

SR04 EFFICIENCY PROGRAMME

MEASUREMENT OF SR04 EFFICIENCIES GUIDANCE ON EFFICIENCY METHODOLOGIES

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MEASUREMENT OF SR04 EFFICIENCIES

GUIDANCE ON EFFICIENCY METHODOLOGIES

1. INTRODUCTION

1.1 This document sets out guidance on how to measure 'Gershon' / Spending Review 04 efficiency gains (see the green box in Figure 1). It should be used by central efficiency teams within departments and across the wider public sector in developing, measuring and reporting efficiency programmes and initiatives.

1.2 This guidance is not prescriptive because the programme is wide and complex. Please discuss any questions you might have with your HMT account manager.

1.3 Departmental responsibilities

1.3.1. Record Spending Review (SR04) efficiency gains

1.3.2. Ensure that your approach is consistent with the principles set out in the SR04 Efficiency guidance

1.3.3. Ensure that you can mount a credible public defence that these gains are efficiencies and not cuts.

1.4 HMT responsibilities

1.4.1. Provide guidance on measurement

1.4.2. Collate efficiency gains from departments and where necessary challenge them where there are concerns that claimed gains might not be genuine efficiencies in accordance with the guidance principles

1.4.3. Report on progress to the PM and Chancellor including advising them on the credibility of the gains claimed.

1.5 Other related guidance

1.5.1. The latest DCLG Efficiency measurement guidance was issued to local authorities in February 2006. HMT has worked closely with DCLG to ensure that the two sets of guidance align by following the same underlying principles¹.

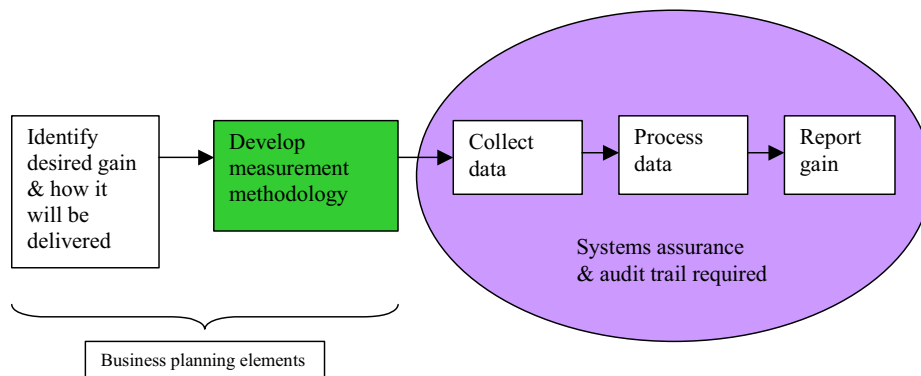
1.5.2. Guidance covering the principles and practice of ensuring confidence in the efficiency gains being reported to the centre (see the purple box in Figure 1) is available in separate HMT Efficiency Data Systems Assurance Guidance.

¹ [Measuring and Reporting Efficiency Gains](#)

1.5.3. More detailed guidance is available on measurement in the procurement workstream² and on the productive time workstream³.

1.5.4. Methods of measuring and reporting on headcount and relocations are not covered by this document, although methods for calculating the financial efficiency gains from reductions in headcount are included. For information on measuring headcount reductions and relocations please refer to HMT guidance.

Figure 1: Elements in the efficiency gain chain covered in this guidance



² [Procurement Efficiency and Value for money Measurement Guidance](#)

³ [Productive Time Measurement Guidance](#)

2. KEY ELEMENTS TO MEASURING SR04 EFFICIENCIES

- 2.1 An important measurement principle in the Efficiency Programme is that quantifying efficiency gains is not achieved through comparison with other departments, agencies, public sector bodies, benchmarking data or national standards. Such comparisons are important tools for considering where you may be able to develop a project to drive an efficiency gain, but the quantification of the efficiency must be against your own previous performance.
- 2.2 Efficiency targets are set in £million. To measure progress against these targets all efficiencies need to be measured in or converted to a financial value. They should be supported by an evidence based assessment of quality to demonstrate they are efficiencies and not cuts. Where the gain is based on valuing an increase in service quality, this is not necessary. Quality assessments are also made against previous performance, not by comparison with others or against a target level of service quality.

Types of efficiency gain

- 2.3 In general, the five types of efficiency defined by Gershon fall into one of two types of efficiency (see box 1).

Box 1: Types of Gershon SR04 efficiencies

Efficiency gains are classified as cashable and non-cashable.

- **Cashable** efficiencies release financial resources whilst maintaining outputs and output quality, thereby enabling the resources that are released to be diverted to other services.
- **Non-cashable** efficiency gains occur when productivity or output quality increases, either for the same resource inputs or a proportionately smaller increase in resource inputs in a way that does not release financial resources that can be deployed elsewhere.

Cashable (in general)

E1 Reduce inputs for the same outputs

E2 Reduce prices for the same outputs

E5 Changing the balance between different outputs aimed at delivering a similar overall objective in a way that achieves a greater overall output for the same inputs ('allocative efficiency')

Non-cashable (in general)

E3 Get greater outputs or improved quality for the same inputs

E4 Get greater outputs or improved quality in return for a proportionately smaller increase in resources

- 2.4 From the classification in Box 1, it can be seen that to calculate efficiency gains we need to measure **inputs** and **outputs**. How to measure changes to **inputs** is dealt with in Section 4. How to measure **outputs** will depend on the sort of efficiency being claimed:
- Where the efficiencies arise solely from reducing inputs, it is only necessary to demonstrate that service quality has not deteriorated. How to do this is dealt with in section 5. This type of efficiency will almost always be cashable.
 - Where efficiencies derived from increasing outputs are claimed, these need to be given a financial value. How to do this is dealt with in section 6. These types of efficiency will usually be non-cashable.
- 2.5 The last type of efficiency, changing the mix of **outputs** to achieve the same overall outcome, is dealt with in section 7.
- 2.6 There is also some general guidance that applies to all kinds of measures. This is in Section 3.

3. GENERAL GUIDANCE

3.1 To measure an efficiency gain departments need:

- A measurement methodology supported by an evidence based quality assessment which will usually be underpinned by a 'balancing quality measure' (unless the gain is directly based on service quality improvement)
- A baseline or starting point
- Agreement with HMT that your methodology and baseline for measurement are appropriate and credible. Such agreement will not be reached if HMT thinks that a particular approach puts the credibility of the programme at risk. Agreement will stem from work you have done with your account manager and/or other members of the SR04 Efficiency Team.

Box 2: examples of different types of measurement methodology

Example 1: Better procurement of goods, services or commodities

The new unit cost minus the previous unit cost multiplied by the current volume, with a balancing quality measure that ensures the specification of newly procured goods, services or commodities is at least as high as previously (see sections 4 and 5)

Example 2: The value of outputs in year 2 compared with the value of outputs in year 1

The value of this gain is the equivalent of the expenditure that would have been needed to produce the outputs had the efficiency action not occurred. Here there is no balancing quality measure since the efficiency itself stems from an improvement in service quality (see sections 4, 5 and 6)

Baselines

3.2 Clear baselines should be set for all the inputs, outputs (or outcomes) and service quality levels that are specified in the measures before efficiency activity is begun. Baselines need to be representative and should therefore take account of any seasonality issues.

When baselining efficiencies and balancing quality measures:

- If you are claiming 2004/05 gains then these must be counted against a suitable baseline (such as 2003/04 outturns).
- If you are claiming new efficiencies (i.e. currently those occurring in 2006/07) then the baseline can be either the start of SR04 (i.e. 2004/05 outturns) or must be the point at which the efficiency action began.

3.3 Efficiency and balancing quality measures can be drawn from a number of sources, and so in turn can baselines. See Box 3.

Box 3: Basic examples of baselines

Efficiency or balancing quality measure	Possible baseline
<i>Efficiency measures</i>	
Reduction in HQ spend	£ figure from line in annual accounts
Improved service quality to identified client group	Base 'value' of service delivered to client group
Paying less for commodity X	Previous unit cost of commodity X
Changing the mix of staff delivering a service	Ratio of one staff type to another
<i>Quality measures</i>	
Customer/user survey	% customers/users satisfied with service delivered
Assessment of customer forms	% cases dealt with accurately first time
Switching to shared service (e.g. call centre)	% calls answered within 15 seconds
Streamlining central policy function	Base value for policy-related PSA

3.4 Departments need to ensure that they only baseline those things that are affected by their efficiency actions. For example a department may wish to reduce the number of specialists in a larger pool of staff and need to baseline the number and cost of specialist staff only, not the entire staff pool.

3.5 If departments have missing baselines they need to put them in place as soon as possible.

- A department may have taken an efficiency action, be gathering data on changes in outputs and /or inputs, but have no set baseline against which to measure efficiencies. Departments will need to determine a baseline against which to measure savings. They may be able to use the evidence gathered pre baseline, plus efficiencies subsequent to the baseline point, to build a counterfactual baseline (i.e. what would have happened if the gain had not been pursued). If they wish to do so then they should propose a counterfactual baseline to HMT.
- If the missing baseline is for a quality measure based on customer/user perception then the department can collect information using surveys or focus groups asking about perceptions of current service levels compared with those pre-efficiency. Careful consideration needs to be given however to how they can roll such a measure forward.

- 3.6 Where 'counterfactual' baselines are used they should be clearly defined and departments will need to provide firm evidence that the money would otherwise have actually needed to be spent. Additional controls should be added to provide further assurance on previous budgets when these are used as baselines. Departments should consider carefully how they are going to publicly present efficiencies against a counterfactual baseline. **Counterfactual baselines should be based on sound evidence and professional judgement. Assumptions can be based on past performance or suitable sources such as the Public Sector Comparator.**

Box 4: Developing counterfactual baselines

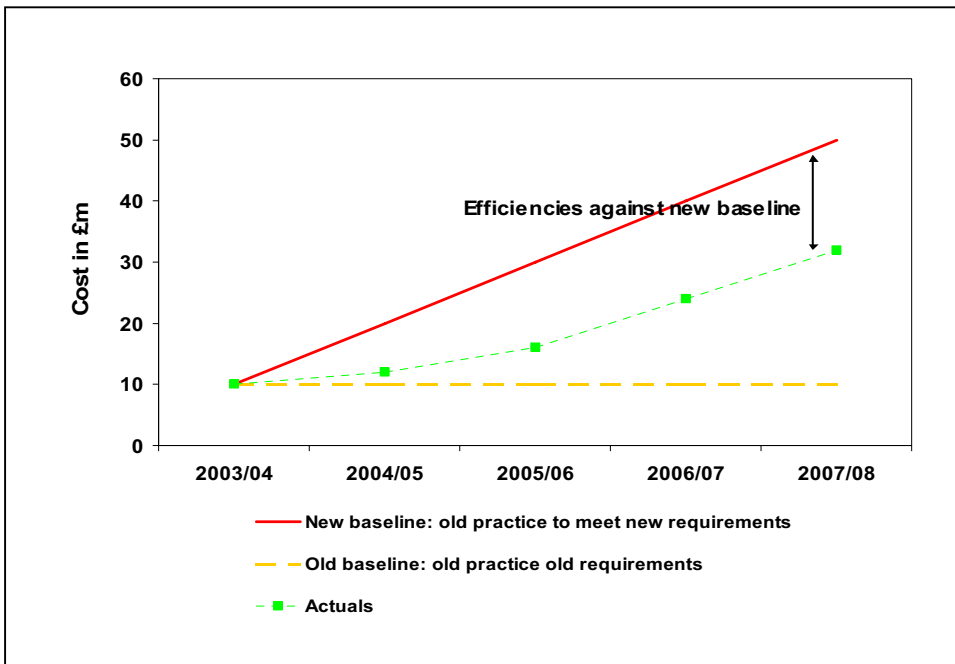
Counterfactual baselines

A department may need to set a baseline to reflect that fact that demand on resource would have risen because of changes in external circumstances, such as the need to implement **new policies that will increase the cost of delivery**. This can complicate baselining for the purposes of the SR04 Efficiency Programme. The recommended method is:

To calculate the new cost of providing to service to meet new requirements but with no new efficiency actions (see red line in Figure 2 below).

- Agree this with HMT
- This becomes the baseline against which actual spend will be compared
- **Ensure that the process for calculating efficiencies is transparent and publicly defensible**

Figure 2: Baselining to account for new policy burdens



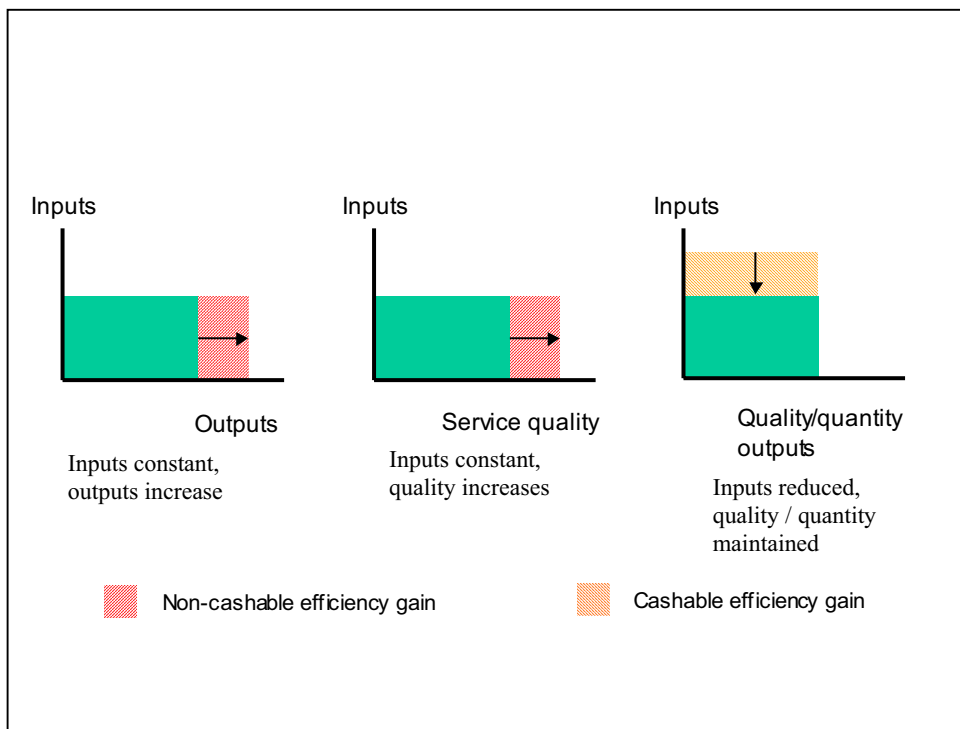
Cashable and non-cashable gains

3.7 Cashable and non-cashable gains are defined in Box 1. For ease of reference, the definitions are repeated here:

3.7.1 **Cashable** efficiencies release financial resources whilst maintaining outputs and output quality, thereby enabling the resources that are released to be diverted to other services.

3.7.2 **Non-cashable** efficiency gains occur when productivity or output quality increases, either for the same resource inputs or a proportionately smaller increase in resource inputs, in a way that does not release financial resources that can be deployed elsewhere.

Figure 3: Efficiency gains can be cashable or non-cashable



3.8 Cashable efficiency gains must have the potential to release resources through:

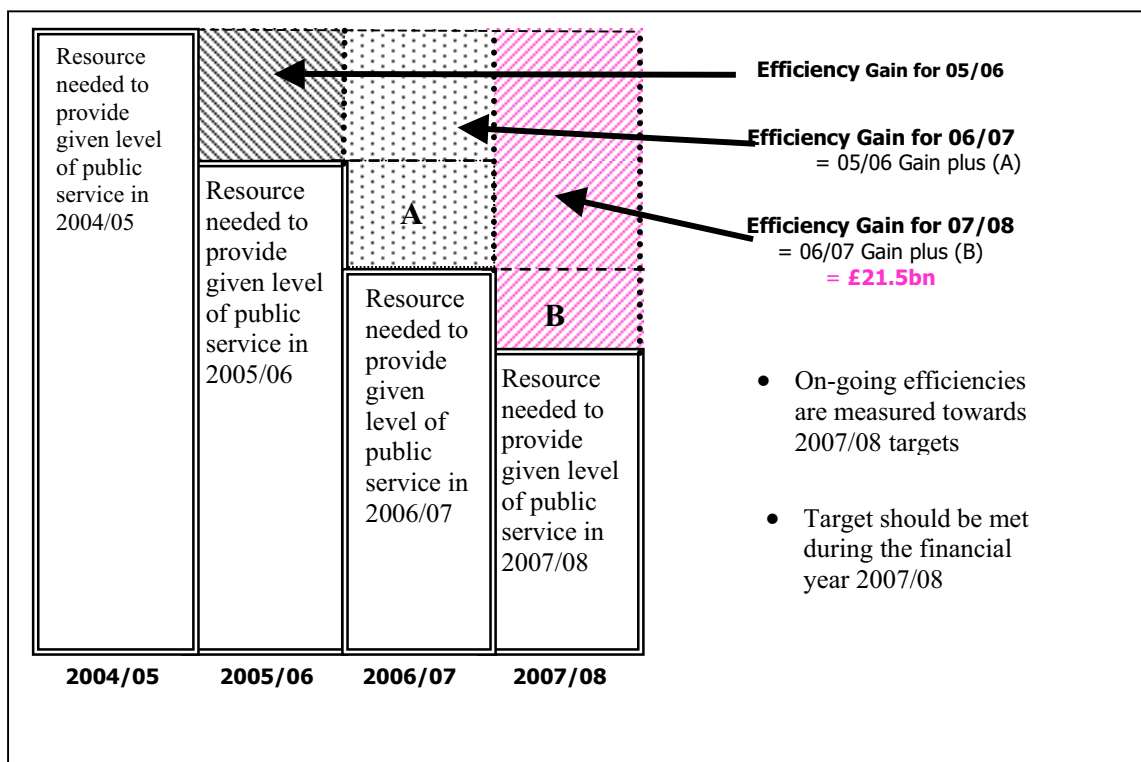
- Savings against previous costs that result in financial resource becoming available to be spent elsewhere on additional activities; and/or through,
- People or resources being freed up to deliver additional services (that would otherwise require additional investment) above and beyond those that they were previously supporting, with the services these resources were previously delivering continuing to be delivered properly (see further advice below on avoiding double counting in this area)

- Withstanding inflation (because less financial resource is required in real terms to deliver the same quantity and quality of services).

Sustainable Efficiencies

3.9 In the SR04 Efficiency Programme at a departmental level the overall cumulative gains are expected to be sustainable. Most efficiencies will be ongoing. How to demonstrate that these are sustainable and how to deal with efficiencies that fluctuate over time, either through changes in volume or because they are 'one-off', is set out below.

Figure 4: How efficiencies build up over time



Ongoing efficiency gains

- 3.10 The gain must exist for the current year and must at least continue at the same level for two subsequent financial years to be counted as an ongoing efficiency for SR04.
- 3.11 To sustain the gain and report it correctly it is recommended, that the efficiency agenda forms part of core business planning, budget and performance management processes.
- 3.12 HMT will be seeking evidence that the cumulative gains reported throughout the programme are ongoing.

Fluctuations in demand

3.13 For some efficiency initiatives the actual value of efficiency gains can fluctuate within a year or between years. Here it is important that the efficiency actions that underpin efficiency gains are sustainable.

3.14 Changes in demand/volumes can impact on efficiency gain profiles. This can happen in-year or year-on-year:

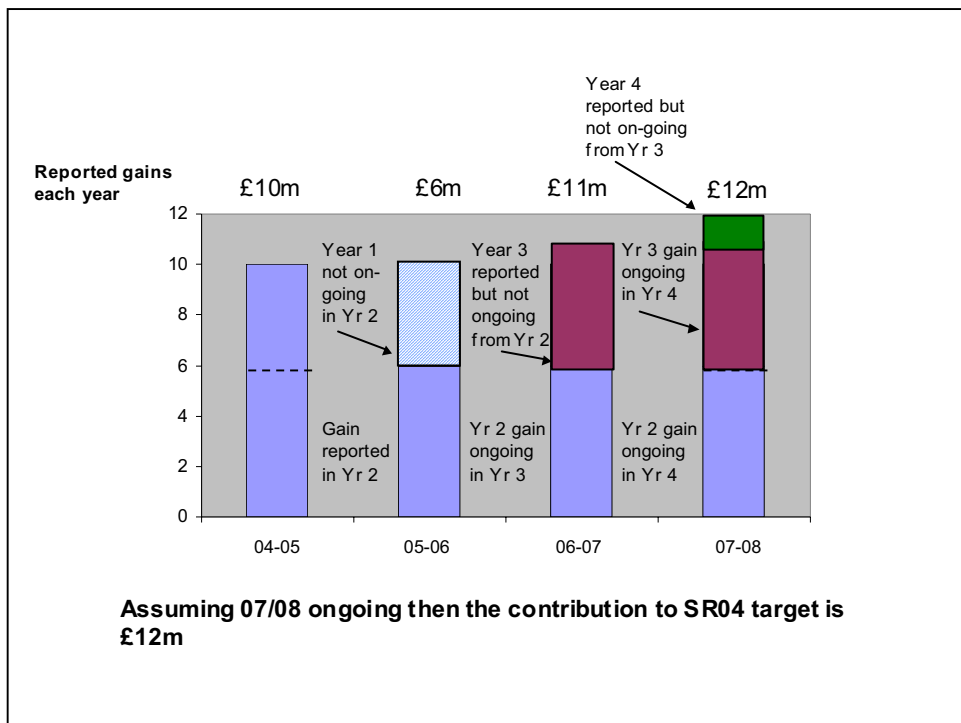
In year

- The absolute reported value of an on-going efficiency may fluctuate quarter-on-quarter for a range of reasons, such as changes in volume of purchases, demand or other seasonal factors.
- Once recorded in a quarterly report to HMT, any fluctuations in ongoing efficiency gains must be recorded in subsequent reports whatever the circumstances of the fluctuation. HMT will ask departments for information as to why efficiencies are fluctuating in-year.

Year on year

- HMT will require evidence that levels have at least remained at the same level year-on-year (see Figure 5 below). This will help build assurance that SR04 efficiencies are on track.

Figure 5: How annually fluctuating efficiencies will count towards final Gershon targets



- Where it is a deliberate departmental policy to move work from one area to another, then it is possible that the efficiencies in area 1 will actually fall, while at the same time they will increase in area 2 so that at a department level, efficiencies are increasing. The efficiencies in both areas will count at the department level despite fluctuations in each individually.

'One-off' gains

- Departments may have taken an efficiency action that is demonstrably sustainable and each year results in a series of annual 'one-off' gains stemming from efficient practice. At a programme level the efficiency actions are sustainable since they have been embedded within departmental processes. These efficiencies can be scored in full on an annual basis, but the general principle is that achieving the SR04 target should require ongoing efficiency gains.

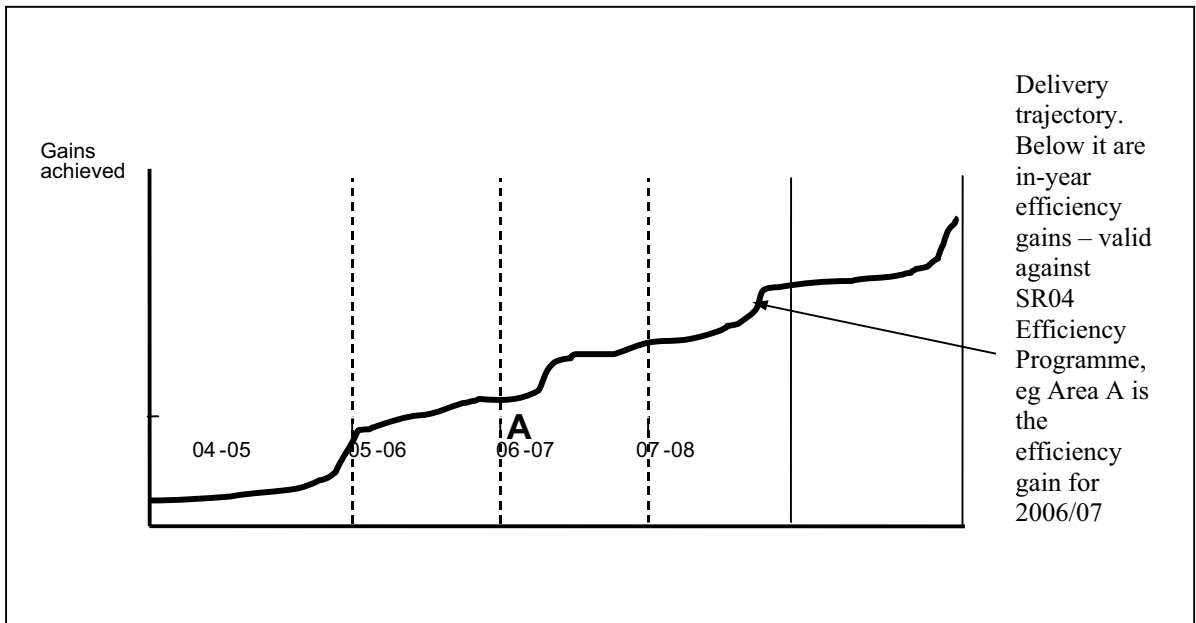
Efficiency gains are measured in-year

3.15 Departments must use in-year measurement. By this it is meant that the amount of efficiency declared must be the amount **actually delivered** during the financial year in question, not the rate at which efficiencies are being delivered at a given point in time. Thus the overall programme target is for “£21.5bn of efficiencies to be delivered during 2007-08”, not “the rate at which efficiencies are being achieved is £21.5bn per year by end March 2008”. Box 5 and Figure 6 below give further examples of this.

Box 5: In Year Measurement

A department that has previously spent £10m pa on widgets, signs a new procurement contract at the end of year 1 to cut its widgets bill by £1m pa. Compared with the start of year 1 the department's annual widgets bill at year-end would now be £1m lower. However, the savings would not be made until year 2, since the department was spending the old cost on widgets (£10m pa) through year 1. No in-year efficiencies for year 1 have therefore been delivered. All things being equal the department will however generate £1m efficiency gains in year 2 against its start of year 1 baseline.

Figure 6: Ensuring that you are measuring in-year



The GDP deflator is the default rate of inflation

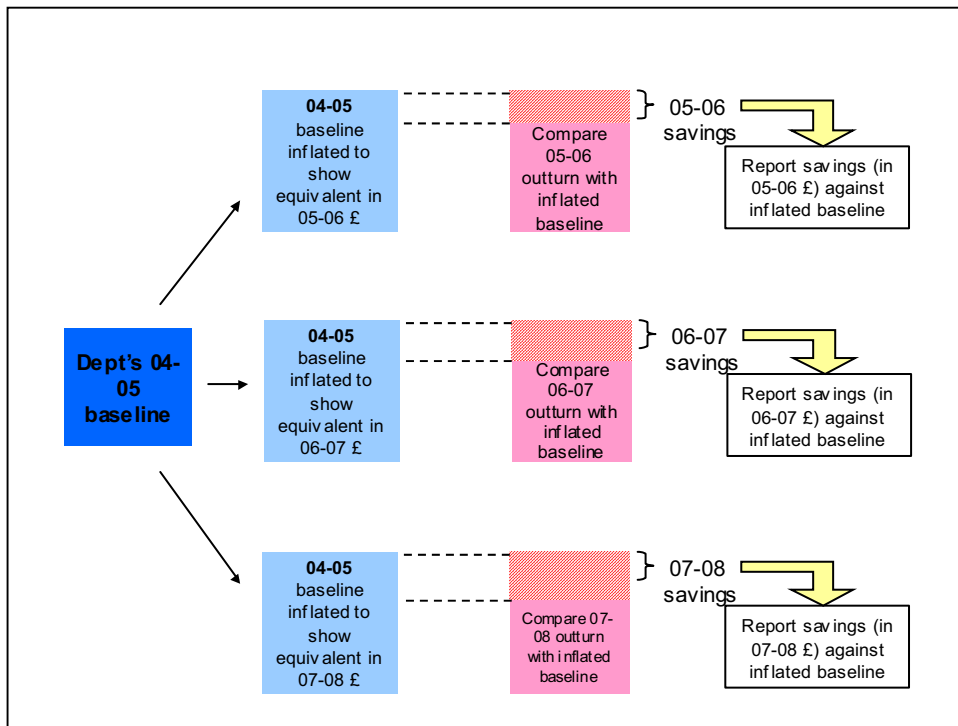
3.16 Efficiency targets are expressed in 2007/08 prices. Departments should use GDP deflators published by HMT when calculating their efficiency gains each year, unless they have specifically agreed a different deflator with HMT. At the time of issue HMT estimates for the GDP deflator are:

- 2004/5: 2.72%
- 2005/6: 2.12%
- 2006/7: 2.44%
- 2007/8: 2.66%.

3.17 While the SR04 targets are set in 2007/08 prices the baselines are usually set in 2004/05 prices. This means that adjustments will need to be made to ensure that figures reported before the end of 2007/08 are on the same basis as the final targets agreed for the SR04 period. You need to do this to ensure you are not underscoring gains made through the programme.

3.18 Departments should follow the example in Figure 7, which is based on the premise that they are reporting **cumulative efficiency gains**. The important principle is that department's should **report in this year's money** - whatever this year is. This means that Departments will have to adjust their gains if the GDP deflator changes.

Figure 7: Reporting efficiency gains: taking account of inflation



Avoiding double counting

3.19 Very often delivery to the public involves multiple delivery agencies. To avoid compromising the integrity of the Efficiency Programme it is important that double counting of efficiency gains is avoided.

3.20 Examples of how double counting might arise include:

- *Counting the same efficiency gain as both cashable and non-cashable*
A cashable efficiency gain may also fulfil the requirements of a non-cashable gain and it is important that the same gain does not get counted twice. It is particularly important to consider this when measuring non-cashable gains arising as a result of quality improvements. However there may be components of a gain that include both, in which case the practice is to calculate the overall gains, calculate the element that can be shown to be cashable and score the remainder as non-cashable.
- *Relationship between different types of efficiency gains*
Cashable gains free up resources. When such resources are utilised elsewhere it is important that the efficiency gains are not double counted. The recipient of the resources that have been freed up can only count efficiency gains for efficiencies over and above what could have been achieved by simply adding these new resources into their existing delivery chain.
- *Public-public partnerships*
When efficiencies are delivered in partnership with another public sector body the total claimed by both parties must not exceed the total efficiency delivered by the partnership. We recommend that parties determine up-front how the sum of efficiency gains will be allocated to each partner. This will generally be based on the proportion of the original funding.

- *Gains shared between processes and budgeting units* Should efficiencies stemming from process savings free up resources for a budget holders who are also claiming gains from their own efficiency initiatives then departments need to ensure that the total efficiency is divided between these parties and is not claimed twice.
- *Gains measured and counted at different levels in the delivery chain* It is important to ensure that the same efficiency gains are not counted twice at different levels within the delivery chain. For example:
 - A process saving made at a systems level cannot be re-counted as a task related saving on the front line. In areas where corporate services gains are achieved it is essential that these are counted either as a systems level efficiency, or as an increase in front-line delivery team efficiency, and not recorded in both places.
 - Public Services are frequently delivered to the end customer by arms length bodies. In Local Government, to avoid double counting, individual local authorities are required to submit their efficiency gains to central government (DCLG) and these are then passed back to individual departments according to the service area. This ensures that there is a single reporting source and that departments and Local Authorities do not double count the same efficiency gains.
 - Areas where budgets are shared pose a risk of double counting. If a department funds an arms length body or agency the recipient of such funds should be asked to report efficiency gains made with the resources received and report these back to the department. The department should not measure efficiency gains against this part of its budget unless it is doing so wholly on behalf of its agent.

Lead indicators

3.21 Some initiatives might only be directly measured once or twice per year. More frequent reporting against such initiatives will often rely on lead indicators, which are often proxy measures that provide estimates of delivery ('preliminary' data as they are likely to change).

4. MEASURING CHANGES IN INPUTS

4.1 This section covers two points. First it sets out how to treat measurement of financial inputs, and second, it outlines how to derive financial efficiency savings from reductions in headcount.

Capital Spending

Efficiencies can be obtained from capital spend just as much as revenue. The same basic principles for counting efficiency gains apply to both.

4.2 If a department has a relatively stable profile of spending projects that are broadly repeated each year then it can calculate efficiency gains directly through their capital programmes. For example:

- Efficiency actions at a programme level can be used to demonstrate ongoing efficiency gains, such as through driving down unit costs for repeated activities. An example would be refitting of housing accommodation to standard specifications.
- Actions taken to avoid capital expenditure can be included, with the value claimed each year being what would have been spent in that year (and not the total savings up-front).

4.3 A department may in contrast have a series of individual 'one-off' capital projects, which are not repeated each year. If the efficiency actions taken to drive down costs and or improve quality are sustainable, then it is possible to claim these in the year in which they fall. Efficiency actions could include streamlining procurement processes or value engineering before agreeing contracts. In these cases:

- Efficiency actions are taken at a programme level.
- Measurement is of the effects of these programme level actions on the individual capital projects.

These will generally be against a counterfactual baseline i.e. what would have been spent had the changes not been taken place.

4.4 Examples of actions that do not count as efficiency gains are:

- Cuts in planned capital programmes that impact on services.
- Slippage of capital expenditure from one year to another.
- Cash receipts from disposals. Departments can however claim efficiencies from savings in depreciation, cost of capital, maintenance and other running costs stemming from the disposal of an asset (local authorities are treated slightly differently – see separate advice).

Depreciation and cost of capital

4.5 Departments can also claim reductions in costs of capital and depreciation derived from avoiding capital expenditure or better management of assets (e.g. extending the life of a capital asset).

4.6 No efficiency gains can result from changes in accounting treatment.

Allowing for costs

4.7 For programmes that are already included in the SR04 Efficiency programme, one-off implementation costs, such as capital spend or write-offs do not need to be subtracted from efficiency gains. The National Audit Office (NAO) guidance says that it is best practice to include all costs, and HMT encourages departments to include all costs for all new efficiency projects.

4.8 The ongoing consequential costs of implementation or capital outlay (such as depreciation, costs of capital etc) should always be subtracted from claimed efficiency gains. You should follow standard practice on depreciation.

4.9 Disposal receipts do not count towards efficiencies.

Savings through procurement

4.10 Refer to procurement measurement guidance.⁴

Financial value of headcount reductions

4.11 As well as financial efficiency savings, departments have targets for reducing headcount and for relocating staff out of London and south-east England. While methods of calculating numbers of staff and relocations are out of scope of this document, several departments are basing parts of their efficiency programmes on financial savings from reductions in headcount.

4.12 There are two recommended methods for calculating these gains:

4.12.1 **Actual costs:** if you are able to record actual costs, such as through a payroll system, then actuals can be used to compare from a base point to the next reporting point. Box 6 provides an example – departments should follow the method in Box 6 for all the relevant grades and then sum the gains for an overall total.

4.12.2 Departments will need to ensure that the difference across the period is recorded and not simply the rate difference between base point and reporting point (see section above on reporting in-year).

⁴ Refer to footnote No. 1 on page 3

Box 6: Using actual costs to calculate efficiency gains from headcount reductions

The cost of employing staff before the efficiency improvement at 2004/05 prices

Multiplied by

Inflation over the period (say 2006/07)

Minus

The cost of employing staff (i.e. pay, pensions and potentially other costs) after the efficiency improvement at current prices (ie 2006/07 prices in this example)

= £ cashable efficiency gain (if a positive figure)

4.12.3 **Capitation rates:** if you do not have the actual costs then you should use capitation rates for the relevant grades of staff that are in your department. Capitation rates will include items such as pay, allowances, earnings-related National Insurance contributions and superannuation. In order to compare between base point and reporting point you will need to know how many staff you have in each grade. Box 7 provides an example – departments should do this for all the relevant grades and then sum the gains for an overall total. Departments should also check that the actual mix of grades is the same as originally assumed, and adjust the overall gain accordingly.

Box 7: Using capitation rates to calculate efficiency gains from headcount reductions

The number of staff before the efficiency improvement

Minus

The number of staff after the efficiency improvement

Multiplied by

The capitation rate for staff (i.e. pay, pensions and potentially other costs) at 2004/05 prices

Multiplied by

inflation over the period

= £ cashable efficiency gain (if a positive figure)

5. BALANCING QUALITY MEASURES

5.1 A general principle of the Efficiency Programme is that there is no efficiency unless it is possible to demonstrate that service levels have at least been maintained. Such means can include a combination of:

- A narrative
- Management judgement and
- Reference to detailed metrics.

Depending on the kind of efficiency measure being used, departments may need a measure to enable the tracking of service quality levels. This is known as a 'balancing quality measure'.

5.2 Balancing quality measures need to relate to the service area in which efficiencies are being claimed, and should cover the majority of inputs that are measured in the efficiency calculation. The cost of developing and using balancing quality measures needs to be taken into account. Sophisticated quality measures may not be appropriate for the smallest efficiency projects or programmes.

5.3 There are a number of possible sources of balancing quality measures. Wherever possible balancing quality measures should be drawn from departments' existing management information such as:

- Appropriate Key Performance Indicators (KPIs) or other performance indicators relevant to the particular efficiency initiative;
- From existing user/customer satisfaction or perception ratings;
- Public Service Agreement (PSA) targets, which should be used where appropriate output-type balancing quality measures are unavailable.

5.4 Each type of balancing quality measure has its own strengths and weakness.

Box 8: The pros and cons of different types of balancing quality measures

	Pros	Cons
Service level targets	Output based Already in place Timely Service specific	May be multiple measures
KPIs	Output based Already in place Timely Service specific	May not be collected quarterly
BVPs	(Sometimes) output based Already in place Externally developed Some scrutiny e.g. from Audit Commission	May not be fully fit for purpose Can be outcome focused
Customer/user surveys and perceptions	Possible to tie into service area Easy (in theory) to understand	Tending towards outcome measure May require extra data collection Question over robustness of validation
Integrated measure, e.g. productivity measure	Maintains link between input: output ratio / service quality Adjusts link to reflect changes in service quality	On own may not capture all significant aspects of quality Complex (and potentially costly) to develop
PSAs	Already developed and used Linked to dept performance Some externally developed (e.g. national statistics)	Not reported quarterly May not be fully fit for purpose Outcome focused so difficult to attribute Broad and high level and subject to extraneous impacts

5.4.1 It is good practice for the value of the balancing quality measure to be recorded every time the value of the efficiency measure is recorded. When it is not practical to record a balancing quality measure the claimed efficiency gain can still be reported, but it cannot be declared 'final' until the quality metric is available.

5.4.2 Where balancing quality measures are used, they will need to be measured and reported before the data can be designated as 'final'. HMT requires, at a minimum, that balancing quality measures are reported following the end of each financial year.

5.4.3 Major business change can induce initial dips in the quality of service outputs, especially in corporate functions such as HR and finance. HMT recognises this as an issue that should be tracked and will require assurance that service quality levels have at least remained at the same level over the course of the programme.

5.4.4 We recommend departments take care to avoid choosing highly volatile crosschecks or ones subject to significant external factors that might not fairly reflect the level of service. A quality check showing a deterioration/decline in performance does not in itself invalidate an efficiency gain. However, in these cases you must demonstrate the reduction in service quality results from other external factors and that the efficiency action has not caused the reduction in quality. You will need to be prepared to explain this publicly if called upon to do so.

Aggregation/bundling

5.5 Some initiatives will have multiple quality measures underpinning their efficiency initiatives. If this is the case a number of principles apply:

- There is no requirement to aggregate the measures into a single quality indicator, although departments may effectively already do this in a balanced scorecard.
- Departments need to be careful that their choice of quality measures does not introduce perverse incentives.
- SROs need to ensure that they can defend publicly any assertions they make on overall quality where some measures have gone down while others have gone up.

Tolerances

5.6 If departments are measuring and reporting a set of quality measures then it is possible that some will move in different directions. Departments should agree how to handle this with their efficiency account managers.

Narrative quality assurance

5.7 Not all service quality assessments can be given a numerical value. In these cases the substitute narrative must be compelling – it must pass a ‘reasonableness’ test i.e. would an impartial observer conclude from information given that quality has been maintained. This can be tested by getting an impartial view from a suitably qualified independent source.

6. MEASURING THE FINANCIAL VALUE OF IMPROVEMENTS IN SERVICE QUALITY

Outputs with direct financial value (i.e. revenue increases)

- 6.1 Generating additional income (from whatever source) by increasing fees or charges or through new sources of income does not constitute an efficiency gain. However, efficiencies can be generated from fees and charges by:
- Improved or increased collection of charges for services (such as increased collection of parking fines over and above any additional costs) where the charges have not been increased in real terms.
 - Sweating assets, such as through increases in demand for existing services, earlier receipt of income, or improvements in income collection rates can in general be counted as an SR04 efficiency; again as long as the charges have not been increased in real terms. Efficiency actions might include advertising campaigns.
- 6.2 An important way to achieve efficiency is by improving performance while keeping costs constant, or improving the amount or quality of service at a faster rate than increases in inputs (a marginal benefit). Measurement here is complex and there is a need for careful consideration of how quality improvements can be valued and then tracked.
- 6.3 One simple example and effective measurement approach is a cost-effectiveness index. This is an indicator of service improvement and expresses the improvement as a percentage increase from the previous service provision. This method can be based on the assumption that the output is at least equal to the input required to make it. This allows a value to be placed on the improvement. As such this is an indirect measure of the value of outputs, but it stems from a direct assessment of an improvement in their quality. Thus, if the cost of provision in the base year is £100,000 and service as measured by an indicator improves by 6%, then this improvement is worth £6,000 in base year terms, provided costs are held constant.
- 6.4 For further information on methodologies see the latest version of the measurement guidance for local authorities⁵.

⁵ [Guide to Completing Annual Efficiency Statements](#)

Box 9: Examples of quality improvement calculation methods

1. Aggregating different kinds of outputs

Ideally this would be based on unit costs. If these are not available it should be done on the same basis as budget and target setting.

- For example, Regional Development Agencies track movements across six of their key indicators, which they then translate into financial values. For details on the method please contact your efficiency account manager.

2. Assuming increases in outputs from movement in inputs

There may be evidence that shifting the profile of inputs will produce greater outputs.

- For example, DFID is shifting its profile of spending from funding individual projects to supporting recipient Government development programmes. There is evidence that this produces substantially greater development outputs per pound spent. The department has calculated the gain by measuring the movements in inputs and applying a defensible multiplier. Two key principles underlie the department's methodology:
 - Using independent and external research as the basis of its benefit assumptions.
 - Choosing a conservative estimate of the benefits on outputs (in this case half what the research literature suggested would be the case).

3. Benefit to the wider economy or valuing the public's time.

We do not recommend that departments adopt either approach, since savings do not accrue to the public purse.

7. CHANGING THE MIX OF OUTPUTS (allocative efficiency)

- 7.1 In his 2004 efficiency report, Peter Gershon included a fifth efficiency type, termed 'allocative efficiency', which was defined as 'changing the balance between different outputs aimed at delivering a similar overall objective in a way which achieves a greater overall output for the same inputs'.
- 7.2 Measurement methodologies designed to capture allocative efficiency savings (type E5) will be considered on a case by case basis. The general principle is that any measurement methodology needs to be based on savings come from reduced inputs and that outcomes should not be given a financial value.
- 7.3 The critical point is that if there is an overall drop in service quality then the activity is not an efficiency. If however, the overall benefit to all recipients is maintained for lower cost (or they experience a service improvement for the same or lower cost) then an efficiency gain can be claimed even if a minority of individuals are disadvantaged.

Box 10: Example of an allocative efficiency

Two service areas combine into a single organisation to serve a common client group.
Each has previously agreed outputs that contributed to the new shared outcome, which are merged in the new entity.
The merger reduces input costs, which is the efficiency gain (see section 4).
The methodology will also need to monitor service outputs (and possibly outcomes) to ensure that overall service levels have at least been maintained (see section 5).

We recommend that you should discuss any questions about the calculation of allocative efficiencies with your HMT account manager.

8. FURTHER INFORMATION

Contact details

For further information please contact the SR04 Efficiency Team – either via your Account Manager or through HMT's Central Enquiries Unit (CEU.Enquiries@hm-treasury.gov.uk)

SR04 Efficiency Team

9. Annex 1: Additional sources of information

Guidance

1. A number of efficiency guidance documents are available:
 - Guidelines for Signing Off SR04 Efficiency Gains.
 - Guidelines for Assessing Data Maturity.
 - 'Procurement Efficiency and Value for Money Measurement: Efficiency Programme Measurement Guidance' available from http://www.ogc.gov.uk/documents/Procurement_Efficiency_and_Value_for_Money_Measurement.pdf
 - 'Productive Time: Efficiency Programme Measurement Guidance' from http://www.hm-treasury.gov.uk/media/FE9/DC/productive_time010405.pdf
 - 'Successful delivery pocketbook' from http://www.ogc.gov.uk/Resources_for_all_successful_delivery_pocketbook_a3.asp
 - 'Management of risk: guidance for practitioners' - please contact the OGC Service Desk on 0845 000 4999 for a copy.

Gershon Review

2. *Releasing resources to the front line: Independent Review of Public Sector Efficiency*, July 2004, led by Sir Peter Gershon can be downloaded from: http://www.hm-treasury.gov.uk/media/B2C/11/efficiency_review120704.pdf

HM Treasury

3. *Choosing the Right Fabric: A framework for Performance Information* is a joint publication prepared by HM Treasury, Cabinet Office, National Audit Office, Audit Commission and the Office for National Statistics. It can be accessed from <http://www.hm-treasury.gov.uk/media/EDE/5E/229.pdf>

Public Audit Forum

4. The Public Audit Forum brings together national audit agencies in an advisory capacity. Its report *Improving Performance Information* can be downloaded from www.public-audit-forum.gov.uk

DCLG

5. The DCLG's guidance on local authority gains can be obtained from <http://www.rcoe.gov.uk/rce/aio/16540>

National Audit Office

6. The first report in the National Audit Office's rolling programme of reports on the efficiency programme *Progress in Improving Government Efficiency*, HC802, February 2006, can be downloaded from <http://www.nao.org.uk>. Appendix 5 of the report provides guidance on data systems for efficiency projects. The NAO website also has a section devoted to public sector efficiency <http://www.nao.org.uk/efficiency/>

Audit Commission

7. The Audit Commission has developed guidance on data quality in the context of performance improvement.