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HM Revenue & Customs

Independent review of reported CSR07 value for money savings

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HM Revenue & Customs

Independent review of reported CSR07 value for money savings

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

8 July 2010

The Comprehensive Spending Review 2007 (CSR07) savings programme builds on previous initiatives intended to improve the efficiency and effectiveness of government operations.

Departments have committed to deliver £35 billion of savings during the three years of the Comprehensive Spending Review Period.

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Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/VFM-savings-HMRC-2010

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Summary

Introduction

1 The Comprehensive Spending Review 2007 (CSR07) savings programme builds on previous initiatives intended to improve the efficiency and effectiveness of government operations.

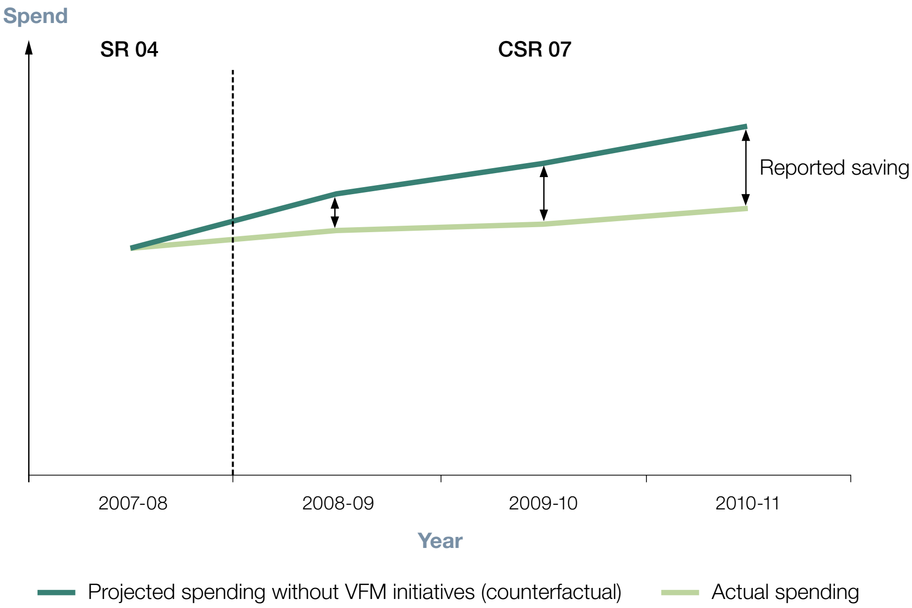
2 During the 2004-05 to 2007-08 spending period, the Government's efficiency programme aimed to secure £21.5 billion of annual efficiency gains; reduce headcount by 70,600 posts; reallocate a further 13,500 posts to the front line of public services; and embed efficiency into the culture of the public sector. Settlements made under the CSR07 for the period 2008-09 to 2010-11 required departments every year to achieve cash releasing savings equivalent to at least 3 per cent of their annual spending. In total, these savings were anticipated to amount to £30 billion across government and local authorities in 2010-11. An additional target of £5 billion was announced in the 2008 Pre-Budget Report, bringing the total anticipated savings to £35 billion.

3 After taking into account the target savings, overall public sector spending was planned to increase by 2.1 per cent a year in real terms during the CSR07 period. Departments were required to identify projects and programmes that would generate cash-releasing savings in order to deliver their agreed commitments within approved spending plans. Following the June 2010 Budget, most departments will be required to make further substantial cash reductions over the next four years.

4 Departments were expected to identify savings against a robust cost baseline. The expected spending in the absence of any actions to contain costs is referred to in Treasury guidance as the counterfactual. The counterfactual is calculated by adjusting 2007-08 spending levels to reflect new spending decisions and unavoidable changes, and increasing by 2.7 per cent a year to reflect the expected domestically generated inflation (GDP Deflator). The reportable cash releasing saving is the difference between the actual in year spend and the counterfactual for that year (**Figure 1**).

5 Individual departments were required to publicise Delivery Agreements that set out the initiatives they planned to put in place to deliver cash-releasing savings. CSR07 savings are to be calculated and reported net of costs in order to recognise the resources invested in the projects or programmes that led to their generation. All departments are required to deliver their savings targets whilst maintaining overall levels of performance, as set out in Departmental Strategic Objectives. Departments' annual departmental reports and autumn performance reports set out the estimated reductions in annual spend achieved over the previous 12 months. **Box 1** defines some key terms.

Figure 1
Illustration of a counterfactual and its use in calculating a VFM saving



Source: National Audit Office

Box 1
Definitions of key terms

Value for money savings must represent lasting improvements to the way public money is spent. They must be:

Sustainable. Savings are the result of a considered change in the way a department does its business, and must exist at least for the current year and continue at the same or a higher level for two subsequent financial years. This is because one-off savings, or savings which delay expenditure, do not help departments live within spending allocations in future years.

Neutral to service quality. Departments need to demonstrate that reforms have not impacted adversely on the quality of public services at the level of their strategic objectives and public service agreements. This is to ensure that the savings do not simply represent cuts in services.

Cashable. Cashable gains involve reducing inputs without affecting service quality. Non-cashable gains, in which outputs are increased for a given level of input, cannot be reported. Departments may reinvest cash savings in higher priority services, so in most cases savings cannot be observed directly in reduced budgets.

Realised. Savings must have materialised in the year in which they are reported in order to have impacted on overall spending. Future savings cannot be anticipated.

Net of costs. The upfront and investment costs and additional ongoing or running costs associated with the generation of savings must be subtracted from the value of the benefit to show the overall improvement to the taxpayer.

Source: National Audit Office

6 We previously reported on savings made by the Home Office and the Department for Transport in 2008-09.[1] The terms under which we undertook this work and the methods used are set out in Appendix 1. We used nine audit criteria (Appendix 2) to assess whether the reported savings fairly represent realised cash savings (Green); may represent realised cash savings, but with some uncertainty in one or more areas (Amber); or do not represent, or significantly overstate, the savings made (Red).

HM Revenue & Customs' savings target

7 In its 2007 Comprehensive Spending Review (CSR07) settlement, HM Revenue & Customs (the Department) was required to reduce its annual expenditure by £674 million by 2010-11 – a reduction of 14 per cent in real terms on 2007-08 levels of expenditure. The target was increased by £80 million in Budget 2009, although the Department can recycle these additional savings into frontline activities.

8 The O'Donnell review[2] that led to the merger of the former Inland Revenue and HM Customs & Excise in 2005 concluded that a single department would generate significant cost savings through improved efficiency. Since 2006, the Department has invested in a transformation programme to create a more efficient and customer-focused organisation that is more effective in improving taxpayer compliance and reducing revenue losses. The Department plans to achieve the majority of the cost reductions through reductions in staff numbers. In the first three years following the merger, the Department achieved headcount reductions of some 12,000 staff (12 per cent of its workforce). In 2008-09 and 2009-10 (the first two years of the CSR07 period), it achieved reductions of a further 10,100 staff (13 per cent), and it plans further reductions in 2010-11.

9 In its 2009 Autumn Performance Report, the Department reported that it had achieved CSR07 savings of some £300 million a year by September 2009, some 40 per cent of its revised target at the mid-point of the CSR07 period. These savings have helped the Department to reduce its annual revenue expenditure in real terms. The Department has achieved further savings in the second half of 2009-10.

Our opinion on reported savings

10 We examined the Department's major savings in staffing, estates, IT and procurement which totalled £288 million a year, some 90 per cent of the reported savings. All of the savings were expected to result in lower annual expenditure. To assess whether the Department had achieved cash-releasing savings, we reconciled the reported savings to the expenditure in the Department's accounts and evaluated individual savings against nine audit criteria (Appendix 2). We rated 87 per cent of the savings as Green or Amber, but have significant concerns over 13 per cent which we rated Red (**Figure 2** and **Figure 3** on page 8).

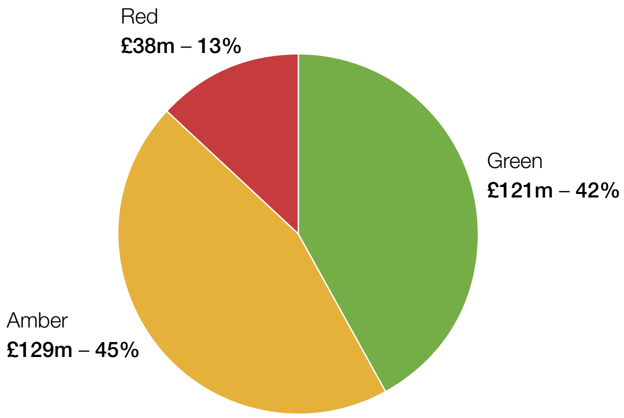
1 *Independent Reviews of reported CSR07 Value for Money savings,* HC 86 2009-10, 16 December 2009, NAO website URL: http://www.nao.org.uk/csr07

2 HM Treasury, *Financing Britain's Future—Review of the Revenue Departments,* Cm 6163, March 2004.

11 The high level of Amber ratings (45 per cent) is mainly because the Department has not reported the savings net of in-year implementation costs as required by Treasury. The Department considered that its CSR07 savings target excluded these costs, as much of the funding came from sources outside the normal spending review process including savings achieved to date, and a £300 million modernisation fund agreed by Treasury in 2006. Many of the savings rated Amber will deliver substantial ongoing reductions in departmental expenditure in future years, as the one-off investment costs enable reductions in staffing levels and the vacation of surplus office accommodation. Other reasons for our ratings are set out below.

Figure 2

Our conclusions on the Department's reported CSR07 savings



NOTE

1 Green – Figures fairly represent savings which in all material respects meet the criteria set out in Appendix 2. Nothing has come to our attention that leads us to believe that the savings are not sustainable, or will impact adversely on strategic objectives.

Amber – There may be realised cash savings that meet the criteria set out in Appendix 2, but there are areas where we either could not obtain sufficient evidence or were not satisfied that certain criteria had been fully met.

Red – Reported figures may significantly overstate savings made. Savings do not meet one or more criteria or the Department was unable to provide evidence across a range of criteria to support the saving.

Source: National Audit Office

Figure 3
Analysis of NAO ratings of savings examined

	Savings rated (£m)			Reason for the rating
	Green	Amber	Red	
Salary savings through headcount reductions	108	90	–	Significant in-year early severance costs have been incurred, and there is uncertainty over the timing of savings in 2009 (Amber).
IT and telecommunication contracts cost reductions	5	5	30	Telephone contract savings were not reported net of ongoing costs, and other savings were not evidenced (Red). Some 2008-09 savings were offset by increased spending in 2009-10 (Amber).
Office estates consolidation programme	–	22	8	Some savings reported were not new to the period (Red). One-off investment costs have not been deducted from the reported savings (Amber).
Procurement of other goods and services	8	12	–	Savings on individual contracts and on post and printing have not led to commensurate reductions in overall expenditure (Amber).
Totals	**121**	**129**	**38**	**Total examined £288 million**

Source: National Audit Office analysis

12 Our main concerns over the savings were that:

- The Department's CSR07 delivery agreement[3] stated that major savings would be verified by comparing actual expenditure during the period to the 2007-08 baseline, increased by 2.7 per cent for inflation. In practice, the Department estimated the salary savings of staff leavers and reported the aggregate figure. We found that the reported salary savings of £198 million were higher than the reduction in expenditure shown by comparing the Department's accounts for 2008-09 and 2009-10 (six months) against the 2007-08 baseline. However, the Department's outturn for 2009-10 shows that further savings have been achieved. We therefore assessed £19 million of these savings as Amber, as they had not been fully realised at the point at which it was reported.
- Where a reported saving has also involved significant one-off investment costs, we have used an Amber rating. The Department's calculation of salary savings excluded some £71 million of early-departure costs in 2008-09 that enabled the headcount reductions to be achieved. The Amber rating reflects that the level of savings reported overstates the net cash releasing savings achieved in year. The salary savings will, however, be realised in future years as early departure costs are one-off payments.

3 HM Revenue & Customs Value for Money Delivery Agreement (revised), April 2009.

- We assessed £38 million of non-salary savings as Red, including:
  - reported annual savings from a cancelled telecommunications contract had not taken into account the £12.5 million a year costs of a replacement contract;
  - a lack of supporting evidence for a further £17 million of IT savings; and
  - all savings should be new to the CSR07 period, but £7.7 million of Estates savings had been realised during the previous spending review period.
- We assessed other reported savings on accommodation and procurement contracts as Amber because annual expenditure in these areas has not reduced, so there is uncertainty as to whether they are cash releasing.

13 For savings to count towards its CSR07 savings target, the Department must demonstrate that the savings have not impacted adversely on its Departmental Strategic Objectives. In its Autumn Performance Report, published in December 2009, the Department reported that it was making progress towards its objectives, but that performance was mixed. For example, on the target to reduce tax losses by £7 billion by 2010-11, compliance yield had increased by £800 million to £12 billion, but the VAT gap (the difference between actual tax collected and the amount that would be due if all traders complied fully with their obligations) had increased by £2.8 billion, over half of which was due to the recession. Because of time lags in obtaining certain data, the Department was unable to report actual performance on some of its indicators and it did not comment on whether and how achieving its savings had affected its performance.

14 The Department has taken action to improve its governance arrangements for the CSR07 savings programme. In particular, it introduced a central Efficiency Steering Group in July 2009 and brought together its savings programmes under the established reporting arrangements for its Departmental Transformation Programme. We concluded that the Department's governance arrangements for the programme now have a number of strong features, but that there is scope to improve further as set out in our recommendations below.

Recommendations

15 For the remainder of the CSR07 period the Department should:

a **Report savings net of investment costs.** Reporting savings gross of in-year costs significantly overstates the actual savings achieved in the period. The Department's monitoring processes should capture all costs associated with savings, including early severance costs. It should expand its guidance to teams and validate the reported figures, checking that one-off and ongoing costs have been distinguished correctly.

b **Reconcile savings claimed to changes in the Department's overall administrative spending.** The Department undertook some reconciliation work during planning in 2010-11, but should extend this approach to its in-year budget monitoring to ensure that claimed savings reconcile to actual changes in expenditure in real terms. In addition, the Department's reconciliation did not distinguish clearly between savings that reduce its expenditure and those that will be recycled, for example to meet the cost of new programmes agreed by Treasury. It should identify where savings have been recycled to strengthen its ability to reconcile between individual savings and its actual spending. This will allow it to demonstrate that savings meet the cash releasing criterion for CSR07, and that their effect is not reduced by other increases in expenditure.

c **Include an assessment of impact on performance when reporting savings**. The Department has introduced a new monitoring form for teams in reporting savings. It should require teams to include an assessment of whether savings have affected operational performance. It should also include an overall assessment of the effects in its public reporting of savings.

Part One

The Department's reported savings

1.1 This Part sets out the Department's CSR07 settlement; its reported savings as at September 2009; and the results of our examination. We reconciled the total reported savings against the Department's accounts and evaluated individual savings against the criteria in Appendix 2. We also examined the effect of the savings on the Department's performance; and its governance arrangements. The Department's Internal Audit reviewed the savings reported in 2008-09 and we have drawn on their findings, along with additional evidence, in reaching our conclusions on the savings reported over the first 18 months of the CSR07 period.

The Department's role

1.2 HM Revenue & Customs is the UK's main tax administrator and also supports families and individuals through the benefits and credits it administers. In 2007-08, the baseline year for calculating savings, the Department spent £4.3 billion on its administrative functions and employed 84,000 full-time-equivalent staff. In 2008-09, it collected £436 billion in tax revenue and paid £35.1 billion in tax credits, child benefits and Child Trust Fund endowments. Its other responsibilities include:

- enforcing the National Minimum Wage;
- administering the collection of student loans on behalf of the Department for Business, Innovation and Skills;
- supervising money service businesses, trust or company service providers, accountancy service providers and dealers in high value goods to ensure that they comply with the Money Laundering Regulations; and
- the creation of the Government Banking Service.

1.3 The O'Donnell review[4] that led to the merger of the former Inland Revenue and HM Customs & Excise in 2005 concluded that it would generate significant cost savings through improved efficiency. The Department plans to achieve the majority of its savings through reductions in staff.

4 *HM Treasury, Financing Britain's Future—Review of the Revenue Departments*, Cm 6163, March 2004.

The Department's CSR07 savings target

1.4 During the three years from April 2008 to March 2011, the Department is required to reduce its annual expenditure by £674 million by 2010-11 – 14 per cent in real terms. Budget 2009 announced that the Department's savings target had been increased to £754 million, but Treasury allowed the Department to recycle the additional £80 million savings into frontline services (**Figure 4**).

Savings reported to date

1.5 In its 2009 Autumn Performance Report, the Department reported that it had achieved annual savings of over £200 million in 2008-09 and that further savings of £200 million were expected in 2009-10. The Department provided us with a detailed breakdown, showing annual savings of £315 million in the 18 months to September 2009 (**Figure 5**).

1.6 The Department is seeking to achieve its efficiency savings through a wide range of initiatives, including its Departmental Transformation Programme which aims to create a more efficient and customer-focused organisation that is more effective in improving taxpayer compliance and reducing revenue losses. The Programme includes: modernisation of PAYE systems; better targeting of Compliance and Enforcement work; expansion of on line services; and various other programmes. Many of these initiatives involve reductions in staff. We reported on the Transformation Programme in 2008.[5] The Department has also implemented additional measures through its annual budgeting exercises including: savings from IT services; a review of back office functions; savings from procurement of post, print and office supplies; rationalisation of facilities management and support services; and improved demand management in telephone contact centres.

Figure 4
The Department's CSR07 savings target

	Planned annual savings compared to 2007-08 baseline		
	2008-09 £m	2009-10 £m	2010-11 £m
Revenue	201	417	632
Capital	14	28	42
Cost reduction	**215**	**445**	**674**
Recyclable savings	–	–	80
Aggregate savings	**215**	**445**	**754**

NOTE
1 All figures rounded to nearest £1 million.

Source: HM Revenue & Customs Value for Money Delivery Agreement (revised), April 2009 and HM Treasury

5 *Comptroller and Auditor General 's report, HM Revenue & Customs' transformation programme,* HC 930 2007-08, 18 July 2008.

Figure 5
Summary of the Department's annual savings as at September 2009

Area of savings	Annual saving £m	%	Description
Salary savings through headcount reductions	198	63	A range of efficiency initiatives taken to reduce staff numbers.
IT and telecommunication contract savings	40	13	Mainly savings in the cost of existing systems supported by the main IT contractor.
Office estates consolidation programme	30	9	Reductions achieved in the overall size of the Department's estate.
Procurement of other goods and services	20	6	Mainly savings on post and printing contracts.
Other savings	27	9	A range of smaller savings (not examined).
Total	**315**	**100**	

NOTE
1 Savings and percentages are rounded.

Source: HM Revenue & Customs

1.7 We assessed the Department's overall reported savings by comparing expenditure in 2008-09 and 2009-10 against a baseline of 2007-08 expenditure, uplifted by 2.7 per cent a year for inflation and adding the costs of administering new programmes, such as the Health in Pregnancy Grant, where the Department is funding additional costs by making savings elsewhere in the business. This comparison will reflect all cost reduction initiatives, including those which do not meet CSR07 requirements.

1.8 The Department reported savings of £210 million in 2008-09, but its audited accounts suggest that its revenue expenditure decreased by only £101 million in real terms in 2008-09 (**Figure 6** overleaf). It estimated further savings of £105 million in the first six months of 2009-10, while its management accounts for the first half of 2009-10 show a decrease in revenue expenditure of only £40 million in real terms compared to 2008-09.

1.9 The Department's CSR07 settlement assumed that capital spending would reduce by £42 million (16 per cent) by 2010-11 as a result of its efficiency initiatives. In 2008-09, however, capital spending increased by £28 million in teal terms, after adjusting the baseline for increased investment in IT systems from work on tax changes announced in Budgets 2008 and 2009. Details of the capital spending for 2009-10 were not available at the time of our review although the Department expected this to be substantially lower than in 2008-09.

Figure 6

Analysis of the Department's expenditure against the CSR07 baseline

	Baseline[2]	Reduction/ (increase)	Further reduction/ (increase)
	2007-08	2008-09	6 months to Sept 2009
	£m	£m	£m
Salary	2,787	130	49
Other revenue costs	1,538	(29)	(9)
Total revenue expenditure/saving	**4,325**	**101**	**40**
Capital expenditure	257	(28)	Not available
Total expenditure/gross saving	**4,582**	**73**	**40**

NOTES

1 Savings calculations allow for inflation at 2.7 per cent.

2 Calculation adjusted to reflect £16 million additional spending on new taxes in 2008-09 and a further £18 million in 2009-10.

3 Excludes early severance provisions and in-year payments totalling £71 million in 2008-09 and £158 million in 2009-10 (2007-08 £71 million).

Source: National Audit Office

1.10 This analysis suggests that the Department's reported savings have not been fully cash releasing in the first 18 months of the CSR07 period, largely because other costs have been incurred or expenditure has shifted elsewhere. In the following sections we examine in more detail the Department's expenditure and reported savings on staff, estates, IT and procurement.

Detailed conclusions on individual savings

Staff reductions: £198 million annual savings reported

1.11 The Department aims to achieve the majority of its cash releasing savings through reductions in staff numbers. In the first three years following the merger of the former Inland Revenue and HM Customs & Excise, the Department achieved headcount reductions of some 12,000 staff (12 per cent of its workforce). In 2007-08 the Department spent some £2.8 billion on salary costs. It reduced staffing by a further 10,100 (13 per cent) in the first two years of CSR07, and plans further reductions in 2010-11 (**Figure 7**). Some 4,600 staff have also transferred to other departments under machinery of government changes, and have correctly been excluded from the reported savings.

Figure 7

The Department's staff numbers: April 2004 to March 2010

NOTE

1 The reduction in staff numbers includes 4,600 UK Borders Agency staff who were transferred to the Home Office during 2009-10.

Source National Audit Office

1.12 Over the first 18 months of the CSR07 period, the Department estimated that it had achieved annual savings of £198 million on staff salaries and pension contributions, of which £121 million was achieved in 2008-09 and £77 million in the first six months of 2009-10. The Department calculated most of its staff savings by multiplying the number of leavers during the year by an estimated average annual salary per leaver.

1.13 Treasury guidance states that savings should normally be calculated by comparing in-year spending with a counterfactual based on spending in 2007-08. The Department's annual accounts show that it spent £2.7 billion on staff salaries in 2008-09. In real terms, and adjusting for the costs of new work agreed by Treasury, this was £130 million less than expenditure in 2007-08. In the first six months of 2009-10, the Department reduced salary related payments by a further £49 million in real terms compared to the same period in 2008-09, giving a total annual saving of £179 million compared to 2007-08. However, the comparison is not straightforward due, for example, to differences in the timing of pay awards. Management accounts for 2009-10 suggest that further savings have been realised. We therefore rated £19 million of the saving to September 2009 as Amber to reflect the uncertainty over the timing of the savings achieved.

1.14 The Amber rating also reflects uncertainties over the Department's method of calculating salary savings that would cause realised savings to be lower than calculated:

- For headcount reductions, the Department continued to use the same methodology it had used under the Gershon programme. This calculated staff savings using a full year's salary even when staff leave late in the year, thus overstating the in-year savings allowable for CSR07. Savings realised in 2008-09 from staff released during 2007-08, which are allowable CSR07 savings, were excluded from these savings – thus reducing the potential overstatement.
- The calculation of staff savings is based on an assumed average salary per leaver. To date, departures have been predominantly among more junior staff than expected, so the actual savings realised will be lower than the Department's estimate.

1.15 Treasury guidance requires CSR07 savings to be reported net of all in-year investment and ongoing costs. However, the Department reported the full salary savings without deducting the early severance costs incurred in-year, thus overstating the actual cash savings achieved in the 18 months to September 2009. The Department initially considered that it did not need to count early severance and other transformation programme costs against its savings target as these are largely being funded from savings achieved to date and through access, subject to Treasury agreement, to a ring-fenced modernisation fund of £300 million to meet specific costs directly related to efficiency and structural change. The Treasury subsequently confirmed that savings should be calculated net of any investment costs, irrespective of the funding source used.

1.16 The Department incurred early departure costs[6] totalling £71 million in 2008-09. We therefore classified £71 million of the reported saving as Amber as the early departure costs are one-off, rather than an ongoing cost, and so the salary savings will be achieved in full in future years. The remaining £108 million of the savings was assessed as Green as they are fully cash releasing and net of costs.

Information technology: £40 million savings reported

1.17 In 2007-08 the Department spent £846 million maintaining and developing its IT systems including capital expenditure but excluding internal staff costs. In its 2009 Autumn Performance Report, the Department estimated IT savings of £40 million, mainly through reductions on its main IT contract (ASPIRE) and a telecommunications contract.

1.18 To test whether the savings on these contracts had been cash releasing, we compared the overall IT expenditure in the 2008-09 accounts and the management accounts for the first six months of 2009-10, with the 2007-08 baseline, adjusted for inflation and for new projects approved by Treasury. As at September 2009, the Department had reduced annual expenditure on IT and telecommunications contracts by £5 million in real terms. We have rated this £5 million as Green.

6 This represents the additional costs over and above existing entitlements; including the lump sum payable to staff on departure and a provision for future payments to the Principal Civil Service Pension Scheme, covering any additional costs up to the expected date of retirement.

1.19 We assessed £29.5 million of the reported IT savings as Red as the Department:

- did not net off the £12.5 million ongoing cost of a replacement telecommunications contract from a claimed saving of £15 million; and
- was unable to provide evidence to support a further £17 million of its claim.

1.20 We have rated the remaining £5.5 million of the savings as Amber as these may be realised cash savings. However, the savings made in 2008-09 on the ASPIRE contract have been offset by increases in expenditure in 2009-10, raising a concern over the sustainability of the reported savings.

1.21 In 2008-09, the Department's capital IT expenditure increased by £20 million in real terms. However, our analysis of the Department's budget data indicated this was a peak due to investment in transformation programmes rather than the result of costs transferred from IT revenue expenditure to capital, so it has not affected our rating.

Estates Consolidation Programme savings – £30 million savings reported

1.22 The Department spent £460 million on its office accommodation in 2007-08, including capital, but excluding internal staff costs. Over half of this expenditure relates to its private finance contract, "the Strategic Transfer of Estate to the Private Sector" (STEPS), let in 2001, covering around 60 per cent of the Department's estate. The contract provided flexibility for the Department to vacate office space each year, up to certain limits, at no additional cost. We reported on the Department's management of the STEPS contract in December 2009.[7]

1.23 For the 18 months to September 2009, the Department reported that it had achieved annual estates savings of £30 million by vacating surplus office accommodation. The Department calculated the reported saving by estimating the annual rent and service charges on vacated properties. It forecasts that it can achieve annual savings of £63 million by the end of the CSR07 period.

1.24 We have rated £7.7 million of the reported savings as Red as they had already been reported in 2007-08 and so were not new to the CSR07 period. The Department's 2008-09 accounts show that revenue expenditure on accommodation increased by £25 million in real terms when compared to 2007-08. In 2009-10, the six-month management accounts show a £6 million decrease in real terms in accommodation expenditure but, overall, estates expenditure remains higher than the baseline year.

1.25 We have therefore rated the remaining £22.3 million Amber as these may represent realised cash savings. The Department has vacated a significant amount of accommodation in the first 18 months of CSR07, including properties totalling 56,000 square metres in 2008-09 and 41,000 square metres in 2009-10. However, the permanent savings realised from these vacations have been offset by increases in estates expenditure, which include the one-off costs of achieving the vacations. The Amber rating reflects that the Department is likely to realise these savings from this rationalisation in future years.

7 *Comptroller and Auditor General's report, HM Revenue & Customs' estate private finance deal eight years on*, HC 30 2009-10, July 2009.

Procurement – £20 million savings reported

1.26 In 2007-08, the Department spent £470 million procuring goods and services, including capital expenditure, but excluding internal staffing, IT and accommodation costs. Of this, the Department's Commercial Directorate directly managed expenditure of some £220 million, including expenditure by other departments using HMRC contracts, and provided advice on major procurements by other directorates.

1.27 The Department reported procurement savings of £20 million in 2008-09. The largest savings were for printing and postage, but there was also a wide range of other reported savings including official travel, consultants and contracted out services. The Department estimated savings using assumptions on reductions achieved in quantities of goods procured or lower average cost.

1.28 The Department's 2008-09 accounts and six-month management accounts for 2009-10 showed some reductions in procurement expenditure. Expenditure on printing, post office services, stationery and office supplies reduced by £6 million in real terms in 2008-09 and a further £2 million in the first six months of 2009-10. We have therefore rated £8 million of the reported savings as Green.

1.29 The Department has, however, increased expenditure on other contracts and, as a result, total spending on goods and services increased by £15 million in 2008-09 and by a further £14 million in the first six months of 2009-10. We rated the remaining £12 million of reported savings Amber as there is uncertainty as to whether costs have been transferred or offset by one-off costs of implementing the savings initiatives. The Amber rating is also supported by:

- the Commercial Directorate has introduced a standardised process for reporting procurement savings. This has a number of strengths, including central validation and guidance on the treatment of savings that do not meet the CSR07 criteria. As a result, the Department identified a further £9 million of savings but correctly excluded these as they were one-off benefits rather than permanent reductions in expenditure. The Commercial Directorate's reporting process therefore provides some assurance that individual procurement initiatives have delivered savings, although it does not reconcile savings to its overall budget.
- The savings calculations are based on assumptions about reduced quantities and reduced prices, and there is a risk that the actual savings realised have been lower than assumed.

Effect of the savings on the Department's performance

1.30 The Treasury's guidance for CSR07 savings states that:

> "The overriding principle is that Departments should be able to demonstrate and explain publicly that as a result of their vfm reforms, their department and sector are delivering better value for money overall. This should be firmly based on Departments' success in living within their settlements and delivering the commitments set for them … though departments may wish to draw on other information as well … departments are responsible for assuring themselves that performance measures are in place to capture any changes in key outputs".[8]

Departments may report savings that may well lead to lower (but acceptable) performance levels in low-priority areas. This requirement is less stringent than the previous spending review rule that savings should have no adverse effect on service.

1.31 The Department reported on its performance against its two Departmental Strategic Objectives (DSOs) in its 2009 Autumn Performance Report:[9]

- DSO 1 – Improve the extent to which individuals and businesses pay the tax due and receive the credits and payments to which they are entitled.
- DSO2 – Improve customers' experience of the Department and contribute to improving the UK business environment.

1.32 **Figure 8** overleaf summarises the Department's reported performance against these targets. It reported that progress towards reducing tax losses by £7 billion by 2010-11 was mixed. The Department uses a range of indicators to measure its performance and there were some positive results; for example, an £800 million increase in overall compliance yield to £12 billion. However, over the same period, the Department reported that the difference between the estimated and actual VAT receipts (the tax gap) increased by £2.8 billion, over half of which was due to the recession. Because of time lags in obtaining certain data, the Department was unable to report actual performance on some of its indicators when publishing its Autumn Performance Report in December 2009.

1.33 The Department did not comment on whether and how achieving its savings had affected its performance when reporting savings achieved in the Autumn Performance Report. While it assesses risks to performance as part of its management of programmes and projects, it does not routinely track the the effects of savings on performance as part of its reporting and monitoring of savings. The Department has now designed an internal reporting template for individual savings which could be expanded to include an assessment of risks to its overall performance.

8 HM Treasury, *Value for Money in the Comprehensive Spending Review – Guidance,* paragraph 2.22-2.27.

9 A third DSO "Reduce the risk of illicit import and export at material which might harm the UK's physical and social well-being" was transferred to the Home Office during 2009-10.

Figure 8
Progress against Departmental Strategic Objectives

Departmental Strategic Objective	Progress reported in Autumn Performance Report 2009
DSO 1	
1.1 Reduce losses by £7 billion over the CSR07 period. Close the annual tax gap by at least an additional £4 billion in 2010-11.	Overall compliance yield increased by £800 million in 2008-09 to £12 billion. VAT tax gap increased by £2.8 billion in 2008-09. Payments against tax debt in 2009-10 were up by almost £5 billion compared to the same period in 2008-09. 2008-09 tax gap for excise duties will not be available until the end of 2010.
1.4 Reduce the level of tax credit error and fraud to 5 per cent by 2010-11.	The 2007-08 estimate of error and fraud was 8.6 per cent. The Department anticipates that 2008-09 figures may show a slight increase but has now introduced an Error and Fraud Strategy.
DSO 2	
2.1 Improve the customer experience that the tax system is simple and even-handed across all customer groups, by at least 3 percentage points (or up to 90 per cent for any group) by 2011.	2.4 per cent improvement achieved.
2.2 Reduce the administrative burden which the UK tax administration imposes on UK businesses by at least 10 per cent by 2011 (equivalent to £510 million per annum).	Administrative burdens on UK businesses have fallen by £552 million per annum.

NOTE
1 No information has yet been published on indicator 1.2 (on the proportion of taxpayers paying what is due), 1.3 (on debt collection), 1.5 (on the take-up of tax credits), or 1.6 (on UK Border Agency revenue targets).

Source: HM Revenue & Customs

1.34 We periodically review the data systems underpinning departments' DSOs. Our most recent review of the Department identified good progress in addressing the weaknesses in data systems found in our previous reviews and developing robust methodologies to measure its DSO targets. The Department has recently implemented a new governance arrangement for its DSOs, including a Performance Committee that will act as the delivery board for all its DSOs. However, we also found:

- the Department could further improve the disclosure of methodologies and any limitations in the data systems; and
- three DSO indicators did not have auditable data systems in time for the 2009 Autumn Performance report, although the Department plans to report against these indicators from 2010-11.

1.35 We also recently examined the Department's administration of National Insurance, focusing on efficiency in using resources since 2006-07.[10] We found that it was likely that the significant reductions in staff numbers deployed on National Insurance administration had led to an overall improvement in efficiency, although there was uncertainty about the extent of the improvement. This was because there was not a clear picture of how total costs had changed and trends in operational performance at business unit level were mixed.

Governance arrangements

1.36 The Treasury requires departments to have robust governance arrangements that provide assurance over the achievement of the CSR07 Programme and the validity of publicly reported savings. We examined the Department's governance arrangements using a standard framework set out in Appendix 3.

1.37 The Department recognised that there were some weaknesses in its governance processes at the start of the period and has taken steps to improve its arrangements. It introduced a central Efficiency Steering Group in July 2009. The Group has been working to reconcile savings to the total settlement and is introducing a standardised measurement and reporting process across the programme. It is also building on strengths of existing governance arrangements, including detailed planning mechanisms for individual savings; and processes for managing risks that particular initiatives will not be delivered on time, with named staff held accountable. The Department's Internal Audit Service also undertakes independent reviews of reported savings.

1.38 We found that there was scope for further improvement in governance arrangements:

- The Department did not monitor how its savings reconciled to actual spending reductions, although it planned to do so according to its VFM Delivery Agreement. The Department undertook some reconciliation work during planning for 2010-11, but the reconciliation does not clearly distinguish savings that reduce expenditure from those that will be recycled into priority areas.
- The Department's measurement methodologies have not always reflected Treasury guidance for CSR07 savings; for example, the need to time-apportion savings realised part way through a year. The Department circulated revised guidance more widely after the end of 2008-09.
- The Department has not commented on the risks to the achievement of its Departmental Strategic Objectives in its public reporting on the savings.

10 *Comptroller and Auditor General's report, HM Revenue & Customs: The efficiency of National Insurance administration* HC 184 2010-11, June 2010.

Appendix One

Terms under which we undertook this engagement

The National Audit Office has agreed to review departments' reported value for money (VFM) savings during the 2008-2011 spending period. Departments are responsible for delivering savings in accordance with targets agreed with Treasury, and reporting progress in annual departmental reports and autumn performance reports.

We have reviewed HM Revenue & Customs' reported savings as at 30 September 2009, as reported in its 2009 Autumn Performance Report. Our review has involved an examination of the evidence supporting the savings against the criteria set out in Appendix Two to this report. These criteria are based on HM Treasury's guidelines on what can and cannot be reported and have been agreed with the Treasury. We have not concluded on whether the Department is delivering value for money in the round with all the resources it has. Rather our review is specifically focused on the savings the Department has reported in the period, and the risk that these do not meet the criteria established by HM Treasury. Our review is based on historic information, and we have not assessed in detail the likelihood of the department meeting its overall savings target for the spending period.

We have conducted this review in accordance with the principles set out in the International Framework for Assurance Engagements. We have performed sufficient work to provide reasonable assurance over the extent to which departments' reported VFM savings meet the criteria. Our conclusions are stated in the main report.

What we did

Our approach to reviewing reported savings has been to:

- Review and assess the calculation, methodology and audit evidence behind the 2008-09 reported savings of each initiative against the criteria set out in Appendix Two, taking into consideration the size of the saving with regard to the detail of the work performed.
- Assess the Departments' governance of the programme, including a review of the controls in place to ensure that savings are properly calculated and meet all other criteria.
- Examine financial information within the Departments' resource accounts and other relevant reports to check for consistency.
- Understand the Departments' design of their programmes for generating VFM savings over the three-year period, through interviews and document review.

Within some of the savings initiatives, the reported saving comprised several smaller savings. In these cases, we firstly evaluated the calculation and overall methodology and then looked in more detail at the evidence supporting individual savings where this was necessary to come to a conclusion on the overall savings.

We reviewed HM Revenue & Customs' estimated savings in four major spending areas (staff, estates, IT and other procurement) which made up over 90 per cent of the reported savings of £300 million. We also sought to obtain assurance over the whole of the reported saving from our review of the Department's overall spending.

Appendix Two

The criteria against which reported savings were evaluated

HM Treasury has set out guidance for departments on how to calculate VFM savings and rules about what can and cannot be counted towards the £35 billion target. We have translated this guidance into a series of criteria that savings must meet. In summary, reported savings must meet the following criteria:

Criteria	Explanation of criteria
Properly calculated	Savings must be accurately calculated. The calculation is likely to be based on baseline cost information, a counterfactual spending profile (which may well involve estimates and assumptions) and outturn spending data.
Net of costs	All upfront and investment costs and additional ongoing or running costs have to be netted off from VFM savings.
Quality neutral in high priority and strategically important areas	Savings must not adversely impact on the achievement of a department's strategic priorities, as set out in Departmental Strategic Objectives (DSOs) and Public Service Agreements (PSAs). Departments should be able to demonstrate and explain that as a result of their VFM reforms, the department and sector is delivering better VFM overall. Departments are responsible for explaining how VFM reforms relate to improved overall effectiveness in high priority areas and delivery of PSA outcomes.
New to the period	Where it has been agreed with HM Treasury, departments are permitted to carry over 10 per cent of over-delivery from SR04 to count towards their CSR07 VFM target. Therefore at least 90 per cent of VFM savings must be gained within the CSR period. In principle, CSR07 savings should not be reflected in the 2007-08 baseline, although departments may have taken early action by introducing a VFM saving reform during 2007-08. VFM savings may also constitute delivery of additional annually cash-releasing savings against initiatives begun in SR04. There must be no double counting of savings in the two periods.
Costs have not been reallocated to another part of the organisation or the public sector	Savings cannot be scored if spend on a particular activity or initiative has simply been reallocated to another similar activity or initiative that is not adding more value.

Criteria	Explanation of criteria
Cash releasing	Savings must increase budgetary flexibility by releasing near-cash resources that can, if desired, be redeployed to meet other pressures. Non-cashable gains are not being counted towards the CSR07 VFM savings target. Departments are encouraged to explain how they are making non-cashable and service improvement gains, but will have to ensure that these are separately presented in savings reports.
Realised	Savings must have been realised by the point at which they are reported.
Sustainable	Savings must be sustainable and the result of a considered change in the way a department does its business. They should not be the result of simply shifting expenditure from one year to another. A VFM saving must exist at least for the current year and continue at the same or a higher level for two subsequent financial years.
Scored only once	Savings cannot be double-counted under separate categories or initiatives.

Appendix Three

The framework used for assessing governance of the savings programme

We examine six areas of a department's governance, to assess the controls that it has in place to provide assurance that:

- reported savings meet the criteria set out in Appendix Two; and
- the department's planned savings programme will be delivered and the department's target for 2010-11 will be met.

This framework has been designed to reflect HM Treasury's guidance to departments on governance in relation to the CSR07 VFM Savings programme, and the principles of the Chartered Institute of Public Finance and Accountancy's Good Governance Standards for Public Services.

Governance area	Weak governance ...	Strong governance ...
Oversight and leadership	There is no board overseeing the VFM programme A board exists but meets infrequently and/or does not scrutinise delivery and risks to delivery There are no sufficiently senior members of staff on the board Senior managers have not demonstrated their commitment to the programme	A senior management team, supported by skilled advisors, oversees the VFM programme A programme board has been established and meets regularly The programme board is chaired by an appropriately senior member of staff (e.g. Finance Director) Senior managers demonstrate their commitment to the programme.
Delivery plan and targets	There is no overall plan bringing together details of how the target will be achieved A plan exists but does not give any detail about savings initiatives/projects The programme is not sufficient to meet the department's target No contingency is built into the plan The programme cannot be reconciled to the department's overall settlement	An overall plan brings together details of how the target will be achieved The programme is sufficient to meet the department's target An appropriate level of contingency is built in For each initiative or body responsible for delivering savings, the timetable for delivery, governance arrangements, risks and measurement issues are set out Planned CSR07 savings can be reconciled back to overall resource allocations.

Governance area	Weak governance ...	Strong governance ...
Risk management	The department has no explicit risk management processes in place Risks have been identified, but there are no plans for their mitigation and/or inadequate monitoring against them Lessons have not been learned from the results of previous assessments There is no recognition of the critical projects for achieving the department's target There is no recognition or management of risks relating to double-counting There is no recognition or management of risks relating to adverse impacts on strategically important/high priority outcomes The role for Internal Audit has not been considered	There is risk management at the programme-level and for individual component projects Each risk has a documented plan for mitigation Results of previous assessments of efficiency savings have been factored into the risk analysis and lessons from SR04 have been learnt Double-counting risks have been explicitly recognised and addressed at a programme-level Priority or critical projects have been identified There is explicit recognition of the risk that strategically important/high priority outcomes may be adversely impacted, and monitoring and management of this The role for Internal Audit in managing and mitigating risks has been considered.
Structures, roles and reporting lines	Roles and responsibilities for delivering savings and progress reporting are unclear Reporting on progress is done on an ad hoc basis and no clear guidelines have been set for how it should be done	There are named individuals responsible for delivering component projects There are clear arrangements for reporting progress against plans to senior management, including savings delivered vs. forecast savings, projections for the year, explanations of major variances, and proposed actions to address variances.
Guidance and training	No or limited guidance has been provided to those responsible for delivering savings The Treasury's criteria for CSR07 VFM savings have not been properly interpreted or not fully communicated Those at the centre have not checked understanding at a local level about responsibilities and interpretation of guidance No guidance has been provided on how to identify savings	Clear guidance has been provided to those responsible for delivering savings, about appropriate governance structures, risk management, how savings should be reported, and Treasury's criteria The Treasury's criteria for CSR07 VFM savings have been properly interpreted in the context of the department and clearly communicated Those at the centre have checked understanding at a local level about responsibilities and interpretation of guidance Where appropriate, guidance has been provided on how to identify savings Training has been provided as necessary.

Governance area	Weak governance ...	Strong governance ...
Monitoring	There is no or limited monitoring of progress against targets Evidence suggests that more frequent monitoring would have alerted the department to delivery or measurement problems Internal Audit's role in assessing progress against targets and compliance with criteria has not been considered	There is regular monitoring of progress against targets. The frequency of monitoring takes into account the assessment of risks to the programme Priority Project reporting is being done in accordance with Treasury requirements The role for Internal Audit in assessing progress against targets and compliance with criteria has been considered.

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