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16 March 2005

Dear Matthew,

Defra's Spring Supplementary Estimate

Thank you for your letter of 3 March in which you sought clarification on Defra's Spring Supplementary Estimate.

Please find below explanations against each of the questions the Committee has raised.

Paragraph 1

1. *How is the Department ensuring that the remaining EYF will all be effectively spent by the year end?*

The full amount of EYF generated by the underspend in 2003/04 was allocated out to the department's business areas at the internal first quarter review in July 2004. This allowed them to schedule their work both internally and with delivery bodies in advance of the formal EYF draw down so as to ensure that the best value for those additional resources could be derived this year.

We planned to draw down the full EYF in the Winter Supplementary Estimate but we were asked by HM Treasury to defer part of it until the Spring Supplementary Estimate. As our right to draw down the funding from an approved EYF claim was not under question, we were able to agree to their request.

As a result of the detailed internal third quarter review, completed at the end of January 2005, the department is forecasting an underspend against the total Department Expenditure Limit (DEL) budget set by the Spring Supplementary Estimate for 2004/05 of £160 million, some 5% of that total and two thirds of the total EYF claimed in 2003/04. As explained further under question 3 below, we do not consider it possible or good financial management to eliminate annual underspends completely. Any overspend, however small, would trigger an automatic qualification of our Resource Accounts and hence potentially adverse comment from the Public Accounts Committee.

Therefore, you will appreciate that we will always aim to manage out-turn to come in below budget. The challenge is how close can we get to budget.

2. *What major projects are funded by the EYF?*

The EYF is being used to fund the continuation of the Over Thirty Months Scheme for cattle culling, work on the reform of the Common Agricultural Policy and the associated change Programme in the Rural Payments Agency, TB compensation, additional work on climate change and more work on fuel poverty.

3. *How has the EYF been accumulated and how are budgeting and forecasting being improved to avoid building up significant EYF stocks in future years?*

The EYF resulted solely from the underspend in 2003/04. In taking up this funding, we appreciate the need to ensure that we minimise the risks of excessive underspends and in particular to avoid significant errors in forecasting, particularly as we near the year end.

The EYF could not be incorporated in the business area budgets for 2004/05 until the first quarter review in July 2004. To prevent this happening again, the internal mid-year review in October 2004 specifically considered whether we could incorporate any forecast underspend in the internal budget setting process for 2005/06 with Ministers. This budget setting process was scheduled for November/December 2004. The internal Management Board concluded that £140 million could be added to the budget for 2005/06 in anticipation of an underspend in 2004/05. This was the basis on which budgets were agreed with Ministers for 2005/06.

During the department's third quarter financial review we looked very carefully at the forecasts provided from across the department, subjected local budget-holders to a rigorous process of challenge and then reported to the internal Management Board on a range of forecast outturns for the year. Whilst the most likely forecast settled at an underspend of around £160m, we were also aware of one single issue which risked wiping out the entire projected under-spend. This level of volatility combined with the imperative on remaining within the Estimate does mean that the potential for significant under-spends can never be eliminated altogether.

It is not just the one-off major risks that inform our approach to budgetary control. In a number of areas Defra's expenditure is very much demand led and this does add to the challenge of trying to forecast spending patterns. Over the past year we have systematically worked at gaining a better appreciation of the risks round current spending programmes and to manage them in a way that allows us greater control over our budgets and creates raised levels of confidence in our forecasts. This should assist in reducing large uncertainty around forecasts in future.

From our third quarter review, we were able to satisfy the internal Management Board that the budgets for 2005/06 need not be re-opened. That is, we were confident that the actual underspend by the end of the year would be at least sufficient to fund the anticipated EYF built into those budgets agreed with Ministers and business areas.

This confidence has allowed the detailed budgeting by business areas for 2005/06 into individual schemes and then profiled across the months to include the anticipated EYF at a much earlier stage than last year, so increasing the chances of full and effective consumption next year. We expect to complete this process well before the beginning of the relevant fiscal year from now onwards,

We also expect the department will incur progressively smaller annual percentage underspends from now on, especially as programmes established by the Spending Reviews of 2002 and 2004 reach maturity. However, given the longer term nature of many of the department's programmes, the lack of forecasting certainty under resource accounting compared to vote accounting, the transition to multi-year allocations and the importance of avoiding an excess vote, we do not anticipate eliminating underspends completely.

They represent a normal budget management tool because under the system of 3 year settlements and guaranteed EYF, departments are encouraged to make sensible use of EYF provisions to manage spending fluctuations between different financial years. Our business planning processes are now built round a three year rather than a one year planning horizon since this gives managers across the department greater certainty about funding availability and allows them to plan the delivery of PSA's and other key departmental objectives in a far better way. For 2005/06 we are aiming to secure EYF of £160m to fund priority programmes in the department, especially on CAP Reform. Planned EYF declines in successive years as pressures on the budget ease. We do recognise the continuing need for sound in-year financial management and the need to ensure that EYF draw down is not excessive. But eliminating planned EYF as part of a process of stronger business planning would undoubtedly prove to be a retrograde step.

The department is also beginning to benefit from other improvements to its in-year financial management systems and processes delivered by its internal finance change programme. For instance, in 2004/05 we have had the benefit of a newly integrated finance system showing detailed budgets for comparison against the actual expenditure at each month end. These reports have been subject to regular review and challenge especially during the quarterly reviews.

Paragraph Two

4. Why has the Administration Cost Limit increased?

£37.9 million of the increase was due to the draw down of the remaining 2003/04 EYF. £0.2 million of the increase was due to several small transfers to and from other government departments.

5. What benefits will this increase bring?

The draw down of Administration EYF is of benefit to the department as part of the total EYF available, rather than as increased administration budget on its own. All of the available EYF was drawn down so as to provide a reasonable amount of contingency against the risk of an excess vote, and the automatic qualification of the resource accounts that would follow.

6. How does the department manage these costs?

Administration budgets are formally agreed with the heads of the department's business areas and show as part of their formal documented delegation each year. Actual results are reviewed monthly against those budgets using reports from the newly integrated finance system, with significant variances requiring explanation. Administration costs are further examined in detail during the quarterly reviews.

We shall review the estimates guidance more carefully at each estimates round to ensure that all relevant information and explanations are included.

I hope this information is helpful to the Committee.

Yours,

Deirdre

Deirdre Kennedy
Parliamentary Clerk