice.

In addition, the FCO is preparing its response to the recommendations contained in the PAC's twenty fifth report: "Foreign and Commonwealth Office (FCO): Adapting the Foreign and Commonwealth Office's global estate to the modern world" for presentation before the Summer Recess.