



The BBC's approach to managing the cost of its support functions

Report by the Comptroller and Auditor General
presented to the BBC Trust Finance Committee,
29 March 2012



BRITISH BROADCASTING CORPORATION

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the cost of its support functions**

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Auditor General presented to the
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29 March 2012**

*Presented to Parliament by the Secretary of
State for Culture, Olympics, Media and Sport
by Command of Her Majesty
May 2012*

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BBC Trust response to the National Audit Office value for money study: The BBC's approach to managing the cost of its support functions

Introduction

As the BBC's governing body, the BBC Trust receives value for money investigations into specific areas of BBC activity to help ensure that licence fee payers are getting the best possible return from their licence fee. These investigations are carried out by the National Audit Office (NAO) or by other organisations commissioned by the Trust.

We carefully examine the findings from each value for money study we receive and require the BBC Executive to provide us with a full response and action plan that explains the actions it will take in response to the recommendations made.

Background to this study

This study was commissioned by the Trust's Finance Committee on behalf of the Trust. We were keen for the NAO to undertake this review as we wanted to gain assurance on the BBC's arrangements for challenging the cost of the activities that support its production of programmes and on the transparency of the BBC's external reporting of overheads, including its target for reducing overhead costs.

We thank the NAO for undertaking this review.

BBC Trust views on the report findings

We welcome the NAO's finding that the BBC has exerted a significant amount of scrutiny on the cost of its support functions and that its current approach is broadly effective in improving value for money.

The NAO recognises that pressure for the BBC to make cost savings is exerted from a number of sources, including challenge from the Trust and Executive Board. However, the NAO concludes that the BBC is overly reliant on financial constraints arising from the level of licence fee funding to provide the main impetus for savings and recommends that the BBC should use a 'Target Operating Model' process to better understand what its support functions should cost to deliver.

We agree that the BBC, in common with many public sector organisations, has tended historically to use top-down limits on its budgets as a starting point for delivering cost savings. Examples of this approach include, in 2010, the Trust offering to freeze the licence fee and, in 2011, the Executive proposing to cut its BBC Online budget. This top-down approach has undoubtedly proved to be an effective way to reduce costs in the past. However, in planning to respond

to the NAO's recommendations the BBC has positioned itself in terms of its financial management to develop a more sophisticated approach to managing its support function costs based on a more detailed understanding of what each of its activities should cost to deliver. This is a challenging task, but it is crucial as the BBC moves into the next stage of its efficiency programme – **Delivering Quality First** – which requires it to deliver further 11 per cent annual efficiency savings by 2016-17 without damaging the quality of BBC output.

The BBC classifies some of its support function costs as overheads for external reporting purposes. Other support function costs that relate directly to the production of programmes, such as the cost of providing accommodation for programme making, are not classified as overheads as they can be directly attributed to BBC content. The NAO concludes that the BBC's target for reducing overhead costs shows a clear commitment to licence fee payers, but is of limited practical use as it does not align with how the BBC manages those costs. Balanced against this, the Trust sees a value in the BBC having a clear and simple commitment to licence fee payers about the proportion of funding spent on content and distribution, as opposed to pure administrative costs. We will explore with the Executive whether it is possible to tie the reporting of overhead costs to the management of those costs in a more meaningful way, recognising that overheads are scrutinised robustly as part of overall support costs and given the BBC's **Delivering Quality First** target for reducing support function costs.

We have sought, and received, confirmation that the Executive has accepted and will action the report's recommendations. In summary, the Executive will take the following main actions:

- continue to develop a better understanding of what it should cost to deliver support functions through a new target operating model which will define the structures and activities necessary to deliver the BBC's strategic objectives;
- continue to improve the BBC's approach to benchmarking through a clear organisational plan which systematically applies benchmarking results to cost reduction strategies;
- ensure there is a consistent approach to challenging costs with the right balance between central coordination and flexibility for local initiatives and that best practice is shared across the organisation. Relating to this, the BBC welcomes the NAO's finding that the BBC's Operations Group has introduced a consistent method of challenging costs in its support functions;
- develop the existing range of performance indicators for the BBC's support functions and integrate these with existing cost reporting as appropriate;

- consider whether it is possible to link the reporting of overhead costs to the management of those costs in a more meaningful way; and
- explain more clearly in its annual report and accounts what is included as an overhead and why.

The Trust is satisfied that the proposed actions are an appropriate response to the NAO's findings and the Executive will report to the Trust on the progress against the agreed actions.

BBC Trust
April 2012



National Audit Office

British Broadcasting Corporation

The BBC's approach to managing the cost of its support functions

Report by the Comptroller and Auditor General

This report has been prepared at the request of the BBC Trust under clause 79(3) of the Broadcasting Agreement between the Secretary of State for Culture, Media and Sport and the BBC dated July 2006.

Amyas Morse
Comptroller and Auditor General
National Audit Office

21 March 2012

This report examines whether the BBC's approach to managing the cost of its support functions supports the achievement of value for money, and considers whether the BBC's reporting of overhead costs improves transparency.

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This report can be found on the
National Audit Office website at
www.nao.org.uk/bbc-support-cost-2012

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Key facts

£3.6bn

total BBC licence fee spending
in 2010-11

£500.5m

total cost in 2010-11 of the
support functions examined
in this report

25%

targeted reduction in the
annual cost of the BBC's
support functions by 2016-17

- Six** of the eight support functions we examined reduced their spending over the five-year period to 2010-11, while one held its spending static
- 23 per cent** decrease, allowing for inflation, in the cost of the BBC's support functions over the five-year period to 2010-11, after excluding the cost of managing the BBC's estate, which distorts the overall trend
- 4 per cent** increase, allowing for inflation, in the total cost of the eight support functions we examined over the five-year period to 2010-11, when the cost of managing the BBC's estate is included
- £421 million** overhead spending reported in the BBC's annual report and accounts, for 2010-11
- Less than 10 per cent** the BBC's planned level of overheads as a percentage of licence fee spending by 2013-14, compared with 12 per cent in 2010-11

Summary

1 We estimate that in 2010-11 the BBC spent some £730 million on its support functions, equivalent to 20 per cent of the BBC's licence fee spending. These functions provide the services necessary to support the BBC in delivering programmes to licence fee payers, for example, the human resources function.

2 In assessing the BBC's approach to managing the cost of its support functions, this report focuses on the support functions in **Figure 1** overleaf, which cost £500.5 million in 2010-11. The BBC classifies some of the cost of its support functions as overheads. The report also examines, therefore, how the BBC reports overheads in its annual report and accounts, and its plans to reduce the proportion of the licence fee spent on overheads. Our methods are set out in Appendix One.

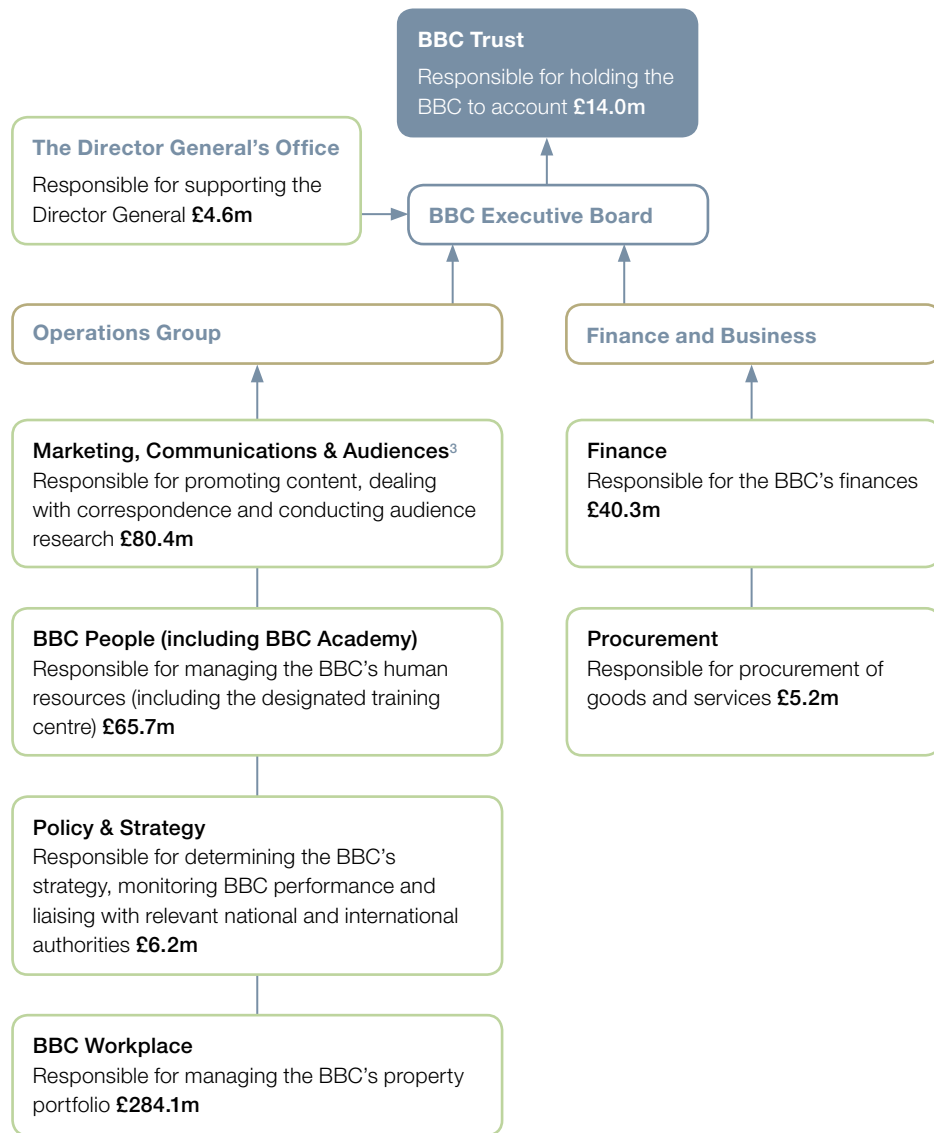
Key findings

The cost of the BBC's support functions

3 **Over the five financial years 2006-07 to 2010-11, the BBC has reduced or held static the cost of all but one of the eight support functions we examined, after allowing for inflation.** Inconsistency in how the BBC monitors its support functions means that it cannot show that the support functions' performance has been unaffected, although overall performance in terms of audience measures has been broadly stable since 2007-08. While the cost of BBC Workplace has increased by 39 per cent over the period after allowing for inflation, the total cost of the remaining seven support functions has decreased by 23 per cent. BBC Workplace is responsible for managing the BBC's estate and accounts for 57 per cent of the spending we examined. Its cost increased from £205.1 million to £284.1 million due to a transitional period in the reorganisation of its estate. New buildings, including MediaCity in Salford and the extension to Broadcasting House, have recently been completed and the BBC plans to dispose of its surplus accommodation, including Television Centre, over the period to 2015.

Figure 1

The areas of the BBC covered by this report and their costs in 2010-11



NOTES

- 1 The green boxes contain the support function, explanation of support function responsibilities and function spend in 2010-11.
- 2 This diagram shows only those support functions included in the scope of this report. It therefore does not include the BBC's spending on technology, which amounted to £232.6 million in 2010-11.
- 3 From February 2011, 'Marketing, Communications & Audiences' separated to become two divisions: Marketing & Audiences; and Communications. For the purpose of this report we have used the former structure, to allow comparison with prior years.

Source: National Audit Office

4 Comparing the costs of the BBC's support functions with those of the wider public sector gives a mixed picture and suggests that there is scope for savings.

We used efficiency indicators to compare the BBC's support functions to the last Cabinet Office benchmarking survey of back-office functions (based on 2009-10 data). The indicators for Marketing, Communications & Audiences, and for Procurement, were better than average but those for BBC People were lower than average. For both Finance and BBC Workplace one indicator was above average and one was below average. The results of such benchmarking exercises need to be treated carefully. However, the BBC has conducted its own benchmarking and the results are broadly in line with our findings. Following the cost of the television licence fee being frozen, the BBC plans to make savings of 25 per cent from its annual spending on support functions by 2016-17.

Challenging the cost of support functions

5 The cost of the television licence fee has a direct impact on the funding available to the BBC, and this largely drives its approach to finding savings.

In the case of its support functions, the BBC has also created incentives to make savings through committing to spend more of the licence fee on producing programmes. The BBC Trust challenges the value for money of BBC spending and sets the BBC's overarching efficiency targets. The BBC sets detailed cost reduction targets that are given force by reducing budgets.

6 The BBC support functions we have examined have been subject to a significant degree of scrutiny by the BBC:

- **The BBC has used a range of techniques to challenge the cost of its support functions to good effect.** It has undertaken a range of reviews into the structure and performance of its support functions. These reviews have varied in scale and scope from annual evaluations of the performance of BBC Workplace to a thorough organisational review of the scale and structure of the Marketing function.
- **Four of the eight support functions we examined, accounting for 79 per cent of the costs we examined, have used forms of benchmarking to inform their understanding of the scope for savings.** These have ranged from commissioning consultants to compare the BBC's performance with that of similar organisations to taking part in established benchmarking surveys. There is scope to follow-up the reviews in a more structured way as the BBC could not generally provide evidence of how benchmarking exercises had influenced the cost reduction strategies of the support functions.
- **The BBC has taken steps to improve how it manages major contracts, which in 2010-11 accounted for 24 per cent of the costs we have examined.** We reported on how the BBC manages strategic contracts in 2009 and found that the BBC had made limited use of its contractual rights to test value for money. Since then, the BBC's Strategic Relationships Board has implemented a programme of reviews of all strategic contracts to assess how far services are being delivered as planned and make use of the BBC's contractual rights.

7 Although the BBC has reduced the cost of the majority of its support functions, there are areas where it could strengthen its approach to challenging costs. By addressing these areas the BBC would be able to provide greater assurance that it is delivering value for money from its support functions:

- **The BBC does not have a coordinated and consistent approach to challenging the cost of its support functions.** Different support functions have used different approaches to challenging costs and by definition some will have been better than others. For example, the support functions we examined initiated their own benchmarking reviews, and some take part in annual benchmarking exercises, but there is no pan-organisation approach. More recently, however, the Operations Group has introduced a consistent method of challenging costs in its support functions.
- **The BBC's approach to challenging costs is not informed by a target operating model that clearly defines the level of service required by the BBC.** A target operating model defines the structure, systems and processes of an organisation, based on its business strategy and objectives. Some of the support functions we have examined questioned whether their activities were essential to the BBC. However, they did not seek to establish how far they contribute to the BBC's overarching strategy and objectives.
- **The BBC's approaches to challenging the costs of its support functions are not based on assessing what the support services should cost to deliver.** The BBC plans to find savings of 25 per cent from its support services by 2016-17 to help deliver the overall savings required by the licence fee settlement. All the support functions we examined have challenged their costs by assessing the impact of cuts necessary to live within the externally imposed cost constraints. By setting cost reduction targets in this way, rather than trying to establish what it should cost to deliver the level of service required by the business, based on the target operating model, the BBC cannot be confident that its targets are pitched at the right level.
- **The BBC has strong processes to monitor the cost of its support services. However, we saw limited evidence of the support functions combining information on cost and performance, which limits the BBC's ability to identify scope for further savings.** The support functions we examined used a consistent, risk-based approach to monitor spending against budgets. However, most had not established key performance indicators beyond those that underpin major contracts. In addition, only one of the eight support functions we examined routinely combines information on cost and performance to assess value for money. Using information in this way would allow the BBC to better target cost reductions on those areas which contribute relatively less value. The BBC plans to introduce a 'value dashboard', which it hopes will allow all areas of the BBC to link information on cost and value and monitor the value of services delivered.

Reporting overheads

8 The BBC has committed to reducing its overhead costs to less than 10 per cent of the licence fee by 2013-14. In 2010-11, the BBC spent £421.0 million on overheads, 12 per cent of its £3.6 billion licence fee spending. The BBC's overheads as a percentage of licence fee spending have remained constant at 12 per cent since 2007-08.

9 The BBC's target to reduce overhead costs shows a clear commitment to licence fee payers, but it is of limited practical use to the BBC. The way the BBC measures and reports overheads is not aligned with how it manages those costs, which are allocated to different areas of the business solely for public reporting purposes.

10 The BBC cannot be confident that its target to reduce overheads is pitched at the right level and it could lead to unintended consequences. The BBC has told us that the target to spend less than 10 per cent of licence fee funding on overheads is intended to promote greater awareness of the need to reduce overheads, rather than establish an ideal level of spending. However, there is no rationale underpinning the target and there is a lack of alignment between the BBC's reporting of overhead costs and its management of these costs through its support functions.

11 The BBC uses a consistent definition and has improved the transparency with which it reports overheads since we last examined this area, but it could still be clearer. There is no universal definition of overhead costs and the BBC does not classify support function costs as overheads where they relate directly to the production of programmes (for example, the cost of providing accommodation for programme-making). We reported on how the BBC defines and reports overhead costs in 2006 and concluded that the BBC's accounts included a limited explanation of what costs were classified as overheads in the accounts. The BBC has since improved the published description but could go further to clarify which costs are included in the overheads figure and explain why some support costs are not.

Conclusion on value for money

12 The BBC has reduced the cost of most of its support functions over the last five years and plans to make further savings. Its current approach to challenging the cost of its support functions is broadly effective in improving value for money.

13 The BBC, however, is overly reliant on financial constraints arising from the level of licence fee funding to provide the main impetus for savings. To deliver value for money into the future the BBC needs to be consistent and rigorous in defining the service it requires from its support functions; identify what that service should cost; and adjust its costs accordingly. The BBC's separate target to reduce its overheads demonstrates a clear commitment to licence fee payers. Without evidence that it is pitched at the right level, however, it is not clear that the target will deliver value for money.

Recommendations

Our recommendations are intended to assist the BBC in developing its approach to challenging the cost of its support functions and reporting its spending on overheads.

- a** **The BBC's approach to challenging costs is focused on achieving specified levels of savings rather than an analysis of what activities should cost.**
The BBC should:
- define the structures and processes necessary to deliver its overarching objectives (a target operating model) and make sure that the activities of each support function contribute to those objectives; and
 - make sure benchmarking results, which suggest there may be scope for further savings, are used in developing cost reduction strategies.
- b** **Although the BBC has been challenging its costs, the approaches used by individual support functions have varied.** To capture best practice across the organisation, the BBC should:
- develop a consistent and coordinated approach to challenging costs that is adopted across the BBC. The recent work by the Operations Group is a helpful step in this direction; and
 - establish a clear organisational plan for benchmarking its activities.
- c** **The BBC has established effective arrangements to monitor the cost of its support functions. However, only one of the eight functions we examined combined information on costs and performance to monitor value for money.** Monitoring unit costs would allow the BBC to identify and investigate variations in value for money across the BBC. The BBC should develop a range of performance indicators for its support functions, integrate these with its existing cost reporting and, where appropriate, perform internal benchmarking.
- d** **The BBC's target to spend less than 10 per cent of licence fee funding on overheads is not supported by a clear rationale.** The target is of limited practical use to the BBC in managing its costs and represents a risk to value for money because the BBC does not know whether 10 per cent is the right level. There could therefore be unintended consequences. If the BBC persists with this target it should prepare detailed analysis to establish the reductions in spending on the support functions necessary to deliver the required reduction in overheads and satisfy itself that these are deliverable.
- e** **While the target to reduce overheads is a clear commitment to licence fee payers, its value is limited without clearly explaining what costs are included and why.** The BBC should develop clear criteria for deciding which costs should be classified as overheads and provide a transparent explanation in its annual report and accounts.

Part One

The cost of the BBC's support functions

1.1 We estimate that in 2010-11 the BBC spent some £730 million on support functions. While there is no standard definition of what constitutes a support function, we have examined those areas of the BBC that support the business in producing programmes and other content for broadcast (Figure 1, on page 6). The support functions we examined cost £500.5 million in 2010-11, equivalent to 14 per cent of licence fee spending.

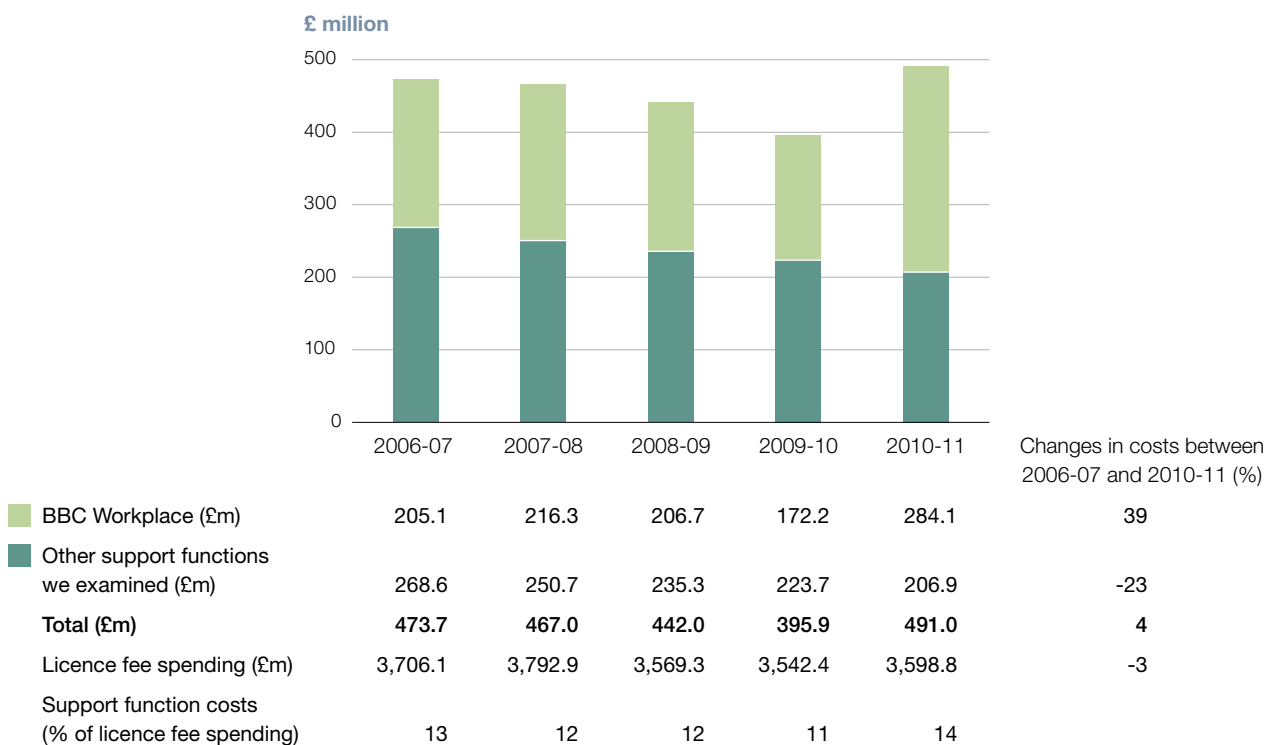
1.2 We have not examined the BBC's spending on technology, of £232.6 million in 2010-11. This is largely covered by a contract that also covers the provision of technology for the BBC's front-line programme-making activities, and it was being renegotiated at the time we prepared our report. We have, however, examined the BBC Trust, which is responsible for approving the BBC's strategy and holding it to account for its use of the licence fee.

How the cost of the BBC's support functions has changed

1.3 We looked at how the costs of the BBC's support functions have changed over the last five years (Figure 2 overleaf). To allow year-on-year comparisons we removed one-off project costs from our analysis, which in 2010-11 reduces the total cost of the support functions from £500.5 million to £491.0 million. More than half of this cost relates to BBC Workplace, the cost of which increased by 39 per cent during the period owing to significant changes to the BBC's estate (paragraph 1.4). Excluding the cost of BBC Workplace, total spending on the remaining seven support functions was £206.9 million, which allowing for inflation was 23 per cent lower (£61.7 million) than in 2006-07 (£268.6 million).

Figure 2

The total cost of the BBC's support functions

**NOTES**

- 1 This figure only includes support function costs in the scope of this report.
- 2 Costs are indexed for inflation to 2010 prices using the Retail Price Index.
- 3 The aggregate total for 2010-11 does not match the total in Figure 5 because figures have been adjusted to make data comparable year-on-year by removing one-off project costs.

Source: National Audit Office analysis of BBC data

1.4 Figure 3 shows the movement in the cost of the individual support functions after allowing for inflation. The cost of six was lower than in 2006-07, the cost of one was the same and the cost of one was higher:

- **BBC Workplace** At £284.1 million, the cost was 39 per cent higher in 2010-11 than in 2006-07, having dropped to £172.2 million in 2009-10 before rising again. The BBC is half way through a 20-year strategy to reduce the size of its estate and improve use of space. The BBC disposed of some property in 2009-10 resulting in a temporary drop in costs and in 2010-11 brought new buildings into operation. New buildings included MediaCity in Salford and the redeveloped Broadcasting House in London. The BBC's planned programme to close down all of the buildings scheduled for disposal, such as Television Centre, runs to 2015. So it is currently maintaining a larger estate than it needs during the transitional period.

- **Procurement** At £5.2 million, the cost in 2010-11 was the same as in 2006-07, having peaked at £6.2 million in 2007-08. The BBC's strategy is to focus on the effectiveness of the procurement function rather than reducing its cost. By increasing its spending on staff involved with contract negotiation and management, the BBC intends its procurement activities will generate savings.
- **BBC People** At £58.7 million, the cost was 9 per cent lower in 2010-11 than in 2006-07. The cost includes both the BBC Academy and the human resources function, and the picture for each is different. The Academy is the BBC's dedicated training centre for internal and external training (under its Royal Charter, the BBC is obliged to provide training services to the wider broadcasting industry).

Figure 3

The cost of the BBC's support functions

	2006-07	2007-08	2008-09	2009-10	2010-11	Change in costs between 2006-07 and 2010-11
	(£m)	(£m)	(£m)	(£m)	(£m)	(%)
BBC Workplace	205.1	216.3	206.7	172.2	284.1	39
Procurement	5.2	6.2	6.0	6.1	5.2	0
BBC People (including BBC Academy)	64.7	75.4	62.4	59.3	58.7	-9
Marketing, Communications & Audiences	97.6	91.4	94.2	92.6	80.4	-18
Director General's Office	5.7	6.4	6.0	4.9	4.6	-19
BBC Trust	18.4	16.9	15.5	13.8	14.0	-24
Policy & Strategy	8.7	7.8	7.5	7.4	6.2	-29
Finance	68.3	46.6	43.7	39.6	37.8	-45
Total	473.7	467.0	442.0	395.9	491.0	4

NOTES

- 1 This Figure does not show all support functions; only those included in the scope of this report.
- 2 Costs are indexed for inflation to 2010 prices using the Retail Price Index.
- 3 The costs for 2010-11 do not match the costs in Figure 1 and Figure 5 because the costs have been adjusted to make data comparable year-on-year, by removing one-off project costs.
- 4 The BBC Trust took over responsibility for overseeing the BBC Executive from the BBC Governors on 1 January 2007. To allow year-on-year comparison, the cost of the BBC Trust in 2006-07 is an estimate based on the first three months of its operation (£4.6 million).

Source: National Audit Office analysis of BBC data

- The jump in total costs in 2007-08 reflected the cost of setting up the Academy. Since then, the cost of the Academy has been broadly stable at an average of £28.4 million a year. So the overall reduction in the cost of BBC People has come from the human resources function, which has reduced its cost from £46.9 million in 2007-08 to £29.6 million in 2010-11, a 37 per cent decrease. The BBC is, however, looking to make savings in both its training and human resources functions to help deliver the cuts required by the freeze in the cost of the licence fee (paragraph 1.6).
- **Marketing, Communications & Audiences** At £80.4 million, the cost was 18 per cent lower in 2010-11 than in 2006-07. Marketing, Communications & Audiences promotes BBC content, deals with correspondence from the press and the public, and conducts programme-related audience research. The reduction in 2010-11 is because the BBC reduced its spending on off-air marketing, such as poster campaigns and cinema advertising.
- **Director General's Office** At £4.6 million, the cost was 19 per cent lower in 2010-11 than in 2006-07. In October 2010, the post of Deputy Director General was abolished, which removed the Deputy Director General's salary costs and reduced administrative costs as support staff were no longer needed.
- **BBC Trust** At £14.0 million, the cost was 24 per cent lower in 2010-11 than in 2006-07. The 2006-07 figure is estimated based on the cost of the BBC Trust's first three months of operation from 1 January 2007. Since the BBC Trust's first full year of operation in 2007-08, its staff costs have remained relatively stable at around £4.8 million a year, whereas the Trust's other operating costs have decreased by 29 per cent, from £7.2 million to £5.1 million. Fees paid by the BBC Trust to Ofcom, to help cover the cost of regulating the television and radio sectors and pay for Market Impact Assessments,¹ have also reduced by 20 per cent, from £4.0 million to £3.2 million.
- **Policy & Strategy** At £6.2 million, the cost was 29 per cent lower in 2010-11 than in 2006-07. The support function has reduced its headcount, from 36 in 2005 to 30 in 2010.
- **Finance** At £37.8 million, the cost was 45 per cent lower in 2010-11 than in 2006-07, with the most significant reduction (32 per cent) in 2007-08. In 2005, the BBC had initiated its Future Finance project, which was part of the BBC's drive to make significant cost reductions in its support functions. This involved creating a new specialist finance centre in Cardiff, embedding finance teams in each BBC division, introducing simpler business processes and contracting out some services.

¹ Market Impact Assessments are conducted by Ofcom to support the BBC Trust's public value tests. Public value tests are assessments carried out by the BBC Trust to establish whether or not to allow the BBC to launch new services or make significant changes to existing ones.

1.5 The inconsistency in how the BBC monitors the performance of its support functions (paragraph 2.24) means it cannot show that performance has been unaffected by cutting costs. Nevertheless, as our report on the BBC's efficiency programme² found, the BBC has broadly maintained its overall performance, in terms of audience measures, since 2007-08. Although this does not mean that the service from the support functions has not changed, it does provide some confidence that reducing costs has not had a significant impact on the BBC's audience facing services.

1.6 Although the BBC has successfully reduced the cost of six of the eight support functions we examined, it must make further savings up to 2016-17 because of the television licence fee being frozen at £145.50 (paragraph 2.2). To contribute to the savings required, the Operations Group (Figure 1) has committed to finding savings of 25 per cent of those costs not tied up in long-term contracts. The Finance function aims to contribute savings of 20.3 per cent by 2016-17 as part of its Finance Effectiveness Programme.

How the costs of the BBC's support functions compare with other organisations

1.7 An important way of trying to gauge the reasonableness of an organisation's costs is to make comparisons with other organisations. We compared BBC costs to the last Cabinet Office benchmarking survey of central government back-office functions.³ The survey drew on indicators developed by the Public Audit Forum⁴ in 2007. Those areas of the BBC for which there were functions performing comparable roles are BBC People, BBC Workplace, Finance, Marketing, Communications & Audiences, and Procurement. We also drew on the results of external benchmarking exercises commissioned by the BBC.

1.8 The results of benchmarking have to be viewed with some caution. For example, Cabinet Office data are unaudited and comparisons are imprecise because organisations' business models and objectives differ. But such benchmarking can give managers assurance or otherwise about the cost of broadly comparable activities and provide a starting point for further investigation.

1.9 The results in **Figure 4** overleaf, show that when comparing the BBC year-on-year, the indicators have improved over the last five years, except for BBC Workplace (which has deteriorated) and for Procurement, which has remained relatively stable. The BBC told us it has no targets to reduce spending on procurement further. However, it continues to benchmark Procurement to make sure it at least maintains current levels of performance, which compare favourably with industry benchmarks.

² Comptroller and Auditor General, *The BBC's efficiency programme*, National Audit Office, November 2011.

³ Based on 2009-10 data; this survey was not repeated in 2010-11 because it was replaced by departmental Quarterly Data Summaries.

⁴ Comprising the National Audit Office, the Northern Ireland Audit Office, the Wales Audit Office, Audit Scotland and the Audit Commission.

Figure 4
Internal performance trends and external benchmarking of the BBC's support functions

Function	Efficiency indicator	Internal performance 2006-07 to 2010-11	External benchmarking position in 2009-10
BBC People (including BBC Academy)	Cost of the human resources function (including training) as a percentage of organisational running costs		
	Cost of the human resources function (including training) per full-time employee		
BBC Workplace	Cost of the BBC estate per square metre		
	Cost of the BBC estate per full-time employee		
Finance	Cost of the finance function as a percentage of organisational running costs		
	Cost of the finance function per full-time employee		
Marketing, Communications & Audiences	Cost of the communications function (including marketing) as a percentage of organisational running costs		
Procurement	Cost of the procurement function as a percentage of organisational running costs		
	Cost of the procurement function as a percentage of total third party spending		

Internal performance – the movement in performance indicators over the last five years

- Efficiency indicator has improved (indicator ratio has decreased)
- Efficiency indicator has remained stable
- Efficiency indicator has declined (indicator ratio has increased)

External benchmarking – the BBC's support functions in 2009-10 compared with those in the wider public sector

- 1st quartile (highest performing in peer group)
- 2nd quartile (above average)
- 3rd quartile (below average)
- 4th quartile (lowest performing in peer group)

NOTES

- 1 Organisational running costs are the total resources that are used by the organisation as a whole to deliver its responsibilities.
- 2 Where relevant, adjustments have been made to the total cost of the functions (for example, removing costs related to audience monitoring, incurred by Marketing, Communications & Audiences, and excluding one-off project costs) to improve comparability with the Cabinet Office back-office benchmarking survey.
- 3 The cost of BBC People includes the cost of BBC Academy, which is not directly comparable with the cost of training functions in the government departments because the BBC also provides training to the wider media industry.
- 4 Although the number of freelance staff is not included when calculating the number of full-time employees for the government departments, we have included them when calculating the number of BBC full-time employees due to the importance of freelance staff to the BBC operations.

Source: National Audit Office analysis of Cabinet Office data

1.10 Figure 4 also indicates that in Procurement and in Marketing, Communications & Audiences the BBC is performing better than the average of the wider public sector. In some areas, however, the benchmarking suggests the BBC needs to continue to question its costs.

1.11 BBC People compares less favourably with the organisations in the Cabinet Office benchmarking survey. BBC People costs 1.77 per cent of total BBC spending compared with the average of 1.49 per cent in the survey, and costs £3,033 per full-time employee compared with the average of £1,517. However, this analysis includes the cost of the BBC Academy, which is not directly comparable with the cost of training functions in the government departments included in the survey because, as required by its Royal Charter, the BBC also provides external training to the wider media industry. In our analysis we have not excluded the cost of the external training because the BBC could not separately identify the Academy's internal and external training costs. In 2009-10, the cost of the BBC Academy accounted for 50 per cent of the cost of BBC People.

1.12 The BBC has separately benchmarked the cost of the BBC Academy and its human resources function:

- Total spending on the BBC Academy is relatively high when compared with training functions of similar organisations. The BBC attributes its relatively higher training costs to its commitments under its Royal Charter, although it plans to make savings in this area (paragraph 1.4).
- The results of the BBC benchmarking its human resources function as a percentage of total costs were mixed. The BBC compared well against a sample of public sector organisations, being positioned in the first quartile, but was positioned in the bottom quartile when compared with private sector organisations.

So while the benchmarking results are not conclusive, they do suggest that the BBC should continue to review the costs of BBC People.

1.13 BBC Workplace compares well with the organisations in the Cabinet Office benchmarking survey in terms of the cost of managing the estate per square metre, but the cost per employee is well above average. BBC Workplace costs £321 per square metre of estate compared with an average of £407 in the survey, but costs £9,831 per full-time employee compared with an average of £5,327. The BBC is performing less well on cost per employee because it is currently maintaining a larger estate than it needs (paragraph 1.4) and the estate includes technical space such as production studios.

1.14 The BBC benchmarks the performance of its estate annually against organisations that use both office and technical space in similar locations to the BBC.⁵ The position in terms of cost per square metre and the cost per full-time employee is set out below:

- In 2009-10, the BBC was performing 3 per cent better than the industry benchmark for the cost per square metre of estate and the BBC equalled the benchmark for 2010-11. The BBC attributes this performance to lower rent and rates compared with the benchmark group.
- In 2009-10, the cost of the BBC's estate per full-time employee was 34 per cent higher than the industry benchmark, this increased to 54 per cent higher in 2010-11. The BBC attributes this performance to the poor use of space in the older buildings and an overall improvement in the industry benchmark.

1.15 The BBC acknowledges it has some way to go to improve the efficiency of its estate and has set itself targets, based on industry benchmarks, as part of its estate strategy. For example, it plans to reduce the average office space per person, from 14.4 square metres in 2009, to 8.3 square metres by 2020. This compares with the Government recommendation of ten square metres per person for government office buildings and the Government's aim of eight square metres per person for new and refurbished buildings.⁶

1.16 The BBC has identified that there is scope for further savings in its finance function. **Finance** costs 1.17 per cent of total BBC spending, performing better than the average of 1.35 per cent for the Cabinet Office survey, but costs £2,011 per full-time employee compared to the average of £1,397. The BBC is planning to reduce costs by 20 per cent by 2016-17 through its Finance Effectiveness Programme (paragraph 2.20).

5 The BBC benchmarks its estate using benchmarking services provided annually by Occupiers Property Databank, a subsidiary of the Investment Property Databank (IPD), which provides performance analysis for the owners, investors, managers and occupiers of real estate.

6 Comptroller and Auditor General, *Improving the efficiency of central government office property*, Session 2010-12, HC 1286, National Audit Office, March 2012.

Part Two

Managing the cost of the BBC's support functions

2.1 The cost of the television licence fee has a direct impact on the funding available to the BBC, and this largely drives its approach to finding savings. The BBC has adopted a series of efficiency programmes in response to past licence fee settlements, including the Value for Money Programme in 2003 and the Continuous Improvement Programme in 2007.⁷

2.2 In October 2010, the Department for Culture, Media and Sport agreed the latest licence fee settlement with the BBC Trust. The settlement maintains the licence fee at £145.50 for five years and transfers new funding obligations to the BBC, including BBC World Service. As a result of the settlement the BBC needs to find savings of 16 per cent of its annual spending by 2016-17. In 2011, it launched the Delivering Quality First programme⁸ to identify savings totalling 20 per cent of annual spending by 2016-17, with the additional 4 per cent available to be spent in priority areas.

2.3 The BBC has committed to spend more of the licence fee on producing programmes and therefore plans to deliver savings of 25 per cent from its support services. We have audited the approach the BBC has taken to challenging the cost of its support functions against good practice principles from our work examining cost reduction programmes across the wider public sector.

How the BBC has challenged the cost of its support functions

2.4 The BBC has established clear accountability for the cost and performance of its support functions. Following a restructure in November 2011, accountability for the BBC's support functions is shared between the Chief Operating Officer (responsible for the Operations Group) and the Chief Financial Officer (responsible for the Finance and Business Group). The Chief Operating Officer and the Chief Financial Officer sit on the BBC's Executive Board, which is overseen by the BBC Trust.

⁷ Comptroller and Auditor General, *The BBC's efficiency programme*, National Audit Office, November 2011.

⁸ BBC, *Delivering Quality First*, October 2011.

2.5 The principal means by which the BBC challenges the cost of its support functions is by applying top-down pressure on budgets. The BBC Trust is responsible for setting overarching efficiency targets for the BBC following licence fee settlements and, more widely, challenging the value for money with which the BBC spends public funds. In response to constraints on its available funding, the BBC establishes cost reduction targets for individual support functions that are enforced by reducing their budgets. We concluded in our report on the BBC's efficiency programme⁹ that in setting such targets the BBC establishes clear lines of accountability and creates strong incentives to deliver the required cost reductions. Targets of this nature do not, however, encourage staff to consider whether by reducing spending they are creating higher costs in other areas of the BBC or find savings over and above the targeted level and it is, therefore, important that they are set at the right level.

2.6 Where top-down pressure is the principal incentive to control costs, organisations must clearly understand the distribution and profile of costs across their business so that they know where to focus their attention. The BBC support functions we examined use a consistent and risk-based approach to monitoring their spending against their budgets. Each uses a standard template to report, comprising a summary dashboard and using red, amber or green ratings to flag up anomalies such as projected over or underspends. This approach allows managers to focus their attention where it is needed.

2.7 The support functions we examined have been subject to a significant degree of scrutiny by the BBC, with the costs and structure of each being reviewed periodically. These reviews have varied in scale and scope, used a range of techniques and have considered the level of service provided by the support function as well as the cost. For example, in 2010, the marketing function undertook a thorough organisational review supported by input from front-line staff and external consultants. Other support functions undertake various benchmarking exercises to challenge costs. BBC Workplace evaluates its performance in managing the BBC estate through annual benchmarking, while Policy & Strategy relies on its knowledge of salaries for comparable roles to benchmark its costs. In total, four of the eight support functions we examined used benchmarking to understand better the scope for savings.

2.8 In 2006, we recommended that the BBC benchmark the performance of its support functions against comparable organisations to help satisfy itself that its costs were at the right level.¹⁰ Since this time, the BBC has commissioned benchmarking reviews of BBC People and the BBC Academy, as well as Finance and Procurement, and BBC Workplace takes part in regular benchmarking surveys. Although benchmarking has been widely used there is scope for the support functions to follow-up the results in a more structured way. The BBC could not generally provide evidence to show how the results of benchmarking reviews were influencing the strategies of the support functions.

⁹ Comptroller and Auditor General, *The BBC's efficiency programme*, National Audit Office, November 2011.

¹⁰ Comptroller and Auditor General, *The BBC's definition of overheads*, National Audit Office, June 2006.

2.9 The BBC has also used outsourcing to put pressure on the cost of its support services. Outsourcing has been a major part of the BBC's approach to managing its support functions since 2005. By competitively tendering contracts to provide elements of support services, organisations can get the best price for a specified level of service. The BBC currently spends some £680 million a year on its strategic contracts; these are contracts with an annual value of at least £2 million, a term of at least five years, and which make a key contribution to the business. The strategic contracts included in the scope of this report accounted for 24 per cent of the costs we have examined. These contracts span a range of the BBC's support functions, including the finance function's administrative services contract with Steria, BBC People's contract for human resource services with Capita and BBC Workplace's facilities management contracts with Balfour Beatty and Johnson Controls.

2.10 In March 2009, we reported on how the BBC manages strategic contracts¹¹ and found that the BBC had kept its spending on strategic contracts in line with forecasts and exceeded its savings targets. However, the way contracts and supplier relationships were being managed varied. We also found that the BBC generally had arrangements in place, such as open-book access rights to suppliers' financial records, to test the value provided by the contracts but had made limited use of these arrangements. Since our report, the BBC's Strategic Relationship Board, set up in 2007 to manage the strategic contracts portfolio, has defined what is expected of contract managers to increase consistency of approach. It has also implemented a programme of reviews of all of its strategic contracts that assess how far services are being delivered as planned and make use of its open-book access rights.

2.11 Although not confined to support functions, one way the BBC has been looking to reduce its costs has been to reduce the number and cost of senior managers. In response to the prevailing economic conditions, in 2009 the BBC Trust asked the BBC to review how it sets senior management pay. The BBC conducted a benchmarking review of senior management pay, compared with pay in a range of public and private sector organisations. As a result, the BBC committed to reduce the overall number of senior managers in the organisation by 18 per cent and reduce the total paid to senior managers by 25 per cent. These targets were not, however, supported by a detailed analysis of the management capability required by the BBC. The BBC originally set a deadline of July 2013 to meet these targets but later brought this forward to December 2011.

¹¹ Comptroller and Auditor General, *The BBC's management of its strategic contracts with the private sector*, National Audit Office, March 2009.

2.12 We have not audited the BBC's achievements in this respect. However:

- In January 2012, the BBC reported that it had reduced the number of senior managers from 640 to 484 (a 24.4 per cent reduction) and reduced their pay from £78.5 million to £57.4 million (a 26.9 per cent reduction).
- The BBC told us that of the support functions we examined, it had reduced the number of senior managers from 191 to 133 (a 30.4 per cent reduction) and reduced their pay from £23.3 million to 17.5 million (a 24.9 per cent reduction).

How the BBC could strengthen its approach

2.13 While the BBC has used a variety of techniques to challenge the cost of its support functions, and has successfully reduced the cost of most of them, it could still strengthen its approach. In particular the BBC could:

- be more consistent and strategic in challenging the costs of its support functions;
- challenge the cost of support functions by developing a target operating model for the BBC as a whole; and
- use information better to challenge costs.

A consistent and strategic approach to challenging costs

2.14 To be sure that its support functions are delivering value for money the BBC needs a strong framework for reviewing the costs and effectiveness of those functions. Where different areas of an organisation use different approaches, by definition some will be more effective than others. It is important that lessons from past performance are used to develop a consistent approach across the whole organisation.

2.15 The BBC assessed the shape and cost of its support functions but these reviews are not part of a concerted, consistent and centrally coordinated approach. Although the BBC has recently taken steps to consolidate most support functions within the Operations Group, there is no one person responsible for the BBC's support functions collectively (paragraph 2.4). Individual support functions have reviewed and challenged their costs in different ways and the BBC does not have a pan-organisation approach to performing benchmarking reviews, which are initiated by individual support functions. For example, only Finance takes part in the annual Chartered Institute of Public Finance and Accountancy benchmarking exercise even though it also covers estate management, human resources, procurement, communications and technology services.

2.16 Although there have been significant differences in the approaches used to challenge costs (paragraph 2.7), more recently the Operations Group has adopted a more consistent approach across its support functions. The Operations Group has required all of its functions to review systematically each activity to identify where savings could be made (paragraph 2.20). This approach has involved using a standard process to challenge activities by considering the value they contribute to the business and whether they could be performed elsewhere in the BBC.

Target operating model

2.17 To challenge its costs effectively an organisation needs to fully understand what it should cost to deliver the required level of service. While benchmarking can indicate whether costs are broadly comparable with similar businesses, to provide a more accurate picture the organisation should develop a target operating model. A target operating model defines the structure, systems and processes of an organisation, based on its business strategy and objectives.

2.18 It follows that in assessing the costs of support functions the BBC needs to consider how far its operating model supports the strategy and vision of the wider organisation. Although all of the support functions we examined have done work to challenge their costs, these reviews have not established how their activities contribute to the BBC's overarching objectives as described in its December 2010 strategy, *Putting Quality First*.¹² Similarly, while the recent reviews conducted by the Operations Group (paragraph 2.16) involved questioning whether activities are essential to the operation of the BBC, they did not use the BBC's overarching objectives to inform this judgement, which would have provided a more effective challenge.

2.19 A target operating model should be based on a bottom-up analysis of the systems, processes and delivery models (for example, internal resources or outsourcing) required to meet the organisation's objectives. One of the challenges of such analysis is breaking away from business-as-usual activities and short-term pressures and fundamentally rethinking how best to deliver the organisation's objectives.

2.20 The BBC support function reviews we have examined focused on delivering savings to help meet the overall savings target required by the licence fee settlement rather than establishing what the support services should cost to deliver by identifying the minimum necessary cost. To meet the BBC's ambition of delivering 25 per cent savings from its support services (paragraph 2.3) the Operations Group considered the impact of potential 20 per cent and 40 per cent budget cuts and the Finance function has begun a restructuring exercise, the Finance Effectiveness Programme, with the predetermined aim of delivering savings of 12 per cent by 2013 and 20 per cent by 2016-17. By establishing cost reduction targets in this way, the BBC cannot be confident that they are pitched at the right level.

2.21 The BBC Trust has come closest to designing a target operating model based on an assessment of the services it needs to deliver. The impetus came from creating the BBC Trust to replace the BBC Board of Governors in 2006, which allowed the BBC to fundamentally rethink the nature of support required. At this time the BBC defined the required structure of the BBC Trust Unit and determined its staffing requirements. The BBC Trust has now been operating for four years and has commissioned a benchmarking review to assess how it compares with other organisations with regulatory activities.

¹² BBC Trust, *The BBC's Strategy: Putting Quality First*, December 2010.

Making better use of information

2.22 To challenge its spending on support services, the BBC relies on exerting top-down pressure on costs (paragraph 2.5). It manages its support functions centrally to provide visibility of total spending and clear accountability. The BBC recognises, however, that there is no incentive for content producing divisions to limit their use of support services. This is because front-line divisions are only accountable for the budgets that they manage, which do not include the cost of the support functions. Without such incentives it is important that the BBC uses information effectively to understand where there are variations in value for money across the business.

2.23 One way to manage the risk of variations in value for money is by using information on unit costs of support services. The support functions we examined have strong processes to monitor their spending (paragraph 2.6), and we saw evidence they considered the potential impact of spending cuts on the services provided (paragraph 2.7). However, we saw limited evidence of functions combining cost and performance data to challenge value for money on an ongoing basis. Of the support functions we examined, only BBC Workplace uses detailed information on the unit costs and performance of providing its service. It reports the unit cost of its individual buildings and also measures the space per employee for different divisions, which allows it to identify and challenge differences.

2.24 In addition, the arrangements for monitoring performance are inconsistent. Most of the support functions we examined had not established key performance indicators against which to track their performance, beyond those which underpin major contracts. These contracts are supported by a wide range of indicators, which define the expected level of service, but there are no service level agreements for support services provided in-house.

2.25 The BBC is currently developing a 'value dashboard', which it intends will be used by all divisions across the BBC, including the support functions. These reports should allow the BBC to link information on the cost and value of its activities, and to monitor this in a consistent format.

Part Three

External reporting of overheads

3.1 The BBC classifies some of the costs of its support functions as overheads in its annual report and accounts. In 2010-11, the BBC spent £421.0 million on overheads, 12 per cent of its £3.6 billion licence fee spending. The BBC's overheads as a percentage of its licence fee spending have remained constant at 12 per cent since 2007-08. In December 2010, the BBC announced a target to reduce the amount it spends on overheads. The BBC plans to increase the proportion of the licence fee spent on producing programme content by spending less than 10 per cent on overheads from 2013-14.

External reporting of overhead costs

3.2 There is no universal definition for overhead costs but the term generally refers to those costs that are not directly attributable to an organisation's products or services, but which are necessary to run the business. As organisations use varying definitions for what costs constitute overheads there is limited value in comparing the spending on overheads of different organisations.

3.3 Not all of the costs of the support functions we examined are reported by the BBC as overhead costs. Where the BBC deems that support function costs relate directly to the production of programmes (for example the cost of providing accommodation for programme-making), they are reported as content costs. In addition, the costs of the BBC Trust and Marketing, Communications & Audiences are not classified as overheads beyond a small element of spending on central communications. Of the £500.5 million support functions costs we examined, £240.0 million (48 per cent) is reported as overheads, this is set out by individual support function in **Figure 5** overleaf.

3.4 In 2006, we reported on how the BBC defines and measures overheads.¹³ We concluded that although the BBC had a system to classify costs between content and non-content, there was only a limited explanation of the costs classified as overheads in the BBC's annual report and accounts. For the BBC's target to be helpful to licence fee payers it needs to be consistently and transparently reported.

¹³ Comptroller and Auditor General, *The BBC's definition of overheads*, National Audit Office, June 2006.

Figure 5
Overhead costs in 2010-11

Support function	Total cost (£m)	Classified as overhead costs (£m)	Percentage classified as overheads (%)
BBC Workplace	284.1	134.6	47
BBC People	65.7	45.7	70
Finance	40.3	40.3	100
Policy & Strategy	6.2	6.2	100
Procurement	5.2	5.2	100
Director General's Office	4.6	4.6	100
Marketing, Communications & Audiences	80.4	3.4	4
BBC Trust	14.0	0.0	0
Total	500.5	240.0	48

NOTES

- 1 Overhead costs examined in this report total £240.0 million. Of the remaining £181.0 million that makes up the total overhead costs of £421.0 million, £110.9 million relates to the BBC's spending on technology, which is not included in the scope of this report. The other £70.1 million relates to other costs outside of the scope of this report, such as divisional management costs and restructuring.
- 2 Costs include one-off project costs and therefore totals do not reconcile to Figures 2 and 3.

Source: National Audit Office analysis of BBC data

3.5 The BBC's internal guidance provides illustrative examples to help staff classify costs between content and non-content but does not provide a clear framework for judging where costs should be assigned. As part of their annual audit, the BBC's external auditors, KPMG LLP, perform tests on the consistency and accuracy of the split between content and non-content costs (including overheads) reported in the notes to the BBC's accounts. During the period examined by this report, from 2006-07 to present, the clean audit opinions given by KPMG provide comfort that there were no material issues in the BBC's accounts relating to the classification of these costs.

3.6 The BBC's annual report now provides greater clarity about what is included in the overheads figure than when we last reported, although there is room for improvement. The annual report describes overheads as "expenditure on the BBC's central functions, for example the Director General's office, BBC People, BBC Finance, Policy and Legal departments". While this explanation is helpful it does not cover the full scope of overhead costs, which also includes spending on IT and some general management costs.

Setting a target for reducing the cost of overheads

3.7 The BBC's target to spend less than 10 per cent of licence fee funding on overheads is of limited practical use to the BBC. The BBC's arrangements for measuring and reporting overheads do not align with how it manages costs. The costs are allocated to different areas of the business for reporting purposes, with 'overheads' being a figure compiled solely for inclusion in the BBC's annual report, and therefore not monitored on an ongoing basis.

3.8 In addition, we have not seen a clear rationale to support the BBC's decision to set the targeted level of overheads at below 10 per cent, nor an assessment of the risks to its other activities of reducing spending on overheads to this extent. The target is not explicitly linked to the work done by individual support functions to challenge their costs. The BBC told us that the target is intended to increase awareness of the need to reduce overhead costs, rather than establish an absolute level for its spending on overheads. This has not been made clear publicly.

3.9 In the absence of a clear rationale underpinning its target the BBC cannot be confident that its ambitions are pitched at the right level. This, coupled with the lack of alignment with how the BBC manages its business, means there is also a risk that the target could lead to perverse incentives to misclassify expenditure as being directly related to content. The BBC can help manage such risks by establishing the reductions in spending that will be necessary to meet this target and the likely impact on the performance of the support functions. In this way it could confirm whether or not overhead costs of less than 10 per cent are the right level to provide the service needed by the business.

Appendix One

Methodology

Methods

Purpose

1 Analysing and evaluating of cost data

We analysed the cost data relevant to the BBC's publicly reported overheads and the cost of its support functions.

To understand how the BBC's publicly reported overhead cost relates to its approach to the management of these costs, and how the costs have changed.

2 Benchmarking exercise

We performed a benchmarking exercise on the BBC's support functions. Where possible, we compared the BBC to the last Cabinet Office benchmarking survey of central government back-office functions, based on 2009-10 financial year data.¹⁴

To broadly indicate the performance of the BBC's support functions relative to public sector organisations that conduct broadly comparable activities.

To try to identify where there is scope for the BBC to improve how it manages its support functions.

3 Reviewing key documents

We reviewed the BBC's documentation for each of the support functions in the scope of the study.

To evaluate how the BBC manages the cost of its support functions and establish whether it uses robust and consistent processes.

4 Interviews with BBC staff

We conducted semi-structured interviews with key personnel involved with, and affected by, the support functions. We also met with the central finance team in Cardiff who are responsible for the production of cost data and are involved in setting budgets for the individual support functions.

To understand and evaluate how the support functions are managed including how accountability and responsibility are defined and how functions are incentivised to reduce costs.

To establish the role of central finance and validate the cost data included in our report.

5 External expertise

We commissioned an external consultant with experience of overhead and support service cost management.

To provide an independent perspective on how best to approach the study.

¹⁴ Cabinet Office, *Benchmarking data, 2009-10*, available at www.cabinetoffice.gov.uk/resource-library/back-office-benchmark-information-200910.