



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

**HC 1280
SESSION 2010–2012**

15 JULY 2011

HM Revenue & Customs

PaceSetter: HMRC's programme to
improve business operations

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National Audit Office

HM Revenue & Customs

PaceSetter: HMRC's programme to improve business operations

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

6 July 2011

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This report can be found on the National Audit Office website at www.nao.org.uk/pacesetter-2011

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Key facts

£115m

minimum costs of implementing PaceSetter 2005-06 to 2010-11

£400m

HMRC's estimate of resource savings from PaceSetter 2005-06 to 2010-11

£860m

HMRC's estimate of additional tax revenues from PaceSetter 2005-06 to 2010-11

2004	First trials of process improvement techniques in HMRC
£3.5 billion	HMRC's running costs, excluding depreciation, in 2010-11
At least £115 million	Expenditure on staff, consultancy, equipment and travel for PaceSetter 2005-06 to 2010-11
£400 million	HMRC's estimate of resource savings from PaceSetter productivity improvements, 2005-06 to 2010-11
£860 million	HMRC's estimate of additional tax revenues from PaceSetter productivity improvements, 2005-06 to 2010-11
67,000	HMRC's full-time equivalent workforce in March 2011
68 per cent	of HMRC staff using PaceSetter techniques to some extent in March 2011
36	HMRC's employee engagement index in 2009, compared with government average of 58
37-40	HMRC's employee engagement index for PaceSetter areas in 2009
400	Trained PaceSetter practitioners in HMRC

Summary

1 HM Revenue & Customs is a large and complex organisation, resulting from the merger in 2005 of Inland Revenue and HM Customs & Excise. In 2010-11, it collected £468.9 billion in taxes and national insurance contributions, paid out £40.5 billion in tax credits, child benefit and other entitlements and cost £3.5 billion to run. In March 2011, it employed around 67,000 full-time equivalent staff.

2 In administering the various taxes, tax credits and benefits, it deals with a customer base covering most individuals and businesses in the United Kingdom. Typically this involves registering people and organisations to pay tax, helping them to comply with their obligations, processing returns and other information, assessing and collecting the tax due, conducting further enquiries and investigations and imposing penalties for serious non-compliance. For tax credits and benefits it processes applications, provides help and checks entitlement, makes payments and undertakes a range of work to tackle fraud and error.

3 The Department's challenge is to balance three objectives: maximise revenues, reduce its costs and improve the experience of its customers. Building on savings achieved under previous Spending Reviews, it is required to reduce its running costs by 25 per cent in real terms by the end of 2014-15 and to reinvest around £900 million of these savings to bring in additional revenue of £7 billion a year by 2014-15, while stabilising and then improving customers' experience. The Department is also expected to reduce tax credit fraud and error by £2 billion a year by 2014-15. Operating efficiently and effectively its many processes is critical to its success.

4 The Department's PaceSetter programme is inspired by 'Lean' approaches to business improvement. In essence, Lean philosophy suggests that organisations can improve product or service quality for the same or less cost by continuously reviewing their processes from a customer perspective to remove waste by reducing duplication and inconsistency, and by identifying and resolving the root causes of operational problems.

5 The Department was one of the first public sector organisations to apply process improvement techniques. It started to experiment with Lean techniques in 2004, in the context of its requirement to make efficiency savings and headcount reductions. It first applied these techniques in large-scale processing operations, such as processing Income Tax Self Assessment returns. This early work evolved into the PaceSetter programme (the programme) which was launched in 2006. PaceSetter combines the Department's process improvement approach with developing leadership and management capability, to improve business performance and staff engagement.

6 Applying PaceSetter typically involves frontline teams and PaceSetter experts working together to analyse and then redesign existing business processes. It also includes training for frontline teams in techniques, such as visual management and a structured approach to problem solving, to enable them to continuously improve the way they work.

7 In 2008, the Department decided to start rolling out PaceSetter throughout the organisation. The Department sees PaceSetter as an important foundation in implementing its new business plan and change programme to become more efficient, more flexible in dealing with customers and more effective in bringing in revenue, over the 2011-15 Spending Review period. The Department has become an accredited partner with Cardiff University's Lean Enterprise Research centre, it is training staff from other government departments through its PaceSetter Academy and is working with the Cabinet Office to help engender good process management across the public sector.

8 This report examines the value for money of the Department's PaceSetter programme to date. Part One covers the development of the programme; Part Two examines the costs and benefits of PaceSetter, and Part Three looks at its implementation and maturity.

9 Our methodology included interviews with Department staff, document review, site visits to four processes using PaceSetter (Figure 2 on page 14), and draws on private sector experience in using process improvement techniques. Appendix One explains our methodology.

10 This report is part of our wider programme of audit on HMRC. The programme includes our annual audit of HMRC's accounts and examination of its systems for the assessment and collection of taxes, and value for money studies and other work either across government or focusing specifically on the Department. In devising our programme we have regard to the NAO's three strategic themes of cost-effective service delivery, financial management and informed government. Recognising the Department's challenge of balancing objectives on revenue, cost and customer experience, we seek to provide objective insight on how HMRC is:

- transforming its performance and improving compliance among taxpayers and benefit and tax credit claimants using its customer-centric approach; and
- achieving value for money by delivering a sustainable cost base while maintaining revenues.

11 In undertaking this study, we took account of the results of previous NAO reviews on the maturity of process management in central government, the efficiency of National Insurance administration, HMRC's Spending Review 2007 efficiency savings, HMRC's management of civil tax investigations and our reports on the Department's accounts. We also plan to publish shortly a report on the Department's plans for delivering cost reductions.

Key findings

12 The Department has pioneered the use of process improvement techniques in central government through its PaceSetter programme, and it was sensible to do so. Process improvement techniques offer the potential to help organisations achieve more with less resource by helping to redesign processes to eliminate waste, inconsistency and duplication and create an environment which enables frontline staff to continuously improve what they do. A number of public and private sector organisations have programmes to apply process improvement techniques.

13 PaceSetter has introduced new ways of working and the Department recognises that its success depends on how effectively leaders and managers apply the techniques. The types of improvements the Department has made vary but have included the redesign of claim forms, standardising procedures across offices and more tailored approaches to checks based on risk. Around two thirds of its workforce are now working in a team where PaceSetter techniques are used to some degree. The Public and Commercial Services Union has over time raised concerns about the way some managers have implemented the approach. In December 2010, the Department and its two main trades unions agreed a statement that PaceSetter contains tools and techniques that, where applied correctly, should help improve business productivity, quality and public service.

14 PaceSetter implementation has led to productivity improvements but the extent of overall efficiency improvements is not clear. The Department estimates that the productivity improvements due to PaceSetter between 2005-06 and 2010-11 are equivalent to £400 million of resource savings and £860 million of tax yield, where yield is a measure of the under-declared tax identified through compliance work. Most of these benefits derive from two parts of the organisation – Customer Operations and Local Compliance. Overall efficiency is the relationship between costs and performance. In Customer Operations, PaceSetter implementation was associated with substantial increases in the average output per person, and staff numbers have fallen substantially. However, there is limited evidence on overall trends in business performance to provide assurance that staff reductions attributed to PaceSetter were achieved whilst maintaining or improving customer service and quality. The evidence that is available on overall business performance shows improvements and deterioration. The picture is complicated by other changes in the organisation, volume and nature of the work in this part of the Department. Local Compliance has also reduced staff numbers and increased its yield:cost ratio. But it is difficult to isolate the effects of PaceSetter, given its implementation alongside other change projects.

15 The Department expects PaceSetter to help it achieve a more motivated workforce. It appears that so far the programme has had a small positive impact on staff engagement but it has not yet transformed the previous low levels. The Department's employee engagement index, derived from its 2009 People Survey, was 36 per cent, compared to an average of 58 per cent across other government departments. The analysis for areas where PaceSetter has been introduced gave an index of 37-40 per cent. The Department's preliminary analysis of its 2010 survey results suggests that staff working in PaceSetter areas continue to give more positive responses on this aspect, though again the impact appears small.

16 The Department has not had a full understanding of the costs it has incurred in implementing PaceSetter. In monitoring the costs of the programme the Department decided to consider only the additional funds provided for equipment and consultants. Its cost figures therefore exclude, for example, the salary costs of PaceSetter experts working with business areas to implement PaceSetter. Our analysis showed that including these costs brings the total spent on PaceSetter from £55 million to £115 million between 2005-06 and 2010-11 on staff, consultancy, equipment and travel costs. Both figures exclude the wider costs associated with implementing changes initiated by PaceSetter and staff time involved in programme activities. The Department considers that for most people the time spent on programme activities replaces other similar activities.

17 The Department's approach to PaceSetter has evolved over the last five years and it has further changes planned. But it has much further to go before it has a mature process improvement approach. Understanding what customers value and considering processes in their entirety across the organisation are important features of process improvement techniques. In applying PaceSetter the Department has used the experience of frontline staff to reflect customers' perspective and has required teams to use customer-related performance measures such as quality and lead time. The Department has started to make greater use of work to analyse 'customer journeys' to target improvements but it has not yet developed sufficiently structured and routine ways to incorporate customer insight into its PaceSetter approach. The Department's approach has lacked sufficient focus on end-to-end processes and using these to systematically prioritise where to apply PaceSetter resources. It has, though, begun to map its top 10-12 processes in detail which it expects to bring a greater focus to this aspect.

Conclusion on value for money

18 We endorse what the Department is seeking to achieve through PaceSetter. It has delivered value by increasing productivity through new ways of working, and it may also have contributed to greater staff engagement. The extent of the efficiency improvements is not clear, however, and some key principles of process improvement are not yet being applied strategically across the entire organisation and embedded into the Department's core processes. Although work has begun on these issues, after five years we would expect the Department's approach to process improvement to be further ahead, more sophisticated and more ambitious in its transformation of the Department. We conclude, therefore, that the programme is not yet value for money.

Recommendations

19 Our recommendations aim to help the Department to obtain the most from PaceSetter as it rolls out the programme further. It should take a more strategic approach, in prioritising its application to areas of greatest potential benefit and integrate PaceSetter with its wider change and cost reduction plans. In applying PaceSetter, it should look to assess entire processes from end to end and reflect more fully the customer perspective, as well as obtaining a better understanding of the planned and actual costs and benefits.

a **The examples of where the Department has implemented PaceSetter indicate it has further to go to make the most of process improvement techniques.** The Department should:

- apply PaceSetter principles to its processes 'end to end', across the organisation, and bring a stronger customer perspective to the work; and
- establish more structured ways to direct improvement efforts to areas that will gain most benefits.

b **The Department does not have clear guidelines on how business areas should prioritise the efforts of PaceSetter-trained staff.** The Department should:

- set central priorities for the deployment of PaceSetter practitioners aligned to its new business plan and informed by the results of its end to end review of processes; and
- ensure that PaceSetter is appropriately aligned to its wider change programme.

- c** The Department has a limited Department-wide understanding of the costs and benefits of PaceSetter at different sites and so cannot make fully informed decisions about how best to adapt the approach and prioritise effort. The Department should:

 - better track and validate the costs and benefits of changes in processes arising from the initial diagnostic phase of PaceSetter, and for significant changes arising from problem solving exercises;
 - where PaceSetter is more established, track how business performance is changing; and
 - carry out further pilots to more fully understand the costs and benefits of applying PaceSetter to 'considerative' parts of the organisation such as those dealing with policy and legislation.

- d** The Department's analysis suggests that PaceSetter is having a small positive impact on staff engagement, but staff engagement at the Department remains low. The Department should:

 - conduct further research into the key factors that affect staff engagement at sites with PaceSetter; and
 - ensure frontline managers have a good understanding of how to apply the approach effectively.

- e** Other government departments are applying business improvement techniques to help them meet expected cost reduction targets. In doing so they should have regard to our findings and recommendations above, our wider review of process management across government and particular features of the Department's experience, in:

 - using external expertise and planning for capability transfer; and
 - robust tracking of costs and benefits.

Part One

The development of PaceSetter

1.1 HM Revenue & Customs' PaceSetter programme is aimed at introducing process improvement, and developing the management and leadership of the Department. This part outlines the development of PaceSetter, including its objectives and approach, and the types of improvements it has generated.

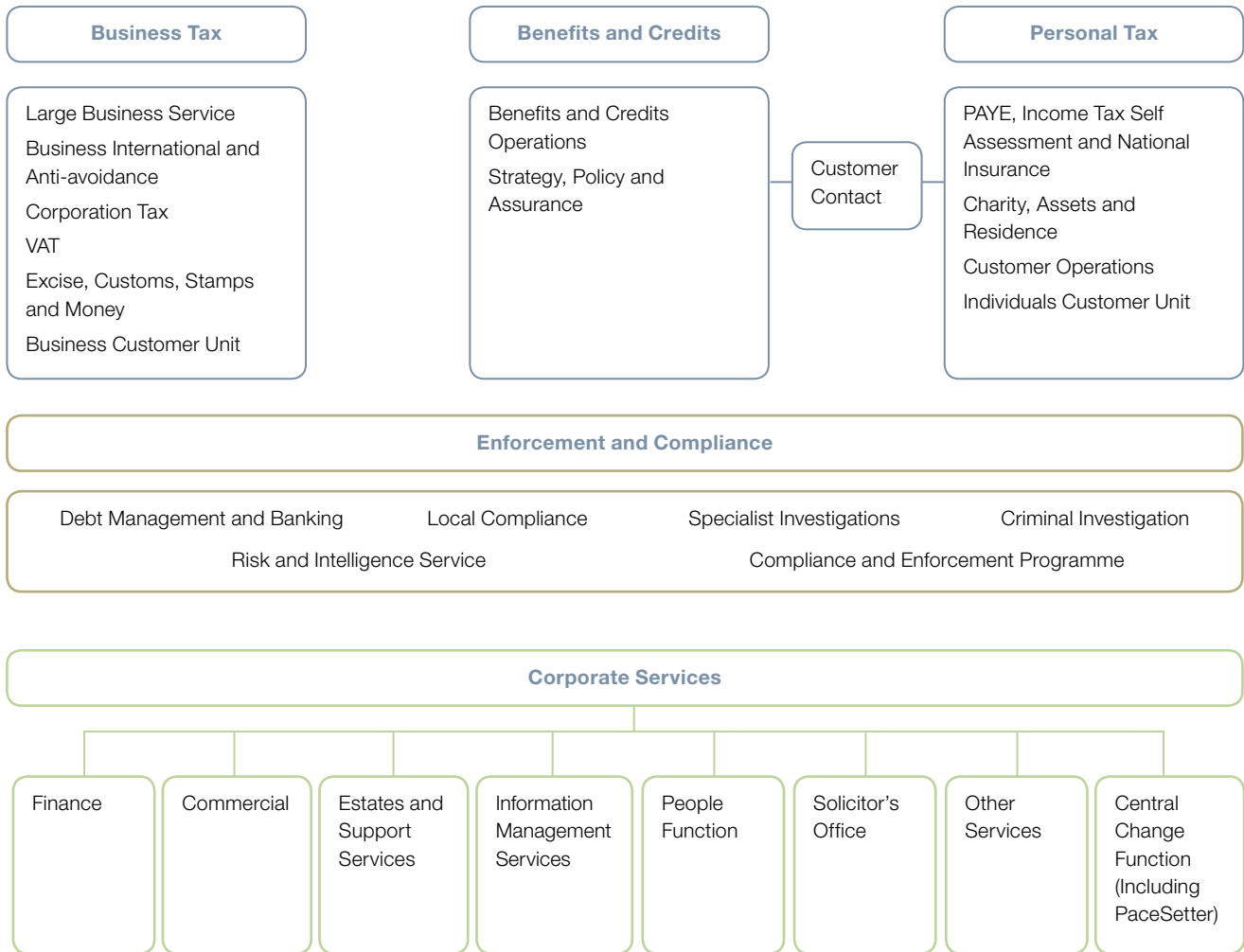
The development of PaceSetter

1.2 PaceSetter is inspired by 'Lean' approaches to business improvement. In essence, a Lean philosophy suggests that organisations can improve product or service quality for the same or less cost by reviewing their processes from a customer perspective to reduce duplication and inconsistency, by identifying and resolving the root causes of operational problems and by using the experience of front-line staff to drive continuous improvements. Various public and private sector organisations have adopted Lean programmes and credit the approach with helping to transform their business and improve staff morale.

1.3 The Department launched PaceSetter in 2006 in the 'Processing' part of the organisation in the context of its requirement to make efficiency savings and headcount reductions to meet its Spending Review 2004 commitments, following a series of pilots designed to trial the application of Lean techniques. At that time, the work in this area typically included dealing with post, forms and returns relating to Income Tax Self Assessment and Pay As You Earn (PAYE) systems, and the work of the National Insurance Contributions Office, tax credit and child benefit offices. (These areas now fall within Personal Tax Customer Operations and the Benefits and Credits operational group as shown in **Figure 1** overleaf).

1.4 PaceSetter remained a discrete programme within this part of the organisation until 2008, though other areas carried out smaller scale projects. In 2008, the Department decided to roll PaceSetter out across the organisation, beginning with the Customer Contact, Debt Management and Banking, and other Enforcement and Compliance directorate. Figure 1 shows HMRC's organisation of its directorate within four main operational groups. In rolling-out PaceSetter, the Department anticipated it would help improve business performance – in terms of productivity and reduced costs, service delivery and quality – and lead to a more motivated workforce.

Figure 1
HMRC's main operational groups



Source: HM Revenue & Customs June 2011

1.5 By March 2011, the programme had been rolled-out to around two thirds of staff, although most areas have yet to embed fully the PaceSetter way of working. The Department is also working with the Cabinet Office to help engender good process management across the public sector. It has undertaken to train staff from other government departments through its PaceSetter Academy. Appendix Two outlines the development of PaceSetter.

The PaceSetter approach

1.6 Through PaceSetter the Department aims to engage employees in streamlining its processes. PaceSetter implementation in a business area usually begins with workshops and training for staff at all levels, followed by a 6-16 week exercise to analyse existing processes, establish which parts really add value, and redesign them to improve performance.

1.7 For example, before PaceSetter each office processing Self Assessment returns did so in different ways, in terms of the number and types of checks carried out, the order in which the processing took place, and office layout. Through PaceSetter the Department designed a standard approach, which it rolled-out to its largest processing sites. This standard approach aimed to streamline the process by stopping unnecessary steps and establishing a more steady flow of work to reduce the amount of time forms 'waited' between different processing steps. Implementing the new approach could involve a variety of changes, such as stopping an initial sort of forms into different categories, advising staff not to print out information available on screen, or moving staff working on sequential steps in the process physically closer together. While individual changes might be small, a number of incremental improvements can make a significant difference over time, particularly in high volume processes such as Self Assessment. The principles behind PaceSetter also influenced the Department's decision to consolidate similar types of processing work in particular offices.

1.8 Through PaceSetter, the Department also aims to encourage teams to continuously improve what they do. One of the main tools it uses is 'visual management'. The purpose of visual management is to display relevant, real-time information to teams to prompt them to take appropriate action. This information may be displayed on a whiteboard or computer screen, and usually includes measures of quality, productivity and workload. In the Processing parts of the Department, for example, PaceSetter has led to hourly tracking of the number of forms each team processes, with performance discussed at daily team meetings. Another key feature is introducing teams to a structured approach for identifying concerns and ideas for improvement, and resolving problems.

1.9 We visited four sites which had applied PaceSetter to their work. **Figure 2** overleaf shows how they have applied PaceSetter to different processes and examples of improvements introduced.

Figure 2

The four case examples examined

Child Benefit	National Insurance	Specialist Employer Compliance	Business International
The process	Recording on HMRC's database new National Insurance numbers issued to adults by the Department for Work and Pensions, (690,000 numbers in 2009-10). Individuals need a number to claim tax credits and some welfare benefits and to work in the UK.	Test checking that employers are complying with their PAYE and other responsibilities such as collecting student loan repayments. The checks involve testing the robustness of employers' systems; and assessing liabilities.	Providing legislative, policy and technical assistance relating mainly to double taxation relief, the Controlled Foreign Companies regime, and company residence.
PaceSetter introduced	October 2007	November 2008	September 2009
Improvements to the process	Performance boards record hourly, daily and weekly performance against targets. The data feeds into management information for all levels of local management. Stimulated a cross-departmental perspective on the process. A single, redesigned form replaced three forms and the flow of work was streamlined.	A national process across Local Compliance, codified in Standard Operating Procedures, eliminating local variations in approach. A more tailored approach to each case based on a standard risk assessment. Introduction of 'T card boards' to show case progression visually.	Introduction of performance boards to manage workflow and monitor performance. An outline strategy for a process to improve decision-making and reduce delays in dealing with avoidance schemes, that has been taken forward as a cross-Directorate project. Identifying ways to improve knowledge management, including reducing duplication in material saved electronically.

Source: National Audit Office analysis

Part Two

The costs and benefits of PaceSetter

2.1 This part examines the Department's spending on PaceSetter and the benefits obtained to date.

Costs

2.2 The Department spent more than £115 million on PaceSetter between 2005 and 2011. The full costs are not known because the Department's figures do not include the cost of frontline staff's time on PaceSetter workshops and training. The Department considers that in most cases this will have replaced similar development activities. It also does not include the costs involved in redesigning processes, such as issuing new forms or guidance for staff, although ongoing changes in the tax system frequently require such resource.

2.3 The costs associated with PaceSetter fall under six main categories:

- **Practitioners and the central team.** With the help of consultants the Department has trained a group of staff as internal PaceSetter experts, known as practitioners. The Department employs 400 practitioners and other staff who mostly work full time on PaceSetter activities either in frontline operations or in developing and coordinating the PaceSetter approach. [2005-06 to 2010-2011 expenditure, £55.8 million].
- **Consultancy.** The Department has employed consultants to help develop the PaceSetter approach, apply PaceSetter tools and techniques, and deliver staff training, including senior leaders. [2005-06 to 2010-2011 expenditure, £39.7 million].
- **Travel and Subsistence.** In the early days, practitioners often incurred travel and subsistence costs, when introducing the programme to different parts of the organisation, away from their usual place of work. Costs have reduced as the Department now deploys most practitioners within their home regions. [2005-06 to 2010-2011 expenditure, £16.2 million].
- **Capital expenditure.** For example on computer equipment, white boards to facilitate 'visual management', and the PaceSetter Academy training facilities. [2005-06 to 2010-2011 expenditure, £3.3 million].

- **Other staff time.** PaceSetter activities involve the time of frontline staff, managers and senior leaders. Introducing PaceSetter to an area usually involves staff participating in workshops and training, and a greater emphasis on regular team meetings. Training for senior leaders involves visits to PaceSetter operations and one to one coaching. Staff time on these activities is not logged. The Department considers that it will in most cases have replaced similar activities.
- **Other implementation costs.** Redesigning processes according to PaceSetter principles may involve additional implementation costs beyond staff time, such as changes to forms, office layout, or guidance for staff. It could also involve changes to IT though in practice PaceSetter has not initiated substantial IT changes because of restrictions on IT spending across the Department. Spending on changes initiated through PaceSetter is not separately identified.

The benefits obtained from PaceSetter

2.4 There is evidence that changes initiated by PaceSetter to streamline business processes have led to some significant increases in output per person per day and enabled reductions in staff. But there are uncertainties over the full extent of the financial benefits from the programme and the extent of improvements in efficiency. The Department's analysis suggests that PaceSetter may have had a small positive impact on staff engagement but staff engagement is low in comparison with other government departments.

The financial benefits

2.5 The Department estimates the value of productivity improvements due to PaceSetter in terms of resource savings for most business areas and in terms of additional tax yield for its Enforcement and Compliance work, where yield is a measure of the under-declared tax identified. It estimates that PaceSetter has achieved productivity benefits equivalent to £400 million of resource savings and £860 million of tax yield between 2005-06 and 2010-11. It has not tracked the overall impact of PaceSetter on service delivery and quality, though the PaceSetter approach does require business areas to track measures of service delivery and quality relevant to their business to understand their process performance.

2.6 The Department considers that PaceSetter has delivered most benefit in the two parts of the organisation where it has spent most on PaceSetter – Customer Operations and Local Compliance. Benefits from Customer Operations account for just over £340 million of the estimated resource savings between 2005-06 and 2010-11 (86 per cent), and £100 million of the resource savings in 2010-11 (82 per cent). Benefits from Local Compliance account for just over £850 million of the yield benefits between 2005-06 and 2010-11 (99 per cent), and all of the yield benefits in 2010-11.

2.7 We examined the evidence of PaceSetter's impact on productivity and cost, within Customer Operations and Local Compliance. We sought to assess the reasonableness of the benefits reported by reviewing the methodology used to estimate these benefits. We did not validate the underlying data.

a) Benefits in Customer Operations

2.8 The Department has reported that the productivity improvements generated by PaceSetter enabled just over 4,400 of the 7,000 staff reductions it made between 2006-07 and 2010-11 within the parts of its business that now fall under its Customer Operations directorate, representing 25 per cent of the workforce. Customer Operations includes the processing of post, forms and returns relating to Income Tax Self Assessment and Pay As You Earn (PAYE) systems, and the work of the National Insurance Contributions Office. How far the staff reductions attributed to PaceSetter represent overall efficiency improvements however, is not clear, as the Department does not have clear information to show overall trends in service delivery, quality and workloads, and the impact of PaceSetter is difficult to isolate from the impact of wider changes in the organisation.

2.9 Before 2009-10, the Department calculated the productivity improvements and staff reductions attributed to PaceSetter implementation in this part of the business by tracking output per person per day at individual sites and translating these into equivalent staff reductions. Initial diagnostic work at each site identified the baseline performance and set target levels for output per person per day on the basis of potential improvements identified. The Department then tracked weekly performance against the baseline and target. Tracking productivity in this way became more difficult during 2009-10 because the introduction of a new PAYE computer system and more automated checks changed the volume and nature of the work. From 2009-10, the Department used estimates of the scale of improved productivity based on their consultants' assessment of industry expectations.

2.10 The Department has reported increases in productivity of at least 30 per cent in offices where PaceSetter is in place, but it was unable to provide a readily available clear audit trail to support this. Analysis of the weekly reports for 2007-08 for the four main areas of processing nevertheless indicated overall uplifts in output per person, per day, of 71, 50, 32 and 12 per cent above the baseline recorded at PaceSetter implementation, though in some cases the dataset was incomplete.

2.11 The analysis, however, also suggested wide variations in the extent of the uplift in individual offices. The largest offices reported uplifts as high as 200 per cent, but some offices reported reductions of 17 per cent. The Department had not carried out systematic analysis to understand the reasons behind these variations. In addition, the output per person was lower in 2008-09 than in 2007-08, although in three out of the

four main areas of processing it was nevertheless substantially higher than the original baseline. Over this period various other organisational changes affected the scale and nature of the workload and therefore possibly the comparability of productivity figures. The overall fall in output per person, per day, in 2008-09, raises questions about the calculation of the additional benefits the Department reported from PaceSetter in that year, and whether it was reasonable to assume that continuous improvement activity in 2009-10 would deliver efficiency improvements in line with industry expectations.

2.12 Overall efficiency is the relationship between costs and performance. Costs within Customer Operations have fallen substantially, with the staff reductions attributed to PaceSetter between 2006-07 and 2010-11 representing around 25 per cent of the original workforce. How far these reductions represent overall efficiency improvements is not clear, however, as the Department does not have clear information to show trends in service delivery, quality, workload, the time taken to process work or work awaiting processing. Where information is available it presents an inconclusive picture.

2.13 For example, in our report *The efficiency of National Insurance administration* we concluded that it was likely that the reduction in staff numbers achieved of around 31 per cent had led to an improvement in overall efficiency, although the extent of the improvement was unclear. The Department had achieved higher productivity targets on individual activities, but it did not have a clear picture of the total costs incurred in administering National Insurance and how these had changed, and operational performance had been mixed. It had improved its performance for overall accuracy of processing but response times for correspondence had deteriorated and it was below its targets for both.¹

2.14 On PAYE, the Department's monitoring of processed work items indicated improvements in meeting quality standards between 2006-07 and 2008-09, although overall performance mostly remained below target (**Figure 3**). Performance on quality reduced in 2009-10 following problems the Department encountered with the introduction of its new computer system. At the same time, there has been a growing backlog of PAYE cases waiting to be processed. These cases require manual review to determine whether additional tax payments or refunds are due or to resolve discrepancies in the underlying records. Our reports on the Department's Accounts have examined these backlogs of work and the problems encountered in introducing the new computer system.² The Committee of Public Accounts concluded in 2011 that by allowing a large backlog of cases to build up, the Department had delayed the repayment of overpaid tax and put at risk the recovery of an estimated £1.4 billion of underpaid tax. Our report on the Department's 2010-11 Accounts examines the Department's progress in resolving these problems.³

¹ Comptroller and Auditor General, *The efficiency of National Insurance administration*, Session 2010-11, HC 184, National Audit Office, June 2010.

² Report by the Comptroller and Auditor General, *HM Revenue & Customs 2009-10 Accounts*, July 2010.

³ Report by the Comptroller and Auditor General, *HM Revenue & Customs 2010-11 Accounts*, July 2011.

Figure 3

Percentage of cases processed meeting quality standards

Year	Accuracy of PAYE processing (%)	Target (%)	Accuracy of manual PAYE processing (%)	Target (%)
2006-07	95.1	98.0	82.1	91
2007-08	95.4	98.5	83.4	93
2008-09	96.2	96.0	83.5	87
2009-10	95.3	96.5	80.0	89

Source: HM Revenue & Customs

2.15 The Department's data on its performance in processing items received by post also shows a mixed picture. The accuracy of post processing showed a general improvement between 2006-07 and 2008-09 and the overall volumes of post awaiting processing had fallen. However, the Department did not meet its timeliness targets to process 80 per cent of post in 15 days and 95 per cent of post in 40 days and performance against the timeliness targets fell between 2006-07 and 2008-09 despite a reduction in the volume of post received. The Department considers that this impact on performance was because it did not immediately recognise that the several different processes for dealing with post required different PaceSetter tools to identify the value and waste in each process.

b) Benefits in Local Compliance

2.16 The other main area where benefits have been achieved is in Local Compliance which undertakes a wide range of enforcement work, including enquiries into individuals' and businesses' tax affairs where it suspects non-compliance and educational and other work to help prevent non-compliance.

2.17 The Department considers that its PaceSetter initiatives have helped to improve the way staff carry out enquiries, for example, by encouraging them to close cases more quickly when they are no longer cost-effective to pursue, by helping to highlight and share good practice between different teams, and by improving the way leaders and managers direct and relate to their staff. As a result PaceSetter activities have contributed to improved performance within Local Compliance – as measured by the value of additional tax revenues they identify (tax yield) – at the same time as reducing staff numbers. In our report on *Managing civil tax investigations* we concluded that increases in yield and reductions in costs had led to an increase in Local Compliance's yield:cost ratio from 8:1 to 14:1 between 2007-08 and 2009-10.⁴

⁴ Comptroller and Auditor General, *Managing civil tax investigations*, Session 2010-11, HC 677, National Audit Office, December 2010.

2.18 It is though inherently difficult to assess the benefits directly attributable to PaceSetter as the picture is complicated by the number of change projects that have influenced the work of Local Compliance. The Department has estimated the impact of PaceSetter by comparing actual yield with a baseline of what it might have expected to achieve after accounting for other factors including the expected impact of staff reductions, inflation, exceptional items, and the effect of organisational change. On this basis it has estimated benefits of £850 million for the period 2007-08 to 2010-11. The estimate is sensitive to the assumptions used and the Department had not analysed the extent of uncertainty. While yield is the most readily measurable element of the impact of compliance and enforcement work, it does not provide a complete measure of performance. For example, it does not reflect the impact of preventive work to improve taxpayer compliance, and it does not always represent the additional tax actually collected.

Performance and benefits tracking

2.19 It is important for organisations to monitor and report the costs and benefits of any change programme, not only to verify that the benefits outweigh the costs, but also to inform decisions about how much to invest, where to focus resource to get the best return, and how to adapt the programme to get more from it. Tracking costs and benefits closely is itself a cost, however, and is difficult when there are a number of changes taking place at the same time. The private sector organisations we spoke to tracked the benefits of their Lean programmes closely for between 12 and 24 months, and within this period tracked the impact on a range of financial and other performance measures. They used the organisation's finance professionals to validate the benefits reported and help build confidence in the approach.

2.20 The Department has had a monitoring and reporting system to track the costs and benefits of PaceSetter, but this could be improved to better facilitate decision-making. The central tracking of PaceSetter benefits has focused primarily on financial benefits. PaceSetter implementation requires business areas to use performance indicators including indicators of customer service and quality, but the Department has had no overall picture of the impact of PaceSetter on customer service and quality. Before our review, the Department had not collated some elements of cost, and hence did not have a full picture of the resources deployed on PaceSetter.

2.21 The Department intends to introduce a revised framework for assessing the benefits from change programmes, including PaceSetter. Business areas will set targets for the benefits they expect from individual change projects, but will then focus on tracking a range of performance metrics, including metrics covering customer service and quality. These metrics will link to a new performance framework for the organisation as a whole. Planned measures include cash collected, unit costs of collection, costs for customers and how straightforward customers find it to deal with the Department. The Benefits and Credits area is developing a standard process for identifying the expected benefits from PaceSetter implementation and reviewing the extent to which these have been delivered.

Staff engagement

2.22 A further benefit the Department expects from PaceSetter is a more motivated workforce. Academic research has reported mixed views from staff on PaceSetter, which were echoed on our site visits. The Department's analysis suggests that PaceSetter may have had a small positive impact on staff engagement but staff engagement across the Department is low in comparison with other government departments as reflected in recent staff surveys.

2.23 In 2006, the Public and Commercial Services Union called for industrial action over Lean working and its impact on staff. Concerns centred around what they saw as excessive individual monitoring, unrealistic targets, and standard operating procedures which they saw as leading to a de-skilled and de-motivated workforce. Around 14,000 staff took part in the action in 2006, and an overtime ban lasted through to 2007. These concerns were echoed in a subsequent academic review of staff views of PaceSetter commissioned by the Union.

2.24 Professor Zoe Radnor's review of PaceSetter, commissioned by the Department in 2007, reported that PaceSetter had resulted in an increase in the quality of work, recommended the Department reinforce the programme, and highlighted the views of staff who welcomed some aspects of the new way of working such as an improved sense of team-working and increased visibility of senior managers. The report also recognised that it had generated anxiety and uncertainty amongst some staff and suggested there was a direct correlation between the engagement of senior managers and the attitude of staff towards it.⁵

2.25 At the sites we visited we heard a similar mix of views from staff about the impact of PaceSetter on their work and motivation. Some staff in the processing sites we visited told us that they welcomed standard working introduced by PaceSetter because it made it easier to train new staff, that 'problem solving' gave an opportunity to share ideas and the focus on visible performance information meant that all staff understood progress against targets which could help increase motivation. At the policy team we visited some staff felt similarly that the visible performance information under PaceSetter had led to better communication between team members and a clearer idea of what other team members were working on. Some, however, had concerns about what they saw as complicated language used to promote PaceSetter and the amount of time involved in collecting statistics.

⁵ Z. Radnor and G. Bucci, *Evaluation of PaceSetter: Lean, Senior Leadership and Operational Management within HMRC processing*, September 2007.

2.26 The Department has analysed its 2009 People Survey results to understand more broadly the impact of PaceSetter on staff engagement. The People Survey is a Civil Service-wide survey of staff views. It includes questions that can be used to derive an employee engagement index. The employee engagement index for the entire department was the lowest across government departments at 36 per cent, compared to an average of 58 per cent across other government departments in 2009. This was an issue highlighted by the Department's 2009 Capability Review together with the very high rates of sickness absence. The Department's analysis gave an employee engagement index for PaceSetter areas of 37-40 per cent, suggesting that PaceSetter may have had a small positive impact on this measure.

2.27 The Department's preliminary analysis of its 2010 People Survey results suggests that staff working in PaceSetter areas continue to give more positive responses to questions about their engagement, though again the impact is small. Overall, the Department's index remained the lowest across the Civil Service at 34 compared to 56 across other government departments. Sickness absence rates can also reflect employee engagement, and at the Department these have fallen from an average of 11.8 days per person in 2005-06 to 9.9 days in 2010-11. The Department considers that Benefits and Credits is one of the more mature PaceSetter areas and that PaceSetter has helped this area improve staff engagement considerably. In 2010, it had a staff engagement score of 44 per cent and it had reduced sickness absence rates by 24 per cent between 2009-10 and 2010-11.

2.28 Following long-running negotiations, the Department and its two main trades unions issued a joint statement in December 2010, that PaceSetter contains tools and techniques that, where applied correctly, should help people improve business productivity, quality and public service. The statement provided guidance on the consistent and fair application of PaceSetter.

Part Three

Implementing PaceSetter

3.1 Most organisations implementing process improvement begin by applying the techniques to self-contained parts of the organisation. This can help engage staff and leadership by delivering tactical 'quick wins', in the form of local cost savings and performance improvements. Realising more significant and sustainable benefits, however, requires a more strategic approach to ensure alignment of operations, that available resources are focused on changes that will have most impact, and that improvements to one part of a process do not displace costs or cause problems for other parts of the organisation. Over time, process improvement programmes ensure frontline staff have access to timely information about customer needs, and how whole processes are performing 'end to end' against these needs, which is used to drive improvements.

3.2 Many organisations introducing programmes like PaceSetter use external expertise to help them initiate change quickly, but over time, they should look to develop their own capability so that expertise for improving the business becomes embedded within the organisation and staff at all levels use their knowledge and experience to drive improvements.

3.3 This part considers the Department's approach to implementing PaceSetter, covering how far it has matured in its strategic approach and prioritisation, training and development of staff and its application of customer and end to end perspectives.

Strategic approach and prioritisation

3.4 The Department first launched a formal strategy for PaceSetter in 2009, though the programme was linked to the Department's strategic objectives from inception. In particular, the introduction of PaceSetter within the processing directorate was aligned to the need to achieve efficiency and headcount reductions to meet the 2004 Spending Review targets. The Department also decided to begin wider roll-out of the programme in three business areas on the basis of strategic priorities. It chose Debt Management and Banking, Enforcement and Compliance and the Customer Contact Directorate because of the importance of increasing cash collected and additional tax generated, and improving its responsiveness to customer enquiries.

3.5 Since January 2009, the Department has seen the roll-out of PaceSetter to all staff as a key indicator of progress, in order to introduce a Department-wide mechanism for continuously improving what it does. It has accordingly set targets for increasing PaceSetter coverage and maturity (**Figure 4**). The target is to increase the percentage of staff operating in a PaceSetter way from just over 68 per cent to 95 per cent by 2013, and the proportion of staff working in areas where PaceSetter is fully embedded ('Living PaceSetter') from less than one per cent to 30 per cent.

3.6 The Department has not, however, had a sufficiently clear and systematic approach to prioritising the allocation of resources associated with PaceSetter. It has not, for example, analysed the relative costs and benefits of achieving different maturity levels in different parts of the organisation. Rolling PaceSetter out to the whole Department means including teams such as those working on legal or policy issues where the work is very different from the high volume processing parts of the organisation, and the benefits and best way of implanting PaceSetter has yet to be established. Without a clear prioritisation of where to deploy its efforts, the Department risks not achieving the greatest possible benefit from its investment in PaceSetter. The private sector organisations we spoke to tended not to set targets for coverage, but instead focused on financial or customer-based goals.

Figure 4
HMRC's targets and current levels of PaceSetter coverage

Percentage of staff operating in a PaceSetter way	Definition	March 2011 (%)	March 2013 (planned) (%)
'Touched' by PaceSetter	"Teams are using basic PaceSetter tools and techniques but have not yet developed performance indicators or set standards for their work"	38	5
'Working' in a PaceSetter way	"PaceSetter is being fully implemented alongside a re-engineered process with day to day support from PaceSetter practitioners"	29	60
'Living' PaceSetter	"A self-sustaining culture of 'better every day' is in place"	1	30
		68	95

Source: HM Revenue & Customs

3.7 The Department expects its business areas to use PaceSetter to help it achieve significant cost reductions between 2011 and 2015. The central PaceSetter team has been working with business areas to prioritise a range of potential interventions and intends that the work underway to map and cost the Department's ten most significant processes from end to end will help it to prioritise where to focus PaceSetter effort.

Training and development

3.8 Many organisations considering a business improvement programme like PaceSetter employ consultants to help initiate change quickly. Over time, however, an organisation should look to develop capability among their own staff to embed the changes and reduce costs.

3.9 From the outset the Department set out to develop an internal cadre of practitioners so that over time they rather than external experts would lead the programme. The Department has trained more than 400 practitioners. Practitioner training includes four weeks of classroom training, since 2009, run by its own staff, interspersed with practical experience gained by working alongside more experienced practitioners. The Department became an accredited partner with Cardiff University's Lean Enterprise Research Centre in 2010. It has established an accreditation programme for all PaceSetter practitioners, creating a profession within the Department. Its most experienced practitioners are now accredited externally with Cardiff and have the skills to accredit other practitioners internally.

3.10 A comprehensive plan for skills and capability transfer helps ensure that an organisation makes the most of its expenditure on consultants. The Department has taken positive steps to transfer skills and capability from consultants to its own staff. Implementing a cross-Department, detailed plan for skills and capability transfer more quickly might have brought costs down and strengthened the Department's own capability. The Department has spent £39million on consultancy for PaceSetter. When it first introduced PaceSetter to its Processing areas it expected to be free of consultancy support within this part of the organisation by March 2007. It continued to use consultants within Processing until early 2009. Consultancy spending increased further when it rolled-out PaceSetter to the rest of the organisation in 2008. As part of its PaceSetter Strategy in 2009, the Department recognised that it had been over-reliant on consultants and aimed to be free of consultancy support by March 2013. Later in 2009, the Department accelerated its plans to reduce consultancy spending in the context of funding pressures and spending reduced significantly from £8.4million in 2009-10 to £0.6 million in 2010-11.

3.11 The Department has also introduced standard training programmes for staff to prepare them for PaceSetter and teach them how to use the tools, such as visual management and problem solving to drive continuous improvements. A separate training programme for senior leaders includes one to one coaching.

3.12 Our site visits suggested that, while PaceSetter has engaged teams in making improvements, the Department has further to go in making the most of PaceSetter tools and techniques. At the site visits we saw examples of projects targeted on particular problems but in general little explicit direction for frontline staff about where to focus their suggestions for improvements to achieve the greatest benefit. A more systematic approach to ensuring teams have a clear understanding of where the greatest potential for improvement might be at that site would ensure the Department makes the most of the effort invested in continuous improvement activities. The Department expects its work to map its main processes from end to end will help target improvement activity.

3.13 As part of long-running negotiations with the Department over PaceSetter, the Public and Commercial Services Union has raised concerns about the way some managers have implemented the approach. The two main trades unions told us that while they support the broad principles behind PaceSetter, they consider its success can depend on how effectively individual leaders and managers apply it. At one site visited, the National Insurance Contributions and Employment Office had introduced its own training programme led by practitioners to help improve the way frontline managers use the tools and techniques introduced by PaceSetter.

Applying customer and 'end to end' perspectives

3.14 One of the key findings of a review of PaceSetter commissioned by the Department in 2007 was that many of the staff were applying tools and techniques without sufficient focus on the end customer and that the Department should create a better understanding of who its customers were and what they really required. The review also emphasised the need for a better understanding of processes from end to end across the organisation, rather than the 'silo' approach that was apparent in many areas.

3.15 The Department has taken steps to improve its understanding of customer requirements. In 2006, in parallel to its PaceSetter programme, the Department established two customer insight units – one for business taxpayers and another for individuals – in recognition of the need to re-focus the Department more broadly on meeting customer needs. These units have carried out research into 'customer journeys' that analyse the interactions between customers and the Department in typical scenarios, and the costs to the Department and customers of those interactions including the costs involved in correcting errors and repeated contacts. Business areas are beginning to apply the insight from such work in PaceSetter problem solving.

3.16 At the sites visited, we saw examples of how PaceSetter has helped to redesign processes with a customer perspective. For example, at the National Insurance site the redesign of the claim form had taken into account staff's understanding of which parts of the form claimants found difficult to complete, and how it might be simplified. At Employer Compliance, a national redesign informed by PaceSetter had led to a more tailored approach to checking compliance cases. Previously, staff applied a standard set of checks in all cases. After the redesign staff tailored their approach according to an initial assessment of risk, with the aim of reducing elapsed times of investigations for taxpayers where the amount of money at stake was low.

3.17 Most of the sites we visited tracked some form of customer-related measures such as quality or lead times. Some also had direct feedback about the customer perspective. In particular, staff at the Child Benefit site had sought to understand from the Department's contact centres the most common complaints about child benefit.

3.18 The examples we saw suggest, however, the Department could do more to develop structured and routine ways to bring an understanding of the end-customer to frontline staff. For example, at the National Insurance site the key customer-related target is that the time between the Department receiving a form from the Department for Work and Pensions and sending a National Insurance card should be no more than 15 days. This is a generic target, rather than reflecting a detailed understanding of whether turnaround within this timeframe is required for all customers. Tracking performance against this target also gives no indication of the total time it takes for the customer to obtain a card (which is determined by the time it takes both Departments to complete this processing). Similarly, at Business International, staff had a generic 28 day target to turn around all types of work. In busy periods staff applied their own judgement as to which customers had the more pressing needs.

3.19 For the customer and the Department, timely, accurate and low-cost completion of a tax liability or benefit claim depends on effective and efficient processing at successive stages in the tax or claims process. Typically the end to end process on tax involves registering people and organisations to pay tax, providing help to enable them to comply with their obligations, processing returns and other information, assessing and collecting the tax due, conducting further enquiries and investigations and imposing penalties for serious non-compliance. The roll-out of PaceSetter to date has been to discrete teams or sites, and so to parts of processes, rather than to end to end processes in their entirety. Teams have therefore focused on practical changes that are within their immediate control.

3.20 Reviewing processes from end to end can highlight more transformational changes, including opportunities to stop work arising in the first instance. Our report *The efficiency of National Insurance administration* (see paragraph 2.13) highlighted that while the different operating units involved in administering National Insurance had begun to work more closely together, there was scope for a more coordinated and systematic approach to reviewing processes through PaceSetter, to maximise efficiency across National Insurance administration as a whole.

3.21 When deciding in 2008 to roll-out PaceSetter, the Department's Executive Committee agreed that enterprise-wide re-engineering would provide a more logical and profitable starting place for re-engineering sub-processes, rather than taking a 'bottom-up' approach to roll-out. However, it concluded it could not undertake this enterprise-wide approach immediately for various reasons, including lack of internal capability as the experience of PaceSetter practitioners had been limited to re-engineering sub-processes. In April 2011, it launched further PaceSetter practitioners' training and PaceSetter practitioners are now leading a project to map and cost the Department's processes from end to end. In redesigning the organisation, the Department has recently introduced new cross cutting roles accountable for driving improvements across the organisation.

Appendix One

Methodology

Below is a brief overview of methods used in this study.

Method	Purpose
<p>1 Document Review and secondary analysis of data</p> <p>We reviewed a range of documents provided by the Department and the Public and Commercial Services Union, took into account previous NAO studies and literature on good practice in applying business improvement methodologies, and analysed Departmental data on the costs and benefits of PaceSetter including its impact on staff engagement.</p>	<p>To establish the development of PaceSetter, and the rationale behind the Department's decisions on why, where and how to apply it.</p> <p>To evaluate the robustness of the evidence available on the costs and benefits of the programme.</p>
<p>2 Semi-structured Interviews with Department officials</p> <p>We carried out semi-structured interviews with key officials within the Department.</p>	<p>To complement the evidence collected through document review.</p>
<p>3 Site Visits</p> <p>We reviewed the maturity of process management at four sites identified by the Department as good practice examples. This included workshops with frontline staff.</p>	<p>To identify potential opportunities for developing the PaceSetter approach.</p> <p>To inform our understanding of the views of frontline staff of PaceSetter.</p>
<p>4 Consultation</p> <p>We engaged consultants from Deloitte to bring their experience of evaluating and implementing process improvement programmes and drew on process management expertise within the NAO. Deloitte interviewed senior executives from three private sector companies that have implemented Lean-based initiatives, Shell, IBM and Scottish Power. We spoke to representatives from the Public and Commercial Services Union and the Association of Revenue and Customs. We liaised with Professor Zoe Radnor, Professor of Operations Management at Cardiff Business School, who carried out a review of PaceSetter in 2007.</p>	<p>To put HMRC's implementation of PaceSetter in the context of wider private sector experience.</p> <p>To take account of wider expertise in undertaking our work.</p> <p>To understand and reflect the views and experience of trades unions involved.</p>

Appendix Two

The development of PaceSetter

Phase of development	Description
2004-05: Initial 'Lean' pilots	The Department employed consultants to pilot Lean techniques to improve efficiency at an Edinburgh site, processing Income Tax Self Assessment returns. Trial reported positive results, suggesting significant improvements in output per person, per day, were possible. The Department extended the trial and began further trials at two sites in Cardiff and Portsmouth. The Department employed another consultancy firm to help develop staff leadership and management capability.
2006: Roll-out within Customer Operations	The Department decided to roll-out implementation more widely within its processing operations. It appointed two consultancy organisations: Unipart to bring experience of applying process improvement tools and techniques and Corven to focus on management and leadership development.
2006-07: Industrial action	The Public and Commercial Services (PCS) Union called for industrial action over Lean working and its impact on staff. Concerns centred around what they saw as excessive individual monitoring, unrealistic targets, and standard operating procedures which they saw as leading to a de-skilled and de-motivated workforce. Around 14,000 HMRC staff took part in the action in 2006, and an overtime ban lasted through to 2007.
2007-08: External reviews	The Department commissioned an external review of its PaceSetter programme, which concluded that though it had a long way to go before it could describe itself as a 'Lean' organisation, the programme had resulted in an increase in the quality of work, and the Department was moving in the right direction. The Department's response to its Capability Review, November 2007, recommended reinforcing the PaceSetter programme. A review commissioned by the PCS Union in 2008 concluded that PaceSetter had a detrimental effect on employees and the service provided to the public.
2008: Wider roll-out	In 2008, the Department decided to roll PaceSetter out to three more business areas: Debt Management and Banking, Enforcement and Compliance and the Customer Contact Directorate. It prioritised these areas because of the importance of increasing cash collected and additional tax generated, and the need to improve its responsiveness in dealing with customer enquiries. It created a central team to provide support to business areas and coordinate the roll-out.

Phase of development	Description
2009-10: PaceSetter Strategy	New Chief Executive inspired the development of the first PaceSetter strategy, which outlined five key success factors for PaceSetter. The Department began pilots of PaceSetter in areas of work such as those involving policy making or specialist tax skills, where the nature of the work is very different from the high volume processing areas where PaceSetter began.
2010: PaceSetter Strategy	A new strategy set a target of 95 per cent PaceSetter coverage in HMRC by 2013. Business areas assumed greater responsibilities for embedding PaceSetter and realising the benefits. The Department's PaceSetter Academy training programme received accreditation from Cardiff University.
2010-11: Negotiations with trades unions	In December 2010 HMRC, the PCS Union and the Association of Revenue and Customs (ARC) issued a joint statement on the application of PaceSetter, saying that PaceSetter contains tools and techniques that, where correctly applied, can improve the quality and productivity of business delivery and public service. It committed all parties to a full and open dialogue and provided guidance on the consistent and fair application of PaceSetter.
Wider government developments	The Department is currently working with the Cabinet Office to help engender good process management across the public sector. It has undertaken to train staff from other government departments through its PaceSetter Academy.

Source: National Audit Office analysis of departmental data



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