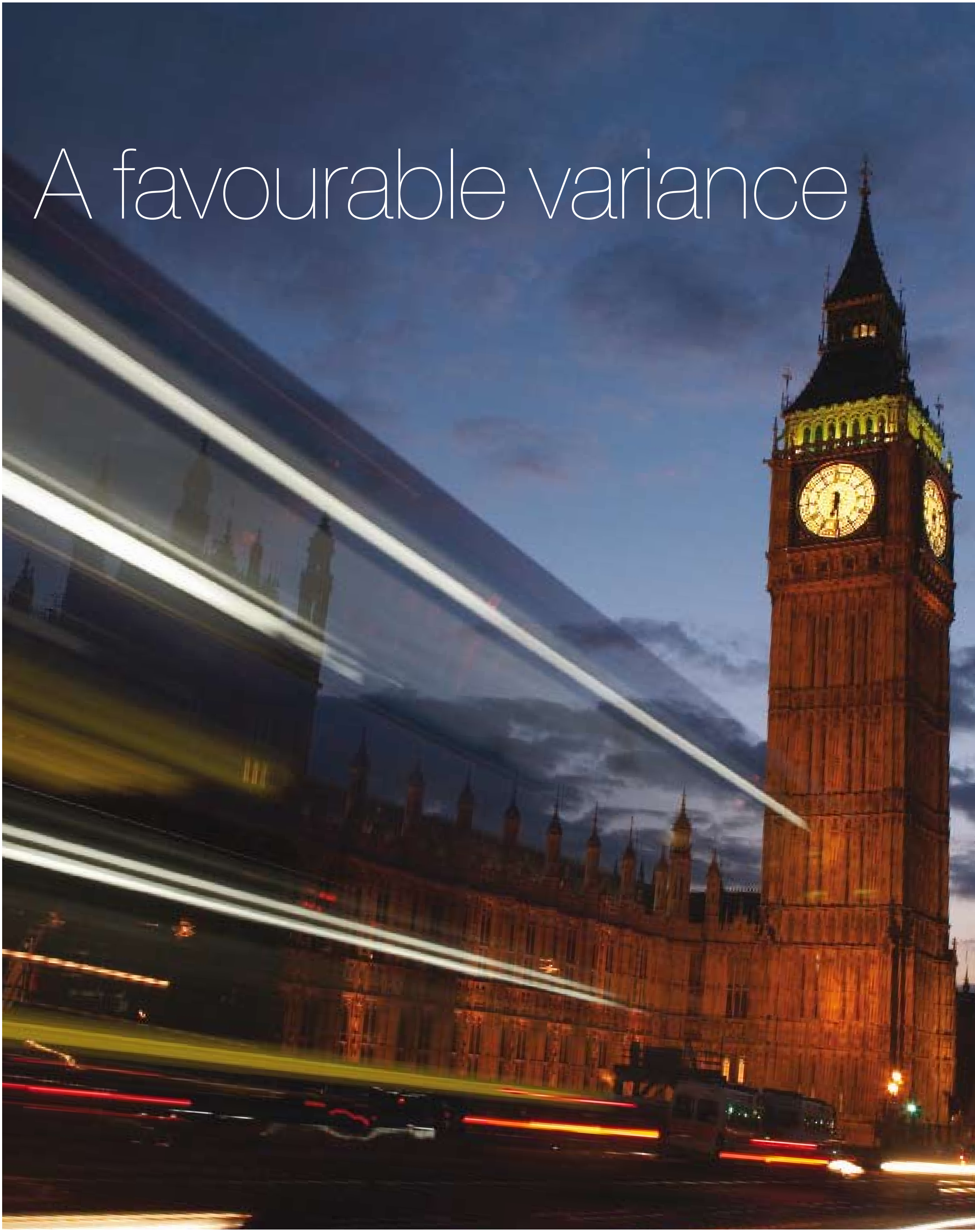
A favourable variance



CIMA's chief executive, **Charles Tilley**, recently addressed HM Treasury's advisers' conference in his capacity as chairman of its best-practice advisory panel on financial management. In the following edited extracts of his presentation he proposes a change of culture throughout Whitehall and explains how it can be achieved.

In his first, brief speech as prime minister on the steps of 10 Downing Street, Gordon Brown used the word "change" eight times. As ministerial appointments and departmental reorganisations ensued, structural change was certainly swift in coming. I hope that his arrival will also mean a change to how the government goes about its business. Because what doesn't change is the need for it to continue on its journey towards being better at using the public's taxes effectively and efficiently.

For this to occur, world-class financial and performance management has to be central to how the country is run. We must put "managing by numbers" and a focus on outcomes into the minds of everyone who works in government, not only those with a specific responsibility for finance. All this needs a change of culture and clear ownership from those leading it.

Under the comprehensive spending review, central government departments have been asked to find efficiency savings of three per cent year on year, releasing £26bn by 2010-11. To be sustainable, the efficiencies must result from reforms to improve performance. Cutting costs alone will not be enough.

The culture of government needs financial management – or, as I prefer to call it, performance management – at its heart. The purpose is to manage government departments effectively to achieve the outcomes (not outputs, which aren't the same thing) that are necessary.

Focusing on outcomes is not easy for any organisation. In business, developing strategy is relatively simple; delivering outcomes from that strategy is much harder. The same is true in government, but it's further complicated by the challenges of satisfying a huge number of stakeholders, securing adequate resources and, of course, dealing with the politics. In business, all actions are taken with a view to increasing shareholder value. For government, the ultimate goal is "a better Britain", although this is clearly harder to define.

Take the recent ban on smoking in public buildings as an example of the challenge of choosing and achieving the right outcomes. The intended outcome here is, of course, to improve the nation's health. But will that be the outcome and what other effects will the ban have? Before it took effect, I jokingly predicted that the country's pubs would install so many patio heaters as to accelerate global warming. On July 1, the first day of the ban, I visited a pub that had just constructed a new smoking room (it had only two walls, which meant that it wasn't a building according to the legislation). The area was packed with heaters! So we may end up healthier under this new law, but it seems that there will be an unintended adverse impact on the environment. From this simple case, it's clear that focusing on outcomes is a challenge and it also has significant implications for achieving effective accountability.

I must stress that a great deal is already happening in central government that's focused on performance management. It's also important to note that there have been successes in many areas. The scale of the work being undertaken is immense (*see panel 1, page 30*), but the role of the Treasury's financial management advisory panels, which were set up a year ago, has been to identify where there are opportunities for more to be done.

Three of these panels have considered specific training, governance and performance management requirements. Their activities have included a survey of training needs for people operating both inside and outside the finance function so far as "managing by numbers" is concerned; the development of a diagnostic tool to achieve a best-practice model in governance structures; and considering what overall performance management looks like in the round.

We on the best-practice panel have listened to a wide range of people immersed in, or directly involved with, central government. As a result of these discussions and research conducted by the Central Office of Information, we believe that we have a clear idea of what's required. The proposals that I'm making here are their messages. I will also be drawing comparisons with the

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PHOTOGRAPHY: GETTY IMAGES, NICK CUNARD

> “Why are qualified audit reports still accepted in the public sector? The accounts at the DWP have been qualified for 17 years”

private sector. This is not to say that the private sector is perfect or that it has all the answers – far from it. But it has focused on performance management and continuous improvement ever since business began.

The current state seems to be that finance is widely seen as a specialism, not a fundamental element of a government department. Return on investment is not at the forefront of people’s minds and, in many cases, departments see themselves as having a pot of money to spend, although even here there is a lack of clarity over what this pot represents. The goal should be to embed finance and performance management thinking so that it becomes a part of a culture that allows capital investment to thrive, creating value in the medium term. At the moment, cutting such investment is easy; it’s not a vote loser.

In the retail industry there used to be a “customer service desk” in every store. The rest of the staff stacked shelves, took cash and so on. Today there is a “welcome desk” in every store. That’s because all of the staff are now involved with customer service. The culture has changed. We need a culture change in central government that involves managing by numbers, but how are we going to achieve it? First, we need someone to take ownership of this culture-change project – someone who really wants the change and is committed enough to make it happen. In New Zealand, where the government made significant changes to its performance management culture and processes ten years ago, the project was driven by senior ministers with the publicly stated support of the opposition. Here in the UK, will such a culture change have the overt backing of Gordon Brown and be driven by the civil service board or Sir Gus O’Donnell, head of the home civil service? Does O’Donnell have the structure and framework to allow him to drive it effectively? As a minimum, he needs visible political support at the highest level.

The best-practice panel suggests that a successful culture change will require four broad elements:

- Transparency and a focus that’s linked to outcomes.
- Appropriate delivery structures akin to those in the private sector.
- Appropriate training for future permanent secretaries and their teams.
- A supportive, yet challenging, culture in government departments.

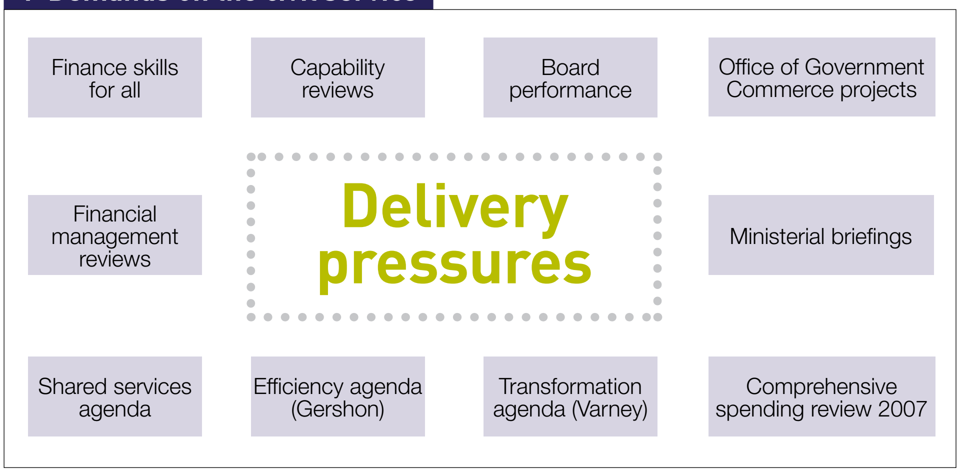
Why are qualified audit reports still accepted in the public sector? At the Department for Work and Pensions the accounts have been qualified for the past 17 years and even those at HM Revenue & Customs have been qualified for the past four years. There have been huge improvements, of course – there were only four qualifications last year – but in the private sector this would never be acceptable. If the accounts of Sainsbury’s were materially qualified, for example, there would be board changes and significant implications for the value and future of the company. I know that one large government department has set itself the objective of eliminating its audit qualification this year, which is a significant initiative.

The government has committed to IFRS, but why not also to international public-sector accounting standards? Is this to retain flexibility? Is such flexibility appropriate?

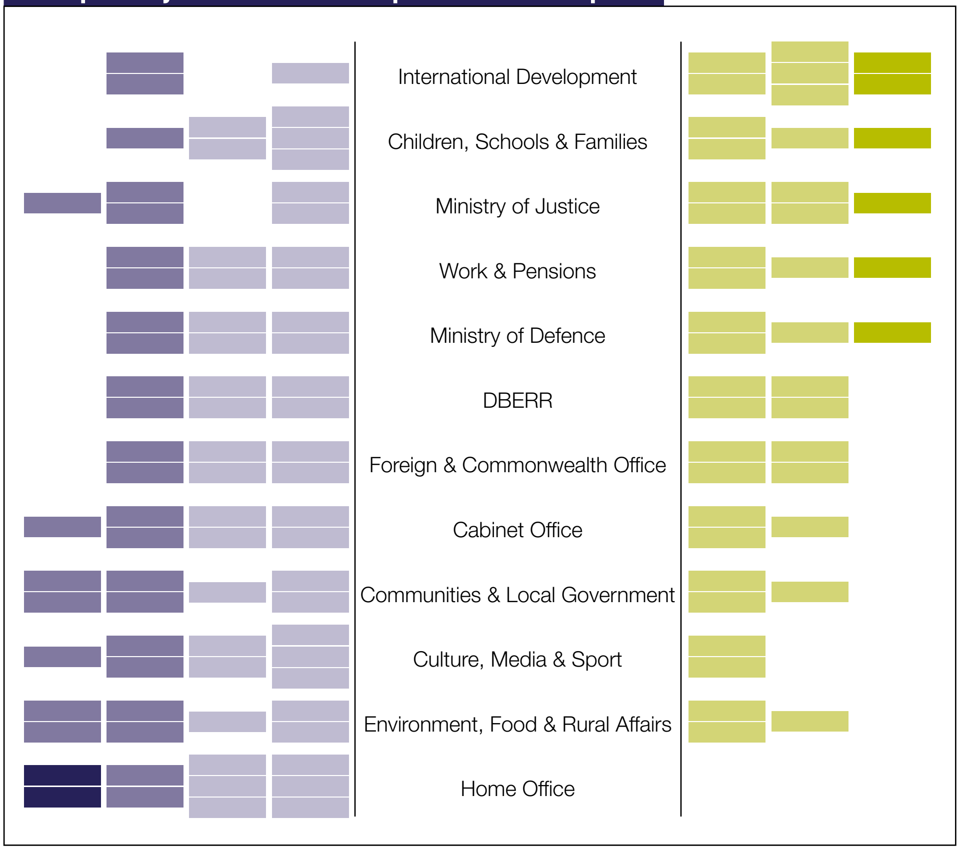
Transparency of reporting is a crucial area. It is important to ensure that an organisation is externally focused here. The operating and financial review (OFR) is a voluntary standard, but over half of the companies in the FTSE 100 still prepare such a document. The OFR talks about where an organisation is and where it’s planning to go. The external focus it encourages, along with a sophisticated debate with institutional shareholders, leads to a clear strategy and focused key performance indicators (KPIs) to achieve the desired outcomes.

According to research by Black Sun and London Business School, a significant majority of companies have seen real benefits in preparing OFRs. These include improved transparency, a stronger focus on risk

1 Demands on the civil service



2 Capability reviews: how departments compare



management, the development of more effective KPIs and the linking of external and internal management reporting. These truly excellent benefits are worth pursuing, despite the challenges of implementation.

In central government a similar report, the "management commentary", is required in resource accounts, but I suggest it does not contain the same level of disclosure and is not read with equal amounts of scrutiny. To achieve the benefits that I have referred to, it is crucial that we achieve substance over form.

Delivery structures are the second key factor in Whitehall's financial culture change. More than 97 per cent of government expenditure is incurred on the delivery of policy. Let's maximise the effectiveness of this expenditure by managing it through effective structures. This is happening in the National Health Service, where foundation trusts are subject to approval and ongoing oversight by their independent regulator, Monitor. In effect, a public-sector market has been established and those trusts that have entered this market have performed far better to date than those that haven't. This is because they have effective structures and boards and expertise to ensure that the services are delivered in accordance with best practice.

The third key factor is the role of permanent secretaries and their management teams, and how they interact with the government and Parliament. Most of any department's activities concern policy implementation. There is also, of course, the key role of developing policy and advising ministers. But are departments effectively structured to put both policy development and implementation together? The current capability reviews have found areas of strength, but also "urgent development areas" and "serious concerns" (*see panel 2, left*). So it seems appropriate that the career path and training of future permanent secretaries should cover both policy development and implementation. These two areas need to be linked.

The fourth and probably most difficult issue concerns the management team's relationship with Parliament. There are some significant differences from the private sector here. Company boards hire chief executives and then challenge and monitor them in a supportive way. It's only when a company's performance becomes unacceptable that the support is withdrawn and the chief executive leaves. In the parliamentary system this form of "supportive challenge" and the accompanying motivational links generally don't exist, but they need to be developed if we are to make the improvements that are needed.

My final question has to be: do we want our £560bn a year in public funds – that's 43 per cent of GDP – administered or managed? The latter will need the culture change I have described, ownership of this change from the top of the civil service and clear political support at the highest level.