HM TREASURY

TREASURY MINUTES

Government responses on the Sixty Second to the Sixty Seventh Reports from the Committee of Public Accounts Session 2010-12

Cm 8335 March 2012

Treasury Minutes on the Sixty Second to the Sixty Seventh Reports from the Committee of Public Accounts: Session 2010-12

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Sixty Second Report

Department for Work and Pensions (DWP), HM Revenue and Customs (HMRC), and HM Treasury (HMT)

Means Testing

Report Summary from the Committee

The Government uses means testing to distribute at least £87 billion of benefits to claimants each year, around 13% of total public spending. The poorest fifth of households rely on means-tested benefits for a third of their net income. The Government is undertaking fundamental reforms of the benefits system, including the introduction of a new means-tested Universal Credit that will replace a number of existing means-tested benefits. In doing this the Government should ensure that it learns from the lessons of the past and coordinates benefits effectively in order to safeguard value for money for taxpayers and claimants.

No one department has overall responsibility for means testing and for ensuring consistency of approach. The issue is dealt with on a department by department basis, with 30 different means tested benefits being managed by nine departments and 152 local authorities in England. No one is responsible for determining how much assistance should be provided through means-tested benefits rather than through other forms of support, or for thinking through the implications of reforms across departments. For example, reforms to higher education, and the resultant bursaries provided by higher education institutions, could have important implications for families who claim means-tested benefits, impacting on incentives to work or to increase hours of work.

Departments currently have a limited understanding of how their design of benefits affects incentives for employment, the burden on claimants, take-up and administrative costs. The Department of Work and Pensions (DWP) and HM Revenue and Customs (HMRC) tend to focus on the impacts of their own large benefit programmes, but overlook other important benefits administered elsewhere, such as free school meals and Council Tax Benefit. Departments need to improve their understanding of how all benefits interact and how changes to eligibility rules can affect claimants. Complexity increases the burden on claimants which can harm take-up, and is likely to disadvantage the most vulnerable members of society in particular.

The Government expects Universal Credit reforms to simplify the system and improve incentives to find work. The DWP's priority is to focus on the effective delivery of these reforms. However, success will also depend on proper coordination between Universal Credit and other means-tested benefits, such as Council Tax Benefit and higher education bursaries that may now be delivered at a disaggregated and local level. In addition, DWP and HMRC are designing real-time information (RTI) system for Universal Credit to reduce the risk of overpayments, with benefits being recalculated as soon as circumstances change. Both DWP and HMRC need to understand how the introduction of this system will impact on small businesses and the self-employed who may not have the necessary IT to administer it.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department for Work and Pensions, HM Revenue and Customs and HM Treasury, as well as witnesses from Age UK, the Child Poverty Action Group and the London School of Economics.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

No single body is responsible for coordinating means testing across government. As a result there is limited oversight of the interactions of benefits that are based on means testing with each other and with those that are not. There needs to be clear responsibility for ensuring the system as a whole works for claimants and taxpayers and addresses the overall balance between means-tested and non-means-tested benefits.

HM Treasury has overall responsibility for ensuring that means testing is applied in a consistent and coordinated way across government. But the Department does not intend to take the direct lead, so it needs to allocate this responsibility to a designated Department or Agency that can be held accountable for the operation of means testing as a whole and the interaction between different benefits, whether means tested or not.

1.1 The Government disagrees with the Committee's recommendation.

1.2 Means testing is an efficient way of focusing financial support on those who will benefit the most. However, there may be undesirable consequences arising from the interactions between different forms of support, as well as outside factors. It is not possible to eliminate these entirely, but the Treasury recognises the importance of avoiding disincentives to work where it is possible to do so, and considers this when designing benefits for working age people. Through the introduction of Universal Credit, the Government will improve financial incentives to work whilst also greatly simplifying the current system of means tested benefits for working age people. There will also be greater coordination of means testing as a result of bringing around 80% of expenditure on means-tested benefits into a single department.

PAC CONCLUSION AND RECOMMENDATION 2

It is not clear what effect some means-tested benefits have on claimants' incentives to work. Improving incentives to work is a key objective of Universal Credit. At present there is no clear picture of how the entire benefit system affects claimants' incentives to work. Instead Departments focus their attention on the core DWP and HMRC benefits and do not look at the wider impact benefits such as free school meals have on incentivising claimants' behaviour.

The Committee expects Departments to do more to understand what impact multiple benefits have on an individual. In particular, the Treasury and DWP should ensure they understand how the wider benefit system affects incentives when they assess the impact of a policy change.

2.1 The Government agrees with the Committee's recommendation.

2.2 Universal Credit will provide a new single system of means-tested support for working-age people who are in or out of work. Support for housing costs, children and childcare costs will be integrated in the new benefit. It will also provide additions for disabled people and carers.

2.3 However, the Government recognises the importance of passported benefits such as free school meals and free prescriptions to claimants and to their decisions about moving into work. The Government aims to ensure that passported benefits are targeted to people that require them most and the Department for Work and Pensions (DWP) is working closely with other Government Departments and the devolved administrations to help them develop appropriate eligibility criteria for passported benefits in good time for the introduction of Universal Credit.

2.4 In June 2011, the Social Security Advisory Committee commenced an independent review of passported benefits and how they will link with Universal Credit, at the request of the Minister for Welfare Reform. The Committee have undertaken their review and the Government will publish its response alongside the final report no later than April 2012.

2.5 In relation to council tax support, the Local Government Finance Bill contains measures to set up local schemes of support for council tax, replacing council tax benefit. The Government will provide guidance to ensure that local authorities understand how to design schemes that supports the work incentive objectives of Universal Credit.

PAC CONCLUSION AND RECOMMENDATION 3

Departments do not understand the impact of administering more means-tested benefits locally. Many more bodies are now using means tests to determine eligibility to benefits, including local authorities for Council Tax Benefit and universities for bursaries. Locally determined entitlements could have a large effect on a family's total income and incentives, for example, if families lose entitlement to a student's university bursary when household income rises.

HM Treasury should work with DCLG, DWP and other affected departments to ensure that guidance to local bodies is consistent with broader welfare policies, and to identify the impact of locally-designed benefits on claimants.

3.1 The Government agrees with the Committee's recommendation on guidance, but disagrees with the Committee's recommendation that it should indentify the impact on claimants.

3.2 The Treasury provides, through its Green Book Guidance and its supplements (including its business case guidance), a standard best practice methodology for appraising the social welfare effects of policy including benefit changes. If properly applied, this includes a provision for all proposals to be considered in the light of their strategic fit with wider Government policy and for consideration of their wider social welfare effects. The Treasury will ensure that its guidance on these issues is passed on to local bodies as part of the wider package of guidance that is being prepared by DCLG and DWP in relation to localised benefits, but it is the responsibility of the local bodies or departments to use this guidance and identify the impact of locally-designed benefits on claimants.

3.3 In relation to the design of support for Council Tax, localisation will give local authorities a greater stake in ensuring local tax payers are supported into work, and greater control over how resources are used to achieve that. The Government will provide guidance on the technical details and the general principles of supporting work incentives, which will help local authorities to design support and consider interactions with Universal Credit.

PAC CONCLUSION AND RECOMMENDATION 4

The benefit system is difficult to understand and places a high burden on claimants. Some benefits, such as savings credit for pensioners, are extremely complex. Current reforms aim to move many claims online, and DWP are testing online systems to ensure they are easy for claimants to use. However, other initiatives to improve the claimants' experience are no longer being pursued. For example, the *Tell Us Once* programme allows claimants to inform one government agency of a death and that agency will then inform other public organisations. The *Tell Us Once* approach could be expanded to other changes in circumstances but this option is not being actively pursued.

DWP, along with other Departments with means-tested benefits, needs to develop a better understanding of the financial costs and other burdens placed on claimants applying for benefits. The Committee would expect this information to be used in delivering Universal Credit so as to improve benefit take-up.

4.1 The Government agrees with the Committee's recommendation.

4.2 The Government acknowledges that some benefits, such as savings credit for pensioners, are complex. In April 2011 a Green Paper on pensions reform was published (*A state pension for the 21st century*) in which a move to a flat-rate contributory state pension above the level of the Guarantee Credit was presented. Such a move could act to reduce the numbers of pensioners eligible for means-testing over the long-term.

4.3 While DWP recognised the value that a *Tell Us Once* approach to the reporting of changes of address would bring to both citizens that use the service and the taxpayer in general, the Government concluded that given the size of the challenge and the department's current work programme, it would not take this worthwhile project forward at this time. Despite this, DWP will continue to consider how it can broaden the coverage of the *Tell Us Once* service to cover other important changes that need to be reported to Government.

4.4 The complexity of the current benefit system makes it slow to react to changes in people's circumstances – for example: people who are afraid to seek work, as well as, making it expensive and difficult to administer. This fuels error by administrators and claimants alike and reduces benefit take-up as people do not understand their entitlements. It is central to the purpose of Universal Credit that it is a simpler system than the one it replaces – simpler to understand and simpler to access.

4.5 Supporting people into work is the key objective of Universal Credit. Universal Credit intends to top up earnings in a way that will make sure that there is a clear financial gain from working. A single taper rate and a simple system of earnings disregards will allow people in work to see clearly how much support they can get while making sure that people considering a job will understand the advantages of work. By removing the distinction between in-work and out-of-work support and making clear the potential gains to work, Universal Credit will reduce the risks associated with moves into employment that exist in the current system. At its heart, Universal Credit is very simple and will ensure that work always pays and is seen to pay.

4.6 Making a claim to Universal Credit will be digital by default – designed from the outset to be delivered by online self-service wherever possible. The sophistication of the online service available will increase over time. Claimants will:

- have online services for employment and benefit services, that will be increasingly integrated over time;
- be able to make a claim, do a 'what if' calculation to understand the impact on household income of changes in earnings, search for jobs, change circumstances and check the progress of their benefit claim online; and
- still receive face-to-face support in helping them get back to work – digital services will support and improve this service.

4.7 The Government is committed to involving users in the development of Universal Credit and is doing this through User Centred Design, a process in which the needs and behaviours of end users are considered throughout all stages of project design and delivery. Users' responses to proposals are tested on an ongoing basis, rather than expecting them to adapt to the final design.

4.8 Since March 2011, the Government has been undertaking fortnightly design sessions with users to investigate how best to administer Universal Credit and to gain feedback on the design of the online interface and the views of users on how Universal Credit could be made to work for them. The Government believes that the greater simplicity of Universal Credit, both in its design and delivery, will lead to a substantial increase in the take-up of currently unclaimed benefits. Most of this impact will be at the lower end of the income distribution.

PAC CONCLUSION AND RECOMMENDATION 5

Departments don't understand why administrative costs of means-tested benefits vary so significantly. The estimated cost of administering a new claim for Pension Credit is £351 while a new claim for Income Support costs £181. There remains little confidence in Departments' estimates of the unit costs of administering claims, although DWP has made some progress in identifying the factors that affect costs.

Without understanding the costs and benefits of different forms of means testing it is difficult for Departments to establish whether they are achieving value for money. DWP and HMRC must build on existing information to identify why their costs vary for different means tests and where efficiencies can be made.

5.1 The Government agrees with the Committee's recommendation.

5.2 The benefit processing and maintenance unit costs published in the DWP Annual Report and Accounts are calculated in line with the relevant international guidelines for public sector output and productivity measurement for National Accounts. The methodology and data systems have also been examined by a number of recent NAO reviews, for example: structured cost reduction and business plan indicators. The report of the structured cost reduction review referred to this as an accredited methodology.

5.3 Comparisons of the costs for administering new claims for Pension Credit and Income Support need to be made on a like-for-like basis. For example, the cost for Pension Credit claims includes the costs associated with Local Service home visits – the face to face service for Pension Credit customers using staff at a higher salary cost than the benefit processors and who incur considerable costs as they travel between customers' homes each day. DWP will continue to undertake further work to provide a more detailed explanation of the differences.

PAC CONCLUSION AND RECOMMENDATION 6

Real-time information systems will be difficult to implement for small businesses. The implementation of tax credits shows that lags in updating information about claimants can lead to billions of pounds of unanticipated overpayments. HMRC is developing a real-time information (RTI) system which will be central to Universal Credit reforms but HMRC has not established how RTI will affect employees in businesses that do not have electronic payroll systems.

HMRC must clarify how RTI will affect small businesses and the self-employed. To try to prevent a repeat of the problems that have affected tax credits, HMRC should develop an effective approach for those claimants and businesses that are likely to be outside the RTI system.

6.1 The Government disagrees with the Committee's recommendation.

6.2 Many small employers use a book-keeper or payroll bureau to operate their PAYE and will continue to do so under RTI. Small employers who operate PAYE themselves will be able to use the free HMRC Basic PAYE Tools submit their RTI returns. There are also free products available from commercial payroll software providers in addition to the more comprehensive products which are chargeable.

6.3 The self employed will not submit RTI. DWP will obtain earnings information direct from the self employed for Universal Credit purposes.

Sixty Third Report

Department of Energy and Climate Change (DECC)

Preparations for the rollout of smart meters

Report Summary from the Committee

Under European Directives, all member states are required to install 'intelligent metering systems' – smart meters – to at least 80% of domestic electricity consumers by 2020. The UK Government has opted for a more challenging programme, with plans for energy suppliers to install smart electricity and gas meters in all homes and smaller non-domestic premises in Great Britain by 2019. We welcome the introduction of smart meters, but have concerns over the way the programme has been planned. The Department of Energy and Climate Change (the Department) estimates that the smart meters programme will cost some £11.7 billion. This is a large complex programme requiring replacing around 53 million gas and electricity meters with significant uncertainties over the estimated costs and benefits involved.

In particular, it is far from certain that all consumers will benefit from the regulatory requirement placed on suppliers to install smart meters in their homes. The Committee recognised, however, that the Department will work to ensure that consumers do benefit from being able to monitor their energy costs. The costs of installing smart meters will be borne by consumers through their energy bills, but many of the benefits accrue in the first instance to energy suppliers. No transparent mechanism presently exists for ensuring savings to the supplier are passed on to consumers, and the track record of energy companies to date does not inspire confidence that this will happen.

The Department has acknowledged that it is accountable for delivering the programme, keeping the costs down and ensuring that consumers benefit through reduced bills from the lower costs borne by suppliers and reduced energy use. The Department insists that suppliers are best placed to deliver the programme and that competition between energy suppliers is the best way to ensure consumers benefit from suppliers' savings. The Committee are concerned, however, that past performance suggests that competition does not work effectively in this market and should not be relied on to keep prices low.

There remain significant uncertainties in a number of key areas in the programme. Consumers may not be willing to cooperate with the installation of smart meters: the communications programme which is promised for 2012 is therefore absolutely vital to help consumers use smart meters to reduce consumption. Significant practical difficulties may arise in procuring and installing the required data communications service before the planned roll-out of smart meters in 2014 (at a projected cost of £3 billion). The Department needs to address remaining uncertainties by conducting proper trials to identify and manage the risks associated with an IT project involving such a substantial amount of money which is financed by individuals as consumers.

The Department needs to ensure that the vulnerable, those on low incomes and those who use prepayment meters also benefit from smart meters. It would be unacceptable if these consumers bore the costs of smart meters through higher charges without getting a share of the potential benefits. The Government must put in place measures to ensure vulnerable people are not readily disconnected if they fall behind with payments.

There are issues around cyber security which need to be addressed if confidence in this new technology is to be gained by the population who are expected to have smart meters in their home and pay for them.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department on preparations for the roll-out of smart meters, including the procurement of the Data Communications Service.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

Consumers will have to pay energy suppliers for the costs of installing smart meters through their energy bills, but many of the benefits will pass in the first instance to the energy suppliers. The costs of installing smart meters will not be transparent in consumers' bills. Energy suppliers will benefit significantly from smart metering, for example, through cost savings on staff associated with automated meter reading. The Committee are sceptical that suppliers will pass on these benefits in full to consumers, given their track record and the failures of suppliers to reduce retail prices promptly when wholesale energy costs have fallen.

The Department needs to build consumer trust by ensuring suppliers report transparently the costs and savings of smart metering and the Department should set out clearly how it will review suppliers' implementation plans and monitor their performance and the information they give to ensure that the benefits are shared with consumers. The Department is relying on competition to drive down prices, but Ofgem have clearly found that the energy market is not functioning effectively as a competitive market. The Department must act to ensure open competition does prevail.

1.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: consultation in spring 2012 (in relation to paragraph 1.2).

1.2 The Government agrees that there is a need for transparency around the costs and savings of smart metering. The Energy Act 2011 gave the Department the power to amend licences to require suppliers to submit information on their smart meter rollouts. The Department will use this power to require suppliers to report on their progress on implementation and on the costs and savings they are making. The detailed approach in terms of what information will be collected is being developed and will be consulted on in spring 2012. The Department has committed to reporting annually on the benefits to consumers to provide transparency and help build confidence.

1.3 The Government notes the Committee's comments on competition in relation to smart metering. The Department's assessment is that an efficient and effective rollout of smart meters can be delivered by energy suppliers and that competition will ensure savings are passed through to consumers. The Department and Ofgem are taking steps to promote more effective competition in the energy market. For example, the Department has acted to reduce barriers to market entry and growth by raising the customer number threshold at which some Government obligations apply. The level at which small suppliers are obligated by the Carbon Emissions Reduction Target and the Community Energy Saving Programme has been raised from 50,000 to 250,000 customers. This should help small suppliers grow and increase competition.

1.4 As part of its Retail Market Review, Ofgem has proposed a range of measures aimed at encouraging consumers to switch suppliers by requiring suppliers to simplify their tariffs and billing information. In February Ofgem also published a consultation on their proposal to improve liquidity in the wholesale electricity market. The Department recognises the importance of a well functioning wholesale market and encourages measures that will deliver the liquidity that will drive competition and boost transparency for consumers. The Government will act where necessary to introduce reforms where the structural barriers to market entry are not addressed through the actions taken by Ofgem.

PAC CONCLUSION AND RECOMMENDATION 2

The benefits of smart meters can only be fully realised if there is widespread take up and consumers use them to reduce their energy bills, yet the role of suppliers in helping to achieve this remains undefined. To benefit from smart meters consumers will need to change their behaviour in response to the information the meters provide on consumption and costs, and change tariff and supplier where necessary to secure the best deal. The Department has some public funding for helping consumers to understand how to make best use of smart meters, and the Committee awaits its consumer engagement strategy due to be published in 2012.

The Department should clearly set out what energy suppliers' responsibilities will be for engaging with consumers to deliver the benefits; and how they will be held accountable to both the Department and consumers. The Department should also set out how it proposes to engage and inform consumers of the potential benefits to them. Furthermore, smart meters have a limited life and the Department, working with industry, should make absolutely clear the potential costs beyond the next decade.

2.1 The Government agrees with the Committee's recommendations.

Target implementation date: consultation in spring 2012.

2.2 The Department will be publishing, for consultation, its proposed approach to consumer engagement in spring 2012. This consumer engagement strategy will set out the Department's proposals on what energy suppliers' responsibilities will be and how this will be reflected in licence conditions so they can be held accountable. The consultation will also set out the steps that the Department will take to engage and inform customers of the potential benefits of smart metering.

2.3 The Department's Impact Assessment takes a long term view of the costs and benefits of smart metering, assessing the costs and benefits in the period to 2030. It takes into account the fact that, during this period, some smart meters will have to be replaced because they have reached the end of their operational life of 15 years.

PAC CONCLUSION AND RECOMMENDATION 3

The benefits from smart meters may not reach vulnerable consumers, those on low incomes and those who use prepayment meters. Already at a significant disadvantage when energy costs rise, the vulnerable, elderly and those on low incomes are at risk of not benefiting from smart metering. Introducing smart meters in this way by expecting consumers to pay for the installation is of itself regressive. Some consumers are not knowledgeable about energy suppliers and tariffs, which are difficult to understand, some do not have a bank account, so will miss out on savings from using direct debits, and some choose prepayment meters to allay the fear of disconnection.

The Department should set out how it intends to ensure vulnerable and low income consumers do not miss out on the benefits from smart metering. The Department must also ensure protocols are in place to ensure that vulnerable customers are not automatically disconnected if they fall behind with payments.

3.1 The Government agrees with the Committee's recommendations.

Target implementation date: consultation in spring 2012.

3.2 The Department will consult on proposals to address the needs of vulnerable and low income consumers in the consumer engagement strategy to be published in spring 2012. Evidence from the Energy Demand Research Project[1] indicated that consumers from areas of relatively high fuel poverty benefited at least as much as those from other areas. However, the Department recognises that some consumers, including some more vulnerable and elderly customers, may face additional challenges in

[1] http://www.ofgem.gov.uk/Sustainability/EDRP/Pages/EDRP.aspx

using the information to make savings. The consumer engagement strategy will therefore propose mechanisms for addressing this.

3.3 The Department's analysis also shows that, in the long-term, for prepayment customers there will be benefits from improved customer service (for example easier ways to top-up) and energy prices for prepayment are also expected to come more into line with those for other customers. The Department will monitor the experience of prepayment customers to ensure these benefits are being delivered.

3.4 Protocols have already been put in place to ensure that vulnerable customers are not automatically disconnected if they fall behind with payments. Ofgem introduced licence modifications and accompanying guidance, which came into effect on 1 October 2011, requiring suppliers to take vigorous action to identify vulnerability in a household when disconnection is being considered.

PAC CONCLUSION AND RECOMMENDATION 4

Trials so far have been inconclusive about consumers' willingness to cooperate with the installation process and to use smart meters to reduce their energy consumption. There are also uncertainties around the practicalities of the proposed timetable for procuring a new system, installing the data communications system, and the rolling-out of smart meters to every home in Great Britain.

The Department told us it expects to gather more evidence during the two years remaining before the start of the roll-out in 2014. To make the best use of this time, the Department should identify the remaining uncertainties and address these by conducting proper trials to gather the robust evidence it needs to identify and manage the remaining risks.

4.1 The Government agrees with the Committee's recommendations.

Target implementation date: ongoing through to 2014.

4.2 There is a strong evidence base from the Energy Demand Research Project and international trials about the levels of savings that can be achieved from smart metering. However, the Department will continue to gather evidence of practical experience, which will inform and direct the mass rollout. The period before the start of mass rollout in 2014 (known as the Foundation stage) is a vital opportunity to test and trial both smart metering technology and different approaches to consumer engagement.

4.3 During the Foundation stage, suppliers will be gaining experience of the practical and technical challenges associated with the installation of smart meters. This will build industry and the Department's understanding of these challenges and inform plans going forward. The Department is sponsoring trials of different technologies for communication in the home. It is also working with industry to determine the requirements for any additional targeted testing and trialling including the arrangements for the end-to-end system testing before the Data and Communications Company becomes operational.

4.4 Suppliers are also using the Foundation stage to test different approaches to consumer engagement, such as alternative forms of feedback or working with third parties. The Department is reviewing existing and planned supplier trials, and working with suppliers to help resolve remaining uncertainties, and to ensure relevant learning for the programme is drawn out. The Department is also considering the scope for trials on other aspects of consumer engagement, including working with local communities, which suppliers may have less of a commercial incentive to pursue.

PAC CONCLUSION AND RECOMMENDATION 5

The data communications service required to link smart meters to suppliers is a complex IT project that may cost as much as £3 billion. There is a risk that the smart metering system may not be able to support the development of smart grids, designed to better match electricity supply and demand, without incurring additional expenditure to modify or upgrade the meters and the data communications system.

The Committee expects the Department to take on board the lessons learned from other large Government IT programmes and to ensure that the contracts they place are sufficiently flexible to cater for smart grids and avoid additional costs falling to consumers.

5.1 The Government agrees with the Committee's recommendation.

5.2 The Department's aim in procuring the data and communications services necessary to delivery smart metering in parallel with the licensing of the Data and Communications Company is to bring forward the economic, consumer and environmental benefits whilst leaving the system under the management of a regulated private sector organisation. As such, the Department will undertake the procurement on behalf of the future licensee, but the contracts will be signed, financed and operated privately on behalf of energy suppliers, network operators and energy service companies.

5.3 The Department recognises that this is a complex and long term system that will need to adapt to meet the changing needs of consumers and the energy industry. Considerable work has been undertaken with stakeholders to consider in detail what the system must deliver in order to realise the identified smart metering benefits and to provide for future smart grid and demand side response benefits where these are expected to deliver significant additional value.

5.4 Taking on board lessons from previous experience, the Department is therefore placing considerable emphasis on operational and commercial flexibility through its setting of requirements, procurement evaluation criteria and contractual mechanisms, so that new or amended data and communications services can be introduced effectively and economically.

PAC CONCLUSION AND RECOMMENDATION 6

The Department and energy suppliers face significant challenges to install smart meters in every home in the country. The Department is confident that it has adequately accounted for the risks involved in the smart metering programme, particularly the risk of cost escalation. The Committee notes these assurances, but does not share the Department's optimism. The Committee expects the Department to proceed on the basis of detailed plans underpinned by robust evidence. The Committee welcomes the Department's confirmation that it will be reviewing progress and could pull the plug or subsequently rethink its approach if the programme is not delivering for consumers.

The Department should report to this Committee in 2013 on: its progress in addressing the issues the Committee has raised; the reasons for any further changes in the estimated costs and benefits from proceeding with the roll-out in 2014; and its plans for monitoring and reporting on actual costs and benefits through the roll-out.

6.1 The Government notes the Committee's recommendation and will report on progress to the Committee in 2013.

6.2 The Government has also committed to Parliament to publishing an annual report on smart metering. The first report is due to be published by the end of 2012.

Sixty Fourth Report

Department for Environment, Food and Rural Affairs (DEFRA)

Flood risk management in England

Report Summary from the Committee

Flood protection is a national priority and features on the National Risk Register of Civil Emergencies. Recently the annual cost of flood damage has been £1.1 billion and is set to rise, and 5.2 million homes are at risk of flooding. In 2010-11 the Department for Environment, Food and Rural Affairs (the Department) spent £664 million on flood and coastal risk management, 95% of which went to the Environment Agency (the Agency).

There have been significant changes in the funding arrangements. In 2009 the Agency projected that its flood risk management budget needed to rise by 9% during the spending review period (2011-12 to 2014-15) to sustain current levels of protection, particularly because risks are growing due to climate change. However during the same period the Agency's flood risk management budget has been reduced by over 10%.

The Department advised that through efficiency savings and the improved use of resources this budget cut will not reduce capital expenditure on flood defences in this spending review period. However, the Agency had not yet adjusted its long-term investment strategy and could not tell the Committee what the scale of the long-term funding gap would be.

The Department has developed an approach to encourage more funding from local sources including private companies and from local authority levies. The Department told the Committee that it wants to increase local contributions from £13 million to a £43 million contribution from such sources, although it had not secured these commitments. Expecting an increase in local authority contributions when their resources are reducing may well be overoptimistic.

The Committee was very concerned that the Department did not accept ultimate responsibility for managing the risk of floods. The Department told the Committee that it shared responsibility with the Agency and local bodies. The Committee are concerned that there is no clarity about where the buck stops. It is not acceptable that local people do not know clearly where responsibility for decisions lies and which body is answerable when things go wrong.

The Department relies on inconsistent and unstructured intelligence on local flood risk management performance. Local authorities are producing risk assessments but the Department does not have plans to assess their quality. The Department needs reliable information to inform its decisions on when and where to intervene if local risk management plans are inadequate.

As local communities are being asked to pay more towards flood protection and take on more of the risk, the Agency needs to improve how it involves them in the decision making process and improve the skills of its staff in this regard. Localism is not just about devolving responsibility to local bodies but also about engaging the community in the decision-making process. At present consultation arrangements on flood defence proposals are not consistent across the country and some people feel the Agency is not listening to their concerns.

The agreement between the Department and the insurance industry that insurance cover will be provided to households at risk of flooding ends in 2013. In some areas premiums appear to have risen as a result of growing uncertainty over local levels of protection. The Department does not monitor insurance charges but it still needs to come to an early revised agreement with industry in order to reduce uncertainty for affected householders.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department of Environment, Food and Rural Affairs and the Environment Agency on how they manage flood risk in England.

Government responses to the Committee’s recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The current strategy for long-term expenditure on flood protection anticipated a higher level of central government funding than is now likely to be available. Risk of flooding affects some 5.2 million homes and the actual cost of flood damage is £1.1 billion and is set to rise. The Agency assured us that during the current spending review period planned capital expenditure would continue to be achieved through efficiency savings and the improved use of resources. However, it is not yet clear how the money required to maintain and improve flood protection in the longer term will be found.

The Agency needs to publish a new long-term strategy reflecting current funding realities in which the assumptions underlying its plans are transparent.

1.1 The Environment Agency agrees with the Committee's recommendation.

Target implementation date: 2013

1.2 The Environment Agency has committed to make a 15% efficiency saving through its procurement strategy for flood and coastal defences. These efficiencies, which will be reinvested into safeguarding and enhancing protection for people and properties, will be achieved through a combination of planning, operational and procurement initiatives. The Environment Agency will sequence work more effectively, embed project packaging approaches, develop longer term programmes of work and use its partners’ planning skills to identify further opportunities for commercial efficiency.

1.3 Within the new Sustainable Engineering Procurement Strategy, savings are being generated from improving the control of project scope, increased standardisation and outcome-based specifications that encourage cost saving and innovation. The use of co-located project teams and bulk purchasing will also contribute to these efficiency savings.

1.4 The Long Term Investment Strategy, published by the Environment Agency in 2009, sets out scenarios describing different future levels of flood risk with a number of potential levels of investment. The Environment Agency has commenced a project to update the evidence underpinning the Long Term Investment Strategy for submission to Ministers in 2013. This will describe the potential changes to flood and coastal risk, depending on the amount of funding available from all sources, being clear about the assumptions made for each scenario.

PAC CONCLUSION AND RECOMMENDATION 2

It is unclear whether local contributions will be sufficient to replace funding that has previously been provided nationally. The Department has developed an innovative approach to attracting local funding. However, the Committee are sceptical about how much it can rely on funding from local sources when local authorities are facing their own funding challenges and balancing many pressing needs. In addition, more complex partnerships and funding agreements will mean schemes take longer to put in place and may cost more to develop.

The Department needs to support local authorities to bring in local partnership arrangements that are clear, transparent and not overly bureaucratic.

2.1 The Government agrees with the Committee’s recommendations.

Target implementation date: April 2012

2.2 The Environment Agency is publishing guidance to help all risk management authorities establish successful partnerships to deliver projects involving more than one funding source.

2.3 The new Flood and Coastal Resilience Partnership Funding policy was introduced in order to increase overall investment levels, enable more local choice, and further improve value for taxpayers' money. External funding towards projects is supplementing national budgets, rather than displacing central funds. The goal to protect 145,000 households by March 2015 is not reliant on the level of local contributions. Contributions will increase the size of the investment programme and mean more projects can proceed. Early indications suggest that up to a third more schemes will be able to proceed in the coming years as a result of the £72 million in external contributions that have been secured to date for the 2012-13, 2013-14 and 2014-15 financial years.

2.4 The new system does not make any assumptions about how external funding may be found. Projects under the new system have secured funding from a range of public and private sector interests. The system incentivises partners to look first to reduce the costs of projects where possible. Despite the current economic situation, several local authorities have committed to part-fund important local projects.

PAC CONCLUSION AND RECOMMENDATION 3

The Department has no way of knowing whether local flood management systems are adequate or when it should intervene. There is no timetable for producing local flood risk management strategies and the Department relies on influencing local authorities through encouragement and guidance. The Department is unable to guarantee that it will receive the information it needs to monitor flood defences effectively and it is unclear who is ultimately responsible for ensuring flood defences are adequate.

The Department needs to articulate what information it will rely on to evaluate local risk management strategies and be clear about when and where it will intervene should local plans be inadequate. The public need to know and understand where responsibility and accountability lie.

3.1 The Government agrees with the Committee's recommendation.

Target implementation date: 2015.

3.2 The Flood and Water Management Act 2010 clarifies the leadership role of the lead local flood risk authority to develop, maintain, apply, publish and monitor a strategy for local flood risk management in its area. These local strategies will inform the public about the roles and responsibilities flood risk management authorities in their area.

3.3. Sir Michael Pitt's review made it clear that national oversight should be matched by local accountability to ensure that local arrangements are fit for purpose. To secure this, an amendment was made to the Local Government Act 2000 giving local authority overview and scrutiny committees powers in relation to local flood risk management which can include the evaluation of local flood risk management strategies.

3.4 The Department requires lead local flood authorities to report annually on their implementation of the Act, including the development of their local flood risk management strategies, the number of investigations carried out under section 19 of the Act into floods in their area, the number and role of staff employed on flood risk management activity, the number of properties estimated to be at risk from local flooding sources and the number of properties where flood risk has been reduced. The Environment Agency will report annually to the Department on national flood and coastal erosion risk management including the role of lead local flood authorities for local flood risk management and the status of local flood risk management strategies. Using this information and a representative sample of local strategies, the Department will evaluate the effectiveness of these arrangements by the end of 2015.

PAC CONCLUSION AND RECOMMENDATION 4

Local communities need to have confidence in the decisions made on managing flood risk but do not always feel involved in the decision-making process.

The Agency needs to engage with communities and other local sources of expertise on preferred solutions, particularly as local communities are being asked to pay more towards flood protection. The Agency should look to improve its consultation processes so they support more meaningful local engagement.

4.1 The Environment Agency agrees with the Committee's recommendation.

Target implementation date: 2012

4.2 The Environment Agency is working successfully with many communities across England and Wales to help them manage and reduce their flood risk, but recognises that there is always more that can be done. Through the implementation of the Environment Agency's Flood and Coastal Risk Management Change Programme, the management structure will be revised to help ensure that it continues to develop better engagement with its partners and communities. Throughout 2012, the Environment Agency will continue to focus on developing the skills of its staff and to develop further tools, such as e-consultation approaches, to facilitate the way it engages with local communities.

4.3 The Environment Agency works closely with lead local flood authorities and other partners when engaging with local communities, including when it develops options for managing flood risk that benefit local communities. The Environment Agency will continue to work collaboratively with other risk management authorities to ensure that the communities affected can fully participate in, and contribute to, the decisions made to manage their local flood risk.

4.4 Through implementation of "*Working with Others"* and "*Flood Wise"* initiatives, the Environment Agency will continue to improve how it engages with local communities. The "*Flood Wise"* initiative has informed over 738,000 people about their flood risk, and through new ways of working, driven by the Flood and Coastal Risk Management Change Programme, the Environment Agency will make its local engagement even more effective.

PAC CONCLUSION AND RECOMMENDATION 5

In light of speculation about the levels of funding available to provide effective flood protection, there is uncertainty over the future availability and affordability of insurance cover for properties in risk areas. The existing agreement between the Department and the insurance industry which guarantees availability of insurance ends in 2013. The Department is leaving it late to reach a new agreement and this will lead to uncertainty and worry for affected households and communities.

The Government needs to reach an agreement with the insurance industry urgently and work more closely with the industry to ensure insurance cover is both available and affordable.

5.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: Spring 2012

5.2 The Government is working closely with insurers to set out what customers can expect once the existing agreement expires in 2013. The Government agrees that availability and affordability of insurance are important. The best way to ensure affordable insurance into the future is to invest in long-term risk reduction rather than subsidising insurance. That is why Government is investing £2.17 billion on flood and coastal erosion risk management in the spending period up to March 2015, providing better protection to over 145,000 homes.

5.3 However, the Government does not agree that that the existing agreement guarantees the availability of insurance. The Statement of Principles provides some reassurance about the continued

availability of flood insurance in specific circumstances, but it does not guarantee cover to all. For example, it does not apply to the majority of households at significant flood risk, nor to homes built since January 2009. It does not influence insurers' pricing of policies; these are commercial decisions taken by insurers independently and are unaffected by the agreement. In practical terms, the Statement of Principles has done little to ensure cover remains widely available and it does not cover affordability.

5.4 In the past, insurers have charged all policyholders a similar price for flood cover, regardless of how likely future flood damages might be. This means that customers at low or no flood risk have been subsidising the costs of flood insurance in high risk areas through their premiums. Competitive pressures together with more sophisticated tools for assessing risk, means that prices in significant flood risk areas are generally increasing to reflect the probability of claims. This is a trend that has happening for some time - research by the Association of British Insurers suggests that around a fifth of customers in significant flood risk areas already pay a risk-reflective price.

5.5 Risk-based terms encourage households and communities to consider what measures can be taken to reduce local flood risk. However, the Government understands the impact that increasing insurance bills may have on lower-income households in flood risk areas. This is why there is continuing work, with insurers, to consider the case for additional measures to address this problem. The Government will consider whether there are feasible, value for money ways of targeting support to help those most in need, to inform further announcements in the spring 2012.

Sixty Fifth Report

Department for International Development (DFID)

DFID: transferring cash and assets to the poor

Report Summary from the Committee

The Department for International Development's (the Department's) transfer programmes deliver cash, food and assets, such as livestock, directly to people living in poverty. Transfers can be used to tackle a range of issues, such as hunger and malnutrition, or access to health and education services, in a variety of contexts. In 2010-11 the Department spent £192 million on social protection programmes, which includes its transfer programmes.

The evidence that the Committee heard suggests transfer programmes are effective in targeting aid, and ensuring the money goes directly to the poorest and most vulnerable people. There is strong evidence of short-term benefits for recipients of transfers, for example better nutrition and greater access to health and education services. Research following-up recipients over a number of years after their participation has so far only been done on one transfer programme. While the results of this longer term evaluation are encouraging, overall there is less evidence for longer-term impacts. No aid spending can be fully immune to waste and fraud, but transfer programmes appear to be less risky than other methods, especially when money can be tracked through electronic payments, as has been done in Kenya.

The Committee are surprised that the use of transfer programmes has not increased more in light of the evidence of positive outcomes. The Department only plans to support transfer programmes in 17 of its 28 priority countries. It does not have an overall strategy for the use of transfers and its decisions on where to support transfer programmes look reactive. The decision as to whether or not to propose a transfer programme is taken by staff working in the country and it is not clear why there are extensive programmes in some countries and none in others.

The Department does not collect data on all the costs of the transfer programmes it supports. For example it does not factor in the cost of diverting health and an education professional to act as payment administrators, as is done in some programmes. The Department is therefore unable to say whether it is lifting more people out of poverty for every pound spent on transfers compared to other programmes. It also lacks information to compare the efficiency of running programmes at district or neighbourhood level. However, the Committee are encouraged that more attention is being given to this area; the Department recently published guidance for its country offices that provides advice on data collection and evaluation. The Committee also welcomes the Department's greater transparency in publishing business cases and reviews, including those for transfer programmes.

The Department's long-term objective is for the governments of recipient countries to take on the responsibility of owning and funding transfers as part of a sustainable social security system. However, the Department has not been clear about how individual programmes will be sustained. It is likely that many transfer programmes can only continue with funding from the Department as in many of its priority countries even a basic social security system may be unaffordable and unrealistic.

On the basis of a Report by the Comptroller and Auditor General, the Committee took evidence from the Department for International Development.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The Department has brought real benefit to poor individuals and communities through the use of transfers. Short-term benefits include getting food directly to families and greater access to health and education. Measurement of long-term benefits is still in its early stages but, where there has been assessment in Bangladesh, benefits outweighed costs by over three times.

The recommendations which follow are intended to help improve the Department's approach to transfers so that they can get better value for money from their use.

1.1 The Government welcomes the Committee's report and its findings.

PAC CONCLUSION AND RECOMMENDATION 2

The Department does not have an overarching strategy for the use of transfer programmes even though these programmes have positive short-term impacts for recipients. The Department produces guidance on when and how to use transfers, but there is an inconsistent approach to their use – Department offices in 11 of its 28 priority countries are not yet planning to use them. While it is understandable that the Department is wary of expanding too fast and making mistakes, given the benefits there should be a systematic consideration of whether transfers could apply in other or all priority countries, although using transfer payments has to sit alongside other interventions to improve essential health and education services.

The Department should produce a clear strategy for the use of transfers, including expected future levels of spending and develop a framework to ensure decisions about their use in each priority country are taken on a consistent basis.

2.1 The Government notes the Committee's recommendation.

Target implementation date: End 2012.

2.2 The Department will look further at where transfers could be used more. Transfers are an instrument to achieve outcomes in areas such as food security and nutrition, rather than an end in themselves. The Department relies on country offices to recommend which instruments offer the best value for money in meeting objectives. A strategy with spending targets that need to be adhered to could result in programmes which offer lower value for money.

2.3 In the Bilateral Aid Review in 2011 country offices systematically considered transfer programmes in relation to local context and other priorities such as health and education. These findings were then reviewed by senior management and external experts. The Review resulted in ambitious expansion plans for the Department, from nine countries in 2009 to seventeen in 2014, including new programmes in South Sudan, Democratic Republic of Congo and northern Nigeria. This expansion will form the Department's strategy, although it has arisen from a bottom-up process rather than originating in the Department's headquarters.

2.4 The Department is satisfied that the eleven priority countries that were not planning transfer programmes had sound reasons for not doing so, in terms of opportunities on the ground, alternative demands for resources and the activities of other donors and partner governments. But we will look further at this. As the Committee acknowledges, it is important the Department does not move ahead of local political and practical reality in seeking to support transfer programmes.

PAC CONCLUSION AND RECOMMENDATION 3

When setting up transfer programmes, the Department has not identified whether or how it expects them to be sustained and where future funding will come from. Ideally the Department wants governments of recipient countries to take on the responsibility of owning and funding transfers in the long term, but this is very unlikely in some countries. Some low income countries only collect between 7% and 10% of GDP in tax and so basic welfare systems that distribute between 2% and 6% of GDP are unlikely to be introduced. Many transfer programmes will therefore be reliant on international funding for the foreseeable future.

The Department needs to be clear from the outset whether and how it expects each programme to be sustained in the long-term, by donors or by government, setting out the expected sources and levels of funding over time.

3.1 The Government agrees with the Committee's recommendation.

Recommendation implemented: value for money guidance has already been published.

3.2 The new publication, *Guidance for DFID country offices on measuring and maximising value for money in cash transfer programmes*, referred to by the Committee, addresses the issue of funding sustainability. Specific variables are recommended on partner government costs as a proportion of recurrent government spending and GDP. The guidance also recommends collecting evidence on tax revenue growth and fiscal balance and on partner governments' commitment to funding programmes after the Department's and other donors' funding has finished.

3.3 The Department will monitor the implementation of the guidance on sustainability, and in other areas, by reviewing programme business cases and other programme documentation, and by surveying country office advisers.

PAC CONCLUSION AND RECOMMENDATION 4

The Department has a limited understanding of the long-term impacts of its transfer programmes. Some programmes are relatively new so an assessment of the long-term effects cannot yet be made, but there are also established schemes where this assessment has not been done. The Department has committed to improve its evaluations of all programme's including looking at the impacts a number of years after the intervention.

When it sets up new programmes the Department needs to put in place measures that will enable it to assess the long-term impacts. It should do appropriate research and evaluation to track whether the benefits are sustained for those people and communities who no longer receive transfers.

4.1 The Government agrees with the Committee's recommendation.

Target implementation date: June 2012**.**

4.2 Long term impacts are already being measured in Bangladesh, Ethiopia and Kenya. All other new programmes have monitoring and evaluation plans built into their design. The new publication, *Guidance for DFID country offices on measuring and maximising value for money in cash transfer programmes* will be strengthened in the area of measuring long term impacts. The Department will also circulate to country offices brief additional guidance on programme evaluation of transfer programmes including measuring long term impacts.

4.3 Measuring long run impacts requires at least one follow up survey to be carried out after the programme has ended. This may not be possible in all circumstances, for example in very fragile environments. It may be more difficult to do where scaling to a national level makes it harder to look at the counterfactual (the world in the absence of the programme). The Department will take account of the need to build local systems at the same time as evaluating programmes which may involve some

compromises on quality and timing of follow up surveys and evaluations.

PAC CONCLUSION AND RECOMMENDATION 5

The Department's ability to evaluate the value for money of transfers is undermined by gaps in data on cost and performance. While transfer programmes appear to be effective, the Department does not have a handle on the full costs or benefits of its programmes. This includes the cost of administering transfer programmes, which is of particular concern when health and education professionals are diverted from their core roles to act as payment administrators, as in Zambia. The Department is also unclear about changes in costs over time as programmes move from set-up phase to steady state. The Department is thus not able to say if it is achieving the best value from each programme, nor can it make valid comparisons between programmes.

The Department agreed to obtain better and more standardised cost data and will report back to us on its progress in two years' time. The Department should obtain sufficient data to compare cost-effectiveness across its portfolio which will allow it to reduce administrative costs, where there is scope to do so, and improve value for money.

5.1 The Government agrees with the Committee's recommendation.

Target implementation date: Early 2014.

5.2 The new publication *Guidance for DFID country offices on measuring and maximising value for money in cash transfer programmes* makes recommendations on estimating full programme costs. Some costs may not be directly measured if the cost of doing so is judged disproportionate to the size of those costs. The Department's guidance recommends how to monitor key costs over time, from set up to steady state and gives international benchmarks to check costs are not inflated.

5.3 The Department will measure cost efficiency across its transfer programmes. The extent to which it can measure cost effectiveness across programmes depends on whether the same outcome variables are measured. These depend on the original programme purpose and so cannot be easily standardized. The Department's guidance suggests measuring the unit cost of a percentage point reduction in poverty gap among beneficiaries as one measure of cost effectiveness.

PAC CONCLUSION AND RECOMMENDATION 6

The Department has not assessed what level of individual transfers will provide the best return on its investment. Whilst an extra few pence a day will allow very poor people to access more food, such a small cash transfer will obviously not transform lives on its own.

Larger amounts transferred to recipients are likely to have a more substantial and long-lasting effect and may therefore be better value for money, but the Department has not tested this hypothesis. We welcome the commitment from the Department to examine this issue in its programmes in the future. The Department should routinely assess the benefits generated by different transfer amounts and gather evidence from pilots where possible.

6.1 The Government agrees with the Committee's recommendation.

Target implementation date: Early 2014.

6.2 The Department will recommend country offices assess the level of transfer values at different stages of programmes, including pilots, accepting that transfer values remain a compromise between coverage and maximising impact, and also must not be set at a level that compromises financial sustainability. The Department's value for money guidance recommends variables to monitor the real value of transfers and recommends regular reviews of transfer levels.

6.3 It is not always possible to test transfer values experimentally during programme design because of local political sensitivities. Where it is possible and politically acceptable the Department is already testing transfer levels, for example in Ethiopia, and also different levels for different groups, as in Bangladesh. Where it is not possible politically the Department has not tested different transfer levels, for example Kenya and Zambia.

Sixty Sixth Report

HM Treasury (HMT), Department for Transport (DFT) and Department for Education (DFE)

Excess Votes in 2010-11

Report Summary from the Committee

The Committee of Public Accounts scrutinises the reasons behind individual Departments exceeding their allocated resources, and reports to the House of Commons on whether it has any objection to the amounts needed to rectify the reported excesses. The Committee may also make recommendations to Departments concerning the causes of these excesses.

In 2010-11, two bodies breached their expenditure limits:

- The Department for Transport breached its Net Cash Requirement by £335.2 million, primarily because of weaknesses in monitoring its budget for the operation of its rail franchises.

- The Teachers' Pension Scheme (England & Wales) breached its Net Cash Requirement by £11.9 million because the Department for Education underestimated the number of members that would retire in 2010-11 and overestimated the contributions that would be collected from employers.

On the basis of an examination of the reasons why these two bodies exceeded their voted provisions, the Committee have no objection to Parliament providing the necessary amounts by means of an Excess Vote. Nevertheless, the Committee expects both bodies to set out what actions they have taken to improve their financial management and avoid exceeding their allocated resources in the future.

The Committee also expects the Treasury, as the UK's Ministry of Finance, to ensure Departments are fully aware of the need to operate within their voted provisions. The Treasury should monitor the progress Departments are making against their Estimates on a timelier basis and, where necessary, take appropriate action to stop Departments exceeding their provision.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

In 2010-11, the Department for Transport and the Teacher's Pensions Scheme (England and Wales) exceeded spending limits approved by Parliament. The excesses occurred as a result of weaknesses in cash management.

Under the terms of the Standing Order of the House of Commons number 55(3)(c), the Committee recommends that Parliament provides the additional resources and cash requested by means of an Excess Vote, as set out in the table below.

DEPARTMENT	RESOURCES		CASH	
	Excess £	Amount to be voted £	Excess £	Amount to be voted £
Department for Transport Excess expenditure	0	0	335,197,000	**335,197,000**
Teachers' Pension Scheme (England & Wales) Excess expenditure	0	0	11,875,000	**11,875,000**
Total	0	0	**347,072,000**	**347,072,000**

1.1 The Government agrees with the Committee's recommendation.

PAC CONCLUSION AND RECOMMENDATION 2

The Department for Transport breached its Net Cash Requirement by £335.2million due to the Department monitoring its overall budget for the operation of rail services on a net basis rather than a gross basis. The Department received £527.7 million income in excess of its Appropriations in Aid limit approved by Parliament but, instead of surrendering receipts related to the excess income to the Consolidated Fund, they spent £335.2 million of it. The surplus cash was available because the Department generated more income than expected on its rail franchises, but the Department did not seek a Supplementary Estimate to increase its operating Appropriations in Aid limit.

The Department for Transport should set out, in its reply to the Committee, what it has done to improve the financial management of its rail budget and how these actions will prevent a similar breach occurring in the future.

2.1 This reply sets out the Department for Transport's actions to prevent recurrence.

2.2 The changes to the budgetary control framework, brought in from 2011-12 under the Government's Clear Line of Sight initiative, have removed the concept of Appropriations-in-Aid and with it the separate control limits on gross income and expenditure. There is no longer a need to monitor income from train operating companies on a gross basis, separately from revenue support payments made to them, for Parliamentary control purposes.

2.3 Nonetheless, the Department has recognised the need for more effective management of the overall budget for support for passenger rail services, including a better understanding of its overall financial position in respect of each train operating company. The Department has undertaken a number of actions to ensure that no breach occurs of any of the control totals under the new budgeting framework.

2.4 The Department monitors its financial position with respect to each train operating company. Regular financial reports to the Departmental Board now include information setting out the Department's forecast budget position in respect of each of the train operating companies, with a note of significant budget risks and opportunities, and the total forecast budget variance is related to the financial performance of the Department as a whole. Separate financial ledgers for rail and the rest of

the central Department were merged from April 2011. This has made it possible to monitor the Department's overall budget in a more integrated manner.

2.5 The Department introduced a new Group Operating Model for its finance function as part of a Departmental restructuring in 2011. This has brought responsibility for managing the budget for Rail, including support for passenger rail services, within the responsibility of the Group Finance Director. This has facilitated closer working between those responsible for managing the rail budget, and those responsible for overall management of the Department's budget and preparing the Department's Supply Estimates.

2.6 The Department also recognises the need to ensure that all relevant staff understand the importance of monitoring all budgetary control totals. Mandatory training sessions were run for all Departmental finance staff to ensure an understanding of the new budgetary control regime applicable from 2011-12. All Directors General were reminded, in their 2011-12 budget delegation letters, of the need to monitor their budget by each control total under the new regime, not just their net budget position. A finance master class has also been provided for Departmental Board members.

2.7 In preparation for the Department's Supplementary Estimate for 2011-12, clear guidance was issued to all areas of the Department, covering the type of changes which each business area needed to identify, so that all changes affecting any of the Parliamentary control totals were properly reflected.

PAC CONCLUSION AND RECOMMENDATION 3

The Teachers' Pension Scheme breached its Net Cash Requirement by £11.9 million because it underestimated the number of members that would retire in 2010-11 and overestimated the contributions that would be collected from employers. The Scheme has incurred four excess votes in recent years, three times due to poor cash forecasting.

The Department for Education should set out in its reply to the Committee what measures it has taken to prevent future excess votes in the Teachers' Pension Scheme. The Committee would expect the Department's internal auditors to review the Scheme in the coming year to assess the adequacy of the measures put in place.

3.1 The Government accepts that the Department for Education should strive to prevent future excess votes and sets out here what action has been taken.

3.2 Parliament expects departments to submit for approval Estimates based upon taut and realistic spending plans. This means that the amount of provision sought in the Estimates must reflect the department's best view as to the amount of expenditure likely to take place in that financial year. The amounts sought in the Estimate should be neither more (perhaps in order to provide a buffer in case of unexpected additions) nor less (perhaps in order to spread out the increase) than is actually expected to be needed. This inevitably leads to a risk that the control totals voted by Parliament may be exceeded because of the fine margins that are involved.

3.3 This is particularly so with pension schemes where income and expenditure are entirely demand-led, making payments and receipts difficult to predict accurately. For the Teachers' Pension Scheme, the Department does not directly employ teachers and therefore has no visibility of workforce decisions being taken at a local level, nor can it take management action to stop or delay payments. In March 2011, a combination of unexpectedly low receipts from contributions and an unusually high level of expenditure due to the number of teachers retiring resulted in the net cash requirement being exceeded in the last few days of March by £11.9 million (0.47% of the net cash budget).

3.4 The Department continues to work closely with the administrator, with input from the Government Actuary's Department, the Treasury and the Office for Budget Responsibility, to refine the forecasts to take into account new emerging trends, central assumptions and anticipated changes in behaviour as a result of perceived and actual changes to the pension scheme. To support this, the reconciliation of forecast against actual cash flow will be monitored at an increased frequency and this improved data will be incorporated into the Supplementary Estimate.

3.5 The new contract for administering the scheme (awarded to Capita in 2011) places a greater responsibility on the administrator to provide better information to enable more accurate forecasts to be produced. These processes and assumptions will continue to be challenged by the administrator's internal audit function, which will carry out an audit in 2012. Additionally, the Department's Internal Audit Unit has included a review of the overall approach in its 2012 plan. Although this work is being undertaken, because of the tautness in estimating required by Parliament, there can be no certainty that future excess votes can be avoided.

PAC CONCLUSION AND RECOMMENDATION 4

The reduction in the number of opportunities for departments to apply for additional funds through Supplementary Estimates, coupled with reductions in departmental budgets, may increase the risk of departments breaching approved spending limits in future.

In its reply to** **the** ***Committee, the Treasury is to set out what more it will be doing to monitor Departments' spending and take action where necessary to avoid breaches of spending limits.

4.1 The Government agrees that the Treasury should do all it can to monitor departments' spending effectively and take action where necessary to avoid breaches of spending limits.

4.2 The Treasury has already taken steps to strengthen control over and monitor departments' spending to avoid breaches of spending control. For example: the introduction of the Clear Line of Sight (CLOS) reforms in 2011-12, agreed with Parliament, lining up parliamentary controls on departments' spending in Estimates with the Treasury's budgetary controls to meet a single set of spending limits and moving to a single Supplementary Estimate round each year; strengthening the control of Annually Managed Expenditure (AME); replacing the End of Year Flexibility scheme with a new Budget Exchange (BX) scheme which strengthens control from 2011-12 while retaining incentives to avoid wasteful end-year spending; and replacing the Combined On-line Information System (COINS) with a new system, Online System for Central Accounting and Reporting (OSCAR), from mid-2012 to provide enhanced management information for both the Treasury and departments.

4.3 In addition, the Treasury is updating *Supply Estimates: a guidance manual* and the *Consolidated Budgeting Guidance*, which emphasise the importance of maintaining firm in-year control. The Treasury will also publish a new framework for further improving spending control, setting out how departments should monitor and share spending information with the Treasury; provide timely and accurate forecasts of full year spend, and a breakdown of monthly spend, from the beginning of the financial year; provide the Treasury with information submitted to Departmental Boards on first order risks, and their mitigation strategies; and ensure that data on the COINS and OSCAR data systems are accurate and up to date on a monthly basis and are reconciled to internal management information.

4.4 Notwithstanding these improvements, there will remain a risk that some departments will overspend. The Treasury analyses the reasons for breaches and takes action to mitigate them. Whether departments have breaches depends on the effectiveness of their in-year financial management. The Government is therefore taking steps through the cross-government Finance Transformation Programme to help finance professionals across Whitehall develop the right skills to deliver continuing improvements in departmental financial management.

Sixty Seventh Report

HM Treasury (HMT)

Whole of Government Accounts

Report Summary from the Committee

In November 2011, HM Treasury published the first audited Whole of Government Accounts (WGA), covering the year 1st April 2009 to 31st March 2010. The Committee welcomed the WGA 2009-10 as a major step forward in improving transparency and accountability. The WGA reveals, for example, that at 31 March 2010 the government's public service pensions liability was more than £1,132 billion and the present value of its future commitments under PFI schemes was £131.5 billion. The WGA also shows that the government wrote off £10.9 billion in unpaid taxes and expected to have to pay £15.7 billion for outstanding clinical negligence claims.

The Committee were surprised to find that Treasury did not have a grip on trends in some key areas of risk or plans for managing them. For example, clinical negligence claims at 31 March 2010 accounted for 15% of provisions for future government spending. Treasury now has the potential to strengthen the management of public finances if it uses the WGA to identify influences on the government's financial position, including where it is most exposed, and uses these to better anticipate the risks that it must address. The Treasury must use this opportunity better to manage these risks.

The WGA will only serve its purpose– telling us what the government owns, owes, spends and receives – if it is timely and robust. The figures in the first audited WGA are too dated because Treasury took 20 months to prepare and publish the report. Treasury must address the issues that led the Comptroller and Auditor General to qualify his audit opinion on the WGA 2009-10. A key issue is Treasury's decision to deviate from accounting standards, by omitting Network Rail, the publicly owned banks, and various other government controlled or owned bodies from the WGA. The accounts as presented by Treasury are therefore incomplete and these are important omissions. Treasury's explanation that it excluded them to align the scope of the WGA with the statistical measures of public finances prepared by the Office for National Statistics is not convincing because the WGA is a financial statement that ought to be prepared in line with generally accepted accounting practice.

The WGA includes estimates of costs several decades into the future, such as public service pensions (£1,132 billion) and nuclear decommissioning (£56.7 billion). Interpreting the movement, year on year, for these liabilities is complicated by the instability of the discount rates used to calculate the present value of future money. For example, in 2009-10 the change of discount rate from 3.2% to 1.8% was largely responsible for a £300 billion increase in the pensions liability. The discount rate for valuing pension liabilities subsequently changed again for 2010-11, to 2.9%, which will result in continuing instability in the estimate of the pensions liabilities. The rationale for settling on a particular discount rate should be transparent so that its validity can be checked.

The Committee have previously highlighted the need for stronger accountability systems to secure effective responsibility for cost and value for money at local levels. The financial information that Treasury received from Academies, which accounted for £1.2 billion of government spending and £2.2 billion of assets during 2009-10, was of poor quality as it included unaudited data and some Academies provided no information at all. This shows that there is a gap in accountability. This issue is likely to grow in importance as new Academies are created, alongside Free Schools, Foundation Trusts and GP consortia.

If the WGA is to provide a solid foundation for improving the management of public money, some key principles must be followed. These are set out below and provide the context for the conclusions and recommendations in this report.

On the basis of the Whole of Government Accounts for 2009-10, and the Comptroller and Auditor General's Certificate and Report, the Committee took evidence from HM Treasury on the information provided in the accounts, how Treasury intends to use the WGA to improve the management of public finances, and its plans for strengthening the quality of future WGAs.

Key principles for managing public finances within the context of Whole of Government Accounts

In considering the recommendations made in this report, the following key principles should be considered:

- As the UK's Ministry of Finance, the Treasury is responsible for managing public sector finances and for managing financial risk.

- Timely, reliable and complete information on what the government owes, owns, spends and receives provides the foundation for managing public finances.

- The WGA will help the Treasury to drive change through its management of the public sector's balance sheet.

- Clear performance measures provide a catalyst for identifying and managing risk.

Spending Teams within Treasury are responsible for ensuring that Accounting Officers do not commit to major new programmes or projects that could put the government's overall financial position at risk, both in the short term and over time.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

Treasury needs to make better use of the WGA to identify and address risks to public finances. The WGA can assist Treasury to fulfil its role as the UK's Ministry of Finance as it identifies key factors behind the Government's financial position and the risks it needs to manage. However, the Committee found that the Treasury's understanding of some aspects of the WGA was poor. This shows why the exercise is so important. For instance the Treasury showed surprise at the estimated £10.9 billion in outstanding tax and it had no knowledge of recent trends in clinical negligence claims or whether plans were in place to reduce the estimated £15.7 billion cost to taxpayers of meeting these claims.

The Treasury should use the WGA specifically to identify key risks to public funds and ensure bodies included in the WGA can demonstrate that they are addressing them effectively. As the WGA shows the net liability and deficit and how these have arisen, given their size, the Treasury should produce a plan setting out how it intends to reduce these and a timetable for when they will be reduced to acceptable and affordable levels.

1.1 The Government agrees with the Committee's conclusion that WGA should be a useful tool but rejects its recommendation.

1.2 The Committee is mistaken in believing that the Treasury alone manages the public sector finances and their associated risks. In the first instance it is for accounting officers to manage their departments to deliver the agreed multiyear budgets and the risks associated with them. The Treasury oversees these processes and seeks to maintain standards. WGA offers useful perspective to help understand some of the strategic and other significant financial risks that the government faces.

1.3 The Government manages the public finances using the National Accounts definitions and presents information about performance using International Financial Reporting Standards (IFRS). It uses the Budget and other fiscal events to set out its plans for reducing the fiscal deficit.

1.4 The two bases of measurement are similar, but slightly different. Each means of handling the information has its strengths. IFRS are good at capturing as yet uncrystallised liabilities, which score in the National Accounts only when they happen. All contingent liabilities are of course notified to Parliament when they arise, and are noted in individual Departments' accounts each year. The Government manages these liabilities as part of its approach to risk and departments take trouble to understand, control and manage them effectively.

1.5 The Committee is mistaken in concluding that £10.9 billion tax has been written off. This sum is the amount of tax debt that HMRC assesses as irrecoverable. Similarly, £15.7 billion is the amount that DH has set aside to meet claims for clinical negligence. Both provisions are explained in notes to these departments' accounts and to WGA.

PAC CONCLUSION AND RECOMMENDATION 2

The WGA has the potential to inform new decision-making and longer-term fiscal planning by providing the fuller and wider context for decisions involving new financial commitments. The accounts show that the total effect of individual decisions can be very significant. For example, at 31 March 2010 the combined value of individual commitments made through PFI deals was £131.5 billion and the present value of future spending on nuclear decommissioning was £56.7 billion. These insights are important when considering the affordability of investing in new infrastructure including nuclear energy, or in considering new PFI schemes.

The Treasury should require its Spending Teams to confirm that decisions taken by accounting officers on new projects and programmes are affordable over time and have been made with an understanding of the comprehensive impact of individual commitments on the aggregate financial position.

2.1 The Government agrees with the Committee's conclusion and recommendation.

2.2 The Treasury's spending teams already seek to ensure that Departments' spending plans are not only consistent with the agreed budgets for the medium term, but are also sustainable for the years ahead when the spending totals are not defined. In addition, each Accounting Officer has responsibility for keeping the long term spending path of his or her organisation within affordable limits.

PAC CONCLUSION AND RECOMMENDATION 3

The WGA needs to be unqualified if it is to be an authoritative resource for accountability and decision-making. The Comptroller and Auditor General qualified his opinion on the WGA 2009-10 for reasons that included the inconsistent application of generally accepted accounting practice.

The Treasury should show how and when it intends to address and resolve each of the reasons for the qualification in future accounts. It should also take a more active role in working with government bodies whose individual accounts have been qualified to resolve the causes of the qualification.

3.1 The Government agrees with the Committee's conclusion, but not its recommendation.

3.2 The Treasury is determined to deliver unqualified WGA as soon as it can reasonably be achieved. This is a considerable task.

3.3 The Treasury already works with public sector organisations to reduce or eliminate the qualifications to their accounts. Improvement will entail changes to accounting policies, better data quality and broadening the scope of WGA. The primary responsibility for the quality of each organisation's accounts of course lies with its leaders and managers.

PAC CONCLUSION AND RECOMMENDATION 4

The Treasury's decision to exclude Network Rail, the government-owned banks and various other government controlled or owned organisations from the WGA is inconsistent with accounting standards and results in assets and liabilities being significantly understated. The Treasury's explanation that it excluded these organisations to align the WGA with statistical measures of public finances prepared by the Office for National Statistics is not convincing. It could not articulate why Higher Education Institutions are excluded from the WGA when Further Education Colleges are included. The WGA is a set of financial statements that should follow generally accepted accounting practice, and Treasury did not even apply the definition used by the Office for National Statistics consistently.

The Treasury should prepare the WGA on a consistent basis and, in line with international financial reporting standards, include Network Rail, the publicly-owned banks and other organisations that are controlled by the government.

4.1 The Government disagrees with the Committee's conclusion and recommendation.

4.2 The Government Resources and Accounts Act 2000 gives the Treasury powers to decide which entities should be included in WGA. The Treasury chooses to align coverage of WGA with the national accounts in order to support long term fiscal decision making. Thus Network Rail, further education colleges, higher education colleges are not within the WGA boundary as they are currently not classified to the public sector in National Accounts. The publicly owned banks are excluded because their figures would materially distort the position of the ongoing public sector.

4.3 Having defined the boundary, the Treasury prepares WGA in line with international financial reporting standards as adapted and interpreted for the public sector context. The Treasury agrees that the bodies included in WGA should be consistent over time.

PAC CONCLUSION AND RECOMMENDATION 5

It is difficult for users to interpret underlying trends in long term liabilities, such as pensions and nuclear decommissioning, because of inconsistency and, more importantly, volatility in the discount rates used. Discount rates are used to calculate the present value of future money. The WGA for 2009-10 used different discount rates to estimate the cost of public service pensions and nuclear decommissioning. Even worse, the discount rate used to estimate the pensions liability changed from 3.2% to 1.8% during 2009-10, increasing the net liability by £300 billion.

The Treasury should be transparent in explaining its reasoning for adopting a particular discount rate and should apply that rate consistently when estimating long term liabilities and identify ways to minimise volatility in this rate.

5.1 The Government disagrees with the Committee's recommendation, and specifically the Committee's view that it is applying discount rates inconsistently.

5.2 In preparing WGA, the Treasury follows IFRS, adapted and interpreted for the public sector. These accounting standards specify how discount rates should be derived and the frequency with which they should be updated. IFRS requires discounts to be derived from different sources depending on the nature of the liability. The specified discount rate for public service pensions for example is based on the yield of AA rated bonds while the discount rate for long-term provisions such as nuclear decommissioning is equivalent to the yield of a risk-free asset.

5.3 This means that IFRS does not allow use of a single discount rate for a variety of cash flows. Nor is it possible to reduce the volatility of discount rates because that would run counter to compliance with IFRS and may result in financial statements that would not provide a true and fair view.

5.4 The Treasury agrees that it should be transparent in explaining its reasoning for adopting a particular discount rate, and will take steps to improve the disclosure currently in the accounts to enhance clarity.

PAC CONCLUSION AND RECOMMENDATION 6

The poor quality of data supplied by Academies and the absence of sanctions shows there is a gap in accountability. The information provided by Academies, which in 2009-10 accounted for £1.2 billion of government spending and held assets of £2.2 billion, was generally poor, and five Academies provided no information at all. This issue is likely to become more important with the creation of new Academies and other organisations that deliver local services such as Free Schools, Foundation Trusts and GP consortia. The Committee have made recommendations in earlier reports about the importance of strong transparency and accountability when services are devolved.

The Treasury should ensure that local bodies, including those that are being newly established, are obliged to prepare transparent, timely and accurate information in a suitable format, and it should apply appropriate sanctions for non-compliance.

6.1 The Government disagrees with the Committee's conclusion that there is an accountability gap. The Government is already implementing its recommendation.

6.2 The Treasury shares the Committee's concerns about accountability for public funds. While the patchy provision of information by academies is disappointing, there is room for improvement in this sector as it mature and develops. Accounting officers are already responsible for making arrangements with local bodies to ensure proper governance and accountability. DFE is working with academies to improve their accountability and the quality of their data flows.

PAC CONCLUSION AND RECOMMENDATION 7

The information contained in the WGA is out of date because Treasury took 20 months to prepare it, which is around three times as long as it takes other countries to prepare consolidated government accounts. Other countries have prepared consolidated accounts in seven months or less. The time taken to prepare the WGA for 2009-10 is in part due to the WGA having a wider scope than accounts produced by other countries but the Committee also recognises that these are the first audited accounts prepared for the whole of government.

The preparation of the WGA can nevertheless be accelerated, and Treasury should develop plans with interim milestones that clearly set out how it and the organisations covered in the WGA will deliver the next WGA faster.

7.1 The Government agrees with the Committee's conclusion and already has plans in hand to comply with the recommendation.

7.2 The Government is committed to preparing WGA more quickly in future, and expects to produce the 2010-11 WGA two months earlier. The Treasury will focus on making incremental improvements for 2010-11 and 2011-12, as these financial years have either already ended or about to end. The Treasury is developing plans for 2012-13 and beyond, with NAO support, to significantly improve the speed of the account production. These plans will set out the planned approach and milestones as recommended by the Committee.

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