



House of Commons

Committee of Public Accounts

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# Financial Management in the Foreign and Commonwealth Office

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**Third Report of Session 2009–10**

*Report, together with formal minutes and oral  
and written evidence*

*Ordered by the House of Commons  
to be printed 9 December 2009*

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## The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

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Angela Eagle MP (*Labour, Wallasey*)  
Mr Philip Dunne MP (*Conservative, Ludlow*)

### Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

### Committee staff

The current staff of the Committee is Sian Woodward (Clerk), Emily Gregory (Senior Committee Assistant), Pam Morris and Jane Lauder (Committee Assistants) and Alex Paterson (Media Officer).

### Contacts

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## Summary

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Against a backdrop of historically weak financial management, the Foreign and Commonwealth Office has made considerable progress over the past three years to improve the accuracy, reliability and timeliness of financial information. Having recognised the need to take action, the Department set up its 'Five Star Finance' Project with a series of targets and milestones, which is due to be completed in the summer of 2010. The challenge is now to complete the project successfully, and to ensure that all the improved procedures and practices are embedded in the normal running of the business.

It was encouraging to take evidence on the positive steps taken by the Department based on firm leadership from the top. In particular, the Department has benefited from recruiting a professionally qualified finance director, taking full advantage of having an experienced non-executive director on the Board, and increasing the number of professionally qualified accountants within the finance function. The Department is also playing its part in sharing good practice across Whitehall, although it was unclear to the Committee whether the Treasury was doing enough to lead the process of sharing knowledge of financial management practice across the whole of government.

Following four successive years of significant under-spends, the Department has strengthened its budget management and costing of activities, including having better information on the costs of individual embassies. The Department now needs to move to the next level, with increasingly refined costing of its different activities, and benchmarking costs across different locations to help drive efficiency.

Over half of the Department's expenditure of some £2 billion is paid out in foreign currency. As a result of the weakening of sterling against other major currencies, the Department has suffered a significant reduction in its purchasing power. To provide budget certainty, the Department forward purchases US dollars, euros and yen.

The Department confirmed that its aim is to maximise the benefits from each of its embassies in pursuit of British trade and foreign policy interests, and that it has no plans to sell-off any of its prestigious buildings around the world.

On the basis of a Report by the Comptroller and Auditor General,<sup>1</sup> we examined the Department on its developing financial management capability and capacity, and on the challenges it faces to embed sound financial management at all levels across its business.

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<sup>1</sup> C&AG's Report, *Financial Management in the Foreign and Commonwealth Office*, HC (2008–2009) 289; C&AG's Memorandum



## Conclusions and recommendations

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- 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. The Department needs to ensure completion of the Project by July 2010 and that momentum is maintained.
- 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.
- 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 become more confident in the financial forecasts they produce.
- 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.
- 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.

- 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.
- 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.
- 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.
- 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.
- 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 non-executive director can make and, importantly, has created a receptive environment. The Treasury should work with all departments in encouraging them to recruit non-executive directors with the right mix of skills to fit the needs of their business.
- 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.



# 1 Foreign and Commonwealth Office financial management capability

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1. The Foreign and Commonwealth Office has traditionally been an under-spending department and acknowledges that there have been several contributory factors in previous years' under-spends<sup>2</sup>:

- Lack of financial skills to monitor budgets effectively;
- Lack of trust in the accounting system to provide accurate monthly actual figures;
- Budget holder prudence to minimise the risk of overspending;
- Lack of ownership of budgets, and
- Lack of personal accountability for significant under-spending.

2. To address the weaknesses in its financial management track record, the Department has made significant progress in developing its financial management capability in recent years.<sup>3</sup> The focus of this effort has been a 'change project', known as Five Star Finance, setting out a suite of milestones to be achieved in order for the Department to meet its objective of establishing itself as one of the best in Whitehall.<sup>4</sup> Following completion of the Project in July 2010 and the attainment of 'Five Stars', the Department plans to maintain the momentum by moving from being a special project, to the procedures and practices being part of the Department's normal operations. There should be a culture of producing high quality numbers, where people can rely upon the data, where they follow all the appropriate procedures and the Department can manage with reliable performance data without having to employ additional resources.<sup>5</sup>

3. The main source of in-year financial information for the Board is the Key Performance Report (KPR). The structure and content of the KPR has improved significantly in the last few years, allowing the Board a detailed view of the Department's financial performance. Until the Board has absolute confidence in how the high level figures are derived, it is likely that the Report will remain a lengthy document. The Department reported that, in terms of reliance on the numbers, confidence is rising all the time and, by the completion of the Five Star Project in 2010, there will be one set of numbers universally recognised around the organisation and, at that stage, the Board can perhaps reduce the size of this KPR. The monthly KPR showed up earlier this year that the Department was heading for an over-spend and enabled the Department to take prompt action to start cutting costs to bring costs back onto profile.<sup>6</sup>

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2 Q 104

3 Q 2

4 C&AG's Report, Summary, para 4

5 Q 4

6 Q 106

4. Following previous advice to Government departments from this Committee,<sup>7</sup> in January 2007 the Accounting Officer appointed a qualified accountant to be Director General Finance and he joined the Departmental Board in April 2007. He is supported in turn by a Finance Director who is also professionally qualified.<sup>8</sup> The recruitment of professionally qualified accountants at the top of the organisation has had a number of positive impacts, which include driving up financial skills more broadly, and providing a much greater focus on the basics of good financial management. As confidence has grown in the numbers, the Department has been able to work its money harder, drive the under-spend down, more actively manage its budgets and also ensure the Department produces better quality and more timely annual accounts.<sup>9</sup> The Department was the first of the main Whitehall departments to lay its combined 2008–09 Departmental Report and Accounts before Parliament on 30 June 2009.<sup>10</sup> This all demonstrated the commitment of the Accounting Officer and the Board to take financial matters seriously.<sup>11</sup>

5. The Department has recognised that it needs to do more to build financial skills, both inside and outside the Finance Department. It launched its Financial Skills Project in July 2007, which has two main strands, professionalising the financial community, and improving financial management skills across the broader Department.<sup>12</sup> By October 2008, the proportion of qualified staff within the Department's finance function was 8%, which was below central government's average of 14%. In September 2009, the percentage of qualified staff within the finance function had increased to 12% and the Department plans to increase this further to 17% by March 2010, through a mixture of direct recruitment of outside experts and sponsoring staff through professional training. The Department still considers that this is not enough and plans to do better, continuing to increase the proportion of qualified staff in the finance function in future years.<sup>13</sup>

6. In previous years, the Department has employed a large number of contractors and consultants to work in its Finance Directorate to assist in the production of the accounts.<sup>14</sup> The Department has set a target for the reduction of its use of contractors by some 50% and, to this end, a specialist recruitment campaign was held in late 2008. The Department plans to deploy those recruited by the end of 2009<sup>15</sup> and expects these measures will lead to costs being roughly half the amount the Department was paying for contractors some two years ago.<sup>16</sup>

7. The Department is also responding to known areas of weakness to improve skills of non-finance staff and, from January 2009, two courses will be on offer to all members of

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7 Q 35

8 Q 1

9 Q 2

10 C&AG's Memorandum, para 11

11 Q 3

12 C&AG's Report, para 2.15

13 Q 65

14 Q 68

15 C&AG's Memorandum, para 4

16 Qq 68–69

the Department, one for improving general awareness of finance in the FCO and the other targeted at budgeting, monitoring and forecasting.<sup>17</sup>

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17 C&AG's Report, para 2.19

## 2 Managing performance and expenditure

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8. The Department concedes that there had been delays in delegating 2008–09 budgets to budget holders within Director General commands, but reported that 2009–10 budgets were issued in March 2009, before the start of the financial year. For 2010–11, the Department will be allocating budgets a month earlier again so that people can focus and kick-off activity much earlier in the year.<sup>18</sup>

9. It is not always clear to budget holders where all the accounting entries relating to the expenditure against their budget have come from. The Department acknowledges that it encountered difficulties with how PRISM, its Oracle based financial accounting system, was originally set up. However budget holders now understand their budgets, directors review them and Director Generals now sign off financial information monthly.<sup>19</sup> Budget holders are now in a position to challenge items charged to budgets and make corrections as necessary.<sup>20</sup>

10. The Department has acknowledged the unclear linkages between business planning and resource allocations, and the lack of financial information in the business planning process. Its starting point for improvement is to develop better management information, in particular through activity recording.<sup>21</sup> Only by making clear progress in this area will the Department develop a clear picture of the full cost of all its various activities.<sup>22</sup> The Department reported that it has got better at costing accurately all projects so it can make informed cost reduction decisions and this is increasingly becoming part of how it manages its activities. Using activity recording, the Department confirmed that it knows the costs of each of its overseas posts.<sup>23</sup> This enables it to identify where there are examples of good value for money and where to go to find cost savings, where the costs are high but the activity is of a lesser priority.<sup>24</sup>

11. One of the FCO's objectives is to "provide a flexible global network for the whole of the British Government". The Department would like other departments to see its embassies around the world as representing them, as well as being places where they put their people if they want to operate abroad, rather than setting up "their own shop". Other departments have told FCO that they like to work from its embassies but they find embassies expensive.<sup>25</sup>

12. The Department confirmed that there was a good correlation between staff placement and where Britain's financial and economic interests rest around the world. UK Trade and Investment's strategy is to concentrate on the 20 or so largest markets in the world.

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18 Q 62

19 Q 47

20 Q 48

21 C&AG's Report, para 2.31

22 C&AG's Report, para 2.33

23 Ev 18

24 Qq 5 and 40

25 Q 6

Following its strategy refresh in early 2007, the Department reviewed whether diplomats were in the right places in relation to where British economic and foreign policy interests now lie. As a result, the Department has moved a significant number of people from Europe towards other fast-growing economies, such as China, and conflict areas such as Afghanistan.<sup>26</sup>

13. The Department's history of under-spends suggests that previous arrangements to embed accurate financial forecasting, a fundamental element of good financial management, have not worked.<sup>27</sup> Part way through 2007–08, a projected overspend led to a request from the Department to the Treasury for additional resources. As the financial year-end approached, however, forecast resource and capital expenditure outturn reduced to an eventual under-spending of £128 million.<sup>28</sup> The Department agreed that the £118 million under-spend on its overall resource budget in 2007–08, which represented 5.7%, was absolutely unacceptable. Some of the under-spend came from being able to save money on security costs in the Middle East and UN subscriptions being lower because sterling was strong at that time. Half of the under-spend related to Annually Managed Expenditure, which the Accounting Officer considered he had no control over. This related to where the valuation of buildings abroad was higher than expected.<sup>29</sup>

14. In 2008–09, the Department's total under-spend was down to £69 million in total, 3.2%, and almost entirely related to an under-spend on anticipated impairments in the value of fixed assets, again under the heading of Annually Managed Expenditure. Departmental expenditure on the 'controllable' element, was very close to 100% of budget. The Department considers that it has stopped being an under-spending department as a result of better financial management and taking into account the pressures arising from weaker sterling.<sup>30</sup>

15. One of the biggest challenges the Department is now facing in terms of forecasting expenditure and managing its budget is the significant fluctuation in foreign exchange valuations. Historically, the Department's budgets have been protected from exchange rate movements and differential inflationary pressures by the Treasury, but with effect from 2008–09 this protection was withdrawn. That year, sterling's value fell by about 20% against most of the major currencies; it has been very volatile since then.<sup>31</sup> Uniquely in Whitehall, more than half of the Department's budget is spent in foreign currencies and so it is vulnerable to the effect of foreign exchange rate movements.<sup>32</sup>

16. To provide budget certainty and to smooth out effects for the following year, the Department enters into a 12 month rolling programme of forward purchases of dollar, euro and yen each month, based on latest estimates of cash flow requirements. The

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26 Q 52

27 C&AG's Report, para 2.49

28 Q 104

29 Annually managed expenditure is demand-led or exceptionally volatile expenditure that cannot readily be controlled by a department.

30 Q 105

31 Q 7

32 Qq 66–67

Department confirmed that in so doing it is not speculating, nor is it taking a view on the future of sterling. Whilst this arrangement provides certainty over the amount of foreign currency the Department will have one year hence, it does not protect FCO from falls in the value of sterling.<sup>33</sup> As a result, the Department has had to absorb a large shortfall in its budget which has meant, both in 2008–09 and 2009–10, having to re-prioritise expenditure and to find efficiency savings to live within this significantly lower purchasing power of sterling.<sup>34</sup>

17. In terms of volumes, in 2009–10, the Department expects to purchase some £500 million in US dollars, in addition to purchases of euro and yen. Beyond that, the Department spends lesser amounts in a further 120 currencies, where no forward purchases are made. If sterling falls against a particular currency, the Department has to absorb the hit directly.<sup>35</sup> The Department is aware that the Ministry of Defence has entered into forward purchases of US dollars for many years, but confirmed that there is no joint purchasing authority across departments. The Department has set up its own arrangements because it is covering a spread of currencies, but over time there would be value in other departments combining together with the FCO.<sup>36</sup>

18. Management of its sizeable asset base across a large global estate presents a significant financial management challenge to the Department.<sup>37</sup> The Department confirmed that it had no plans to sell off historic or prestigious overseas residences. It only sells where properties are no longer needed, are less prestigious buildings or, just very occasionally, if there is a property which is extremely high value but low on the Department's priority list.<sup>38</sup> The Department has issued an instruction from the top to "sweat the asset", that is to make the maximum use of all embassy buildings and houses. It is standard practice now to use the residences for a range of commercial events.<sup>39</sup>

19. The Department has to maintain a programme of building and enhancing embassies in locations where security is challenging and current embassies are not secure, and also keep up to date and maintain a very large spread of embassy and residence buildings around the world on a limited budget. Although the Department considers it is managing this activity competently at the moment, it considers it could do this better with professional help. To bring further expertise into the management of estates, the Department has recently appointed a qualified estates professional as its Director of Estates, whose remit will include helping to drive asset sales to yield more capital to invest in the estate,<sup>40</sup> as the amount of capital available to buy new accommodation is very small.<sup>41</sup>

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33 Qq 14–17

34 Q 7

35 Qq 18–19

36 Qq 20–21

37 C&AG's report, para 1.13–1.14

38 Qq 9–11 and 54

39 Q 53

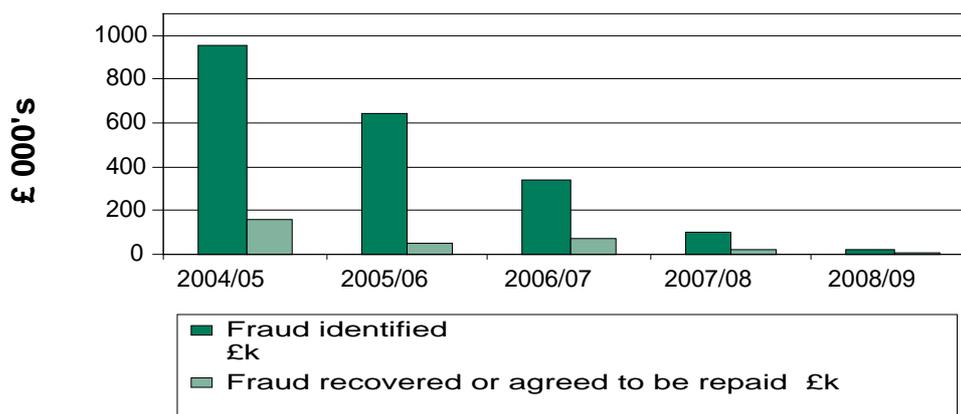
40 Q 8

41 Q 31

20. The Committee took evidence from the Department on the 2004–05 Resource Accounts on 15 February 2006, with a specific focus on the C&AG’s Report on the fraud at the British Embassy, Tel Aviv,<sup>42</sup> together with consideration of emerging details of a further fraud concerning the theft and misuse of satellite phones in Iraq. The C&AG issued a further report on the 2005–06 Resource Accounts providing additional details on the outcome of the investigation into the satellite phones.<sup>43</sup> The Department set out how there are now better financial controls in place so that similar frauds could not happen now. For example, proper arrangements are now in place to authorise purchases, receipt goods and to check bills to confirm that they are legitimate and proper expenses, before passing them for payment.<sup>44</sup>

21. **Figure 1** shows that the total amount of fraud identified each year by the Department has fallen from just under £1 million in 2004–05 down to a historic low of £20,000 in 2008–09.<sup>45</sup> The Department considers that this significant reduction correlates with the introduction of the PRISM system, which requires staff to follow a rigorous procedure, obtaining the right permission before purchasing items. The Department confirmed that it had not had a major fraud for some time and, whilst not being complacent, it considered the direction of travel is positive.<sup>46</sup>

**Figure 1: Fraud identified and recovered 2004–05 to 2008–09**



Source: C&AG’s Memorandum

22. Whilst acknowledging that the previous generation of FCO recruits was not as representative of modern Britain as this intake generation now is, the Department considers that its workforce has become more representative of modern Britain, through its recruitment practices over a number of years.<sup>47</sup> Of the 11 members of the current Board, seven are state-educated.<sup>48</sup> The Department acknowledges, however, that at some grades its UK workforce does not yet fully reflect modern Britain. In particular, women, black and minority staff and people with disabilities are currently underrepresented at senior and

42 C&AG’s Report on the 2004–05 Resource Accounts, HC (2005–06) 776, pages 48–50

43 C&AG’s Report on the 2005–06 Resource Accounts, HC (2005–06) 1495, pages 57–60

44 Qq 58–61

45 C&AG’s Report, para 2.10 and Figure 10, C&AG’s Memorandum, para 5 and Figure 1

46 Q 46

47 Q 86

48 Q 84

middle management level and its Diversity and Inclusion Strategy for 2008–2013, “Fairness for All”, aims to redress the balance.<sup>49</sup> The Department does not consider itself to be socially exclusive<sup>50</sup> but, although it monitors the diversity of its staff by gender, ethnicity and disability, it does not collect data on social origins, by educational background or by geography, to substantiate this view.<sup>51</sup>

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49 Q 108; Ev 17

50 Q 87

51 Qq 90, 99 and 101

## 3 Disseminating good practice

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23. The Department has a senior accountant from KPMG on its board as a non-executive director. He also chairs the Department's Audit and Risk Committee, which provides a robust challenge, holding the Department to account for its financial management. The Department reported that he has helped, alongside the Director General, Finance and the Director of Finance, to raise standards, to challenge, to demand accuracy, not to be satisfied with inadequate data, bringing a rigour that is seen by the Accounting Officer as being very important. The challenge that non-executives can bring with their outside experience is very helpful, not just to the Audit and Risk Committees, but to departmental Boards more generally. The Committee notes that there are plenty of people who have a senior business background, alongside a basic level of understanding of accounting matters, who are capable of making a very good contribution to Government departments as non-executives. It is crucial that departments provide the receptive environment, as FCO has done, to maximise the positive contribution that non-executive directors can make.<sup>52</sup>

24. In addition to the Financial Reporting and Management Group in the Treasury, which holds regular seminars and training events with finance directors and departments to spread good practice, there is a strong network of finance directors around Whitehall.<sup>53</sup> For example, the FCO's Director General Finance sits on the Finance Leadership Group.<sup>54</sup> As part of the Five Star Finance programme, the Department is keen to act as a beacon and share good practice. The Director of Finance has set up a Business Improvement Group. This Group brings together people from across Whitehall who are interested in sharing good practice and learning from each other.<sup>55</sup>

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52 Qq 43–45

53 Q 36

54 Q 37

55 Q 38

# Formal Minutes

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**Wednesday 9 December 2009**

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Nigel Griffiths  
Rt Hon Keith Hill

Geraldine Smith  
Mr David Curry  
Dr John Pugh

Draft Report (*Financial Management in the Foreign and Commonwealth Office*), proposed by the Chairman, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 24 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

*Resolved*, That the Report be the Third Report of the Committee to the House.

*Ordered*, That the Chairman make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 6 January at 3.30 pm]

## Witnesses

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**Wednesday 21 October 2009**

*Page*

**Sir Peter Ricketts KCMG**, Permanent Under Secretary, **Mr Keith Luck**, Director General of Finance, and **Mr Tim Gardner**, Finance Director, Foreign and Commonwealth Office

Ev 1

## List of written evidence

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| 1 | National Audit Office           | Ev 13 |
| 2 | Foreign and Commonwealth Office | Ev 17 |

## List of Reports from the Committee of Public Accounts 2009–10

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First Report	A second progress update on the administration of the Single Payments Scheme by the Rural Payments Agency	HC 98
Second Report	HM Revenue and Customs: Improving the Processing and Collection of Tax: Income Tax, Corporation Tax, Stamp Duty Land Tax and Tax Credits	HC 97
Third Report	Financial Management in the Foreign and Commonwealth Office	HC 164

# Oral evidence

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## Taken before the Committee of Public Accounts on Wednesday 21 October 2009

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Mr David Curry

Mr Ian Davidson  
Mr Alan Williams

**Mr Amyas Morse**, Comptroller and Auditor General, **Mr Robert Prideaux**, Director, Parliamentary Relations and **Mr Mike Suffield**, Director, National Audit Office, gave evidence.

**Mr Marius Gallaher**, Alternate Treasury Officer of Accounts, HM Treasury, gave evidence.

### REPORT BY THE COMPTROLLER AND AUDITOR GENERAL Financial Management in the Foreign and Commonwealth Office

*Witnesses:* **Sir Peter Ricketts KCMG**, Permanent Under Secretary, **Mr Keith Luck**, Director General of Finance and **Mr Tim Gardner**, Finance Director, Foreign and Commonwealth Office, gave evidence.

**Q1 Chairman:** Good afternoon and welcome to the Committee of Public Accounts. Today we are considering the Comptroller and Auditor General's Report, *Financial Management in the Foreign and Commonwealth Office* and we welcome Sir Peter Ricketts and his colleagues. Would you like to introduce your two colleagues, Sir Peter?

**Sir Peter Ricketts:** Thank you, Chairman. Keith Luck is our Director General of Finance and Tim Gardner is our Finance Director; two qualified accountants.

**Q2 Chairman:** Thank you. The Report highlights weaknesses in the Department's financial management track record but recognises the considerable work that the Department has done to improve the accuracy, reliability and timeliness of financial information as well as to align financial and operational reporting. I would like to welcome, by the way, the Kenyan delegation visiting us today as part of their work with the Crown agents, so all our friends from Kenya are very welcome today and I hope they find our hearing interesting. Sir Peter, we do not often say this in this Committee: it is a good Report and clearly you were one of the weaker departments before and you have made considerable progress. One of the things you have done is to appoint a qualified finance director, and the qualified finance director has been in post since 2007. We have always argued that all departments should have a qualified finance director and I helped ensure that when we appointed this year a new Comptroller and Auditor General he was the first ever qualified chartered accountant. This is part of what we have been campaigning for for years, so what difference has it made having a qualified finance director?

**Sir Peter Ricketts:** It really has made a difference, Chairman, not just because I speak in both their presences but it has helped us to drive up financial skills and a sense of the importance of the numbers in the Department. You are right, we were not as

good as we should have been, people did not have confidence in the numbers that came to us and therefore we had a consistent record of under-spending. As confidence has grown in our numbers we have been able to make our money work harder, drive the under-spend down, more actively manage our budgets and also ensure that we have better quality accounts at the end of the year. We have been able to lay our accounts before Parliament more rapidly than most other government departments, and in good shape I think, and that is also part of a stronger financial culture that these gentlemen have brought to the Department.

**Q3 Chairman:** Do you want to comment at all on your experience coming into the Department?

**Mr Luck:** Just to add to that, Chairman, Sir Peter is perhaps being modest because of course as you implied the mere fact of appointing a qualified finance director or director general in my case shows how committed Sir Peter is to getting the numbers right and, indeed, right across the board finances are taken very seriously. I have to say there is plenty of support from our non-executive director colleagues on the board as well here.

**Q4 Chairman:** How are you going to maintain the momentum now, Sir Peter? You have got this Five Star Finance project; it ends next July so presumably you have got plans to keep things going and get better.

**Sir Peter Ricketts:** Absolutely, we have. We have first of all got to get to the end of this project and get it absolutely complete, and we are well on the way to doing that, but then what I would really like is for it to become not a special project that we have to work away on but the way the department runs normally, that there should be a culture of high quality numbers where people get the data right, where they follow all the appropriate procedures and we can

manage with reliable performance data without having to put in quite the resources we have had to get to this point.

**Q5 Chairman:** Are you confident that you know how to accurately cost all your projects so that you can make good cost reduction decisions?

**Sir Peter Ricketts:** We have certainly got better at that and we have had to put that into practice in the course of this year in cost reductions, as I hope we can go on to talk about. We have now got costed activity recording which means we know what our people cost wherever they are abroad, we know what our embassies cost and we can follow more closely where there is good value for money, so where we have to come to find cost savings we know where to go, where there is high cost but perhaps less priority. It is increasingly becoming part of how we manage, yes.

**Q6 Chairman:** One of the FCO's objectives is "To provide a flexible global network for the whole of the British Government." Big words, but how is all this going to make a difference in that?

**Sir Peter Ricketts:** The point there really is that we want other departments to see our embassies around the world as representing them as well and as being the places where they put their people if they want to operate abroad, so that rather than setting up their own shop somewhere else in the city they come to the embassy and they use the embassy platform. For that we have got to offer them a good, secure, effective place to work from and make it as cheap as possible, and what we hear from departments is that they like coming and working in embassies but they find us expensive by the time there have been the security costs and other things. By getting better data, by seeing where the costs are, we can look to drive them down and we are trying to do that by cutting the back office and reducing the management costs so that the cost of departments sending people to our embassies gets less.

**Q7 Chairman:** How are you going to manage the movement in exchange rates that you are affected by in terms of a threat to your resources?

**Sir Peter Ricketts:** It has been a really difficult problem, Chairman. The way that it was done previously was that the Treasury provided us a mechanism so that if sterling was stronger we gave money back, if sterling was weaker they gave us money. That was withdrawn, as the NAO Report says, in the CSR in 2007. In the year after that we saw sterling fall by around about 20% against most of the major currencies and it has been very volatile since then. We put in place arrangements to do forward purchasing of currencies and we have extended that out prudently because we wanted to be absolutely sure that we were not open to any criticism for speculation. It covers dollar, euro and yen which are the three biggest currencies, but not all the other 120 currencies that we operate in around the world, and forward purchasing can smooth out currency fluctuations but it cannot help you if sterling drops 20% because then the forward

purchasing you do over time will be 20% down as well. We are, therefore, having to absorb a very large shortfall in our budget which has meant, both last year and now this year, working really hard to find efficiency savings and, frankly, cuts to live with a lower purchasing power of sterling. We are managing that but I will not hide from you that it has been pretty difficult.

**Q8 Chairman:** The NAO are preparing a report on the management of your overseas estate and that will come to this Committee, Sir Peter, in the New Year or the early Spring, so you have got this new systematic approach that you developed for financial management. How are you going to spread it around the rest of your business, for instance how you manage your estate?

**Sir Peter Ricketts:** We have been managing this very large global estate for many years. We can do it better and we have recently taken on a qualified estates professional as our director of estates to bring qualified expertise to this. We have both got to maintain a programme of building new embassies in places where security is really difficult and current embassies are not secure and also keep up to date and maintain a very large spread of embassy and residence buildings around the world on a limited budget. Getting a professional in to help us do that and also to help drive asset sales, to yield some more capital to invest in our estate—that is his remit. We are managing competently at the moment but we could do better with professional help.

**Q9 Chairman:** You are not going to sell off cheaply residences that do so much for our image just to meet some Treasury demand?

**Sir Peter Ricketts:** No, Chairman.

**Q10 Chairman:** Often residences were bought very cheaply after the war or even donated to us and they serve this country very well. There are no plans to do that.

**Sir Peter Ricketts:** There are no plans to do that. Where we sell is where we have got properties that we no longer need or just very occasionally if there is something which is extremely high value but low on our priority list, but mainly it is where we no longer need properties. I do not plan to sell wonderful historic residences that do so much for the UK, no.

**Q11 Chairman:** That is very good news. We are not penny-pinchers in this Committee we hope.

**Sir Peter Ricketts:** Very good.

**Q12 Chairman:** Treasury, talking of that, can I ask you a question: how are you going to spread this excellent good practice that we have been hearing about so far around the rest of Whitehall?

**Mr Gallaher:** Within the Treasury there is a Financial Management Reporting Group which disseminates guidance and best practice across all Whitehall departments and public sector organisations, and certainly we look with great interest at what is going on in the Foreign Office. I will certainly take the message back to the Treasury

that this has been commended to some extent by the Committee and that we should forward this message across all departments to look at what is going on in the Foreign Office.

**Chairman:** Thank you. David Curry.

**Q13 Mr Curry:** Especially those buildings bought after the Napoleonic War, if I can say so.

**Sir Peter Ricketts:** Indeed, Mr Curry; they were particularly good value at that time.

**Q14 Mr Curry:** Tell me a bit more about your foreign exchange activities. How much do you buy forward in each currency and how far forward do you buy them? Of course, if you buy forward you are by definition taking a view on the performance of sterling. How do you do that without people saying the Foreign Office thinks sterling is going to fall—quite a good bet over the last few years. Mr Luck, tell me about the mechanism, what volume do you buy and how far forward do you buy? Have you got a mechanism to hedge those purchases?

**Mr Luck:** Actually, Mr Curry, it is really forward purchase, it is as simple as that. It is a simple outright purchase in so many months time. We now extend out for a full 12 months and, based on our latest cash flow, we will put in place one-twelfth every month until if one moves forward a year you would then have twelve small rates stacked up when those contracts mature. As Sir Peter has said, that smooths out the effect.

**Q15 Mr Curry:** In a sense you are doing a yearly contract each month.

**Mr Luck:** Exactly.

**Sir Peter Ricketts:** We are doing a rolling programme. We absolutely do not want anyone to be able to say we are speculating or we are taking a view on the future of sterling, so every month we buy forward 12 months. What we are interested in is budget surpluses.

**Q16 Mr Curry:** One understands why you do it, because of the position you are in, but is there a penalty in doing that? There is bound to be, is there not?

**Sir Peter Ricketts:** There is a fee, there is a cost of doing it and it gives you budget certainty for the following year because you know what you will get in foreign currency a year hence, but it does not protect you from falls in the value of sterling because that comes through in a delayed way.

**Q17 Mr Curry:** It is only three currencies, dollar, yen and euro you say.

**Sir Peter Ricketts:** Yes, our three biggest effectively.

**Mr Luck:** You asked about volumes.

**Q18 Mr Curry:** In a country like South Africa where you have got a significant operation and it will get even more significant with the sporting events coming up, how do you deal with that?

**Sir Peter Ricketts:** We are exposed to the currency risk there, or in a country like Brazil, and if sterling falls against that currency we have to absorb the hit.

**Q19 Mr Curry:** You have told me how far forward; what sort of volumes are we talking about?

**Mr Luck:** In US dollars now it is £500 million for the current financial year and for yen it is £7 million. The yen is our third largest currency, so once you get beyond the yen you are into another 120 currencies which are relatively small.

**Q20 Mr Curry:** Presumably the Ministry of Defence is in the same position as you. It has to have contracts for providing kit overseas and contributing to projects overseas.

**Sir Peter Ricketts:** The MOD have done a forward purchase of dollars for many years but no other currency.

**Q21 Mr Curry:** But they do it separately; there is not a sort of joint purchasing authority.

**Sir Peter Ricketts:** They do it separately. We have set up our own arrangements because we are covering a larger spread of currencies but over time I would see lots of value in other departments clubbing together with us to do it together because DFID, the other major international department, I do not think do any forward purchasing, so there is scope actually for better inter-departmental working.

**Q22 Mr Curry:** Correct me if I am wrong factually on this question, please, but am I right in thinking that staff working overseas, for example in Washington, are paid in sterling and get the current rate for their salaries?

**Sir Peter Ricketts:** Yes. UK staff—because we have locally employed staff who are paid in dollars—are paid in sterling, they are UK civil servants, they pay tax in this country and they get allowances on top of that which can be adjusted to compensate for the exchange rate.

**Q23 Mr Curry:** Somebody who was, say, sent to Washington four years ago would have done very well, would they not, in terms of their dollar salary? Their replacement sent six months ago would be significantly worse off, am I right?

**Sir Peter Ricketts:** No, because there is a compensating factor which is the allowances that people get to ensure that it is adjusted.

**Q24 Mr Curry:** We have heard that before if I may say so. I am refreshed to know that we are not the only ones . . .

**Sir Peter Ricketts:** We have a very vigorous system for ensuring that allowances are paid with full propriety and regularity but there are overseas allowances which are adjusted for the cost of living in the country, so if sterling is very strong and the dollar is very weak then your overseas allowance is less. If sterling is extremely weak and the dollar is very strong then overseas allowances are greater, so there is that compensating mechanism.

**Q25 Mr Curry:** People who are doing the same job would broadly speaking find themselves in the same financial position irrespective of what the exchange rate happened to be doing at that time.

**Sir Peter Ricketts:** That is the idea; it should be neutral as far as they are concerned.

**Q26 Mr Curry:** Again, correct me if I am wrong factually, does not the Foreign Office have a tremendous hierarchy of accommodation in the sense that if you have a certain status you get accommodation with three bedrooms as it were and if you are a bit lower you get two and a half bedrooms and a new sofa. You get a dining room table made of beech if you are a certain level. Just explain it, if you go to an overseas post you find that according to the ranking of staff that gives an entitlement to a certain quality of accommodation. Is that false or is that correct?

**Sir Peter Ricketts:** It used to be more true than it is now; we have got more egalitarian recently. What tends to affect space is the size of your family so you can have a more junior officer with four children so they will get a larger place and a single but more senior person might be in a small flat.

**Q27 Mr Curry:** On the whole you buy your real estate, do you not, or do you rent?

**Sir Peter Ricketts:** We have a mix.

**Q28 Mr Curry:** What is the proportion in let us say the major capitals?

**Sir Peter Ricketts:** It varies a lot actually. In some it is almost entirely owned and in others it is largely rented, but we need a degree of renting because we have got to have some flexibility. Again, if you have a single person replaced by somebody with five children you need to have different sizes of place.

**Q29 Mr Curry:** Are you continuing to buy accommodation or have you moved now to a system where you would normally expect to rent?

**Sir Peter Ricketts:** We are not buying much now, partly because it is very inflexible. Once you have bought a house you have to put somebody into the house whatever size of family they have got.

**Q30 Mr Curry:** Let us take the United States as an example. We all know what has happened with the sub-prime crisis over the last few years. Presumably you could have more or less bought Bethesda quite cheaply.

**Sir Peter Ricketts:** Indeed, if we had the money.

**Q31 Mr Curry:** Were you not tempted at that stage to say looking ahead, this is a good opportunity to perhaps settle our costs for the future?

**Sir Peter Ricketts:** You are absolutely right, these are the sorts of things we need to work with. I am hoping that Alan Croney, our new Estates Director, will help us with that. It is a bit moot at the moment because we are very, very short of money to buy anything; all the capital we have got is going into these security builds that we are needing to do in places like Harare

or Islamabad or Baghdad. The amount of capital we have to be able to make those choices is very limited at the moment.

**Q32 Mr Curry:** Even on normal accommodation there is a quite heavy security bill but I suspect you probably cannot just hire local contractors to do things because of the security concerns.

**Sir Peter Ricketts:** That is a concern in embassy buildings; on residential accommodation we can use local contractors but what we do do though is make sure they come up to UK health and safety standards. In many countries in the world if you hire something the electricity is not up to our standards and so we have to go in and do work on that. That is another cost of renting, unless you rent for a long time. Where we are working in embassies we need to be careful to use UK contractors for reasons that you will understand.

**Q33 Mr Curry:** In terms of your consular network, does the same apply there?

**Sir Peter Ricketts:** Yes, absolutely the same, there is no distinction, we are all part of the same organisation.

**Mr Curry:** If I have time later I will come back if that is all right.

**Q34 Mr Bacon:** Sir Peter, we have travelled a bit with this Committee and I with another committee have been to various embassies around Europe and elsewhere. It is often striking how impressive are the individuals one meets as ambassadors and if you were a government official or a minister visiting you would want exactly the sort of briefing which they seem to provide to a Committee like us, it is an extremely impressive service. What I also find heartening is that you are sitting there with two chartered accountants or two management accountants, but qualified accountants, because your predecessor Sir Michael Jay came before us once and when asked what his reflections were on his job he, having been a very senior ambassador indeed—one of the most senior—then had the job that you now have of running the Department and he said, which I thought was incredibly illuminating, he was surprised how difficult it was, as if the background you get in learning about statecraft and how to brief ministers in capitals of the world is good preparation for running a large organisation with 16,000 employees in 240 offices in 100 countries when plainly they have got very little to do with one another. You are still in charge but you must rely on these managers around you quite a lot. Am I right in saying, did you hire Mr Luck after you took over?

**Sir Peter Ricketts:** I did.

**Q35 Mr Bacon:** Did you take a conscious decision to look for a manager with a financial management background who was qualified?

**Sir Peter Ricketts:** Absolutely I did, yes, but also following the advice of this Committee and other committees that we should make sure that we had qualified finance people.

**Q36 Mr Bacon:** It is marvellous to know that someone is listening because I have been banging on about this for years. There was a time when 23% of principal finance officers only had a financial qualification and I gather from the Treasury the figure is now well over 90%. I would like to pursue with the Treasury if I could a bit further the questions that the Chairman asked about how you are spreading this around Whitehall. You said in answer to the Chairman that you are trying to tell departments to look at the Foreign Office, but how do you do that? Do you send them an email or do you actually have seminars with other departments where you force them to confront the fact that it is possible to improve your financial management?

**Mr Gallaher:** The Financial Reporting and Management Group in the Treasury holds regular seminars with financial directors and with the departments every quarter, every six months and we will take the message back from this particular hearing and point out the example of the Foreign Office. Certainly we will get the message across to other departments that there is something worth looking at here.

**Sir Peter Ricketts:** Mr Bacon, there is also quite a strong finance directors network around Whitehall now so I hope that we are feeding our . . .

**Q37 Mr Bacon:** You all meet up, do you, Mr Luck?

**Mr Luck:** Indeed, and I sit on the Finance Leadership Group—the chair is John Thompson the head of Finance Profession.

**Q38 Mr Bacon:** He started at Norfolk County Council so it is no wonder he is doing so well.

**Mr Luck:** He did indeed. Perhaps I should point out that as part of our Five Star Finance programme we are keen to act as a beacon and share good practice, and one of the things that my colleague Tim Gardner has done is set up a business improvement group where he brings together people from across Whitehall who are interested in working on a real tangible issue—they decide whatever it is each meeting—and share good practice.

**Q39 Mr Bacon:** I would like to ask a question about how you cost things because for an organisation—shall we say one of the defence procurement bodies—it is relatively easy to say this is how much hardware we got and this is the associated software, the people that went with getting it, and the total cost was therefore X plus Y equals Z. The Foreign and Commonwealth Office is a rather sophisticated professional services organisation and it is not nearly as easy to pin down where the costs are. If you are, say, a middle-ranking diplomat in Washington working on trade issues or something you are going to be spending part of your time on steel tariffs and part of it on general bilateral trade with the UK. How do you begin to come out with a figure that gives you a sense of what it is costing your department to do X or to do Y, because unless you can do that in the climate that we are entering how

are you going to come up with informed choices as to where you rationalise? You might just come up with easy choices which may not be the best choices.

**Sir Peter Ricketts:** You are absolutely right and we have also got to have a system that is not so time-consuming to fill in that people will not do it. If you ask people to fill in a system saying what they are doing every half an hour, like a solicitor would, you will not get diplomats to do that.

**Q40 Mr Bacon:** Every six minutes is my experience with lawyers.

**Sir Peter Ricketts:** It has to be a light touch system. What we have been trying to do first of all is have an accurate idea of what it costs us to maintain each individual embassy, which is already quite complicated because we have contributions from other departments, we get revenue for our consular services, there is an awful lot of moving parts. We have now got a pretty accurate idea of what it costs for each embassy.

**Q41 Mr Bacon:** Is that a public figure?

**Sir Peter Ricketts:** Yes, I think it is.

**Q42 Mr Bacon:** Could you send us a chart?<sup>1</sup> What would be interesting would be to see it ranked by cost with the most expensive one at the top, which one would expect to be one of the big countries where you have got the biggest staffs, and then also if you could rank it by cost per member of staff in that embassy.

**Sir Peter Ricketts:** We do have that data now and I believe some of it at least has come out in PQs but we can certainly let the Committee have that. We can now calculate cost per member of embassy and then you have to apply judgment on top of that as to whether the work that they are doing in that place really is high priority as against somewhere else. There is a certain amount of data, therefore, which you then have to apply judgment to.

**Q43 Mr Bacon:** You have got a senior accountant from KPMG, Alistair Johnston, on your board as a non-executive, which I am very interested in, because when you look around in Whitehall most departments now go through the motions of having non-executives but looking at their backgrounds sometimes one wonders what it is that they are bringing to the department they are joining. Having somebody like the vice-chairman of KPMG as a non-executive sounds like quite a good move.

**Sir Peter Ricketts:** Yes.

**Q44 Mr Bacon:** This may be one for the Treasury or the National Audit Office might like to comment as well, but what else is happening in Whitehall along those lines? Does anyone have data—perhaps the Treasury—on how many other major government departments have got a non-executive with a similar background as Mr Johnson?

<sup>1</sup> Ev 18

**Mr Gallaher:** We will certainly look into it and see what we can find out in terms of information on non-executives and forward that to the Committee.

**Q45 Mr Bacon:** That would be very helpful. Have you found that Mr Johnson's presence has made a big difference?

**Sir Peter Ricketts:** Yes, absolutely essential. He also chairs our Audit and Risk Committee and so he is challenging and holding to account the whole finance side of the organisation, and I can say without disclosing secrets that he does that pretty robustly. He has helped, with Mr Luck and Mr Gardner, to raise standards, to challenge, to demand accuracy, not to be satisfied with inadequate data and he has brought a rigour to it that has been really important. The challenge that these people can bring with their outside experience is very helpful, not just in the Audit and Risk Committee but in the board as a whole.

**Mr Morse:** Although I cannot quote the information we have pretty good information on non-executives across Whitehall. I just would like to say though that there are plenty of non-executives who are capable of making a very good contribution across Whitehall—in other words people who have got a senior business background, and nowadays you would not reach a senior position in business if you did not understand basic accounting to quite a good level quite honestly. The question is having a really receptive environment for them to function in, and what I really give great credit to Sir Peter for is the fact that they are functioning in an environment where their contribution is really being drawn forward by the leadership of the department and where it is echoing with this strong finance function. So there are a number of things aligned to produce a good result. It is much easier to be a good non-executive director if you are in that position, to be quite honest. Quite a lot of talent is being attracted into the non-executive ranks; it is giving it the connections to allow it to really function well.

**Q46 Mr Bacon:** Some years ago we took evidence on the resource accounts of the FCO and the instant cause was the fraud in the Tel Aviv Embassy that had been dragging on for 17 years. Presumably the Foreign Office has learnt something from that particular fraud because it went on for such a long time. Have there been any other frauds recently, if not ones that have dragged on for that long, that you have identified?

**Sir Peter Ricketts:** Well, there have been some rather small ones but I am actually rather proud, Mr Bacon, of the track record of the last five or six years. The graphs in the NAO Report and then in the supplementary note that they did for you show that the levels of fraud that we discovered in the organisation had fallen to absolutely historic lows—£20,000 last year. £20,000 is still too much but nonetheless on an organisation with a budget of £2 billion it is not bad. The NAO say that this may be because of improved and tighter financial controls or it may be because there are not enough whistle blowers coming forward to disclose fraud. Of

course, I would never be complacent about that and we do keep encouraging whistle blowing because it is a very good way, but it correlates with the introduction of our new management information system, PRISM, which is an Oracle system which has forced everybody dealing with money around the world through a rigorous system, getting the right sort of permissions to purchase and all those things. I believe that the introduction of this management information system has something to do with this steep decline in frauds in the organisation; we have not had a major fraud in the organisation for some time. I am absolutely not complacent, but the direction of travel is right.

**Chairman:** I am afraid there is a division in the House so we have to break for about eight minutes. We will be back as soon as we can.

*The Committee suspended from 4.01 pm to 4.07 pm for a division in the House.*

**Chairman:** We are now quorate. Mr Richard Bacon?

**Q47 Mr Bacon:** Sir Peter, I would like to ask about the paragraph in the Report entitled "Unexpected expenditure charged to budget holders" at 2.55 on page 23. It says: "It is always clear to budget holders where all the accounting entries relating to the expenditure against their budget have come from. The principal contributory factor is that the accounting system is set up so that it is possible, if correct purchase to pay procedures are not followed, for anyone to post items to any budget codes increasing the risk of erroneous entries." It goes on to say that 24% of purchase orders at the beginning of January 2009 were charged to budget holders outside the directorate which had raised them. It does not really sound like you have completely got a grip of this, does it?

**Sir Peter Ricketts:** Might I ask Mr Luck to respond to that.

**Mr Luck:** It is true that we have had difficulties with the way that PRISM, our Oracle-based financial system, was originally set up but it is something that the board has returned to time and time again to try and ensure that budget holders understand their budgets, so in signing off now each month the resource management officers go through with the budget holders any movements to their budgets so that they can understand items here. In turn, directors review their budgets and directors general are now signing them off. You have hit on a difficulty we have had because of the way the system has been implemented.

**Q48 Mr Bacon:** This is not merely budget holders failing to comprehend what is going on. It is things being charged to their budget that should not be charged to their budget, is it not?

**Mr Luck:** It is and therefore being in a position to challenge those and have those corrected and then to improve the system so that does not happen in future.

**Sir Peter Ricketts:** In some cases I think it is people charging items to budgets entirely legitimately but catching the budget holders out.

**Q49 Mr Bacon:** I can quite see if the Ambassador to Rio, or what is the capital of Brazil—I should know?  
**Sir Peter Ricketts:** Brasilia.

**Q50 Mr Bacon:** Let me take a better example because who would want to hold a party there! I can quite see why the Ambassador to Paris would want to throw a big party and charge it to the Embassy in Berlin, that would make perfect sense, but that is not what has happened.

**Sir Peter Ricketts:** I think what this is referring to is where you are holding a budget as a regional director and then the personnel side put into your budget personnel costs or the estate side put into your budget the costs for renting and maintaining property, so it is parts of the organisation putting costs on the budget holders that perhaps they were not expecting and therefore it makes it difficult to keep control of your costs particularly towards the end of the year.

**Q51 Mr Bacon:** I hope part of the answer to this will come when you send us the figures of the staff and where they are distributed. What is your headcount now? It was 16,000.

**Sir Peter Ricketts:** It is about 15,000 now.

**Q52 Mr Bacon:** To what extent in trying to allocate them around the world do you take a global view of Britain's financial and economic interests and say, "Well, trade with China is X% and trade with India is X% and we are expecting it to grow in the following way over the next five to 10 years so our representation in China and India, particularly on the trade side, should be X." Is there a correlation? Does it match in terms of where the staff are versus where the economic interests are?

**Sir Peter Ricketts:** The answer is yes, essentially. First of all, UKTI have done that exercise for the specific people who do trade and investment work abroad and their strategy is now concentrating on the 20 or so largest markets in the world. That has moved UKTI staff to India, China, South Africa, Brazil and those sort of countries. On our own side when the Foreign Secretary came to us two and a half years ago we did a strategy review and part of that was to look at where we had got our diplomats, are they in the right places in relation to where British interests are now, both economic interests but also foreign policy interests, and we moved a significant number out of European posts towards these same countries—India, China, Afghanistan, South Africa, Brazil and others—so we have not shut embassies in Europe because it is still important to keep them but we can do it with fewer people. We have pushed more people out to the fast-growing economies and the conflict areas.

**Q53 Mr Bacon:** As a Committee we visited the British Embassy in Italy and met the Ambassador there and I was very impressed by the villa and its potential for entertaining. It seems that the Embassy hires it out to big companies like BP who hold board meetings there, which is very impressive. How widespread is that and how much of a push is there

from you at the top and the board to make sure that all the Ambassadors across the world are being that enterprising? That was the initiative of one particular Ambassador in Italy but presumably everybody ought to be doing it?

**Sir Peter Ricketts:** It is normal and they are doing it. The instruction from the top is sweat the asset and make the maximum use of these wonderful embassy buildings and houses and, where you can, get commercial companies to sponsor events so that we get the benefit as well. It is standard practice now to use the residences for all sorts of commercial events.

**Q54 Mr Bacon:** I was very reassured by your answer to the Chairman where you said there was not any proposal to get rid of them because they did often come for free in many cases and we would not want an accounting change to require you to get rid of them for any reason.

**Sir Peter Ricketts:** I think they are real assets and it is smaller and less prestigious places that we would consider getting rid of.

**Q55 Mr Bacon:** But you did do that in the case of the British Ambassador's residence in the Holy See? You got rid of a cheaper and better residence and replaced it with one that is best described—it is quite a grand garret—as an attic flat. Although it has a good view of Rome it is still an attic flat and is more expensive than the previous one which was better. Why did that happen?

**Sir Peter Ricketts:** I am afraid it was before my time, Mr Bacon, and I do not know the detail of it. I am surprised if the flat is cheaper.

**Q56 Mr Bacon:** The present flat where the British Ambassador to the Holy See now is is more expensive but not as good as the previous British Ambassador's residence.

**Sir Peter Ricketts:** As I say, it happened before my time and I would need to look into it.

**Q57 Mr Bacon:** Could you send us a note?<sup>2</sup>

**Sir Peter Ricketts:** Of course.

**Q58 Mr Bacon:** I have only one more question and that is about the theft of satellite telephones because you may remember when we last looked at the resource accounts a batch of satellite telephones was stolen in Iraq and the thieves, one presumes, then used these phones to dial up betting lines and indeed sex chat lines resulting in bills of several hundred thousand pounds, which the Foreign Office just merrily paid, you signed the cheques and no-one seemed to look askance at the fact that there was a £200,000 phone bill each month. Why would that not happen now?

**Sir Peter Ricketts:** We have learned some very painful lessons from that. Part of it is about proper purchase to pay arrangements, proper receipting of goods received because part of the problem was that phones were sent out to Iraq but were never received.

<sup>2</sup> Ev 17

**Q59 Mr Bacon:** They were by somebody!

**Sir Peter Ricketts:** They were intercepted on the way.

**Q60 Mr Bacon:** Did you ever get them back? Sir Michael Jay told us—I do not think he personally did—“We dialled the number but nobody answered.”

**Sir Peter Ricketts:** I do not think we ever got them back, no. Part of it is better financial controls so that when bills come in people who pay the bills make sure that they are legitimate and proper expenses, and I think the fact we have got this PRISM system now and a better culture for numbers has instilled better discipline. I hope we have put the systems in place that mean that would not happen again. It was a very painful episode for us.

**Q61 Chairman:** So if a mobile phone bill comes in for one mobile phone for £200,000, Mr Luck is there to spot it for the first time ever in the history of the Foreign Office, is he?

**Mr Luck:** Not personally Chairman but, yes, there are processes in place absolutely to do that and, as indicated in my previous answer, the budget managers are now really switched on to examining all the costs that are coming through.

**Chairman:** That is very reassuring. Alan Williams?

**Q62 Mr Williams:** We are told there are delays in delegating budgets to budget holders. What effect does this have and why is it happening after all this time?

**Mr Gardner:** It was happening. The effect of it was that it added to the underspend because people were getting their budgets later in the year. We quickly picked up on that. I think colleagues have noted in the last year we gave out budgets before the beginning of the financial year and this year we are giving out budgets a month earlier again, and that means that people can focus on what they are supposed to be doing and kick off activity much earlier in the year.

**Q63 Mr Williams:** C&AG, do you think that improvement is adequate or do they need to do even more?

**Mr Suffield:** We have looked at it and we think that the steps that have been taken are sensible and appropriate but we continue to look at it going forward.

**Q64 Mr Williams:** Then again you have advised us that there is confusion in the Department over roles and responsibilities. For a long-established department that seems a rather strange predicament.

**Sir Peter Ricketts:** I am sorry if there is still confusion. I think the NAO Report was referring in particular to the lines of reporting for some of our major programmes where they tended to be having to report to a number of different committees. I do want to sort that out because I think if we have a major programme it needs to be overseen but it does not need to be overseen by two or three different committees. That is just of waste of everyone’s time. I have in mind some reorganisation of the committee

structure under the board to make sure that does not happen. I think financial roles and responsibilities are pretty clear actually.

**Q65 Mr Williams:** We are told that across government 14% of staff have financial and management skills whereas you, strangely enough, only have 8%, just over half of that. Why are you trailing so dismally behind?

**Sir Peter Ricketts:** Mr Williams, we were spurred into action on that before the NAO Report but even with it and the supplement that the NAO have given the Committee shows that we are already up to 12% and we are heading for 17% by end of this year. We are training a lot more of our own staff in financial matters and also taking on some experts from outside so we will get to about 17% of our finance staff with qualifications by the end of this year. I still do not think that is enough, I think we can do better than that, and I would want to go on increasing the proportion of qualified people in the finance function.

**Q66 Mr Williams:** We have been talking about the foreign exchange fluctuations. What proportion of your budget is affected by that?

**Sir Peter Ricketts:** More than half our budget is spent in foreign currencies.

**Q67 Mr Williams:** Really?

**Sir Peter Ricketts:** Uniquely in Whitehall more than half our budget is vulnerable to foreign exchange rate movements.

**Q68 Mr Williams:** Historically you have employed a large number of consultants and contractors on finance. Are you still doing so?

**Sir Peter Ricketts:** We are reducing them.

**Q69 Mr Williams:** How effectively and what are they costing at the moment?

**Sir Peter Ricketts:** I am aiming to complete a 50% reduction in contractors by the end of this year, that is 50% less than two years ago, as a result of training more of our own staff and bringing in career civil servants with qualifications, so they will certainly be costing us half what they were two years ago. I do not have an absolute figure in my mind but I am determined that we shall drive down the cost of contractors because we can certainly get better value for money by having them on our books as civil servants.

**Q70 Mr Williams:** Finally to C&AG, on the foreign exchange fluctuations obviously the Department for Overseas Development must have the same problems to contend with. Have they been any more effective, to your knowledge, in meeting the problems than the Foreign Office or vice versa?

**Mr Suffield:** The Department for International Development is possibly a little bit behind FCO in the way that they have sought to manage this risk but I know that they are in contact with the Department to try and learn from the approach that FCO have taken.

**Q71 Mr Davidson:** Can I start by saying that I think you have a lot of very fine staff who on occasions have given absolutely excellent briefings to Members as we meander around the world when we have the opportunity to do so. Sometimes I must confess they do give the impression that they prefer MPs to come in the tradesmen's entrance but I suppose they cannot always overcome their background. I am sometimes tempted to confirm their prejudices by stealing their spoons but I have always resisted—most of the time! Can I ask about the tax treatment of your staff abroad. Do they pay income tax the same as everyone else?

**Sir Peter Ricketts:** Yes.

**Q72 Mr Davidson:** So they are all charged on a UK basis?

**Sir Peter Ricketts:** Yes, we are UK civil servants, we go on getting paid in the UK paying UK tax whether we are at home or abroad.

**Q73 Mr Davidson:** If they are seconded what happens then?

**Sir Peter Ricketts:** The same.

**Q74 Mr Davidson:** If people were seconded to Brussels, for example, they would not fall under the rules of not paying tax the way that somebody employed by Brussels would?

**Sir Peter Ricketts:** If they are seconded to the Commission for example then I think they pass under a different regime. I think then the Commission pay their salary and I suppose they then pay Belgian tax. I am not absolutely clear about that. But as long as they are working for the British government they are paid in the UK and they pay tax in the UK.

**Q75 Mr Davidson:** Can you give us a note about what happens if people are seconded in these circumstances to Brussels? That would be helpful.<sup>3</sup>

**Sir Peter Ricketts:** Of course.

**Q76 Mr Davidson:** Arising from paragraph 1.8, where it has mention of the link with UKVisas, you seem to be responsible for providing staff and providing floor space yet UKVisas pays for it. Why I want to explore this is I am particularly unhappy about what seems to be a relatively poor service in some circumstances from UKVisas taking too long and in many cases coming out with decisions which I think are far too soft. You sometimes get the impression that in order to get a decision out the way people just grant visas. Can you make clear to me whose responsibility it is to fund these things adequately? Is that through yourselves or is that through the Home Office budget? To what extent are the constraints on the physical space and the number of staff they have caused by constraints in space that you have or is it any other reason?

**Sir Peter Ricketts:** The responsibility for the visa operation is now with the Home Office and with the UK Border Agency. That was a change a couple of

years ago. It used to be a shared enterprise between us and the Home Office. It is now a Home Office responsibility and Home Office ministers set the policy. We provide the space for them to operate abroad because the embassies have always been the place where we have had visa work. The budgets are provided by UKBA and they come from visa income. Partly because the number of visas being issued has been falling in the economic recession they have had real pressure on their budgets and they have been doing some pretty fast restructuring, a lot of hubbing and spoking, ie they have one big visa factory somewhere and then a lot of embassies round about send their visa applications into this centre and get the answers back again. That has been pretty disruptive because a lot of visa sections have closed down and moved into hub and spoke working and that has caused delays. It is not a problem of space in our embassies. It is really an effort by UKBA to drive down the cost of the operation by going for this hub and spoke model.

**Q77 Mr Davidson:** In a sense they are not here to answer themselves but I just wanted to be clear because in paragraph 1.8 it talks about employing some 3,000 staff from or recruited via the FCO but you then have no responsibility for them once they are handed over?

**Sir Peter Ricketts:** The Home Office set the policy on the visa issuing but they contract to us, if you like, to provide a visa service abroad so we provide the staff, we receive the applications.

**Q78 Mr Davidson:** So the enormous queues in some locations that I have seen would be your responsibility or theirs?

**Sir Peter Ricketts:** It is our responsibility to manage them well in the embassies. I do not know when you have last seen a queue outside an embassy because more often than not we have outsourced the application process to commercial providers who have downtown offices who collect all the data, the passports and money and send them into the embassy, and therefore queues outside embassies are a thing of the past in my experience.

**Q79 Mr Davidson:** I am glad to hear that because, yes, my experience might be dated. If I were in any of the locations in South Asia I would not see queues; is that correct?

**Sir Peter Ricketts:** Absolutely not and you would not see members of the public coming to the embassy because they would go to a downtown office.

**Q80 Mr Davidson:** And be queuing there?

**Sir Peter Ricketts:** They have got plenty of staff so, no, it is not bad actually, and the decisions are taken by people sitting in the embassy.

**Q81 Mr Davidson:** I accept that my information is perhaps dated but if that is overcome that is good.

**Sir Peter Ricketts:** There used to be a real problem with visa queues but this outsourcing has helped a lot.

<sup>3</sup> Ev 17

**Q82 Mr Davidson:** You have brought in talent at the top level which I think we very much welcome. Can you clarify for me why you think it was that the Foreign Office was so bad in the past and had such a bias against numbers basically?

**Sir Peter Ricketts:** I think we are an organisation that is there to do foreign policy and the people who come to the Foreign Office are basically interested in foreign affairs and going out and doing business in the world and over the decades not enough attention was paid, frankly, to managing the money, the resources and the people, and I think we have understood it is no good just being good at foreign policy; you have got to manage your business properly.

**Q83 Mr Davidson:** To what extent have you overcome the fact of being unrepresentative of society as a whole? For our Kenyan visitors they will see in many sections of government we have got the tribe, as it were, of public school/Oxbridge people occupying a disproportionate number of positions at the top of the government system. To what extent is that still the position in the Foreign Office?

**Sir Peter Ricketts:** Unfortunately we are three white males here. I cannot avoid that.

**Q84 Mr Davidson:** How many of you are from public schools?

**Sir Peter Ricketts:** No actually. I checked on members of my board. We have 11 members of the board and seven went to state schools.

**Q85 Mr Davidson:** So five did not, five went to public schools.

**Sir Peter Ricketts:** Four.

**Mr Davidson:** Sorry!

**Mr Bacon:** It is obvious which one you went to!

**Q86 Mr Davidson:** You spotted that deliberate mistake! That is still disproportionate but that is very helpful. In terms of the top 10 officials inside the Department outwith the board, what would the pattern be there? Is the pattern at the top level different from the pattern at the bottom level of people coming in?

**Sir Peter Ricketts:** Yes, we are much more representative of modern Britain with the people that we are recruiting today. We recruit pretty much 50/50 men and women and large numbers of ethnic minorities from all part of the UK. My generation is a reflection of what we recruited 30 years ago and there were many more men. Some were public school, although I am not from public school and a lot of my colleagues are not, and we were not as representative of modern Britain as the intake generation now is, absolutely. As they are growing up through the Foreign Office we are getting more women into more senior jobs, more women ambassadors, more ethnic minorities in senior positions. At the top we are still white and male.

**Q87 Mr Davidson:** I understand the point about women and race and so on. More difficult to measure is the question of social background. To what extent are you less socially exclusive than you used to be and can you produce figures to substantiate it?

**Sir Peter Ricketts:** I do not feel we are socially exclusive at all.

**Q88 Mr Davidson:** There again the Foreign Office never did and it clearly was, so what evidence can you produce to show that you are less socially exclusive than you were?

**Sir Peter Ricketts:** I think if you looked at the qualifications of the people in top jobs around the Foreign Office now you would find scientists, you would find people from all parts of the UK, people who have been to universities in all parts of the UK, with very different life stories, and we are not by any means a socially homogenous group.

**Q89 Mr Davidson:** Do you have figures that monitor this?

**Sir Peter Ricketts:** That is a purely impressionistic survey.

**Q90 Mr Davidson:** Let me be clear. You have figures that would monitor gender and you have figures that would monitor race, but you do not have any figures that monitor social origins?

**Sir Peter Ricketts:** Correct.

**Q91 Mr Davidson:** Which would tend to be an indication to me that you do not take that seriously.

**Sir Peter Ricketts:** No, Mr Davidson, I would disagree.

**Q92 Mr Davidson:** Surely if you did take it seriously you would monitor it?

**Sir Peter Ricketts:** I do not think it matters, frankly, what social background people come from, as long as they bring intellect—

**Q93 Mr Davidson:** That is a traditional Foreign Office view, is it not?

**Sir Peter Ricketts:** I do not know if it is or not.

**Q94 Mr Davidson:** It used to be a traditional Foreign Office view that it did not matter what gender people were either but when we moved into the 20th century that started to change and now all the time the top of government is becoming more progressive and aware of the range of abilities and talents that there are in society. You are saying that the Foreign Office does not monitor social origins and sees no need to do so?

**Sir Peter Ricketts:** I do not know how we would start to monitor social origins.

**Q95 Mr Davidson:** So you do not even know how to do it. I am having a lot of my prejudices confirmed. Is it something that has ever been discussed in the Department?

**Sir Peter Ricketts:** We monitor diversity in all sorts of ways, the number of women, the number of ethnic minorities.

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**Q96 Mr Davidson:** Run through the numbers of ways you monitor it again—gender, race, easily visible.

**Sir Peter Ricketts:** What we are trying to do is recruit the best people for the jobs.

**Q97 Mr Davidson:** Sorry, what other ways did you monitor diversity?

**Sir Peter Ricketts:** We recruit qualified accountants when we need accountants. We look for people with the right skills for the job.

**Q98 Mr Davidson:** I understand the point about accountants being diverse but in terms of coming back to the usual categories, and you indicated race and gender, I am seeking to clarify what other categories you monitor.

**Sir Peter Ricketts:** I wonder if I could ask you what other categories you think we should monitor for social origin?

**Q99 Mr Davidson:** The way it usually works is we ask the questions but social origin, disability for example?

**Sir Peter Ricketts:** Yes.

**Q100 Mr Davidson:** So you have figures for disability and you have figures for social origin? No? Educational background?

**Sir Peter Ricketts:** I am trying to understand what you mean by social origin.

**Q101 Mr Davidson:** By educational background, by geography?

**Sir Peter Ricketts:** No, we do not collect that data.

**Q102 Mr Davidson:** I cannot think of anybody from my constituency who has ever gone to work in the Foreign Office. Nobody knows of anybody. There is not a role model. If I thought there was a role model then I would wheel them out round the schools in my area. I have managed to get some senior policemen. I have managed to get some people who are Army officers (because most of my constituents would join the Army at a different level) to show people that these jobs are open to them. I could wheel out lots of apprentices and so on and so forth. I have never found anybody from the Foreign Office. I find that a cause for concern. I am also concerned that is something that has not occurred to yourself.

**Sir Peter Ricketts:** I am very conscious that we should have as diverse a group of people in the Foreign Office as possible, diverse from all parts of the UK, from all sorts of educational backgrounds and all sorts of degrees and qualifications, but I have not tried to quantify social origins.

**Q103 Mr Davidson:** I find it interesting because I remember having this conversation with Robin Cook when he was Minister at the Foreign Office, and he was echoing the concerns I had and indicating that he was going to try and do something about it to make sure it was more socially diverse.

There was, I seem to remember, a brief effort at that time to do so but that seems to have disappeared now.

**Sir Peter Ricketts:** I recognise the word diverse and we are desperately trying to increase the diversity of the Foreign Office. It is the social diversity that I am struggling with.

**Mr Davidson:** Thank you, Chairman.

**Chairman:** Mr Bacon has a last question.

**Q104 Mr Bacon:** I have just a couple of questions about the pattern of underspending because the NAO Report tells us there has been a consistent pattern of underspending over several years, which one might think highly commendable and a cause for a reduction in your budget but it does not appear to be that the underspend was deliberate. In fact the Report goes on to say that you actually bid for extra resources. This is in paragraph 2.59. “Part way through the year a predicted overspend led to a request from the Foreign Office to the Treasury for additional resources.” Yet in that year as the financial year end approached the forecast resource and capital expenditure outturn reduced to an eventual underspend of £128 million. We are familiar in the National Health Service with underspends and overspends and deficits and so on and a year or so ago there was a surplus of £500 million which was based on a budget of £100 billion. You are tiny compared to that and yet you have still got £100 million sloshing around more than you thought you had. How does that happen?

**Sir Peter Ricketts:** Mr Bacon, I absolutely share your frustration at that tendency to underspend we have had for many years. The NAO Report is right in what they say in paragraph 2.50 where they list a number of reasons why we were traditionally underspenders. We did not have the financial skills and we did not have confidence in the budget. There was an extreme keenness not to overspend and that was leading to an underspend. I have made it a priority of mine to try to reduce that underspend. The reasons why we underspent in that year 2007–08 are also set out somewhere in the Report.

**Q105 Mr Bacon:** At 2.60 and a little of bit of it was due to the change in sterling. However, £64 million of the underspend was in part due to higher than expected efficiencies in reducing expenditure. I have yet to translate that into English in my own mind but higher than expected efficiencies in reductions of expenditure led to a £64 million underspend. You hire the brightest people. It is known that the Treasury and the Foreign Office hire the brightest people out of universities and although they will not necessarily be financial managers, how difficult is it, notwithstanding the issue about the conversion of currencies, to figure out here is a certain sum of money that you have got to spend, no more and no less, and go and spend it to achieve the objectives of the department? It is an extraordinary gap for a department that is relatively small?

**Sir Peter Ricketts:** I share a lot of your frustration. Can I explain to you where I think we are on underspends. In that year you referred to, as you say,

a £118 million underspend on our overall resource budget, 5.7%, is absolutely unacceptable, and I share the Committee's view of that. Some of it was because we were able to save some money on our security costs in the Middle East. Some of it was because we found that our UN subscriptions in those great days when sterling was stronger cost us less. There were a number of things like that. We should have spotted them. Half of that underspend is in this mysterious category called annually managed expenditure which is something I feel I have no control over as accounting officer because it effectively relates to the valuations of our buildings abroad and write-downs on those valuations when we occupy the buildings, so if the valuation is higher the write-down is lower and we have an underspend in our annually managed expenditure. That was about half the total. The following year, the year that has just closed 2008–09, we were down to £69 million in total, 3.2%, which is lower, and almost all of that was impairments on annually managed expenditure. On the budget that I control, the near-cash budget, we were within a whisker of a 100% spend. That is largely because of having to absorb all the pressures of the currency movements but we are determined to maintain that. I think we have stopped being an underspending department—I am very keen it should not be an overspending department either—as a result of better financial management and also as a result of the pressures on us from sterling that underspend has essentially gone, except in this category of annually managed expenditure which relates to movements that I do not control as accounting officer.

**Q106 Mr Bacon:** Just a couple of other areas. On information available to the board it says in paragraph 2.73 that the board is still having to get quite detailed information to support the high-level data so that members of the board can drill down to the underlying figures. At 2.74 it says: "Until the Board has absolute confidence in how the high level figures are derived, it is likely that the Report will remain a lengthy document." Plainly, if the Board cannot rely on the figures upon which it is being asked to make decisions then it cannot be confident to make those decisions. How long is it going to be before you have information that you can rely on? Can you give me an example of one of these key performance reports, which are the in-year financial information reports, that has formed the basis for a significant board decision?

**Sir Peter Ricketts:** In terms of reliance on the numbers, I think our confidence level is rising all the time and we will be at Five Star Finance at the end of our finance improvement programme when there is one set of numbers universally recognised around the organisation, and I hope that by next summer, which is the date we have set to be at Five Star Finance, we will have got to that point. Then the board can perhaps reduce the size of this key performance report. It is actually full of very useful data but our confidence level is growing and the sorts of things that are covered in it are set out in the table on page 26 of the NAO Report. That gives you an

idea of the sort of ground we are covering in it at the moment. This key performance report, the monthly report to the board, showed up earlier this year that we were heading for an overspend in the budget because of currency pressures on us and other pressures that had arrived in our budget and it was the signal for us to take some pretty drastic action to cut costs this year to bring us back on to a profile to spend fully but not to overspend. That was a signal to the organisation upon which we acted to start looking at costs.

**Q107 Mr Bacon:** Finally you said earlier in response to a question about the hierarchy of properties that it was now much more egalitarian than it used to be. You will know Belgium and Brussels well. When we were visiting Brussels recently, among other things to see OLAF, the anti-fraud agency in Brussels, we met Kim Darroch, and we went to the residence which used to be the residence of the British Ambassador to Belgium. A swap was done and the British Ambassador to Belgium was, from what we understand, kicked out into a bungalow in the woods and UKREP and the UKREP Ambassador went to this rather smart palace is not too grand a word in the centre of Brussels. How does that tie in with your egalitarian approach? How does the British Ambassador to Belgium feel about being shoved out in the woods?

**Sir Peter Ricketts:** The Ambassador who has most visits by Cabinet ministers, Members of Parliament and other senior visitors is the UKREP Ambassador and therefore it is right he should have a place to do honour to them and entertain them properly. The Ambassador to Belgium has less of an entertaining load, frankly and therefore can manage in a smaller, more modest property. We are not entirely egalitarian in the sense that ambassadors do get the residence but below that level the space you get depends on the size of the family you have rather than the rank you are.

**Chairman:** I think Mr Davidson has a last supplementary.

**Q108 Mr Davidson:** Could I just return to the point I made about diversity before. I wonder if you could give the Committee a note outlining the steps that the Foreign Office has taken and any indication that you have of success, not just in terms of gender and race but in terms of being more egalitarian and less exclusive and elitist as an organisation?<sup>4</sup>

**Sir Peter Ricketts:** I will do my best, Mr Davidson.

**Mr Davidson:** I am sure you will. Thank you.

**Q109 Chairman:** My last question is to the Treasury because I was a bit underwhelmed by the response to the questions we were putting to you about our campaign to get professionally qualified finance directors in place. You said that you would take it up with the management group. I take it that you are talking in terms of real action and not just talking about this?

<sup>4</sup> Ev 17

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**Mr Gallaher:** Absolutely.

**Q110 Chairman:** Sir Peter and colleagues, that concludes our hearing. Clearly you have a pat on the back from the NAO which is richly deserved, but there is this worrying underspend which we have

talked about in the latter part of this hearing which shows that we are still to make further progress in better financial management, which I am sure you will achieve.

**Sir Peter Ricketts:** Thank you very much, Chairman.

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**Memorandum by the Comptroller and Auditor General, National Audit Office**

The purpose of this memorandum is to provide an update to the above mentioned C&AG's Report incorporating figures from the FCO's Departmental Report and Resource Accounts for 2008–09 and recent progress on the Five Star Programme. (Note references are to the original Report).

**SUMMARY**

1. The Department has responded positively to the recommendations raised in our report and continues to work to drive through the changes required to improve its financial management. The headline out-turn figure for 2008–09 shows a reduction in the net underspend to £59 million (2.5%) [Figure 2]. This is an improvement over the Department's performance in recent years, meeting the Accounting Officer's challenging target for an overall underspend of less than 1% for controllable costs (Paragraph 2.62).

**IMPROVING FINANCIAL MANAGEMENT**

2. The Department has recently assessed itself as having achieved four stars under its Five Star Finance programme. It aims to achieve four and a half stars by January 2010 and five stars by July 2010. Achievement of four stars partly reflects the implementation of new IT systems, and specifically that of "Hyperion" (Paragraph 2.54), the new budgeting tool. Hyperion is designed to improve the management of budgets and to allow for clearer linking between operational and financial reporting. The Department plans for the rollout of Hyperion to be phased, starting with 50 key users in the UK in October 2009, other UK staff in November and then across the overseas network, starting with key posts in Europe and North America from January 2010.

**FINANCIAL GOVERNANCE AND LEADERSHIP**

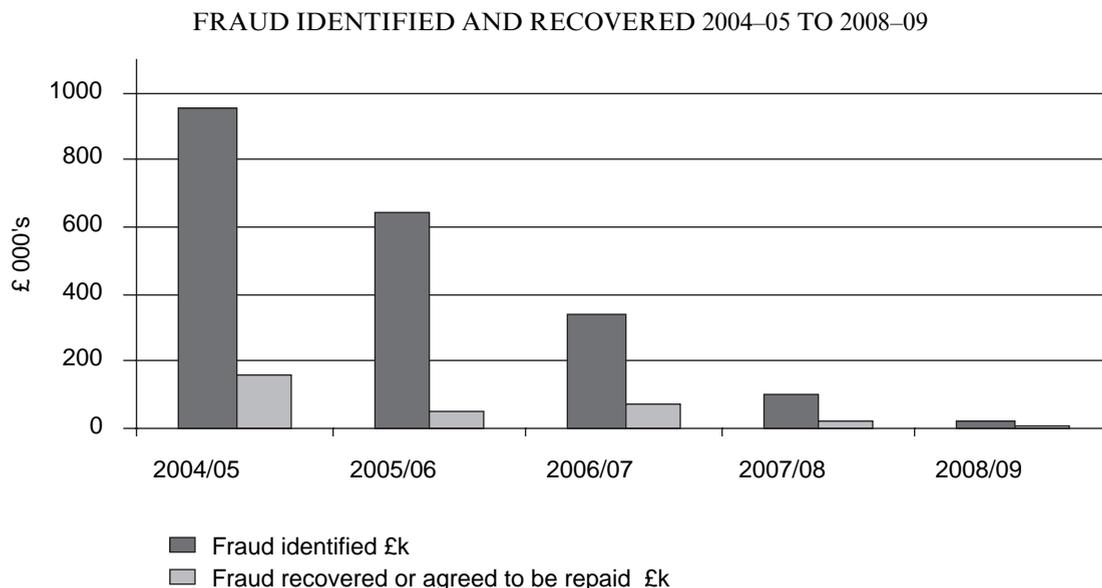
3. The Department recruited eight trainee accountants in 2008 (Paragraph 2.18) and a further seven in 2009 to the Government Finance Professionalism training schemes. Including existing staff undertaking qualifications, the Department is currently sponsoring 57 staff for professional finance training, an increase of 90% over 2008. The percentage of qualified staff within the finance function has increased from 8% in 2008 (Paragraph 2.13) to 12% in September 2009. The increase is a result of direct recruitment of qualified staff and the higher take-up of the Department's various professional skills training programmes.

4. The Department has set a target for the reduction in its use of contractors (Paragraph 2.23) by 45–50% from the 2008 figure. It has told the NAO that it is on track to achieve this target. To this end, a specialist recruitment campaign was held in late 2008. The Department expects to deploy those recruited by the end of 2009.

## FRAUD

5. The downward trend for reported fraud and fraud recoveries (Paragraph 2.11) within the Department continued in 2008–09 (Figure 1); fraud valued at £20,000 was identified in the year and £8,000 was recovered or agreements put in place for repayment. It remains unclear whether this reduction is the result of a tighter control framework or a reduction of the number of Whistleblowers (the main source of identifying fraud).

Figure 1 (Update of Figure 10)



## FINANCIAL PLANNING

6. The Department implemented quarterly Activity Recording from April 2008 (Paragraph 2.31). This has enabled it to begin to understand better its costs and allocate them to Departmental Strategic Objectives. The Department considers that the accuracy of data is improving, and it is being used increasingly during the financial year, not just at the year end.

7. The Cabinet Office Capability Reviews of FCO in 2008 and 2009 noted that good progress had been made in embedding the business planning process and culture across the Department and that the quality of business plans has improved in the last 12 months. As a result, the 2009 Capability Review updated its assessment of business planning from an “urgent development area” to a “development area”.

## FINANCE FOR DECISION MAKING

8. During 2008–09 the Department introduced a requirement that all submissions to the Finance and investment committees (Paragraph 2.42) had to include sensitivity analysis. Submissions are also required to identify areas of uncertainty, and how these uncertainties impact on the overall financial risk of the project.

## FINANCIAL MONITORING AND FORECASTING

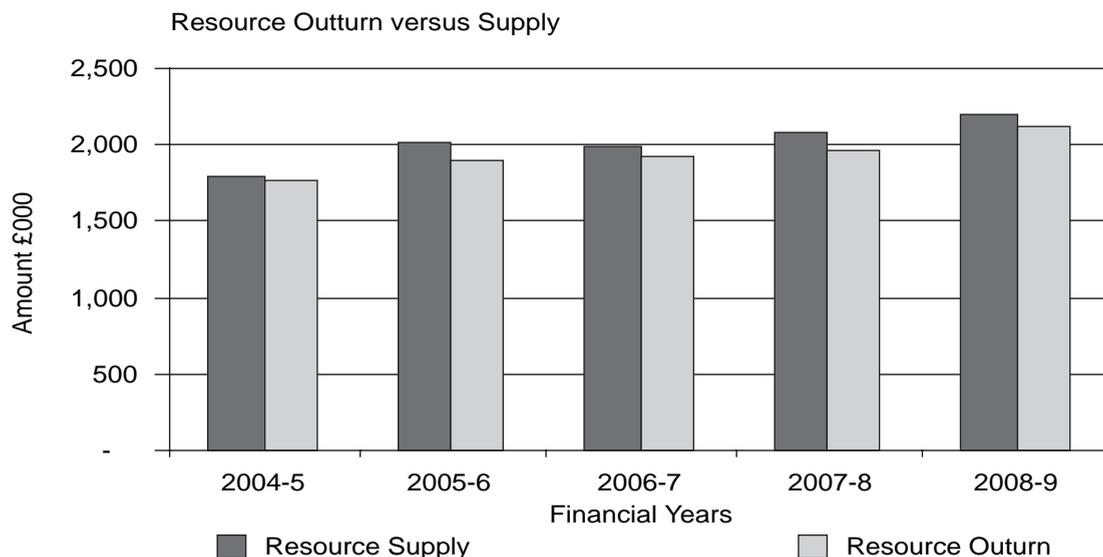
9. In 2008–09 the Accounting Officer set the Department a challenging target of spending within 1% of controllable costs. This target was achieved. Overall, taking into account non-controllable Annually Managed Expenditure, the Department came within 3% of its resource allocation (£69 million; Figure 2). This is in contrast to its recent history of underspends (Figure 3) (Paragraph 1.25). However, the Department overspent its Capital budget by £10 million (Figure 4).

10. During 2008–09, the Department introduced a system of quarterly reviews of the budgets and forecasts at Director General level to help identify likely underspends (Paragraph 2.63) and potential additional cost pressures. The increased focus resulted in the release of excess budget to central finance in the first half of the year of £36 million. This was re-cycled to other priority areas within the Department.

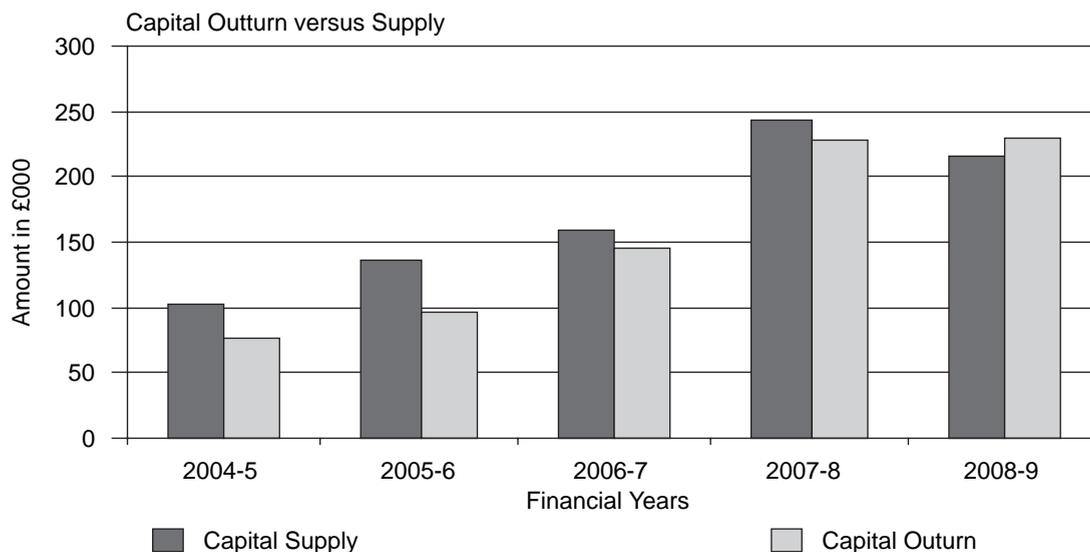
**Figure 2 (Update of Figure 14)**  
DEPARTMENT'S SPEND IN 2008-09

<i>Budget expenditure type</i>	<i>Budget (£m)</i>	<i>Actual (£m)</i>	<i>Underspend/ (Overspend) (£m)</i>
Resource	2,194	2,124	69
Capital	225	235	(10)
Less depreciation	(80)	(80)	—
<b>Total</b>	<b>2,339</b>	<b>2,279</b>	<b>59</b>

**Figure 3 (Update of Figure 6)**



**Figure 4 (Update of Figure 7)**



#### FINANCIAL AND OPERATIONAL REPORTING

11. The Department was the first of the main Whitehall departments to lay its combined 2008/09 Departmental report and accounts before Parliament, on the 30 June 2009 (Paragraph 2.73).

12. The Department has told us that it is continuing to work to improve the format of the Key Performance report considered by the Board in support of in-year re-prioritisation of financial resources. The Department expects to issue its first Hyperion based KPR to the Board for November 2009. This is expected to enhance significantly the linkage between operational and financial reporting within the Department with a view to increasing the Board's confidence in the figures reported.

**Memorandum from Sir Peter Ricketts KCMG, Permanent Under Secretary of State, Foreign and Commonwealth Office**

When I appeared before the Committee on 21 October, I was asked to provide further material on the following:

- the new Residence for the Ambassador to the Holy See;
- the arrangements regarding the payment of tax for FCO staff seconded to the EU Commission;
- Social diversity in the Foreign and Commonwealth Office; and
- the costs of overseas posts.

Question 56 (Mr Bacon): *Holy See Residence*

The former Residence, Villa Drusiana, was originally given up in order to move the Ambassador into an owned property on the Villa Wolkonsky compound, which houses the Residence of our Ambassador to Italy and other staff accommodation. The Vatican had advised us that they would be content with this arrangement. After we had served irrevocable notice to quit Villa Drusiana the Vatican informed us that they were no longer willing to accept that the Villa Wolkonsky compound should provide the Residence of our Ambassador to the Vatican.

A suitable replacement property was found at a total annual cost (rent, rates, community charge and parking) of €201,064: significantly less than the annual lease on the Villa Drusiana which had increased to €300,000 from 1 April 2006. The new Residence is more centrally located in Rome and thus easier to get to and it also has ample car parking attached (which was a problem at the old location). The central location, and a new outsourced system of catering, staff headcount, has led to a dramatic increase in the use of the residence for representational purposes while at the same time reducing costs significantly. For example, in the most recent calendar year for which figures are available (2008) over 1,500 people were entertained at the residence. This represents a threefold increase on the numbers entertained at the old residence, but on a budget which is 60% less than the 2005 figure in purchasing power terms. One innovation made possible by the move has been a series of dinners to mark the Queen's Birthday instead of the traditional large Reception. This has attracted more senior guests while at the same time reducing expenditure.

Question 75 (Mr Davidson): *Taxation arrangements for FCO staff seconded to the EU*

All FCO staff on secondment from the FCO to EU Institutions remain on the FCO payroll and pay UK tax. On occasion some staff have taken special unpaid leave to take up jobs in EU institutions, and in these cases they fall under the tax regime of the relevant part of the EU institution for which they are working. But in these cases they are not FCO employees and are not working for the British Government.

Question 108 (Mr Davidson): *Social Diversity in the Foreign and Commonwealth Office*

There is a legal requirement that we must monitor the gender, ethnicity and disability status of our staff. We are not legally required to monitor their regional/social/educational background, or indeed other elements of diversity such as sexual orientation or religion, but we would obviously like to be helpful. We are working with the Cabinet Office as they consider this question of monitoring other aspects of diversity.

We are getting the message out to local communities, schools and universities UK-wide that the FCO welcomes people from all parts of UK society. We have identified a range of measures to help the FCO create a more inclusive culture, attract and retain talent from the widest available pool and better represent modern Britain.

We actively seek to recruit staff from all regions of the UK. Over the next year we plan to attend regional careers fairs in Belfast, Birmingham, Cardiff, Edinburgh, Glasgow and London. In addition we plan to attend university careers fairs in Bath, Bristol, Cambridge, Durham, Edinburgh, London, Nottingham, Manchester and Oxford. The Diplomatic Service is also promoted annually by the Cabinet Office's Fast Stream at universities and schools fairs across all regions of the United Kingdom.

To attract broader talent we have launched two new recruitment initiatives. The Partner University Programme, partners the FCO with 10 of the UK's best performing universities with the aim of attracting high-calibre undergraduates from ethnic minority and low income backgrounds. In 2008 59 students applied and 21 students were selected to take part. The Band D external recruitment campaign brought a range of diverse skills into the organisation at Team Leader level including project /financial/change management and hard language skills.

There are certain minimum educational qualifications required for entry to the FCO. The level required for recruitment to our A1 Band is two GCSEs or Standard Grades, for our A2 Band it is five GCSEs or Standard Grades, and all other Bands require an undergraduate degree. Apart from some technical jobs where relevant qualifications are required eg finance, no account is taken of educational background in choosing people for posts. Between bands A to SMS1 staff are promoted on merit through assessment centres and promotion competitions. Appointments in these grades are decided by competence based

interview chaired normally by the line manager. Over time, as the diversity of the office increases so will the diversity of our senior management. Some measures we have taken to broaden the mix of staff internally include opening all senior jobs to competition from across Whitehall.

From my own contact with our new entrants, I know that they do increasingly represent modern Britain in terms of regional background and in other ways. In the absence of comprehensive data, I did a straw poll among 31 recent recruits to our Fast Stream programme. A significant majority came from State schools (19 against 11 from private schools and one from a religious school). Six were from Scotland, including four from Glasgow.

Question 42 (Mr Bacon): *Costs of Overseas Posts*

I have attached to this letter as an annex a table which shows the costs for each of the Foreign and Commonwealth Office's (FCO) British diplomatic missions overseas for the financial year 2008–09. These figures represent the combined income, excluding that from property sales which would otherwise distort the return, eg Madrid, and expenditure totals for each mission, but do not include central overhead and programme costs. Where a negative figure is shown in the table, this indicates that the mission generates more income than it costs to run. This net income from issuing visas is returned to UKBA and does not fund the FCO. Staff numbers at each Post are also listed, although some posts listed are only manned seasonally, by staff employed locally or by Honorary Consul. Some have also now closed although there are residual estate costs.

30 November 2009

**Annex**

2008–09 COSTS OF OVERSEAS POSTS

<i>Post</i>	<i>Total not including central overheads, Programmes and Proceeds From Sale of Capitalised Assets</i>	<i>Staff Numbers</i>
Baghdad	£29,965,383	65
Kabul	£26,376,466	116
UKMis New York	£22,478,210	88
Paris	£17,018,913	176
Berlin	£14,733,604	98
Tokyo	£13,321,765	144
Washington	£12,817,750	223
Brussels UK Rep	£10,906,955	131
Peking	£9,227,459	238
Rome	£8,554,413	108
Madrid	£7,027,605	112
Brasilia	£6,933,971	150
Khartoum	£6,888,789	241
Warsaw	£5,928,649	76
Nairobi	£5,759,236	150
Vienna Embassy	£5,371,835	51
Athens	£5,320,477	73
Erbil	£5,110,129	3
Ankara	£5,054,948	94
Hong Kong CG	£4,918,549	106
Basra	£4,807,907	12
Singapore	£4,746,511	82
Moscow	£4,626,384	198
Mexico City	£4,332,602	85
Copenhagen	£4,295,678	50
Berne	£4,198,554	33
The Hague	£4,174,365	47
Buenos Aires	£4,098,300	66
Brussels Embassy	£4,052,875	69
Stockholm	£3,740,423	52
Lashkar Gar	£3,738,413	28
Brussels UK Del	£3,582,363	38
Budapest	£3,580,748	54
Lisbon	£3,562,122	49
Nicosia	£3,545,347	66
Tel Aviv	£3,505,860	52
Seoul	£3,462,196	80

<i>Post</i>	<i>Total not including central overheads, Programmes and Proceeds From Sale of Capitalised Assets</i>	<i>Staff Numbers</i>
Sao Paulo	£3,395,780	46
Bucharest	£3,395,398	55
Helsinki	£3,387,591	41
Caracas	£3,314,990	43
Beirut	£3,306,733	20
Geneva CG	£3,265,913	34
Abuja	£3,251,058	236
Jakarta	£3,249,842	87
Oslo	£3,217,558	38
Bogota	£3,213,170	100
Prague	£3,164,021	60
Amman	£3,072,255	109
Sana'a	£3,055,430	100
Sofia	£3,037,748	42
Addis Ababa	£2,996,870	159
Jerusalem	£2,976,815	62
Baku	£2,880,295	42
Osaka	£2,811,485	26
Santiago	£2,753,287	49
Belgrade	£2,748,896	67
Kinshasa	£2,728,009	75
Kingston	£2,721,879	76
San Francisco	£2,683,145	29
Kuala Lumpur	£2,625,435	116
Algiers	£2,561,412	49
Jeddah	£2,552,825	35
Accra	£2,540,837	325
Rabat	£2,535,273	75
Brussels JMO	£2,500,848	123
Geneva UK MIs	£2,458,891	23
Lima	£2,293,292	52
Milan	£2,240,310	30
Sydney	£2,219,142	23
Dublin	£2,217,968	55
Bangkok	£2,203,741	159
Luanda	£2,146,309	40
Zagreb	£2,075,435	35
Tripoli	£2,007,063	90
Bridgetown	£1,958,671	38
Tbilisi	£1,952,407	32
Kiev	£1,943,186	62
Muscat	£1,919,941	64
Karachi	£1,915,823	81
Havana	£1,911,153	51
Boston	£1,880,014	23
Kampala	£1,875,026	76
Abu Dhabi	£1,855,021	96
Damascus	£1,803,481	37
Almaty	£1,771,486	13
Johannesburg	£1,735,799	25
Gibraltar	£1,734,463	17
Toronto	£1,707,443	26
Pristina	£1,696,768	41
Cairo	£1,672,626	138
Harare	£1,594,329	67
Houston	£1,588,219	24
Montevideo	£1,575,925	23
Valletta	£1,570,804	26
Chisinau	£1,543,719	28
Ottawa	£1,525,778	67
Sarajevo	£1,507,393	36
Munich	£1,494,983	20
Freetown	£1,491,416	239
Dusseldorf	£1,458,180	71

<i>Post</i>	<i>Total not including central overheads, Programmes and Proceeds From Sale of Capitalised Assets</i>	<i>Staff Numbers</i>
Vilnius	£1,453,939	25
Port of Spain	£1,453,286	30
Lusaka	£1,418,244	37
Guangzhou	£1,413,052	81
Tallinn	£1,408,526	31
Dar Es Salaam	£1,406,782	55
Bratislava	£1,399,594	25
Chongqing	£1,369,939	36
Shanghai	£1,363,175	88
Cape Town	£1,357,021	39
Ljubljana	£1,356,602	17
Maputo	£1,354,739	33
Melbourne	£1,353,296	15
Belmopan	£1,330,558	31
Georgetown	£1,291,889	23
Tunis	£1,256,422	54
Hanoi	£1,232,990	39
Skopje	£1,204,644	36
Guatemala City	£1,199,978	22
Rangoon	£1,195,957	93
Luxembourg	£1,166,540	12
Rio De Janeiro	£1,155,716	43
Bandar Seri Begawan	£1,143,493	23
Barcelona	£1,065,212	17
St Helena	£1,062,972	3
Malaga	£1,038,869	10
Riga	£1,038,142	28
Pyongyang	£1,006,541	10
Suva	£985,427	20
Tashkent	£973,123	64
Panama City	£959,175	19
Tehran	£958,108	149
Miami	£938,830	15
Taipei BTCO	£928,663	54
Dushanbe	£925,878	38
Lille	£911,327	11
Vancouver	£903,414	14
Phnom Penh	£869,593	29
Geneva UK Del	£864,874	6
Kigali	£853,860	27
San Jose	£849,442	20
Port Moresby	£844,923	15
Strasbourg	£840,952	10
Grand Turk	£830,370	6
Yaounde	£814,218	48
Quito	£793,277	24
Atlanta	£786,231	9
Vienna OSCE	£783,957	13
Yerevan	£765,887	19
La Paz	£744,289	20
Ashgabat	£739,414	17
Naples	£732,472	10
Plymouth	£713,111	5
Reykjavik	£695,189	10
Santo Domingo	£694,948	14
Vienna UK Mis	£691,691	10
Lilongwe	£689,496	44
St Petersburg	£647,684	28
Tortola	£646,109	6
Tristan Da Cunha	£626,074	1
Anguilla	£623,546	5
Stanley	£615,386	4
Lyon	£611,473	10
Dakar	£577,021	35

<i>Post</i>	<i>Total not including central overheads, Programmes and Proceeds From Sale of Capitalised Assets</i>	<i>Staff Numbers</i>
Podgorica	£576,437	8
Brisbane	£568,051	9
Holy See	£551,965	5
Auckland	£533,450	10
Victoria	£514,377	9
Honiara	£505,691	11
Windhoek	£504,707	22
Grand Cayman	£504,390	6
Montreal	£502,324	6
Vientiane	£497,808	1
Ibiza	£479,582	4
Al Khobar	£476,166	9
Perth	£463,647	7
Ekaterinburg	£457,251	11
Asmara	£456,338	10
Ho Chi Minh City	£453,042	29
Bordeaux	£446,025	6
Banjul	£444,605	72
Alicante	£407,858	9
Port Louis	£407,377	22
Astana	£406,779	25
Bangalore	£404,313	17
Tenerife	£401,001	5
Palma	£378,666	6
Florence	£371,692	7
Marseilles	£363,048	6
Portimao	£355,777	7
Gaborone	£343,293	18
Alexandria	£324,870	17
Ascension Islands	£316,411	1
Abidjan	£290,092	6
Las Palmas	£279,402	4
Castries	£265,010	4
Orlando	£262,311	6
Tirana	£253,690	36
Hamilton	£248,275	3
Casablanca	£245,482	20
Ulaanbaatar	£232,803	13
Conakry	£205,352	4
Doha	£202,409	43
Bilbao	£196,013	4
Kaduna	£186,941	0
Monrovia	£180,134	1
Calgary	£171,166	3
Denver	£167,566	2
Bahrain	£133,094	45
St John's	£128,664	0
Venice	£123,885	2
Banja Luka	£112,826	4
Oporto	£112,374	1
Kathmandu	£93,073	111
Tangier	£89,764	2
Hyderabad	£84,256	5
Atyrau	£74,608	2
Monterrey	£71,309	4
Port Harcourt	£61,262	1
Bujumbura	£51,341	1
Corfu	£41,971	3
Funchal	£36,737	1
Heraklion	£35,416	3
Lahore	£35,043	1
Durban	£30,101	4
Chiang Mai	£28,880	1
Guadalajara	£28,277	2

<i>Post</i>	<i>Total not including central overheads, Programmes and Proceeds From Sale of Capitalised Assets</i>	<i>Staff Numbers</i>
Salonika	£25,664	1
Bamako	£24,562	1
Izmir	£22,608	5
Nassau	£22,300	0
Phuket	£16,044	0
Kingstown	£15,348	76
Rhodes	£14,280	2
Recife	£13,825	2
Porto Alegre	£13,342	2
Pattaya	£12,338	0
Djibouti	£11,579	0
Curacao	£10,716	0
Genoa	£10,362	0
Zakynthos	£7,257	1
Juba	£6,723	0
Kos	£6,677	2 seasonal
Port Elisabeth	£6,104	1
Azores	£5,820	0
Asuncion	£5,691	0
Patras	£5,667	0
Nuku'Alofa	£5,039	0
Vienna UK Del	£4,734	12
Port Au Prince	£4,588	1
Cagliari	£4,230	0
Cali	£3,525	1
Vigo	£2,656	1
Paramaribo	£2,430	0
Cartagena	£2,390	1
Bissau	£2,143	0
Ahmedabad	£1,955	2
Pune	£1,854	0
Dallas	£1,521	0
Seattle	£1,472	0
Medellin	£1,450	1
Kandahar	£1,325	0
Curitiba	£1,198	0
Antananarivo	£787	1
Amsterdam	£707	15
Maseru	£594	0
Fukuoka	£549	0
Mbabane	£363	0
Antwerp	£329	0
Adelaide	£304	0
Eilat	£227	0
Nagoya	£66	0
Kano	£60	0
Aden	£50	0
Douala	£40	0
Tegucigalpa	£18	0
Stuttgart	-£188	0
St George's	-£366	0
Dili	-£1,057	0
Varna	-£5,980	0
Pretoria	-£7,588	169
Minsk	-£8,894	19
New York CG	-£80,035	96
Chicago	-£410,297	24
Dhaka	-£516,705	273
Colombo	-£919,603	102
Kolkata	-£973,085	44
Manila	-£1,193,041	95
Los Angeles	-£1,231,761	49
New Delhi	-£1,267,267	402
Kuwait	-£1,372,816	84

<i>Post</i>	<i>Total not including central overheads, Programmes and Proceeds From Sale of Capitalised Assets</i>	<i>Staff Numbers</i>
Lagos	– £1,449,438	323
Dubai	– £1,470,006	101
Wellington	– £1,853,119	49
Istanbul	– £3,108,523	121
Riyadh	– £3,406,903	105
Canberra	– £6,701,961	100
Islamabad	– £8,911,240	423
Bombay	– £9,521,078	158
Madras	– £12,805,774	107

The headcount numbers shown in the table include staff in place to support other Departments operating on the FCO platform.