National Audit Office

REPORT BY THE
COMPTROLLER AND
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Managing staff costs in central government

Summary

1 In 2009-10, the public sector, excluding public corporations, directly employed 4.4 million full-time equivalent staff at an estimated cost of £164 billion. This represented 23 per cent of total government expenditure, including sectors such as the National Health Service, education and the police. Around 500,000 or 11 per cent of public sector staff were employed in the central government departments and agencies that constitute the civil service. Staff costs in the civil service in 2009-10 totalled £16.4 billion. Salaries of £13 billion were paid, including performance-related pay, with around three quarters of civil servants earning gross annual pay of £30,000 or less.

2 This report provides a high level review of how staff costs have been managed in central government. It does not attempt to assess whether value for money has been achieved in any one organisation, or to conclude on overall value for money. Part One of the report sets out the recent trends in civil service staff numbers and costs. Part Two of the report examines central initiatives to control staff costs across the civil service, and challenges for the centre in managing staff costs in central government. Part Three of the report examines actions within departments and agencies to identify opportunities to reduce staff costs. Our analysis draws on the expectations set out in our report *A framework for managing staff costs in a period of spending reduction* (**Figure 1**), published in August 2010.

Key findings

Recent trends in civil service staff costs

3 **There were 493,000 full-time equivalent civil servants in March 2010; a 1 per cent decline on numbers at March 2001.** This number had fallen back from a peak of 538,000 in March 2004. Since March 2010, numbers have fallen further with the most recent figures reporting 479,000 as at September 2010. Comprehensive data on the wider central government workforce including consultants, interim staff and outsourced capability is not available.

4 **Over the same period civil service staff costs rose by 10 per cent in real terms.** Accounting for the slight decrease in numbers, staff cost per full-time equivalent civil servant was 11 per cent higher in real terms than in March 2001. Across the whole public sector, where staff numbers have increased by 13.7 per cent over the decade, staff costs have increased by 40 per cent.

Figure 1

A framework for managing staff costs in a period of spending reduction

1 Identifying and appraising options for staff cost reduction

- Using information to establish a clear understanding of staff costs
- Using information to identify staff cost reduction opportunities:
  - across existing business model
  - through changes to business model
- Using information to appraise options for staff cost reduction

2 Planning staff cost reduction

- Mapping future needs and current capability
- Building capability to address gaps
- Understanding the full costs and wider impacts of reducing capability
- Assessing the overall value for money of the cost reduction programme

3 Delivering staff cost reduction

- Setting strong direction for the change programme
- Implementing the change programme
- Learning from the change programme

4 Embedding a business as usual approach to staff cost management

- Using information to provide ongoing challenge to staff costs
- Expanding the ownership of staff cost management

Source: Comptroller and Auditor General, A framework for managing staff costs in a period of spending reduction, August 2010

5 **The increasing proportion of higher-grade staff in the civil service is the principal cause of the cost increase.** Between March 2001 and March 2010, the number of administrative grade staff declined, consistent with the expectations of savings to back office and processing functions intended by the 2004 Efficiency Programme. All higher grades grew in number, with civil service management grades 6 and 7 showing a 67 per cent increase (around 14,000 posts). We estimate that this change in grade mix across the civil service accounts directly for 50 per cent of the 10 per cent real terms cost increase recorded over the decade.

6 **Although some of the change in grade mix can be attributed to an intended reduction in administrative activity, the increase in higher grades has not been a planned growth.** Some central government organisations have recognised 'grade creep' – the uncontrolled migration of work up to higher pay grades – taking place. The centre's advisory capacity on pay grading has diminished in recent years but there has been some limited action within organisations to review grading structures. There is no central control of grade mix and promotion outside the top 200 Senior Civil Service posts.

7 **We estimate that 35 per cent of the real terms increase in staff costs is due to increases in salaries and performance-related pay.** Levels of performance-related pay have increased from virtually zero in 2000-01 to around £200 million in 2009-10, or 1 per cent of the total paybill. The total paybill has grown approximately 1 per cent above inflation on average each year through the period April 2001 to March 2010. The remaining 15 per cent of total staff cost growth over the decade is attributable to increasing employers' pension and National Insurance contributions. Changes in the grade mix also indirectly affect these costs, with higher grades and associated higher salaries leading to increases in performance-related pay and employers' pension and National Insurance contributions.

Central control of staff costs

8 **The delegated pay system is not designed for central control of the overall paybill.** However, the Treasury aims to control overall spending through setting departmental budgets and administrative spending limits within the Spending Review process. It also sets the parameters for annual civil service pay increases within which departments have the freedom to set their pay. The Treasury does not scrutinise all departmental pay plans in detail, or have specific processes to monitor actual expenditure on staff costs.

9 **The system of delegated pay setting has resulted in pay divergence across the civil service.** The Treasury's objective is to allow departments to set pay in alignment with market rates. While variation may be legitimate, for example due to conditions in the market, wide divergence in pay scales for similar jobs in different departments can lead to inflationary pressures when there are government reorganisations. Concerns have also been raised about a potential future risk of financial liabilities under equal pay legislation.

10 **The centre of government has announced a range of immediate central actions in response to spending pressures, including time-limited freezes on cross-government recruitment and pay.** These are blunt mechanisms for controlling costs in the short term. There are also some longer-term actions in progress including reform of the Civil Service Compensation Scheme to reduce the costs of staff leaving the civil service under voluntary or compulsory terms.

11 **It is too soon to evaluate the consequences that may arise from central action, including risks to staff engagement and retention.** 'Grade creep' may continue as a means of retaining staff who cannot be offered pay increases. Actions which increase central control may increase the risk of government being identified as a 'single source' of pay, broadening the scope for potential equal pay claims.

12 **The 2010 Spending Review period will see a reduction in the Human Resources profession across central government from over 8,000 to 4,000 staff.** The Cabinet Office and the Treasury are also facing cuts in their administration budgets.

Departments and agencies' management of staff costs

13 **Departments and agencies will be responsible for delivering the sustainable reductions in staff costs required by the 2010 Spending Review.** Actions to reduce spending on overtime and reductions to rates of allowances and travel-related costs are already underway, though these remain minor and can require agreement with staff and trade unions. Reforms including closer alignment of pay with regional employment markets have also been considered. Most departments nevertheless expect to further reduce headcount over the coming period.

14 **Organisations do not have a comprehensive understanding of their own staff costs in order to support staff cost reduction activity.** Lack of staff time recording constrains an organisation's assessment of the cost and value of its activities, risking poor decisions around prioritisation or stopping of activities. Departments and agencies have reported some success in freeing staff capacity through improving business processes and fundamentally changing ways of working, including through information technology, but weaknesses remain in the information required to realise the full potential of this activity.

15 **The required headcount reductions in the civil service will not be achieved by the natural turnover of staff.** Recent trends in declining staff turnover suggest funded redundancies and early retirements will be required, increasing the up-front costs involved in realising savings. Such programmes can have a negative impact on staff morale; a risk heightened by the backdrop of a cross-government pay freeze.

16 **Staff skills risk being underutilised or lost due to poor management information in this area.** Departments reported concerns over the completeness of information on staff skills. Poor information risks sub-optimal deployment of talent, unnecessary use of contracted labour and potential loss of key capabilities through the redundancy and early retirement schemes that may be required over the Spending Review period.

Conclusion

17 Total expenditure on central government staff costs has increased by 10 per cent in real terms over the ten years to March 2010. The majority of this change is attributable to increases in higher grade staff. This shift in grade composition has not been a planned process, with variable practices across departments and agencies and an absence of central control. There is evidence of poor control over the numbers and roles of higher grade staff, inadequate management information to support effective staff cost management including a lack of time recording systems and skills information, and a lack of a structured approach to staff cost reduction. Work on identifying potential savings has begun but risks to value for money will remain if the above weaknesses are not addressed.

Recommendations

18 Controlling staff costs and delivering staff cost reduction across central government presents a broad range of risks. We recommend that these risks are identified and managed collectively by the Cabinet Office, the Treasury, and individual departments and agencies. This is particularly important in the current environment of budget reductions, and when roles and responsibilities are set to change. While our report has focused on managing staff costs in the civil service, these risks and recommendations will have wider application in the management of staff costs across the whole public sector.

For the centre of government:

a **The system of delegated pay places responsibility for pay setting with departments, and the Cabinet Office and the Treasury are not attempting to exercise overall control of the paybill, other than through general controls on departmental budgets.** This system has resulted in pay divergence and an upward drift in staff employed at higher grades. While some of this change and the resulting increases in cost may be justified in terms of the business needs of departments, we recommend the centre of government reviews its ability to understand and challenge the management decisions that drive increases to the civil service paybill.

b **Centrally mandated measures such as the public sector pay freeze are intended to reduce departmental costs in the short term.** They carry risks to staff engagement and retention and to the civil service's ability to recruit in the longer term. They also risk encouraging a 'stop-start' approach to pay growth and we recommend that the centre is quick to establish a more sustainable approach. The centre should also identify and manage the risks involved in using such measures and monitor whether cost savings have been achieved.

c **The respective roles of the centre of government and departments on staffing issues are changing.** There is a risk that uncontrolled reform of the Human Resources capability across government will lead to gaps in controls and accountability for staff costs. The centre of government will need to ensure that controls are not weakened as the system undergoes reform.

d **There is a lack of comprehensive information on the total civil service workforce, including the costs of external capability.** The Cabinet Office should build upon earlier data collection exercises to collate workforce costs and provide integrated resource information, including consultants, interims, temporary staff and outsourcing.

For civil service departments and agencies:

- e **The growth in staff costs has mainly been driven by increases in staff in higher grades.** Greater discipline is required over the creation of posts and the management of promotions to prevent any further inflationary effects that increases in grade can have on staff costs. Departments and agencies should make better use of pay benchmarking data and existing good practice to ensure that grade distribution is appropriate for departmental workforces.

- f **Delivering future reductions in staff costs will require departments to demonstrate an improved understanding of the cost of staff time.** Good quality information on the cost of staff time will support cost savings through process improvement, and prioritisation of activities. Organisations should improve their understanding of workforce costs and staff allocation to specific activities, utilising established costing techniques.

- g **Organisations do not have adequate information to understand the skills they have, the skills they need to retain and the skills they require.** Poor information compromises any evaluation of existing skills against future resource requirements, and risks loss of key capabilities through redundancy and early retirement schemes. Organisations should conduct activity to map levels of skill and experience across the workforce.

- h **Despite changes proposed to the Civil Service Compensation Scheme, the up front costs of voluntary or compulsory redundancy schemes and early retirements will be significant.** Further costs may be incurred if capabilities are unintentionally lost through these processes and have to be subsequently replaced. Organisations need to plan and target these schemes in line with future capability requirements to minimise these risks.

- i **There is a risk of falling staff morale as departments and agencies go through organisational change to deliver challenging budget reductions over the Spending Review period.** Against the backdrop of pay freezes and promotion limitations, there is a risk of declining staff engagement and a resultant effect on organisational performance. Departments and agencies need to plan, resource and control cost reduction programmes as major change management programmes.