



# Capability Review of HM Revenue & Customs

# Foreword

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The purpose of departmental Capability Reviews is to use honest and robust assessments of future capabilities to identify the specific measures that are needed if central government departments are to play their part in enabling the UK to meet the considerable challenges of the future.

Over the course of the last generation there has been a transformation in the UK economy and wider society. In the era of globalisation, international trends in, for example, migration, production techniques and energy consumption have a profound effect on an outwardly facing nation like the UK. Global competition places a premium on productivity and flexibility. Harnessing new technology, developing new, high-value skills and embracing change have all enabled the UK economy to respond to these challenges, but only because companies, communities and individuals have had to learn to adapt to rapid change. As the pace of change quickens, skills and flexibility will become even more important.

Just as these trends have required a major change in the behaviour of all parts of UK society – corporate, community and individual – the challenges of the future require a response from government too. If the state, through public services, is to enable the UK to thrive over the decades to come, public services and those who deliver them must also become more flexible and adaptable, more individual, more expert and more professional.

And the environment in which public services are delivered is also changing fast. Migration, an ageing population and changing lifestyles are amongst the factors that have made the UK population – the users of public services – more diverse than ever before. The nature of public services means that often the normal market-based ways in which suppliers learn what customers think of services are only partly available. But technological and lifestyle changes mean that the public's expectations are rising, as those who use services rightly demand something tailored to their needs and delivered in the way most convenient for them.

Equipping public services for these challenges requires a transformation of the nature of government. The Capability Reviews mark an important part of this process for the centre, with an examination of what the needs going forward are for each government department.

Underpinning each review is how each department can play the role of enabler. In the modern era of technological change and consumer choice, it is not for government to control or prescribe what people want and receive.

Instead, a clear vision of what the centre should do is fundamental. High-level targets are an important tool, but the centre cannot and should not seek to micro-manage everything. Instead, the centre needs strong strategic capability to set and review priorities, as well as robust systems for managing performance and tackling areas of weakness. Getting the right skills in place, particularly operational skills, is of critical importance. Equally crucial is ensuring that policy is designed in

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a way that uses what works for customers and providers. These are the themes of the Capability Reviews.

Each Capability Review has been carried out by the Capability Reviews Team in the Cabinet Office, with a team of external reviewers assembled specially for the department under review. These reviewers have been drawn from the private sector, the wider public sector and board-level members of other government departments. The teams' wealth of experience provides external challenge and insight as well as contributing to sharing best practice across Whitehall.

I would like to thank and acknowledge the support of the review team for HM Revenue & Customs (HMRC), without whom this report would not have been possible.

The members of the team were:

- Bill Alexander CBE, former Chairman, Xansa plc and former Chief Executive, Thames Water plc
- Mike Anderson, Director General, Department for Environment, Food and Rural Affairs
- Peter Ellwood CBE, Chairman, ICI plc
- Tim Godwin OBE, Assistant Commissioner, Metropolitan Police Service
- Jane Platt, Chief Executive, NS&I (National Savings & Investments)

This report is just the beginning. The real challenge for HMRC comes in implementing what has been identified as needing to be done. Key actions which address the areas for improvement have been agreed between the Cabinet Secretary and the Acting Chairman of the Department. The Capability Reviews Team will regularly review progress and provide support to help ensure that HMRC is on track to deliver.



Sir Gus O'Donnell KCB  
Cabinet Secretary and Head of the Home Civil Service

December 2007

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# The Department's response

**The Department has responded to the findings of the review and identified five key strands of action. The Cabinet Secretary will use these to hold the Acting Chairman to account on progress.**

## The Acting Chairman's response

HM Revenue & Customs' (HMRC's) Capability Review took place at an important time for us. We demonstrated the real progress we have made since HMRC was created in 2005 and shared some of the key challenges that lie ahead.

The review coincided with a serious loss of Child Benefit data for millions of customers and their families. The Chairman, Paul Gray, stepped down and I was appointed Acting Chairman. I have decided that our immediate priorities must be to strengthen our data security and improve our service to customers and to the tax and other intermediaries who represent around 18 million of our customers. So, I want to use this opportunity both to respond to the Capability Review and to address these shorter-term priorities.

We have already started work to:

- urgently address the issues that caused the recent breach of data security. We will implement the findings of the interim Poynter Review of Data Security, and ask the Poynter review team to oversee a management risk review covering processes, procedures and levels of authority and discretion throughout the Department;
- rebuild HMRC's reputation and confidence with customers and agents, including improving the quality of and ease of access to our services; and
- invest significantly in improving our underlying infrastructure, including working with the British Bankers' Association to establish a secure electronic data transfer standard with external parties such as banks.

Turning to the Capability Review, we agree with the reviewers' findings. They reflect our own assessment at the start of the review process but add a tighter focus and greater clarity. And the findings are set in the context of needing to drive change at a much faster pace.

The review highlighted major strengths in HMRC including: our resilience and proven ability to bring in the money that funds public services, whilst driving down costs and delivering greater efficiency; some truly inspirational managers and areas of excellence; bright and committed people with a strong sense of honesty and integrity; and our clear desire to transform and improve.

However, we cannot stand still. Customer expectations are rising and we have to transform the Department to meet these expectations. At the same time we must deliver stretching performance and efficiency targets.

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To meet these challenges, we will:

## 1. Clarify accountabilities

The reviewers acknowledged that our organisational structure helped to bring about more collegiate working following the creation of HMRC and ensured the integration of our two legacy departments. But we recognise that this structure is confusing for our customers, stakeholders and staff, and that roles, responsibilities and accountabilities are neither simple nor clear. We will now create a simpler structure so that everyone understands who is responsible for what. This will start with an immediate review of the responsibilities of the top team and quickly move to the rest of the Department. Alongside this we will ensure that everyone's personal accountabilities are clear and sharper so we can remove unnecessary levels of management and over-engineered processes. This will empower our managers so that they are clear about what decisions they can make, what risks they can take to drive up performance and how they will be held to account. A clear and effective governance structure will make decision making quicker and more transparent and allow us to be faster in identifying and responding to issues.

To achieve this we will:

- simplify our Executive Committee (ExCom) members' responsibilities in December 2007;
- clarify the role of ExCom, simplify its supporting committees and ensure that the Board has the right rigour, experience and expertise to perform its functions effectively, by February 2008;
- start an immediate review of our organisational structure to simplify it and shorten our chains of command, implementing those changes by July 2008; and
- develop clear personal accountabilities for all, starting with our senior leadership team in February 2008.

## 2. Set a clear direction

The reviewers acknowledged that we developed our 'Ambition' – our statement of our role, aims, values and what we stand for – to provide a more coherent vision of the future. We will now make this more compelling for our staff, stakeholders and customers so they understand what it means for them in practice and what needs to change. Ownership of this starts with our senior leadership team, but must quickly pass to all managers so they become visible and passionate advocates of the Ambition. We will enhance and sustain this, building on our Strategic Framework and Target Operating Model which will set out simply and coherently what HMRC is trying to achieve, how we will work and organise ourselves and what we need to do over the next few years to fulfil our Ambition.

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To achieve this we will:

- launch a programme of sustained engagement with our staff and stakeholders, led by a more visible and energising top team, setting out our future direction with greater clarity and passion. This will start in January 2008, with the initial focus on helping our key leaders and managers to own the Ambition;
- extend this from March 2008 with middle managers in each business unit exploring with their staff what continuous improvement and being customer focused means in the context of their day-to-day work; and
- develop the next stages of our engagement programme, based on our Strategic Framework, from April 2008.

### 3. Increase the pace of change

The reviewers acknowledged that our PaceSetter programme, using well-proven Lean process improvement and management techniques, has significantly improved efficiency, productivity and management. We will now accelerate the pace of change, using PaceSetter as the way we do change across the whole Department. This will embed a culture of continuous improvement, driving up our overall performance and efficiency and improving our service to customers. Key building blocks include an agreed Strategic Framework and getting the right people in the right places at the right time, so that they have certainty about their future. Our change initiatives will be brought together and managed alongside our regular business so that everyone understands what we are changing, when and why.

To achieve this we will:

- bring a new focus to improving business performance, managing it together with our change initiatives under the Chief Operating Officer, from December 2007;
- complete the Strategic Framework by March 2008 enabling ExCom to use it to identify what changes we want to focus on and what changes we will stop;
- build on the success of PaceSetter by immediately accelerating the adoption of its principles across all our business units;
- speed up the reshaping of our workforce, so we can give the majority of our staff early certainty about the future of their job and their office, and when these decisions will be implemented; and
- create a single HMRC plan by May 2008, incorporating change into our regular business planning process. The plan will map out what steps we will be taking, and when, to transform our business. We will report progress on a regular basis to staff and stakeholders.

### 4. Generate passion, pride and motivation

The reviewers acknowledged the pride, professionalism and expertise of many of our staff and saw some inspirational and award-winning leaders and managers. We will now harness their skills and what we have learnt through PaceSetter to grow

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and broaden our leadership capability at all levels. Our tax and other professional skills will be enhanced to keep pace with the private sector and we will grow new skills, including financial, risk, change and performance management. Our staff will feel more connected to and inspired by our senior leadership team so there is shared understanding and ownership of the challenges facing the Department, now and in the future.

To achieve this we will:

- ensure we have the right leaders in the right places to secure improvements for our customers and to drive PaceSetter behaviours more quickly across the Department, starting in December 2007;
- develop an HMRC-wide plan to grow our entire leadership capability by extending PaceSetter across the business, starting with our key middle managers in our largest business units in February 2008;
- develop our future leaders, implementing our Talent Management Strategy from March 2008;
- refresh our HMRC skills strategy in the light of the completed Strategic Framework and our location strategy by July 2008 so that our recruitment and development processes are starting to deliver the right people with the right skills at the right time;
- immediately accelerate our back to the floor programme, extending it beyond ExCom to the full senior leadership team. This will encourage a two-way exchange of ideas and insights helping to deliver continuous improvement, improve motivation and build credibility; and
- communicate regularly to staff and stakeholders the important role that HMRC plays, day in, day out, for customers, for ministers and for the UK.

## 5. Use evidence and analysis to drive performance

The reviewers acknowledged that we have made progress in creating a more effective performance management system and improved strategic planning process. We have a significant analytical capability and now need to use that capability to better effect. Using our Strategic Framework, we will develop a set of accurate and relevant key performance indicators (KPIs) to drive and measure performance effectively. We will significantly improve our management information, and how we use it, so we can make robust, transparent, evidence-based decisions, for example around our strategic priorities. Our underlying business planning processes will be simplified and our individual and corporate performance management processes will be aligned.

To achieve this we will:

- develop KPIs, based on our Strategic Framework, by April 2008;

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- simplify our performance management framework and reporting processes, ensuring that they are applied consistently and rigorously across the Department from April 2008;
  - use these frameworks to identify what customer, management and performance information we need to manage the business effectively, by June 2008;
  - provide improved training and regular coaching to our managers so they know what information is available and how to access and use it to drive up performance, to be delivered from November 2008;
  - simplify our business planning process by September 2008, building on lessons learnt this year, and support it with better decision-making tools;
  - use our appraisal system more effectively by aligning corporate and individual performance objectives for 2008/09; and
  - ensure that the 2009/10 business unit plans include only those activities that are in line with our strategic direction.

We do not underestimate the scale of the challenges ahead. Taken together, these actions form an ambitious, but achievable, plan to deliver the world-class service that our customers deserve. Given the calibre of people in HMRC, I am confident that we will rise to this challenge.



Dave Hartnett  
Acting Chairman  
HM Revenue & Customs

December 2007

# 1. The Department

**The role of HM Revenue & Customs (HMRC) is to administer the UK's tax and customs systems to ensure society's financial well-being.**

HM Revenue & Customs was established in April 2005 by the Commissioners for Revenue and Customs Act 2005, bringing together the Inland Revenue and HM Customs and Excise. HMRC is a non-ministerial department, accountable to the Chancellor of the Exchequer for the discharge of its functions. On a day-to-day basis, responsibility for oversight of the Department is delegated to the Financial Secretary to the Treasury. Ministers have oversight of the policy and general direction of HMRC but are not involved in the handling of individual cases. Advice to Treasury ministers on tax policy is provided by HM Treasury and HMRC in partnership, HM Treasury leading on strategic work and policy development and HMRC leading on policy maintenance and delivery.

HMRC is responsible for administering and collecting 5 direct taxes (including Income Tax), 15 indirect taxes (including VAT) and National Insurance contributions. Customs duties are collected on behalf of the European Commission. The Department also pays and administers tax credits, Child Benefit and the Child Trust Fund.

HMRC currently plays a key role at the frontier, protecting the UK's border against the illegal import and export of illicit narcotics, radioactive and nuclear materials, counterfeit goods, and smuggled cigarettes and alcohol. The Department also seeks to facilitate legitimate international trade and travel and is responsible for administering European Union customs requirements. It also plays a significant role in the criminal justice system, working with the Home Office and the wider law enforcement community, including the police and the Serious Organised Crime Agency (SOCA). The customs operational work at the frontier will, in due course, move to the recently announced UK Border Agency.

The Department also undertakes a range of other enforcement activities, such as the national minimum wage regulations and the recovery of student loans. Finally, HMRC has one executive agency, the Valuation Office Agency, which provides valuation and property services to a range of public sector clients.

HMRC's 'Ambition' (its vision) sets out its role to administer the UK's tax and customs systems and its aim to ensure society's financial well-being. It also sets out the four values HMRC seeks to embed in its day-to-day work: customer focus, trust, support and protect.

Almost every UK individual and business is a direct customer of HMRC. The Department has over 30 million individual customers and 4 million business customers, and in 2006/07 it collected a total of £423bn in taxes and duties. The Department also: paid out £18.5bn in tax credits; handled 140 million customer

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enquiries; maintained 60 million taxpayer records and 71 million National Insurance records; facilitated the movement of £573bn worth of goods and 200 million passengers across our borders; and undertook 350,000 tax enquiries and visits.

Unlike most other government departments, the vast majority of HMRC's services are delivered by its own staff. As of November 2007, the Department had 85,000 staff (full-time equivalents) which represents nearly 20 per cent of the entire Civil Service, occupying 600 offices across 300 locations. However, the day-to-day operation of HMRC's information technology services and the majority of the estate is outsourced. In 2006/07, HMRC's budget was £4.5bn, representing less than 1 per cent of government expenditure.

HMRC's executive decision-making body and top team is made up of the 10 members of the Executive Committee (ExCom). The most recent addition to ExCom is the Chief Operating Officer role, created in October 2007, to coordinate and drive performance across the Department, including chairing the Cross-Cutting Performance Committee (CCPC) and leading the Departmental Transformation Programme.

HMRC is organised into 32 business units of four types: operational units, product and process groups, customer units, and corporate functions. The 10 operational units employ 73,000 of HMRC's staff (full-time equivalents) and focus on delivering high-quality, cost-effective services such as processing, local compliance and customer contact. The six product and process groups are responsible for the design and specification of the Department's taxes, duties and other products, and the processes by which they are delivered. The two customer units (one for business, one for individuals) identify and understand the requirements and behaviours of customers and act upon this learning. The 14 corporate functions, such as HR, finance and communications provide a range of services to guide and support HMRC.

Since the creation of HMRC, a matrix management arrangement has been in place to coordinate the work of these business units, each of which is headed by a member of ExCom or a director. This arrangement was chosen specifically to facilitate more effective working across the different heads of duty and organisational boundaries. Together, ExCom and the team of directors form the senior leadership team in the Department, known colloquially as 'the 46'.

Since June 2007 ExCom has delegated some of its responsibilities to 17 sub-committees. One of the key sub-committees is the CCPC, which has oversight of the Department's performance and is involved in the day-to-day running and decision making of the Department.

HMRC's Board is made up of the members of ExCom and six non-executive board members. The Board provides challenge, oversight and assurance of the work of

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the Department. Its primary purpose is to allow executive and non-executive members to discuss and review key operational and strategic matters, including the development of the future strategy for the Department.

## 2. Current delivery challenges

**HMRC has three objectives, which are underpinned by 10 Public Service Agreement (PSA) targets. The Department is making progress on its PSA targets and it has delivered on some challenging efficiency targets ahead of schedule. HMRC has also achieved a number of notable successes, including the introduction of the Child Trust Fund and the use of well-proven Lean process improvement and management techniques.**

**HMRC has three objectives, which are underpinned by 10 PSA targets.**

The Department's Ambition is reflected in the three objectives and 10 PSA targets to be achieved by 2007/08.

**Objective 1: Improve the extent to which individuals and businesses pay the amount of tax due and receive the credits and payments to which they are entitled.**

- PSA 1: Reduce the scale of VAT losses to no more than 11 per cent of the theoretical liability.
- PSA 2: Reduce the illicit market share for cigarettes to no more than 13 per cent; reduce the illicit market share for spirits by at least a half; and hold the illicit market share for oils in England, Scotland and Wales at no more than 2 per cent.
- PSA 3: Reduce underpayment of direct tax and National Insurance contributions due by at least £3.5bn a year.
- PSA 4: Increase the percentage of self assessment returns filed on time to at least 93 per cent.

**Objective 2: Improve customer experience, support business and reduce the compliance burden.**

- PSA 5: Respond accurately and completely to requests for advice: increase to at least 80 per cent the proportion of individuals and businesses who said they achieved success at first point of contact; and increase to at least 90 per cent the accuracy and completeness of information and advice given and actions taken in respect of contact.
- PSA 6: Provide simple processes that enable individuals and businesses to meet their responsibilities and claim their entitlements easily and at minimum cost: increase to at least 90 per cent the proportion of small businesses that find it easy to complete their tax returns; demonstrate a measurable improvement in new and growing businesses' ability to deal correctly with their tax affairs (including increasing the proportion of applications for VAT registration that are complete and accurate to at least 50 per cent); and increase to at least 85 per cent the proportion of individuals who find their self assessment statements of account, Pay As You Earn (PAYE) coding notices and tax credit award notices easy to understand.

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- PSA 7: Deal effectively and appropriately with information provided, so that levels of contact are kept to a minimum: increase to at least 95 per cent the rate of accuracy achieved in administering self assessment, PAYE, tax credits and National Insurance contributions; increase to 35 per cent the percentage of self assessment tax returns received online and increase to 50 per cent the percentage of VAT returns filed online.

**Objective 3: Strengthen frontier protection against threats to the security, social and economic integrity, and environment of the UK in a way that balances the need to maintain the UK as a competitive location in which to do business.**

- PSA 8: Improve our capability to intervene at the frontier.
- PSA 9: Improve our effectiveness by 50 per cent in identifying irregularities in third-country freight.
- PSA 10: Maintain the extent to which importers, exporters and their agents believe we are striking the right balance between frontier protection and maintaining the UK as a competitive location in which to do business.

**The Department is making progress on its PSA targets.**

The Department is on course or well ahead to meet 3 of its 10 PSA targets (PSAs 8, 9 and 10).

The position on the other seven targets is mixed:

- On current projections, the Department is at risk of not meeting PSA 1, to reduce the scale of VAT losses. Despite the improved receipts performance in 2006/07, the latest assessment is that the scale of VAT losses have been reduced to 14.2 per cent of their theoretical liability against a target of 11 per cent for the Spending Review period.
- For PSA 2, the Department remains on target with respect to oils and it is reasonably close to meeting the target for spirits. HMRC is expecting to deliver the target for illicit tobacco market share.
- PSA 3, to reduce underpayments of direct tax and National Insurance contributions is proving challenging to meet. HMRC currently expects a shortfall of £0.7bn.
- On PSA 4, a change in the rules means that 2.1 million, mainly compliant, customers no longer have to file self assessment returns, whilst there was an increase of over 200,000 new-to-self-assessment customers. As a result, the Department is on course to receive 86 per cent of self assessment returns on time against a target of 93 per cent.
- On PSA 5, the Department is likely to meet the target for accuracy and completeness of information, advice given and actions taken. However, it is behind trajectory to achieve the target of 80 per cent of customers feeling they achieved success at first point of contact where performance currently stands at 75 per cent.

- On PSA 6, the Department is well ahead of trajectory for one of the three indicators – to increase the proportion of small businesses that find it easy to complete their tax returns to at least 90 per cent. However, it is behind trajectory for the other two.
- For PSA 7, at the end of September 2007, the Department was running at 36 per cent of self assessment tax returns filed online so is on course to meet its target of 35 per cent by 31 January 2008. In respect of the accuracy target, progress has been made, particularly on PAYE. However, the overall target is still at risk. HMRC will not meet its target of 50 per cent of VAT returns filed online within the Spending Review 2004 period.

The recently completed Comprehensive Spending Review 2007 confirmed HMRC's Departmental Strategic Objectives for the period 2008/09 to 2010/11. They are to:

- improve the extent to which individuals and businesses pay the tax due and receive the credits and payments to which they are entitled;
- improve customers' experience of HMRC and improve the UK business environment; and
- reduce the risk of illicit import and export of material that might harm the UK's physical and social well-being.

### HMRC has delivered on some challenging efficiency targets ahead of schedule.

- HMRC has met its target to deliver a reduction of 12,500 full-time equivalent posts by March 2008, eight months ahead of schedule.
- HMRC has already met its Gershon efficiency targets of saving at least £507m in annual running costs (including IT and estates savings) by 31 March 2008.
- HMRC is also on target to meet its Lyons relocation target to move 1,950 posts out of London and the South East by April 2008.

### HMRC has also achieved a number of notable successes, including the introduction of the Child Trust Fund and the use of well-proven Lean process improvement and management techniques.

- The Department has continued to deliver the flow of revenue into the Exchequer whilst progressing one of the largest UK public or private sector mergers. It brought together two very large departments of more than 100,000 staff, with separate legislative bases, systems and processes, cultures and terms and conditions without additional funding and without interrupting the flow of revenue.
- The Department has introduced the Child Trust Fund, a long-term savings and investment account for children, set up with an initial contribution from the Government. Since it was launched in 2005, over 3.04 million accounts holding £1.3bn of assets have been opened, with take-up at 75 per cent.
- HMRC has developed a more strategic and risk-driven approach to compliance activity including, for example, the offshore banking disclosure project through

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which HMRC expects to collect over £400m of extra revenue from those who have not paid tax on offshore bank accounts.

- The Department has developed an integrated and well-received service for large-business customers, including strengthening the role of client relationship managers.
- The Department has recognised changing customer expectations and has tailored its services to meet their needs, such as greater online filing of tax returns. In 2006/07, one-third of the 9 million self assessment returns issued were filed electronically.
- HMRC has introduced well-proven Lean process improvements and management techniques, which produced significant improvements in efficiency, productivity, and management and staff performance in processing services. In processing, Lean has delivered headcount savings of nearly 2,500 full-time equivalents and has increased productivity by up to 50 per cent and quality by an average of 40 per cent.
- The Department has recently won a number of awards: two European Call Centre Awards in recognition of its Bathgate Contact Centre; a *Whitehall and Westminster World* Civil Service Award for its fight against cocaine smuggling from Jamaica and Ghana; and an award from the Institute of Payroll Professionals for its work with employers, agents and payroll developers.
- Business and accountancy groups praised HMRC for its swift response to flooding in July 2007, where HMRC gave quick advice to businesses and individuals about tax deferral and the waiving of interest and surcharges in light of the circumstances.

### 3. Challenges for future delivery

**HMRC must rebuild customers' trust and confidence quickly and will remain under close public scrutiny for its response to reputational issues. The Department plays a critical role in identifying and responding to new challenges and threats. These challenges need to be met against the background of a changing customer base which has increasingly complex tax affairs and rising expectations of service quality and responsiveness. HMRC must continue to deliver the revenue that is essential to the provision of quality public services, whilst transforming how it does business and cutting costs. The professional expertise of the Department's staff needs to be developed and retained in order to keep pace with the private sector and deliver an excellent service. Alongside efforts to address ongoing legacy issues, HMRC must continue to make significant strides to modernise the Department.**

HMRC must rebuild customers' trust and confidence quickly and will remain under close public scrutiny for its response to reputational issues.

The recent loss of Child Benefit data means that HMRC will be under intense public, parliamentary and media scrutiny for the way it deals with this and other reputational issues, such as tax credits and VAT registrations. The most important challenge for HMRC will be rebuilding trust and confidence amongst its staff, customers, agents and stakeholders. This will be a significant task given the size of its customer base, which includes over 30 million individual customers and 4 million business customers.

The Department plays a critical role in identifying and responding to new challenges and threats.

The rapid rise in recent years of Missing Trader Intra-Community VAT repayment fraud (with attempted fraud estimated between £2.25bn and £3.25bn in 2006/07) illustrates the critical role that HMRC has in addressing emerging challenges and threats. Working in partnership with HM Treasury, HMRC must continue to identify and respond to new challenges, for example management of borders reform, the pensions reform agenda, the impact of the migrant worker population, and the continued pressure on receipts through fraud, tax avoidance and possible erosion of tax bases.

These challenges need to be met against the background of a changing customer base which has increasingly complex tax affairs and rising expectations of service quality and responsiveness.

Economic, social and technological changes mean people now live much more complex lives – making their tax affairs more complex. At the same time customer expectations are increasing. To meet them, HMRC must improve customers'

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experience of dealing with the Department through good service levels and convenient and tailored forms of communication and guidance. It must also secure customers' engagement, to ensure that everyone pays what they owe and receives what they are due. HMRC must also identify and take opportunities to reduce the burden placed on its customers, making sure they find it easy to meet their obligations and to receive their entitlements.

**HMRC must continue to deliver the revenue that is essential to the provision of quality public services, whilst transforming how it does business and cutting costs.**

Whilst HMRC has delivered some stretching efficiency targets ahead of schedule, its financial settlement for the next three years requires further reductions in spending of 5 per cent year on year, amounting to approximately £230m per annum, together with an additional relocation target of 2,300 posts by April 2010. HMRC must deliver these efficiencies at the same time as continuing to deliver the revenue which is essential to fund the Government's priorities.

**The professional expertise of the Department's staff needs to be developed and retained in order to keep pace with the private sector and deliver an excellent service.**

The Department's work demands high levels of professionalism and tax-specific skills which are in high demand in the private sector. It will be a continuing challenge for the Department to develop and retain these specialist skills, in addition to identifying and securing the new skills and capabilities it requires to meet the challenges ahead.





**Alongside efforts to address ongoing legacy issues, HMRC must continue to make significant strides to modernise the Department.**

HMRC recognises that further progress is needed to resolve a number of performance issues it inherited from the legacy departments. For example, stabilising the operation of the tax credits IT system and reducing the high number of PAYE open cases. At the same time, HMRC must press ahead with its programme of service transformation – for example investing in infrastructure to enable greater online filing – and organisational reform, including changes to its workforce, estates consolidation and control of costs.



## 4. Assessment of capability for future delivery

- The Department's capability for future delivery was assessed as 'strong' or 'well placed' in 2 of the 10 elements in the model of capability. These were 'build common purpose' and 'plan, resource and prioritise'.
- Four elements were assessed as a 'development area'. These were 'take responsibility for leading delivery and change', 'build capability', 'focus on outcomes' and 'manage performance'.
- Four elements were assessed as an 'urgent development area'. These were 'set direction', 'ignite passion, pace and drive', 'base choices on evidence' and 'develop clear roles, responsibilities and delivery model(s)'.
- There were no areas of 'serious concerns'.




### Leadership

<b>L1</b>	Set direction		<b>Urgent development area</b>
<b>L2</b>	Ignite passion, pace and drive		<b>Urgent development area</b>
<b>L3</b>	Take responsibility for leading delivery and change		<b>Development area</b>
<b>L4</b>	Build capability		<b>Development area</b>

### Strategy

<b>S1</b>	Focus on outcomes		<b>Development area</b>
<b>S2</b>	Base choices on evidence		<b>Urgent development area</b>
<b>S3</b>	Build common purpose		<b>Well placed</b>

### Delivery

<b>D1</b>	Plan, resource and prioritise		<b>Well placed</b>
<b>D2</b>	Develop clear roles, responsibilities and delivery model(s)		<b>Urgent development area</b>
<b>D3</b>	Manage performance		<b>Development area</b>

The model of capability is shown at Annex A.  
The assessment categories are shown at Annex B.

## 5. Capability Review findings

### Leadership

**HMRC has many committed staff with high levels of professional competence. The departmental Ambition is increasingly recognised within the organisation, but the senior leadership has more to do to energise HMRC with this vision and to clarify what it means for staff. The senior leadership has not been successful in injecting pace, confidence and dynamism throughout the Department. The top team has shown an awareness of the key issues and challenges facing HMRC, and a willingness to address them, but has more to do to demonstrate that it can take the tough decisions required to set priorities and to bring about organisational clarity. The development of a robust plan to retain and develop the right mix of skills and expertise of staff depends upon HMRC's ability to resolve staff uncertainty and to be clear about what the Department will look like in the future.**

**HMRC has many committed staff with high levels of professional competence.**

- Stakeholders speak very highly of the professionalism and expertise of many of the Department's staff.
- Staff and HM Treasury stakeholders are proud of the performance of the Department in continuing to deliver revenue during a significant period of change.
- There is a strong sense of honesty and integrity amongst staff, underpinning HMRC's key role in government to deliver revenue to fund public services.
- There are some inspirational and award-winning managers in the Department, particularly on the front line.
- HMRC has made progress towards creating a culture of openness to ideas and a willingness to share problems and aspirations.

**The departmental Ambition is increasingly recognised within the organisation, but the senior leadership has more to do to energise HMRC with this vision and to clarify what it means for staff.**

- HMRC has developed its Ambition to provide a more coherent picture of the Department and its vision for the future. There is increasing awareness of the Ambition amongst staff and stakeholders. The most recent staff survey found that 63 per cent of staff are aware of the Department's long-term goals (an increase from previous surveys).
- Although there is buy-in to the vision amongst the senior leadership, middle managers and below are not clear what this vision means and how it will be achieved. The Department needs to address a disconnect between 'the 46' group and middle managers, about the ability of HMRC to set direction.
- Staff are aware of the vision but they need more clarity about what it means for them and how the Department will look in the future. In the latest staff survey,

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44 per cent of staff said they feel well informed about the Ambition, but only 15 per cent feel involved in achieving it.

- ‘Customer focus’ is a significant element of the vision for the Department but has not yet been translated into something that is fully understood and embraced throughout the Department and beyond. Many staff, partners and stakeholders are still struggling with the concept of a ‘customer’ in relation to HMRC.

### The senior leadership has not been successful in injecting pace, confidence and dynamism throughout the Department.

- Some individuals display high levels of energy and enthusiasm. However, the need to improve pace, confidence and dynamism is highlighted as a major issue by staff and stakeholders.
- The need for a faster pace of change was consistently referred to as an element for urgent action, particularly to resolve uncertainty around office closures and staff relocations.
- Surveys of staff show that 43 per cent of staff are satisfied with their job and 20 per cent are satisfied with the Department. Both have fallen steadily in recent surveys. More staff take a negative view of the impact of change in the Department than a positive one (48 per cent to 21 per cent).
- At senior level, the SCS survey also shows a need for improvement. 17 per cent hold the view that senior management is effective at leadership and 22 per cent (compared to the 34 per cent Civil Service benchmark) report confidence in the management of the Department. 41 per cent (compared to the 56 per cent Civil Service benchmark) say the SCS inspire staff with a positive vision.
- Some staff are very proud of the specific role they perform, and of their team or business unit, particularly those working on the front line, but there is less sense of pride and of belonging to HMRC as a corporate whole. There is yet to be created a unified culture with a clearly held set of values and behaviours.

### The top team has shown an awareness of the key issues and challenges facing HMRC, and a willingness to address them, but has more to do to demonstrate that it can take the tough decisions required to set priorities and to bring about organisational clarity.

- The top team has maintained HMRC’s core business of delivering revenue whilst leading the Department through a significant period of change.
- The matrix management approach has helped to bring about more collegiate working amongst Executive Committee (ExCom) members. However, coupled with the extensive series of sub-committees, the approach has diffused accountability for leading delivery and change and slowed decision making at senior leadership level. This has led to an increase in the risk of errors being made further down the organisation.
- The very recent appointment of a Chief Operating Officer is a positive step forward in clarifying accountability and driving performance, but his role and

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responsibilities are yet to be fully defined or accepted by senior and middle management.

- The top team lacks the right kind of external support, expertise and challenge to carry out its responsibilities effectively.
- 12 per cent of staff feel that change is managed well in HMRC, according to its most recent staff survey (compared to the 25 per cent Civil Service benchmark). 22 per cent of respondents to the latest HMRC survey of Senior Civil Servants agree or strongly agree that change is managed well (compared to the 33 per cent Civil Service benchmark).

The development of a robust plan to retain and develop the right mix of skills and expertise of staff depends upon HMRC's ability to resolve staff uncertainty and to be clear about what the Department will look like in the future.

- The Department has many good-quality staff with high levels of professionalism and expertise.
- There is a widely held view amongst staff that because of efficiencies and staff relocation there are no promotion or transfer opportunities. Managers would like to see much greater flexibility in the processes available to them to secure and deploy the resources they need.
- The Department recognises that it faces a challenge in ensuring that it retains and develops staff with the right mix of skills and expertise for the future. It also recognises that it must move faster to resolve uncertainties around the future vision in order to meet this challenge.

## Strategy

The Department has made good progress in building common purpose with some of its key stakeholders and partners. It is unclear how the Department uses evidence, including customer understanding, to make management decisions. Its analytical capability is not focused on producing the evidence it requires to support strategic decision making and prioritisation. This stems from significant gaps in the management information available in the Department. HMRC has focused effectively on the core outcome of delivering revenue, but it is not clear how its various initiatives for the future are prioritised and fit together into a coherent and realistic programme.

The Department has made good progress in building common purpose with some of its key stakeholders and partners.

- HMRC has markedly improved relationships with some key stakeholders and partners. The Department's work with the insurance industry is a good example of how the Department has moved from a difficult relationship to a positive one.
- There is evidence of much closer joint working with other government departments and parts of the public sector. An example is HMRC's work with the Department for Work and Pensions (DWP) and local authorities on joining up services to people moving in and out of work. Staff in both HMRC and DWP speak positively about their collaborative work and clear commitment at senior levels to working together effectively.
- Progress made by HMRC following Sir David Varney's *2006 Review of Links with Large Business* has led to improved relationships with many large businesses, for example through strengthening the system of client relationship managers.
- Whilst some stakeholders recognise that the Department has shown an increased willingness to engage, there is much more to be done to transfer and adapt this good practice, particularly for large-volume customer groups, such as individuals and small to medium-sized businesses.

It is unclear how the Department uses evidence, including customer understanding, to make management decisions. Its analytical capability is not focused on producing the evidence it requires to support strategic decision making and prioritisation. This stems from significant gaps in the management information available in the Department.

- HMRC has done some work to understand the correlation between inputs, outputs and outcomes, but this work is underdeveloped.
- As a result, there is a lack of transparency in strategic decision making and prioritisation, and staff and stakeholders are unsure how evidence is used to arrive at decisions and priorities.

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- There are significant gaps in the management information available in the Department. Decision making is not based on management information. More good-quality analysis and evidence would lead to a strategic, rather than an ad hoc, approach to prioritisation.
  - The Department has a large resource of analytical capability to draw on, particularly within the Knowledge, Analysis and Intelligence unit. However, this capability needs to be better exploited to improve HMRC's operational performance.
  - In 2006, a National Audit Office report, *HM Revenue & Customs: Filing VAT and Company Tax Returns*, said that HMRC needs to develop a better understanding of which businesses do and do not comply and why, and the barriers to compliance, so that it can target its efforts to best improve compliance.

HMRC has focused effectively on the core outcome of delivering revenue, but it is not clear how its various initiatives for the future are prioritised and fit together into a coherent and realistic programme.

- HMRC has a strong focus on the core outcome of delivering revenue to fund public services.
- Whilst some positive steps have been taken towards improving strategic planning, the process is complex and still untested. As the process is ongoing, there is as yet no clear, coherent and achievable strategy linked to the future vision and, therefore, no plan which would transform the Department's delivery model.
- The senior leadership could work more effectively with HM Treasury to influence the pressures placed on the Department and to improve its own strategic decision making.

## Delivery

**HMRC has planned effectively to continue to deliver revenue during a period of significant change, and progress has been made on improving the planning process to deal with future challenges. The current matrix management and delivery model does not provide clear personal accountabilities and responsibilities and makes decision making unnecessarily complex. Although some progress has been made on managing performance, HMRC needs to do more to identify and address performance issues effectively.**

HMRC has planned effectively to continue to deliver revenue during a period of significant change, and progress has been made on improving the planning process to deal with future challenges.

- It is widely recognised inside and outside the Department that HMRC has done well to continue to deliver its core business post-merger, whilst also making good progress on its efficiency targets. Net tax receipts collected went up by 7 per cent in 2005/06 and by 6 per cent in 2006/07.
- The Department has shown real resilience and pride in its proven ability to deliver throughout turbulent times, and there is a clear desire amongst staff to transform and improve, to ensure it continues to deliver in the future.
- HMRC recognises the need to improve business planning processes to deal with future challenges. A new process is underway to ensure that business plans are coherent.
- The introduction of well-proven Lean process improvements and management techniques is a particularly positive example of HMRC's ability to plan and resource activity that aids efficiency, productivity and management.

The current matrix management and delivery model does not provide clear personal accountabilities and responsibilities and makes decision making unnecessarily complex.

- Whilst some staff feel that the matrix management model has aided collaborative working across the organisation, many are critical about the clarity on personal accountabilities, responsibilities and decision making within the model.
- Stakeholders say the organisational structure should be more transparent and that they have difficulty in identifying where responsibilities for decisions lie. They express concerns over an underdeveloped sense of personal accountability for delivery.
- The lack of clear accountabilities leads to insufficient focus and rigour on effective risk management across the Department. Concerns have been expressed about HMRC's ability to recognise issues sufficiently early for dynamic intervention, for example in relation to VAT registration delays and the obvious need for robust and operative processes to safeguard data security.

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- The complex management structure leaves many middle managers unclear as to where, when and how they are empowered to take decisions.
  - Both staff and stakeholders point to the proliferation of committees, which compounds issues around the role and responsibilities of the Board, ExCom and the sub-committees.
  - HMRC has recently decided to develop four detailed Target Operating Models to underpin its Strategic Framework, reflecting the complexity and diverse nature of its business functions. However, the overall vision is complex and not clearly articulated. Whilst four might be the right number, this is not obvious and urgent attention is required to simplify and communicate a unifying vision of its Target Operating Model.

Although some progress has been made on managing performance, HMRC needs to do more to identify and address performance issues effectively.

- HMRC has taken steps to create a more effective performance management system through the introduction of a Quarterly Performance Review system and the creation of the Cross-Cutting Performance Committee (CCPC). However, the role and responsibilities of the new Chief Operating Officer and the CCPC on performance management, particularly in relation to ExCom and the Board, are not sufficiently clear.
- The Department does not have a small number of key performance indicators with clear line of sight all the way through the Department which undermines its ability to identify and address performance issues quickly.
- The gaps in robust management information contribute to a culture where not all staff feel a sharp sense of responsibility towards tackling performance issues and striving for excellence.
- In 2007, a National Audit Office report, *HM Revenue & Customs: Accuracy in Processing Income Tax*, found that the Department is now managing its performance on accuracy more effectively, but that the sheer scale of this work means that errors have considerable impact on both the Department and on individual taxpayers.

## 6. Key areas for action

**HMRC is a department with a proven ability to deliver and a clear desire to transform and improve. The Capability Review identified four key areas for action, which are critical if the Department is to respond successfully to meet its current and future challenges.**

### Area for action 1 – accelerate the pace of leadership throughout the organisation, in particular pushing the vision with passion, drive and pace

- Whilst staff's awareness of the Department's vision has increased, HMRC's senior leadership needs to articulate more clearly and convincingly what that vision means for all of its business areas, what HMRC will look like in five years' time – from both a customer and an operating perspective – and how it intends to get there.
- Though it remains a source of continued debate within the Department, HMRC should not retreat from use of the term 'customer' to describe the individuals and organisations it interacts with. However, the senior leadership needs to translate, in a disaggregated way, what being 'customer focused' means in different business areas, so that staff can identify with it and see how it relates to their work.
- Communications need to be more energising and more consistent, with a particular focus on reaching middle managers and transforming them into passionate owners and advocates of the vision to staff, stakeholders and customers.
- The top team should inject much greater pace into decision making and implementation – particularly around the transformation plan for the Department – and be more confident in taking some calculated risks within the political and financial constraints.
- The top team should be ruthless in reviewing and cutting back the number of change initiatives, to focus on those which contribute most to the achievement of its vision. This prioritisation should be clear to the organisation, unequivocal and adhered to rigorously by all.
- The change initiatives that remain should be drawn together into a coherent and realistic change programme which fits with the vision, establishes a clear critical path and can be communicated and easily understood by the Department and its stakeholders.

### Area for action 2 – transform an information-rich, intelligence-poor department through better management information and evidence-based decision making

- HMRC should prioritise efforts to improve its management information and, in particular, to better understand the input/output equation in terms of both financial and non-financial benefits. This information should then be used to establish a focused set of key performance indicators for the Department and to make fact-based decisions on stopping low-priority activities.

- The Department should partly refocus the analytical capability in the Knowledge, Analysis and Intelligence unit so that the unit can provide more robust support to efforts to improve business performance.
- HMRC should ensure that its workforce has the training and understanding it needs to be a demanding and intelligent user of management information and the Knowledge, Analysis and Intelligence unit, in order to drive the business.
- The top team should set a visible example to the organisation, by using management information to drive transparent and fact-based decision making, particularly in its prioritisation efforts.
- The Department should simplify its strategic and business planning and performance management processes, connect them more effectively to decision making and implement them rigorously.
- The top team should discuss with HM Treasury options for greater flexibility for HMRC in delivering its overall targets. The top team should also take the opportunity presented by its Comprehensive Spending Review 2007 settlement to present HM Treasury ministers with more radical options to transform the business.

### Area for action 3 – establish clear, simple lines of personal accountability and roles

- In light of events that occurred during the course of the review, it is critical that the top team looks urgently at structural options for the Department. This should include exploring separate roles for a chief executive and a non-executive chairman and ensuring that the Board has non-executive members with the right experience and expertise to guide, support and challenge the executives in the discharge of their responsibilities.
- The Department must urgently sharpen personal accountabilities at all levels of the organisation and ensure that these lines of accountability are clear to staff and stakeholders.
- HMRC should rationalise the different strands of work looking at future models for delivery, and commit to completing work as soon as possible on its Target Operating Model.
- HMRC should clarify and communicate the role of the senior leadership and of the new Chief Operating Officer role in particular. The top team should reiterate its collective commitment to embedding the Chief Operating Officer role and ensuring it is well understood throughout the organisation.
- HMRC should simplify and clarify the committee structure to speed up decision making.
- A very clear framework of personal accountability will allow HMRC to remove unnecessary levels of management structure and simplify over-engineered processes, thereby shortening chains of command within the Department. Within this framework, HMRC should empower its middle managers to make appropriate decisions.
- The Department should augment one of its existing external reviews to include an immediate management risk review, covering all processes, procedures and levels of authority and discretion throughout the Department.

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## Area for action 4 – reignite staff motivation and the credibility of and confidence in, and of, the senior leadership to lead successful transformation of the Department

- The senior leadership (and, increasingly, leaders below ‘the 46’ level) should show more visible leadership within the Department, reinforcing the same simple, clear messages over time.
- The senior leadership should be honest and courageous in talking about the difficult decisions that must be made, aligning the expectations of those inside and outside HMRC with reality.
- Having clarified the vision under Area for action 1, the senior leadership should move quickly to develop a robust plan to retain and develop the mix of skills and expertise that the Department needs for the future.
- The top team should demonstrate to staff that it has taken unequivocal, collective ownership of the transformation of the Department.

# Annex A: The model of capability



The model of capability has been designed specifically for the Capability Reviews. It was developed through consultation with senior leaders in Whitehall and external experts. The model is deliberately selective and designed to focus on the most crucial areas of capability – leadership, strategy and delivery.

The reviews provide an assessment of capability for departments, identify key areas for improvement and set out key actions to address these areas.

The scope of the reviews is to assess the capability of departments' senior leadership in the areas above, using the model of capability. The model enables judgements to be made against 10 elements across leadership, strategy and delivery, using an underlying group of 39 questions.

Each review has been carried out by the Capability Reviews Team with a team of external reviewers assembled specially for the department under review. These reviewers have been drawn from the private sector, the wider public sector and board-level members of other government departments.

The Capability Reviews Team will regularly review progress and provide support to help ensure that the department is on track to deliver.

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## Leadership

### Key questions that test current capability

#### L1 Set direction

- Do you have a clear, compelling and coherent vision for the future?
- How do you take tough decisions, and do you follow them through?
- How do you generate common ownership of the vision with your political leadership, the board, the organisation and delivery partners?
- How do you keep the vision up to date, seizing opportunities when circumstances change?

#### L2 Ignite passion, pace and drive

- Are you visible, outward-looking role models, communicating effectively and inspiring the respect, trust, loyalty and confidence of staff and stakeholders?
- Do you display integrity, confidence and self-awareness in your engagement with staff and stakeholders, actively encouraging, listening to and acting on feedback?
- Do you display passion about achieving ambitious results for customers, focusing on impact, celebrating achievement and challenging the organisation to improve?
- How do you create and sustain a unifying culture and set of values/behaviours which promote energy, enthusiasm and pride in the organisation and its vision?

#### L3 Take responsibility for leading delivery and change

- How do you role-model an effective corporate culture of teamwork at board level, including making effective use of non-executive directors?
- Do you and the senior leadership team accept the pressing need for change, demonstrate your personal commitment to it and act as an effective guiding coalition?
- How do you initiate and drive work across boundaries to achieve delivery outcomes?
- How do you manage change effectively, addressing and overcoming resistance when it occurs?

#### L4 Build capability

- How do you identify and nurture talent and grow experience in individuals and teams?
- Do you have the right skills across the organisation to deliver the vision? Do you have a workforce development strategy to get the best from everyone and plan effectively for succession in key posts?
- How do you manage the performance of everyone transparently and consistently, rewarding good performance and tackling poor performance? Are everyone's performance objectives aligned with the strategic objectives of the organisation?
- Do you reflect the diversity of the customers you serve?

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## Strategy

### Key questions that test current capability

#### **S1 Focus on outcomes**

- Do you have a clear, coherent and achievable strategy with a single, overarching set of challenging outcomes, aims, objectives and success measures?
- Is your strategy clear what success looks like and focused on improving the overall quality of life for customers and benefiting the nation?
- How do you negotiate trade-offs between 'priority' outcomes?
- How do you work with your political leadership to develop your strategy?

#### **S2 Base choices on evidence**

- How do you understand and respond to what your customers want?
- How do you identify future trends, plan for them and choose between the range of options available?
- How do you ensure that your decisions are informed by sound evidence and analysis?
- How do you cultivate innovative solutions to existing and new problems?

#### **S3 Build common purpose**

- How do you engage, align and enthuse partners in the delivery chain to work together as a team to deliver the strategy?
- How do you remove obstacles to effective joint working?
- How do you work with partners when developing strategy?

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## Delivery

### Key questions that test current capability

#### D1 Plan, resource and prioritise

- Do your business planning processes effectively prioritise and sequence deliverables to deliver your strategic outcomes?
- Are your delivery plans robust, consistent and aligned with the strategy? Taken together, will they effectively deliver all of your strategic outcomes?
- How do you maintain effective control of the organisation's resources? Do your delivery plans include key drivers of cost, with financial implications clearly considered and suitable levels of financial flexibility within the organisation?
- Are your delivery plans regularly reviewed?

#### D2 Develop clear roles, responsibilities and delivery model(s)

- Is the purpose of the centre/headquarters functions clear?
- How do you identify and agree roles, responsibilities and accountabilities for delivering your strategic outcomes across the delivery chain? Are these understood and supported by appropriate rewards and incentives, and governance arrangements?
- Do you have clear and well understood delivery models which will deliver your strategic outcomes?
- How do you work with partners to build capability in the delivery chain?

#### D3 Manage performance

- Do you take personal responsibility for driving performance and striving for excellence across the organisation in pursuit of your strategic outcomes?
- Do you have high-quality, timely and well-understood performance information, supported by analytical capability, which allows you to track performance across the delivery chain? Is performance information aligned with the strategic objectives of the organisation?
- How effectively are programmes and risk managed across the delivery chain? How do you realise and recycle benefits from programmes?
- How do you use financial information to drive greater efficiency and value for money?

# Annex B: Assessment categories

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**Strong** – good capability for future delivery in place, in line with the capability model. Clear focus on the action and improvement required to deliver transformation over the medium term.



**Well placed** – well placed to address any gaps in capability for future delivery through practical actions that are planned or already underway. Is making improvements in capability and is expected to improve further in the medium term.



**Development area** – the department should be capable of addressing some significant weaknesses in capability for future delivery by taking remedial action. More action is required to close those gaps and deliver improvement over the medium term.



**Urgent development area** – significant weaknesses in capability for future delivery that require urgent action. Not well placed to address weaknesses and needs significant additional action and support to secure effective delivery. Not well placed to deliver improvement over the medium term.



**Serious concerns** – serious concerns about current capability. Intervention is required to address current weaknesses and secure improvement in the medium term. (NB only used infrequently, for the most serious gaps.)

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Publication date: December 2007

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The material used in this publication is constituted from 75% post-consumer waste and 25% virgin fibre

Ref: 284226/1207

Prepared for the Cabinet Office by COI