



National Audit Office

# The impact of costing across government

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Society for Cost Analysis and Forecasting, 17 September 2013

# Structure of talk

- NAO study on costing
- Our key provisional findings
- Why problems persist
- Conclusions and discussion

# Role of the NAO

## Our role

- To provide independent information, assurance and advice to Parliament on use of public resources
- To help promote better financial management and value for money

## Our audit work

- Totally independent of government
- Financial: To audit the accounts of all central government bodies
- Value for money (VFM): To produce around 60 reports each year,

## Our audiences

- The Committee of Public Accounts (PAC) – chaired by Margaret Hodge
- Other Select Committees
- The public

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# What is the impact of costing on government activity?

- Why costing matters
- How costing affects:
  - strategic allocation of resources;
  - project management;
  - delivering services cost-effectively; and
  - working with third parties
- Why problems with costing persist

Plan to publish in autumn – also costing panel

# Methods

- Review of the NAO's back catalogue
- Case studies
- Focus groups
- Review of central government guidance and departmental board minutes
- Private sector comparison

# Methods: Case studies and key issues highlighted

Decision-making area	Some characteristics of good practice	Main case studies
<b>Strategic resource allocation</b>	Ongoing assessment of costs Cost estimates linked to outcomes and outputs	Ministry of Defence Equipment Plan Patient-level costing in the NHS
<b>Managing projects and programmes</b>	Cost estimates updated in advance of decision points Cost variances examined and understood	Thameslink FiReControl
<b>Delivering services more cost-effectively</b>	Cost allocation used to incentivise better performance Full costs of activities understood	Managing the defence inventory Customer call costs in HM Revenue & Customs
<b>Working with third parties</b>	Contract design reflects estimated costs of different activities Benchmarking of supplier costs	Troubled Families programme Rural broadband

# Provisional Findings: Summary

1. Government has not sufficiently recognised the importance of strong costing to achieve value for money, particularly in a context of spending reductions.
2. This puts billions of pounds of public money at risk and could damage public services.
3. While there are some encouraging areas of improvement, progress has historically been limited.
4. Without a systematic approach to improving costing throughout the public sector, we will see recurring problems in the planning and delivery of public services

# Provisional Findings: **NAO's prior reports**

- **120** out of **127** recent value-for-money reports show poor costing contributed to findings
- **£861bn** of activity covered by the **120** reports
- **85** of the **127** reports in which poor costing contributed to a conclusion of poor value-for-money

# Why problems persist: **proximate causes**

- **Failure to link inputs to outcomes:** Overall, 97 per cent of our reports found difficulties in linking input costs to outcomes.
- **Failure to consider the full costs:** We consistently identified poor consideration of costs to stakeholders such as other government departments (61 per cent of reports) and service users (74 per cent).
- **Inadequate data:** We found issues with cost measurement in 73 per cent of our reports.

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# Provisional Findings: **Why costing matters**

Government is facing two key challenges that costing has a significant impact on:

- **Fiscal constraints** The government plans for departmental spending to fall in real terms from £428.8 billion in 2009-10 to £362.6 billion in 2015-16, a reduction of 15.4 per cent.
- **Demand for services** Changing demographics and service user needs

# Decision making: **Allocation of resources strategically**

Of 120 recent reports that found costing issues **59** identified issues with costing in allocating resources, covering 15 government departments and **£326bn** of activity

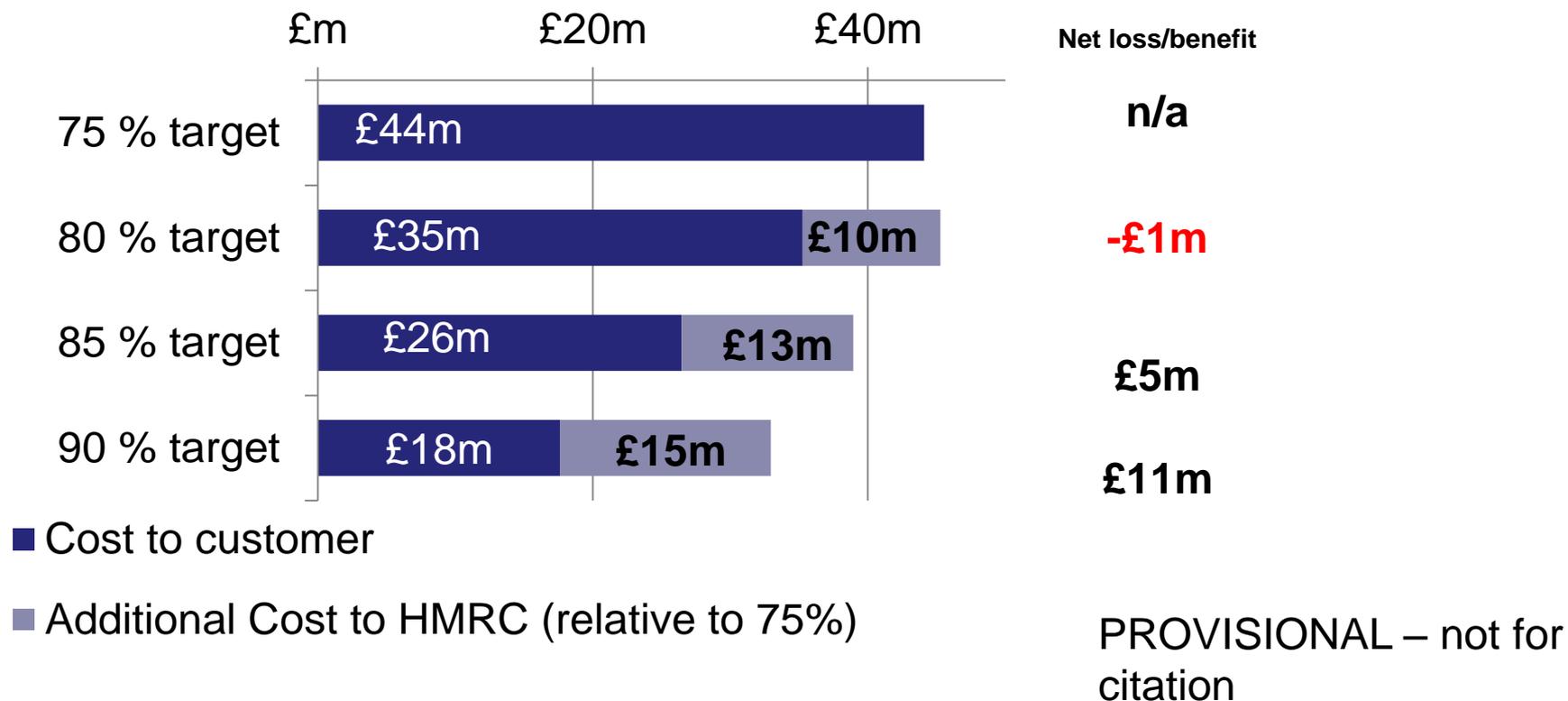
- **Bernard Gray's report on defence acquisition found the MOD had:** "substantially overheated equipment programme...too many types of equipment being ordered for too large a range of tasks at too high a specification".
- This resulted from poor cost information used in decision making due to poor understanding of lifetime costs and lack of incentives to submit realistic estimates
- In the **69** projects included on the NAO's MOD major project reports from 2000-2012 overall costs increased by **11.4%** or **£6.1 bn**

# Decision making: Projects and programme management

Costing issue	Thameslink	FiReControl
Understanding of cost drivers	Able to identify problems and their effects	Links between components and cost implications not made
Revision of estimates	Estimates became more accurate as the project developed	Estimates were revised only towards the end of the project
Systems in place to capture data	Project management process included data collection	Limited information on actual cost outturns collected during the first few years of the project
Cost information used to support decision-making	Timing of decision points informed by cost developments Relevant information provided at key decision-making stages	Cost information not produced at decision points

# Decision making: Delivering services more cost-effectively

Overall spending reductions require departments to provide their existing services more efficiently.



# Decision making: **Working with third parties**

- **Promoting valuable activity by suppliers.** If government understands the costs of different activities for its suppliers, it will know the implications of different contract terms
- **Ensuring value for money in bid pricing.** Benchmarking of bids against public sector and other comparators allows government to identify potentially excessive bids, particularly when competition is limited
- **Allowing flexibility after the contract is signed.** Understanding what effects suppliers' costs can help government strike a good deal if contracts are renegotiated

# Decision making: Working with third parties - Rural Broadband

- DCMS aim for 90% of premises in all areas of the UK to have access to at least 24 megabits per second internet speed by providing grants to local bodies who procure services for their areas
- The market for superfast broadband is dominated by BT. The lack of competition means that cost benchmarking is particularly important to achieve value for money.
- The Department has only limited assurance that cost assumptions in supplier bids are reasonable and contain significant contingency.

# Structure of talk

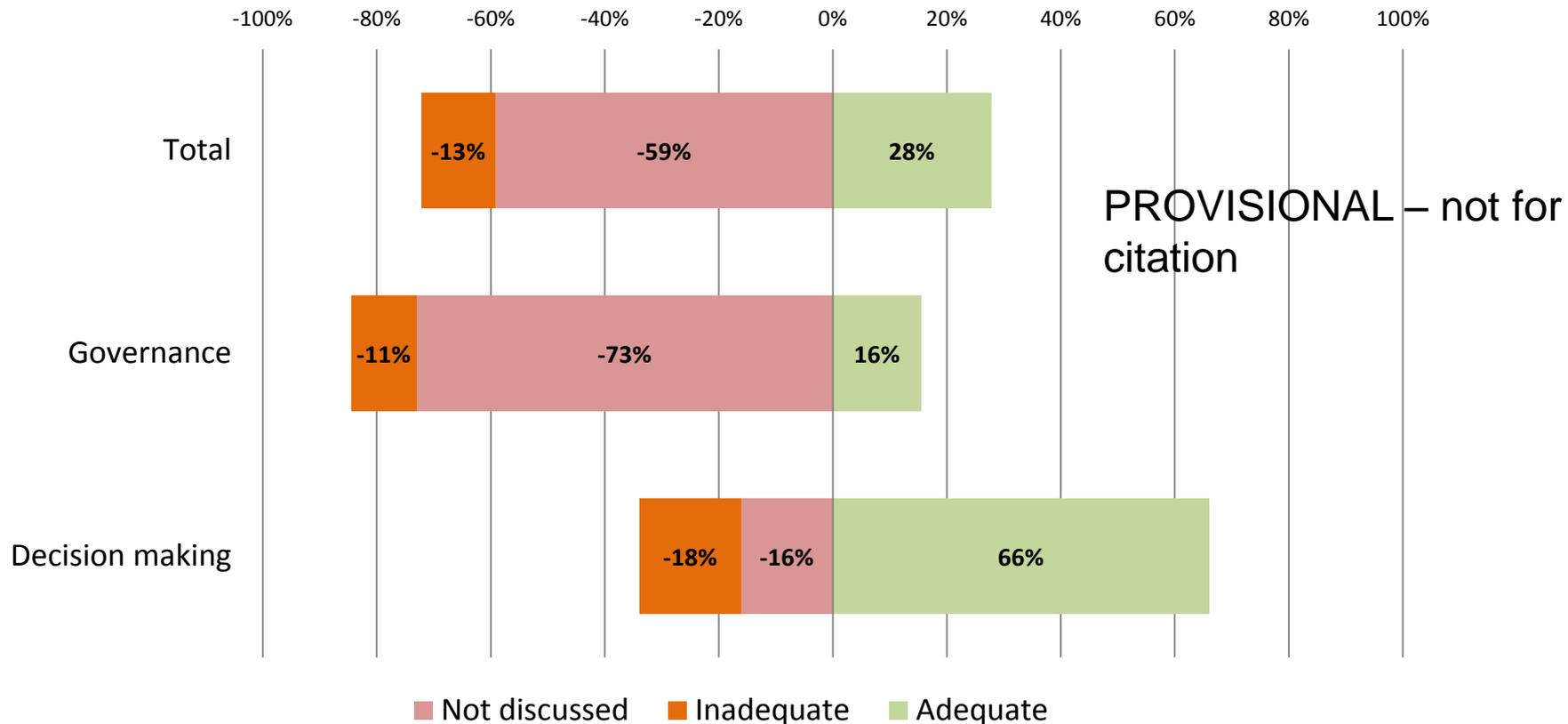
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# Why problems persist

- Senior management emphasis
- Incentives within departments
- Not making the most of opportunities to improve

# Why problems persist: Senior management emphasis

## Costing discussion in departmental boards is limited



# Why problems persist: **Incentives within departments**

Our focus groups also raised several issues with poor incentives to improve costing:

- Many **costs** are **not allocated** to budget holders
- There is **little scrutiny of cost estimates** by senior management.
- There is **potential to lose resources** if understanding of costs improves.
- The availability of **contingency** budgets **masks poor cost estimates**.
- Senior staff require **simplified analysis**.

# Why problems persist: **Big opportunities to improve**

There is a long way to go before government achieves excellence in costing. But we have found several examples of improved costing in public bodies:

- **The Department of Health:** linking inputs to outcomes
- **The Ministry of Defence:** improved processes
- **HEFCE:** transparent systems

As part of the 2013 spending round, the Chancellor announced a review of government financial management capability

# Learning from the private sector

Deloitte produced a report for us on private sector costing. Case studies explored some ways in which private sector enterprises are transforming costing.

These included ‘tone from the top’ and the use of internal service catalogues to encourage business units to use resources efficiently.

- **Leadership** e.g. Global pharmaceutical company
- **Skills** e.g. Global Energy Provider
- **Processes** e.g. Major UK airport

Deloitte concluded that: "The public sector can look to the private sector for examples of leading costing behaviour"

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# Recommendations

## Departments

- Set a clear tone from the top
- Ensure that basic information is good enough
- Encourage managers to experiment with how they use costing beyond the basic requirements
- Identify gaps in costing capability, and act to address them.

## Cabinet Office and HM Treasury

- Set clear expectations about the costing information they need to perform their roles of leadership, coordination and challenge.

## The Finance Leadership Group

- Place costing at the heart of financial transformation.

# Overview

- Our conclusions
  - Costing matters, and it's underappreciated.
- What we hope you will take away
  - Good time for transformation in approach
  - Costing expertise needs to be championed across government – not just 'pockets of excellence'
- What do you think could be done to generate improvements?