DPMC: Value for Money and Right Sizing the Budget

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Purpose

This report was commissioned by the Department as part of a suite of work to provide the incoming Chief Executive with the information necessary to identify what needed to be done to better position DPMC for the future. It responds to the specific issues raised in Terms of Reference attached as Schedule 1. While the immediate request was to identify what it would take to "right size the budget", the brief is to consider this issue in terms of what the Department should be doing to deliver more value for money.

Executive Summary

A May 2011 Strategic Review of DPMC concluded that "... under the present structure DPMC is doomed to struggle. The department is too small and fragmented to offer the flexibility and capability that should be provided to support the Prime Ministers ... (with) much of the work routine". I agree with that conclusion.

DPMC also faces significant short-term financial pressures that cannot be met solely from savings without a significant degradation in support for the Prime Minister and Cabinet. Some additional funding will be required. That imposes an obligation on the Department to add more value.

However, addressing these immediate financial pressures will not in itself address the fundamental viability issues facing the Department. The 2011 Review's recommended merger with SSC would solve the problem but has been discounted because of the implications for the Commissioners position. However, creating a "virtual corporate centre" with Treasury and SSC inside a single budget envelop is possible (similar to that established for the Justice sector). That would help ensure the Department's longer-term financial viability at the same time as it created the extra value necessary to justify additional funding. It would require changes in the way DPMC is managed, although these could be delivered without too much difficulty.

Output Classes: How can DPMC deliver more value for money?

DPMC exists to support the Prime Minister as head of the administration and the Governor General as representative of the Crown. The Department has three output classes that group the activities of almost the entire Department: Policy advice to the Prime Minister; Support to the Governor General; and Intelligence Coordination and National Security Priorities. There is an additional very small output for the Chief Science Advisor.

a. DPMC can and should not try and compensate for weaknesses elsewhere

None of these on-going functions are designed to try and compensate for deficiencies elsewhere in the state services, with the possible exception of the Chief Science Advisor. However, from time to time the Department does form specific groups to tackle cross-agency issues of particular concern to

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the Prime Minister: e.g., positive aging; Y2K; employment taskforce; Crime Prevention Unit; Climate Change; Better Public Services. The Department is also currently leading projects on youth mental health and controlling "P" and is about to establish the National Cyber Policy Office.

Some of these tasks do fit neatly with the core role of the Department. However, others are more likely to have ended up being run out of DPMC because of the relative difficultly in the past of creating effective sector groupings of independent agencies and their Ministers to tackle these sorts of cross-agency issues. This should become a lot easier in future as agencies learn to work effectively together to deliver this Government's BPS goals and as the corporate centre develops and is able to provide greater assurance to the Prime Minister that important cross-agency issues will be effectively addressed at the sector level.

This is one test of an effective corporate centre: can it provide the necessary assurance to the Prime Minister that a particular cross agency result that he or she wants to see delivered can be successfully delegated to the relevant departmental sector grouping? If so, then the extent to which DPMC needs to lead a particular project – or incubate a new state sector capability – should be relatively rare. That should allow for more predictability in the Department's costs over the four year planning cycle as well as allowing a greater focus on those areas where DPMC can make a distinctive contribution.

b. DPMC needs to be managed in a more unified way

My findings also reinforce the conclusion of last year's Strategic Review that the effectiveness of DPMC could be enhanced by operating in a less fragmented way.

DPMC is currently managed as seven almost completely separate units reporting directly to the CE, with the budget managed centrally. This fragmentation exacerbates the problems caused by the Departments small size (average of about 120 FTE).

While the small size and diverse nature of the Department's business creates viability issues, some of the negative impact of size and scope could be ameliorated if the senior managers acted as a team in setting a clear purpose and vision for the Department; setting departmental priorities (and reallocating resources among units where possible to better support those priorities); and agreeing each units operational plans. It would then be possible to delegate each unit manager more authority to deliver against those plans within their budget (i.e., to manage their people and their budget to deliver the best possible result).

c. Effectively supporting the Governor General has some distinctive aspects

While this more unified approach applies to support for the Governor General and maintenance of the residences, this is an output that has two distinctive features. Clearly, it is the Governor General who needs to set the objectives for that role and agree the operational plan required to deliver those objectives. This is also the only output class with significant physical assets and it is necessary to ensure that the right asset maintenance schedule is identified and agreed and funding clearly earmarked for this purpose.

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d. Working closely with SSC and Treasury to create an effective corporate centre is likely to add greatest value and, if successful, be increasingly critical to effective Government

By far the most important set of changes needed to deliver more value for money are those that create the opportunity for the Prime Minister to more effectively leverage his or her unique position to support better collective outcomes. There are two areas where this is likely to be particularly important. First, better integrated policy and delivery across what are still largely independent agencies working to their own Ministers with their own portfolio priorities (this was a theme of the Better Public Service Advisory Group). Second, more attention to building institutional capacity to support more effective and efficient delivery of the governments "core business" (a system weakness identified in the Performance Improvement Framework reports). Improvements in both areas are needed to deliver the BPS targets the Government has set itself.

DPMC does not have the capacity or capability on its own to support the Prime Minister in this task: i.e., to help Government set the agenda; provide the Prime Minister with the necessary assurance that government has the policies in place and the capability and capacity to deliver on its priorities and improve core business; or point out what needs to be done to be able to provide that assurance. Neither does it have the necessary understanding of – or reach into – agencies to anticipate and address the problems that could cast doubt on the competency of the government to deliver.

What DPMC does have that is unique is its proximity to the Prime Minister and Cabinet. This gives the Department an intimate understanding of the government's collective ambitions, preferences and priorities. It also gives the Department the authority to reflect that understanding back to officials and to engage the Prime Minister to identify and resolve tensions that may arise between individual portfolio priorities and these collective priorities.

However, DPMC lacks the powers and processes necessary to ensure that understanding is properly reflected in way agencies are funded or their performance is defined, managed and assessed. Nor does it have the capacity or reach to develop insights into the strengths and weakness of the individual agencies that must deliver the results the government is seeking; effectively monitor performance; and take remedial action if these agencies go off track. Treasury and SSC have these levers and DPMC needs to work "as one" with its central agencies colleagues to provide a full range of corporate centre capability and capacity in order to provide the Prime Minister and the Cabinet with the advice and assurance they need. This is particularly important in delivering the Government's BPS target results.

In short, success requires a much more effective combination of:

- the advantages DPMC derives from its proximity to the Prime Minister and to Cabinet with
- the capacity and reach that the SSC and the Treasury have into the rest of the bureaucracy through the budget and performance management processes.

Adding value will require changes in the Policy Advisory Group and Cabinet Office

Creating a value adding corporate centre will require changes to the way the Policy Advisory Group (PAG) works and the way it works with the Cabinet Office. Much of what PAG does is routine and reactive. There is also considerable scope for the Cabinet Office doing more of what the PAG is currently doing (and departments doing more of what the Cabinet Office is currently doing). For

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example, departments - working with their Minister's Office if necessary - should be required to provide the first draft of the note that covers each Cabinet or Cabinet Committee paper. Cabinet Office could then refine that if necessary and brief the Prime Minister on upcoming Cabinet and Cabinet Committee meetings. Cabinet Office could also brief the Prime Minister on the outcome of the Cabinet Committees that he or she could or does not attend (with less need for two Cabinet Office people plus a PAG member to attend each meeting). This could relive the PAG of much work that is reactive and routine.

PAG should be focussed on working with the other two central agencies to advise the Prime Minister on the priorities that should be set for each portfolio – or portfolio groupings – and then provide the Prime Minister with assurance that the priorities that the Prime Minister and Cabinet have set for the administration will be delivered and indentifying when and how the Prime Minister can be most personally effective in ensuring that priority results are achieved.

If the corporate centre is working well it should be able to anticipate and address those areas where capacity and capability issues – or poor risk management – within the state services are likely to create problems that would otherwise have required a reaction from the PAG and, ultimately, the Prime Minister. Providing the necessary assurance also means more time spent with Treasury and SSC making sure the systemic aspects of effectively delivery are firmly in place; that milestones are established and performance well monitored; and that these agencies are actively engaged to assist if delivery is going off track.

If the PAG is effective in this more systematic and proactive "assurance" role, it will economise on the need for direct Prime Ministerial authority and effort to be expended in ensuring that priority results are delivered. A more proactive approach with Treasury and SSC should also mean that fewer problems arise that casts doubt on the competency of Government. These are also useful tests of an effective corporate centre.

Security, risk management and crisis response are central to an effective corporate centre

While these considerations will have the greatest implications for the management and operation of the Policy Advisory Group and the Cabinet Office, the Department's role in "intelligence coordination and national security priorities" are important components of an effective corporate centre and add value to what DPMC can bring to the table.

It is only the Prime Minister who has the authority to bring the government together to respond to immediate threats or crisis in a timely way. The nature of that response often defines an administration. It is inevitable that Prime Ministers will look to their own Department to help coordinate crisis response. That, in turn, requires the Department to be proactive in identifying the risks that need to be managed and ensuring that the various agencies of State are managing those risks appropriately, especially security threats. While crisis response relies heavily on the authority of the Prime Minister, effective risk management requires the sort of capacity and reach that SSC and Treasury can bring to the table.

National security is one of the first responsibilities of government and often requires redefining the boundary between the individual and the State. It is not surprising, therefore, that Prime Ministers typically take responsibility for the two security agencies and look to their Department to ensure

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that the security effort is well prioritised and coordinated and that intelligence product is independently assessed (although that does not imply that DPMC need be responsible for producing that assessment).

Right Sizing the Budget

DPMC faces a significant immediate fiscal challenge as well as more fundamental questions about its ongoing financial viability. Addressing the immediate challenge will require some difficult savings and funding decisions to be made. Addressing the viability issue requires the Government to consider a different funding model.

a. The Impact of the Central Agency Shared Service (CASS)

The CASS budget is the sum of running costs (personal and direct operating of about $11m), a "managed fund" (depreciation, capital charge, recruitment and training of about $4m) and an improvement program (of about $0.9m to start next year, if agreed).

The impact of CASS on DPMC across each dimension is as follows:

a. Based on activity weightings, about 19% of the running costs have been allocated to DPMC: i.e., about $2.1m of the $11m total for 2012/13. This is an increase of $685k for DPMC (with about $450k of DPMC's costs for 2011/12 actually funded by Treasury and SSC).
b. About 16% of the "managed fund" has been allocated to DPMC: i.e., about $665k of the $4m total for 2012/13. This is an increase of $319k for DPMC (almost all for "learning and development" and "depreciation").
c. About 20% of a one-off CASS development cost for 2012/13 (i.e., $185k) which is anticipated to reduce the on-going CASS costs in each out-year by an equivalent amount.

In short, CASS will increase DPMCs costs for 2012/13 by about $1.19m, with an on-going impact of about $820 per annum. The impact of CASS on the costs of the three central agencies varies significantly, with DPMC's costs increasing and Treasury and SSC declining, albeit with an overall reduction in the combined running cost to central agencies of about $560k.

While any cost allocation mechanism is subject to judgement, the approach applied to the CASS expenses is sound (and slightly lower than the allocation based on cruder measures, like FTE or "active users").

CASS is costing DPMC more because it is providing a better and more robust set of IT, Finance, Information Management and Human resources services than it was able to provide as a stand-alone department (with about $200k for additional depreciation). It would be surprising if the Department as small as DPMC could offer a like-for-like service at a lower cost. Moreover, given the similarities in the operations of the three departments it is likely that DPMC would have eventually converged with the service standards of the other two departments (especially to improve managerial decision making and support improved staff efficiency). Indeed, the cost of the stand alone service was the fastest growing cost centre in DPMC over the last nine years.

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b. Options for savings in baseline, changes in priorities and adequacy of funding

The size of the financial challenge facing DPMC is daunting. The Terms of Reference acknowledge that DPMC has found itself under increasing resourcing and funding pressures that have obliged it to look to other agencies for assistance. That assistance now stands at some $700k for 2011/12, excluding the fact that the Department's contribution to CASS has been subsidised by the other two central agencies to the tune of $620k. When the impact of the 3% efficiency dividend (about $0.5m) is added for 2012/13, DPMC faces an "all up" challenge of about $2.5m for 2012/13 ($1.8m cash shortfall plus the $700k on-going subsidy from other departments) falling to about $2m in the out-years as CASS efficiencies kick in. This is a little over 13% of the 2012/13 budget. Even then, more work needs to be done to identify the amount it needs to earmark to maintain the two Governor General residences in their current condition (albeit that is unlikely to be a large sum in the short term).

DPMC can meet some of the immediate cash shortfall through better management of existing functions. In particular, it should be able to make further savings in what is now the CE's office as the CASS arrangements bed in as well as some economies in the new Cyber office and possibly even in the National Assessment Bureau (e.g., as more assessment product is generated elsewhere and if it was amalgamated with the new Coordination Group).

However, the immediate savings here and elsewhere are unlikely to be large enough to meet the cash shortfall for 2012/13 without significant changes in capability:

- The focus for the PAG and Cabinet Office should be to reorient what they do – rather than be looking to make savings - in order to help deliver the value uplift possible from the corporate centre.
- Support for the Governor General appears to me to be about right, with the issue here largely around ensuring the right level of asset maintenance within the current budget.
- The cost of the Chief Science Advisor is relatively fixed and the big question is whether this role needs to be in DPMC or would be better embedded in MoBIE where the Advisor would have more operational leverage (as, for example, the Chief Medical Officer is embedded in the Ministry of Health).

The Intelligence and Security area has been recently reviewed and the changes made appear to be a significant improvement (esp., the way the various agencies are working together and the role of the new Intelligence Coordinator Group).

While NAB is not really core business for DPMC, locating this function elsewhere is more likely to result in cost shifting rather than cost reduction and may well reduce the effectiveness of the function. The assessment function is, to a large degree, a shared service provided to a large number of end-users of the intelligence community. It is possible to conceive of this function being provided by another large Ministry (MFAT, for example). Housing the assessment function in a larger agency might also help make NAB a more attractive place to work because it would be able to offer its staff a wider set of career options.

However, reallocating NAB is more likely to shift cost rather than improve value for money. Indeed, the risk is that the reduced status and the greater distance from the rest of the Intelligence

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Community could reduce value for money from the assessment function (especially so quickly after a major review). Unless NAB was shifted largely intact, the bigger risk is that its role would resurface in less efficient and effective forms elsewhere. Keeping NAB in DPMC also helps round out the contribution that the Department can make to the emerging corporate centre.

In summary, DPMC is unlikely to be able to meet its entire cash shortfall for 2012/13 without what is effectively cost shifting that impact negatively on value. Current levels of capacity and investment are also being maintained by the generosity of other departments that is unlikely to outlive the current projects (at least not at a $700k level). Moreover, DPMC's small size and relatively broad scope constrains its ability to reprioritise and to absorb negative financial shocks or take on additional activity. If Government wants the DPMC budget to "stand alone" within a four year baseline then the Department will need that baseline increased by at least $1m.

c. Enhancing DPMCs long-term viability

DPMC is a very small and fragmented department – with an average of 120FTE spread across 7 different units – which leaves each unit relatively thinly stretched and the Department poorly placed to respond to shifting priorities or adverse financial shocks. While this could be better managed, it will remain a fundamental problem.

DPMC is "doomed to struggle" under the current arrangements and has only be able to delay the inevitable by the generosity of other departments. It needs to be part of a much larger budget entity in order to ensure its long-term financial viability and provide the desirable financial flexibility. The Government should only consider extra funding if the Department is likely to be able to generate extra value as part of this larger entity.

All of these conditions could be met by taking the idea of a more unified corporate centre and setting a budget envelop for the three central agencies to manage within (i.e., a budget arrangement that is similar to that being developed for the Justice Sector agencies). The discussion above illustrated how the creation of a more cohesive corporate centre would help all three central agencies add more value and why DPMC's active engagement was both essential and brings real value to the collective table (albeit with some changes to the way DPMC is managed).

More work is required before the Government could be confident that the opportunities created by a more cohesive corporate centre could be realised. However, if this can be done then it would be reasonable to re-set the collective budget envelop and associated 4 year budget plans to capture those benefits.

Central agencies have already agreed to form an executive board to set priorities across the set of "corporate centre" functions, although the idea of a combined budget envelop is controversial and has not (yet) been agreed.

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Conclusion

The Government has a clear choice between:

EITHER:

a. Maintaining existing arrangements and addressing the near term financial problem with some combination of baseline increase and expenditure reduction, although if this were the chosen path and the Government wanted to hold a four year budget baseline, then it is realistically looking to add at least $1m to the DPMC baseline;

OR

b. Addressing the fundamental size and scope problem by accelerating the development of a corporate centre; making the changes inside DPMC needed to make its contribution more valuable; placing the three central agencies inside a collective budget envelop (albeit maintaining each Vote); and asking this larger budget entity to provide an assurance product of sufficient quality to justify retaining the collective CASS savings (which may require increasing the collective baseline by this amount if, as seems likely, these savings have already been earmarked for other uses).

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Schedule 1

Terms of Reference: Value for Money and Right-Sizing DPMC's Budgetary Requirements

Context

A review of the current state of DPMC's finances has been proposed. This will ensure that there is a good understanding of the value-for-money of current DPMC service provision, and also of the extent of resourcing required for DPMC to deliver the services required by its Minister, to an appropriate extent and standard and what is required to get DPMC to run more effectively

DPMC's role, *inter alia,* is to support the effective conduct of executive government, and to lead and coordinate a range of government policy initiatives. In meeting these expectations DPMC has in recent times found itself under increasing resource and funding pressures. It has been required to look to other agencies for assistance with additional short-term staffing support, and financial input, in order to carry out a number of particular tasks that have been requested.

The recent transition to the new Central Agencies Shared Services (CASS) has also presented budget challenges for DPMC. The delivery of IT, IM, HR and Finance functions that were formerly delivered by DPMC from a very modest budget are now being provided by a more expensive CASS, but to an enhanced degree. CASS offers a more resilient, comprehensive and robust delivery of these functions for DPMC.

The relative cost levels of CASS, DPMC, Treasury and SSC are evident from the BASS surveys for 2009/10 and 2010/11. The higher costs that have been allocated to DPMC as a result of the establishment of CASS are not able to be borne by the existing DPMC budget. For the remainder of 2011/12 this issue has been managed by the SSC and Treasury providing – very welcome - additional funding to DPMC. In addition, the Government has applied a 3% efficiency savings on baselines form 2012/13. This reduction in baselines will place additional pressure on DPMC to make cost savings across all of its activities. These cost savings will need to be made in an environment where there is a growing demand for services from Ministers and increasing costs for remuneration and other inflationary pressures.

In Budget 2012 a capability bid of approximately $1m (the value of the efficiency savings) was submitted but was not approved.

The review will be undertaken by a person external to the three Central Agencies.

Alongside the upcoming staff climate survey, and the Performance Improvement Framework Self-Review, this financial review will form part of the brief for the incoming Chief Executive, and provide a sound basis for s/he to embark on her/his new role.

Purpose

The purpose of the review to is ensure that

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1. DPMC's output classes are delivering effective and timely advice, and efficient and effective support and value for money to the Prime Minister, the Governor-General and the taxpayer;
2. DPMC's allocated costs for CASS are reasonable, justified and efficient;
3. Develop options for savings (if any)which can be made within DPMC's baseline with identified impacts of any reduced or discontinued services on the government's objectives;
4. DPMC's priorities and internal budget allocations are appropriately set up to achieve the government's objectives;
5. DPMC's funding (operating and capital) is adequate to meet future requirements including those of CASS;
6. DPMC's long term viability is enhanced, so that it remains fit-for-purpose and is right-sized to meet future expectations.

Scope

The review should include an evaluation of current financial information including forecasts such as the Four Year Budget Plan, and examine the transition to CASS and its costs implications for DPMC. The reviewer should consult key external stakeholders including the Prime Minister, Deputy Prime Minister, Governor-General, and the central Agencies CEs, and make recommendations on how DPMC management and Central Agencies CEs might assess future funding requirements.

It is expected that the review be completed within a six week timeframe. The completed review will be reported to the Chief Executive of DPMC.

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