



The Prime Minister's
**OFFICE OF PUBLIC
SERVICES REFORM**



HM TREASURY

**ASSESSING THE COSTS AND BENEFITS OF
GOVERNMENT INSPECTION ACTIVITY: GUIDANCE**

Questions related to this guidance should be directed to:
Jeremy.skinner@hm-treasury.gsi.gov.uk (020 7270 5482)

Assessing the costs and benefits of government inspection activity: Guidance

Table of contents

Summary	3
Introduction to a cost benefit analysis framework	5
The costs of inspection	7
The benefits of inspection	8
Presenting and using the results	11
Conclusion	12
Appendix 1: Extracts of relevant principles and recommendations from the CO/HMT sponsored review by OPSR	13
Appendix 2: ‘Inspecting the Treasury’ – a hypothetical example	14

1 Summary

Policy background

1.1 In July 2003 the Government published its *Policy on Inspection of Public Services* together with the report *Inspecting for Improvement: Developing a customer focused approach*. This followed a review of inspection and external review, commissioned jointly by the Cabinet Office and the Treasury, and undertaken by the Prime Minister's Office of Public Services Reform.

1.2 The policy sets out ten principles for public service inspection, and a clear action plan for government, departments and inspectorates. One principle arises from concern over the recent expansion of inspection activity, and that resources spent on inspection activity must be justified in terms of the benefits provided. The policy therefore requires inspectorates to have regard to **value for money**, delivering benefits commensurate with cost, and departments are charged specifically with reviewing the **cost-effectiveness** of inspection activity within the context of their overall performance frameworks (Recommendation 7(c)).

Objectives of implementing a framework for cost benefit analysis

1.3 Inspection activity should therefore be evaluated in terms of its costs and benefits, and this paper provides departments with a suggested framework for this work. The framework is intended:

- as guidance to assist departments, having been discussed and developed through a workshop held with departments, inspectorates and service providers on 17 October 2003
- to be adapted and used within departments to suit local circumstances, whilst retaining a core methodology, and
- to be applied in such a way as to balance the need for a rigorous and robust approach without adding unduly to administrative burdens.

Approach

1.4 This paper recommends that the assessment should be carried out 'bottom-up', by first considering the costs and benefits of inspection on a sample of service units, before extrapolating the results for a particular sector and reviewing the results at an aggregate level.

1.5 In summary, this paper recommends the following approach:

- **Costs and benefits should be assessed in terms of the impact on an individual organisation** – e.g. a school, college, hospital, or prison. The costs and benefits of all inspection regimes – as they affect a single institution - should be assessed. Departments, inspectorates and inspected bodies (and their representatives) will need to agree on their respective contributions to this analysis.
- **Full costs** of inspection, should be identified and valued in monetary terms. There will be some costs (such as the impact on morale, recruitment and

retention), which may be difficult to quantify, but, if significant, they should be clearly described.

- The **benefits** of inspection may be quantified through assessments of the recommendations made by inspectors, which have been agreed and implemented. Other benefits may be assessed using surveys.
- A **sample** of individual organisations should be used as the basis of assessing costs and benefits of inspection. This could initially be done on a pilot basis (e.g. 1 school, 1 hospital, 1 prison), to help work out the detailed methodology for the relevant services and subsequently expanded to cover a representative sample of the sector.
- The **results for each organisation could be benchmarked** against the average.

Structure of the paper

1.6 This paper discusses how costs and benefits related to inspection can be assessed, introducing a generic framework (section 2) and describing the costs of inspection (section 3), the benefits (section 4) and how they can be evaluated. It briefly discusses how the results can be presented and used (section 5).

1.7 Appendix 1 provides an extract of the relevant principles and recommendations from the OPSR/HMT review of inspection. Appendix 2 provides a hypothetical example – ‘Inspecting the Treasury’ – which is designed to illustrate some of the main technical issues discussed in sections 2-4.

2 Introduction to a cost benefit analysis framework

General principles

2.1 The Treasury's *Green Book, Appraisal and Evaluation in Central Government* describes the general approach to carrying out cost benefit analysis of all government activity, and should be referred to for areas of specific guidance. The main principles that it sets out and which are relevant in this context are:

- 'All relevant costs and benefits should be included in an assessment'¹; in appraisal², the relevant costs and benefits are those that change as a result of any decision. **But for evaluation purposes, the most relevant costs and benefits are the full (or total) costs and benefits (within the scope of the issue being assessed; in this case, costs and benefits generated by inspection activity).**
- 'Benefits should be valued [in monetary terms] unless it is clearly not practicable to do so'³; and
- 'Costs and benefits that have not been valued should also be appraised; they should not be ignored simply because they cannot easily be valued. All costs and benefits must therefore be clearly described in an appraisal and should be quantified where this is possible and meaningful'⁴.

2.2 In order to understand the costs and benefits of inspection regimes on a chosen sector or sub-sector (e.g. 'criminal justice' or 'prisons') – and of all inspection activity – the recommended starting point is the inspection of a single service providing organisation or institution (e.g. a prison or a school). By assessing the costs and benefits as they fall on a sample of these basic 'units', the results can then be extrapolated, benchmarks established, and comparisons made across institutions and sectors. This 'bottom-up' approach can also accommodate changes in the inspection regime, and for those changes to be monitored.⁵

Aims and objectives

2.4 The overall aim is to develop a broad understanding of the *full* costs and benefits of inspection - rather than to develop precisely accurate figures for only some costs or benefits. In other words, while it is good to be accurate, it is better to be comprehensive in the analysis.

2.5 There should be a clear overview and purpose to the analysis. Cost-benefit analysis requires both costs and benefits to be, first, *identified*, following which some *quantification and valuation* may be possible. In both respects this is often simpler

¹ p19, *The Green Book, Appraisal and Evaluation*

² Appraisal is the work carried out before decisions are made; evaluation is the retrospective analysis

³ p21, *ibid*

⁴ p.34, *ibid*

⁵ Currently, various changes are happening in inspecting organisations. For instance, a hospital may have been inspected previously mostly by the Audit Commission, but from now on mostly by CHAI. But the cost of inspection can still be attributed to the hospital – and the full cost, both of the Audit Commission and CHAI and the related compliance costs, can be estimated.

for costs than for benefits. This can be made even more difficult if the intended benefits of the activity are not specific, understood, and linked to clear organisational objectives. Therefore, before starting any cost benefit analysis, it may be helpful to reflect on, and clarify, exactly what benefits are being *sought* in the system, from the use of independent inspection⁶.

2.6 The costs and benefits (as quantified) can then be compared and suitable benchmarks agreed in particular sectors. Furthermore, sectors can and should be compared to ensure that inspection coverage overall is reasonable - neither excessive nor too light-touch.

Scope

2.7 The scope of the analysis should be agreed. In this case, costs and benefits should relate only to the activity of the relevant external inspecting organisations (not, for example, to those of internal performance management systems of the institution being inspected, even though inspectors may well rely on these when determining their judgements). On the other hand, the scope of the analysis should include costs and benefits that may be incurred just because of the *existence* of the inspection regime - whether or not a particular inspection visit takes place.

Approach

2.8 The level of detail in the analysis should be **proportionate** to the resources available, and the scale and nature of the inspection service being reviewed. The costs should be estimated as accurately as possible given the time available to carry out the work. But, where costs and benefits are uncertain, these can be expressed as a range rather than a point estimate. For the initial work in assessing the benefits of inspection, it may be difficult to find suitable data, and too costly to generate or find the data where it is missing (for instance, carrying out surveys to assess how beneficial the inspection service is). Where this is the case, this should be highlighted and a longer-term programme of work be established to ensure that benefits are measured for future assessment.

2.9 The analysis should be carried out **collaboratively**. Whilst it is departments that are charged with undertaking the review of cost-effectiveness of inspection, inspectorates are also charged with assessing their own value for money and effect on outcomes. Input and participation is essential, not only from departments and inspectorates, but from inspected bodies (which bear a large proportion of the compliance costs, and also should be the primary beneficiaries of inspection).

2.10 Before carrying out a cost benefit assessment, the respective roles in the exercise of the inspectorates and other monitoring bodies, as well as the inspected bodies, should be clear. Pilot studies of individual organisations would help to understand the amount of time involved, and tease out any methodological problems.

⁶ The Government's Policy on Inspection of Public Services sees the purpose of inspection as being (i) to assure the public of the safety and quality of services provided; (ii) to help improve these services; and (iii) to inform national and local policy formulation in respect of these services. As part of the implementation of this Policy, Departments have been asked to set out their overall performance framework for the delivery of their objectives and services, and to describe the contribution they expect of inspection within this performance framework.

3 The Costs of Inspection

Introduction

3.1 The full opportunity cost of inspection for a single service unit, such as a school, college, hospital or prison, should be built up using standard cost attribution techniques. For instance, the costs of an inspector can be attributed to a single organisation by the amount of time he or she both spends there and subsequently spends writing up reports. Other costs, such as the compliance cost, can also be attributed.

3.2 This exercise can then be repeated for a sample of organisations. If there were a sufficient sample within each sector, the total costs of inspection could be then be extrapolated, within a range reflecting some inherent uncertainties about such techniques.

Costs of inspection

3.3 Table 1 sets out the type of costs that would need to be identified and summed to provide the total cost of inspection to a single organisation.

Table 1 – The direct and indirect costs of inspection (the inspector and the inspected) to a single organisation

Organisation	Cost type	
	Direct	Indirect costs and overheads
Inspectorate 1, 2, 3 etc.	FTE salary costs of inspectors based permanently at the inspected body. Expenses e.g. travelling, publication costs.	FTE costs apportioned by time spent inspecting the inspected body; e.g. interviewing, reading documents, preparing reports, giving feedback. Other central costs associated with inspection. E.g. moderation activity (ensuring that performance rating categories are fair), apportioned on a fair basis
Inspected body	Opportunity cost of any space occupied full-time by the inspector(s) Opportunity cost of any FTEs who liaise full time with inspector(s)	Opportunity cost of space utilised part-time by inspectors, for which there is likely to be an alternative use. Opportunity cost of time spent being interviewed, preparing documents for review, and guiding visits.
Department 1, 2, 3 etc.		Any central government overheads associated with inspection, apportioned to the inspected body (e.g. total departmental costs related to inspection divided by the number of inspected bodies). These overheads may be fixed, though.
Totals		

3.4 Once the costs have been identified, these can be compared to the benefits.

4 The benefits of inspection

Introduction

4.1 Estimating the value of benefits is a more difficult and challenging task. However, the benefits are reasonably distinguishable from each other, and those that could be assessed are discussed below.

Providing well informed, objective judgements of the inspected body and its services⁷

4.2 Inspection provides an independent view of the overall capability of an inspected body and the quality of its services. This is perhaps the primary function of inspection, and could be considered its primary benefit. Ministers, as elected representatives, are acutely conscious of this benefit. They are ultimately responsible for the portfolio of services and service providers under their aegis. They cannot easily discharge this duty without being able to trust information about the services and service providers for which they are responsible.

4.3 The new principles of inspection now require inspectors to focus on outcomes and to take the user's perspective. This means that judgements must be informed and objective, but should also be relevant and clearly communicated to the public and service users.

4.4 In practice, this benefit could be assessed by:

- 3-5 yearly comprehensive review of the inspection methodology, outputs and the overall quality of the inspection service, to be carried out by the sponsoring department.⁸
- Annual reviews of a random sample of inspection reports by the sponsoring department, taking into account the views of inspected bodies and their service users. Such reviews would ensure that the agreed methodology was followed – and modified as necessary; and
- Simple quantitative measures, which could include the number of inspection reports, and the percentage issued on time; e.g. an annual PI.

4.5 Ministerial, Parliamentary and public confidence in the inspection service, and the inspected body could be assessed in a periodic survey, every two or three years for instance.

4.6 The annual, and more strategic, reviews should consider the qualitative aspects of reporting, to address issues such as the impact on morale, recruitment and retention. For instance, how sensitively has poor performance been reported? Has this been communicated well? Has the focus been on improving performance, or merely to offer unconstructive criticism? Alternatively, has the inspectorate held back

⁷ 'The role of inspection is to provide well-informed, objective judgements...', p11, *Government's policy on inspection*

in reporting their opinions and not addressed failures in performance squarely? This will be a difficult area to judge, but could have a dramatic impact on the next benefit.

Providing constructive recommendations to improve outcomes⁹

4.7 Improving outcomes should be the focus for both the inspector and the inspected. But while this should be an obvious benefit of inspection, it can only be indirectly related to the work of inspectors. Inspectors do not have direct responsibilities for improving the inspected service, which remains the duty of the body under inspection. A service improvement should be deemed to be a benefit of inspection only if it would not have improved without the inspector's recommendations and their implementation.

4.8 Improved outcomes can only be valued in monetary terms if the benefit of the baseline level of service output is already valued in monetary terms. This will probably be true only in a minority of service areas. However, although many benefits cannot be valued, many can be quantified, such as a reduction in the number of prison suicides, or an increase in the percentage of prisoners engaging in educational or purposive activities.

4.9 The pace of improvement may increase as a result of inspection, resulting in the same benefits being delivered and received sooner. This is a benefit that is difficult to quantify in monetary terms, but could be expressed in terms of the amount of time by which the benefit was brought forward.

4.10 All inspectorate recommendations should be gauged, amongst other issues (e.g. whether the recommendation is urgent or not), in terms of the expected ultimate impact on the end user (or other outcome, depending on the nature of the activity).

4.11 In doing this, expected impacts should be quantified where this is possible and meaningful (e.g. the expected impact on existing PIs or targets). Simple approximations could be used – for instance, whether the recommendations will have a high, medium or low impact on outcomes. Outcomes, and the impact that recommendations would have on them, should be described clearly if there is no sensible quantifiable measure.

4.13 The number of agreed recommendations expected to have a high or medium impact on service outcomes should then be aggregated (including the total impact on performance indicators). Of those, the inspector should record how many were agreed and implemented.

4.14 A summary report should be prepared, discussing the impact that the inspection has had on service levels (or other outcomes) for each organisation or for the sector as a whole. This should be discussed and agreed with the organisation (or representative bodies) where appropriate.

⁹ ‘...and constructive recommendations. It is for inspection to assess whether the systems and policies being operated by management of the service provider are delivering effective outcomes for the service user, and to make recommendations according to the findings from the inspection process.’, p11, *ibid*

4.15 Inspectors should collate statistics for all inspected bodies and send these with an annual report to their sponsoring departments. Sponsoring departments should agree the format of such reports and statistics and review them.

Efficiency and economic savings identified implemented and realised in practice

4.16 By their nature, efficiency savings are usually quantified in monetary terms, either in total terms or in unit cost savings. In the past, the Audit Commission has tracked the implementation of vfm project recommendations in monetary terms. Audited bodies have been required to state the savings achieved as a result of implementation. Of course, there is a risk of semi-collusion in such exercises. It looks good for both the inspector and the inspected if savings can apparently be both identified and implemented. This risk needs to be guarded against in structuring the analyses.

4.17 Savings in £s identified and recommended by the inspector should be agreed with the inspected body. Once again, the amount of savings realised should be tracked, collated and reported (against the amount identified) – probably in a combined report with the one above.

Spreading best practice

4.18 Inspectorates are able to identify good practice and share it across inspected services. This is potentially an important benefit which should not be ignored. However, the tangible results of spreading good practice are likely to result anyway in agreed recommendations or positive feedback from surveys. Nonetheless, as part of the annual and strategic reviews of inspectorates, the extent to which inspectorates have identified and spread good practice should be assessed.

4.20 **There is another issue related to benefits, but conceptually different. This is the ‘what if’ position – what if there was no inspection service?** Would the service worsen if there were no direct inspection *or no threat of inspection*? Potentially, there could be no difference, or at worst, fraud and corruption could become endemic, service quality could spiral downward and public confidence in the whole political system could decline markedly.

4.21 Some research has compared the impact of particular inspection visits – using un-visited bodies as the control group. But this kind of research seems to ignore some obvious points. Poor organisations are more likely to be inspected; and the impact of the *threat* of inspection may have been ignored.

4.22 Other qualitative aspects should also be considered – which may have a beneficial or detrimental effect. Inspections and reports can have a significant impact on morale, recruitment and retention for instance. These effects should be described, and where possible quantified and valued.

5 Presenting and using the results

5.1 Consideration should be given at the outset to how the results from the cost benefit analysis will be presented and used. This will need to be approached differently for different audiences.

5.2 Benchmarking is one way of using the results proactively, allowing the impact of inspection on similar organisations (eg hospitals, schools) to be compared within a sector, and the overall impact of inspection on different sectors of public services to be compared. Benchmarks could include:

- Number of high impact (on outcomes) recommendations per inspected body per year:
 - Percentage agreed
 - Percentage implemented
- Total cost of inspection per annum/denominator cost per organisation (e.g. administration costs)
- Survey satisfaction results
 - of inspected bodies (overall service)
 - of departments (quality of inspection reports)

6 Conclusion

- 6.1 This paper has set out some of the key principles which should inform the development and application of a cost benefit analysis framework to the inspection of public services. It has set out a generic framework that may be adopted, adapted and tailored by individual departments and inspectorates, in analyses they undertake to fulfil the requirements of 'The Government's Policy on Inspection of Public Services' (July 2003), in particular the principle that 'inspection itself should be able to demonstrate it delivers benefits commensurate with its cost, including the cost to those inspected'.
- 6.2 Further advice on the content of this guidance, and support (resources permitting) in the application of it in particular exercises, is available from the Public Services Delivery Analysis Team at HMT:

Jeremy.Skinner@hm-treasury.gsi.gov.uk
020 7270 5482

Appendix 1

Extracts of relevant principles and recommendations from the CO/HMT sponsored review by OPSR

The review suggested that the co-ordination of policy might operate along the following lines:

- *Overall costs of inspection and external review could be scrutinised as part of the spending review cycle and a broad national programme agreed by Ministers through the Cabinet Committee on Public Services and Expenditure (PSX) As a result of this recommendation, a new cabinet committee, PSX(I) has been established.*
- *In the intervening period PSX would take oversight of delivery and ongoing refinement of the programme as a whole, including any adjustment to the programme in the light of new pressures or circumstances (it is not expected that PSX would need to monitor individual departmental programmes established within the agreed parameters);*

As part of the policy on inspection of public services, the following principles, amongst others, were established:

Inspectors should have regard to value for money, their own included:

- *Inspection looks to see that there are arrangements in place to deliver the service efficiently and effectively*
- *Inspection itself should be able to demonstrate it delivers benefits commensurate with its cost, including the cost to those inspected*
- *Inspectorates should ensure that they have the capacity to work together on cross-cutting issues, in the interests of greater cost effectiveness and reducing the burden on those inspected*

Recommendations from inspection review

Amongst actions recommended for departments were:

- *Determining a resourcing strategy for the inspection programme*
- *Specifying, within the overall programme for inspection of the department's services, opportunities or requirements for collaboration between inspectorates, external reviewers and regulators, and agreeing with inspection bodies, and naming, the lead and the participating inspectorates for cross-cutting reviews*
- *Reviewing the cost effectiveness of inspection activity*

And amongst actions recommended for inspectorates:

Developing an agreed framework for estimating the costs of inspection to inspected services

Appendix 2

‘Inspecting the Treasury’ - a hypothetical example

Introduction

1 In 2020, economic mismanagement, financial indiscipline and instances of fraud broke out in the Treasury. The government of the day demanded, under Parliamentary pressure, an annual, detailed NAO review of the Treasury. It’s now 2030, and the Treasury has become highly respected once more – managers (and ministers) now want to ensure the annual NAO inspection is more cost effective.

Costs

2 During 2 week review by an accountant, the following facts emerge.

- 10 auditors (average FTE salary + on-costs of £100,000 per annum) work full-time at the Treasury, occupying space that could otherwise be utilised by a Treasury team, (which is currently off-site, renting 100 m2 office space from Westminster City Council at £200,000 per annum.)
- A further 5 specialists work on average a couple of months each at the Treasury, and there is some additional input from senior audit managers. This additional cost is estimated at a further 1 FTE (£150,000) per annum.
- There is 1 FTE liaison officer at the Treasury who works full time on inspection. 2 others spend around half their time working. Collectively, the auditors conduct around 2000 hours of interviews per year. Combined with the preparation and follow up costs, the compliance cost is estimated at 1-2 FTE per annum (at £100,000). There is some uncertainty over this figure however – reflecting disagreement between HMT staff and the auditors over what work is essential and would be incurred anyway.
- Inspection reports, printing and miscellaneous expenses came to around £30,000.

3 The total cost compared with other departments is therefore assessed as follows.

Estimated costs of HMT Inspection activity	£000	£000
Inspectors		
Salary + oncosts	1150	
Miscellaneous	30	
Opportunity cost - office rental incurred	200	
Sub-total		1380
Compliance		
Liaison officers	150	
Interviews, preparation and follow up	80-250	
Sub-total		230-400
Total		1610-1780
Total Treasury admin costs		120,000
Inspection cost as % of total admin costs		1.3 - 1.5%
Benchmark - Whitehall average		0.8%

4 Not included in these costs were some agreed recommendations that had cost implications. For instance, it was agreed that an external survey should be commissioned, which cost £15,000 and led to some major improvements. The benefits were considered to at least exceed these costs – otherwise the recommendation would not have been agreed.

Benefits

5 In 2021, 6 major reports were issued relating to: economic management, fiscal discipline, internal control, human resources, PFI and PPP, and ministerial expenses. A minister and two senior officials resigned. Improvements were identified, and all the high priority recommendations were implemented over the following year. All further medium priority recommendations were implemented within 2 years.

Evaluation

6 In 2030, officials challenged the relevance of the auditors' reports and their recommendations. The Treasury's reputation (according to surveys of the public and that have been conducted every three years since 2004) has returned to its long-term average; and all major recommendations had been implemented.

7 On the benefits side, ministers and senior management challenged the ability of the auditors to make 'independent objective judgments on the quality of the service' provided by the Treasury. Ministers and senior staff were quite aware of the ability of officials; and the public could assess whether they were highly taxed (or not) and how well the economy was doing – among other issues of concern to them.

8 Ministers and senior management also criticised the relevance of the auditors' recommendations – which were not leading to tangible improvements. But on the other hand, they recognised the additional value that the auditors provided in assessing the Treasury's internal controls, and their assessment of financial forecasts. And they recognised that the organisation could never again afford to suffer the low point of 2020.

Conclusion

8 A two-year work programme was agreed; in the first year to reduce inspection activity to the Whitehall average benchmark cost; and in the second, to carry out a bottom up review of the whole inspection and auditing activity of the Treasury. This resulted eventually in a 50% reduction in audit, a more streamlined process and inspection activities redirected towards more fruitful areas.