National Audit Office

Report
by the Comptroller
and Auditor General

Cabinet Office, HM Treasury

Central government staff costs

HC 79 SESSION 2015-16 5 JUNE 2015

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Report by the Comptroller and Auditor General

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

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This report examines departments' progress in reducing staff costs and numbers, and how the centre of government is influencing the speed and direction of change.

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Contents

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Key facts

£11.13bn
annualised salary cost of civil servants, as at 31 March 2014

405,000
civil servants in post (full-time equivalent), December 2014

£2.49bn
net reduction in annualised salary costs (real terms), 2010 to 2014

18%	reduction in civil servant numbers, March 2010 to December 2014
£2.29 billion	cost saving from headcount reduction (main part of the £2.49 billion net decrease), 2010 to 2014
£191 million	cost saving from changes in average salaries (secondary part of the £2.49 billion net decrease), 2010 to 2014
£292 million	additional annualised salary costs from changing the grade mix of staff, 2010 to 2014
5	expert services that Civil Service Human Resources runs for departments

Summary

1 In 2010, the world economy was in recession and the UK faced its own financial crisis, with the government posting its highest-ever budget deficit in 2009-10. The coalition government announced that a main priority would be to control the government's finances, including public spending.

2 A substantial proportion of public spending is for human resources: staff directly employed, with temporary staff paid directly or through agencies, and consultants paid through firms. In 2013-14, the public sector workforce of 4.4 million employees cost £164 billion, representing 23% of the total public expenditure. The civil service accounts for 9% of the workforce (405,000 people in December 2014).[1] In the 2010 Budget, the government clarified that a key part of its fiscal policy would be to cut staff costs to help reduce the deficit. However, we concluded in 2011 that departments did not have a structured approach to reducing staff costs.[2]

Our report

3 This report examines:

- how far departments have reduced civil service staff costs and how they have done so (Part One);
- whether departments are managing their workforces strategically to make sustainable reductions (Part Two);
- how the Cabinet Office, HM Treasury and Civil Service Human Resources are supporting staff cost reduction (Part Three).

4 We analysed data from the Office for National Statistics and departments' resource accounts. We looked at workforce planning in four case study departments: HM Revenue & Customs (HMRC), Ministry of Defence (MoD), Department for Transport (DfT) and Department for International Development (DFID). We discussed the centre of government's role with the Cabinet Office and HM Treasury (the Treasury), and consulted public bodies, private sector representatives and trades unions.

5 We focus primarily on the civil service, and its departments and agencies, as the centre of government has more influence and accountability for this part of the workforce. The wider workforce in these bodies includes consultants and temporary staff but these, as well as outsourced functions, are outside the scope of this report.

1 All staff numbers in the report are presented on 'full-time equivalent' basis.
2 Comptroller and Auditor General, *Managing staff costs in central government*, Session 2010-11, HC 818, National Audit Office, March 2011.

Key findings

Civil service staff costs

6 **Government departments reduced their salary bill substantially between 2010 and 2014, while the cost of temporary staff and consultants was also lower**. As at 31 March 2014, the civil service annualised salary bill stood at £11.13 billion. After adjusting for transfers of functions into and out of the civil service, this was £2.49 billion (18%) lower in real terms than at 31 March 2010. Other data the Cabinet Office collected suggest the wider costs of departments' workforces in 2013-14 included £1.1 billion spent on temporary agency staff and consultants, which was £1.6 billion (58%) lower in real terms than in 2009-10 (paragraphs 1.5 to 1.6).

7 **The number of civil servants has fallen significantly, reducing annual salary costs by around £2.29 billion**. The *Civil Service Reform Plan* (June 2012) set out a vision of a smaller and more strategic civil service with a projection of 380,000 staff (23% smaller than March 2010) by March 2015. Overall, the number of civil servants fell by 18%, from 492,000 in March 2010 to 405,000 in December 2014, which is slightly above the projection adjusted for organisational changes that brought some existing public sector employees into the civil service. The reduction in staff numbers has reduced salary costs by around £2.29 billion, representing most of the £2.49 billion net decrease in salary costs overall (paragraphs 1.3 to 1.4 and 1.14 and Figure 2).

8 **Departments reduced the number of civil servants mainly by minimising recruitment, which has affected the age profile**. Reducing headcount by restricting recruitment costs less in the short term than paying staff to leave. The Cabinet Office restricted departments' ability to recruit externally. The number of new entrants to the civil service therefore declined from an average of 9,400 per quarter in 2009-10 to only 2,800 in 2011-12 (less than 1% of the civil service). In comparison, the number of leavers per quarter averaged 8,700 between 2009-10 and 2013-14, with a peak of 12,300 leavers April–June 2011. Following the low level of recruitment the age profile of the civil service has changed, creating a generational gap: 20- to 29-year-olds reduced from 14% to 9% of the civil service (2010 to 2014), while 50- to 59-year-olds increased from 26% to 31%. We consider it fair to assume that low levels of recruitment and the creation of a generational gap potentially heightens the risk that the civil service will not have the talent and skills needed for future challenges. Although there is a growing awareness in government of this risk, there is not yet a clear understanding of the potential consequences and the necessary management actions (paragraphs 1.8 to 1.9).

9 Departments also reduced staff salary costs by holding back average salaries within grades. In May 2010, the government introduced a two-year pay freeze, later extended to a 1% increase for each of the next two years, but deferred for those departments that had already agreed multi-year pay deals. Pay increases have been affected by a move to remove automatic increases ('progression pay'). We estimate that changes in average salaries, including by restraining pay awards, reduced annualised salary costs by around £191 million in real terms between 2010 and 2014 (paragraphs 1.11, 1.12 and 1.14).

10 Departments' workforces have become more senior in grade, which can reflect new ways of working but increases the average cost per head. Departments made bigger reductions of staff in junior grades, including reducing the proportion of staff in the two junior administrative grades from 46% in 2010 to 40% in 2014. This is compared with an increase in middle management staff (grade 7, senior and higher executive officers) from 26% to 30%. This, at least in part, reflects departments introducing new ways of working, including reducing clerical roles and increasing the need for digital skills. We estimate that although overall salary costs have reduced by £2.49 billion, the change in grade mix resulted in additional annualised salary costs of around £292 million in 2014 compared with 2010 (paragraphs 1.13 and 1.15 and Figure 5).

11 Departments are likely to have to reduce staff costs further during this Parliament. The coalition government committed to balancing the current budget by 2017-18, and its spending plans would require further reductions in day-to-day public spending. If some public spending is protected, the burden of reductions will be uneven. Departments will have to manage staff cost reductions strategically, to reduce the risk of damaging public service delivery (paragraph 1.16).

Strategic workforce planning

12 Some departments have made good progress in setting out long-term operating models, but others have made less progress. The Committee of Public Accounts reported in 2012 that departments did not have long-term plans to work with fewer staff. The government agreed that all departments should set out these plans. Since then, two of our case study departments have undergone significant change. HMRC has reduced its workforce by 20% since 2010 and is undergoing further major transformation. The MoD introduced a new operating model in 2014, following Lord Levene's Defence Reform report in 2011. However, transformation in departments is not as widespread or advanced as we expected, and departments need information-based operating models that facilitate more efficient working practices (paragraphs 2.2 to 2.5).

13 **Progress in planning for the period after 2015 varies among our case study departments**. There is some planning for existing long-term projects or programmes. Of our case study departments, three had not completed detailed plans for other business activities after the 2010–2015 Parliament, which would improve their readiness for negotiations within the next spending review. The departments ascribed this to uncertainties over a future government's priorities and whether their departmental responsibilities will change (paragraph 2.10).

14 **Our case study departments have weaknesses in their approaches to developing strategic workforce plans, which could hinder staff cost reductions**. In 2011, we reported a lack of a structured approach to staff cost reduction. This time we have found that departments had good intentions to develop strategic approaches. But none had progressed to implementing them across their group. Other than developing workforce options as part of its estates strategy, HMRC's strategic workforce planning was mainly qualitative and DFID's workforce plan only included projected total staff numbers in each area of the business. Although operating a group human resources function, DfT does not plan across the group. It believes its agencies are best placed to do their workforce planning and there is no need to produce an overall plan. Similarly, MoD expects its business areas to carry out workforce planning (paragraph 2.9).

15 **Case study departments continue to lack comprehensive and reliable information on the skills their workforce possesses and their needs**. In 2011, we reported that departments lacked information on their workforce's skills. This time, we have found that case study departments continue to lack systems to monitor all staff skills, restricting how they assess capability. Departments also find it challenging to assess their skills needs, as they have not sufficiently developed new long-term operating models to be clear about the skills they will need (paragraphs 2.11 to 2.14).

The centre of government's role

16 **The centre of government is supporting and monitoring, but not yet leading, strategic workforce management across government**. The Cabinet Office, HM Treasury and Civil Service Human Resources are all involved with workforce management, including giving pay guidance, approving workforce restructuring plans and providing central services. Departments are increasingly using Civil Service HR's expert services. This is likely to have reduced government HR costs, which highlights potential efficiencies in centralising corporate functions. However, the centre has done little so far to help departments with strategic workforce planning. The relevant expert service launched only in April 2015, which left little time to help departments in producing workforce plans to underpin their submissions for the next spending review, currently expected to take place in autumn 2015 (paragraph 3.2 to 3.5).

17 **The centre is not producing an overall strategic workforce plan for the civil service**. The 2013 capabilities plan set out actions to address skills gaps in key areas in the civil service. However, an overall strategic workforce plan for the civil service would help the centre to plan better for, and support departments in making, reductions. The centre cannot yet produce a plan because departments' workforce information and projections are incomplete and not comparable. Improved information would strengthen how well the centre understands the cross-government picture and its ability to provide strategic leadership (paragraphs 3.3, 3.6 to 3.7).

18 **HM Treasury has promoted pay restraint and is starting to give more pay bill flexibility to departments, but could engage more consistently with their workforce plans**. As well as assigning department budgets, the Treasury sets the pay frameworks for departments. It also considers their applications for extra funding to address capability shortages or to reform employment terms and conditions. To give more flexibility on pay, the Treasury is piloting arrangements that allow organisations flexibility and autonomy over their pay bill. Departments welcome this, as it allows them to target their pay budget more flexibly. The Treasury is informing and challenging departments by carrying out statistical analysis of pay data that highlight possible inconsistencies between how much departments pay similar staff. In running the next spending review, the Treasury can consider how to create sufficient incentives for departments to continue looking for reductions throughout the spending review period (paragraphs 3.8 to 3.15).

Conclusion on value for money

19 Departments have significantly reduced their staff costs and numbers. They reduced staff numbers mainly by minimising recruitment, and the age profile of the civil service has changed. It remains to be seen what effect this has had on the future pipeline of talent and skills. In addition, departments' progress in developing and implementing long-term operating models is not advanced enough to sustain existing reductions and to be well placed to make the expected reductions during the 2015–2020 Parliament.

20 To achieve value for money, departments face the challenge of ensuring that their reductions are sustainable. They must prioritise developing and strengthening their long-term operating models and strategic workforce plans, and ensure they recruit or develop the critical skills needed. The centre of government is building its strategic role, but must do more to support departments to meet these challenges; for example, by giving them more expert services and more flexibility to manage their pay bill.

Recommendations

21 For all departments:

a Develop long-term operating models that are more information-based to allow them to get the best possible levels of service with reduced budgets.

b Develop strategic workforce plans to support the transition to, and operation of, their long-term operating model.

c As part of strategic workforce planning, use better approaches to assessing skills gaps and whether to fill them by recruitment or staff development.

22 For the centre of government:

d Lead efforts across government to make sustainable reductions through strategic workforce planning as part of the spending review, developing a workforce plan for central government, and supporting departments through the workforce planning expert service.

e Consider departments' recent history of staff cost reduction, not penalising those departments that continued to make reductions throughout the spending review period.

f Get better value by allowing departments more flexibility in how they manage their overall pay bill and not only prescribing specific controls on pay awards.

Part One

Civil service staff costs

1.1 In May 2010, the UK faced a financial crisis, with an economic downturn and a record government deficit in 2009-10, later measured as £165 billion in *Whole of Government Accounts*. The coalition government announced that a key priority would be to stabilise government finances. In the 2010 Budget, the government was clear that staff costs needed to be reduced. In this part of the report we examine reductions in civil service staff costs from 2010 to 2014.

Staff

1.2 The public sector is labour-intensive: around 4.4 million people worked in the public sector in 2013-14, including 2.4 million in the NHS and education. HM Treasury (the Treasury) estimates the cost of these staff was £164 billion, around 23% of UK public spending. With 9% of the public sector workforce being civil servants, staff costs are a large part of many departments' allocated budgets, and five departments spend more than £1 billion a year on staff costs (**Figure 1** overleaf). The major part of costs is salaries, but there are other parts such as employers' national insurance contributions.

1.3 Departments recognised in 2010 that they needed to reduce staff numbers because of falling budgets. In June 2012, the government published its *Civil Service Reform Plan* proposing a vision of a smaller, cheaper and more strategic civil service. There was no target. However, the government expected the civil service would be some 23% smaller by March 2015, with around 380,000 staff, than in March 2010.[3]

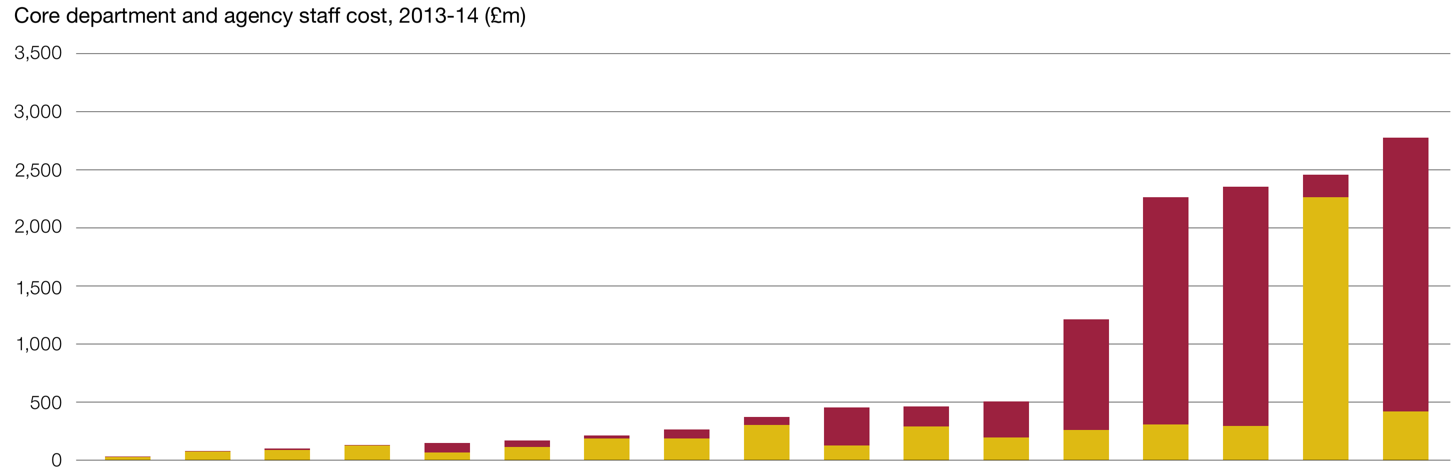
1.4 By December 2014, departments had reduced civil service staff by 18%, from 492,000 in March 2010 to 405,000, with 14% of that reduction having occurred by June 2012 (**Figure 2** on page 13).[4] Adjusting the original projection for organisational changes that brought existing public sector employees into the civil service produces an updated projection of 400,000, which is only 5,000 less than the number of staff in December 2014.

3 Cabinet Office, *Civil Service Reform Plan*, June 2012.
4 These are full-time equivalent numbers, from the Office for National Statistics, and do not include other public servants who are not civil servants.

Figure 1

Departmental spending on staff, 2013-14

Five departments spent over £1 billion on staff costs, and staff costs represent more than half of seven departments' administration spending



	DCMS	HMT	DECC	DCLG	DFID	CO	DfE	BIS	Defra	DfT	DoH	FCO	HO	HMRC	MoJ	MoD	DWP
Programme staff cost (£m)	3	0	11	2	78	53	24	74	64	326	169	310	951	1,955	2,055	192	2,352
Administration staff cost (£m)	29	77	87	128	67	115	189	189	306	130	292	195	262	309	295	2,264	422
Total staff cost (£m)	32	77	98	130	146	168	213	262	371	456	461	505	1,212	2,264	2,350	2,456	2,774
Administration staff cost as a percentage of total administration cost (%)	55	45	67	45	57	35	55	48	48	54	38	38	54	33	60	–	37

Notes

1 Total staff costs were £14 billion in 2013-14. These costs include salary, other employer's costs and redundancy costs. These costs cover core departments and their executive agencies, with the exception of the Cabinet Office and MoD whose agencies fall outside of these departments' accounting boundaries. Non-departmental public bodies are excluded.

2 The staff costs are based on resource account data, which include a slightly different set of organisations and employees (for example, locally-engaged non-civil service staff) to the Office for National Statistics data we use to calculate 'annualised salary costs'. So 'staff costs' and 'salary costs' cannot be compared directly.

3 Military personnel costs, amounting to £9.3 billion, have been excluded from MoD staff costs. We have not included a figure for MoD 'Administration staff cost as a percentage of total administration cost' as differences in the administration cost boundary meant it was not comparable with other departments in 2013-14; and MoD came more into line with other departments in 2014-15.

4 FCO staff costs include those associated with delivering the functions of other government departments, including front-line service delivery such as visa applications. These costs are subsequently re-allocated and charged to other departments.

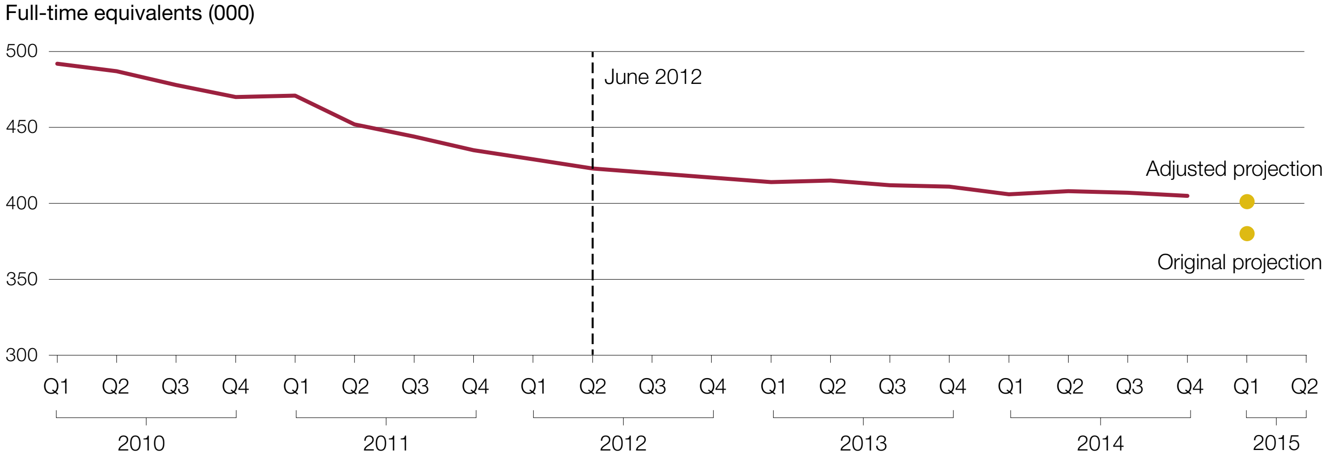
5 Numbers may not sum due to rounding.

6 DCMS = Department for Culture, Media & Sport, HMT = HM Treasury, DECC = Department of Energy & Climate Change, DCLG = Department for Communities and Local Government, DFID = Department for International Development, CO = Cabinet Office, DfE = Department for Education, BIS = Department for Business, Innovation & Skills, Defra = Department for Environment, Food & Rural Affairs, DfT = Department for Transport, DoH = Department of Health, FCO = Foreign & Commonwealth Office, HO = Home Office, HMRC = HM Revenue & Customs, MoJ = Ministry of Justice, MoD = Ministry of Defence, DWP = Department for Work & Pensions.

Source: Departmental resource accounts, 2013-14

Figure 2
Number of civil servants, 2010 to 2014

Departments made good early progress in reducing staff numbers, although the rate of decline slowed after June 2012 when the projection was announced



Notes

1 The actual figures include the effects of changes to the organisational structure ('machinery') of government and transferring services to the voluntary or private sectors (for example, the Probation Service).

2 The original projection of 380,000 FTE (March 2015) was based on departments' estimates, including machinery of government changes they expected at the time.

3 The adjusted projection of 400,000 FTE includes the effect of changes to government structures that were not anticipated in the original projection (see Appendix Two).

4 In comparison, the local government workforce has fallen by 19% over the same period, from 2.16 million to 1.75 million.

Source: Office for National Statistics, *Quarterly Public Sector Employment Survey, 2014 Quarter 4*

1.5 The annualised cost of civil service salaries was £11.13 billion as at 31 March 2014. After excluding entities that moved into or out of the civil service during the period, this represents a real-terms reduction of £2.49 billion (19%) over the four years since 2010.[5] These figures represent the amount that departments and agencies paid in civil servants' salaries, and do not include extra employment costs.

1.6 These figures also do not include the cost of temporary staff and consultants. According to information the Cabinet Office collected, departments spent £800 million on temporary agency staff and £300 million on consultancy in 2013-14. The total of £1.1 billion was £1.6 billion (58%) lower than the amount reported in 2009-10 (all stated in 2013-14 prices).[6] However, because of how these services are defined for the Cabinet Office collection exercise and accounted for by departments, some expenditure on short-term staffing may fall outside the figures that the Cabinet Office reports.

5 We estimated annualised salary costs, of departments and their agencies, using data for 31 March 2010 and 2014. Our estimate differs to departments' annual resource accounts figures, which do not include all agencies but do include other employment costs and redundancy costs (see Appendix Two). In addition, the Cabinet Office measured the pay bill for the civil service and non-departmental public bodies, and reported a reduction of £2.39 billion in cash terms between 2009-10 and 2013-14. Because of the difference in methods, this figure is not directly comparable with the NAO figure.

6 Comptroller and Auditor General, *The 2013-14 efficiency savings reported by the Efficiency and Reform Group*, Session 2014-15, HC 442, National Audit Office, July 2014. Some data come from unpublished NAO analysis underlying this report.

How departments reduced staff costs

1.7 Departments reduced staff costs through:

- reducing staff numbers; and
- changing average salaries; while
- increasing the seniority of staff (ie changing the mix of grades of staff employed), which itself increased staff costs.

Reducing staff numbers

1.8 In May 2010, the government introduced spending controls, including a freeze of external recruitment. Departments that needed to recruit externally had to get authorisation from the Cabinet Office, which allowed exceptions for front line or 'business-critical' staff. In response to the reduced budgets in the spending review in October 2010, most departments started to reduce their workforce, mainly by reducing the number of entrants. The number of departures from the civil service peaked in the three months April to June 2011. At that time 12,300 people left, compared with an average of 8,700 per quarter between 2009-10 and 2013-14. The new entrants declined from an average of 9,400 per quarter in 2009-10 to an average of 2,800 (0.6% of the civil service) per quarter in 2011-12 (**Figure 3**). This represents a relatively low level of recruitment and risks creating a generational gap that may be difficult to address in the medium term.[7]

1.9 The age profile of the civil service has already changed: 20- to 29-year-olds reduced from 14% of the workforce in 2010 to 9% in 2014, while 50- to 59-year-olds increased from 26% to 31% of the workforce. We did not have the evidence to assess the impact of this, potential or realised, but we believe it is fair to assume that low levels of recruitment and the creation of a generational gap potentially heightens the ongoing risk that the civil service will not have the talent and skills needed for future challenges. For example, we consider it likely that increased use of technology will be a key component in future operating models of departments. Without the right type and level of recruitment, departments may not have the skills needed to adapt to new information-led ways of working. Although there is a growing awareness within departments of this risk, they do not yet have a clear understanding of either the potential consequences or any necessary management action.

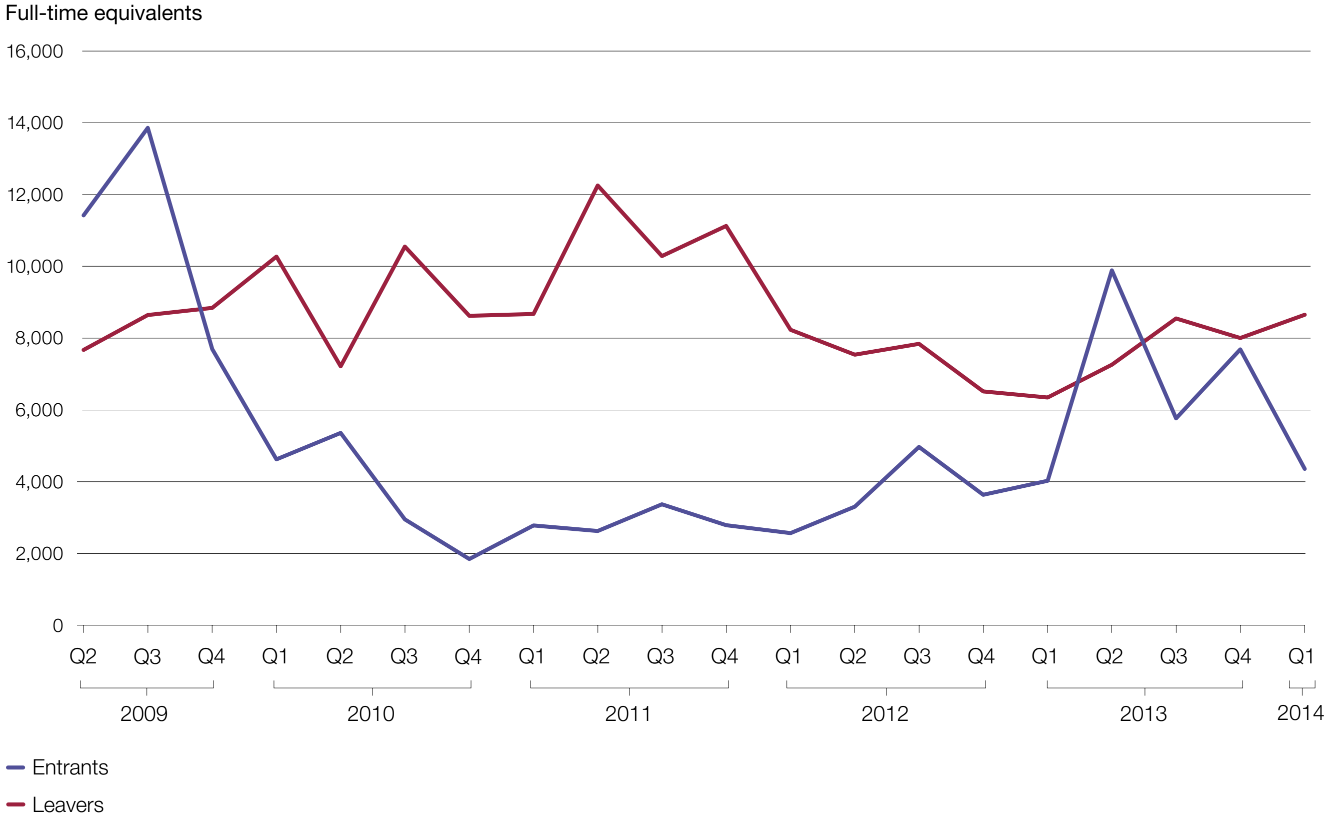
1.10 We examined the basis of departures from the civil service, focusing particularly on whether numbers of staff leaving via paid exit packages (redundancy or severance) might have displaced some resignations (a voluntary departure without an exit payment). The analysis suggests that the rise in redundancies during 2011 in particular may have contributed to slightly lower resignations from 2011 onwards (**Figure 4** on page 16). The increase in leavers since early 2013 is mainly from increased retirements, transfers of posts to the private sector and non-renewal of fixed-term appointments.

7 For example, the Chartered Institute of Personnel and Development reported that the median labour turnover rate in UK organisations surveyed in 2012 was 12.7% (*Resourcing and Talent Planning: Annual Survey Report 2012*).

Figure 3

Civil service entrants and leavers, 2009 to 2014

The number of civil servants has fallen mainly because recruitment levels were so low between 2010 and 2012



Source: National Audit Office analysis of *Annual Civil Service Employment Survey*, Office for National Statistics

Changes in average salaries

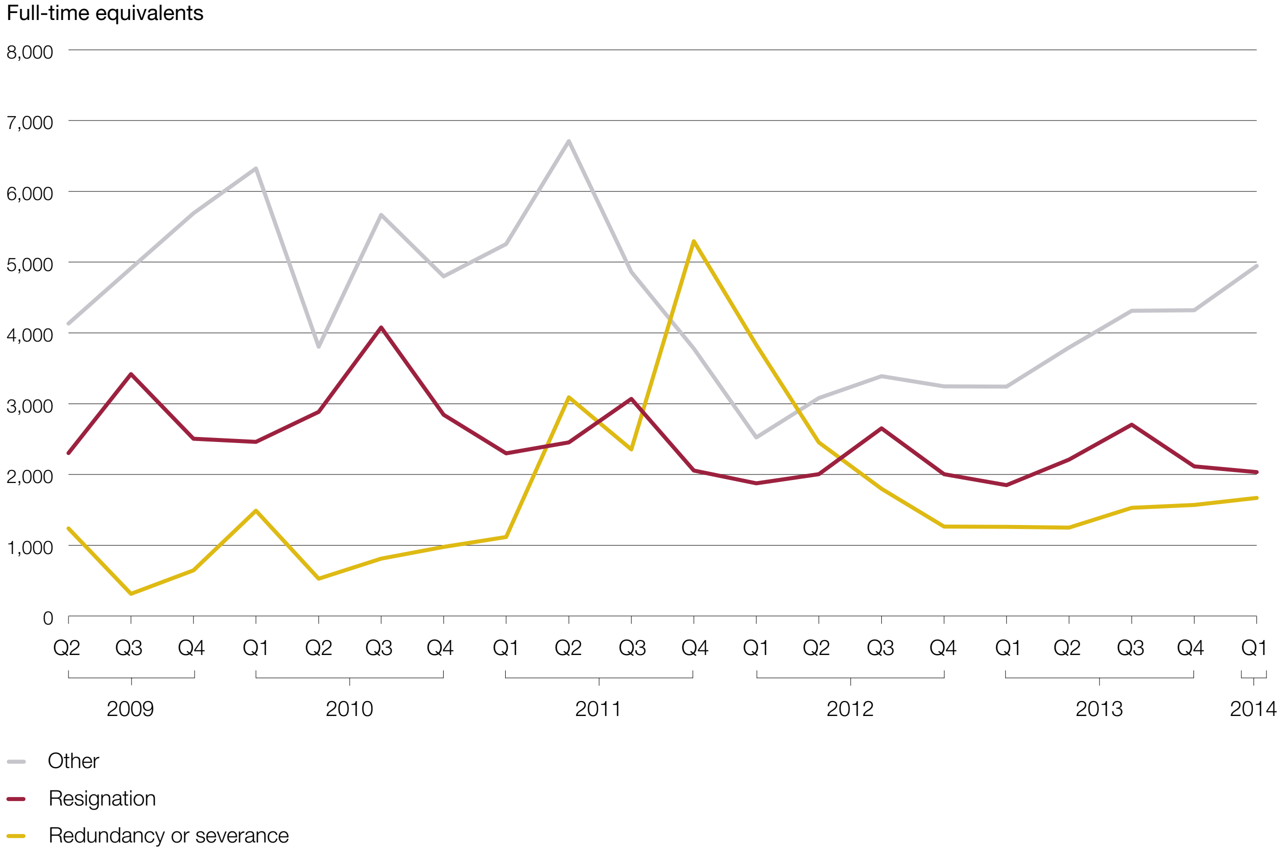
1.11 In the 2010 Budget, the government announced a two-year pay freeze in public sector pay, covering all employees other than those earning less than £21,000 per year. Exceptions were where employers had previously agreed pay awards for 2010-11.[8] In addition, around 13% of civil servants still had increases in 2012-13 through progression pay arrangements where their salary increases each year as long as their performance is adequate. In the 2011 autumn statement, the government announced that public sector pay awards should average 1% for 2012-13 and for 2013-14.

1.12 Departments also find that the average salary of staff in specific grades is affected by turnover within those grades. For example, staff leaving a grade, whether through promotion or leaving the organisation, are often at the higher end of the grade pay range whereas incoming staff tend to be on a lower salary in the same grade.

8 Five of the 17 main departments, including HMRC and MoD, had already agreed pay increases and so entered the two-year pay freeze in 2011-12.

Figure 4
Civil service leavers by type, 2009 to 2014

There was a significant increase in leavers from redundancy or severance in 2012, while resignations fell in the second half of the period



Notes

1 'Redundancy or severance' includes compulsory and voluntary redundancy.

2 'Other' includes discharge or dismissal, retirement and 'other cause'.

Source: National Audit Office analysis of *Annual Civil Service Employment Survey*, Office for National Statistics

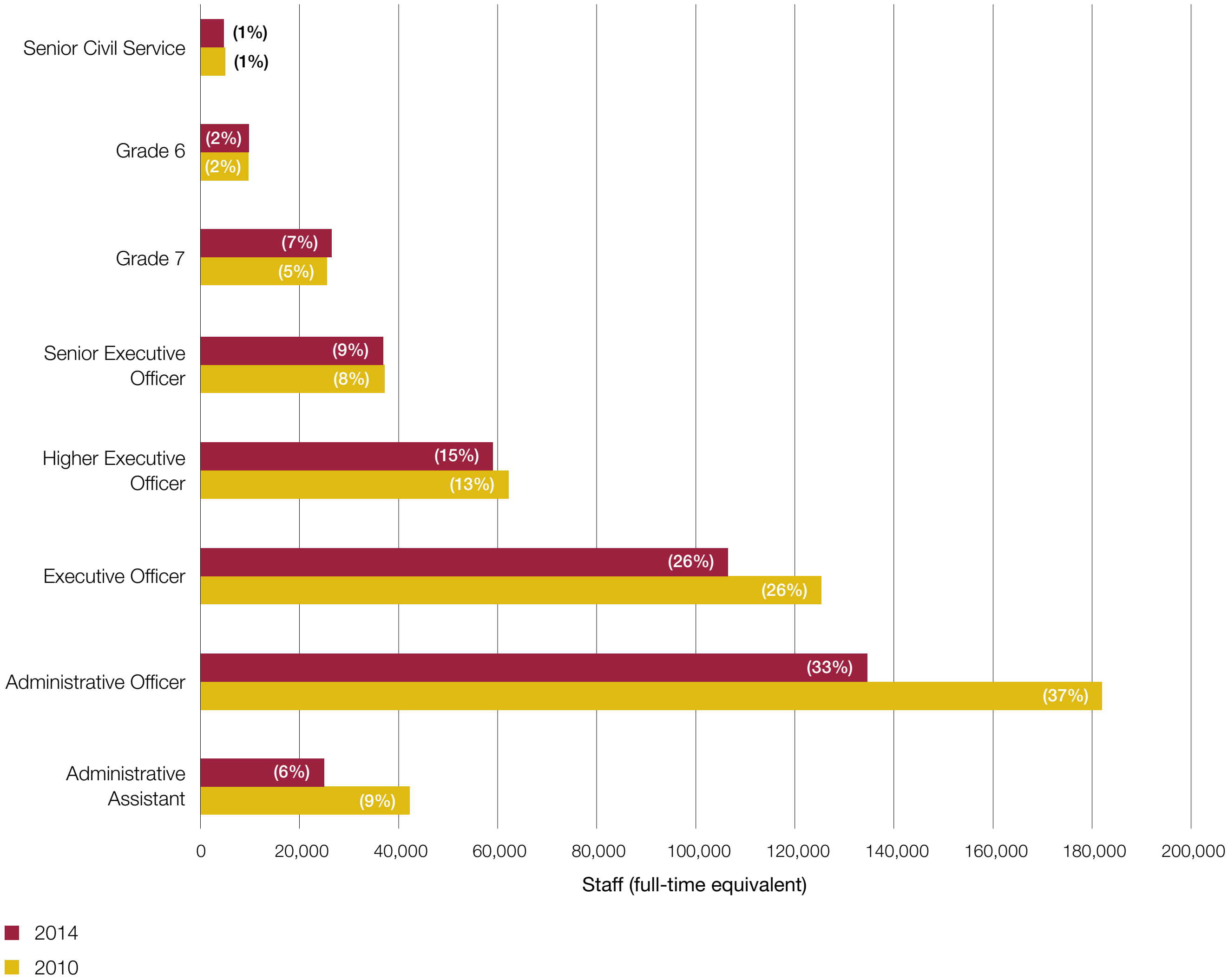
Increasing the seniority of staff employed

1.13 Departments' staff costs are affected by changes in workforce composition, for example replacing staff in more junior grades with fewer staff in more senior grades. We found that the staffing mix changed significantly between March 2010 and March 2014. In particular, middle management (grade 7, and senior and higher executive officers) increased from 26% to 30% of the workforce. The proportion of staff in the most junior grades fell from 46% to 40% (**Figure 5**). This, at least in part, reflects departments introducing new ways of working, including the reduction in clerical roles and increase in the need for digital skills.

Figure 5

Number of staff in grade and proportion of the civil service, 2010 and 2014

The biggest fall in numbers (March 2010 to March 2014) was in junior grades, while numbers in some senior grades increased



Notes

1 The percentage shows the proportion of the civil service represented by the grade that year.

2 Percentages may not sum to 100 due to rounding.

Source: National Audit Office analysis of *Annual Civil Service Employment Survey*, Office for National Statistics

Financial contribution of the main components of the cost reductions

1.14 After excluding entities that moved into or out of the civil service during the period, the cost of civil service annualised salaries has been reduced by £2.49 billion in real terms (2010 to 2014). This excludes other components of staff costs, such as employers' contributions to pensions and national insurance. We carried out variance analysis to estimate the financial effect of the two components of this net reduction in civil service salary costs.[9]

- **Reducing staff numbers**

  This saved an estimated £2.29 billion (17% of the annualised salary bill as at 31 March 2010) in the salary bill. The biggest savings came from the four departments with the most staff: Department for Work & Pensions, Ministry of Justice, Ministry of Defence and Her Majesty's Revenue & Customs (**Figure 6**).

- **Changes in average salaries**

  Salary increases were capped below inflation since 2010. Together with the impact of turnover of staff *within* grades, this reduced the annualised salary bill by an estimated £191 million (1%) compared with keeping pace with inflation. All departments, apart from Home Office, Ministry of Justice and HM Treasury, saw reductions in average salaries (**Figure 7** on page 20).[10]

1.15 However, by 2014 most departments had increased the proportion of staff in senior grades compared with junior grades. We estimate that although overall salary costs have reduced by £2.49 billion, this change in grade mix has increased annualised salary costs by around £292 million (2%) (**Figure 8** on page 21).

Future staff costs

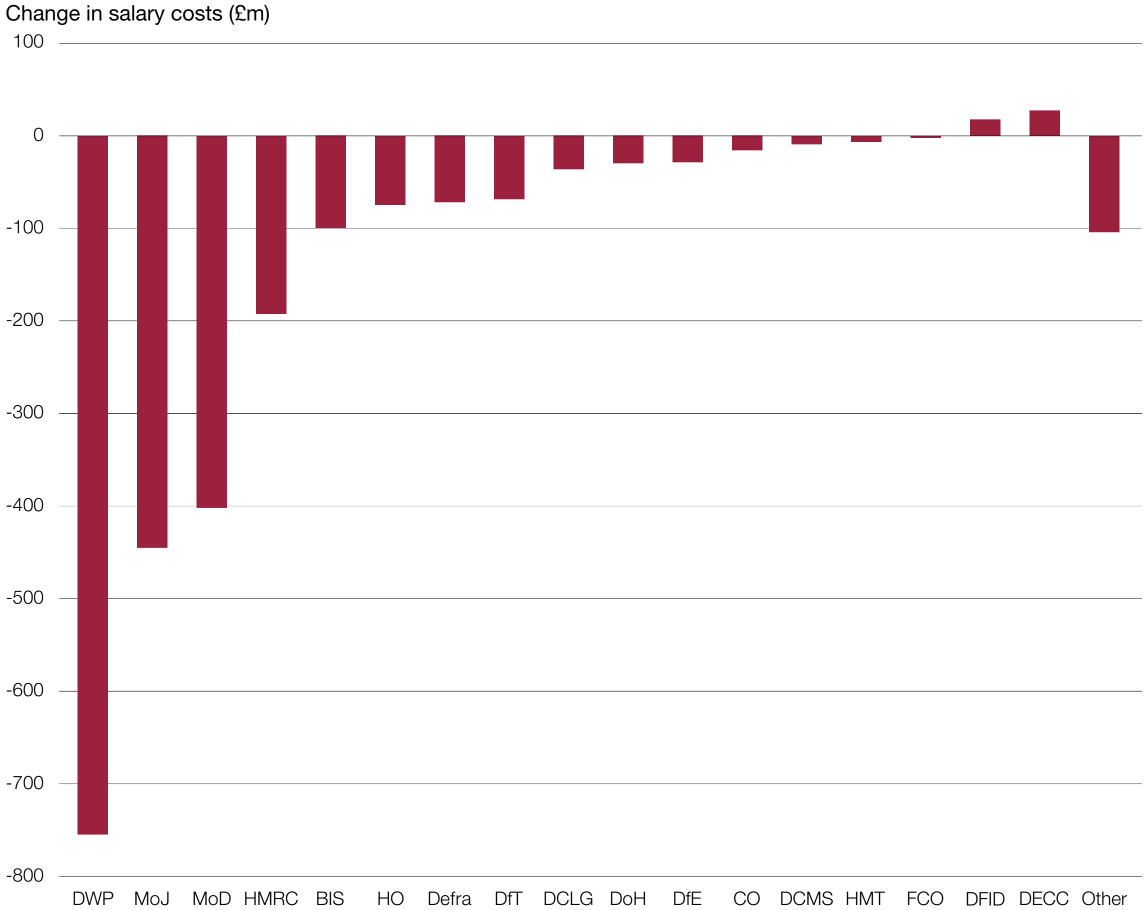
1.16 In March 2015, the coalition government stated that it planned to clear the annual deficit by 2017-18.[11] This would require further reductions in spending on day-to-day public services, particularly for those departments whose budgets are not protected (as has been overseas aid, the NHS and schools). Significant budget cuts are likely to require corresponding reductions in departments' staff costs. Departments will have to manage their workforce strategically, to manage the risks to public service delivery. In Part Two, we consider whether they are doing so.

9 Variance analysis is a management accounting technique that quantifies differences between actual and budgeted (or previous) performance and identifies the underlying causes.
10 This estimate includes the effect of progression pay.
11 HM Treasury, *Budget 2015*, March 2015, p. 23. The annual deficit referred to here is on the cyclically adjusted current budget, which does not include borrowing for investment.

Figure 6

Financial effect of changes in staff numbers, 2010 to 2014

All but two departments reduced costs through staff reductions



	DWP	MoJ	MoD	HMRC	BIS	HO	Defra	DfT	DCLG	DoH	DfE	CO	DCMS	HMT	FCO	DFID	DECC	Other
Change in salary costs (£m)	-755	-455	-402	-192	-100	-75	-72	-69	-36	-30	-29	-16	-9	-6	-2	17	27	-104
Change in salary costs (%)	**-26**	**-23**	**-20**	**-10**	**-16**	**-9**	**-22**	**-13**	**-27**	**-18**	**-25**	**-12**	**-32**	**-9**	**-1**	**24**	**56**	**-7**

Notes

1 Figures are in Q1 2014 prices. Figures represent civil servants working in departmental groups, and include the civil service bodies within them. Ministry of Defence costs cover civilian staff only. 'Other' includes devolved administrations, minor departments, and most non-ministerial departments and regulatory bodies.

2 For the purposes of comparability we have excluded bodies that have moved in or out of the civil service during this period (see Appendix Two). Any changes below that of organisation-level, for example a transfer of a team or directorate between departments, is not reflected in the analysis as those staff are not identifiable within the data. The Department of Health is particularly affected by this, because significant numbers of civil servants transferred to the wider public sector as part of recent reforms.

3 The cost increase at Department for International Development was because of an increase in budget in line with policy to spend 0.7% of gross national income on overseas development.

4 The cost increase at Department of Energy & Climate Change was due to a 50% increase in the number of staff.

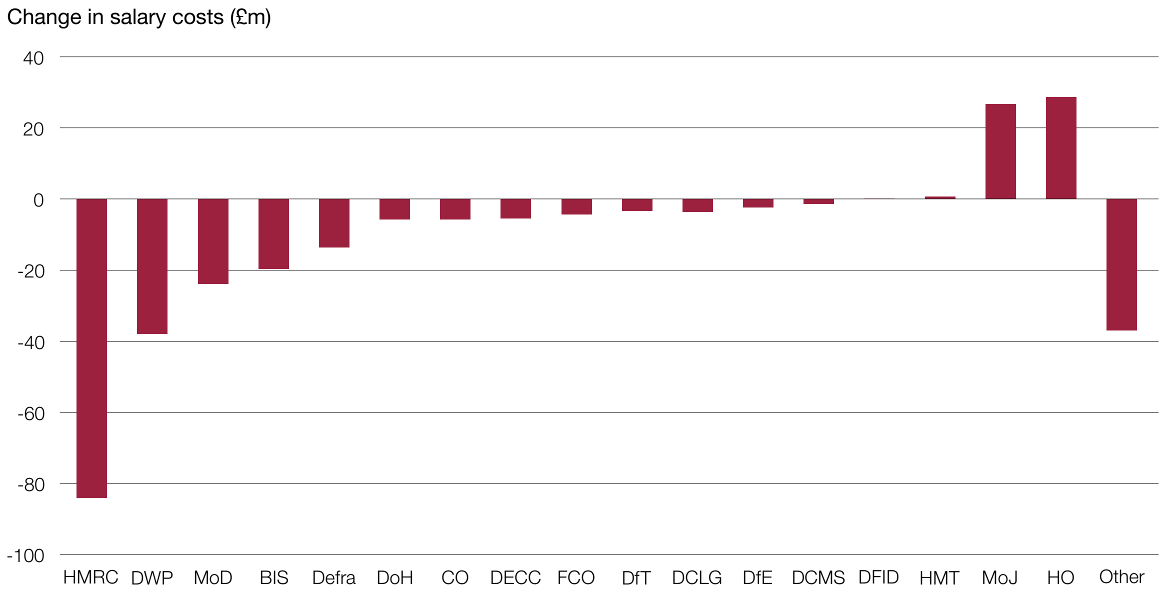
5 DWP = Department for Work & Pensions, MoJ = Ministry of Justice, MoD = Ministry of Defence, HMRC = HM Revenue & Customs, BIS = Department for Business, Innovation & Skills, HO = Home Office, Defra = Department for Environment, Food & Rural Affairs, DfT = Department for Transport, DCLG = Department for Communities and Local Government, DoH = Department of Health, DfE = Department for Education, CO = Cabinet Office, DCMS = Department for Culture, Media & Sport, HMT = HM Treasury, FCO = Foreign & Commonwealth Office, DFID = Department for International Development, DECC = Department of Energy & Climate Change.

Source: National Audit Office analysis of *Annual Civil Service Employment Survey*, Office for National Statistics

Figure 7

Financial effect of changes in average salaries, 2010 to 2014

All but three departments' costs reduced through changes in average salaries



	HMRC	DWP	MoD	BIS	Defra	DoH	CO	DECC	FCO	DfT	DCLG	DfE	DCMS	DFID	HMT	MoJ	HO	Other
Change in salary costs (£m)	-84	-38	-24	-20	-14	-6	-6	-5	-4	-3	-4	-2	-1	0	1	27	29	-37
Change in salary costs (%)	**-4**	**-1**	**-1**	**-3**	**-4**	**-3**	**-4**	**-11**	**-2**	**-1**	**-3**	**-2**	**-4**	**0**	**1**	**1**	**4**	**-2**

Notes

1 Figures are in Q1 2014 prices. Figures represent civil servants working in departmental groups, and include the civil service bodies within them. Ministry of Defence costs cover civilian staff only. 'Other' includes devolved administrations, minor departments, and most non-ministerial departments and regulatory bodies.

2 For the purposes of comparability we have excluded bodies that have moved in or out of the civil service during this period (see Appendix Two). Any changes below that of organisation-level, for example a transfer of a team or directorate between departments, is not reflected in the analysis as those staff are not identifiable within the data. The Department of Health is particularly affected by this, because significant numbers of civil servants transferred to the wider public sector as part of recent reforms.

3 The increased costs in Ministry of Justice were mainly due to increased costs in the National Offender Management Service, notably at more junior grades.

4 The increased costs in the Home Office were due mainly to it having omitted certain salary costs in the data it submitted to the Office for National Statistics in 2010 (thus understating its 2010 baseline cost by £23 million in our analysis). However, this explanation was not provided in time for the National Audit Office to revise its analysis.

5 HMRC told us that reduced average salaries reflected the department's pay settlements (including freezing the top of most pay ranges over the period), and leavers at the top of their pay range being replaced by staff recruited or promoted at the lower end of the pay ranges.

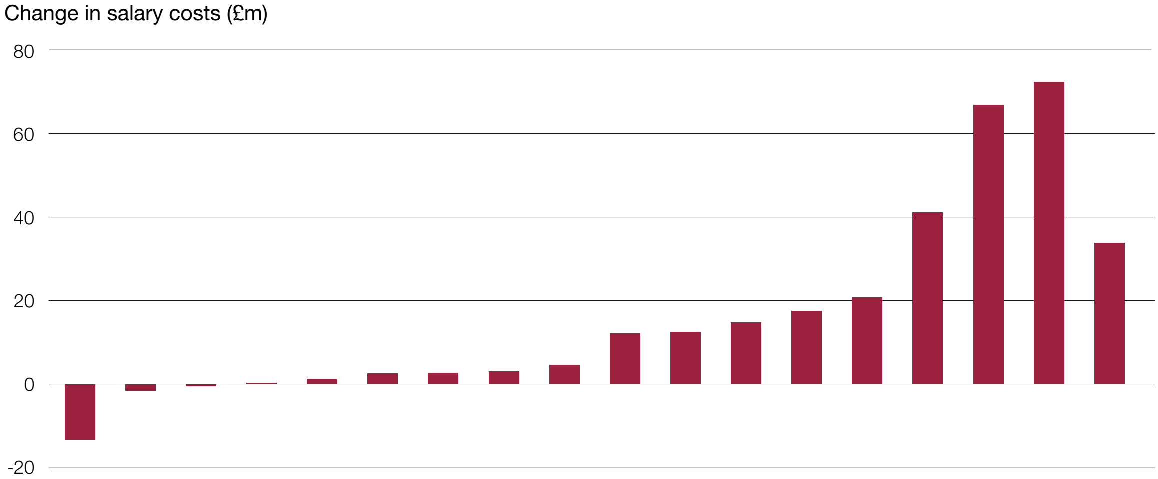
6 HMRC = HM Revenue & Customs, DWP = Department for Work & Pensions, MoD = Ministry of Defence, BIS = Department for Business, Innovation & Skills, Defra = Department for Environment, Food & Rural Affairs, DoH = Department of Health, CO = Cabinet Office, DECC = Department of Energy & Climate Change, FCO = Foreign & Commonwealth Office, DfT = Department for Transport, DCLG = Department for Communities and Local Government, DfE = Department for Education, DCMS = Department for Culture, Media & Sport, DFID = Department for International Development, HMT = HM Treasury, MoJ = Ministry of Justice, HO = Home Office.

Source: National Audit Office analysis of *Annual Civil Service Employment Survey*, Office for National Statistics

Figure 8

Financial effect of changes in staff mix, 2010 to 2014

Three departments reduced costs by changing their staff mix, while 14 increased costs



	MoJ	DoH	HMT	DCMS	DfE	DCLG	CO	DECC	DFID	Defra	DfT	FCO	BIS	HO	DWP	MoD	HMRC	Other
Change in salary costs (£m)	-13	-2	-1	0	1	3	3	3	5	12	13	15	18	21	41	67	72	34
Change in salary costs (%)	**-1**	**-1**	**-1**	**1**	**1**	**2**	**2**	**7**	**6**	**4**	**2**	**7**	**3**	**3**	**1**	**3**	**4**	**2**

Notes

1 Figures are in Q1 2014 prices. Figures represent civil servants working in departmental groups, and include the civil service bodies within them. Ministry of Defence costs cover civilian staff only. 'Other' includes devolved administrations, minor departments, and most non-ministerial departments and regulatory bodies.

2 For the purposes of comparability we have excluded bodies that have moved in or out of the civil service during this period (see Appendix Two). Any changes below that of organisation-level, for example a transfer of a team or directorate between departments, is not reflected in the analysis as those staff are not identifiable within the data. The Department of Health is particularly affected by this, because significant numbers of civil servants transferred to the wider public sector as part of recent reforms.

3 The decrease in cost at Ministry of Justice reflects a reduction in the proportion of staff at the equivalent of grades 6 and 7 compared with those in AO and EO grades in the core department, and an increase in the proportion of AO grade staff at Her Majesty's Courts and Tribunals Service.

4 HMRC told us that the shift to a more senior grade mix was a result of automation of administrative processes and increasing resources in higher-graded compliance work.

5 MoJ = Ministry of Justice, DoH = Department of Health, HMT = HM Treasury, DCMS = Department for Culture, Media & Sport, DfE = Department for Education, DCLG = Department for Communities and Local Government, CO = Cabinet Office, DECC = Department of Energy & Climate Change, DFID = Department for International Development, Defra = Department for Environment, Food & Rural Affairs, DfT = Department for Transport, FCO = Foreign & Commonwealth Office, BIS = Department for Business, Innovation & Skills, HO = Home Office, DWP = Department for Work & Pensions, MoD = Ministry of Defence, HMRC = HM Revenue & Customs.

Source: National Audit Office analysis of *Annual Civil Service Employment Survey*, Office for National Statistics

Part Two

Strategic workforce management

2.1 To make large-scale cost reductions, organisations must look beyond short-term savings and think radically about removing costs sustainably, in the longer term. This involves: developing a long-term operating model that will sustain lower operating costs; and having a workforce capable of making the transition and running the new model. This part of the report examines departments' progress in:

- developing long-term operating models; and
- strategic workforce planning, particularly examining four case study departments.

Developing long-term operating models

2.2 In 2010, departments started to reduce staff numbers quickly (Figure 2) but did so without long-term operating models that require fewer staff. We raised concerns about this approach in 2012 and 2013. We noted that headcount reductions resulted from a target to reduce administration costs,[12] and departments often lacked a clear future operating model based on a strategic view of their business.[13]

2.3 In 2012, the Committee of Public Accounts criticised the centre of government for failing to ensure that departments had long-term operating models.[14] The Cabinet Office agreed to review the long-term operating models from seven departments and present results by March 2013 and to follow this up with a review of the remaining departments by September 2013.

2.4 In April 2013, the Cabinet Office gave the Committee operating models for six departments. It acknowledged that models did not explicitly explain how the departments would meet objectives while making the planned savings. The Cabinet Office also committed to setting up a common framework for operating models. However, in July 2014 the government advised that it considered that the Committee recommendation had been superseded by the Functional Leadership Programme.

12 Comptroller and Auditor General, *Financial management in government*, Session 2013-14, HC 131, National Audit Office, June 2013.
13 Comptroller and Auditor General, *Managing early departures in central government*, Session 2010–2012, HC 1795, National Audit Office, March 2012.
14 HC Committee of Public Accounts, *Managing early departures in central government*, Eighth Report of Session 2012-13, HC 503, August 2012.

This programme focuses on strengthening corporate business functions such as legal services, finance and HR, which has value but it does not replace the need for the centre to oversee departments in developing long-term operating models.[15]

2.5 Since 2013, some departments have started to develop operating models. For example, in April 2014 the Ministry of Defence (MoD) introduced a new operating model following Lord Levene's Review, and HM Revenue & Customs (HMRC) has developed its 'blueprint' for how it will deliver its services in future. However, the centre of government lacks a clear view of how departments are developing operating models and does little to equip departments to develop the models. Central programmes, such as shared services, the Crown Commercial Service and Civil Service Human Resources (Civil Service HR), do encompass certain aspects of those models, which affect how departments work. Departments' new operating models will require better information than current models. This will enable more efficient working practices, such as having more automation of administrative functions and more self-service public functions, as well as allowing the reduced workforce to pinpoint rapidly and respond effectively to problems that arise.

Implementing strategic workforce planning

2.6 Strategic workforce planning is essential to an organisation that is changing how it works, to ensure that the workforce can make the changes and work in the new model. A strategic workforce plan must be flexible, adaptive and reflect integrated business, finance and human resource planning, as well as identifying any workforce skills gaps. We examined:

- the four case study departments' approaches; and
- the departments' progress in completing these plans.

More information about the case study departments is in Appendix Three. We also considered departments' workforce management, against what the private sector does to reduce staff costs. We outline some private sector practices in Appendix Four.

Approach to strategic workforce planning

2.7 The case study departments used either a delegated or centralised approach to group planning. The former involves the core department or corporate centre as a relatively 'hands-off' facilitator to the rest of the departmental group. The latter involves a coordinated, department or group-wide planning exercise.

- **Delegated approach**
  In both MoD and the Department for Transport (DfT), business areas or agencies do their own workforce planning. The head office considers that business areas understand their human resource requirements best and can assign resources most effectively.

15 HM Treasury, Treasury Minutes, *Progress report on the implementation of Government accepted recommendations of the Committee of Public Accounts*, Sessions 2010–2012 and 2012-13, Cm 8899, July 2014.

- **Centralised approach**
  The Department for International Development (DFID) and HMRC are developing workforce plans that cover the entire department. For HMRC, this allows it to identify efficiencies *across* business areas. It redeployed 8,450 people to its compliance and enforcement business areas, while overall staff numbers reduced by 20% since March 2010.

2.8 Strategic workforce planning is most effective when it is integrated with financial planning and business planning. Some parts of government recognise this and are integrating workforce planning into their day-to-day business activities. For example, DFID used to carry out business and financial planning separately to workforce planning. It found that without workforce information on skills they had, or could get, their plans were incomplete. As part of its planning for 2015-16, DFID has integrated workforce planning into its wider business planning processes.

Departments' progress

2.9 To stay within budget for the spending review period, most departments decided to reduce staff numbers swiftly, for example by stopping lower-priority work. They left until later the reductions expected from a more strategic approach. Case study departments have made variable progress in developing strategic workforce plans, with HMRC and MoD having department-wide plans:

- HMRC has set out its vision of how it will deliver its services, including setting out its ambition of being a smaller organisation in fewer locations. It has also modelled the workforce impacts of natural wastage and identified staffing options for the consolidation of its estate, but has not yet completed the quantitative analysis for longer-term planning of the skills it will require.

- DFID's workforce plan consists of projections of total staff numbers for individual business areas, with numbers of front line staff increasing in response to the increased overseas aid budget.

- DfT's agencies such as the Driver & Vehicle Licensing Agency and the Maritime & Coastguard Agency have carried out their own workforce planning. The core department's workforce plan has projections of total staff numbers for each area but does not use its agencies' plans to create an overall workforce plan.

- MoD's main business areas, under the new operating model, undertake their own workforce planning to meet their specific business needs, although their progress in developing plans is variable. The MoD is starting to bring together these plans for the whole ministry.

2.10 Departments have made significant workforce reductions, and must manage the impact on public services of any further reductions. A lack of planning beyond 2015 would increase the risks of departments facing workforce problems and not being well informed when they go into the next spending review. Departments should be planning strategically, for at least two to three years ahead. However, of the four departments only MoD was able to provide us with detailed plans of staff numbers by grade beyond 2015, with projections up to 2023-24. Departments said that uncertainty over future government priorities meant they could not know their requirements before the 2015 general election. For example, DfT does not know which transport projects a future government will approve. DFID's budget is closely linked to the government's commitment to contribute 0.7% of national income on overseas aid.

Skills information

2.11 An important part of a department's strategic workforce plan is assessing the skills its workforce has and those it will need for its new operating model. This assessment relies on good-quality information to determine the 'skills gap' and whether to develop, recruit or borrow (for example, secondees) to fill the gap.

2.12 However, the case study departments still find it difficult to collect accurate data on workforce skills and needs. Departments could therefore make ill-informed workforce decisions, such as those about redundancy programmes.[16] Some skills are difficult to acquire quickly, as employers face more competition in the labour market, and developing skills internally can take time. This increases the risk that departments have to fill gaps using expensive temporary staff or consultants. Private sector employers use information to respond quickly to changing needs. For example, they release staff where information suggests they are not needed and they pay what they need to quickly hire staff to meet a sudden skills shortage.

2.13 In our 2013 report we found little reliable data on professional qualifications or experience across departments.[17] In response, the Cabinet Office required departments to complete a skills audit for civil servants. However, the Cabinet Office did not require skills data on other public servants (non-civil service staff), which limited the benefit to some departments.

2.14 Departments consider that keeping skills needs assessments up-to-date is time-consuming and challenging. The MoD, for example, had difficulty in collecting and updating skills information across the Department and decided that a central collection of skills information for all staff was of little practical value (**Figure 9** overleaf). Another barrier to collecting usable skills information is that performance appraisal frameworks usually assess performance against competencies rather than professional skills. Annual appraisals processes often do not give the human resources team information on professional skills.

16 Comptroller and Auditor General, *Managing early departures in central government*, Session 2010–2012, HC 1795, National Audit Office, March 2012.

17 Comptroller and Auditor General, *Building capability in the Senior Civil Service to meet today's challenges*, Session 2013-14, HC 129, National Audit Office, June 2013.

Figure 9
Understanding MoD skills requirements

The MoD's HR function carried out three workforce planning exercises in 2012 and 2013 to understand better the future requirement for civilian workforce skills across the department, but faced problems in doing so:

- The data collected were not considered reliable, possibly because managers saw no added value to their business of undertaking the exercise.
- There was no systematic method for reconciling financial and the detailed skills data as part of business as usual, so the plans became out-of-date and not useful.
- Senior managers did not support the third data collection exercise to develop a department-wide plan because workforce decisions are delegated within the Department.

In a separate exercise to meet a Cabinet Office requirement, in 2014 the MoD collected data on its civil servants' skills. However, its wider value was limited across the Department because many business areas used a mixture of civil servants, military personnel and temporary staff.

More recently, the MoD has decided to focus its central efforts on those areas where skills are particularly important or where it is concerned about possible shortages. It expects local managers to assess the needs of their staff based on advice from senior managers and functional and professional leads.

Source: National Audit Office

Digital services

2.15 Most departments have made limited progress in using digital services more in their strategic workforce planning, to achieve significant staff reductions. The government expects digital services to reduce staff costs by processing transactions efficiently and introducing more customer self-service. To help kick start digital services, departments have been developing and implementing digital exemplars. However, we have seen little evidence that departments are making the expected savings.

Part Three

Central oversight and support

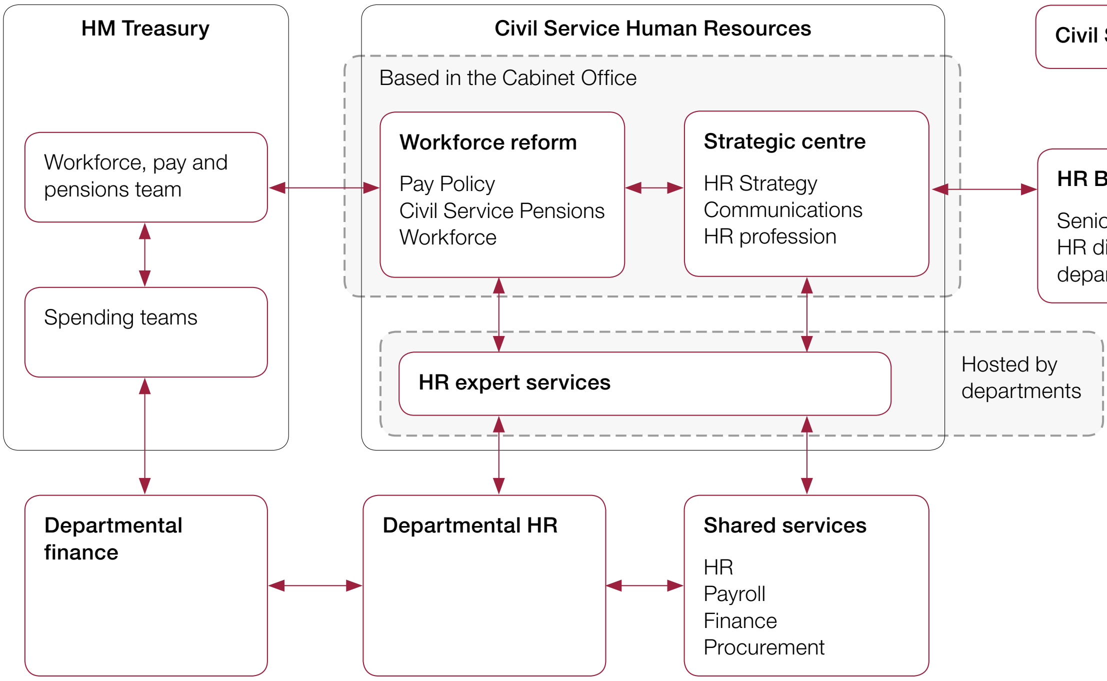
3.1 The centre of government (the centre) coordinates and oversees the government's work. The Cabinet Office, HM Treasury and the cross-departmental Civil Service Human Resources manage workforce issues. In this part we examine:

- the centre's role and responsibilities, including the Civil Service HR group;
- how far the centre uses workforce information from departments;
- the centre's spending controls; and
- the extent to which the centre influences the wider public sector.

Operating model for government

3.2 We and the Committee of Public Accounts have asked the centre of government to do more to achieve better coordination and management of the business of government, and it has accepted these responsibilities. For leadership and oversight of human resourcing activities, the centre has set out its organisational structures and responsibilities (**Figure 10** overleaf).

Figure 10
Organisational structures for human resources



Source: Civil Service Human Resources

Civil Service Human Resources

3.3 Civil Service HR was set up in 2011 to modernise human resourcing in the civil service and provide shared services. We have previously recognised that this could bring a more strategic approach to human resource management across the civil service. For example, the civil service capabilities plan set out four priority areas, and corresponding actions, where more skills were needed.[18] However, we noted that Civil Service HR had further to go in providing leadership and persuading departments to participate fully in the shared approach.[19] It is now starting to show, through the performance of the established expert services and efficiencies within departments' human resources functions, the benefits of this shared corporate approach (**Figure 11** overleaf). Civil Service HR is using the 'expert service' model to set up extra services for other areas of HR management.

18 Cabinet Office, *Meeting the challenge of change*, April 2013.
19 Comptroller and Auditor General, *Building capability in the Senior Civil Service to meet today's challenges*, Session 2013-14, HC 129, National Audit Office, June 2013.

Figure 11
Efficiency measures for human resources for the civil service

	Aim	March 2009 (Actual)	March 2014 (Actual)
HR to staff ratio	1:100	1:50	1:102
Cost of HR per employee	£644	£1,060	£614
Cost of HR per annum	£277 million	£524 million	£258 million

Note

1 The efficiency aims were set by Civil Service HR in 2009.

Source: Civil Service Human Resources

3.4 The four active expert services, Civil Service Employee Policy, Civil Service Learning, Civil Service Resourcing, and Organisational Development & Design, cost £21 million in 2013-14. They are mostly funded by departmental contributions based on headcount, with the largest departments paying the most.

- **Civil Service Learning**
  Gives access to learning products to civil servants and some other public sector employees, helping 102,000 people to attend face-to-face courses in 2013-14.

- **Civil Service Employee Policy**
  Helps departments to simplify HR policies across the civil service, including new performance management policies, which 90% of the civil service has implemented. It also gives policy expertise and implementation support to help departments make staff cost reductions.

- **Civil Service Resourcing (CSR)**
  Supports departments' recruitment, redeployment and talent management activities, including five departments and their agencies that have commissioned CSR to manage their recruitment. CSR aims to manage all civil service recruitment, which it believes would bring significant efficiency savings.

- **Organisational Development & Design**
  A small service that helps departments and arm's-length bodies to improve organisational performance through 'people-based approaches', including managing the impact of cost reductions on the business.

3.5 Civil Service HR is developing a fifth expert service – **Strategic Workforce Planning (SWP)** – to share expertise and give the centre a single view of workforce planning across government and to challenge poor practices. As set out in Part Two, departments' strategic workforce planning is inconsistent and there is insufficient urgency in completing long-term plans with enough detail. The SWP service should help to improve the quality and consistency of workforce planning and help the centre to challenge departments. However, the SWP service only launched in April 2015. This will limit its impact in helping departments to prepare for the next spending review, currently expected to take place in autumn 2015.

Using workforce information

3.6 The centre of government needs good-quality information from departments on workforce issues, to have a cross-government picture, manage risks and take strategic decisions for the whole civil service. For example, information from departments on future recruitment requirements could help CSR to plan recruitment campaigns and identify redeployment opportunities for staff no longer needed.

3.7 However, as set out in Part Two, some departments do not yet have systems to understand existing staff skills, and their future requirements. Departments' HR information systems are often incompatible with central data requirements, creating duplicate collection and reporting. This may be why departments sometimes see central data collection exercises as not helping their own workforce planning. For example, the MoD's skills audit, a requirement of the civil service capability plan, focused only on its civilian staff. However, MoD has an integrated workforce strategy with military as well and civilian staff. Departments also consider the centre makes overlapping requests for similar information and they are unclear how the centre uses the information. Civil Service HR and the Cabinet Office are reviewing the workforce information they collected and how to streamline their reporting requirements.

Spending control

3.8 The traditional government operating model has been one of departmental autonomy within an overall spending framework that HM Treasury sets. The Treasury allocates departmental budgets and departments work within them. Within the 2010–2015 Parliament, the spending review 2010 set out departmental budgets for the four years to 2014-15 and the spending round 2013 set out budgets for 2015-16.

Pay control

3.9 HM Treasury also sets the pay frameworks for departments to work within, including requirements for getting its approval for non-standard pay arrangements. The Treasury, with Cabinet Office advice, publishes annual pay guidance with which departments are expected to comply when agreeing pay settlements. The Treasury monitors compliance and collects data on pay changes that departments implement. This guidance restricted pay increases to 1% for the previous three years (2012-13 to 2014-15), which followed a two-year pay freeze.

3.10 The Cabinet Office, supported by the Treasury, has encouraged departments to reform and harmonise their pay and terms and conditions. In the autumn statement 2013, the government set out an ambition to end progression pay by 2015-16 for civil servants. Then, around 13% of civil servants had employment contracts with automatic annual increases, known as progression pay. Removing progression pay typically involves the Treasury giving a department one-off funding so it can buy out certain conditions from its workforce. Departments must submit business cases setting out a payback period, but departments and the Treasury can take a long time to reach agreement. In the Budget 2015, the Treasury reported that it had agreed proposals with all departments.

3.11 The Treasury has also allowed departments some flexibility for specific recruitment issues where higher salaries are necessary to attract and retain required skills. For example, the Treasury approved a DfT business case for the Rail Executive to pay some staff above standard rates because of difficulties recruiting high-quality candidates.

3.12 However, departments' HR directors remain concerned that they still have insufficient flexibility within the Treasury's pay framework, and are constrained in how to pay their workforce. Since 2014-15, the Treasury has been trialling a pay bill control pilot in the Department for Environment, Food & Rural Affairs (Defra) and the Intellectual Property Office. This arrangement gives employers control within the overall pay budget rather than limiting headline pay awards. The Treasury has not yet evaluated the pilot, but expects to consider it before the next spending review. Departments are keen for this approach to be available more widely as they believe it will let them make better use of their funding.

3.13 The Treasury does statistical analysis to estimate pay differentials in departments, agencies and arm's-length bodies (after controlling for some individual, role and departmental characteristics). The results show possible inconsistencies across core departments between the salaries of comparable staff in comparable grades. The Treasury facilitates and encourages benchmarking of pay across departments and challenges those bodies appearing as outliers. Using this analysis to ask departments for clarification, explanation and justification is an example of how the centre of government can use its position to better understand the cross-government picture and to support effective cost reduction.

The next spending review

3.14 Following the May 2015 general election the Treasury will need to agree departmental spending settlements for 2016-17 and beyond. We have found that the information departments gave the Treasury, to support spending decisions as part of the 2010 spending review, was often not complete or robust. The Treasury required departments to give only limited explanations of their proposed spending and there were particular gaps in workforce information.[20] The next spending review gives the Treasury an opportunity to assure itself that departmental settlements are supported by effective and deliverable workforce plans.

3.15 Since the 2010 spending review, staff reductions took place mainly in the first 24 months, and reductions then slowed (Figure 2). Before the next spending review, departments might hold back possible reductions, knowing that they must offer further reductions in that spending review.

The centre's influence in the wider central government and public sector workforce

3.16 As mentioned in Part One, the civil service represents only 9% of the public sector. Given that Civil Service HR does not have responsibility outside of the civil service, the centre currently needs to achieve influence through informal networks and the departments' sponsorship of their arm's-length bodies.

3.17 Civil Service HR is exploring how non-civil service bodies, such as non-departmental public bodies, could access its expert services. This is prompted in part by organisations moving from the civil service to the wider public sector and who wish to continue to use Civil Service HR services. Wider use of its services would have implications for the Civil Service HR business model, but could support better workforce planning through the sharing of good practice between the civil service and the rest of the public sector.

20 Comptroller and Auditor General, *Managing budgeting in government*, Session 2012-13, HC 597, National Audit Office, October 2012.

Appendix One

Our audit approach

1 We examined departments' progress in reducing staff costs and numbers, and how the centre of government is influencing the speed and direction of change, while recognising that departments (and their arm's-length bodies) employ their own staff.

2 We organised our work around three questions:

- Have departments significantly reduced their staff costs?
- Do departments have a strategic view of workforce planning, to make further cost reductions?
- Through its power and influence, does the centre of government contribute to staff cost management across government?

3 Our audit approach is summarised in **Figure 12** overleaf. Our evidence base is described in Appendix Two.

Figure 12
Our audit approach

The objective of government

The government expects to reduce the civil service headcount by 23% between 2010 and 2015, to 380,000 staff, resulting in a reduction of staff costs. Departments are likely to have to make further reductions after 2015.

How this will be achieved

Departments are being challenged by the centre to produce the required reductions in headcount and costs while ensuring they retain and attract key skills.

Our study

This study examines the progress that has been made to reduce staff costs and numbers in departments since 2010, and how the centre of government is influencing the speed and direction of change.

Our evaluative criteria

Have departments significantly reduced their staff costs?	Do departments have a strategic view of workforce planning in order to make further cost reductions?	Through its power and influence, does the centre of government contribute to staff cost management across government?
• Analysis of published data sources (Office for National Statistics, Resource Accounts, Workforce Management Information and Quarterly Data Summaries) • Searches of Hansard and the internet for written ministerial statements	• In-depth case study reviews of workforce planning in four departments • Discussions with government agencies and non-departmental public bodies to discuss workforce planning and their relationship with their parent department and the centre of government • Discussions with external experts	• Interviews with Cabinet Office and HM Treasury • Consultation with the Cabinet Office coordinated HR Board • Review of Committee of Public Accounts reports, Treasury Minutes, Cabinet Office and HM Treasury publications

Our evidence

(see Appendix Two for details)

Our conclusions

Departments have significantly reduced their staff costs and numbers. They reduced staff numbers mainly by minimising recruitment, and the age profile of the civil service has changed. It remains to be seen what effect this has had on the future pipeline of talent and skills.

In addition, departments' progress in developing and implementing long-term operating models is not advanced enough to sustain existing reductions and to be well placed to make the expected reductions during the 2015–2020 Parliament.

To achieve value for money, departments face the challenge of ensuring that their ongoing reductions are sustainable. They must prioritise developing and strengthening their long-term operating models and strategic workforce plans, and ensure they recruit or develop the critical skills needed.

The centre of government is building its strategic role, but must do more to support departments to meet these challenges; for example, by giving them more expert services and more flexibility to manage their pay bill.

Appendix Two

Our evidence base

1 We reached our conclusions using evidence collected between August 2014 and December 2014. Our fieldwork comprised:

- **Data analysis**
  Resource accounts, Office for National Statistics data, Workforce Management Information (www.gov.uk/search?q=workforce+management+information) and Quarterly Data Summaries (see paragraphs 3 to 6 below).

- **Reviews**
  In-depth case study reviews of workforce planning in four departments (see paragraphs 7 to 9).

- **Interviews**
  Interviews with Cabinet Office and HM Treasury (see paragraphs 10 to 11).

- **Consultation**
  With external stakeholders and experts including:

  - The cross-government 'HR People Board' to discuss experiences and expectations of future workforce planning in their departments, the centre's role and recommendations for effective workforce planning.

  - A focus group with several government agencies and non-departmental public bodies to discuss workforce planning, the relationship with parent departments and the centre over workforce issues and any recommendations for effective workforce planning.

  - Discussions with external experts including senior managers from businesses in the professional services, telecoms and pharmaceutical sectors, and the Chartered Institute of Personnel and Development about approaches to staff cost reduction and skills requirements.

- **Searches**
  Searches of Hansard and the internet to identify ministerial statements announcing progress or plans for staff costs and headcount reduction.

- **Publications review**
  Review of Committee of Public Accounts reports, Treasury Minutes and Cabinet Office and HM Treasury publications.

Data analysis

2 We used the audited consolidated accounts for the main government departments to identify current spending on staff. From each set of 17 departmental accounts, we used the staff costs, at the administration and programme level, for core and agency to represent the civil service.

3 To analyse cost reductions and headcount reductions, we analysed Office for National Statistics (ONS) data on the civil service. Using data from the ONS *Quarterly Public Sector Employment Survey*, we plotted the reduction in actual civil service full-time equivalent (FTE) staff. The original projection of 380,000 (March 2015) was based on departments' estimates in early 2012, and included machinery of government changes they expected at the time. We have adjusted this original projection for unanticipated organisational changes that moved existing public sector employees in or out of the civil service (such as the creation of Public Health England) to produce an updated projection of 400,000. We did this by:

- increasing the projection by the current FTE in those bodies created or moved into the civil service that were not included within the 2012 projections;
- excluding existing civil servants who transferred into the new bodies; and then
- excluding the projected March 2015 FTE in bodies that subsequently moved out of the civil service.

4 We used the ONS *Annual Civil Service Employment Survey* from 2010 to 2014 to analyse the following:

- numbers of entrants into the civil service;
- numbers of leavers out of the civil service and their cause of leaving;
- numbers and proportion of civil servants by grade; and
- variance analysis of the impact on annualised total salary cost, from changes in pay, staff numbers and grade mix based on the bodies included in the ONS data (**Figure 13**).

5 To complete the variance analysis, we identified which civil service bodies could be used for comparison. Where possible, 2010 data have been adjusted to reflect the agencies contained within the relevant departmental group boundary as at 31 March 2014. For example, the Land Registry and the Met Office are now included within the Department for Business, Innovation & Skills (BIS) in both March 2010 and March 2014 as opposed to the Ministry of Justice (MoJ) and the Ministry of Defence (MoD) respectively in 2010. Where bodies have merged with or into other bodies we have reflected this by adjusting the 2010 data.

Figure 13
Calculating the variance

Total variance

Real-terms increase/decrease in annualised salary costs from March 2010 to March 2014

Price variance

Impact of real-terms increase/decrease in annualised salary cost per FTE

Price Variance Calculation:

2014 number of staff by grade
x
2010-2014 change in average salary by grade

This method eliminates the change in staff numbers (by holding it constant at 2014 levels) to estimate the impact of changing average pay rates for each grade between 2010 and 2014. Numbers are aggregated to body then departmental group level.

Quantity variance

Real-terms impact of increase/decrease in FTE

Quantity Variance Calculation:

2010 average salary by grade
x
2010-2014 change in number of staff by grade

This method eliminates the change in annualised pay rates (by holding them constant at 2010 levels) to estimate the impact of changing FTE staff numbers for each grade between 2010 and 2014. Numbers are aggregated to body then departmental group level.

Grade mix variance

Real-terms increase/decrease in annualised salary cost resulting from changes of the proportions of staff in each grade

Mix Variance Calculation:

(2014 number of staff by grade x 2010 average salary by grade)
minus
(2010 grade mix x total number of staff in 2014 x 2010 average salary by grade)

This method eliminates the change in overall number of staff and annualised pay rates (by holding them constant at 2014 and 2010 levels respectively) to estimate the impact of change in grade mix between 2010 and 2014.

Source: National Audit Office

6 Government bodies which are included in the ONS data in 2010 but not in 2014 (for example, due to becoming NDPBs or transferring to the private sector) or are in the 2014 data but not the 2010 (for example, bodies that have switched from NDPB to agency status) are excluded from our analysis. Some departments' wider groups include a significant number of staff who are not included in our analysis. For example, the BIS Group includes six research councils, which employ around 5,000 staff who are not civil servants and so are not included in the analysis.

Case study departments

7 We carried out more in-depth work in four case study departments: HM Revenue & Customs (HMRC), the Ministry of Defence (MoD), Department for Transport (DfT) and the Department for International Development (DFID).

8 Our work involved the following:

- Interviewing departments to see their response to the reductions in the spending review 2010 and how they have achieved targets, including any strategies or workforce plans used.
- Further analysis of departments' workforce plans and strategy to see how sustainable their proposals are, what thought they gave to productivity and skills, and what input the centre gave.
- Meeting with spending teams within HM Treasury to discuss their relationships with departments, progress made against targets and future workforce plans.
- Reviewing our previous work for examples of good practice of workforce planning and conducting academic research to help form our framework for managing staff costs, against which we measured the case study departments.

9 We chose our case studies for several reasons:

- HMRC is the second largest employer in the civil service.
- DfT is a decentralised department that had just completed a significant employment reform.
- DFID has high staff unit costs and is one of the few departments with an increased budget during the 2010–2015 Parliament.
- MoD is a large employer and works in a complex environment with military and civilian staff in the UK and overseas.

Interviews with the centre of government

10 We interviewed staff at Cabinet Office and HM Treasury to understand how they help departments to reduce staff numbers and costs, how well the centre of government has worked together and how they have worked with front-line departments.

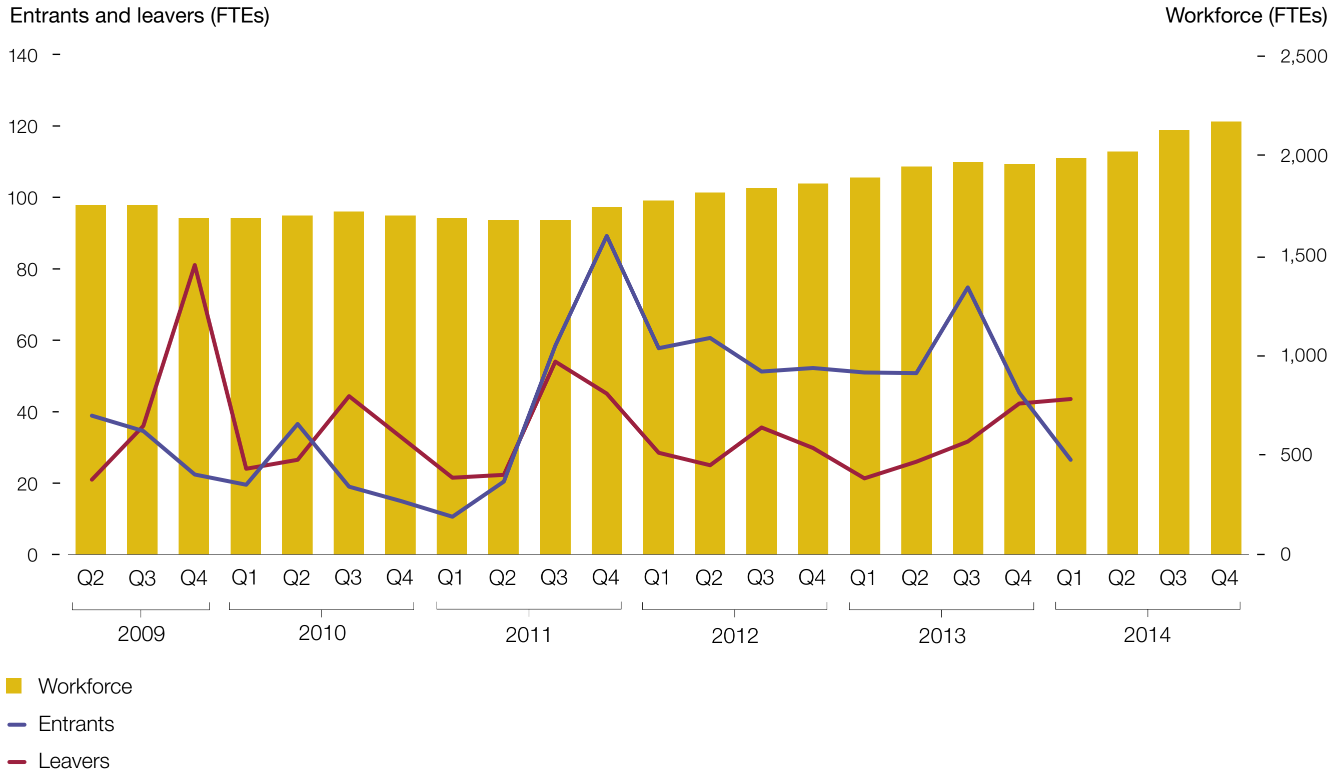
Appendix Three

Workforce changes: four case study departments

1 This appendix summarises the changes in the workforce in DFID (**Figure 14**), DfT (**Figure 15**), HMRC (**Figure 16**) and MoD (**Figure 17**), including their progress on strategic workforce planning.

Figure 14
Department for International Development (DFID)

Workforce changes, 2009 to 2014



Notes

1 Entrants and leavers include movers within the civil service.

2 The entrants and leavers data may not reconcile with the published workforce totals due to possible differences in which reporting period entrants and leavers are recorded and inconsistencies in the reporting of part-time and casual staff.

3 The data exclude DFID's locally recruited 'Staff Appointed in-Country', who are employed outside the UK and form about one-third of DFID's workforce.

Commentary

1 **Workforce changes since 2010.** The DFID workforce has grown since late 2011, in response to the requirement to manage an increased overseas aid budget.

2 **Long-term operating model.** DFID changed its operating model, placing more of its staff in developing countries and fewer in back-office functions in the UK.

3 **Strategic workforce plan.** DFID's workforce planning set out projected workforce numbers for its individual business areas up to March 2014, and it extended this with a business planning process up to 2015-16. It is now developing a new strategic workforce planning methodology.

4 **Skills strategy.** DFID undertakes an annual skills audit to check it is developing the skills it needs to meet its priorities. To help manage an increasing aid budget DFID has prioritised developing programme management and commercial skills.

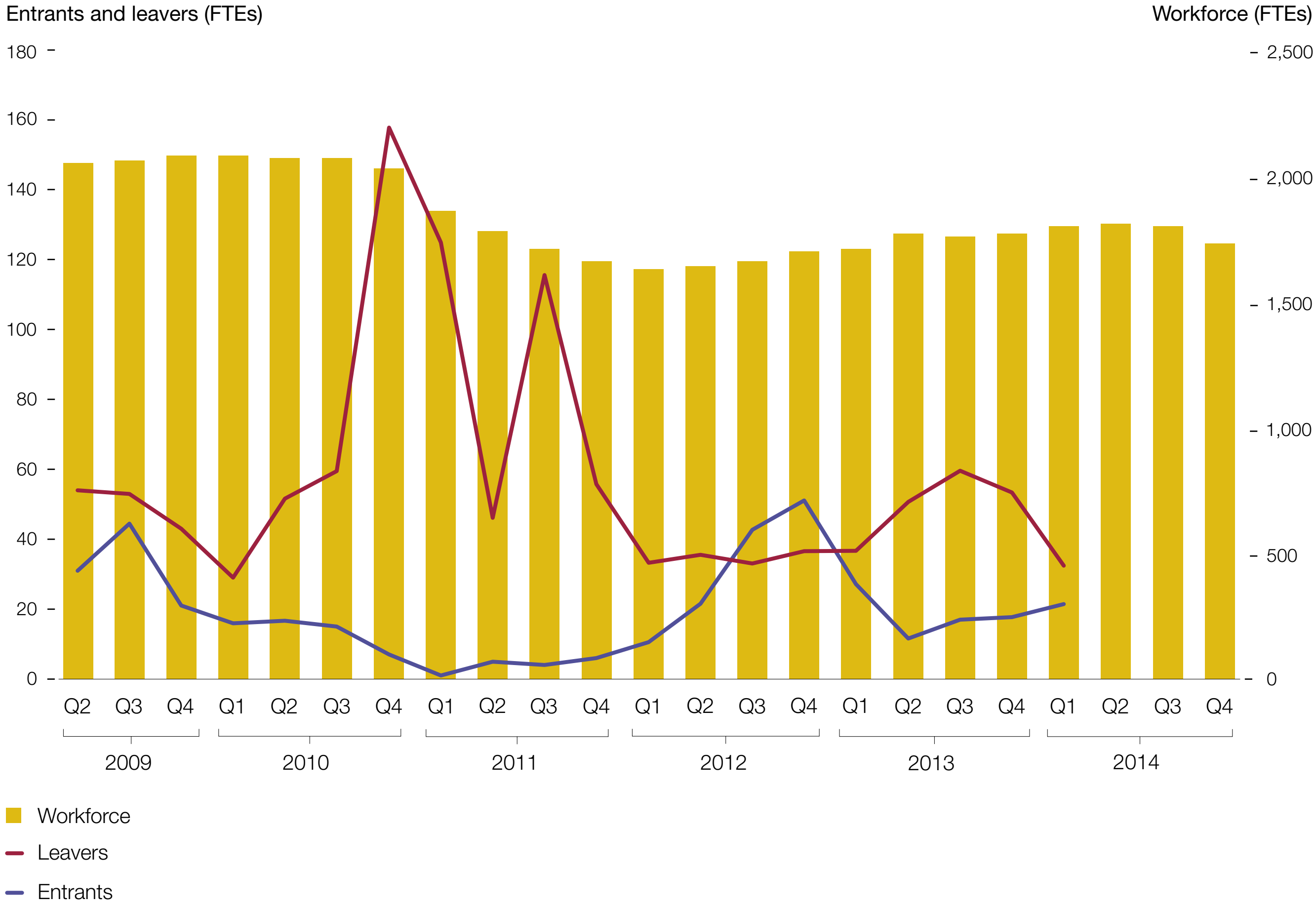
5 **Workforce challenges.** DFID operates in increasingly fragile and volatile states and this has implications for the recruitment and deployment of its employees.

Source: National Audit Office analysis of Office for National Statistics *Annual Civil Service Employment Survey* and *Quarterly Public Sector Employment Survey* data

Figure 15

Department for Transport (DfT)

Workforce changes, 2009 to 2014



Notes

1 Entrants and leavers include movers within the civil service.

2 The data are for the core department.

Commentary

1 **Workforce changes since 2010.** Some DfT agencies have completed major workforce restructures. Overall, DfT has reduced its workforce by 15% since 2010.

2 **Long-term operating model.** DfT's annual corporate plan includes assessing skills requirements, but it has not set out a long-term operating model.

3 **Strategic workforce plan.** DfT reviews lists of projects and timelines to identify skills requirements. It forecasts grade and location FTE requirements for the following financial year but this does not capture skills requirements.

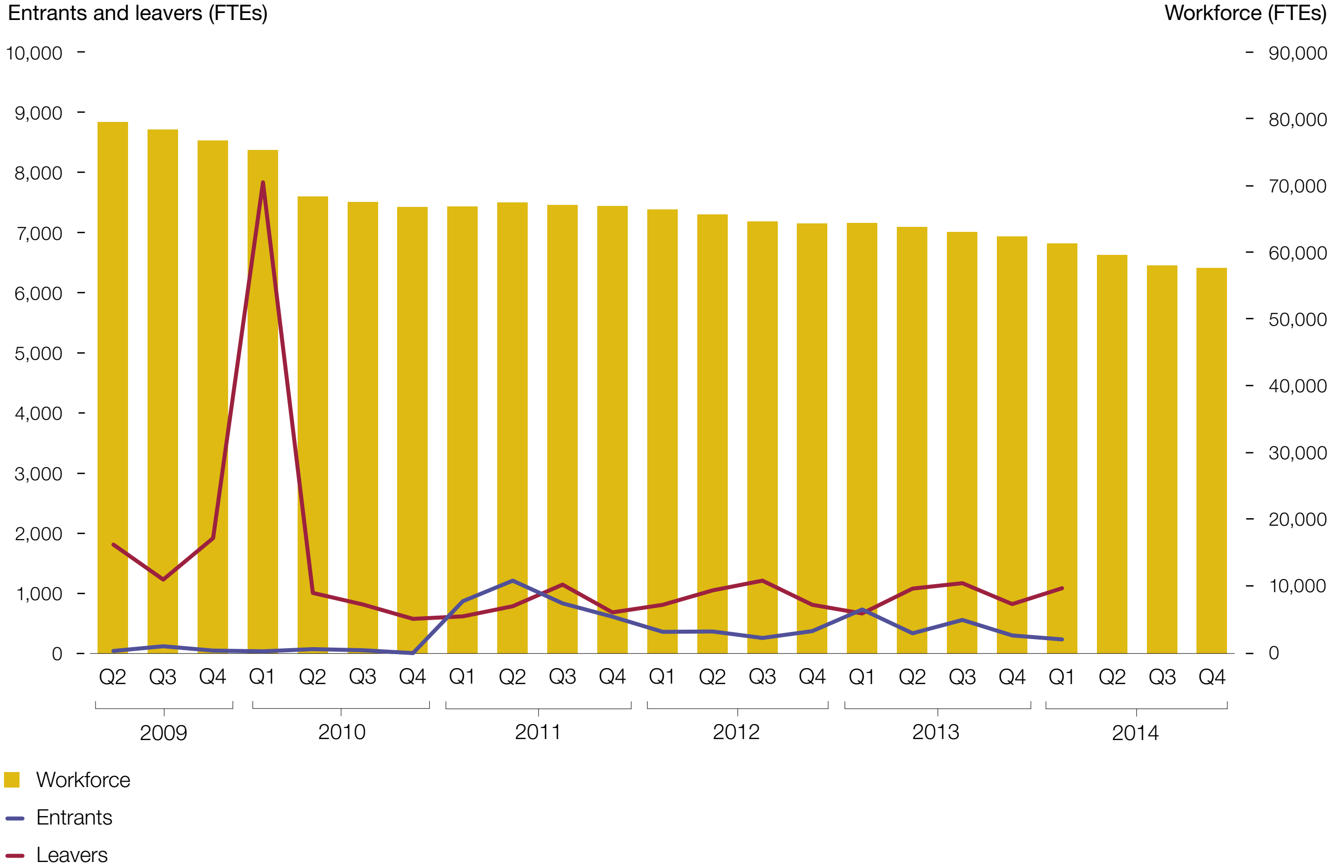
4 **Skills strategy.** DfT gathers skills information and identifies skills gaps across the core department and captures high-level information from its agencies. The Driver and Vehicle Licensing Agency has completed a skills audit to identify skills and training needed to use digital operations more. The Maritime & Coastguard Agency is planning better training and a competency framework.

5 **Workforce challenges.** Over the next two years DfT will make large-scale structural changes, while managing further budget restraint and expected increases in road and rail usage.

Source: National Audit Office analysis of Office for National Statistics *Annual Civil Service Employment Survey* and *Quarterly Public Sector Employment Survey* data

Figure 16
HM Revenue & Customs (HMRC)

Workforce changes, 2009 to 2014



Notes

1 Entrants and leavers include movers within the civil service.

2 The data are for the core department.

Commentary

1 **Workforce changes since 2010.** Initial 2010 Spending Review and 2013 Spending Round plans were to reduce the HMRC workforce to 52,000 by March 2016, but projections were later revised upwards following increased funding for enforcement and compliance. HMRC's workforce was 56,300 at March 2015, a 20% reduction from 2010, and is estimated to increase to 58,900 FTE by March 2016.

2 **Long-term operating model.** HMRC has produced a 'blueprint', setting out how it plans to work. An ambitious change programme already under way involves widespread reform, investment in people and how they work, and how HMRC interacts with taxpayers.

3 **Strategic workforce plan.** HMRC carries out an annual business planning exercise, producing detailed projections for each business line for the following year. This has allowed HMRC to develop 'tactical delivery plans' to address specific areas. HMRC is still developing systems to produce an overall workforce plan for the next five years but it expects its workforce to be flexible and deployed responsively to demand.

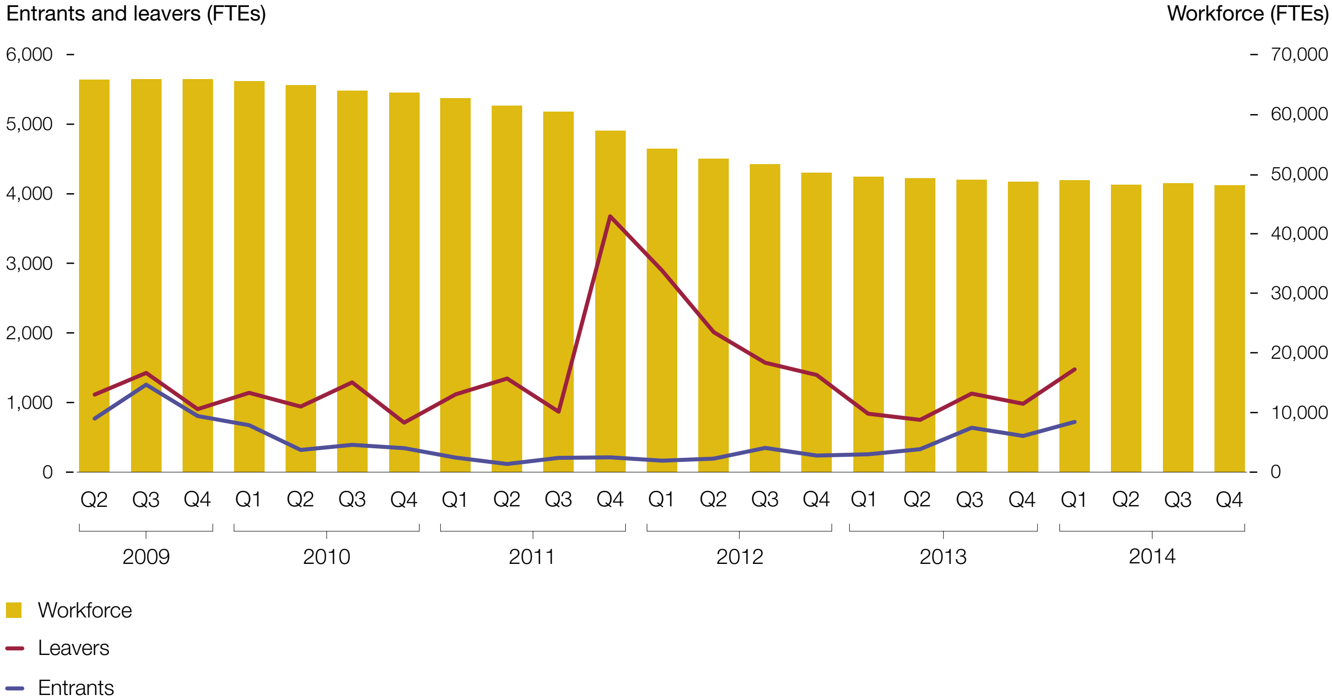
4 **Skills strategy.** HMRC is identifying skills it needs for its new operating model, but has not yet measured its requirements or skills gaps. HMRC has identified the continuing need to grow its tax profession and has introduced a tax academy and an apprenticeship scheme. It also predicts increasing digitalisation will create a need for a wider range of skills such as customer service.

5 **Workforce challenges.** HMRC faces a significant challenge to maintain performance while transforming the organisation, including changing workforce skills and rationalising its estate. With an ageing workforce, HMRC risks losing experienced staff through retirement.

Source: National Audit Office analysis of Office for National Statistics *Annual Civil Service Employment Survey* and *Quarterly Public Sector Employment Survey* data

Figure 17
Ministry of Defence (MoD)

Workforce changes, 2009 to 2014



Notes

1 Entrants and leavers include movers within the civil service.

2 The data are for the core department and includes civilian staff only.

Commentary

1 **Civilian workforce changes since 2010.** Following the 2010 Spending Review, the MoD agreed to reduce its civilian workforce by around 25,000 people. The main reductions were between 2009 and 2012.

2 **Long-term operating model.** In September 2014, MoD published its new operating model (*How Defence Works*) following Lord Levene's Defence Reform report (2011). The model envisages a smaller, more effective armed force, using the 'whole force' concept. MoD has devolved financial control to its six 'top-level budgets' (TLBs) and they decide how to integrate civilian, military, temporary and outsourced resources.

3 **Strategic workforce plan.** MoD delegates workforce planning to its business areas, which produce workforce information up to 2023-24.

4 **Skills strategy.** MoD has a skills strategy setting out skills needed and how to get them, and the management of skills is delegated to business areas. The MoD does not collect detailed skills information, but it is now monitoring critical skills requirements across the department.

5 **Workforce challenges.** MoD's budget has not been protected and so further civilian reductions may be likely. It is constrained by the need to meet government commitments to maintain its three services above specific levels, meaning that overall budget cuts focus more on civilian staff and may result in (more expensive) military staff in civilian roles. The MoD workforce is ageing, with 46% of the civilian workforce aged over 50 as at March 2014.

Source: National Audit Office analysis of Office for National Statistics *Annual Civil Service Employment Survey* and *Quarterly Public Sector Employment Survey* data

Appendix Four

Cost reduction and workforce planning in the private sector

1 This appendix summarises private sector practices, setting out the main aspects of their approach to staff cost reduction. This is simply a record of what we found out about the private sector. We understand the context differs in the public sector and we have not tried to assess whether these approaches could or should be applied in central government. We do think it is useful, however, for central government to know the benefits, and risks, of practice elsewhere.

2 The key practices and beliefs included:

- **Change management process**
  A good management process is critical, and requires performance information.
- **Decision-making**
  Workforce and capability information is vital. It is also vital to make quick decisions (and be willing to act on data that are 'good enough').
- **Cultural change**
  Where cultural change is needed in an organisation, a high turnover of staff makes it easier.
- **Flexible contracts**
  Where operating models are changing, a workforce with flexible employment contracts (for example, fixed-term contracts), is likely to be efficient and help the transition to the new operating model.
- **Redundancy disincentives**
  Redundancy schemes risk productivity by demotivating staff and prompting talented staff to leave. Processes can distract management, and a drawn out process is undesirable when management already know which staff they would like to leave the organisation.
- **Voluntary schemes**
  These schemes are difficult to run well, as talented staff often apply to leave (as they are confident of finding alternative work) and staff whose applications to leave are rejected may become less engaged.

- **Flexibility**
  A flexible approach to staff exits is beneficial. Voluntary agreements, between the employer and selected employees who are no longer needed, can work well for both parties if done correctly.
  - It does not waste management time in performance management effort and delaying the inevitable departures.
  - It does not disrupt other staff.
  - An agreement can be reached quickly.
- **Support for leavers**
  Outplacement support, helping staff find work, helps ensure that leavers depart on good terms with their former employer.
- **Replacing skills, and pay packages**
  When releasing many employees swiftly but realising it has shed critical skills, private sector companies quickly rehire and are prepared to be flexible in pay packages to get the right people.

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