National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 1089
SESSION 2010-2012

23 JUNE 2011

Reducing costs in the Department for Work and Pensions

Key facts

£535m

Target for running cost reductions in 2010-11

£2,669m

Target for running cost reductions 2011-15

£17 billion	The cost reductions required in benefits and pensions between April 2011 and March 2015
23 per cent	The Department's share of total public spending
£155.6 billion	The Department's settlement for expenditure on benefits and pensions in 2011-12
£7.8 billion	The Department's settlement for expenditure on running costs in 2011-12
£455 million	The cost reductions to be achieved in benefit and pensions spend in 2011-12
£1,451 million	The reduction in running costs the Department has to achieve in 2011-12

Summary

The Department for Work and Pensions has to make significant cost reductions

1 Reducing the budget deficit is a Government priority. The June 2010 Budget and the Spending Review in October 2010 announced significant spending reductions across government departments. The Department for Work and Pensions (the Department) has the largest annual expenditure of any central government department and so its cost reductions will be central to the Government meeting its priority objective.

2 The Department has already signalled its commitment to securing cost reductions. Since 2007, the Department has reported reductions of £2 billion in its running costs, and initial outturn data show that the Department met the target set in the June 2010 Budget to reduce its running costs by a further £535 million in 2010-11. This latter reduction had to be achieved in the nine months remaining of the financial year. It was largely delivered through a ministerial decision to close the Future Jobs Fund and the implementation of Cabinet Office requirements to introduce moratoria on consultancy and marketing expenditure, plus a freeze on recruitment.

3 Despite these successes, a much tougher challenge lies ahead. The Spending Review outlines the expected cost of benefits and pensions each year and the Department's budget to administer these payments and its other functions. By the end of 2014-15 the Spending Review settlement will result in cost reductions of nearly £20 billion (**Figure 1**). As with all the figures in this report, to allow reconciliation to the 2010 Spending Review, we have not adjusted costs to take account of forecast inflation.

Figure 1
The cost reductions to be delivered by the Department under the 2010 Spending Review

	2011-12 (£m)	2012-13 (£m)	2013-14 (£m)	2014-15 (£m)	Total (£m)
Cost reductions in benefits and pensions	455	2,495	5,860	8,150	**16,960**
Cost reductions in running costs	1,451	442	403	373	**2,669**
Total cost reductions	**1,906**	**2,937**	**6,263**	**8,523**	**19,629**

Source: National Audit Office analysis of Department data

4 The vast majority of the reductions will be to expenditure on benefits and pensions, rather than administrative spending. These payments are not within the Department's direct control as they must be paid to those who apply and are eligible. The reductions therefore depend upon the policy changes announced in the June 2010 Budget, the subsequent Spending Review and the March 2011 Budget, reflecting for the most part adjustments in benefit rates and entitlements.

5 The Department is directly accountable for the reductions in running costs. The Department's 2011-12 Delivery Plan notes that the reductions will be delivered largely through the rationalisation of existing support functions, increased self-service and automation of benefit delivery procedures, and reductions in workload as the economy is expected to recover. Compared to the cost reductions required in benefits and pensions, the majority of the savings in running costs have to be delivered earlier in the Spending Review period. While the reductions in running costs represent only a small proportion of the total, these changes can have a wider impact on the cost of benefits and pensions. For example, the payment by result contracts for the Work Programme, introduced in June 2011, reflect the Department's recognition that expenditure in this area should be more than offset by an associated reduction in benefits. The relationship between running costs and welfare expenditure also means that poorly executed cuts could have an adverse impact. Any deterioration in the accuracy of benefit decision-making or levels of fraud, for example, could increase the risk of overpayments in benefits and pensions which the Department has already estimated to have cost £3.3 billion in 2009-10. It is therefore crucial that the Department executes reductions in running costs in a structured way so as not to undermine the reforms to the benefit system.

6 This report is the first in a series by the National Audit Office on how departments are implementing their cost reductions. Our examination of the Department for Work and Pensions has focused on its planned reductions to running costs between 2011-12 and 2014-15.

7 Securing value for money from cost reductions involves more than just implementing planned cuts. Uniform top slicing of budgets or indiscriminate cost-cutting can leave an organisation at risk of building up higher costs in future. The Permanent Secretary, who took up post in January 2011, has taken a close personal involvement in how the cost reductions might be achieved. The Department has recognised that expenditure cuts can generate long-term sustainable efficiency savings only as part of a fundamental reform of its existing work practices, such as restructuring to remove layers of administration, focusing more on service delivery, and by changing behaviours to raise awareness of the need for cost control in future.

8 We have assessed the performance of the Department against the following criteria:

- The need to fully understand how costs are incurred at present and their relationship to service delivery value. (Part Two)
- A clear vision of how the organisation can be restructured to reduce unnecessary costs in the future. (Part Three)
- A clear plan for how this vision can be achieved. (Part Four)

9 The Department is only at the start of its new cost reduction challenge, and we will continue to monitor progress. Our examination was based on the state of the plans as at May 2011, but they continue to evolve.

Key findings

Sustained efficiency savings will depend upon the Department basing its plans more on the cost and value of its activities

10 Departments should have a good understanding of the distribution and profile of costs in their business, and the links between costs and the delivery of value (outputs such as claims processed and outcomes such as reducing reliance on benefits). Information on the distribution and profile of business costs enable rational choices about what to stop, what to change and what to continue. Without this information, cost reductions are less likely to lead to efficiency savings.

11 The major operational businesses within the Department have developed plans to live within their 2011-12 budgets. The development of these plans included modelling exercises and some benchmarking in order to establish what cost reductions might be made. The analysis was largely based on quantifying the potential reduction in full time equivalent staff numbers, for example using data on the expected further headcount reductions to be generated during the Spending Review in Jobcentre Plus and the Pension, Disability and Carers Service through streamlining processes and the increased use of online services. At the time of our audit, the plans for each business area were not sufficiently developed to enable us to confirm that any inconsistencies and duplications had been resolved.

12 In setting operational budgets for 2011-12, the Department did not make sufficient use of its activity-based costing model to drive performance improvements. Since 2007, the Department has been developing an activity-based costing model which is now sophisticated and versatile. The model has previously been used to determine staffing requirements in the Department's two agencies, the Pension, Disability and Carers Service, and Jobcentre Plus. However, the tool has not yet been used sufficiently to identify differences in the unit cost of activities across offices so that the gap between the best and worst performers can be reduced.

13 The Department has not been able to quantify the impact of cost reductions on service delivery in sufficient detail to measure efficiency savings. The Department recognised that in order to respond quickly to the Government's priority objective by reducing costs in 2010-11, it would not be able to demonstrate long term efficiencies and would need to find savings wherever it could. The moratoria on consultancy and IT projects, for example, generated an immediate cost reduction, impact, but it is not clear to what extent costs will be deferred or displaced elsewhere. Establishing a causal link between a cost reduction instigated by a department and any changes in service delivery is difficult but important. External factors are difficult to isolate and the change may impact on a range of different activities and outcomes, but the Department should nevertheless attempt to consider effect on value to identify waste. The Department does measure overall changes in productivity by comparing changes in its costs against changes in an index of outputs. The Department noted that, at the request of the new Permanent Secretary, the management team in Jobcentre Plus had started monitoring its productivity each month from April 2011, and that there were similar plans for the Pension, Disability and Carers Service. However, there are, as yet, no such arrangements in place for corporate centre functions.

14 The Department recognises that it has to improve its understanding of the value of its activities and the associated costs. It previously relied on its Investment Committee to challenge proposals. However, an internal review in 2010 concluded that staff still placed more value on achieving targets within the resources available than pursuing cost effectiveness. The Permanent Secretary has recognised the importance of behavioural change in this area. As a first step, the Department is introducing Performance Agreements to specify the services to be delivered as well as the budget available for each business area.

The Department does not yet have a sufficiently detailed model of how it wants to run in the long term

15 Through having a clear vision of how the organisation will operate in future, senior managers are more likely to be able to prioritise what changes are needed and to explain to staff what their role might be. The approach can be referred to as defining a Target Operating Model. The model is, in effect, a vision of how an organisation will look in future given its objectives and will enable the Department to identify those areas that can be trimmed to reduce costs. The model should be supported by a detailed outline of how it will operate in practice. At the outset the model can be defined in broad terms and include some areas of uncertainty, such as how Universal Credit might be implemented. Such a model should then be refined through regular iteration as the Department's analysis of information develops. For example, the confirmation in May 2011 that Universal Credit will initially be delivered by staff from the Department and HM Revenue and Customs means that the model can be refined further.

16 **Despite the uncertainties over how the implementation of Universal Credit would affect business processing, Jobcentre Plus has developed its model of how it will operate in the future to a greater extent than other parts of the Department.** The development work started in Summer 2010. The model involves a reduction in the number of contact centres, benefit delivery centres and Jobcentres, and a greater reliance on online services. The plan acknowledges that any changes in how Universal Credit will be implemented would affect the model, but Jobcentre Plus was right to press ahead to develop a broad model anyway.

17 **The Department's full model for how it will operate is taking longer to develop.** In April 2010, the Department's executive team approved an Organisational Design Review that outlined a proposed rationalisation of corporate functions in the Department and its agencies, such as Finance, Legal Services and Human Resources. The review outlined a headcount reduction of approximately 5,300 posts by April 2014, although much of the detail of how services would be reorganised had yet to be resolved. The savings from the review do not readily reconcile with the reductions required under the Spending Review. Following his appointment in January 2011, the Permanent Secretary has instigated reviews of the Department's corporate functions. These reviews, including the associated headcount reductions, are due to be completed by March 2012. In the meantime, the Department does not have an operating model as clearly defined as that for Jobcentre Plus.

18 **The Department has not developed sufficient contingencies to mitigate uncertainty.** In order to manage the unknowns in the implementation of welfare reforms and the possibility that some cost reductions might not materialise, the Department and its agencies should build contingencies into the plans. The Department confirmed that it plans a regular programme of 'deep-dive' examinations to scrutinise the progress of each business unit in securing their cost reductions. We consider that it is prudent to plan for an extra 50 per cent of the value of cost reductions required. Jobcentre Plus confirmed that it had built some contingencies by reducing its anticipated savings from headcount reductions by 20 per cent. The business plans for the Department did not include explicit contingencies, although the Permanent Secretary has brought forward the planned headcount reductions in the Department's corporate functions.

The Department will have to strengthen its oversight of progress if it is to maximise sustainable reductions

19 The fundamental reorganisation of a department to secure cost reductions depends upon the successful implementation and management of a transformation programme. By following a step-by-step process of incremental change within an overall strategy, an organisation should be able to restructure its activities without disrupting ongoing service delivery. A transformation programme will typically involve a suite of projects and initiatives to restructure existing processes, a communications strategy to convince and assure staff of the need for change, and a measurement system to monitor progress and evaluate impact.

20 The Department has recognised the need to raise staff awareness of the requirement to reduce costs. The Department had nearly 98,000 full time equivalent permanent employees at 31 March 2011. The executive team has a crucial role in helping staff to deal with the potential consequences of cost reductions and to remain focused on service delivery. Many of the initiatives implemented in 2010-11, such as a restriction on first class travel, should encourage staff to be more prudent with public funds. Jobcentre Plus and the Group Finance Directorate had also posted information on the Department's intranet and held discussions with staff to listen and respond to their concerns and suggestions for savings, although this approach is not consistent across all corporate service functions.

21 The Department has not yet developed detailed plans beyond 2011-12 to meet the Spending Review reductions in running costs. Existing delivery plans only cover 2011-12, although Jobcentre Plus has a more detailed plan up to 2014-15. The Department's Transformation Programme Board, which first met in May 2011 and comprised members of the executive team, will oversee the corporate centre redesign and the broader cultural change required, but the plans beyond March 2012 are not yet specified.

22 While the Department has agreed the budgets for 2011-12 with each of its business areas, individual responsibilities had not been finalised at the start of the year. By April 2011 the Jobcentre Plus management team had clarified accountabilities and responsibilities with each director, but this process had not been adopted across the whole of the Department. The Department noted that each manager understands their role in securing cost reductions, but until accountabilities are clearly specified, ambiguities increase the risk that cost reductions will not be achieved. Performance Agreements have been agreed with each Director General and are being cascaded down through the organisation.

23 The introduction of revised governance arrangements should help to improve programme oversight. The Department did not monitor progress in reducing costs adequately in 2010-11 and there were insufficient data collated on unit costs or the quantity and quality of service delivery. The Department has introduced a Transformation Programme Board from May 2011 to oversee planned changes to the design and culture of the organisation. From October 2011, it will be supported by a Portfolio Management Unit whose role will be to monitor progress in delivering the Department's change programmes.

Conclusion on value for money

24 The Department's challenge of securing a £2,669 million reduction in running costs in four years, at the same time as implementing substantial welfare reforms and a £17 billion reduction in benefits and pensions, requires a good understanding of its expenditure, a clear vision, and a coherent, well informed plan. Work is under way but three months into the Spending Review period, there is some way to go before the Department can demonstrate it has a strategic and structured approach to its cost reductions. The Department cannot rely on uncoordinated annual savings plans for sustained cost reductions, particularly given the challenges posed by the major benefit reforms it must implement. There are emerging signs of progress, but unless these materialise as part of a structured approach, there is a risk of not achieving substantial savings, and therefore value for money.

Recommendations

25 We make the following recommendations:

a To improve its understanding of the cost and value of its activities, the Department should:

- Use the activity-based costing model to compare performance across the different offices in Jobcentre Plus and the Pension, Disability and Carers Service to identify potential efficiencies.
- Adapt the activity-based costing model for use in the corporate centre and set a clear timeline for its implementation.
- Develop clear plans for changing staff attitudes to cost control. These plans should include tying in the Performance Agreements with the staff appraisal system so that managers can be held to account and encouraging each business area to link unit costs with value in their proposals by demanding such information in any written submissions.

b **The Department has not yet developed a detailed model for how it expects to deliver services in future.** The Department should:

- Task the Transformation Programme Board to complete the development and refinement of a Target Operating Model.
- Cross-check the Performance Agreements for each business unit against the Target Operating Model for consistency and to ensure that there are sufficient contingencies in case some cost reductions do not materialise.

c **Without a clearly specified overall plan to deliver the cost reductions by March 2015, the Department cannot monitor progress effectively.** The Department should:

- Establish clear programme management arrangements, including a timeline of key steps in the process and formal governance arrangements so that progress can be monitored.
- Specify responsibilities for delivering the savings and determine a clear reporting line. Each manager should have an accountability statement setting out what changes they are expected to implement and by when.