House of Commons
Committee of Public Accounts

Progress with VFM savings and lessons for cost reduction programmes

Fourth Report of Session 2010–11

Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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Summary

The £35 billion value for money target set as part of the 2007 Comprehensive Spending Review required public bodies to make sustainable cash-releasing savings, whilst maintaining the delivery of departmental priorities. The CSR07 Value for Money Programme (the Programme) set demanding criteria for what could be classed as a saving—for example, one-off savings were ruled out as they would not constitute sustainable cost reductions.

The £35 billion target represented savings of 3 per cent a year for each department's expenditure at the start of the period. By March 2010, two years into the three-year programme, departments and local authorities had reported only £15 billion of savings, less than half of the total needed to reach the £35 billion target.

Furthermore, the National Audit Office found that only 38 per cent of savings they reviewed represented realised value for money savings. Despite the importance placed on the Programme at the top of government, departments could not even measure adequately what savings they had made, and the Treasury failed to create a framework for reliable reporting. Neither the Treasury nor departments had an incentive to report only soundly-based savings. The programme did not enable departments to find cost reductions by rethinking the way services are delivered.

The current financial environment is fundamentally different from the position when the Programme was launched in 2007, with substantial cash reductions required over the next four years by most departments. The scale of savings needed will require much more radical action, but the results from this programme left us with grave concerns as to whether departments are ready to implement effectively a programme of value for money savings. There is a serious risk that departments will rely solely on cutting front-line services to reduce costs, without adequately exploring the potential to reduce costs through other value for money improvements.

Notwithstanding that the Treasury may continue to delegate day to day responsibility for delivering savings to individual departments, in future appearances before the Committee we will expect to see evidence of the Treasury' leadership: taking full responsibility for the delivery of efficiency savings across government as a whole; demonstrating a full grasp of the causes of under performance in any department; and intervening where performance does not meet expectations.

We are concerned at the implication from Treasury that it will simply reduce departments' budgets and then walk away from responsibility for the delivery of the level of savings required across government. Bearing in mind the disappointing performance of this Programme, we believe the Treasury will need to take a very different approach to value for

money improvement in the next spending period.

We took evidence on the basis of report by the Comptroller and Auditor General[1] on progress with the Programme.

1 C&AG's Report, Session 2010–11, *Progress with VF savings and lessons for cost reduction programmes*, HC 291

Conclusions and recommendations

1. **The Committee expects efficiency improvements to make a major contribution to the cost reductions now required across government. If departments had been successful in making real savings of 3% a year, less painful cuts would be necessary now. Services will suffer because the Treasury did not get the framework right for the CSR07 savings programme. Accounting Officers should be, as the title indicates, personally accountable for delivering the full amount of savings committed to, and the Treasury should create a framework where that accountability is clear and unequivocal.** The following recommendations reflect how we expect the Treasury and departments to respond to the lessons from the CSR07 Programme.

2. **The value for money savings target for CSR07 was not based on robust evidence about what departments could realistically achieve, and it is not surprising therefore that performance has fallen well short of ambitions.** Regardless of whether the government adopts a headline efficiency target for the next Spending Review period, future value for money initiatives need to take a more sophisticated approach. The Treasury should set and agree expectations for each department based on individual assessments of their circumstances, the improvements they have achieved to date, and their ability to deliver improved value for money.

3. **Two years into a three year programme, departments have reported only £15 billion of savings towards the £35 billion target set by Ministers.** Departments should include contingencies sufficient to allow for the risk that, inevitably, some individual efficiency projects will be delayed or will fail to produce the intended benefits.

4. **Further, of the reported savings reviewed by the National Audit Office, just 38 per cent fairly represented sustainable savings.** Departments should only report savings which have been subject to robust quality assurance.

5. **Many of the savings reported by departments were unconvincing because departments did not have financial and performance data to back up their claims, and savings could not be reconciled to their financial outturn or their original spending settlement.** The low quality of savings claims suggests that there is still some way to go in improving the quality of financial information and management in the civil service. In order to live within lower budgets, departments need to be able to predict better the impact of their actions on their bottom line and to demonstrate any impacts on performance. They need a clear understanding of factors affecting costs and the net financial effect of savings measures on the public purse.

6. **The Treasury's top-down design of the Programme, and limiting the timeframe to three years, did not create the right incentives for departments to improve value for money in the round.** There were few suggestions for improvements from front-line civil servants. Departments should create opportunities for staff to have a say in how service delivery can be made more efficient and to improve value for money. The Treasury should expect departments to prepare a long term plan to

reduce their costs, with realistic timetables. The Treasury should regularly monitor progress against milestones.

7. **The Treasury chose not to monitor departments' progress in delivering savings in any detail, and demonstrated only a limited understanding of reasons for lack of progress in individual departments.** For example, the Treasury could not explain the key reasons for the Department for Communities and Local Government's poor performance. This is at odds with the established principle of collective responsibility across government, whilst the individual department's reporting that it would not make its target, without identifying mitigating action, demonstrates a lack of ownership of its own target. When delegating responsibility to departments, the Treasury should establish information requirements with clear parameters of success, tailored to individual departments, to enable it to monitor progress and intervene where performance fails to meet expectations.

8. **The Treasury acknowledges that it alone does not have the internal capability or resources to direct value for money programmes across government.** The Treasury will need to work in partnership with the new Efficiency and Reform Group to support and challenge departments to seek value for money improvements, provide appropriate expertise, disseminate best practice and establish a centralised approach in areas where it is most efficient to do so.

9. **Departments reported savings which did not stand up to external scrutiny, and there were no consequences for senior officials in those departments that failed to deliver savings.** There should be clear consequences for senior civil servants who fail to deliver planned improvements in value for money for taxpayers.

10. **The inability of departments to improve value for money in a time of increasing budgets casts doubts on government's ability to reduce costs now while minimising the impact on front-line services.** Departments reported few examples of savings from major changes to their business in CSR07. In reducing costs in the next period, departments need to fully exploit opportunities to improve value for money by delivering existing services in radically more efficient ways. They should not simply look to cut expenditure by cutting front-line services. Our parallel report on Achieving Sustainable Cost Reductions sets out what we expect to see departments doing to make the required reductions. There should be full and transparent reporting of the impact of cost reduction on services, and where departments do cut service lines altogether, this should be based on a full understanding of the value that is no longer produced, in particular so that a cut in one area does not lead to additional expenditure elsewhere.

1 Progress on the value for money programme

1. Since the 2004 report by Sir Peter Gershon,[2] there have been a number of centrally managed programmes intended to promote efficiency and value for money across the public sector. This is the third report by this Committee on this important subject.[3] In the current financial climate, with the 2010 Comprehensive Spending Review is setting out the largest reduction in spending for decades, it is more important than ever that departments meet savings targets set by Ministers. Departments need to ensure that the impact of spending reductions on key services is minimised by making as much use as possible of improved efficiency and value for money.[4]

2. The current three year value for money programme tasked departments and local authorities with finding cash-releasing savings of £35 billion a year by 2010–11. The headline target was based on the assumption that all public bodies could deliver savings of three per cent per annum,[5] and more on their administrative budgets, with an additional £5 billion added to reflect the contribution from other efficiency reviews.[6] Departmental targets did not take into account individual departments' previous performance, their cost structure, or the unreliability of the efficiencies reported during the previous Spending Review period up to 2007–08. The overall target assumed that the previous programme had delivered £26 billion of savings to 2007–08, although the Treasury recognises that many of the reported savings were implausible.[7] Partly as a result of these blanket assumptions, there are wide variations in reported performance between individual departments (**Figure 1**). Some major spending departments are lagging behind, particularly the Departments of Education, Health and Communities and Local Government where most spending is by local delivery bodies.[8]

2 Sir Peter Gershon, *Releasing resources to the front line: Independent Review of Public Sector Efficiency*, July 2004

3 Committee of Public Accounts, *Progress in improving government efficiency*, 55th Report of Session 2005–06, June 2006: *The Efficiency Programme: A second review of progress*, 48th Report of Session 2006–07, July 2007

4 Qq 1, 46

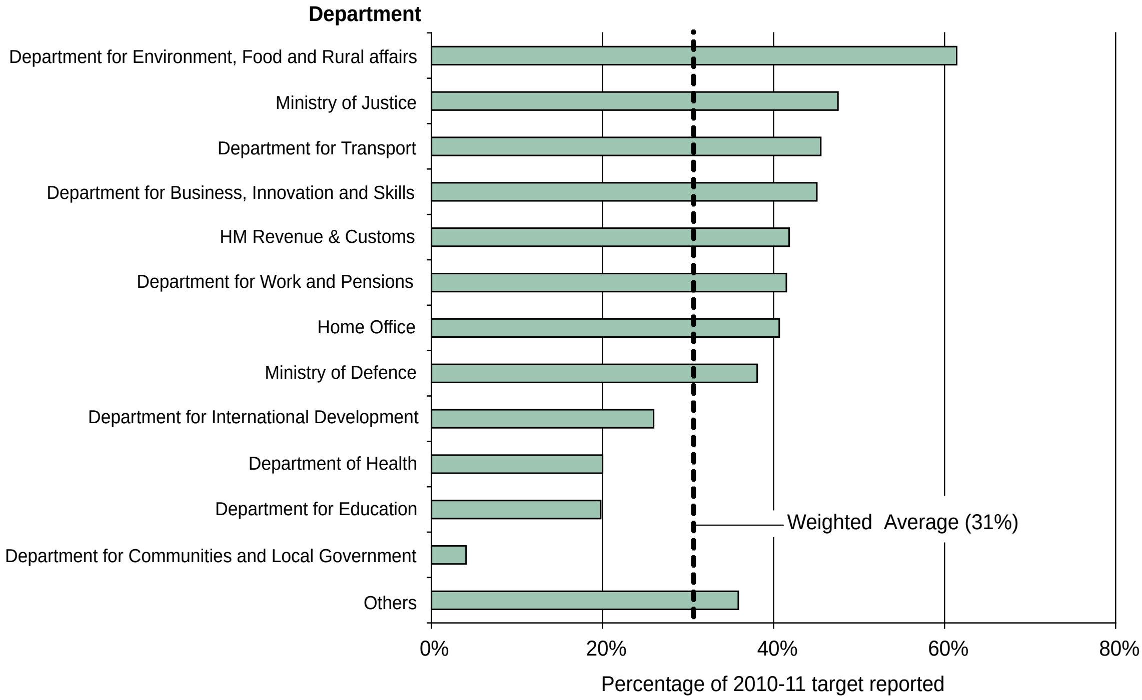
5 Excluding annually managed expenditure such as benefits and tax credits

6 Qq 5–8, 22; C&AG's report, para 1.8

7 Qq 3, 6 and 7

8 Qq 9, 14; C&AG's report, paras 2.2–2.3

Figure 1: Progress reported by departments against 2010–11 savings targets as at 30 September 2009



3. At September 2009, the halfway point in the current three year programme, departments had reported savings totalling £10.8 billion – less than a third of the overall target. A further £4 billion has been added in the second half of 2009–10.[9] The Treasury attributed the slower than expected progress mainly to lags in departments finalising the data used to calculate savings, but it lacked detailed information on progress against plans by individual departments.[10] From publicly available information it is clear that some large savings are unlikely ever to be delivered. For example, the Department for Communities and Local Government plans included £734 million of savings on affordable housing by 2010–11, yet no savings have been achieved to date due to the downturn in the housing market.[11]

4. In addition, more than half of the reported savings independently scrutinised by the National Audit Office do not fully meet the tougher criteria established by the Treasury to address weaknesses in the previous efficiency programme. Despite previous recommendations by this Committee and by the Treasury Select Committee[12], savings claims have still not been sufficiently challenged prior to publication. The Treasury accepted that there was still room for improvement as 18 per cent of the reported savings

9 National Audit Office analysis of departmental Resource Accounts 2009–10

10 Q 19; C&AG's Report, paragraph 2.2

11 Qq 27–30; Department for Communities and Local Government Core Financial and Performance Tables Report, July 2010

12 Treasury Select Committee, Thirteenth report of Session 2008-09, *Evaluating the Efficiency Programme*, HC 520

were not real savings and a further 44 per cent were uncertain when measured against the tougher criteria. The remaining 38 per cent fairly represented savings—a higher proportion than in the previous programme.[13]

5. The Treasury told us that financial management within the public service has improved in recent years but there is still some way to go to reach standards common in the private sector. All savings reported against the target of £35 billion should release cash: either reducing a department's overall spending whilst maintaining or increasing public services, or redeploying resources to expand key frontline services which would otherwise have required additional funding from taxpayers. Departments were generally unable to reconcile their reported savings to either their financial accounts or to their spending agreements with the Treasury. The Treasury maintained that given that most departments were enjoying real terms increases in resources during the previous spending review period, any comparisons between savings claimed and spending were meaningless. This suggests that neither departments nor the Treasury understand the impact of savings on their bottom line or on the additional services being delivered in the period.[14]

13 Qq 2, 15, 26

14 Qq 4, 12–13, 16

2 The Treasury's design of the programme

6. The design of the current value for money programme built on the lessons learned from the previous efficiency programme which ran to 2007–08 and which was subject to detailed central management by teams from the Office of Government Commerce and the Treasury. Under the new programme, while the Treasury continued to monitor a small number of key projects in detail, responsibility for identifying potential savings and managing projects was delegated to spending departments. In theory, the targeted savings were removed from agreed spending plans, and departments therefore have to make savings in order to deliver agreed services whilst living within their budget.[15]

7. For the current Programme, the Treasury decided not to have a large central unit to monitor progress across government, as it did not wish to second-guess individual departments' decisions and wanted them to take full responsibility. The Treasury's intention was to set clear parameters and hand departments the responsibility for delivery.[16] Treasury spending teams were available to discuss efficiency with each department, and the Treasury could feed its views on financial management into the Capability Reviews.[17] However, the complexity of the definition of savings meant the parameters were not clear, and departments could not meet the Treasury's demanding requirements for reliable reporting.[18]

8. The Treasury's monitoring of progress by individual departments appears to have been insufficient for the Accounting Officer to be aware of the reasons for departments' poor performance. The slowest progress to date is from the Department for Communities and Local Government, which had only reported £40 million of savings at the half-way point, against a target of £987 million. The main reason for this appears to be a factor outside the control of the department (see paragraph 3). The Treasury was unable to explain to us whether or how the department would be held to account for its performance or whether the savings it could not deliver would be written off.[19]

9. The Treasury's role is to control and plan public spending and to ensure that there is accurate measurement of the outputs which spending gives rise to. The Accounting Officer considered an external source of expertise would have more credibility than the Treasury itself in giving advice to departments on areas such as procurement. An Efficiency and Reform Group has been established within the Cabinet Office to be a source of expertise in such areas, and to play a role in holding departments to account. The Efficiency and Reform Group will control some things tightly from the centre, such as such as bulk procurement and IT projects, although the Treasury considered that other areas like school spending should be devolved.[20]

15 C&AG's Report, paras 3.2–3.4

16 Qq 10–12, 26

17 Qq 12, 29

18 Q22; C&AG's report, para 8

19 Qq 30–33

20 Qq 23, 35–36

10. The Programme did lead to some improvements in the oversight of savings within departments, with efficiency teams reporting on progress to departmental boards. The departments which have made relatively better progress in making savings have been more innovative in redesigning processes and services. Nevertheless, few of the reported savings represent major departures from previous practice, and there was little evidence that suggestions from the front line played a significant role.[21]

11. Furthermore, individual departments have not taken full responsibility for making savings, as the above example of the Department for Communities and Local Government indicates. Circumstances change, but in reporting that it would not in fact make the planned savings, without being able to identify mitigating action, the Department did not demonstrate ownership of its own target. It is not clear whether this target was unrealistic or the Department has performed badly, nor what sanctions are available to the Treasury if departments under-perform.[22]

21 Qq 3, 19; C&AG's Report, paras 2.16, 3.13–14

22 Qq 28–33; Ev 12

3 Lessons for cost reduction

12. The next spending period will involve substantial cash reductions over the next four years in most departments. Previously most departments could redeploy efficiency savings to spend on services, but the need to cut total cash costs in future increases the urgency of making improvements in efficiency. With expenditure on most programmes falling, it will become more obvious whether departments have kept within spending targets, and there will be less need for a separate savings target. The key test of value for money will be whether departments are able to maintain services.[23]

13. Instead of headline targets, there is likely to be a greater emphasis on transparency with more information published to quantify inputs and outputs, which in turn is intended to lead to stronger public accountability and better decision-making. The Treasury aims to develop a structure that creates an incentive to free up resources for departmental priorities, but acknowledges that ways other than pay incentives will have to be found given likely pay constraints.[24] The Treasury argued that, while the measurement of efficiency was complex when budgets were increasing overall, clear spending allocations and falling baselines would simplify this task: it would be clear that costs had been cut, and it was a matter of testing whether service provision was maintained. However, there is clear evidence, for instance from police forces, that spending does not have to fall for efficiency to improve.[25]

14. The Treasury also expects improvements in value for money to come from the spending review, when the programmes with the lowest rates of return are cut. This may work for capital projects with a monetary rate of return, but requires metrics such as unit costs to measure the relative efficiency of services. While this can be done in areas such as tax collection, the multiplicity of objectives in some departments makes it very challenging to develop appropriate metrics.[26]

15. The experience of the current Programme shows that there are a number of challenges for departments in implementing cost reduction. The Programme focused departments on meeting their target at the expense of thinking more widely about how to improve value for money. The Programme has not resulted in departments working together effectively, with little evidence of collaboration. Departments will be more successful at making savings if they take value for money seriously at the highest level, and instil a culture of efficiency where people throughout the organisation are engaged in seeking improvements.[27]

16. Most departments did not plan changes which would take longer than three years to deliver. Having a long-term framework helps create an environment where real structural changes can be made with a longer-term pay-off and there is more opportunity to embed changes. International examples of savings programmes had longer-term plans even where

23 Qq 1, 24, 43, 46; C&AG's Report, para 4.1

24 Qq 18, 34–35

25 Qq 3, 18, 21, 40

26 Qq 24, 43–45

27 Qq 17, 19; C&AG's Report, paras 3.11, 4.2

lower savings were targeted. There is a risk that a long-term target means action will be deferred, but it is clear that the current programme has not created incentives for major change in most areas. Few, if any departments have made much progress in redesigning services despite being aware that cost reductions would be needed in the future.[28]

17. Departments also struggled to provide evidence of real savings where they were being delivered by the bodies they funded. The Treasury assumes there is capacity to drive up efficiency in front line services, but does not think central government should seek to influence how, for example, schools spend their money. Instead, the centre needs to design a system which creates incentives for improvements to be made locally. Even if such incentives are in place, performance data will also be needed to assess the impact of cuts to the cost of services.[29]

18. Where savings were made by departments themselves, information systems were not always adequate to support them. Better monitoring of efficiency will depend on improvements in financial management in future years. The quality of leadership and decision-making in departments, and the management of disciplines such as procurement, will continue to be essential to achieving value for money.[30]

28 Qq 41-42; C&AG's Report, paras 3.11, 4.3

29 Qq 20–21, 25, 35; C&AG's Report para 4.2

30 Qq 37, 45; C&AG's Report para 4.2

Formal Minutes

Wednesday 27 October 2010

Members present:

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon
Jackie Doyle-Price
Matthew Hancock
Chris Heaton-Harris
Rt Hon Mrs Anne McGuire
Mr Austin Mitchell
Ian Swales
James Wharton

Draft Report (*Progress with VFM savings and lessons for cost reduction programmes*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 18 read and agreed to.

Conclusions and recommendations 1 to 10 read and agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Tuesday 2 November at 9.00 am]

Witnesses

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Sir Nicholas Macpherson KCB, Permanent Secretary, HM Treasury	Ev 1

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Second Report	Delivering Multi-Role Tanker Aircraft Capability	HC 425
Third Report	Tackling inequalities in life expectancy in areas with the worst health and deprivation	HC 470
Fourth Report	Progress with VFM savings and lessons for cost reduction programmes	HC 440

Oral evidence

Taken before the Public Accounts Committee

on Wednesday 8 September 2010

Members present

Margaret Hodge (Chair)

Mrs Anne McGuire
Austin Mitchell
Nick Smith
Mr Richard Bacon
Joseph Johnson
Matthew Hancock
Jackie Doyle-Price
James Wharton
Eric Joyce
Stephen Barclay
Ian Swales

Amyas Morse, Comptroller and Auditor General, NAO, gave evidence. **Gabrielle Cohen**, Assistant Auditor General, NAO, **Keith Davis**, Director, NAO, and **Paula Diggle**, Treasury Officer of Accounts were in attendance.

Witness: **Sir Nicholas Macpherson**, Permanent Secretary, HM Treasury.

Q1 Chair: Welcome, this is the first time you have come in front of us as a Committee, so thank you for attending on what is a really important subject. What I think is at the heart of this is that, reading this Report as a whole and thinking about it, as you probably have too, leaves one concerned. If you look at us internationally, we have a pretty strong centralised system of government. We've also got collective responsibility within Government. I expect that you speak daily to all your Permanent Secretary colleagues; I know that you meet weekly. I also know that both the Chancellor and the Prime Minister at the time took this value for money exercise extremely seriously. Yet, as you read this NAO Report, what comes out is that Departments have failed to deliver; that we cannot properly measure whether or not they have delivered according to what was asked of them; and that the Treasury itself chose not to monitor in any very coherent way, so does not appear to have known what was going on. That leaves us, in the current context where we are going to be facing massive expenditure cuts, really sceptical as to whether you, as the civil service, can cut much more deeply in a shorter period. Over to you to try to tell me that I should have any confidence at all in it.

Sir Nicholas Macpherson: Well, thank you for that endorsement. I think it is a good time to be discussing this subject because we have entered the end game of perhaps the most demanding spending review in 80 or 90 years. You are absolutely right: this is critical. I would perhaps not be quite as negative as you in terms of summarising where we are. I think it is fair to say that central Government has been trying to run Government-wide efficiency programmes since the Gershon review in 2004. I should say that this was not the first Government to do that—there were lots of efficiency programmes under earlier Governments— but that was the first time under the Government which came to an end in May where there was an attempt to drive efficiency forward across the board. I think the Gershon approach was a good start; it got efficiency firmly back on the agenda. Not least learning from the relevant National Audit Office Report, we have tried to learn as we go along. The 2007 efficiency framework was stronger than the Gershon one—I am happy to go into detail and will no doubt be asked in due course. The National Audit Office, which rightly has high standards, refers to the 2007 framework being more robust and defensible, partly because it was more robust and defensible. I think it is fair to that it has been slightly less easy for Departments to claim that they have made progress; nevertheless they have made some progress. I think the Report makes a number of really good points. The challenge for us, and for you in holding us to account, is how we move this agenda, in the sense that this is going to be the third programme of driving forward efficiency. It is going to start with the advantage that it is actually going to be even more urgent than it was before. I cannot remember the precise figure, but the Report makes the point that, in the last spending review, the vast majority of programmes were still rising year by year in real terms. In this spending review the vast majority of programmes are going to be falling year by year in real terms. To use that cliché, there will be a burning platform against which Departments will be seeking to make progress. Do you want me to comment on the Treasury's role now, or would you like me to come back to that later?

Q2 Chair: Let's come back to the Treasury role. You can take endless paragraphs from the Report, but let me just take page five, paragraph eight as an example. NAO Reports by their nature are guarded are and polite, but if you look in that paragraph it says: "Departments have not . . . addressed the weaknesses we highlighted in previous programmes . . . These problems include the use of unsuitable baselines for the calculations of savings, a lack of transparency over arms-length bodies' reporting process and difficulties in demonstrating links

between savings and performance." You at the Treasury are the smartest guys in the public sector business—you are not running a small voluntary organisation or a parish council; you are running a £700-billion business—and you cannot get the basics right, and that is after NAO Report after NAO Report. It gives me, and I think probably the Committee, very little confidence as we move forward in a much tougher spending review environment. If you cannot get those basics right, how the hell are we going to actually produce the cash savings that are required by Government?
Sir Nicholas Macpherson: The first point I would make, is that you missed out the "fully" in "Departments have not fully addressed weaknesses", but I take your point: there are still weaknesses in the system and we need to drive those out. This Report will help do that. If you take the example of baselines, I think understanding of this has increased considerably over time. One of the criticisms of the Gershon process was that people were taking credit for efficiency savings which did not even fall in the relevant period and the baselines were completely unclear. What is striking in this Report, and in the series of Reports which underpin it, is that, yes, the NAO have identified a couple of areas where the baseline was wrong, but it is fair to say that the Departments in question—I am thinking in particular of the Ministry of Defence—were quite quick to put that right, which suggests to me that there is a desire to improve.

Q3 Chair: I have to come back at you. I could pick out on other quotes and there are other people desperate to come in, but elsewhere it says there is no lasting legacy—the value for money programme "has not made a significant impact on how Departments do their business." It feels to me a very amateurish approach. If the NAO had not done this Report we would not know, and I cannot see evidence of any preparedness for what is about to hit us. At the civil service level, it feels very, very, very out of control.
Sir Nicholas Macpherson: I understand the points you're making. What I would say is that one of the problems in the last two efficiency programmes was that spending was still increasing reasonably quickly, so the baseline from which you were calculating efficiency was, by its nature, quite complicated. For example, the approach which underpinned the CSR07 programme was to take the baseline, assume a certain level of inflation and then deduct what actually happened from that notional baseline. This is quite complicated stuff, and I think it's fair to say that in the next spending review period it is going to be a lot clearer, because spending is not going to be increasing; it's going to be falling. The best test of efficiency in that context is whether service provision is maintained or improves against the background of falling spending. There is a choice: either you can seek to drive a programme like this through targets with ever-increasing numbers of billions attached and assess performances against those targets; or, as I suspect the current coalition Government will approach it, you create an environment where Departments are very clear on the performance of their programmes by publishing performance indicators and ultimately leaving it to the public, to Parliament and to the National Audit Office to assess clear inputs against reasonably clear outputs. For every problem which this Report highlights, I think it is fair to say—the Comptroller and Auditor General can speak for himself on these matters—that there are also quite a lot of positive developments. If you look at some of the Departments that have been assessed to have performed best, they tend to be ones that are dominated by central Government as opposed to arm's-length bodies. They also tend to be ones which have had quite tough budget constraints, which have really forced innovation in terms of delivery.

Q4 Mrs McGuire: I hope you do not mind if I quote from when you were speaking at a seminar in December 2009 at All Saints College in Oxford, where you said that "the Treasury had changed in modern times" and that you had "embraced modern accountancy practices and had been reasonably successful in embedding better spending practices", yet we have a Report before us that identifies that there was a lack of robust data, that there was unsuitable baselines, there was a lack of transparency over arm's-length reporting bodies and that savings had not be subjected to sufficient quality control. How can you reconcile that statement in Oxford in December with the conversation that we are having here this afternoon?
Sir Nicholas Macpherson: The programme of improving financial management across Government has started from quite a low base. It is fair to say that for about 140 years, going back to Gladstone through to the early 1990s, all accounting in Government was done on a cash basis. The idea that assets might depreciate simply did not enter into the equation. The level of finance professionalism was low—I think that, as recently as six or seven years ago, only 38% of what were called principal finance officers, now called finance directors, had professional qualifications; now all of them do. These are quite big changes. In the private sector, professionalism moved way ahead; we are seeking to catch up. This is a long, hard march. I think we have made progress and I think that is reflected in the data we get month in, month out. It is also reflected in fewer accounts being qualified, and in accounts being laid more quickly so that the vast majority of accounts—nearly all accounts this year—were published before the summer. That is all progress but, as this Report highlights, there is still a lot more to be done. I am confident that we have got better financial management than we had five years ago; but are we at the cutting edge of financial management? Clearly not, and this Report will be a useful source of encouragement for those who want to push further and faster on this front.

Q5 Austin Mitchell: I find your answers vague and equivocal for what I thought would be a fine-honed Treasury axeman. I mean it is all, "on the one hand A, on the other hand, B" and we are trying to shine

a beam of light into a mud pool—that's what you're saying, essentially. Let's come down to the basics, how was this £35 billion figure fixed on and was it too large?
Sir Nicholas Macpherson: Underpinning the £30 billion was a view that it should be broadly possible to drive out efficiency savings of 3% a year across Government. There was also a view that you could take out even more from Departments' administration costs. My recollection is that, in broad terms, if you added that up it came to £30 billion. Subsequently, a couple of further efficiency reviews were carried out by the previous Government, which gave it confidence to raise that £30 billion to £35 billion. Obviously since this Government has got in, it has taken another £6 billion out.

Q6 Austin Mitchell: This is a triumph of hope over expectation, isn't it? Here you are taking expected efficiency savings, which are always a very vague concept. Any Government that is trying to show itself as efficient and economical says "efficiency savings" and they cover any sins. So you have added up possible efficiency savings that have not yet been made from the Gershon review, which in some respects was a fiddle, and then you have added £5 billion for luck and that's it.
Sir Nicholas Macpherson: No, I don't think that's fair. The Gershon savings preceded this programme and were calculated to have delivered £26 billion of savings. Those £26 billion savings were in the bag. The view was—

Q7 Austin Mitchell: But when we looked at the Gershon savings, some of those were fiddles as well. They also included disasters like the Rural Payments Agency, which made efficiency savings by firing staff, then came across a horrendous problem because it realised it had not got enough staff to deal with it, and started hiring them all back again.
Sir Nicholas Macpherson: Quite possibly, in the case of the Rural Payments Agency, although I think the problems with that were not just about getting rid of staff. There were also fundamental problems with the design of the system. I take your point that there were faults with the Gershon programme. Those faults were identified by the National Audit Office. They informed the design of this system—I will not bother reading out the tables which explain how it was improved, but the NAO acknowledged that it is a more robust and defensible framework. But I agree with you. It is always tempting for Government to come up with very large numbers. You get to a spending review or you have been increasing spending a lot and suddenly people begin to think, "Well, spending has increased a lot, what are we getting for it?" Historically, at that point Governments have decided that they require an efficiency programme. There is always a risk with Governments that they want to latch onto some large figure, which will sound quite good on the day—

Q8 Austin Mitchell: So you are putting the blame on Government?
Sir Nicholas Macpherson: No I am not.

Q9 Austin Mitchell: You are saying that Treasury did not give any advice on this issue; it is the Government's fault.
Sir Nicholas Macpherson: No, I am not saying that. I think the Treasury certainly supported and advised that an efficiency programme was a good idea. All Governments are rather better at presenting things than civil servants, so they tend to latch on to the big message. My point is that sometimes latching onto large figures—on the one hand it can provide a source of drive and ambition. If you have got a target it does concentrate the mind and I think they can be helpful as a pump-priming device; but over time, targets can give rise to a certain amount of cynicism—

Q10 Austin Mitchell: We clearly believe in big fixed targets. We also believe in virtue, motherhood and apple pie and all these other things; but Treasury is the sharp brains, you know all the tricks. I don't know the Treasury, but I've watched "Yes, Minister" and I can predict that there are going to be all kinds of fiddles in dates, in transferring people from one function to another, and in pushing all the sacrifices on outside agencies that the Department controls. They are going to fiddle it, aren't they? Treasury knew this. Why did you not set firmer and clearer parameters at the start of this process to prevent those fiddles?
Sir Nicholas Macpherson: What you identify is a genuine trade-off for the Treasury. When dealing with a programme like this, you can either set up some big unit in the Treasury which is going to interfere in every nook and cranny of every Department. It is a perfectly respectable model, but it is one that ends up with Departments claiming the Treasury is second-guessing them at every twist and turn. Or the Treasury adopts a different role, which is to be very clear as to what the parameters of the programme are, but then pin responsibility totally on Departments for fulfilling the objectives—in this case efficiency savings. Following the Gershon review, we did have a very big central unit. I am not sure it added a huge amount of value. This time around we stepped back a bit and took as our role defining what efficiency was, and as I say, I think the National Audit Office thought in broad terms that the definition was more robust that the previous programme. Then it is down to Departments. Now we can keep the score—

Q11 Nick Smith: When you said "a big unit", I think I read in the Report it was 30 people in the Treasury before.
Sir Nicholas Macpherson: The Gershon one started off in the OGC and I think initially it was 60 or so, and it got down to about 30.

Q12 Mr Bacon: Can I just pursue this very interesting point Mr Mitchell is making? If you are going to take the second of your routes—the clear parameters route—it then begs the question, which is raised at the beginning of paragraph eight, of why the Treasury did not require Departments to do certain things. If you are going to have clear parameters, then that is what you, the Treasury, need to do. For example, it says in paragraph eight, "Departments were not required to reconcile reported savings to their CSR07 spending agreement or to their annual audited accounts". Why not? If it is about definitions and parameters, those are very obvious things to require Departments to do. Why was it not done?

Sir Nicholas Macpherson: Well, in terms of the accounts one of the problems—

Mr Bacon: Or the CSR07 spending agreement. They were "not required to reconcile reported savings to their . . . spending agreement or their . . . accounts." I do not want to get sidetracked into whether it was the audited accounts. But there was no reconciliation required. You were talking about clear parameters and definitions, and making sure things are properly reconciled is surely at the heart of that, if you are going to go with your second model.

Sir Nicholas Macpherson: It is, and I think without running a central unit, the teams in the Treasury played quite a useful role in holding Departments to account. One of the problems with this programme was that, even with the best will in the world, you could not, in many cases, reconcile the figures to the accounts because the spending levels are rising year by year. As the Report makes clear, you could do it far more easily where Departments' budgets were falling.

Q13 Mr Bacon: Pedal backwards—I did say I did not want to get sidetracked into the auditor's accounts. They were not reconciled to the CRS07 spending agreement. That was not actually a moving train; it was an agreement that you had entered with them.

Q14 Chair: You had defined the parameters of what you would count as a VFM saving within that agreement and, however you take the figures, we have delivered so far probably 10% of the total £35 billion, not thinking about the £6 billion added to it. It beggars belief that the only Departments that have got anywhere close to it are the small Departments that spend nothing. If you look at the big Departments—Education, Health, Defence or Local Government, which is probably two-thirds of total public spending—they have done hardly anything. Something is deeply wrong in the way that the civil service monitors itself and works collectively together.

Amyas Morse: Chair, I think it is £10 billion not 10%, and we updated it to £15 billion, which is in fact about half, roughly speaking.

Chair: But only a proportion a year.

Amyas Morse: I am only saying, in case it goes into the record.

Q15 Joseph Johnson: But the Chair's statement was in relation the level of sustainable savings—11.7% on the numbers in the Report if you do the proportion you sampled of the proportion achieved.

Sir Nicholas Macpherson: The National Audit Office says that 38% of them are sustainable, so those ones are completely kosher, but around the next 44% there is some uncertainty. You are choosing to argue that some uncertainty means they're just rubbish. My understanding of the National Audit Office Report is that it is the 18% which are rubbish, which were overstated and do not represent savings. That figure is too high, and I recognise that suggests that we all have got a lot more to do.

Q16 Mr Bacon: I think we can agree that the uncertainty is uncertain rather than necessarily rubbish, but I still have not heard an answer to my earlier question. Why were Departments not required to reconcile reported savings to their spending agreement? It was an agreement with you. Why were they not required to reconcile those savings to the agreement?

Sir Nicholas Macpherson: I would argue that they did report to us. Subsequently the National Audit Office has argued that some of those reported savings are not robust enough. Where we are getting into a problematic area is this issue of reconciling it to the settlement. The fact is that there were these settlements; they were rising. Reporting various random efficiency savings against global figures in settlements does not tell you very much. In some Departments it works quite well. For much of this period the Treasury had a falling baseline; it was quite easy to reconcile it to the settlement because you could say, "Look, this is how much the Treasury is spending. This is what the counterfactual would have been if there hadn't been cuts". At the same time we could argue that the level of service the Treasury was providing was either unchanged or improving. It is not so much difficult; it is that reconciling spending to a rising baseline does not tell you very much. That is the point I am trying to make.

Q17 Matthew Hancock: In that case, was it wrong to put so much weight on that since, as you have just said, this process that you use is not valid? Was it wrong to put weight on the £35 million figure at all?

Sir Nicholas Macpherson: I think there are arguments both ways. Coming up with the £35 billion figure and allocating that figure out to Departments concentrates minds. I can remember that, for some strange mathematical reason, the Treasury had a target of £35 million. We had to achieve £35 million; I can remember that concentrated my mind. The more general point is that over time, if you just have a succession of what appear to be fairly random global figures, cynicism can set in and people can begin to game the system. One of the challenges with targets, and I know fashions change and Governments change and sometimes targets are in, sometimes they are out, but if you have targets for a long time people begin to focus on hitting the target, while missing the point.

Q18 Matthew Hancock: Is that what happened?
Sir Nicholas Macpherson: I am not saying it happened totally, but I think perhaps we've reached a time when targets can only take you so far. In the next spending review, we are going to have clear settlements which have falling baselines. It will then be rather more obvious whether Departments are achieving efficiency savings, because you can see whether service quality is being maintained, and assuming that it is, you can then see what has happened to the baseline against it.

Q19 Jackie Doyle-Price: I would like to take this debate a bit further on now to look at where there has been more and less success within particular Departments. Looking at figure six on page 17, we can see that there has been a very wide range of performance, from a reasonably good performance against the target by DEFRA and a very poor performance on the part of the CLG. From your perspective in the Treasury, what sort of evidence and behaviours have you found as to why some Departments have done better than others?
Sir Nicholas Macpherson: There are two things going on. First, the Departments whose bodies are the most devolved—I am looking at Education which, under this regime, is basically responsible for schools and the CLG which is responsible for local government—there is a genuine lag in reporting. I would not look at this figure and assume DEFRA must have been better at efficiency than Education; it may be, but it may not. I just want to make that caveat to begin with. Moving on from that I think it is fair to say that some Departments have managed to create a stronger culture in terms of how efficiency is embedded in the way that they do business. That may partly be because they have had to be doing it for a longer time, so Departments whose baselines have been falling for quite a long period, like Work and Pensions or Revenue and Customs, have had to make quite tough decisions around how they are going to deliver a service, or it may have encouraged them to be more innovative. Speaking from some experience, having spent my summer holidays filling in my tax return via the self-assessment online, this is one of the successes of HMRC and is a classic efficiency improvement. You can do it online, it is very user-friendly, it saves a huge amount of resource and it is more efficient than the days when a relatively poorly paid clerical officer at HMRC would have to go though it line by line. I recognise there are some other issues with HMRC which may not make today the day to—
Chair: I was going to say, I hope they find that we have paid the right level of tax.
Sir Nicholas Macpherson: To be fair to them, all they are doing is maintaining the PAYE system that has stood the Treasury in very good stead since 1944, but is more difficult to work when people are moving jobs so often. Coming back to what makes a Department efficient. The first thing is just taking efficiency very seriously and embedding it in the way you do business. It is not some game; it is not asking your finance function to fiddle the figures at the end of the year to keep the Treasury off your back. It is about embracing it, setting up structures within your Department, ensuring that senior management really own it, it is part of their objectives and their success is measured against achieving progress on efficiency. I think it is also—it comes out in the Report in one of the criticisms of the programme—that the programme did not involve the so-called front line enough, which is also relevant. People throughout the organisation have got to own efficiency. Sadly, it is a slightly dry area which people associate with cuts and it is quite difficult to excite people about this, but it is about ensuring that this is not just a top-down exercise where the Treasury says, "Right, we're going to do this," but there is a bottom-up process, where people right across the organisation are really engaged with a view to coming up with ideas. You all know far more about this than I do from your dealings with your constituents; people do have ideas about efficiency—indeed the Treasury website got 100,000 of them. Alongside ones like putting crocodiles in job centres, there are some really good ideas.
Chair: I am going to move you on because there are a lot of people. James is going to come in, but I just want to make two comments on what you have said so far. First, I do not think that it is good enough for the Treasury to say that there are all these other big Departments; somehow there is collective responsibility and what comes out of this Report is that all these Departments are failing to deliver. The other thing I want to say to you, I find it deeply depressing that the only time Departments will take value for money seriously is if you cut their bottom line. That might be a civil service view; I certainly think that when we were Ministers, it was not our view, and it is very depressing to find that the civil service takes that view—it is only when you get the cuts to service that you start thinking about value for money. I take that as comments and I am going to pass to James, who has been desperate for a question.

Q20 James Wharton: You will be relieved that I do not want to explore further the idea of putting crocodiles in job centres. I was struck by the departmental variance that was thrown up in the figures we have seen, and Jackie has touched on the difference between DCLG, which is down below 5%, and DEFRA, which is up around 60%, even before you look at qualitative issues. Within that, the approach that different Departments take is something that I would like to explore a little bit more. My concern is that, particularly now that we are entering a time when Departments are required to find savings that are somewhat more significant than they were when this was brought in and value for money was being implemented, one of the things that the Report has identified is that around 50% of the savings are where central Departments are pushing their savings down to the bodies that they then fund—effectively, what we might term as front-line services—rather that the Department finding efficiency itself. What is the Treasury doing to try

and control that tendency of a Department, where it needs to find a saving and just pushes it onto somebody else's budget.
Sir Nicholas Macpherson: The point about the 50% is partly a function of where public spending takes place. A huge amount of spending takes place at the level of schools, local authorities and hospitals. I do not think it is fair to say that savings have been pushed down to the front line disproportionately; if anything, the reverse is true. Some of the central Government Departments have had some of the biggest cuts, and in that context I would mention both the Department for Work and Pensions and Revenue and Customs. There is an interesting question about whether a central programme should take credit for savings in schools, and the Report makes some good points about that, relating to how much to devolve and how much you centralise. I do not think you can leave schools and so on out of the equation.

Q21 James Wharton: Within the context of the lessons you are drawing from the value for money programme, what have you learnt that the Treasury can do going forward, when we are looking at future spending decisions, to mitigate the impact on frontline services and the actual things that people see and our constituents come and talk to us about, and ensure that central Departments take their fair share of the difficult spending decisions that we are heading into?
Sir Nicholas Macpherson: Successive Governments have attached a very high priority to protecting and improving service delivery. Our starting assumption is that it is the intermediate tiers and the headquarters which should be reduced the most, and there are two reasons for that. One is that they are a source of cost in themselves, but also they are a potential burden on the services themselves. The more bureaucrats you have in Whitehall, the more they have to justify their activity by, for example, requiring libraries to have a library plan. It must be a priority to reduce the size of the civil service and the headquarters function of Government. On the whole I think those parts of Government have been reduced more, certainly because the Treasury has more direct control over those as it is possible to keep a better control on thing like pensions and wages. I think that should be the priority, but equally in determining the settlement for local government, schools and so on, you have got to assume that there is capacity there to drive up efficiency. The question then is, should central Government hold schools directly to account? I think not, because that changes the fundamental relationship between the central Government Department and the devolved body. If I may come back to the Chairman's point very briefly, I do not accept that I said that you can only get efficiency by cutting budgets. I think it is easier to measure it sometimes, but as this Report sets out, there are a lot of areas, in particular the police, where there have been clear efficiency improvements against the background of rising spending provision. I do not want you to think that the Treasury institutionally thinks that increasing spending is pointless and can have no effect on anything. That is simply not the case.
Chair: I was reflecting what I thought were your words, which were that if budgets were going up it was very difficult to get value for money savings out of it.

Q22 Joseph Johnson: Can we just turn to the measurement and reporting of savings? A casual read of the NAO Report makes it seem as though the Departments have been pulling the wool over your eyes—they have been reporting savings which in reality are not there. I am concerned that the Treasury was not more alert to this going on. The NAO Report states quite clearly that 18% of the savings did not represent or significantly overstated savings and that only 38% were sustainable, with this great amber area—44% of the savings—where we do not know either way. I am just worried that the Treasury lost track of what was going on.
Sir Nicholas Macpherson: I do not think the Treasury lost track of what was going on, but an 18% red figure is not one that I am hugely proud of. I would like to see a lower figure than that. One of the problems we are dealing with here is that you are looking at this massive programme which is designed on the basis of some fairly rough and ready assumptions around what the baseline is. I was explaining earlier about how the baseline was constructed by attaching an estimate of inflation to spending in the initial year. It has been quite difficult to nail down efficiency given the definitions used here. On the plus side, the National Audit Office acknowledged that this was a more robust programme that its predecessor, which followed on from the Gershon review. We set the bar a lot higher in terms of quality of reporting, and what this study shows is that we have failed, against this more demanding bar, to make as much headway as we would have liked. There is plenty of room for improvement.

Q23 Chair: What is going to change? What are you going to change?
Sir Nicholas Macpherson: I think we are going to change quite a few things. Coming back to the issue Mr Bacon raised, we are setting up a new efficiency reform group in the Cabinet Office, which is going to play a critical role. It is going to play a role in holding Departments to account but it will also be a source of expertise in terms of encouraging more sensible approaches to bulk procurement, say. One of the problems that the Treasury has incurred in running this programme is that, on the one hand, the Treasury's role is to control and plan public spending, but it also has a role in ensuring that there is some measurement of the output which the spending on the services gives rise to. When you then bring efficiency into the equation, the Treasury can play a reasonable role in some of the measurement issues, but once you get into quite deep, arcane, areas around delivering public services, there is a benefit I think in having a source of expertise which is not in the Treasury. This is something which, over time, has

either been in the Treasury or the Cabinet Office; it was in the Cabinet Office in the 1990s and then the Office of Government Commerce was created. On the face of it, the efficiency and reform group looks like an exciting development. They have recently recruited Ian Watmore as their new chief executive, and he has a background in running large projects. I would hope that a partnership between the Treasury and the Cabinet Office may result in better outcomes next time.

Q24 Eric Joyce: Sir Nicholas, can I just ask you something about targets? You characterised targets earlier as "pump-priming devices" and said that they "concentrate the mind". Whether there is a rising or reducing baseline, would it be fair to say that is their primary function and that of themselves they do not actually have any meaning?
Sir Nicholas Macpherson: Targets?
Eric Joyce: Yes. For example, at the moment the Government has set its own new target which is higher than the previous Government's target. Under the last Government's target, we made savings substantially below what we had hoped—not to put to fine a point on it—so in essence, when the Government sets a target, it is of itself not a meaningful statement; it is simply something that concentrates the mind. Would that generally be the Treasury view?
Sir Nicholas Macpherson: That is quite a deep question. I do not think that there will be a single Treasury view. One of the lessons of the last decade is that you have got to approach targets with massive discipline. There is a risk that you create targets for everything, and the more targets you have, the more people responsible for delivering them become cynical and slightly detached from them. All sorts of business school analysis suggests—I am sure Amyas would know more about this than I do—that once you get beyond having more than five or six objectives no one can possibly measure performance against them and people lose interest. You have got to be focused. When you want to create a step change, you need to administer a shock to the system, and against a background when spending was increasing, targets had a perfectly respectable role to play in that that context. Obviously when spending is falling, you are going to have your work cut out to maintain and improve services anyway, so perhaps targets are less relevant. The problem with targets is their proliferation. It is always tempting to announce a new one. I have seen Chancellors from both political parties come and go. Occasionally they have had one or two targets, like getting the basic rate of income tax down to 25p; sometimes they have had 20. I think you have just got to be quite continent. The basic problem for Government is that, for a company, there is only one target which is the bottom line; it is about profit, earnings per share, which you can monitor and you can hire and fire people on that basis; with Government, for all Departments you have a multiplicity of objectives. Obviously where you can marketise things, that can help drive performance where there are very clear metrics of unit cost—for example, the amount of income tax brought in compared to the amount or people employed to bring it in is quite an obvious metric. But if you take something like the Treasury, which has a multiplicity of objectives, it is actually very difficult to measure output in a way which can really help drive performance. Sometimes targets can help, but I do not think they are a sustainable way of driving performance year after year.

Q25 Eric Joyce: I was just thinking of the one target of £41 billion. Should we regard that as something that should just concentrate the mind or is it something meaningful?
Sir Nicholas Macpherson: The spending review will determine whether there are any targets at all. On the whole, this Government has made clear that targets are not their preferred way of driving performance. They have taken the view that transparency is the best way of driving performance. We will see how the precise mechanics of that play out in the spending review. I am not aware that this Government is seeking to drive performance on efficiency through targets; in fact it is rather the contrary. At the moment, performance is being driven by the fact money is being taken out of your baseline, so you have got to make some decisions to live with it.
Chair: I want to bring in Stephen, but I have just got to pull you up on that. If you are going to cut spending, you must measure the impact it has on services. It is crazy not to. I am not sure what you would call it, but we in this Committee will be watching the cuts in spending and the impact it has on services. I am assuming you, the Treasury, and the Government are developing some mechanism to enable us to do that—or the NAO will have to assist in that. Certainly the NAO is providing a framework, part of which will be, if you cut *x* what impact does it have on front-line services. I bring in Stephen again; you may want to comment on that.

Q26 Stephen Barclay: You mentioned a moment ago setting up a new group to hold Departments more to account, but appendix 2 suggests that the NAO reported in 2006 that "The central challenge function within the Treasury has been reduced" and "Savings continue to be insufficiently challenged". The Commons Treasury Committee in 2007 also said, "We recommended that the government ensure that a coherent framework for the verification and reporting of savings is established." Why would you not take more heed of those recommendations?
Sir Nicholas Macpherson: We did take heed in some important respects. One of the criticisms of the Gershon programme was that Departments did not own it sufficiently. The risk is that the bigger the Treasury role, the more the centre of Government second-guesses Departments, the less the Department owns the challenge. If you are working in a Department and it feel like things are being done to you, your main objective is just to feed the centre whatever will keep the centre quiet.

Q27 Stephen Barclay: Taking that then, previously you were saying that it was for the Departments to own. You are saying at the time, previously in the

last few years, the Departments were owning this, this was part of the objectives for the accounting officer. If you turn to figure 6 and we look at, as was referred to earlier, the Department for Communities and Local Government. If they were owning that, what has happened to the accounting officer for that Department? Have they been promoted to be the top civil servant in Scotland or are they being managed in some way? What I am driving at is: how are they held accountable? How are they owning that target?
Sir Nicholas Macpherson: As I said earlier, I do not think you should read too much into the DCLG figures. They are reporting with a greater lag because of their responsibility for local government. Let's take in abstract—

Q28 Stephen Barclay: Can we take that in specific if we can, because you also said earlier that was actually due to a time lag. If one looks at the element as to whether it is a time lag, in the "Department for Communities and Local Government Core Financial and Performance Tables Report" of July 2010, it says, in explanation of why it has only achieved £40 million of the target of £987 million; in note 2, "There continues to be a considerable risk that the Department will not achieve the planned affordable housing saving", which is the majority one—£734 million of the initial £887 million. It is saying that even in July 2010, not that there was a time lag, but that because of the housing market, it was unlikely to achieve its target and it is reporting at the halfway stage that zero savings had been made. It is further reporting that for the reduction in costs for running the Department, its target was £43 million and it had made zero savings. It is actually saying it is not about a time lag; the Department was not expecting to deliver this.
Sir Nicholas Macpherson: If you are asking what does the Treasury do if it feels a Department is underperforming, I would prefer not to get into individual specific cases.

Q29 Stephen Barclay: I am trying to understand the element of oversight. Was it that the Department were owning this and did not perform, but they were not held accountable; or that it was a lack of oversight from your central team, and you are saying, "We did not have the central oversight. We ignored the earlier recommendations because we relied on the Department to own it—and they did own it. It is just a time lag in the data, and that is why we are not there."
Sir Nicholas Macpherson: I do not accept your premise that we chose to ignore it. Conversations around efficiency tended to take place between individual Treasury spending teams and the Department rather than through some separate central unit. Where the Treasury has concerns about the performance of a Department there are a number of ways of trying to change things. The previous regime had a programme of departmental capability reviews and the Treasury would make it very clear if it did not think much of Department X's finance function or approach to efficiency. If there is a view in Treasury that the permanent secretary or the accounting officer of the Department is failing to promote the efficiency agenda, that will be fed into the—

Q30 Stephen Barclay: They are not saying that, are they? They are saying it is out of their control and due to the downturn in the housing market. The irony is that the Governor of the Bank of England was saying on 26 June 2008, in response to a question on this, question HM, "Governor, if you were to sum up how you think the housing market will be in the next 12 to 24 months, what message do you have publically here?" Mr King: "It is very difficult to know, it is very, very hard to judge". What I am driving at is you are setting a target—£734 million of an £887 million target. Subsequently, when that is clearly off track, you are increasing that target by a further £100 million, and you are saying, "There is a time lag, so there is a potential they will deliver that". Yet back in 2008, when this target was being set, the Governor was saying, "We cannot rely on that criteria." So what did you know in the Treasury that the Governor did not know, because clearly this target was only going to be delivered subject to house price movements?
Sir Nicholas Macpherson: There is no point in me trying to give you the detail of this particular case because I do not have the information at my fingertips. If you want to understand the background to the target, I would be happy to write to you.[1]

Q31 Chair: Some principal things that are coming out of that. There is a target established by a Department, they then say they cannot reach it, Government increases it and they never get there. Are we writing off the value for money in DCLG under this programme?
Sir Nicholas Macpherson: There are two things here. One is, do changing circumstances make you miss targets? Clearly they do. The Treasury used to have a target for fiscal rules and on many bases it missed those by huge amounts. That reflected world factors and no doubt reflected the Treasury, too. Circumstances change. The next issue is: what determines changes in a target? If you are saying that you think the Treasury made a fundamentally wrong judgment in changing a target given the circumstances, I would happily come back to you to explain.

Q32 Chair: Have you written this off?
Sir Nicholas Macpherson: I have not got sufficient detail in front of me to tell the answer to that question.

Q33 Stephen Barclay: I was merely asking whether it was a lack of oversight from the Treasury that is at the root of the issue; whether it is that the target was never realistically achievable or within the gift of the Department because they were reliant on other factors; or whether it is actually the fact—you were the one that used the phrase, "We are ensuring that

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senior management own the objectives"—that the person that was owning them has just been promoted. I am trying to establish where responsibility lies. Even the £40 million that they do report as savings is relating to the Fire and Rescue Service, and the NAO have produced Report 285, which is pretty damning and flags that the whole board of Firebuy Limited has just been fired; that the Department established an arm's-length body which was flawed; the procurement was unnecessary and expensive—it goes on and on. People can read it for themselves—it is set out in paragraphs four, five and six. And that is the only £40 million that is reported at the half way stage. Clearly something has gone wrong either with the setting of the target, with your oversight, or with their delivery, and it seems a little unclear to me where responsibility sits.
Sir Nicholas Macpherson: As I said, I would be very happy to come back to you with a considered answer to that question.

Q34 Matthew Hancock: I want to talk about the future because we have heard and read the Report about how you improved between Gershon and the CSR07. We have also heard about some very clear flaws in the CSR07 plan and how it was delivered; they are in the Report too. I think what most of us are worried about is the future and the fact that we are about to go into an absolute corker of a spending review. There are two questions I want to ask. The first is that you have talked about the Treasury getting into every nook and cranny versus letting the Departments do it for themselves, which could be the command and control against an incentive-based structure. You said you had made a bit of a change from Gershon to CSR07 on that. How much of a change have you made in terms of the next one and do you think that will work?
Sir Nicholas Macpherson: I think where we are heading goes with the grain of evolution. First moving to a more transparent framework, in terms of trying to publish more information both on inputs and also, I would assume, outputs, is going to create stronger accountability. This has been already seen in a number of areas and some of which goes back to the previous Government—simple things like publishing people's salaries and their expenses and so on doesn't half concentrate minds. I recognise that can cause problems, but transparency actually encourages better decision making, so there's that.

Q35 Matthew Hancock: What do you mean by, "there's that"? That is a change? How much of a change and will it help?
Sir Nicholas Macpherson: I think it will. The critical thing on this is to get the balance right. It is how you translate data into information or information into data—I cannot remember which way round it is. It is trying to come up with some metrics that actually bite—that's the first thing. There are some things which enable comparison across Departments and programmes—common metrics on how big is the HR function, in proportion to the unit of delivery, how big is finance division and so on. Then there are things which give you assurance around efficiency—that is going to be important. I think the incentive regime is about what actually motivates people to drive efficiency through? Pay incentives play some role, but quite frankly there is not going to be that much pay around, so I think we have got to try and develop a structure that rewards people who are doing the right thing and freeing up resources. I think the most rewarding thing for many public servants is being able to free up resource to spend on things which management within the organisation and the people who work there think are priorities. The third thing comes back to the efficiency and reform group, which I think is important. There are some things which you should just devolve. I do not think central Government should be seeking to influence how schools spend their money. Even if the central Government is right, by the time it had passed a message through various intermediate stages, the world would have moved on. You cannot just run things from the heart of Whitehall. But there are some things that should be run very tightly from the centre, so you can mandate things like procurement of commodity bulk goods. You can lay down the law on recruitment freezes in the civil service; you can look at IT projects in the round. This was my point earlier: the centre can only do that if it has a credible group doing it. I think historically Treasury, when it has got a clear spending constraint to impose, is pretty good at controlling spending. What Treasury is less good at doing is credibly telling people how to procure goods. Historically when the Treasury had an internal procurement unit it was regarded as pretty second-rate. The challenge of the role of the centre is to create a centre of expertise which can genuinely add value and where the centre can make a difference. Again, I am not claiming that the world changed overnight following the election—under the previous Government the Office of Government Commerce was an important step forward in managing procurement, projects, property and so on—but I think the group which has been set up in the Cabinet Office takes that one step further. In the fullness of time, when I am called back to account for performance on efficiency I would hope that you would call me and Ian Watmore, because I think the Treasury and the Cabinet Office working in partnership are a lot stronger than when they are working on their own.

Q36 Matthew Hancock: Is what you have described is what we have read about as the tight-loose approach to the centre's control?
Sir Nicholas Macpherson: It is. I think it is known in the trade as tight-loose. It is not an expression I find trips off the tongue, but I understand why people find it attractive.

Q37 Matthew Hancock: The second question I want to ask is why so many things went wrong, no matter what the direction of travel. You have accepted the 18%, where the Treasury did not seem to know where the money went, and some of the other examples that we have been talking about. Why did it go wrong and why could only £15 billion savings after two years be identified, even on the Departments

basis? Is that because there was not the will to it? Is it because the number had been plucked out of the air without any thought about how to get to it? Why did it go wrong and why have we got such a negative Report on the £35 billion attempted savings?
Sir Nicholas Macpherson: I do not accept it is a totally negative Report. I think there are some positives and there are some negatives in it. What you are asking is why is there—
Matthew Hancock: Yes, because if we are going to improve in the future we need to understand why it went wrong in the past. ***Sir Nicholas Macpherson***: I think for both Treasury and Departments—again Chairman I do not want you walking away from this meeting saying that Treasury is blaming Departments and abdicating responsibility, I think we are all responsible—this has been, in a sense, a journey. Coming back to things like financial management which are absolutely critical to this, I think we have made progress on financial management but there is a hell of a lot still to go. I was mentioning earlier that we have got more professionalism, but the data underpinning a lot of the financial systems is still not nearly good enough. One of the things which this Report highlights, and actually comes out in a lot of other Reports the NAO have been doing that will be relevant, such as structured cost reduction, is that we need to achieve far better data and have far stronger financial systems. There is an agenda to improve that.

Q38 Ian Swales: I have a specific question: to what extent have external consultants been involved in all of this programme, both in the Treasury and in the Departments?
Sir Nicholas Macpherson: I think they have been involved, but with the passage of time, we are trying to do rather more of it ourselves. Consultants can only take you so far, and it is very important that you should really employ consultants only where it is genuinely cheaper to bring people in on a temporary basis to help you with something, then seek to build up that capacity in house. To use the example that I have used in this Committee before, on the whole, if I need legal advice—if I am taking over a bank—there is no point in having in-house investment bank capacity in the Treasury; you want to buy that in, and that makes sense. It may give rise to a large cost. But I think consultants can give you some assistance. If this programme is going to deliver on efficiency, it has got to be embedded in the civil service. You cannot just buy in financial management; it has to be owned by the board of the Department.

Q39 Ian Swales: Sorry can I just do a supplementary on that? Have you got the balance right? Have you got the people who are actually coming in and asking the difficult questions? A lot of people say you should not have consultants, but actually there is a reason why they exist, and is because often because people do not ask themselves the difficult questions. Have you got the balance right?
Sir Nicholas Macpherson: I think the balance is broadly right, but it is very difficult to get wholly right. For example, at the moment there is a notion that targets help create ambition; there has been a presumption you do not employ consultants at the moment to try and get a step reduction in costs. I think it is a good thing to do but I would hope, in the medium term, Departments could be trusted to allocate their budgets in a way which is sensible. The centre can have a role in utilising consultants as necessary and I remember the original Gershon review was supported by a mixed team at the Treasury under a guy called Paul Kirby, who I think had been at the Audit Commission and then moved to KPMG. You can have a bit of mixed economy sometimes; you do need access to new ideas.

Q40 Amyas Morse: You are talking about the way ahead. I wanted to see if I had understood this properly, so forgive me for intervening. I get the impression, when you are talking about CSR07 as being adjusted, so I am seeing the mechanism as the total amount of affordable CSR which will deliver the target, and that is how much CSR will be allocated to the Departments, so they will get a reduced CSR and then it will be up to them to demonstrate how they are going to deliver the services in that more constrained budget. Is that the basic mechanism?
Chair: A yes or no to that, as I am then going to take you on to Nick.
Amyas Morse: I am just trying to be clear, is that how it is going to work?
Sir Nicholas Macpherson: Broadly, yes.

Q41 Nick Smith: Two quick questions from me. On page 29 of the NAO Report, they say comparable cost reduction programmes in other countries have been planned over a longer time period and could lead to bigger savings. I say that knowing that we have been asked to make larger savings than last time in a shorter time period. Secondly, how can you make sure that, in the future, Department reports on savings stand up to external scrutiny? This comes back to the point that Stephen was making about the housing element of the CLG Department Report. These Reports really have to be open to scrutiny; how are you going to make sure that happens in the future?
Sir Nicholas Macpherson: On your first point on international programmes, there are lessons that we can learn from them and there has been a lot of interest across Government in what has happened in Canada. To put it in perspective, I think the scale of the programmes which have been pursued in Britain are altogether greater than in Canada and France. I know this Committee rightly wants to focus on where we can improve and has argued that we are all pretty useless, but in terms of international practice, Britain is usually seen as being up there as the most innovative, and people come here to ask us how we run these programmes. I do not want to overdo that, but I do not think there is a massive amount we can learn from these other countries. Interestingly, if you talk to people who actually work in Canada—this picks up with some of the earlier points—there is a general sense that most of the problems were just devolved to the provinces. Central Government cut

programmes, cut grants and then retreated from the field. Your second point, on the precise framework—

Q42 Nick Smith: Just going back to your first answer, you do not think that longer time frames are useful and it is different in other places too?
Sir Nicholas Macpherson: I think it is important to have a long-term framework as well as a short-term one. There is no point deferring your difficult decisions to 10 years' time; but equally, as noted in the Report, you want to create an environment where people will take decisions which deliver savings not just in the short term, but will make real structural change, which may have a bigger pay-off down the line. I think the Report overdoes this. Anybody who worked in Whitehall in the last few years knew that resources would be hard to find. That is not a political point—whoever won the election, we were heading for a pretty tough spending review and Alistair Darling acknowledged that as much as the current Chancellor. I think in the back of all our minds, we have all known that we have got to take those long-term decisions. To pick up on your point, the benefit of long-term programmes is that you are more likely to have more coherence, and it does take time to embed things in Whitehall, and it is always tempting to change programmes too often, too quickly. Wherever we move to next, I hope that it will be a framework that stands the test of time because that is what actually strengthens financial management and the approach to efficiency.

Q43 Mrs McGuire: Thank you. I feel we have meandered round the Treasury and what I have not got a sense of is what lessons you have taken out of this value for money Report as to how you are going to manage the next period, which as you have said and which we all understand, will be a less benign financial structure for the delivery of services. Given the fact you have said that there is now more professionalism in the Treasury—I think there is a question about where we recruit Treasury officials and whether they should be civil servants or come from other backgrounds—what are you doing now to look at value for money within a less benign financial situation than the one that you have found yourselves in and that has provoked this quite critical Report?
Sir Nicholas Macpherson: I think we are doing a number of things. The spending review process itself will tend to improve value for money. The spending review is the context where the big decisions on allocative efficiency take place. Inevitably, Government will pull out of some areas as a result of the spending review. The challenge is to pull out of the right areas. That is the first fundamental point in terms of this agenda. The second point then is about how we monitor efficiency in the coming years. Now, to pick up on what I think was Mr Bacon's earlier point, I am far more confident that it will be possible to monitor efficiency against accounts and the published baselines—indeed we are keen to learn lessons from this Report in doing that. The fundamental point is one which I suppose I keep trying to make but I do not think I have managed to communicate very well. Let's take the example of the Treasury. If the Treasury's resource was cut by a third and if over the next three years, through public performance indicators, I can prove that the Treasury has at least maintained its performance, that the public finances are on track, public spending is under control and the banking system is generally working, I think it is reasonable to argue that with a 33% cut, we may have made a 33% efficiency gain.

Q44 Mrs McGuire: Can I just come in? I think we are actually getting the two things confused here. Value for money is not necessarily about political decisions to cut certain programmes which may in themselves be valuable. I feel that there is a bit of wool being dragged across the discussion, or a red herring, whatever analogy you want to use here. There are decisions that are made in the political context of a Government and there is value for money and I do not frankly think the two are interchangeable.
Sir Nicholas Macpherson: They may not be interchangeable but they relate to each other. I think there is something—

Q45 Mrs McGuire: I think there is a relationship, but with the greatest respect, I fear you are trying to relate the two in a way that does not address some of the issues raised in the value for money Report.
Sir Nicholas Macpherson: Can I take one very simple example of why I think this relevant. I take your point that it is alongside value for money. Let's take the allocation of money for capital projects; if the Treasury could take every single capital project which Departments are bidding for in the spending round and work out what the rate of return on that project is and then rank all those projects, then there will be greater efficiency in terms of the allocation of capital than there would be if the Treasury did not make those calculations and just handed out those resources on the principle of political strength. I do think allocation of resource matters, and I accept that is something which is intensely political and should not be a matter for officials. Officials should inform that debate; Ministers have got to decide how resources are allocated, but I do not want to lose sight of it because allocative efficiency is part of value for money. The National Audit Office makes clear that this programme did provide for getting out of low-priority areas. Sometimes you are doing some activity and you realise you are only doing it because a decision was made 10 years ago that this was quite important, but the world has moved on and you no longer need, in the case of the Treasury, to have a very large overseas aid team. Having said that, I do recognise that a lot of these things around value for money and efficiency are not political decisions; they are about the quality of management and leadership in the Department, the quality of decision making, financial management and procurement and so on. That has got absolutely nothing to do with politics. Whoever the Government is you want to see those things done well.

Q46 Chair: Can I just come back to you on the general themes to bring the meeting to an end? This Committee would love to have a Report before it which praised the way in which a particular part of Government was delivering a particular service. It is not in our interest simply to be critical. I think we have made that clear and one of our Reports coming out soon will demonstrate our confidence in the change that the Government has made in relation to one particular area of administration. So we are not in that business. However, we have to deal with what is there before us. I think what the discussion has shown and what I feel comes out of this—perhaps you can end on this—is that value for money means maintaining the same quantity of direct service to the public, but delivering it for less. It is not a question of prioritising which services you choose to deliver, and it is not a question of cutting. This is not a particularly partisan question, but I think that what this depressingly shows is that when Government attempted a value for money exercise—i.e. carry on delivering services but deliver them for less—the bureaucracy was unable to deliver. So when we come to the future of how we are going to deliver these financial cuts, it looks like the only way we can do it is by pulling out of delivering services to the public. That is deeply depressing for me in reading out of this Report. If we had been able to find 3% efficiency savings year on year as was required under the value for money programme, the pain of the future cuts would be far less on the public, but that is not where we have got to. I do not know what you feel about that. That seems to be the kernel of where this takes us: it is going to be cuts in services, rather than greater efficiency in delivery of services.

Sir Nicholas Macpherson: I totally agree with you that the country needs to see better value for money in its public services. I think this programme has made some progress, and for every bad story there is a good story. I am not as downbeat as this Committee, but I would agree with you: we need to make further progress still. I think this is a helpful Report. We have to build on it and you have got to continue to hold us to account because your role is really important.

Chair: We look forward to praising you. Thank you.

Supplementary memorandum from HM Treasury

In response to your questions at the PAC hearing on 8 September 2010, this letter provides further clarity on the Department for Communities and Local Government's CSR07 Value for Money programme.

Departmental targets were negotiated on an individual basis between departments and the Treasury. A 3% reduction in the resource element of Departmental Expenditure Limits was used as the starting point for negotiations across government.

The Department for Communities and Local Government (CLG) published their initial efficiency plans in its CSR07 VFM Delivery Agreement in January 2008. In the document CLG described how it planned to make savings and the risks associated with these initiatives.

The majority of CLG's CSR07 VFM savings were due to be made through the Affordable Housing Programme through reducing the unit cost of subsidizing affordable housing. These savings were dependent on a number of factors including cross subsidies from the wider housing market and continuing increases in land values. The risk posed by falling land value to CLG's VFM programme was acknowledged in the delivery agreement. At the time of publication in January 2008 these risks were judged to be reasonable. Over the course of the CSR period there was a major downturn in the housing market, driven by global events, so this risk was crystallized.

As a consequence a large part of CLG's planned efficiency savings became undeliverable on the timescale envisaged.

From the start of the CSR07 period the Treasury monitored departmental savings internally both through the priority projects process and via contact between officials. By monitoring departments externally and internally, my officials have been aware of the challenges they faced. The issues surrounding CLG's savings were identified at an early stage, once the housing market downturn started, and CLG and Treasury officials worked closely to explore he scope for mitigating action, which in this case was limited.

The responsibility for delivering each department's programme rests with that department. From my appearance before the Committee, I know you find this frustrating. The Spending Review next month will provide a new opportunity to review the performance regime associated with public spending, and the balance of responsibility between the Treasury and Cabinet Office on the one hand and service departments on the other.

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