Northern Ireland Assembly

Research and Information Service
Briefing Note

Paper 166/12 17 October 2012 NIAR 780-12

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Estimating the cost of machinery of government changes

1 Introduction

This briefing note has been prepared for the Assembly & Executive Review Committee following its meeting on 9th October 2012. At the meeting the Committee requested information on costs of machinery of government changes. The briefing highlights two examples of costing machinery of government changes, including reorganisation of government departments and arms-lengths bodies. It outlines the methodology used by the National Audit Office and Institute for Government in their reports on this issue. Costing machinery of government (MoG) changes is a complex task using cost models and, potentially, externally commissioned specialist advice.

2 National Audit Office report on reorganising central government

In 2010 the National Audit Office (NAO) produced a report on reorganising central government, with a particular focus on arm's length bodies. As part of its report the NAO examined the costings around 51 government reorganisations in the period 2005-2009. As part of the project, NAO commissioned PricewaterhouseCoopers (PWC) to analyse and interpret financial information to estimate total reorganisation costs. The methodology is reproduced in Appendix 1. The NAO report found that:

> We estimate the gross cost of the 51 reorganisations covered by our survey to be £780 million, equivalent to £15 million for each reorganisation and just under £200 million a year. Around 85 per cent of the total cost is for establishing and reorganising arm's length bodies. The main cost areas relate to staff, information technology and property.[1]

The report admits that this estimate is incomplete and does not cover all direct and indirect costs or all of the reorganisations that took place in the time period. One of the report's conclusions was that:

> The value for money of central government reorganisations cannot be demonstrated given the vague objectives of most such reorganisations, the lack of business cases, the failure to track costs and the absence of mechanisms to identify benefits and make sure they materialise. Some arm's length bodies apply sound cost management and systematic benefits measurement, but even they cannot necessarily demonstrate value for money. Overall, the value for money picture is unsatisfactory and the costs are far from negligible[2].

The NAO recommended that:

- There should be a single team in government with oversight and advance warning of all government reorganisations
- For announcements of significant reorganisations, a statement should be presented to Parliament, quantifying expected costs, demonstrating how benefits justify these costs and showing how both will be measured and controlled
- Intended benefits should be stated in specific measurable terms that enable their later achievement (or otherwise) to be demonstrated
- The planned and actual costs of reorganisations should be separately identified within financial accounting systems so costs can be managed and subsequently reported
- A breakdown of planned and actual costs and financial benefits of every significant central government reorganisation should be reported to Parliament in the organisation's annual report in the year the reorganisation is announced
- Each body at the heart of a central government reorganisation should share with the Cabinet Office an analysis of lessons learned within two years of the date of the reorganisation[3].

3 Institute for Government: Making and breaking Whitehall departments

A 2010 report from the Institute for Government estimated the cost of "for a new policy department and a mid-sized merger to be representative of the costs incurred in most department changes – roughly in the neighbourhood of £15m"[4]. The report notes that "We

[1] http://www.nao.org.uk//idoc.ashx?docId=c29af9d8-e22a-499b-bd5f-f31111d0b83f&version=-1
[2] As above
[3] http://www.nao.org.uk//idoc.ashx?docId=c29af9d8-e22a-499b-bd5f-f31111d0b83f&version=-1
[4] http://eprints.lse.ac.uk/27949/1/Making_and_breaking_Whitehall_departments_%28LSERO%29.pdf

believe our costs are pretty conservative since they do not include an estimate of disruption costs resulting from institutional memory loss, delivery risk or stakeholder relationship losses”[5]. This may not be as much of an issue in Northern Ireland, where the departments are still relatively new.

The IFG report posed some interesting questions based on its findings that should be asked before embarking on large-scale change[6]:

Questions to ask before reconfiguring departments		Our analysis shows that:
1.	Have we considered the alternatives to machinery of government change?	Administrative savings and greater policy coordination can often be achieved without reconfiguring departments.
2.	Are we prepared to spend at least £15m on this?	Restructuring costs are at least £15m.
3.	Are there big pay differences between staff in the affected departments? If so, are we prepared to level up salaries or risk industrial action?	Levelling-up differential pay can be a massive cost, exceeding £170m in one case.
4.	Can we afford a productivity dip and to wait for at least two years before realising concrete benefits of this reorganisation?	It takes at least two years for the new organisation to settle and three or more years to start realising expected benefits.
5.	Is this reorganisation really just about the politics of cabinet formation?	Changes undertaken for purely political reasons are the least likely to deliver real benefits.

The report found that “There is currently no regular or systematic information kept in Whitehall on the costs and benefits of departmental reorganisations”[7].

Furthermore, it criticised the Treasury’s insistence that any reorganisation be ‘cost-neutral’:

> The Treasury stance means that no more money is made available to a new or reorganised department than was provided in previous approved expenditures, even if the net effect of a set of changes is to enlarge the overall number of departments, and hence to multiply the number of private office and communications sets-ups providing key services to a secretary of state and a set of junior ministers. In modern terms this departmental core usually numbers around 130 civil service staff, some very senior, and costs around £15m a year to provide. The new department is expected to cover such elements by finding compensating savings from elsewhere within its existing or transferred-in budgets. This is a very difficult thing to do quickly and without much (or indeed any) preparation time[8].

The Institute devised a Department Change Cost Model based on interviews with senior civil servants, Department annual reports and documentation of change, Civil Service Statistics and Select Committee hearing minutes.

[5] As above
[6] http://eprints.lse.ac.uk/27949/1/Making_and_breaking_Whitehall_departments_%28LSERO%29.pdf
[7] As above
[8] http://eprints.lse.ac.uk/27949/1/Making_and_breaking_Whitehall_departments_%28LSERO%29.pdf

4 Conclusion

Estimating the cost of machinery of government changes retrospectively represents a most challenging task. Nevertheless, the National Audit Office and the Institute for Government have employed complex methodological approaches to attempt to do so.

Based on its methodology, the Institute for Government estimated the cost "for a new policy department and a mid-sized merger to be representative of the costs incurred in most department changes – roughly in the neighbourhood of £15m' and the NAO report reported a similar average cost for reorganisations. Treasury rules, however, require that any such reorganisations are 'cost-neutral' meaning that no more money is made available to a new or reorganised department than was provided in previous approved expenditures.

More accurate assessment of the costs of machinery of government change would, as the NAO highlights, require that: the intended benefits of reorganisation are stated in specific measurable terms so that their later achievement (or otherwise) can be demonstrated; and that the planned and actual costs of reorganisations are separately identified within financial accounting systems so that costs could be managed and subsequently reported.

Whilst retrospective examination of the costs of machinery of government change is challenging, attempts to accurately estimate the costs or savings deriving from future machinery of government changes may be even more difficult. Such estimation would require, at the very least, a plan detailing proposed changes; a statement of intended benefits; and an estimate of predicted savings and costs.

Regarding future machinery of government changes within the Executive, the Minister of Finance told the Assembly in October 2009 that "reducing the number of Departments from 11 to six would save tens of millions of pounds per annum on an on-going basis".[9] It is unclear, however, how this estimate was arrived at.

A previous research paper prepared by RaISe considered the potential savings of reducing the number of Northern Ireland departments and noted that '*The NICS (Northern Ireland Civil Service) may have some advantages over their Whitehall counterparts when it comes to reorganisation. Some functions are already delivered as shared services, such as HRConnect, IT Assist and Account NI, for example*'. Whilst factors such as these may make machinery of government changes more straightforward and less costly, the paper also noted that '*On the other hand, the fact that some back-office functions are already shared may undermine further the potential for reorganisation to deliver savings. In addition, if the changes require contracts with the shared services partner organisations to be renegotiated, there could be costs in varying those contracts*'[10].

[9] Official Report 6 October 2009, available online at: http://www.niassembly.gov.uk/record/reports2009/091006.htm#AQO168/10

[10] Northern Ireland Assembly Briefing Note, 'Reducing the number of departments: possible savings', NIAR 271-11

Appendix 1- Extracts from NAO and Institute for Government reports

The following are extracts from the NAO and IFG reports on machinery of government changes. The reports are based on studies of Whitehall departments, so the scope of such changes would be significantly different to any potential changes made to Northern Ireland departments.

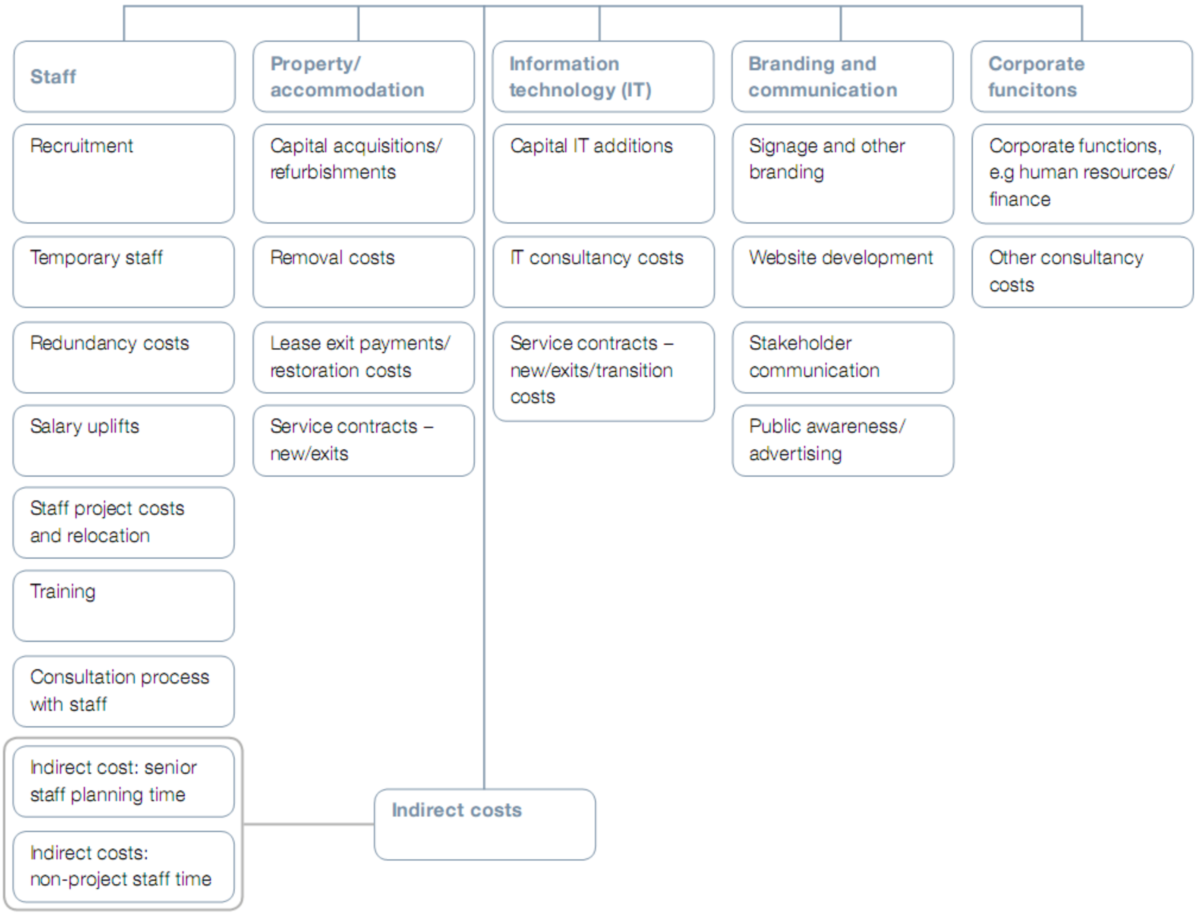
National Audit Office

We commissioned PricewaterhouseCoopers to construct a cost estimation model to determine a reasonable estimate of the total cost of the reorganisations we surveyed. This model comprised four main elements

- A cost framework, to form the basis for questions asked in the survey and data input into the model.
- Typologies of different types of reorganisation
- Assessment of data completeness and quality
- A proxy process to give best estimates for cost data that were missing or of poor quality in the surveys.

PricewaterhouseCoopers used their experience of mergers and acquisitions to develop a cost framework for capturing reorganisation costs. The model comprises six cost categories and 22 cost elements (Figure 1). Our survey asked respondents to rate the impact (no, low, moderate, high) of relevant cost elements on each cost category and to provide their best information on these costs.

Cost framework for central government reorganisations developed by PricewaterhouseCoopers



Based on their experience of mergers and acquisitions and analysis of the survey responses, PricewaterhouseCoopers identified ten broad typologies of central government reorganisation. The typologies reflect the nature of the reorganisation and whether or not the body is standalone or has a parent body

The ten typologies of central government reorganisation

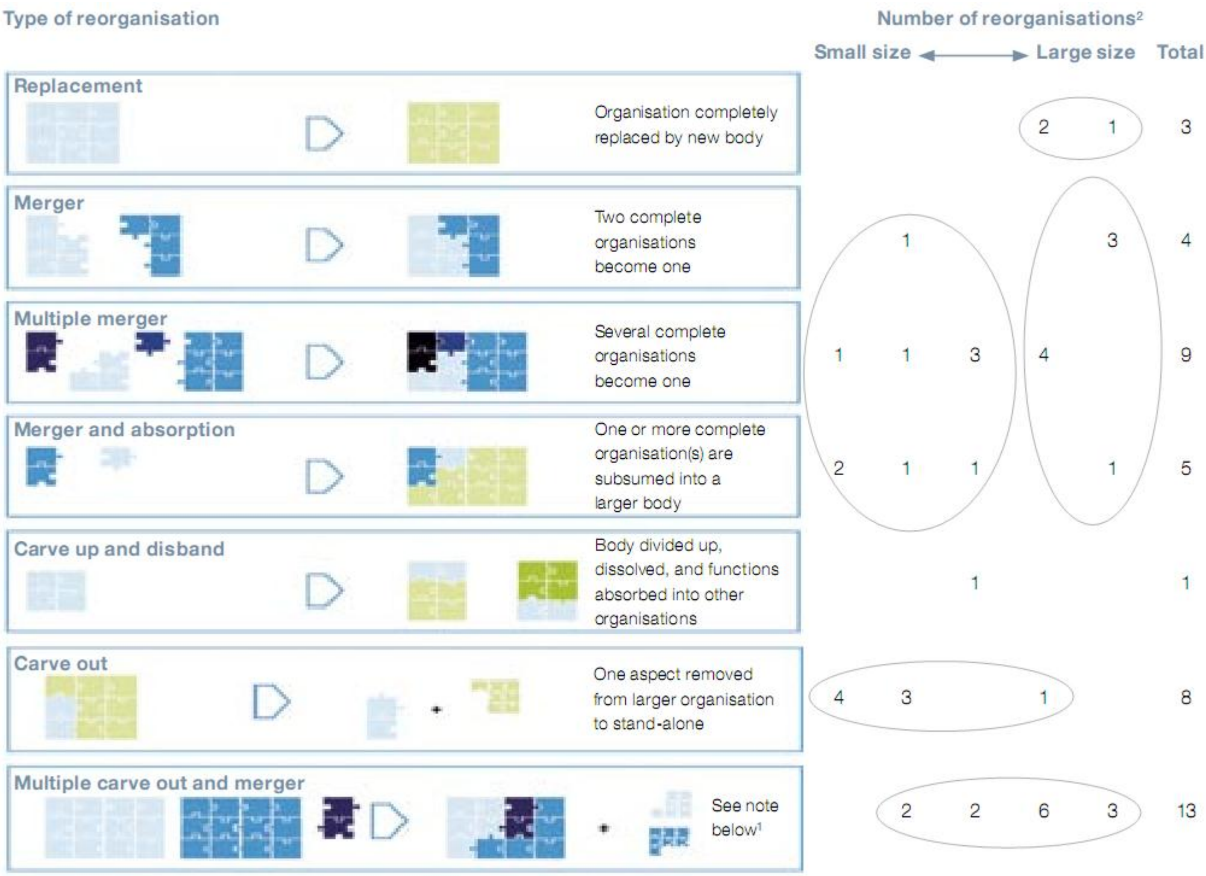
Old organisation was standalone	**1 Replacement:** An existing body is compeletely replaced by a new organisation **2 Merger:** Two existing organisations are combined into one organisation **3 Multiple merger:** Several existing organisations are brought into one organisation	**4 Merger and absorption:** Organisation(s) are subsumed into a larger body **5 Carve up and disband:** An existing body is divided up, dissolved and its functions absorbed into other organisations
Old organisation had a parent body	**6 Carve out:** Part of a larger organisation is removed to stand alone **7 Multiple carve out and merger:** Parts of several organisations (in some cases including entire organisations) are removed and combined into a new standalone organisation	**8 Transfer:** Part of one organisation is moved to be part of a new parent organisation **9 Multiple transfer:** Parts of several organisations are moved to be part of a new organisation
	New organisation is standalone	**New organisation has a parent body**

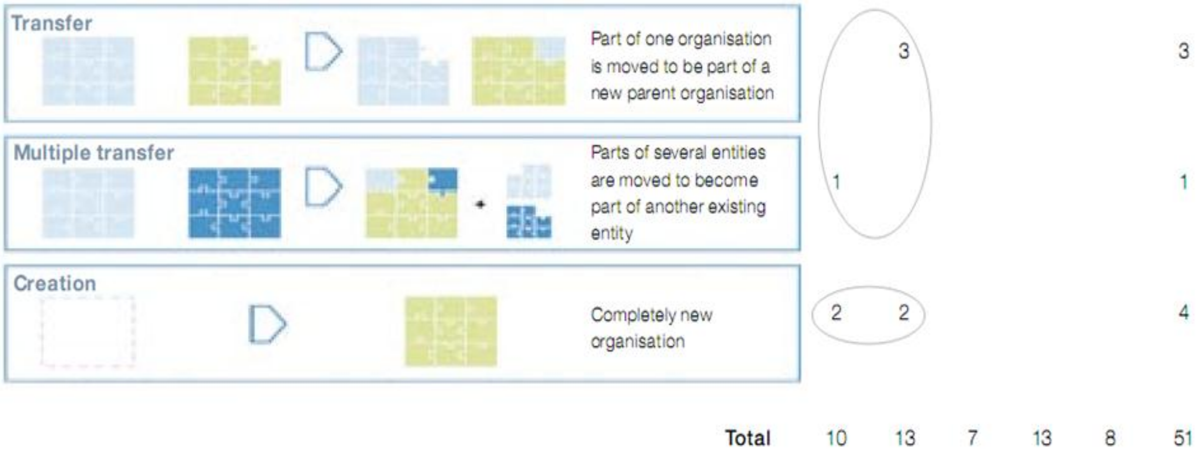
Other types

10 Creation: Creation of a completely new organisation

PricewaterhouseCoopers assigned each reorganisation covered by a survey response to one of these ten typologies, sub-classifying them in terms of the size of the organisation, defined by staff numbers and budgets, and identifying clusters of similar reorganisations according to typology and size (Figure 3).

Survey responses varied in terms of the completeness and quality of the data provided on implementation costs. The time constraints of our fieldwork meant it was impracticable to validate the data directly, so PricewaterhouseCoopers carried out checks on internal consistency and reasonableness, supplemented by cross-checks to annual accounts and to narrative aspects of the survey responses where appropriate. On the basis of these assessments, they assigned quality ratings to the data supplied.





PricewaterhouseCoopers developed a proxy analysis approach to determine a best estimate of costs for data that were missing from responses or for responses which were assessed as poor quality. This involved two key stages.

- For each reorganisation typology, PricewaterhouseCoopers used survey data that had been assessed as good quality to develop standard average costs to use as proxies for each cost element.

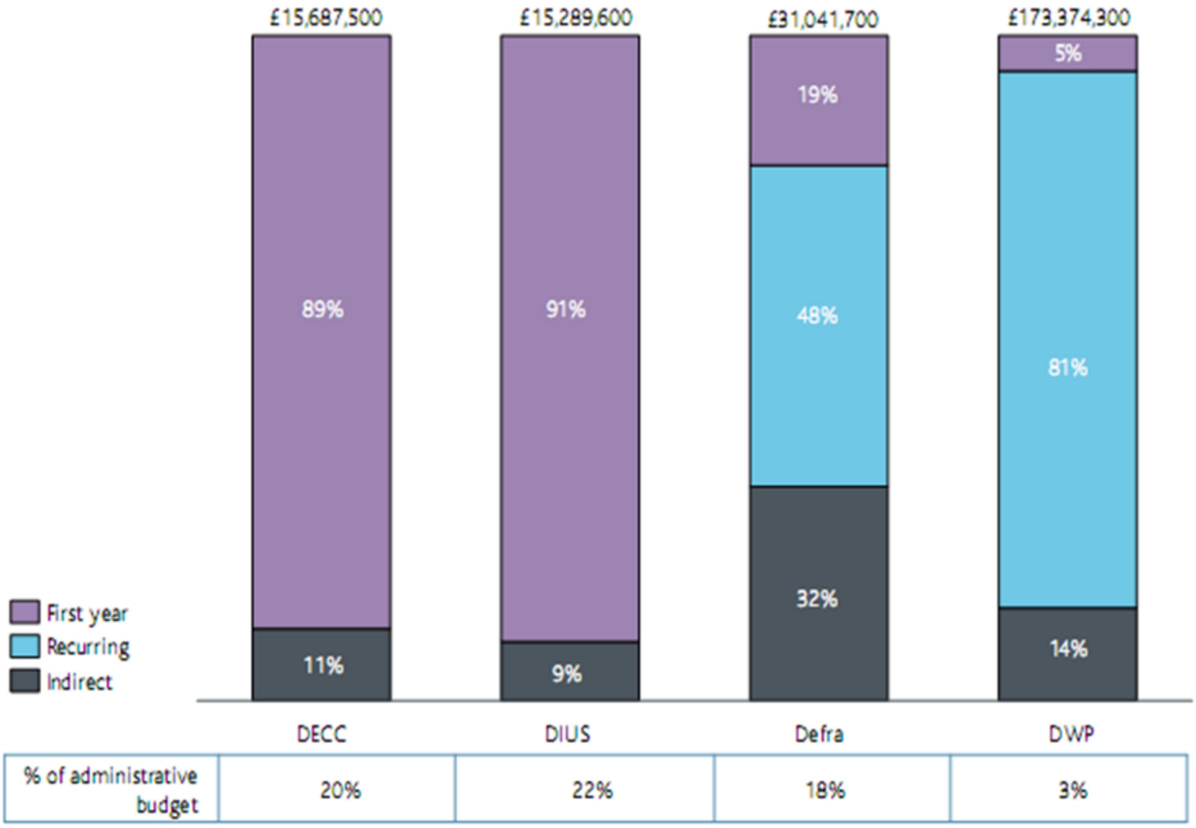
- PricewaterhouseCoopers then applied these proxies to fill in gaps in the completed returns, scaling-up or down the proxies depending on the size of the change and the body, along with other knowledge of the reorganisation available from the survey return, and drawing on results from other reorganisations in the same clusters.

The proxy approach generated, for the 51 surveyed reorganisations, £230 million in costs additional to the £550 million gross costs reported in the survey returns.

Where the type, scale and size of reorganisation were known, PricewaterhouseCoopers' cost estimation model could be used to generate estimates of reorganisation costs for non-surveyed reorganisations. PricewaterhouseCoopers applied the model to 16 of the 42 non-surveyed reorganisations for which we had this information, estimating gross costs of £87 million. We did not include this estimate in our report because this area of estimation, using full proxies, is subject to a greater degree of uncertainty than the £230 million estimate based on partial proxies.

Institute for Government

First-year costs are tangible costs incurred in the first year of the department's operations. Recurring costs refer to differential pay settlements which were agreed to in the first year of the department's operations as a result of a merger. The settlement may be paid over several years. Increases to salaries as a result of the merger remain for the lifetime of the new organisation and therefore are coded as recurring although we do not attempt to predict how much these cost beyond the settlement payout. Indirect costs refer to productivity losses which we estimate for disruptive changes[11].



[11] http://eprints.lse.ac.uk/27949/1/Making_and_breaking_Whitehall_departments_%28LSERO%29.pdf