REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 1788
SESSION 2010–2012

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Cabinet Office and HM Treasury

Cost reduction in central government: summary of progress

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Cabinet Office and HM Treasury

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

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This report can be found on the National Audit Office website at www.nao.org.uk/cost-reduction-2012

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Key facts

2.3%

(£7.9 billion) real-terms fall in spending within departments' control from 2009-10 to 2010-11

19%

planned real-terms fall in spending in 15 departments from 2011-12 to 2014-15

In 2010-11

0.1 per cent (£0.7 billion)	**increase** in real terms in government's Total Managed Expenditure – to £689 billion in 2010-11
2.3 per cent (£7.9 billion)	**decrease** in spending within departments' direct control (Departmental Expenditure Limits) in real terms – to £336 billion
	Figure 1 on page 11 explains the difference between Total Managed Expenditure and Departmental Expenditure Limits. Figure 5 on page 18 explains the difference between the figures
£3.75 billion	estimated savings reported by the Efficiency and Reform Group
£406 million	**cost** to departments of compensation payments for early departures from the civil service this year
21,200 staff	**reduction** between 2009-10 and 2010-11 in average number of full-time equivalent staff employed by departments (including permanent and temporary staff)

From 2011-12 to 2014-15

3 per cent	real-terms fall in forecast Total Managed Expenditure to 2014-15
12 per cent	planned real-terms fall in Departmental Expenditure Limits
19 per cent	planned real-terms fall in Departmental Expenditure Limits in departments other than Health and International Development, which are protected

Summary

1 The Government's spending plans require most government departments to reduce their spending in real terms over the years to 2014-15. For 2010-11, departments needed to reduce spending by £5 billion compared with the plans announced in the March 2010 budget. Over the period from 2011-12 to 2014-15, the budgets of departments other than Health and International Development are falling by 19 per cent in real terms.

2 The scale of cost reduction means that departments need to look beyond short-term cost-cutting measures and make major organisational changes. To minimise impacts on services, departments and the bodies they fund will need to identify and plan for sustained cost reductions, and deliver them as part of a well-managed change programme. This is an initial report on progress with cost reduction across central government. It provides an overview of how departments reduced costs in 2010-11 and gives a snapshot of progress with longer-term planning, based on National Audit Office examinations in 12 departments.

Key findings

On 2010-11

3 **Despite the short timescale, departments successfully managed within their reduced spending allocations for 2010-11.** This meant they reduced the spending within their direct control (Departmental Expenditure Limits) by 2.3 per cent in real terms compared with 2009-10. The main reductions were as follows:

- Administrative (back-office) spending fell by £1.5 billion.
- Capital spending in departments fell by £1.6 billion, which is partly the result of spending being brought forward to 2009-10.
- There was a further net fall of some £4.8 billion in Departmental Expenditure Limits. Policy decisions to protect spending in some areas meant that 11 departments needed to cut programme spend. The largest fall was in grants paid by the Department for Communities and Local Government to local authorities.

4 **Government spending moratoria and efficiency and reform initiatives have contributed more than half of the overall cost reductions achieved in 2010-11.** These aimed to help departments meet as much as possible of the 2010-11 reductions by cutting back-office and avoidable costs. In July 2011, the Cabinet Office's Efficiency and Reform Group reported to the Public Accounts Committee that it had helped save some £3.75 billion through these initiatives. Our analysis of the audited accounts of the 17 main departments confirms that spending in the areas targeted was reduced on this scale. In particular, large reductions have been made in spending on consultants, temporary staff, property and information technology. Departments reduced their staff by the equivalent of 21,200 full-time posts in 2010-11, including permanent and temporary posts in departments and their agencies. However, the reduction in spending in the year is partly offset by in-year cash costs of early departures included in departments' accounts which we estimate at £406 million for early departures from the civil service in 2010-11. Larger savings in staff costs are likely in future as the impact of the pay freeze and further staffing reductions take effect.

5 **Around £1.6 billion of the spending reduction we have identified is in capital spending.** While some of these reductions are likely to reduce the cost base in the long term, for instance by reducing the size of the government estate, other reductions may not be fully sustainable. The fall of 35 per cent in IT capital spend is partly the result of decisions to permanently halt or reduce spending on specific projects, and partly the result of action to reduce the costs of IT products and services including through contract renegotiation. However, it is unlikely that IT capital spending will remain at this lower level in total, given the key role of IT and online services in increasing productivity.

6 **We cannot say how these changes affected value for money in 2010-11.** Some departments and arm's-length bodies have systems that relate costs to activity levels and outcomes, but there is no consistent way of identifying whether specific savings measures have improved efficiency or affected services. The system of Public Service Agreements used by the previous administration to measure overall departmental performance has been replaced. From 2011-12, departments are publicly reporting their performance quarterly using a new system of input and impact indicators. This will allow more consistent performance tracking in due course. In most departments, some of the new impact and input indicators are linked but not all of them, or similar areas are covered but there is no real link between inputs and impacts. It is, therefore, too early to draw conclusions as to whether performance has been adversely affected.

7 **Departments will need to change business practices to prevent spending patterns reverting to their previous form.** The 2010 Spending Review assumed that the reductions required in 2010-11 would continue, and requires most departments to reduce spending by an average of 19 per cent over four years to 2014-15. Cost reductions made to date need to be sustained or replaced with further savings if departments are to meet their Spending Review allocations.

Looking forward

8 **Departments need to make more fundamental changes to achieve sustainable reductions of the scale demanded by the Spending Review.** Short-term measures, though successful to date, will not be sufficient. Departments will need to have a clear vision of how they and their delivery partners will operate with a permanently lower cost base. They need a clear map of the changes needed to move to this model, and rigorous processes for realising the resulting savings.

9 **Most departments have yet to develop a clear picture of their future state or a detailed plan based on a strategic view across the business.** Most of the departments we examined have started to design new target operating models, and some have cost reduction strategies, although initial spending reductions were made before coordinated plans were in place. Where departments have developed change programmes, they also have good governance arrangements and systems to track progress in reducing costs.

10 **Departments' financial data on basic spending patterns is sufficient to manage budgets in-year, but information about the consequences of changes in spending is less good.** There are few examples of systems that link costs to performance. Without improvements in impact measurement, departments will not be able to track or manage the impact of cost reduction on service provision. Not understanding the factors driving cost and the consequences of spending cuts makes it difficult for departments to forecast future spending.

11 **Cost reduction plans need to build in contingency.** Our experience of previous savings programmes is that an average of 20 per cent of gross annual savings targeted are not realised. In managing within spending plans, departments have to manage a number of risks, including fluctuations in income (such as volatile rail revenues in the case of the Department for Transport). The plans we have examined do not have sufficient contingency to cover either the risk that savings are not realised or the impact of external uncertainties. Departments therefore depend on finding greater savings in future years to fill any gaps.

12 **Departments do not always understand the cost drivers and cost value ratios of devolved bodies sufficiently to make good decisions about changes in funding.** Nine departments spend more than 50 per cent of their budget through arm's-length or devolved bodies. Departments that deliver through others need to have a coherent strategy to deliver their objectives at lower cost, which takes into account the value delivered by different funding streams. The departments we have looked at do not have full capability to do this. Generally their strategy combines cuts to lower priority funding with an expectation that delivery bodies will manage their own costs down. However, some are working towards increasing their understanding of these costs. By delegating cost reductions, departments place much reliance on financial and change management capability in the devolved bodies. Departments need to manage the resulting risks.

Conclusion on value for money

13 Central government departments took effective action in 2010-11 to reduce costs and successfully managed within the reduced spending limits announced following the 2010 election. This resulted in a 2.3 per cent real-terms reduction in spending within departments' control, compared with 2009-10. Some £3.75 billion or around half the reduction was in areas targeted by the Efficiency and Reform Group for cuts in back-office and avoidable costs.

14 Most departments need to cut spending much more – by a further 19 per cent over the four years to 2014-15. Departments are less well placed to make the long-term changes needed, partly because of gaps in their understanding of costs and risks. From our reviews to date, departments have not yet developed new lower-cost operating models. Departments cannot achieve long-term value for money until they identify and implement new ways of securing their objectives with a permanently lower cost base.

Recommendations

For departments

a **The forward plans we have examined are not based on a strategic view across departments' business.** When examining cost reductions in the next year, we will be looking for:

- whether departments have considered alternative delivery arrangements and have a clear vision (target operating model) setting out how to deliver services with significantly reduced resources;
- cost reduction portfolios which include change initiatives to achieve target operating models;
- leadership commitment to the target operating model and change portfolio;
- whether change programmes and initiatives are well designed with robust plans, realistic resource requirements, clearly defined organisation and roles, effective and integrated project and programme management processes, and clear responsibilities and milestones to monitor progress;
- changes to working practices where necessary to deliver the target operating model and processes to realise savings;
- contingency plans to manage risks to the change portfolio, including a pipeline of potential additional savings measures;
- evidence that cost and performance information is used to identify ideas for cost reduction and continuous improvement; and
- testing, evaluation and implementation of the resulting innovations.

b **Few departmental systems can link costs to outputs and impacts, making it difficult to evaluate the effect of cost changes on what departments deliver.** Departments should make progress in developing a fuller understanding of the costs of the activities and services they deliver and of the outcomes they achieve, as well as the consequences of cost base changes.

c **Departments do not have good enough information on devolved bodies' costs and performance to secure value for money when funding is reduced.** Departments use a range of approaches in relating to the bodies they fund, as indicated in Figure 12 in Part Three. Where there are major changes in the delivery landscape and new delivery models for local services, departments must understand how such arrangements will secure value for money across the system. When working with existing delivery bodies, departments should assess their cost-effectiveness and the risks of change. In particular:

- departments need to sufficiently understand costs and performance to then allocate funds across business areas based on assessing value obtained from funding;
- to share cuts evenly across delivery bodies, department should assess those bodies' financial and change management capability; and
- where confidence cannot be derived from such an assessment, departments should work with delivery bodies to identify where to make efficiencies and support bodies in doing so.

For the Cabinet Office and Treasury

d **It is not clear how far spending reductions represent year-on-year changes in efficiency, or whether front-line services are affected.** The Treasury and Cabinet Office are developing common reporting formats for accounts and other departmental performance information. They need to establish consistency between:

- the data available for the public to assess departmental performance, including outcome measures;
- central departments' information requirements; and
- the programme and administrative spending reported by departments and their arm's-length bodies in the resource accounts audited by the National Audit Office.

e **Departments do not consistently adopt good practice in taking a structured approach to cost reduction.** The Treasury monitors departments’ overall spending while the Efficiency and Reform Group intervenes in specific areas that benefit from a common approach. The central departments should work together to form a shared understanding of progress and gain an overview of departments’ strategic capability. The Treasury and Cabinet Office should develop mechanisms to challenge, intervene or provide more support for weaker departments, including using experts across departments. They should agree how to align these across their respective roles and work with cross-government governance structures where possible.

Part One

Introduction

The Government's spending plans

1.1 After the 2010 election the Government announced an immediate reduction in 2010-11 spending from the levels set in the March 2010 budget. It announced further reductions to reduce the structural deficit over the 2010 Spending Review period to 2014-15:

- The Government announced reductions totalling £6.2 billion in Total Managed Expenditure (see **Figure 1**) in 2010-11. Some £500 million of the savings were re-used for further education, apprenticeships and social housing. The reductions were shared with the devolved administrations, so net departmental spending reduced by £5 billion.
- The Government added some £32 billion of spending reductions by 2014-15 to the £51 billion reduction implied by the March 2010 plans.

Figure 1
Understanding Treasury spending plans

The Treasury's annual Budget Reports and its control system for departmental spending have two discrete areas:

- **Departmental Expenditure Limits** (DEL) covers both resource spending (staff, rents and other annual costs) and capital spending on assets, the benefits of which extend over more than one year. DEL covers all of a department's administrative costs, and the planned cost of programmes where departments' planning benefits from the certainty in future funding provided by the Spending Review process, for example, health and defence.
- **Annually Managed Expenditure** (AME) covers capital and resource spending in areas where costs are difficult to predict more than a year in advance and are influenced by factors outside the department's control, for example, welfare costs, tax credits and interest on the national debt.

Taken together, DEL and AME are known as **Total Managed Expenditure** (TME). For Parliamentary control purposes, TME and departments' annual accounts include non-cash items such as depreciation of assets, movements in creditors and other provisions for future costs. In such cases costs are deemed to have been incurred in-year but any cash payments take place outside the accounting period.

Source: HM Treasury

1.2 Although individual spending departments and other public bodies must deliver the bulk of reductions, two departments play key central roles:

- The Treasury led the Spending Review 2010 exercise to plan departments' spending during the period 2011-12 to 2014-15. It also monitors overall spending and reviews departments' requests for additional funds from Parliament. The Treasury's approach to the Spending Review focuses on departments keeping within their agreed spending allocations. However, the Treasury expects improved value for money to be important in making sure that spending reductions do not simply lead to proportionate cuts in front-line services.
- The Government formed the Cabinet Office's Efficiency and Reform Group in May 2010 to help departments cut costs centrally in key areas such as civil service staffing, procurement, estates and process efficiency.[1] Its role includes approving specific departmental spending proposals in key areas such as staff exit programmes, consultancy, accommodation, media and marketing and major capital projects.

1.3 The Government's spending plans as set out in its annual budget reports, and in the Spending Review, reflect the impact of proposed policy changes. The plans also allow for likely cost pressures in the period including both general inflation, and specific factors such as the increasing numbers of elderly people and the likely impact of wider economic conditions on welfare and tax credit spending.

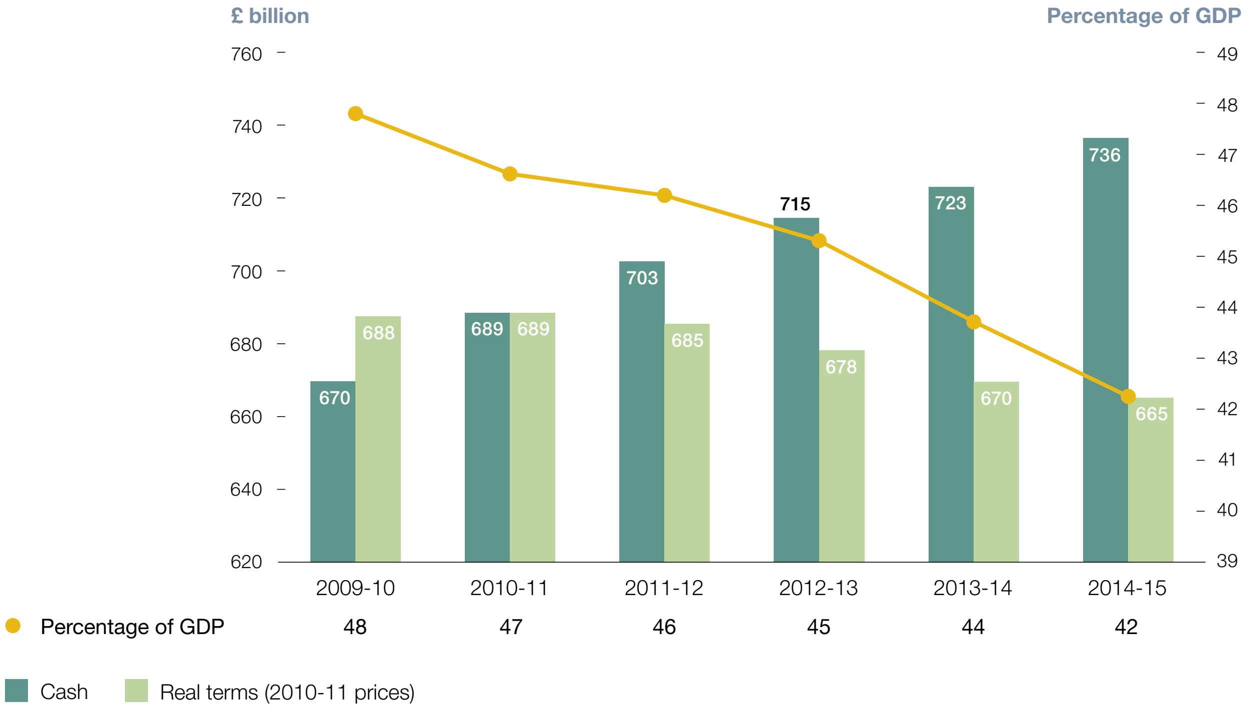
1.4 The Government established the Office for Budget Responsibility (OBR) in 2010 in order to independently assess the public finances. Its latest forecast, in the 2011 Autumn Statement, was for Total Managed Expenditure (Figure 1) to increase from £689 billion in 2010-11 to £736 billion in 2014-15. In cash terms this represents an increase of 7 per cent, but a fall of 3 per cent in real terms.

1.5 Owing in significant part to the Government's planned fiscal consolidation, the OBR expects Total Managed Expenditure to fall during the 2010 Spending Review period from 47 per cent of the gross domestic product (GDP - the most commonly used measure of the overall size of the economy) to 42 per cent by 2014-15 (**Figure 2**). Its latest assessment, included in the Autumn Statement 2011, is that despite slower than expected growth, public sector net borrowing will fall from its current level of 9.3 per cent of GDP to 4.5 per cent during the period. However, its predictions depend on wider economic developments particularly in the Euro area.[2] If the economy fails to grow even at the lower rate now predicted, Annually Managed Expenditure may rise as a share of GDP, whilst tax receipts may be lower than forecast.

1 Further details can be found in the Comptroller and Auditor General's report *Cabinet Office: The Efficiency and Reform Group's role in improving public sector value for money,* Session 2010-11, HC 887, National Audit Office, March 2011.

2 Office for Budget Responsibility, *Economic and fiscal outlook,* November 2011, paragraph 1.10.

Figure 2
Total Managed Expenditure 2009-10 to 2014-15



Source: Autumn Statement 2011

1.6 The Government's deficit reduction strategy has a greater impact on departmental spending than these overall totals suggest because it:

- will reduce administration budgets (spending on running departments, excluding front-line activities) by a third by 2014-15; and
- includes additional policy commitments announced since the June 2010 budget and unavoidable cost pressures, for example, additional interest payments on the national debt.

1.7 In the 2011 Autumn Statement, the Treasury estimated that Total Managed Expenditure in 2014-15, as shown in Figure 2, will be over £77 billion[3] lower in cash terms than if:

- Departmental Expenditure Limits had grown in line with inflation; and
- the policy changes in welfare spending and other Annually Managed Expenditure announced by the June 2010 and 2011 Budgets, and the Autumn Statement had not been implemented.

1.8 Unlike previous cost reduction programmes, there are no centrally monitored efficiency targets covering the current Spending Review period. The head of the Efficiency and Reform Group told the Public Accounts Committee that around half the spending reductions should represent efficiency savings across the public sector, rather than cuts to services. However, there is no formal target and no central guidance on how such improvements can be calculated or reconciled against spending plans.

NAO expectation of structured cost reduction

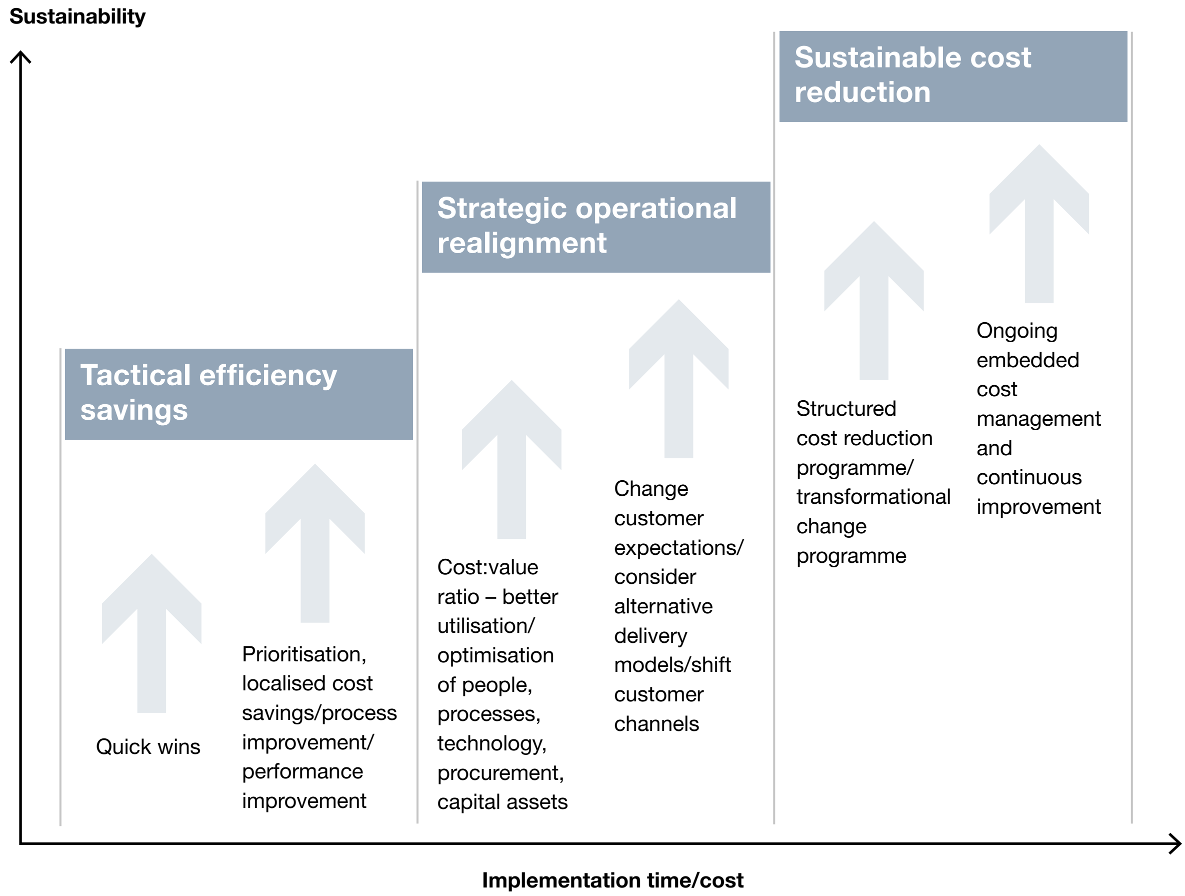
1.9 The National Audit Office has recommended that departments adopt a structured approach to cost reduction. The long-term aim should be for departments to improve their cost management and to be continually challenging costs, monitoring the relationship of costs incurred to outcomes achieved, and working towards an environment for continuous improvement (**Figure 3**).

Scope of this report

1.10 This report examines the 17 largest central government departments' expenditure outturn in order to assess their success in delivering the in-year spending reductions announced for 2010-11. It also draws on the results of recent National Audit Office reviews of individual departments to assess government's readiness to deliver the further annual spending reductions as required by the Government's deficit reduction strategy and the 2010 Spending Review up to 2014-15. Further details of our methodology are at Appendix One.

3 Of this total, £49 billion represents the reduction in spending covered by Departmental Expenditure Limits assumed in the March 2010 budget, and confirmed by the Coalition, and £28 billion represents additional reductions introduced since the 2010 election. This is some £6 billion less overall than the projection in June 2010 (paragraph 1.1) owing to updated economic projections.

Figure 3
Stages of cost reduction



Source: A short guide to structured cost reduction, National Audit Office (2010)

Part Two

Success in reducing costs in 2010-11

2.1 This Part reviews overall central government spending in 2010-11 both in comparison to planned spending levels agreed through the annual budget planning processes and to 2009-10 outturn. We also assess departments' success in living within the funds voted by Parliament during the year, reduced by their share of the £6.2 billion budget cut announced in May 2011. **Figure 4** summarises the areas targeted for reductions in May 2010. We have analysed the spending of the 17 main central government departments using their audited accounts for 2010-11 in order to identify changes in spending compared with 2009-10. We also evaluate the £3.75 billion efficiency and reform savings that the Cabinet Office estimates departments achieved during 2010-11.

Figure 4
Planned Spending Reductions in 2010-11

Area of saving	£m
Delaying and stopping contracts and projects, and negotiations with major suppliers	1,700
Grants to local authorities	1,165
Consultancy and travel and other discretionary areas	1,150
Devolved administrations	704
Arm's-length bodies	600
Property costs	170
Recruitment freeze across the civil service	120
IT spending	95
Other savings	520
Total	**6,224**

NOTE
1 These reductions were in addition to cuts of £5 billion in planned spending for 2010-11 detailed in Budget 2009 once the impact of the credit crisis became clear.

Source: HM Treasury

Overall performance of main departments

2.2 Government spending plans for 2010-11 envisaged a small increase in Total Managed Expenditure compared with 2009-10. However, this resulted mainly from a £12 billion increase in debt interest payments and other Annually Managed Expenditure largely outside departments' direct control. For our analysis of overall outturn, we are therefore focusing on spending within Departmental Expenditure Limits. **Figure 5** overleaf shows the differences between Total Managed Expenditure and Departmental Expenditure Limits and the real-terms change in Departmental Expenditure Limits from 2009-10 to 2010-11, in total and across departments.

2.3 The reductions announced in May 2010 implied a fall of 3.6 per cent in real terms from 2009-10 outturn for the 17 main departments. A number of departments required supplementary estimates in 2010-11,[4] which largely related to policy changes and reflected increases in provisions for future costs, which have no immediate impact on spending. The main increases were in the Ministry of Defence, to write off surplus equipment following the Strategic Defence and Security Review, and the Department for Business, Innovation and Skills owing to revaluation of student loans. After these changes, the fall in Departmental Expenditure Limits was 2.3 per cent in real terms, although there were increases and decreases in individual departments reflecting policy decisions (Figure 5).

2.4 The large-scale reduction of in-year spending plans placed unprecedented pressure on departments' financial management systems. No department exceeded the net spending allocation approved by Parliament in 2010-11.

Overall spending reductions in the main 17 departments in 2010-11

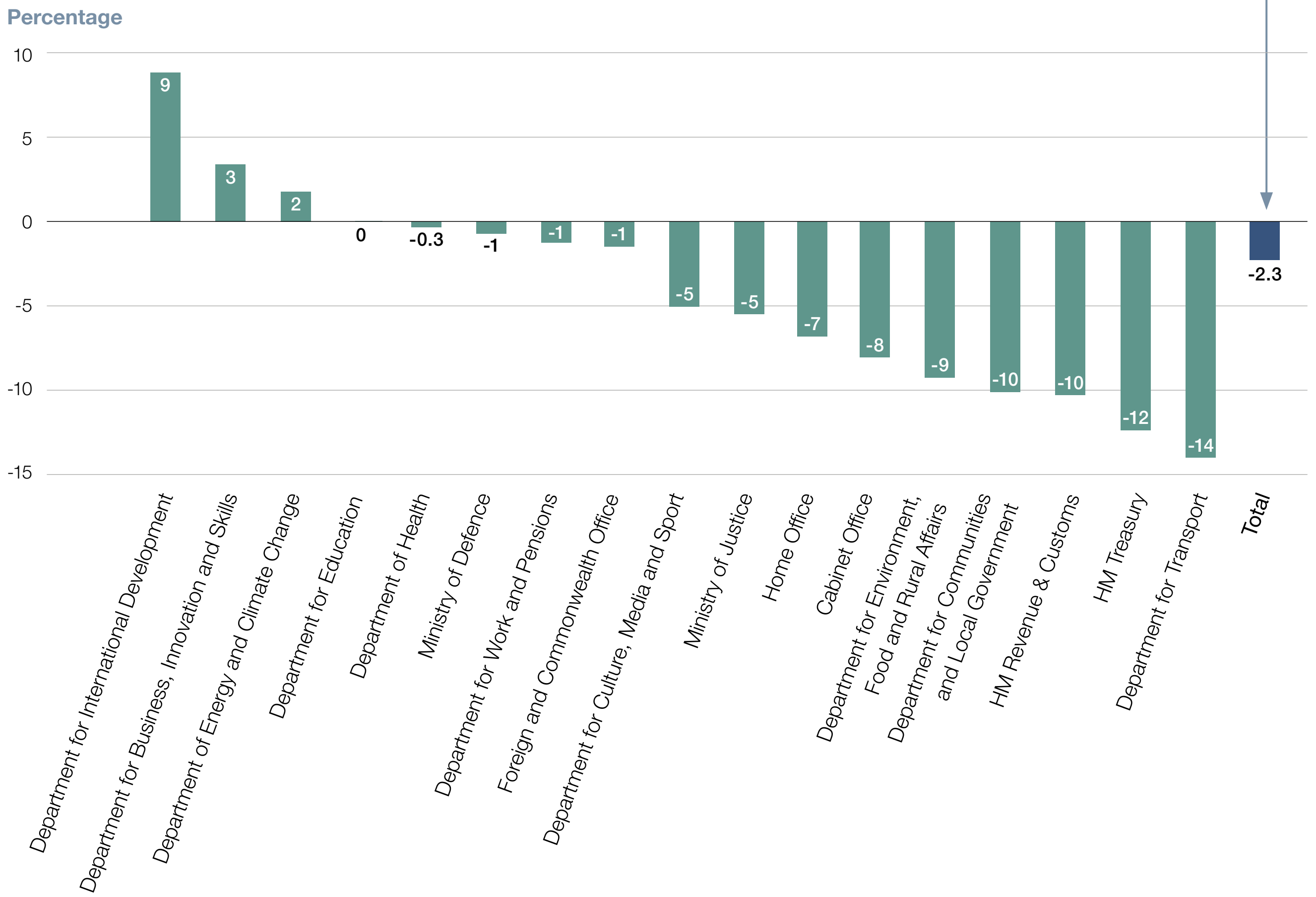
2.5 The £6.2 billion of spending reductions announced in May 2010 included some £1.9 billon delegated to the devolved administrations and local government and some £1 billion from specific policy decisions to end programmes, for example, stopping contributions to the Child Trust Fund and ending some elements of employment programmes. The remainder were to be achieved by a range of efficiency and reform measures (Figure 4).

4 Supplementary estimates are submitted by departments to seek adjustments to their main Parliamentary Votes. These can cover, for example, the impact of the annual Budget, other major policy decisions or simply unforeseen receipts and costs. Overall, the level of supplementary estimates requested by departments during 2010-11 was not unusual.

Figure 5
Government expenditure and departmental spending 2010-11

	2009-10 real terms (£bn)	2010-11 (£bn)	Difference (£bn)
Total managed expenditure	**688**	**689**	**0.7**
Less: Social security and tax credits	192	194	
Devolved administrations	58	56	
Gross debt interest	32	43	
Locally-financed spending	32	29	
Other non-departmental spending (EU, public corporations and lottery)	18	19	
Small departments and security services	5	4	
Other (non-cash) adjustments	7	8	
Resource and Capital Departmental Expenditure Limits for 17 main departments	**344**	**336**	**-7.9 (2.3%)**

Change in outturn Departmental Expenditure Limits from 2009-10 to 2010-11 (real terms)



NOTE
1 Data on charts will be rounded for simplicity.

Source: National Audit Office analysis of 2011 Budget, Public Expenditure Statistical analysis 2010-11, Public Expenditure Outturn White Papers 2009-10 and 2010-11, Departmental accounts 2010-11

2.6 We tested whether departments had delivered spending reductions by examining the real-terms change in departmental spending from 2009-10 to 2010-11 disclosed in departmental accounts. The accounts present spending in terms of:

- administrative costs, which can be split into staff-related expenses and other costs (including, for example, accommodation, IT support and other costs that cannot be directly related to delivering a particular service or output); and
- programme costs, which cover grants and other contractual payments to bodies that directly deliver services or programmes, as well as internal staff accommodation and IT costs that are directly attributable to individual services.

2.7 In order to assess changes in the underlying administration cost base we excluded non-cash items, miscellaneous receipts and one-off early departure costs of £279 million. Administrative spending fell from £16.8 billion in 2009-10 to £15.3 billion in 2010-11 (a reduction of £1.5 billion or 9 per cent in real terms). The reductions in individual departments (**Figure 6** overleaf) varied from a 22 per cent reduction by the Treasury, to a small increase in the Foreign and Commonwealth Office.[5]

2.8 Programme spending covers direct spending on front-line services including grants to third parties. It includes items covered by controls on Departmental Expenditure Limits and Annually Managed Expenditure (Figure 1). Again, excluding non-cash items, receipts and early departure costs of £367 million, overall programme spending fell by £3.4 billion (1 per cent) in real terms. There are significant variations between individual departments (see **Figures 7** on page 21 and **Figure 8** on page 22) including:

- real-terms increases in spending on international aid (£1.1 billion), education (£691 million) and health (£187 million), reflecting the priorities announced by the Government;
- a £2.4 billion increase in welfare payments reflecting the impact of the economic downturn and demographic changes; and
- substantial reductions in grants by the Department for Communities and Local Government, including £2.2 billion to local authorities.

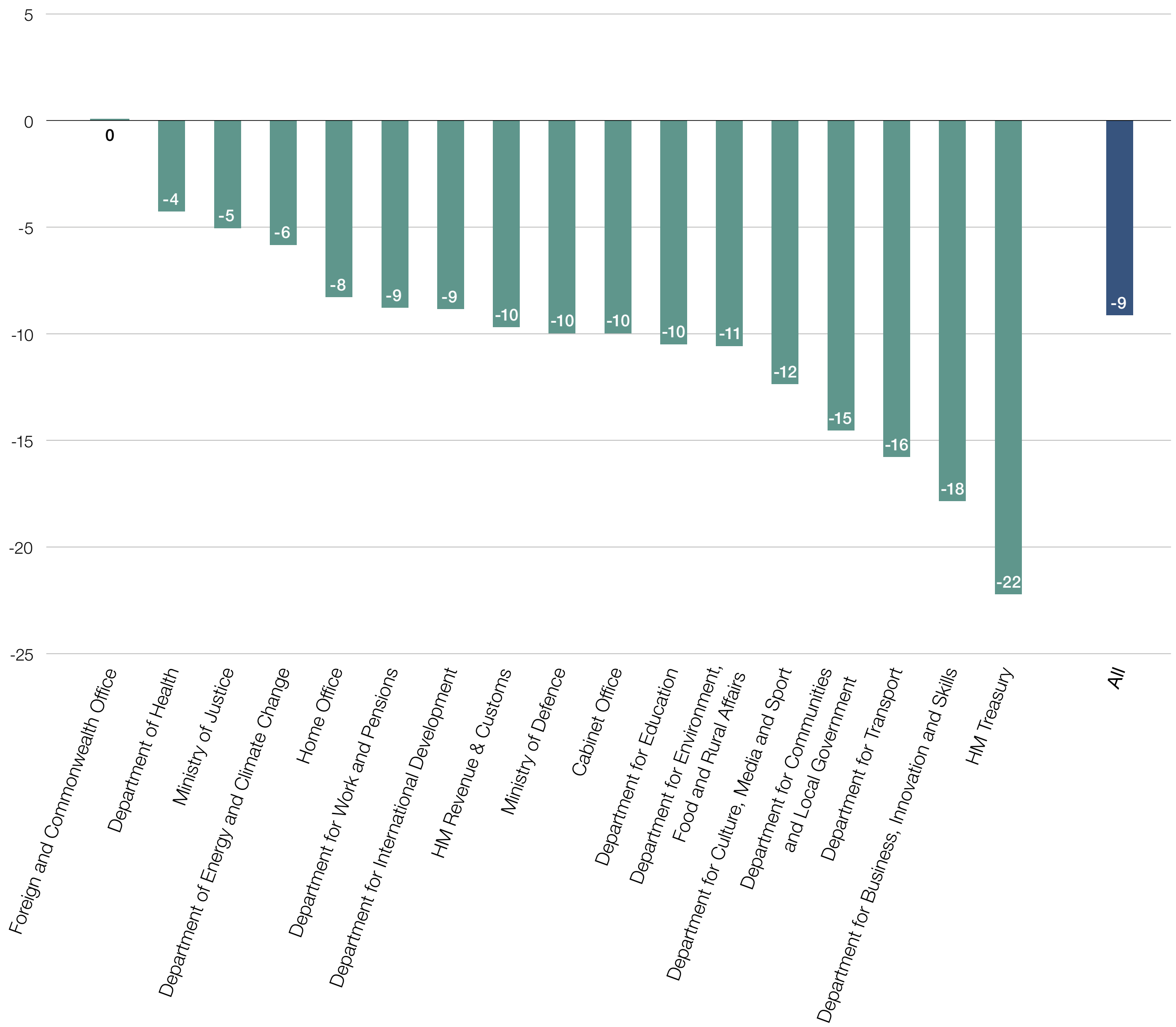
2.9 Some of these changes are movements in Annually Managed Expenditure (Figure 1) and do not contribute to the reduction in Departmental Expenditure Limits discussed in paragraph 2.3. They are shown here for completeness and to maintain consistency with departmental accounts. The fall in programme spend within Departmental Expenditure Limits is approximately £5 billion.[6]

5 These changes include changes in the definition of administrative costs which could not always be fully reflected in prior year figures.

6 The remainder of the total £7.9 billion reduction in Departmental Expenditure Limits is accounted for by capital expenditure (paragraphs 2.10 to 2.13), and movements in early departure costs (paragraphs 2.17 to 2.19, and non-cash items and provisions (paragraph 2.3) for which year-by-year comparison is not meaningful.

Figure 6

Real-terms change in administrative spending 2009-10 to 2010-11 by department



NOTES

1 The analysis excludes income, non-cash items and adjusts for the costs of early departures to give a better view of the underlying cost reductions.

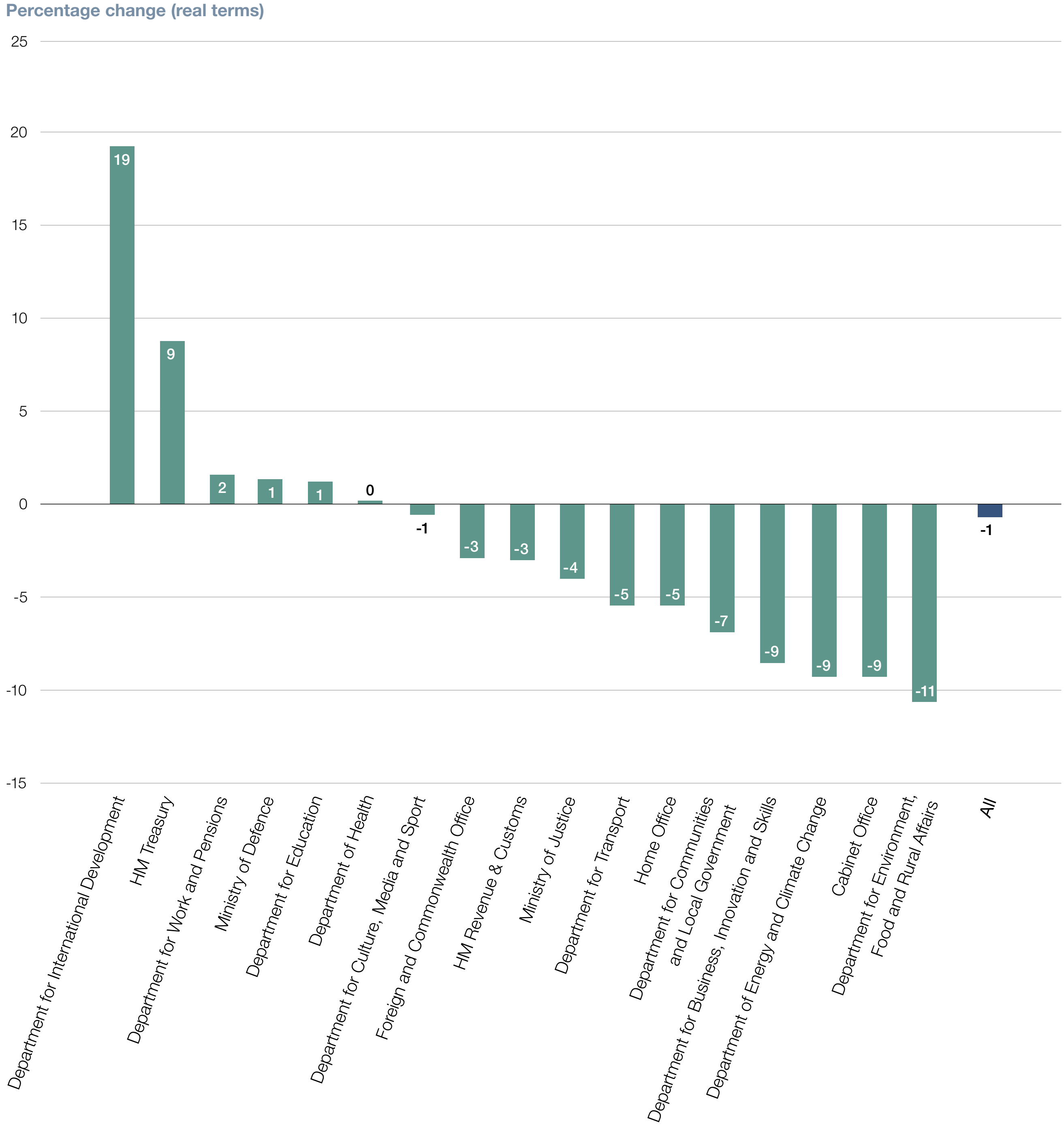
2 The Ministry of Justice's figure excludes spending by the devolved administrations.

3 Data on charts will be rounded for simplicity.

Source: National Audit Office analysis of departmental accounts 2010-11

Figure 7

Real-terms change in programme spending by departments 2009-10 to 2010-11



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2 The Ministry of Justice's figure excludes spending by the devolved administrations.

3 Data on charts will be rounded for simplicity.

Source: National Audit Office analysis of departmental accounts 2010-11

Figure 8
Analysis of real-terms variations in programme spend 2009-10 to 2010-11

Department	Reduction (£m)	Increase (£m)	Real-terms change in spending (%)	Explanation for changes
Department for Work and Pensions		2,441	2	Impact of economic downturn
Department for International Development		1,082	19	Government target to increase aid to 0.7 per cent of GDP from 2013
Department for Education		691	1	Increased funding for children from poor backgrounds
Ministry of Defence		376	1	Net effect of large number of savings and additional costs, e.g. equipment support and fuel costs
Department of Health		187	<1	Government held to existing health spending plans for 2010-11
HM Treasury		5	9	Increase in coinage costs
Department for Culture, Media and Sport	34		-1	Mainly reduced expenditure by the BBC
Cabinet Office	39		-9	Mainly reductions in grants paid by Office for Civil Society
Foreign and Commonwealth Office	62		-3	Reductions in front-line staffing and other support costs
Ministry of Justice	381		-4	Mainly reductions in grants and savings on accommodation
Department for Energy and Climate Change	389		-9	Mainly reduction in grants to nuclear decommissioning authority to offset higher commercial income
HM Revenue & Customs	396		-3	Mainly savings in child benefit payments
Home Office	643		-5	Reductions in police grant and significant reductions in IT, estates and consultancy spending
Department for Environment, Food and Rural Affairs	671		-11	Mainly reduced grants and rural payments
Department for Transport	706		-5	Reductions in arm's-length bodies, reduced road maintenance and less support for passenger rail services. However, local authority road grants increased by £171 million
Department for Business, Innovation and Skills	2,046		-9	Impact of higher fees in higher education and closure of regional development agencies
Department for Communities and Local Government	2,788		-7	Reductions in grant to local authorities and other delivery partners
Total	**8,155**	**4,781**	**1**	
Net total	-3,374			

NOTE

1 The analysis excludes income, non-cash items and adjusts for the costs of early departures to give a better view of the underlying cost reductions.

2 The Ministry of Justice's figure excludes spending by the devolved administrations.

Source: National Audit Office analysis of departmental accounts

Capital spending

2.10 Capital spending in any year is subject to separate spending limits agreed with the Treasury. Departmental Expenditure Limits incorporate capital grants from departments to devolved bodies and additions to departments' own fixed assets. Capital grants are included in our analysis of programme spending (Figures 7 and 8). **Figure 9** shows the change in capital additions in the 17 main departments. The number of capital projects managed by departments, and their average cost, is highly variable from year to year. However, using the same price and growth assumption we used to evaluate programme and administrative cost reductions suggests that capital spending has reduced by £1.6 billion (10 per cent) in real terms.

2.11 Departmental reductions in capital spending in 2010-11 reflect:

- cancellation, or curtailment and delay of some major programmes with heavy IT requirements such as identity cards;
- the moratoria on IT spending and controls on major projects which require Cabinet Office approval for large new spending; and
- the negotiations with major cross-government suppliers (Figure 4).

2.12 However, 2009-10, which we have used as our baseline, includes capital spending brought forward to offset the impact of the credit crisis which was expected to reverse in 2010-11 and beyond. This has contributed to the Department for Transport reducing its capital spending on major transport projects by £357 million (18 per cent) in real terms.

Figure 9

Real-terms reductions in capital spending by central government departments 2009-10 to 2010-11

	Reduction since 2009-10	
Area	**(£m)**	**(%)**
IT	537	35
Land and buildings	392	18
Transport projects	357	18
Military equipment	-184	-3
Other capital spending	544	12
Total reduction	**1,646**	**10**

Source: National Audit Office analysis of departmental capital spending

Post publication this page was found to contain an error which has been corrected
(Please find Published Correction Slip)

2.13 Changes in spending on land and buildings may be sustainable where they reflect reductions in government's use of property. The fall of 35 per cent in IT spend is partly the result of decisions to permanently halt or reduce spending on specific projects. However, it is unlikely that IT capital spending will remain at this lower level in total if investment in IT is necessary to allow departments to deliver more efficient services while reducing staff and to support business changes such as delivering services online.

Reducing specific areas of spending

2.14 In May 2010, the Government announced a series of initiatives to help secure the £6.2 billion of cost reductions required in 2010-11, these include:

- A freeze on recruiting permanent civil servants, fixed-term appointments and temporary staff, with Ministerial or Accounting Officer approval needed for exceptions in front-line and business critical posts.
- Public sector pay frozen for two years. However, most groups had already received pay awards for 2010-11, so large savings will begin to accrue only from 2011-12.
- Negotiations with major cross-government suppliers, led by Cabinet Office Ministers, to identify cost reductions. The suppliers were predominantly providers of IT and accommodation services.
- Restrictions on entering new building leases and renewing existing leases beyond contractual break points, without the agreement of the Government Property Unit.
- Moratoria on employing consultants, government advertising, and restricting business travel and related expenses.
- Increased use of cross-government procurement contracts to ensure the lowest possible prices are being achieved.
- Reforming and reducing the number of arm's-length bodies – this programme has been the subject of a separate review by the National Audit Office.[7]

2.15 In July 2011, the Cabinet Office wrote to the PAC Chairman setting out estimated cash savings through increased efficiency or reduced spend, totalling £3.75 billion arising from central initiatives managed by its Efficiency and Reform Group. The savings were estimated using various information sources and were reviewed by the Cabinet Office's internal audit service. In order to corroborate these figures, we compared the estimated savings to details from the audited accounts of the main 17 departments, which were not available at the time of the internal audit review. We estimated the real-terms change in spending on both administration and programmes from the accounts (**Figure 10**) and discuss the likely savings in more detail in the following paragraphs.

7 Comptroller and Auditor General, *Reorganising central government bodies*, Session 2010–12, HC 1703, National Audit Office, January 2011.

Figure 10

Review of Cabinet Office's estimated savings in 2010-11 from its value-for-money initiatives

Efficiency and Reform Group estimate			NAO review of accounts of main 17 departments	
Area	**(£m)**	**Source**	**(£m)**	**Comment**
Staffing related savings				
Recruitment moratoria	295	Based on quarterly Office for National Statistics data on civil service numbers	603	Based on average number of staff employed in 2009-10 and 2010-11
Reduction in temporary staff	492	Departmental returns submitted by finance directors	233	
Consulting moratorium	869	Departmental returns submitted by finance directors	645	NAO estimate is likely to be conservative
	1,656		**1,481**	
Other resource costs				
Supplier renegotiation	806	Cabinet Office tracking of results of negotiations with 41 suppliers and departmental actions	–	The effect of negotiations is reflected across the cost categories below
Marketing and advertising moratorium	397	Estimated reduction in departmental spend through the Central Office of Information	373	Audited Central Office of Information accounts 2010-11
Other IT	140	Departmental returns submitted by finance directors	255	External contractors costs and PFI contracts
Travel and subsistence	138	Departmental returns submitted by finance directors	148	
Office supplies	39	Analysis of spend through central contracts	53	Accounts do not always separately identify these costs. NAO estimate is likely to be conservative
Various	25	Suppliers data and departmental returns submitted by finance directors	–	Reported savings are in areas not identifiable from published accounts
Property	106	Annual cost of leases ended from May 2010 to March 2011 from a central database of government property	326	Accounts include wider land and property-related costs. Some departments have made greater than expected savings on their estates costs. However, some reductions may be due to changes in accounting treatment
	1,651		**1,155**	
Capital spending				
Scrutiny of IT projects	296	Analysis of Efficiency and Reform Group decisions made in 2010-11 (including projects reported by departments as stopped)	537	Reduced capital spending on IT related items
Review of major projects	147	Analysis by the Major Projects Group of 2010-11 impact of changes in 13 delayed or cancelled projects	392	Reduced capital spending on land and buildings
	443		**929**	
Total	**3,750**		**3,566**	

Source: Efficiency and Reform Group and National Audit Office analysis of Departmental accounts 2010-11

2.16 The Government announced a recruitment moratorium, except for key front-line staff with ministerial approval, in May 2010. The aggregate reduction in Departmental Expenditure Limits also created pressure to reduce staff costs. The June 2010 Budget then announced that public sector pay would be frozen for two years. However, staff earning less than £21,000 a year will be awarded a fixed annual increase of £250 (pro rata for part-time staff). This freeze applied in 2010-11 only to groups that had not yet reached legally binding agreements and had little impact on overall departmental salary costs.

2.17 Our analysis of the accounts for the 17 major departments found that during 2010-11, departments reduced the average number of permanent staff employed by the equivalent of 16,200[8] (4 per cent) full-time equivalent staff, and a further 5,000 temporary staff (17 per cent). Using average costs, we estimate that these staff resources would have cost departments an additional £836 million (including employer's pension and National Insurance contributions).

2.18 These staff reductions were achieved mainly through natural wastage: including resignations, normal retirements and by releasing staff at the end of their fixed term contracts. In addition, the departments we examined agreed over 17,000 early departures during 2010-11. These departures mainly took place in the second half of the year and in early 2011-12. We estimate that during 2010-11, departments and agencies met in-year cash costs totalling £406 million for early departures from the civil service.[9] This programme will, however, produce significant savings in future years. The National Audit Office will shortly publish a review of the value for money obtained from early departures, which examines redundancy costs and the likely savings in future salary costs.

2.19 The pay freeze and early departure programmes will reduce costs in future years. Whether the reductions are sustainable depends on departments making longer-term changes to their business so that they can manage their operations with a smaller workforce.

2.20 Other categories of spending are not analysed within annual accounts on a comparable basis to the savings reported by the Cabinet Office. For example, consultancy costs may be classified either as a staff cost or, for example, as an IT cost, depending on the type of contract used and the area of spend. In addition, our figures are likely to understate total cross-government savings because we were unable to analyse spending by grant-funded bodies, some of which are included in the Cabinet Office savings. However, we were able to identify:

- Some £1.7 billion of 2009-10 spending described as consultancy. Departments reduced these costs by £645 million in 2010-11 – a real-terms reduction of 37 per cent.

8 This excludes groups of front-line staff not covered by the recruitment moratorium including service personnel, NHS staff and locally-employed staff overseas. These groups also reduced, by some 2,000 staff years, saving an estimated £95 million in 2010-11.

9 This excludes payments made for staff whose departures were agreed in 2009-10 or before as these costs are met from provisions made by departments in previous years. Across some 300 pension schemes, the main 17 departments met early departure cash costs of £646 million (£279 million for administrative staff and £367 million for programme staff). In addition, the departments created £397 million of provisions to cover costs in 2010-11 and beyond arising from departures agreed during the year.

- The 17 major departments we examined reduced their overall land and property-related cash spending by £326 million in 2010-11, 4 per cent less in real terms than in 2009-10. Of this, some £110 million relates to specific leases ended in 2010-11.
- Departments reduced reported media and advertising spending by 72 per cent in real terms during 2010-11. The Government has announced that the Central Office for Information will be closed. The Office managed the bulk of Government's advertising spend for departments.
- Departments reduced staff business travel costs by £148 million (28 per cent) in real terms.
- Departments reduced information technology-related spending by £255 million (6 per cent) in real terms. In addition, there were significant reductions in capital spending on IT (paragraphs 2.10 to 2.13).

2.21 Overall our review confirmed that departments made significant spending reductions in the areas targeted by the Cabinet Office-led initiatives. We cannot evaluate the impact of reductions in consultancy and IT spend on departments' future capability, but where changes in estates spend represent a permanent reduction in the property occupied by government, they are likely to be sustainable. Some advertising spending has been reinstated in 2011-12, but the Cabinet Office has taken action to sustain reductions by introducing new arrangements for collaborative procurement. For advertising, for instance, a small team in the Efficiency and Reform Group will approve high priority campaigns, with five departments taking lead roles across government in specialist areas.

2.22 There are limitations to this analysis because departments do not classify spending consistently at the level of detail required. The main tables of departmental accounts follow a standard pattern with certain key figures always shown. However, the detailed breakdown of administrative and programme spending is not consistent as each department's analysis is different, to suit its own needs and accounting systems. The Economic Secretary to the Treasury announced in August 2011 that a common account format would be developed.

2.23 The reductions made to date could be regarded as value-for-money improvements if they do not have a disproportionate impact on performance. We cannot assess overall performance for 2010-11 as the previous system of measuring departmental performance through Public Service Agreements, which reflected the previous Government's priorities, has been discontinued. From 2011-12, departments are publishing a new system of input and impact indicators to measure their performance. This will enable performance tracking in due course. But, as 70 per cent of the indicators have not been reported publicly before, not all of them currently provide a historic data series for tracking change.

2.24 Departments need to link cost data to output and outcome data to identify whether specific measures represent efficiency improvements or will have an unintended impact on services. Our recent report on financial management in government found it was rare for departments to have good information on the unit cost of outputs or the value of outcomes.[10] In most departments, some of the new impact and input indicators are linked, but not all of them, or similar areas are covered but there is no real link between inputs and impacts. We plan to examine the data systems supporting these indicators in a rolling programme over the next three years. In addition, our programme of reports on departments provides evidence on the value for money delivered by specific programmes.

Early evidence on 2011-12

2.25 Though imperfect, we consider the best early in-year measure of relevant spending to be the cash withdrawn from the Consolidated Fund. This is effectively the current account for most departmental spending. Withdrawals made by departments up to 31 October 2011 have fallen by 4.9 per cent in real terms compared to the same period in 2010-11 (**Figure 11**). This reduction is greater than the 2.5 per cent fall forecast by the Treasury for the full year and is in line with public spending data published by the Office for National Statistics and the Treasury.

Figure 11
Withdrawals from the Consolidated Fund April–October

Real terms (£bn)	2009-10	2010-11	2011-12
Withdrawals to 31 October	272	265	252
Percentage fall		2.6	4.9

NOTE
1 Covers most spending within Departmental Expenditure Limits and some Annually Managed Expenditure, but not welfare benefit payments from the National Insurance Fund.
2 Adjusted to 2010-11 prices.

Source: Consolidated Fund Supply by Vote, National Audit Office

10 Comptroller and Auditor General, *Progress in improving financial management in government*, Session 2010-11, HC 487, National Audit Office, March 2011.

Part Three

Departments' readiness for making structured cost reductions in 2011–2015

3.1 The 2010 Spending Review planned for reductions in departments' spending for 2011-12 to 2014-15 against a baseline of 2010-11 budgets adjusted for one-off items. Once commitments to protect health and overseas aid spending are taken into account, the Spending Review reduced other departments' spending limits by a total of 19 per cent in real terms over the period to 2014-15. This is in addition to the 2.3 per cent reduction in 2010-11. Departments will need a more structured approach than they adopted for 2010-11.

3.2 Our *Short Guide to Structured Cost Reduction*[11] set out our expectation that reductions of this size would need to involve a major change programme in order to bring down costs sustainably. This Part summarises the evidence from a number of recent National Audit Office reviews on how well placed individual departments are to deliver such programmes. The reviews give a snapshot of developments in key areas within the departments, but do not cover all departments or all relevant issues, so we are not able to give a comprehensive cross-government assessment. The reviews we have used are:

On cost reduction in departments:

- *Reducing costs in the Department for Work and Pensions*
- *Reducing costs in the Department for Transport*
- *Reducing costs in HM Revenue & Customs*
- *Spending reduction in the Foreign and Commonwealth Office*
- *Ministry of Defence: Managing change in the Defence workforce.*

On financial management:

- *Department for Culture, Media and Sport: Financial Management*
- *Department for International Development: Financial Management Report*
- *Ministry of Justice: Financial management Report 2011.*

11 National Audit Office, *Short Guide to Structured Cost Reduction*, 2010.

On overseeing front-line bodies:

- *Department for the Environment, Food and Rural Affairs: Managing Front-line delivery costs*
- *Department for Business, Innovation and Skills: reducing bureaucracy in further education in England*
- *Department for Education: Oversight of financial management in local authority maintained schools*
- *Department of Health: Delivering efficiency savings in the NHS.*[12]

Preparations to date

3.3 As part of their 2010 Spending Review submissions, departments were asked to set out savings under two broad categories:

- the possible savings from improving efficiency, getting better value for money from public spending and stopping low value programmes; and
- more fundamental savings from changing or reducing the role of the state.

The Spending Review announced savings in internal efficiency and cuts in administration and back-office costs across nearly all departments. Most departments also identified reductions in activity and ended projects and functions, or made plans to increase revenues from service users. For example, the Department for Culture, Media and Sport cancelled seven projects with a value of £73 million.[a] While a fifth of the cost reductions in the Department for Transport come from efficiencies, over half represent cuts or deferrals to planned outputs (from a sample of 73 per cent of the Department's budget).[b]

3.4 This approach was not surprising in the short timescale available for planning in 2010. However, the Public Accounts Committee has stated that it expects departments to improve value for money by delivering existing services in radically more efficient ways,[c] and they should not simply look to cut spending by cutting front-line services. Over time, departments need to develop plans based on an understanding of the costs and value delivered if they are to reduce costs while maintaining value for money.

3.5 Before attempting to deliver substantial cost reductions, an organisation should create a target operating model which is a vision of how it can work differently to deliver its objectives at a sustainable lower cost. This vision can be defined in broad terms initially but then refined as analysis develops, and supported by a clear plan to migrate from the current state to the new operating model.

12 Full references are set out in an endnote to this report. Further cross-references to the reports in this part refer to the endnote.

3.6 Most departments have an overall vision for cost reduction but have yet to design a robust target operating model or detailed plan. Some departments have plans in place but they need to do more to develop their overall strategy. HM Revenue & Customs,[d] the Department of Health[e] and the Department for Transport[b] anticipated the budget reductions and began planning their strategy as early as 2009.

3.7 Other departments successfully achieved short-term cost reduction using a series of independent initiatives. To meet 2010-11 targets, many departments reduced the budgets of their operational units or arm's-length bodies and then allowed them to design and implement their own cost reduction initiatives within those reduced budgets. For instance, Jobcentre Plus, carried out modelling to plan cost reduction and design its own future state in summer 2010.[f] There is evidence, though, of departments designing more holistic approaches. The Department for Work and Pensions started an organisational design review in April 2010, which we concluded could provide the basis for a target operating model.[f]

3.8 In managing within spending plans, departments have to manage a number of risks, such as fluctuations in income, some of which are outside their control. For instance, the Department for Transport is exposed to unpredictability in rail revenues.[b] Cost increases in the Ministry of Defence's major projects were affected by macro-economic factors, such as exchange rate variations, as well as decisions to delay spending.[g] Our experience of previous savings programmes is that some 20 per cent of forecast annual savings are not realised. The plans we have examined incorporate elements of contingency. For example, HM Revenue & Customs' plans include contingency for under-recovering income,[d] Jobcentre Plus reduced projected headcount savings by 20 per cent to counter optimism bias,[f] and Strategic Health Authorities identified 5 per cent more savings than required.[e] However, contingencies are not consistently built into plans or are insufficient to cover key risks. In practice, departments are relying on being able to identify further savings initiatives in later years should current plans fail to deliver.

Capability and change programmes

3.9 Five departments made the cost reductions required in 2010-11 solely through cutting administration costs and through the impact of the Government spending moratoria. The Departments of Health and Education did not need to cut other costs except in capital programmes. The remaining departments cut some programme costs to stay within 2010-11 budgets, mainly by reducing grants to local bodies. While this was successful in keeping departments within 2010-11 budgets, over the period to 2014-15 departments need to develop concrete plans to operate with lower costs.

3.10 For costs under departments' direct control, the structural changes they must make to secure cost reductions depend on them successfully implementing and managing an organisational transformation programme. Departments should develop plans from a sound basis, using robust information, with good governance arrangements to monitor progress and, if necessary, take corrective action. We discuss strategies for managing costs where spending is mainly devolved in paragraphs 3.18 to 3.21 below.

3.11 Of the departments we have examined, HM Revenue & Customs, the Department for Work and Pensions and the Ministry of Defence were aiming to secure the bulk of cost reductions from within their organisations. HM Revenue & Customs has established comprehensive governance arrangements to reduce costs, with a central team and programme management infrastructure.[d] The Department for Work and Pensions put in place a transformation programme board in May 2011 to oversee the redesign of its corporate centre and broader cultural change. However, it cannot finalise plans beyond 2011-12 as they depend on the future business model after the introduction of Universal Credit.[f] The Ministry of Defence has developed detailed plans and processes for reducing civilian and military headcount before the detail of a new operating model has been determined.[h]

3.12 Where departments do have change programmes with effective governance in place, this has allowed them to communicate their plans to their staff. We identified strong leadership as a key factor in the success of the Foreign and Commonwealth Office's cost reduction efforts.[i] The Department for Work and Pensions' finance team have provided 'What the Future Holds' updates and interactive briefings for staff.[f] Central government action has underlined departments' individual efforts to incentivise staff. The Government rewrote the Civil Service Code in 2010 to emphasise the importance of using public money and resources properly.

3.13 We reported more widely on financial management capability across government in March 2011.[j] Departments have well-established systems for setting budgets for the year and tracking spending to monitor whether business areas keep within those budgets. Departments focus less on longer-term financial planning and financial management information is not always clearly linked with performance reporting. However, all the departments we examined are working to improve their financial management.

3.14 When they identify and prioritise cost reductions, organisations need to understand the scope for improving efficiency and the consequences of cost reductions. They must therefore have a detailed knowledge of where costs are being incurred, the factors driving costs and the value of activities. Most departments have good basic information about costs and can track the progress of cost reductions. However, there are only a few examples of systems, such as the appraisal system by the Department for Transport for capital projects, that can relate costs to levels of activity or outcomes.[b]

The Department for Work and Pensions has developed an activity-based costing model to cost activities and processes, but has not used it to routinely drive performance improvements.[f] The Department for Education has used a model to measure school efficiency for some years, but has not used it as a decision-making tool for cutting costs.[k]

3.15 Departments may not hold information linking costs to outputs and impacts but we have found that many arm's-length bodies do hold and use this information. For example, the Centre for Environment, Fisheries and Aquaculture Services within the Department for Environment, Food and Rural Affairs held sufficiently detailed information to be able to challenge its project managers to reduce costs without affecting services. The resulting savings identified from some 200 projects made up 30 per cent of the Agency's efforts to meet their efficiency savings target.[l]

3.16 We have seen few examples of using sensitivity analysis to forecast the impact of changes in spending. For the Strategic Defence and Security Review, the armed forces conducted scenario modelling to assess the impact of various options to reduce headcount. The Ministry of Defence also undertook financial modelling to forecast the likely costs and savings of civilian and military headcount reduction. The outputs are sensitive to the assumptions made and the Ministry will need to make adjustments as it implements reductions.[h] The Ministry of Justice has also developed workflow models to help improve its medium-term operational and financial planning. These have enabled the Ministry to forecast the impact of events such as the summer 2011 riots on the justice system. The models allow the Ministry to see how its savings plans bridge the gap between previous spending levels and its new, lower, target spending levels.[m]

3.17 The Spending Review and departmental business plans do not allow us to identify the balance of cost savings between efficiency measures and service reductions, or evaluate the resulting impact. Departments' quarterly data summaries include impact indicators but as indicated in paragraphs 2.23 to 2.24, departments need to more closely align input and impact indicators before they can be used to measure changes in efficiency or the impact of cost reductions on services.

Reducing costs in devolved delivery bodies

3.18 For the majority of departments, the Spending Review implies that reductions will be needed in delivery partner bodies' spending as well as in the core department. These partners are usually autonomous bodies but can represent a significant proportion of a department's spending. Nine departments spend more than 50 per cent of their budget through arm's-length or local bodies. We have observed three types of approach for managing cost reduction in devolved bodies (**Figure 12** overleaf). There are some examples of across-the-board reductions in delivery body funding (which we have characterised as a 'rationing' role). However, the most common approach combines priority-based changes to the funding allocated to delivery bodies ('purchaser' role) with an expectation that delivery bodies will manage their own costs down.

Figure 12
Reducing costs in devolved bodies

Main approaches	What it involves	What it requires	Current state and way forward
Rationing role	Share cuts evenly and expect devolved bodies to cut their own costs.	Excellent financial and change management in devolved bodies. Similar levels of cost-effectiveness across funded bodies.	Some examples especially where allocation decisions are formula-driven (e.g. Education)[1] or themselves devolved. Scope to adopt when departments can be confident in capability of devolved bodies.
Purchaser role	Decide what funds to spend on devolved bodies in return for what activity levels.	Good understanding of value gained from funding levels and consequences of changing them.	Frequently adopted but understanding of costs and value is variable. Would be enhanced by awareness of unit costs and strategic overview of value delivered across areas the department funds.
Partner role	Work with bodies to identify where they can make efficiencies and support them in doing so.	Transparent cost and performance information. Willingness to treat devolved bodies as partners and share good practice.	Some examples of this approach emerging (transport,[2] further education).[3] Scope to use more widely where the department has a strong relationship with delivery bodies.

NOTES

1 Comptroller and Auditor General, *Department for Education: Oversight of financial management in local authority maintained schools*, Session 2010–12, HC 1517, National Audit Office, October 2011.

2 Comptroller and Auditor General, *Department for Transport: Reducing costs in the Department for Transport*, Session 2010–12, HC 1700, National Audit Office, December 2011.

3 Comptroller and Auditor General, *Department for Business, Innovation and Skills: reducing bureaucracy in further education in England*, Session 2010–12, HC 1590, National Audit Office, December 2011.

Source: National Audit Office analysis

3.19 We would expect departments to use a combination of these approaches to allocate cost reductions based on an understanding of the risks and capabilities of each body. Most departments do not, at present, have the information to make these decisions even when their arm's-length bodies do hold such information.

3.20 If departments select a mix of approaches without understanding delivery bodies, there are a number of risks to value for money:

- Where current levels of cost-effectiveness vary, undifferentiated cuts will not address these variations.

- If departmental decisions on changing the allocation of funds are to result in improved value for money, they must be informed by high-quality cost and performance data. We have found that departments' understanding of delivery bodies' performance varies.
- Delivery bodies' ability to manage their own costs down depends on their own management capability. Departments adopting this approach need effective monitoring and intervention mechanisms.

If departments reduce budgets without understanding the current cost-effectiveness of an organisation, they are unlikely to be able to predict how far cost reductions will affect services.

3.21 To manage the risks to value for money across these approaches, departments need to share good quality data on costs and outcomes and use it to make decisions about cost reduction strategies. In the Spending Review timescale, departments made a pragmatic assessment of delivery bodies' capacity to absorb changes. We have seen departments making progress towards a considered approach to delegating cost reductions. The Department for Culture, Media and Sport used a combination of the approaches above to choose which budgets to reduce, and will now reduce the level of monitoring for some bodies based on a risk assessment.[a] The Ministry of Justice now has governance arrangements based on a structured risk assessment of its sponsored bodies.[m] The Department of Health assessed and approved all its strategic health authorities' plans, but assigned some a higher level of supervision. The Department also helped authorities to share good practice, pairing them so that those with less robust plans could learn from similar authorities.[e]

Appendix One

Study methods

Method	Use in the report
Review of published documents on public spending:	**To identify changes in planned and forecast spending**
• Annual Budget Reports 2008 to 2011.	Understand changes in plans for 2010-11 spending, and plans for deficit reduction up to 2015-16.
• HM Treasury Spending Review 2010 report.	This set detailed annual Departmental Expenditure Limits, up to 2014-15 covering administrative, programme and capital spending.
• Office for Budget Responsibility Pre-Budget forecast June 2010.	This report forecast overall spending if existing policies and trends continued and is the baseline against which overall cost reduction performance can be assessed.
Financial analysis	**To assess the level of cost reduction achieved in 2010-11**
Analysis of 17 audited departmental resource accounts for 2010-11 and comparable 2009-10 data.	To analyse resource and capital spending in 2010-11 and compare with 2009-10 up-rated by 2.7 per cent to identify significant changes in activity levels and cash costs in real terms.
Review of Whole of Government Accounts departmental returns.	These provide a consistent breakdown of capital spending and grants. The accounts were also used to evaluate the economy and efficiency savings reported by the Cabinet Office.
Review of Internal Audit assessment of savings reported by the Cabinet Office.	We compared reported savings against spending reductions in real terms extracted from our analysis of accounts.
Review of:	To make an initial assessment of spending reductions in 2011-12.
• issues from the Exchequer 2009-10 to 2011-12; and	Departments' cash drawings give some assurance that they are on target to deliver further spending reductions in 2011-12.
• Office of National Statistics monthly data releases.	Monitoring of reductions in civil service staffing and overall spending on National Accounts basis.
Analysis of departmental value-for-money examinations	**To assess departments' structured cost reduction strategies**
Analysis of NAO value-for-money reviews on cost reduction in departments and interviews with study teams.	To identify common problems and good practice amongst leading departments, including progress on cost reduction strategies; programme management arrangements; progress monitoring; and overseeing arm's-length bodies.

Endnotes

a Comptroller and Auditor General, *Department for Culture Media and Sport: Financial Management*, Session 2010-11, HC 821, National Audit Office, March 2011.

b Comptroller and Auditor General, *Department for Transport: Reducing costs in the Department for Transport*, Session 2010–12, HC 1700, National Audit Office, December 2011.

c HC Committee of Public Accounts, *Progress with VFM savings and lessons for cost reduction programmes*, 4th Report of Session 2010-11, HC 440, November 2010.

d Comptroller and Auditor General, *Reducing costs in HM Revenue & Customs*, Session 2010–12, HC 1278, National Audit Office, July 2011.

e Comptroller and Auditor General, *Department of Health: Delivering efficiency savings in the NHS*, Briefing for the House of Commons Health Committee, National Audit Office, September 2011.

f Comptroller and Auditor General, *Department for Work and Pensions: Reducing costs in the Department for Work and Pensions*, Session 2010-12, HC 1089, National Audit Office, June 2011.

g Comptroller and Auditor General, *Ministry of Defence: Major Projects Report 2011*, Session 2010–12, HC 1520, National Audit Office, November 2011.

h Comptroller and Auditor General, *Ministry of Defence: Managing Change in the Defence Workforce*, National Audit Office, forthcoming.

i Comptroller and Auditor General, *Foreign and Commonwealth Office: Spending reduction in the Foreign and Commonwealth Office*, Session 2010-11, HC 826, National Audit Office.

j Comptroller and Auditor General, *Progress in improving financial management in government,* Session 2010-11, HC 487, National Audit Office, March 2011.

k Comptroller and Auditor General, *Department for Education: Oversight of financial management in local authority maintained schools*, Session 2010–12, HC 1517, National Audit Office, October 2011.

l Comptroller and Auditor General, *Department for the Environment, Food and Rural Affairs: Managing Front-line delivery costs*, Session 2010–12, HC 1279, National Audit Office, July 2011.

m Comptroller and Auditor General, *Ministry of Justice: Financial management report 2011*, Session 2010-12, HC 1591, National Audit Office, November 2011.

n Comptroller and Auditor General, *Department for Business, Innovation and Skills: reducing bureaucracy in further education in England*, Session 2010-12, HC 1590, National Audit Office, December 2011.

o Comptroller and Auditor General, *Department for International Development: Financial Management Report*, Session 2010-12, HC 820, National Audit Office, April 2011.

Report by the Comptroller and Auditor General

Cost reduction in central government: summary of progress

HC 1788 Session 2010–12

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CORRECTION

Page 23 Figure 9

Figure 9 (page 23) of the report contains errors in the lines 'Military equipment 13 <1' and 'Other 348 18'. It should have read 'Military equipment -184 -3' and 'Other capital spending 544 12'.

Please see the old Figure below

Figure 9

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Source: National Audit Office analysis of departmental capital spending

Please see the corrected Figure overleaf

Figure 9

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