National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 291
SESSION 2010–2011

20 JULY 2010

HM Treasury

Progress with VFM savings and lessons for cost reduction programmes

Summary

1 The Treasury is responsible for the Government's financial and economic policy, which includes agreeing spending commitments and priorities with departments. One of its objectives is to improve the quality and value for money of public services. The Treasury has targeted improvements in value for money through a number of programmes, most recently the Value for Money Savings Programme (the VFM Programme) which runs from 2008-09 to 2010-11 and was a requirement of the 2007 Comprehensive Spending Review (CSR07). This report summarises the progress to date, examines the design of the VFM Programme and the resulting incentives for value for money, and the lessons for securing value for money and cost reduction in future.

2 Departments and local authorities have reported annual savings of £10 billion towards the government-wide target of savings totalling £30 billion in 2010-11 (later increased to £35 billion). This represented a saving of at least 3 per cent of departments' expenditure at the start of the period. The required savings were removed from departments' approved CSR07 budgets. Departments therefore needed to make cash-releasing savings in order to deliver their agreed programme within approved spending plans. This does not necessarily mean a reduction in overall spending – the budgets of 11 of the 17 main departments increased in real terms between 2007-08 and 2010-11.

3 CSR07 savings were intended to represent lasting improvements in the way public money is spent. The programme also sought to relate savings more closely with departments' three year spending settlement and day-to-day financial management. The Treasury set out specific criteria which CSR07 savings should meet – they must be new, release cash, be reported net of any in-year implementation costs and be sustainable (see Appendix Three). All CSR07 savings which meet the Treasury's criteria can be described as value for money improvements. However, the concept of value for money is broader than the CSR07 savings definition, and some improvements cannot be counted against the target but can be reported separately as qualitative improvements. CSR07 savings are not the same as efficiency savings, as reported under previous efficiency programmes, which could include improvements in output which did not release cash. However, unlike previous programmes, CSR07 savings can include service reductions in low priority areas.

4 The current financial environment is fundamentally different from the position when the Programme was launched in 2007, with substantial cash reductions required over the next four years by most departments. Not all cost reductions can be reported as CSR07 savings, as the latter are required to be sustainable improvements. However, it remains essential for departments to demonstrate that they have improved value for money and to accurately measure the cost and impact of savings measures.

Key findings

5 Departments have made some progress in their management of their value for money programmes compared with previous spending periods. They have set up or strengthened structures to identify possible future savings and monitor progress. The CSR07 programme addresses some of the weaknesses we reported in previous programmes: targets cover all departmental activity, savings are reported net of costs and the principle that cash should be released has focused attention on reducing costs.

6 However, departments' management of their programmes could have been improved. In particular:

- Departments' planned programmes did not contain sufficient contingency, and at this halfway point only one major department had reported savings of more than 50 per cent of its 2010-11 target. This suggests that while some departments are broadly on course to meet their targets, departments may have difficulty in delivering the overall £35 billion target in 2010-11.
- Savings have not been subject to sufficient internal quality control prior to external reporting.

7 To date we have reviewed savings totalling some £2.8 billion from five major departments which are to deliver around 40 per cent of the total across central government. We concluded that:

- 38 per cent fairly represented sustainable savings;
- 44 per cent may represent savings, but with some uncertainty; and
- 18 per cent do not represent, or significantly overstate, savings.

8 Departments have not fully addressed weaknesses we highlighted with previous programmes to improve efficiency. These problems include the use of unsuitable baselines for the calculation of savings, a lack of transparency over arms-length bodies' reporting processes, and difficulties in demonstrating links between savings and performance. This is partly the result of measurement weaknesses, with many departments not having the robust data systems needed to substantiate improvements in value for money. For example, departments were not required to reconcile reported savings to their CSR07 spending agreement or to their annual audited accounts, and were often unable to do so. Those departments which spend much of their budgets through arms-length bodies face additional challenges demonstrating their savings comply with the VFM Programme. Departments did not always have systems to identify what the arms-length bodies were doing to save money, making it difficult to determine whether savings had been realised.

9 A quarter of the savings resulted from changes to business processes, which may allow staff reductions through improved efficiency, with the remainder drawn from a wide range of areas including accommodation, IT and other procurement. Many reported savings resulted from the continuation of initiatives started in the previous spending period. While this shows that departments were taking sustained action to make savings, further cost reduction will require more innovation and fundamental changes to the way services are delivered. The Programme has focused departments' attention on a narrow set of incentives for savings. Some real improvements which would fall within wider definitions of value for money are not rewarded by the Programme. For example, longer-term reforms which can be costly in the short term and fundamental changes to how services are delivered which would have been difficult to deliver in the three-year timeframe of the CSR07 programme.

Conclusion on value for money

10 The CSR07 savings programme builds on previous initiatives, and addresses some of their weaknesses. Of the reported savings we have examined to date, 38 per cent represent clear improvements to value for money. However, there are uncertainties around a further 44 per cent, which indicates that departments do not have the information on cost and performance to fully demonstrate that savings have been made. The remaining 18 per cent do not represent sustainable improvements in value for money. These results, and the rate of savings reported to date, mean it is unlikely that departments will deliver £35 billion of savings which fully meet the CSR07 criteria. The proportion of savings which do not meet those criteria is evidence that the Programme was not well enough understood across government and of insufficient quality control within departments before savings were reported publicly.

11 Few of the savings made under the Programme represent major departures from previous practice. The Programme did not create sufficient incentive for departments to make wider improvements to value for money, or to reduce their costs. The scale of savings now needed means that departments will have to think more radically about how to reduce costs and how to sustain this in the longer term.

Recommendations

For the Treasury

a **The Treasury set rules for the Programme to ensure savings represented sustainable cash-releasing improvements, but departments reported many savings which did not meet these criteria.** Targets set in terms of cost reduction may be easier to track using existing financial systems than CSR07 savings, but robust criteria for calculating savings will remain relevant. For future savings programmes or similar initiatives, the Treasury should:

- ensure that the technical rules have been widely consulted on, are published and made readily available to working level departmental staff before the commencement of the programme;
- ensure that training has been provided to departments; and
- clarify the benefits for departments and senior officials who are able to demonstrate improved value for money, and the potential consequences for departments which under perform.

b **Departments have reported few savings from major or long-term changes to their business.** To encourage long-term thinking, the Treasury should consider an on-going programme for value for money, rather than just for the three years of a spending period, and set milestones for improvements in systems for delivering value for money, as set out in Part Four of this report (Figure 11). The Treasury should facilitate cooperation between departments, for example on collective purchasing for some standard items, and should support improvement by sharing best practice, benchmarking data and peer review.

For departments

c **Departments do not have sufficient data on cost and performance to evidence all the reported savings.** To reduce the risk that savings cannot be substantiated, departments need to improve their financial systems so that they can identify unit cost of activities and identify better proxies for current performance in areas where the measures used for their key objectives are subject to uncertainty or long delays. Good information will be needed to support planning for cost reduction:

- to ensure strategic decisions about what to stop, change or continue are based on the best possible evidence;
- to understand the effect of potential cost cuts on outputs and outcomes; and
- to track whether benefits are being realised.

d **Some departments are unlikely to realise sufficient cash-releasing savings to meet the cross-government target.** If departments are to find savings which reduce costs without compromising value for money, they need to plan for measures which exceed their target, based on an assessment of the risk of non-delivery which in our experience averages some 20 per cent of annual savings.

e **In many cases, departments could not produce evidence that activities in delegated areas had produced sustainable cash-releasing savings.** If departments are accountable for specific objectives relating to this expenditure, they need sufficient information about local actions to show whether performance is on track and identify variations. Where this is not the case and delivery bodies have discretion about how to operate, these bodies should have direct responsibility for delivering savings. Departments should not report savings in activities which they do not control, and should not be asked to do so.

f **The Programme did not generally require expenditure to be reduced at a departmental level, but this will be needed in future.** Departments will need to plan systematically for cost reduction. This will involve reviewing strategic priorities, evaluating the cost-effectiveness of existing activities and identifying:

- activities which do not contribute enough value and can be stopped; and
- where to innovate and look elsewhere for new ways of delivering services and programmes.

Taking this approach will require major change programmes in departments, for which departments will need change management capability. The longer term goal should be for cost management and continuous improvement to be part of day-to-day business.