



Treasury Minutes on the First and the Fifth Reports from the Committee of Public Accounts 2006-2007

1st Report: Tsunami: Provision of support for humanitarian assistance
5th Report: Postcomm and the quality of services

**Presented to Parliament by the Financial Secretary to the Treasury by Command of Her Majesty
February 2007**

TREASURY MINUTES DATED 8 FEBRUARY 2007 ON THE
FIRST AND THE FIFTH REPORTS FROM THE COMMITTEE
OF PUBLIC ACCOUNTS SESSION 2006-2007

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First Report

Department for International Development

Tsunami: Provision of support for humanitarian assistance

1. The Committee inquired into the response by the Department for International Development (DFID) to the tsunami, which struck Indian Ocean countries on 26 December 2004. The Government committed £75 million in humanitarian assistance to the tsunami victims. The PAC found DFID's response to be rapid and impressive in delivering assistance to the survivors. But the PAC also found that by May 2006 some £9 million of the grants given to third parties remained unspent. Drawing on lessons from the tsunami, the Committee recommended that: DFID and the international community should:

- work further to improve international humanitarian response capacity and effectiveness;
- DFID should develop a more systematic framework with the Ministry of Defence for use of military assets in disaster response; and
- DFID should continue working to reform the United Nations humanitarian aid system.

2. The Committee had before it the report of the National Audit Office's inquiry into DFID's tsunami response and evidence from the Department. The Committee also heard oral evidence from the Department's Permanent Secretary and other senior officials, whom the PAC congratulated on DFID's tsunami response. DFID accepts and is implementing all the PAC's recommendations.

PAC conclusion (i): The Department was successful in responding rapidly and effectively. The Department should seek to share their techniques with others, eg other Governments, Non-Government Organisations (NGO) and Charities.

3. DFID has a strong record in rapid and effective humanitarian response. The Head of the National Audit Office, which examined DFID's tsunami response, said that: "The speed of DFID's response after the tsunami was impressive...". At the Committee's hearing with DFID's Permanent Secretary the acting Chairman said: "...this is a good report. We are almost lost for words and questions. I think it is appropriate to give praise where praise is due and I think it is very due here. Unusually for this Committee, can I ask you to take back to your colleagues who work with you our thanks and congratulations on what they did in helping to face this disaster."

4. DFID has close and frequent contacts and partnerships with others active in humanitarian response, eg an operational response grouping with Scandinavian, Dutch and Estonian colleagues. DFID takes every opportunity to share its techniques and to promote good practice as widely as possible.

PAC conclusion (ii): The Department should develop a wider selection of humanitarian relief partners to enable delivery of an even better response.

5. DFID agrees that it would be beneficial to maximise the range of partnerships available for channeling disaster relief in order to broaden capacity and choice. DFID will intensify its discussions with partners to develop this further.

PAC conclusion (iii): There should be more systematic co-ordination between the Department and the Ministry of Defence on the use of military assets in disaster relief, and a firm timetable should be set for agreeing such a framework.

6. In October 2006 DFID and the Ministry of Defence agreed a memorandum of understanding to systematise and strengthen co-operation with the military in disaster response. The Departments plan to test this memorandum on exercise in Africa early in 2007.

PAC conclusion (iv): The Department should publicise more widely its advice on how public donations may be best channeled.

7. DFID has produced a "How you can help" booklet on disasters to guide the public on the most effective ways to contribute. DFID will also place on its website a link to the Local Government International Bureau and the Local Government Association giving advice to and through local authorities.

PAC conclusion (v): Some 16 months after the disaster some £9 million had still to be spent by recipients out of over £50 million DFID grants made to third parties such as UN agencies and NGOs, raising concerns over UK taxpayers' money being properly used. The Department should obtain audited figures and recover unspent funds where appropriate.

8. £2.5 million of the £9 million has been returned to DFID. £3.8 million of the £9 million was channeled through the Asian Development Bank for water and sanitation work in Indonesia through a four-year recovery project in partnership with the Indonesian Government. DFID has now obtained accounts for all the remainder of the £9 million except for some £1 million, which we know has been spent, but for which we continue to press for full financial statements so that we can settle our accounts.

PAC conclusion (vi): The Department should work further to promote strengthening of the UN humanitarian aid system and collaborate on this with other Governments and agencies.

9. DFID has a substantial programme of work for reforming the international humanitarian system. We are a founder and champion of the Central Emergency Response Fund (CERF). We promote better co-ordination between international donors and NGOs. DFID launched a new White Paper in July 2006, which underlines our commitment to UN reform and better responses to humanitarian disasters. DFID is Chair of the Good Humanitarian Donorship initiative, working with major humanitarian donors to improve humanitarian assistance.

10. The UK made an important contribution to the UN Secretary General's Panel for system wide coherence, of which the Chancellor was a member. The Panel called for an enhanced humanitarian coordination role for the UN in emergencies, early recovery and prevention through established mechanisms. It also called for the CERF to be fully funded.

Fifth Report

Postcomm

Postcomm and the quality of services

1. In March 2006, Postcomm proposed, and Royal Mail accepted, a new quality of service and price control regime, replacing the existing regime of 2003. The new regime allows Royal Mail to increase the price of first and second-class stamps by 6 and 5 pence respectively between April 2006 and March 2010. It also sets quality of service targets and financial incentives aimed at improving mail services.

PAC conclusion (i): Postcomm's new quality of service regime does not target delivery and collection times, or items of mail lost by Royal Mail. Complaints data show these aspects of performance concern consumers. Postcomm should impose specific targets or financial penalties where it identifies persistent problems for consumers as a result of poor collection and delivery performance.

2. Postcomm accepts the recommendation. Postcomm is undertaking a review of customers' needs in relation to collection and delivery times. In conjunction with Postwatch and Royal Mail, we have commissioned extensive market research on these issues. The results, along with other important information such as consultation responses, will underpin our view on whether any regulatory intervention on collection and delivery times is required. We expect to publish our views on this around May 2007.

3. Royal Mail's most recent complaint data for the period from April to October 2006 shows that many more customers complain about lost mail than about collection and delivery times – 411,216 complaints about lost mail compared to 285 complaints about collection times and 8,781 about delivery times (out of a total of 870,552 complaints).

4. In the context of collections and deliveries, Postcomm has already introduced licence targets for:

- the percentage of collection points served each day (the target is 99.90 per cent, Royal Mail's performance as at Quarter 2 is 99.95 per cent); and
- the percentage of delivery routes completed each day (the target is 99.90 per cent, Royal Mail's performance as at Quarter 2 is 99.98 per cent).

5. Additionally, Postcomm has linked financial incentives for Royal Mail in the price control regime to these licence targets. If performance drops below 99.80 per cent, Royal Mail is permitted to recover less revenue from customers' i.e. it must reduce prices (or contain any permitted price increases below the level which would otherwise be allowed). Further penalties may also be applied, following investigation by Postcomm, if Royal Mail's performance falls below 99.40 per cent.

6. Royal Mail is also now required to publish its delivery and collection time specification. This states the latest delivery and collection times for different types of area (eg urban, rural, etc).

7. Royal Mail's estimates of the volume of mail lost, stolen, damaged or interfered with, suggest that mis-delivery of mail is the biggest cause of estimated mail loss, accounting for over half of estimated losses. Therefore in 2006 as part of the price control settlement, Postcomm introduced a new licence target for "correctly delivered" mail. Royal Mail is now incentivised to deliver correctly 99.50 per cent of mail. The most recent published performance as at Quarter 2 was 99.65 per cent.

PAC conclusion (ii): Royal Mail's schemes to compensate for the 15 million items of mail a year which are lost, stolen or damaged do not offer adequate protection for consumers. Compensation schemes are complex and hard for consumers to understand. Postcomm should improve consumer protection by introducing simpler schemes, which are easier for the consumer to understand and use.

8. Postcomm accepts the recommendation. On 30 November 2006, Postcomm published the first stage of a consultation on Royal Mail's compensation schemes for lost, damaged and delayed mail. One of Postcomm's key proposals is that there should be a single loss and damage compensation scheme (whilst retaining the compensation scheme for delay), drafted in accordance with a framework of principles requiring, amongst other things, simplicity and clarity. Postcomm's preference is for Royal Mail to draft this scheme, but Postcomm could draft the scheme, applying the same principles if customers and stakeholders thought that to be the better option. The consultation closes on 13 February 2007. Once it has considered the responses, Postcomm will publish a proposals document.

PAC conclusion (iii): Postcomm does not have information on the cost to Royal Mail of improving or relaxing its quality of service targets. Without this information Postcomm cannot be sure it is setting the appropriate targets or financial incentives. Postcomm should obtain this information before it starts planning for the 2010 price control.

9. Recommendation accepted. However, Postcomm is heavily reliant on Royal Mail making such calculations and providing this information.

PAC conclusion (iv): Certain postcode areas, particularly in London, experience consistently worse levels of services than others. Postcomm should research why some postcode areas persistently experience the lowest levels of service and press Royal Mail to develop a strategy for addressing these chronic problems over the current price control period.

10. This recommendation is rejected. Royal Mail's most recently published quality of service performance as at Quarter 2 shows that only one postcode area – Peterborough (PE) – out of a total of 118 is currently performing below the licence target to deliver 91.5 per cent of first class mail the next working day. At the end of Quarter 2 the PE postcode area was a narrow 0.2 per cent below the annual licence target. Royal Mail has indicated that it is likely to achieve the target by the end of the year. All London postcode areas are performing at, or above, their target.

11. Postcomm does not consider that conducting research is necessary or proportionate at a time when licence targets are being met. There are automatic adjustments to Royal Mail's revenue, if it fails to meet its licence targets. Postcomm considers that this mechanism provides appropriate incentives on Royal Mail to maintain its quality of service levels. However, Postcomm may investigate if performance deteriorates significantly, as it did some years ago.

PAC conclusion (v): Postcomm's investigation into Royal Mail's performance in 2003-04 lasted more than 12 months, longer than the legal time limit. Postcomm should set out clear criteria for judging and investigating poor performance by Royal Mail, so that the investigative process becomes more streamlined and decisions can be taken within a shorter time frame.

12. Postcomm accepts the recommendation. The automatic adjustments to Royal Mail's revenue, introduced in May 2006 as part of the 2006-2010 price control, creates more certainty for Royal Mail by introducing four clearly defined bands of regulatory action, in the event that Royal Mail does not meet its licence target for a particular product or service. They therefore give a clear indication in advance of the likely consequences of any given level of service quality. There is a *de minimis* band of 1 per cent (0.1 per cent for the collections completed, deliveries completed and correct delivery targets) below the service targets in the licence, which will not lead to any compensation requirement or regulatory action.

13. If performance falls below the *de minimis* band, but is not more than 5 per cent below the target, Royal Mail must reduce prices and / or pay compensation to customers. If any single service or product is 5 per cent (0.5 per cent for the collections completed, deliveries completed and correct delivery targets) or more below its target, Royal Mail will be presumed to be in breach of its licence, subject to consideration of evidence in rebuttal.

PAC conclusion (vi): In 2003-2004, Postcomm did not fine Royal Mail for missing all its targets, but in 2002-2003, it imposed a fine of £7.5 million for missing only two targets. Postcomm needs to take a consistent and accurate approach to its imposition of financial penalties on Royal Mail and it should evaluate the effects of these fines on Royal Mail's behaviour to determine if they are effective in encouraging improved performance.

14. Recommendation accepted. Postcomm's published policy on financial penalties explains the process by which it decides whether to impose a penalty and how it considers the amount of any penalty. Postcomm considers that penalties should be set at a level that encourages compliance with licence conditions. In 2006, Postcomm imposed three penalties on Royal Mail:

- 26 April 2006 – £271,000 for failing to meet its licence targets in three postcode areas – Royal Mail has paid this penalty. Royal Mail's quality of service has improved since the events (including Postcomm's investigation) that led to this penalty;
- 24 August 2006 – £9.62 million for failing to protect the integrity of the mail – Royal Mail has appealed against this penalty and has asked the Court to quash it. The appeal is due to be heard in March; and
- 14 September – £1 million for failing to ensure that it did not obtain unfair commercial advantage – Royal Mail has appealed against this penalty and has asked the Court to quash it. The appeal is due to be heard in May.

PAC conclusion (vii): Royal Mail still accounts for around 97 per cent of mail volumes in the regulated area. Competition has developed mostly through 'access' agreements, whereby Royal Mail signs commercial agreements to deliver post that has been collected and sorted by other companies. Postcomm should investigate whether the current arrangements for the access area of the market need to be changed in order to prevent Royal Mail from using its dominant position to hinder the development of competition.

15. Recommendation accepted. In the recent price control review, Postcomm introduced measures to prevent Royal Mail acting anti-competitively by squeezing the margins available to access operators, and signalled a review of the level of such margins in 2008.

16. Postcomm considers that the access regime has been a successful stimulant to the introduction of competition. It has also been instrumental in influencing Royal Mail's behaviour in a positive way. Postcomm also believes that access enables rival operators to build up the scale of their postal businesses and their consumer contact, allowing subsequent building of their own delivery networks. Where access to Royal Mail's delivery network is based on Royal Mail's reasonable costs for fulfilling such activities, this should not prevent the development of sustainable competition.

PAC conclusion (viii): Competition can lead to higher quality of service for consumers but could also conflict with consumer interests, for example if it threatens the universal service at a uniform tariff. At present, Postcomm largely relies on Royal Mail for notification of conflicts between competition and the interests of consumers. Postcomm should develop its independent analysis of the level and effects of competition on the UK postal market and identify and mitigate potential conflicts.

17. Recommendation accepted. Postcomm is, and has always been, committed to understanding the implications of its decisions on the maintenance of a universal service. Each year, a large proportion of Postcomm's internal and consultancy resources is spent on considering the interactions between competition and the financing of the universal service. Postcomm is also committed to consult widely on any of its major proposals to ensure it can fully take into account the views of all its stakeholders.



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