

**SECTION 6: IMPROVING THE
MANAGEMENT OF FINANCE**

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6.1 Internal audit

Internal audit is responsible for the systematic and independent review and appraisal of accounting, financial and other management systems. In the U.K. there is no statutory obligation for government departments to maintain an internal audit service but failure to do so may lead to criticism by the Public Accounts Committee (PAC). The permanent head of a government department is personally accountable to Parliament, through the PAC, for resources for which he or she is the Accounting Officer. Internal audit is seen as an important ally and source of advice.

The context for change

The prime responsibility of internal audit is to assure the Accounting Officer that the various internal control systems within the department are operating satisfactorily. In order to give this assurance, reviews are carried out, using a system-based approach to audit. This means that internal audit reviews and appraises the accounting financial and other controls relevant to the system under review. Internal audit should evaluate the controls established by management to:

- achieve their objectives;
- ensure the economical and efficient use of resources;
- ensure compliance with established policies, procedures, laws and regulations;
- safeguard their assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption;
- ensure the integrity and reliability of information and data.

As well as forming an opinion on the adequacy, reliability and effectiveness of the controls in each systems audited, the Head of Internal Audit (HIA) consolidates the results of the year's audits into an annual report in which is expressed an opinion on the whole system of internal control.

Internal audit also needs to consider and comment on, from the audit standpoint, new projects at their planning and development stages.

The HIA maintains an analysis of the organisation's systems and associated risks. This assessment forms the basis for producing short-term and longer range plans.

All systems within the audit universe will be risk assessed, their frequency of audit determined and the audit resource requirements calculated. Some high risk systems may require annual review while low risk systems are reviewed over a longer cycle. Normally the HIA will maintain a rolling programme of audits for a three- to five-year period, updating it annually. The annual plan, being the first slice, identifies the immediate audits to be performed and any other required audit activity.

Implementing change

The development of Internal Audit in the U.K. Government in its present form began in the early 1980s. In its report of 1981, the PAC criticised the general standard of internal audit in government departments and charged the Treasury to ensure that standards were raised. PAC's main concerns were:

- the audit of computer-based systems was inadequate;
- a lack of professional skill and management within audit;
- inadequate personnel policies;
- inadequate direction from the centre.

As a result departments were required to meet specified requirements in respect of staffing and work programmes of internal audit.

Key stakeholders were the PAC, National Audit Office and Treasury which thought that improving financial management in government could be assisted by the establishment of an effective internal audit service. The support of senior management in all government departments was also needed.

Potential obstacles may include the need to overcome negative management attitudes to audit, seeing it as a policeman rather than as an aid to management, and, once this resistance is overcome, the need to convince management, often working with restricted resources, that the benefits of an effective internal audit service, which may not be easily quantifiable, outweigh the costs.

Improvement in internal audit has been achieved through the following:

- the introduction of Standards for internal audit as set down in the Government Internal Audit Manual (GIAM). This was first published in 1983, revised in 1988 and is currently under review with the aim of a revised version to be published in 1994/95;
- introduction of a comprehensive training programme for Internal Auditors, designed to meet the Basic Audit Training Standard which is set out in GIAM;

- a programme of reviews by Treasury's Internal Audit Development Division (IADD) to ensure compliance with Standards, to identify areas for improvement, and to disseminate best practice.

Standards: The Internal Audit Development Branch of the Accountancy Finance and Audit Division had the role of setting internal audit standards and monitoring progress. IADD was established as a separate division of the Treasury in 1985. It has eight audit and three support staff and a budget of £340,000.

Training: An effective internal audit unit requires a mix of skills, not only professional skills which can be developed through training, but also personal skills, particularly the ability to communicate orally and in writing with staff at all levels. A training programme of 18 weeks' (now reduced to 14) formal tuition in various internal audit-related subjects was established, in conjunction with the Civil Service College and a number of institutes of Higher Education. Formal exams at the end of the course, combined with practical experience certified by the Head of Internal Audit, lead to the award of the Basic Audit Training Standard. Staff are also encouraged to obtain a professional qualification in internal audit, such as Membership of the Institute of Internal Auditors. This has led to the professionalisation of the U.K. Government internal audit service. The cost of training an internal auditor is about £14,000 excluding salary costs. A number of additional training courses, for example, for senior audit managers, or for computer audit specialists, are also available and internal audit staff are encouraged to take appropriate training.

The initial costs depend on whether a training programme is already available which can be easily adapted to government needs or whether one needs to be developed from scratch. Thereafter, the bulk of the costs will be recurrent staffing costs. In the U.K. trained internal auditors were in great demand by the private sector and there was considerable loss of staff. Internal auditors here are therefore paid higher salaries than those for some comparable Civil Service grades in order to retain staff.

Reviews: Since 1988, IADD has conducted a series of reviews of selected aspects of internal audit activities; this marks a change from the previous policy which was to review all aspects of internal audit in specific departments. About a dozen departments are selected for each review which covers a particular aspect of internal audit or the standards. The aim is to identify weaknesses in approach as well as good examples from which other units can learn. Each department reviewed receives a letter containing any detailed observations and an overall report is copied to all Principal Finance Officers (PFOs).

After about three reviews (approximately a year) the process is completed by the Head of the Government Accountancy Service and Chief Accountancy Adviser to

the Treasury writing to Permanent Heads of Departments asking for confirmation that any necessary action has been taken. Examples of subjects have been reviewed are staffing, performance management, computer audit and fraud.

IADD is also a source of information and advice for internal audit units, organises two conferences a year on internal audit topics, and produces a quarterly magazine distributed to all government internal auditors.

Progress has been steady over the last ten years. In November 1987 the Tenth Report of the PAC was published. Its main conclusions were that:

- a) improvements had been made but many units were still not achieving the standards laid down;
- b) staffing shortages gave rise for concern about senior management's commitment to internal audit;
- c) the staffing position in computer audit was worrying.

The standard of internal audit was, however, much improved compared to the early 1980s, and much progress has been made since then. The overall conclusion from IADD's programme of reviews has been that IAUs are well ordered with appropriate planning and approach. There are fewer vacancies and the proportion of qualified staff has improved though there are still concerns about the shortage of staff skilled in computer audit. New guidance on Information Systems Audit (Computer Audit) has been prepared and will shortly be issued.

The development and structure of internal audit in departments is now being affected by the proposed extension of market-testing to specialist and professional skills. Some internal audit units have already been market-tested. IADD has a role in advising departments on tendering and the establishment of specifications for audit services.

As a result of development of agencies and the moves towards market-testing, it has been necessary to reconsider elements of the GIAM standards to indicate more clearly which parts are mandatory and which are guidance on practice; the current revision will also incorporate any changes identified as necessary as a result of IADD's programme of reviews.

Supporting material

- (i) The role of Internal Audit and the standards to which it works is set out in the Government Internal Audit Manual, available from HMSO. ISBN 0-11-560018-3, 1988, £13.00

- (ii) The Government Information Systems Audit Manual (GISAM) HMSO, ISBN 0-11-560051-5, 1993, £20.00

6.2 External auditing

Most external auditing of U.K. public bodies is carried out by the National Audit Office (NAO), although some bodies are audited by private sector firms. Local Authorities and Health Authorities are audited by the Audit Commission (England and Wales) and the Scottish Accounts Commission (Scotland). There is a separate Northern Ireland Audit Office auditing public bodies in the Province. In the U.K., public sector external auditors are independent of Government and work directly to the Commissions or, as in NAO's case, to Parliament.

The National Audit Office is wholly independent of the Executive and Judiciary. Its work is governed by three Acts of Parliament:

- the Exchequer and Audit Departments Act 1866;
- the Exchequer and Audit Departments Act 1921; and
- the National Audit Act 1983.

The NAO is headed by the Comptroller and Auditor General (C & AG) who is appointed by the Queen, on the advice of the Prime Minister and the Chairman of the Public Accounts Committee (PAC). The independence and tenure of the C & AG is assured since removal from Office is the prerogative by the Queen following an address by both Houses of Parliament. The position is not fixed term and the salary is paid directly from the Consolidated Fund without requiring the annual approval of the Executive or of Parliament. The C & AG alone decides on the extent and conduct of the audits and other examinations carried out and the content of the reports he makes to Parliament.

The NAO's primary role is to provide independent assurance, information and advice to Parliament on the accounts of government departments and a wide range of other public bodies, and on the economy, efficiency and effectiveness with which they use their resources. This is done by certifying annual accounts and publishing independent reports on the results of value for money examination. It provides a similar service to the governing bodies of many international organisations.

Under the 1983 Act the C & AG was empowered to appoint such staff and determine their rates of pay as the postholder considers necessary to discharge the functions of the office. In doing so, the C & AG is expected to take account of the general rates of pay applicable to the Civil Service.

The 1983 Act also provides the statutory basis for NAO's reports on the results of both audits of accounts and examinations of the economy, efficiency and effectiveness with which audited bodies use their resources. The NAO publishes

their value for money reports to meet their primary value for money aim of providing Parliament with independent assurance, information and advice on the use of major resources in departments and other audited bodies. They are written for the Parliamentary reader and for the public in general. The Act does not entitle NAO to question the merits of policy objectives.

National Audit Office reports are considered by the House of Commons Public Accounts Committee who have power to send for persons, papers and records and to make visits outside Parliament. It takes evidence in public from the Accounting Officer or Chief Executive of the department or body concerned. Other officials may attend and can also give evidence. C & AG and Treasury officials are also present. The PAC tends to concentrate on value for money reports. They make their own reports to the House, including appropriate recommendations for action by the government department concerned.

The Government's response to such recommendations is made in "Treasury Minutes" laid before the House. It is this process which gives real effect to findings in the C & AG reports. The Committee's work and the Government's response to it may also be debated by the whole House on one or two days a year. The NAO follow up recommendations made in Treasury Minutes and normally report to the PAC if there is a delay or lack of progress in implementing the recommendations.

NAO audits to standards which are consistent with best professional practice in the U.K. and international auditing environment. An audit follows a planned and thorough approach:

- gaining management awareness of the audited body's business and of its financial procedures;
- preparing an audit plan for approval at Directorate (i.e. partner) level;
- conducting audit tests and recording the results;
- management review of the audit results;
- audit completion, culminating in the Comptroller and Auditor General's opinion on the financial statements.

The context for change

In recent years, the U.K. Government has taken steps to improve the management of the massive resources devoted to running public services. One of the key aspects

of both the Financial Management Initiative and the Next Steps Programme has been the drive to set clear objectives for managers and to introduce systems to measure output and performance. The Citizen's Charter has highlighted the importance of quality, choice, standards and value in public sector services.

External auditors, whilst naturally independent of government, have provided material for reports to Parliament on the implementation of these initiatives by:

- Providing audit opinions and reports on the financial statements of the organisations. This material considers regularity, propriety and stewardship and ensures that both Treasury direction and generally accepted accounting practice have been followed in the preparation of the financial statements;
- Examining the economy, efficiency and effectiveness of the organisations. This will consider how the initiatives themselves have been implemented, as well as the value for money actually delivered by the service;
- Providing advice and guidance to new agencies on accounting systems and policies and technical issues. For example, NAO is very often asked to comment on draft accounts directions for new bodies.

The overall objective is to ensure that the financial statements which they audit provide users, principally Members of Parliament, with relevant and reliable information. This information must be supported to give assurances that monies voted by Parliament have been used as intended and that budgets have not been exceeded. The information must be adequate to help them judge whether resources have been used efficiently and effectively.

Implementing change

Legislation provides an external audit body with its remit; independence from the executive; a source of funds and arrangements for oversight. In the U.K. the 1983 Act established a Public Accounts Commission with three main functions in respect of NAO:

- to appoint an accounting officer;
- to appoint an auditor, and
- to examine expenses incurred.

NAO employs about 800 staff including both professional and support grades. It recruits graduate trainees who are then required to qualify with the professional accounting institutes in the United Kingdom.

Experience has shown that the skills necessary for a successful audit team are essentially the same as would be required for any successful business venture: qualified accountants, accounting technicians, statisticians and computer specialists, backed up by good quality administration staff, including personnel, finance and building services specialists. It is important that the balance is correct between the various grades and skill levels of staff and this is particularly so in relation to audit grades. It is also important that, to attract the highest calibre staff, pay rates are consistent with the private sector and there are promotion and career development prospects.

It is necessary to buy-in specialist assistance from time to time on short-term contracts. The NAO does this particularly on value for money audits, where a topic is so specialised that skills from other professions are needed in order to consider properly all the issues. Examples include pharmacists, engineers, retired military officers etc. However, the practice is not restricted solely to VFM audit. Specialist assistance is contracted in when auditing financial statements, for example, in relation to the audit of pension schemes or charities or with regard to taxation matters.

Key stakeholders, in addition to those listed, include the support of a Parliamentary body to whom the auditors report (i.e. the PAC) and who guarantee the auditors' status and rights of access to information. A second Parliamentary body, The Public Accounts Commission (TPAC), oversees their operations, approves their funding and their strategic plans.

6.3 Accruals-based accounting, assessing value for money, and introducing capital charging

Improving the efficiency, output and outcome performance of the public sector in the U.K. has been a high priority for the Government over the last decade. A number of public sector management initiatives have been introduced:

- Financial Management Initiative (FMI), launched in 1982. This marked the start of a general and co-ordinated drive to improve financial management in government departments. One of the key aims was to devolve responsibility for budgets and financial control to line management units and to individuals wherever possible, giving them clear objectives and full information to help their decisions.
- The Multi-Departmental Review of Budgeting (MDRB) which in 1986 focused on the need for top management to set priorities, manage resources and review performance and for achievements to be evaluated regularly.
- The Government Purchasing Initiative (GPI) which in 1984 aimed to develop professionalism in Government Purchasing and to set up a unit to improve value for money through best practice.
- The Next Steps Initiative (1988), whose aim is to deliver government services more efficiently and effectively and devolve executive functions of government to agencies. Chief Executives of Agencies are directly and personally responsible to Ministers for their performance.

This entry deals with three topics relevant to the drive for greater efficiency:

- i) the use of accruals-based accounting;
- ii) assessing value for money;
- iii) introducing capital charging.

Accruals-based accounting

In contrast to cash accounting, the accruals method records income (revenue) and expenditure (costs) as they are respectively earned and incurred, not as money is received and paid. For stewardship purposes, the transactions are brought together in an "income and expenditure account" covering the financial period. For example, a sale is recorded when a body has the right to demand payment from the customer, and a purchase is recorded when the liability to pay has arisen. In addition, the

cost (or current value) of fixed assets is charged against income as depreciation over the estimated useful lives of the assets.

The advantages of accruals accounting are:

- Easier to measure financial performance, e.g. the extent to which costs are recovered and the percentage return being earned on capital employed. Financial targets are normally set in these terms;
- Establishes the resources consumed in a period (not cash disbursed) and accordingly provides a means of setting efficiency targets and measuring the actual performance achieved.

Budgeting and financial reporting for the "core" (non-commercial) elements of the U.K. public sector have traditionally been on a cash basis. Parliament votes an annual grant to departments on the basis of estimated payments and receipts within a year. This is then compared with actual payments and receipts at the end of each year.

In commercial parts of the public sector, accrual accounts along private sector lines have been the norm. Several departments engaged in manufacturing and trading have prepared their accounts on this basis for many years. However, of the traditional areas of government, only the Executive Agencies launched in 1988 have been expected to prepare commercial-style accruals accounts. Consideration is currently being given to extending similar arrangements to government departments.

The context for change

Following the introduction of accruals-based accounting in Agencies, attention is now turning to the traditional departments, where accounts are still prepared on a cash basis. However, the requirements for efficiency in resource allocation and value for money in service provision are just as important as in Agencies. Whilst cash accounting is still essential for the purpose of controlling cash, it is not the best way of judging value for money. There is no mechanism for dealing with depreciation of capital assets, interest on capital or internal charges within the cash budgeting system. It is against this background that the U.K. Treasury is introducing a pilot study on accrual accounting in a number of departments. This will consider:

- whether the new system is demonstrably useful to departments in terms of allocating resources and improving value for money;
- whether the cost of introducing the new system is reasonable;

- whether it will provide information to Select Committees, MPs, academics and the public in terms of enhancing accountability.

Public sector reform in the U.K., involving reduced detailed controls over managers, greater flexibility in resource use, making managers more accountable for performance within a clear framework of objectives and resources, and the underlying pre-eminent objective of producing value for money in public services, have clearly demonstrated the need for additional, more robust indicators of financial performance than traditional cash-based accounting arrangements can provide. New accrual-based financial reporting is seen as an adjunct to traditional cash reporting (not a replacement for it), which will enhance the tools available to assess and reflect performance in value for money terms.

The introduction of delegated budgetary responsibility and executive agencies called for refinement of existing accounting arrangements and development of new financial management procedures. The traditional system excluded from managers' control a number of non-cash resource items (e.g. depreciation, cost of capital, debtors, creditors, stock balances, rents, superannuation etc.) which were considered relevant, to varying degrees, to achievement of the broader results-orientated goals set for managers under various reform initiatives. The focus, and assessment of performance, on the basis of value for money (VFM) criteria implied the need for financial management information which showed how total resources were applied and managed, in addition to information on cash payments and receipts.

The creation of Executive Agencies contains the main structural shift in recognition of the need for accruals-based data as a means for managers to plan, address and be accountable for, performance in value for money terms. It has also provided additional means for Parliament and users of public services more objectively to assess public sector performance.

The presumption is that accruals accounting will bring real benefits to Agency management. Assessment of the system will be a main feature in initial reviews of individual Agency framework documents.

Implementing change

U.K. experience suggests that the following are among the basic requirements or preconditions for successful introduction of accruals-based accounting:

- i) non-cash items to be brought into the cash accounting system, for example, opportunity cost rentals and superannuation;

- ii) supplementary accruals-based information to be produced – memorandum trading accounts and capital asset registers;
- iii) additional requirements calling for accrual-based, rather than cash-based, information need to be made as a result of market testing and for Executive Agencies.

There needs to be continuous involvement of professional accountants and senior management, and professional accountancy staff in the department need to be committed to the change. There is often difficulty in obtaining agreement to introduce accrual accounts from those whom the old system has served well.

Starting from scratch, the whole exercise is likely to take a minimum of two years. This could be shorter if elements of the required system are already in place, e.g. if the body has already been operating a chargeable service based on full cost recovery, using memorandum accounts; or longer if the body has a large number of outlets widely spaced across the country and supplies a large range of goods and services.

The typical steps or stages in implementing accruals accounting are as follows:

- i) set up a Steering Group and a Project Team with responsibility for the task;
- ii) recruit the necessary expertise, if not available in-house;
- iii) determine the data to be captured:
 - fixed assets and investments
 - raw materials, stocks and work in progress
 - debtors and creditors
 - pre-payments and accrued income
 - provisions
 - capital and reserves
 - turnover and other income
 - cost of sales
 - operating expenses;
- iv) determine the type and frequency of the management and financial information required;

- v) decide the accounting policies;
- vi) draw up a system specification and implementation plan, including the required go-live date;
- vii) select consultants, if necessary (likely to be needed, unless the in-house team is highly competent and has adequate resources);
- viii) select the hardware and software required to operate the system;
- ix) set up the necessary accounting code structure;
- x) install the selected system, and adapt as necessary (keeping adaptations to a minimum);
- xi) test run the system;
- xii) confirm, or amend, the date for live running.

In November 1993 the Chancellor of the Exchequer announced a decision in principle that government departments should introduce resource accounting systems based on commercial accounting principles similar to those already in place in Agencies and most other parts of the public sector. Detailed proposals were set out in a Green Paper on Resource Accounting and Budgeting, published in July 1994. The introduction of resource accounting will help departments to manage their current and capital resources more efficiently and effectively and to relate the cost of their inputs more closely to their objectives and outputs.

Assessing value for money (VFM)

This frequently arises in an auditing context (internal and external), but can equally receive priority within an organisation's normal management structure. Many U.K. Government organisations tackle it through:

- initial appraisal of capital projects;
- post-contract reviews of projects;
- special reviews of services, whole units of government, or programmes of expenditure.

The VFM dimension runs through U.K. structures in other ways. For instance, in the criteria used to decide whether it is better to provide something in-house or buy it from the wider marketplace. VFM requires a consideration of "life-cycle" costs, e.g. the ongoing cost of maintenance throughout the expected life of buildings and equipment.

Introducing capital charging

In the U.K. Government, this operates at two levels:

- i) The general externally imposed rule that departmental trading units and Agencies must include in their costs (on which their performance is partly based) interest on capital at a rate fixed by the Treasury. This is part of working to a "full economic cost" (FEC) base.
- ii) Within Agencies of central government and certainly within the National Health Service and latterly local government in the U.K., interest is normally charged within the management (internal) accounts to impress upon local managers the real costs of the assets they hold and thereby encourage efficient use of them.

Usually, the greatest difficulty arises in the initial stage of defining the assets utilised (capital and current) by each accountable unit within the organisation. Obviously, this is much easier if accrual accounting has been in operation for some time, in the establishment of reliable asset registers, generally computer-based.

Supporting material

Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government, HMSO, Cm 2626, £9.40

6.4 Estate management

This paper covers developments since 1983 in the management of the Civil Estate – as distinct from the Defence Estate or other Operational Estates (e.g. Prisons) – and explains the role of Property Holdings (PH) since 1990 as central manager of the Common User Estate (CUE). The aims of PH are:

- to work with other government departments in managing the CUE in such a way as to meet their accommodation requirements economically, effectively and efficiently;
- to recover from departments the full cost of their accommodation on the CUE and also to collect opportunity cost rents on the Departmental Estate (specialised properties managed directly by the departments occupying them); and
- in all aspects of its work, to act as an environmentally aware organisation.

Originally, the Government's Estate was managed centrally and accommodation was simply made available to departments as necessary. There were no arrangements for charging individual departments for the accommodation they occupied.

In 1983, the Property Repayment System (PRS) was introduced. At first this was a broad cost signal and then it was progressively refined (1984-88) and there was a gradual increase in the works delegation to occupying departments.

In 1990, the Civil Estate was divided. Property Holdings was then set up to manage the "Common User" estate, mainly general purpose offices comprising about 72 million square feet in approximately 3,000 properties, with the remaining 40% of the Government's former Civil Estate, mostly specialised and storage buildings like courts and laboratories, or buildings in remote locations, managed from then by individual occupying departments.

On the Common User Estate, departments became responsible and accountable for deciding the amount, location and quality of accommodation they required and then paying for it. Property Holdings were responsible for identifying and advising on the range of options and costs for meeting departments' office requirements. PH was responsible for managing the CUE portfolio as a common resource across departments, so as to be able to offer departments accommodation which represented best value for money. Departments are tied to using PH for specific services which are essential to PH's strategic management role which need to be carried out centrally.

The context for change

The Financial Management Initiative in 1982 resulted in managers having:

- clear objectives;
- resource budgets to implement;
- being subject to critical scrutiny of the output and value for money of resources employed.

Accommodation is one of the key resources employed, and with the emphasis placed on resource management, many departments sought more direct control over their accommodation.

With departments responsible for the cost of their own accommodation, stewardship of resources is likely to be more thorough and better value for money should be achieved.

Implementing change

The U.K. experience has shown that the basic requirements or pre-conditions for successful action in this field are charging, organisation and structure and liaison which is in turn dependent on departments being organised themselves to deal with accommodation matters.

The skills necessary to achieve these results include professional advice, accounting and general management and communication skills.

Key stakeholders, whose commitment is necessary for success are the Treasury, larger departments and parent department.

In the U.K.'s experience, the obstacles to achieving success are likely to be the capital programme, fluctuations in the market and sudden changes in requirements/unforeseen accommodation demands.

The Government announced in May 1988 that the Common User element of the Civil Estate was to be managed by Property Holdings, and specialised properties would become the responsibility of individual occupying departments. The division took effect from 1 April 1990.

6.5 Improving procurement and purchasing procedures

Procurement is the overall process of acquiring goods and services to meet customer needs. The procurement cycle begins when a need is identified, and ends when the required goods or services have been paid for. But the procurement process goes beyond the cycle to cover more strategic issues such as procurement strategy, storage, distribution/logistics and external resource (supplier) management. Procurement is synonymous with 'total supply chain management'. Purchasing is a subset of the procurement cycle and involves activities such as sourcing, negotiating and contracting for goods or services.

In January 1986, the Treasury's Central Unit on Purchasing (CUP) was created to take forward the Government Purchasing Initiative. CUP's role is to offer help and advice to central government departments and agencies on best purchasing practice and achieving better value for money (VFM) in purchasing and supply. It also monitors departments' progress in implementing the recommendations in the 1984 Report "Government Purchasing". Since 1986, its role has been extended to providing advice and guidance to departments on the commercial aspects of market testing activities and project management in the works/construction field. The Unit is staffed with a mix of civil servants and professional advisers on secondment from the private sector.

The context for change

The Central Unit on Purchasing was established to address a number of areas of concern, identified in the 1984 Report, for example:

- concern that the Government were not getting best value for money from its significant spend on goods and services;
- lack of professionalism among staff engaged in purchasing;
- inadequate training and career development programmes for purchasing staff;
- inadequate exposure to commercial experience and "state of the art" techniques;
- insufficient awareness of cost and time-saving techniques;
- inadequate information systems to support the development of purchasing strategy.

Both *market-testing* and *competitive tendering* are closely linked to procurement.

Market-testing is a management initiative which aims to ensure that services are delivered which provide best value for money for the taxpayer. The development of market testing programmes is essentially a management task, although there may be input from procurement professionals at the planning stage (for example, advice on conditions in the market and the availability of potential, external contractors to undertake the work – which may influence the choice of services to be tested).

To secure best value for money, *competitive tendering* exercises are run which ascertain the overall cost of either providing the service in-house, or contracting it out to a third party supplier. This process is essentially a procurement exercise. However, buying services is intrinsically more difficult than buying goods, and requires special skills in the staff involved. The keys to success are having a clear, performance-based specification of the services required, allowing potential suppliers to offer innovative solutions, and developing contracts which provide incentives for improved performance by the supplier.

Implementing change

Experience in the U.K. suggests that the essential pre-requisites for developing purchasing practice include the following:

Costs

- knowing how much is being spent, on which goods and services and with which suppliers;
- knowing who is spending the money within the organisation.

Skills

- equipping staff engaged in purchasing with the requisite skills through formal training and career development programmes.

Key stakeholders

- budget-holders: convincing them that purchasing is important and that value for money opportunities do exist.

Information

- essential for the development of purchasing strategy – to identify where the major opportunities exist;
- giving purchasing staff relevant up-to-date guidance on best practice and techniques;
- visibility – encouraging departments to set challenging targets for value for money improvement, monitoring progress and publishing performance.

CUP has an advisory role and does not prescribe to individual departments and agencies. Their progress has been variable across U.K. Government. But U.K. experience suggests the following broad timescales:

- publication of original proposals to establishing the Central Unit on Purchasing: one year;
- creating a professional cadre of purchasing staff with the requisite skills: at least five years;
- the development and implementation of integrated procurement systems: three to five years.

A recent study of the organisation of procurement has identified seven key success factors which characterise effective and successful procurement activity:

- i) a clear policy and strategy for developing procurement activity;
- ii) effective management information and control systems;
- iii) development of procurement expertise and its deployment;
- iv) a procurement role in corporate management;
- v) an entrepreneurial, pro-active approach towards its role in the organisation, working in partnership with users;
- vi) focus resources and efforts on those areas where they will be of most value;
- vii) central co-ordination of procurement activities to ensure sharing of expertise, efficiency and VFM, through aggregation of demand and rationalisation of products or suppliers.

This sets the basic agenda for CUP's future activities.

As part of the general drive to ensure that civil servants are equipped with the skills experience and capabilities they need, 45 per cent of purchasers in key government posts are currently working towards professional qualifications. The target is to have that increased to 75 per cent by 1996.

Supporting material

Government Purchasing, Progress Report to the Prime Minister, HMSO 1992, ISBN 0 11 560047 7, £22.00

6.6 End year flexibility

This entry covers both capital and running costs expenditure of central government. In principle, money voted for one specific year has had to be spent during that year. If it is not spent, it has traditionally been forfeited. The purpose of end year flexibility (EYF) is to avoid or minimise this restriction.

The context for change

The objectives of the end year flexibility scheme are:

- to avoid potential disruption arising from unavoidable slippage from one year to the next;
- to reduce surges of spending at the year end, which have poor value for money and are often wasteful.

Implementing change

In 1983, departments were allowed to carry forward into the next financial year any underspending on eligible *capital* expenditure. Departments are encouraged to delegate EYF carry over to individual line or project management level, to enable project managers to secure the proper management benefits from the scheme.

The scheme allows up to five per cent of cash-limited eligible provision (voted or non-voted) to be carried forward from one year to the next. But the rules ensure that capital underspend must first be used to cover any overspend on other parts of a cash limit. Rollover to a further year is possible, but the maximum entitlement in a year is limited to five per cent of the sum of the capital provision for the previous year and entitlement not taken up (or £2 million if greater).

Entitlements are announced by the Chief Secretary in an arranged Parliamentary Question each July on the basis of figures in the annual White Paper on the provisional out-turn for cash limits in the previous year. Parliamentary rules on annual authorisation for voted expenditure still apply, since in that case the money has to be re-voted in a Supplementary Estimate. Increases in provision resulting from the take-up of end year flexibility are charged to the Reserve.

The *running costs* scheme, introduced in 1988, is likewise intended to help departmental management and budgeting. It is available to departments operating under the gross running costs control regime who have:

- i) secured in the Survey a three-year settlement for their running costs provision, based on a satisfactory management plan. Nearly all major departments now have three-year survey settlements;
- ii) satisfied the Treasury that they can operate an EYF scheme on running costs in a way that will continue to improve efficiency.

Carry-over was originally limited to one half per cent of the year's final running cost limit but, following a recent review, the EYF for 1993-94 carry-over is now unlimited. As with the capital scheme, underspending must first be used to offset any excesses elsewhere on a Vote. The position on entitlements and take-up is similar to that for the capital scheme.

The carry-forward of underspends from one year to the next results in higher public expenditure than would otherwise have been the case if the carry-forward had remained an underspend. There is also the hidden cost of the uncertainty which carry-forward has on forecasting public expenditure. By the very nature of the scheme, the eligible underspends cannot be identified until the end of the financial year and their levels can vary substantially from year to year. There are also administrative costs associated with the schemes.

The key stakeholders are the project managers. One of the main objectives of the scheme is to avoid low-value end year spending. If a department centrally retained the EYF facility for overall cash management purposes, the incentive for individuals at project management level to avoid underspends would continue.