



Treasury Minute on the Seventeenth to Twenty-first Reports from the Committee of Public Accounts 1993–94

- 17th Report: Pergau Hydro-Electric Project
- 18th Report: Insolvency Service Executive Agency: Company
Director Disqualification
- 19th Report: HM Customs and Excise: Account Matters
- 20th Report: Housing Corporation: Financial Management of
Housing Associations
- 21st Report: Sale of the Scottish Bus Group

**Presented to Parliament by the Financial Secretary
to the Treasury by Command of Her Majesty
June 1994**

LONDON : HMSO

**TREASURY MINUTE DATED 29 JUNE 1994
ON THE SEVENTEENTH TO TWENTY-FIRST
REPORTS FROM THE COMMITTEE OF
PUBLIC ACCOUNTS, SESSION 1993-94**

Seventeenth Report

Overseas Development Administration

Pergau Hydro-Electric Project

On the appraisal of the Pergau project

PAC conclusion (i): We note that the Administration are confident that expenditure on the project was regular and therefore complied with the relevant legislation. We presume that this was based on legal advice and would like assurance that this was the case.

1. The Accounting Officer took the view that the decision raised issues of economy and efficiency but not of regularity in terms of the legislation. As the Secretary of State informed the Foreign Affairs Committee in his memorandum of 21 February 1994, no legal advice was sought.

PAC conclusion (ii): In view of the prospective size of the Pergau project, we consider that it is essential that it should have been subject to a full economic appraisal. . . .

PAC conclusion (iii): We consider that the appraisal was superficial and inadequate. . . . We look to the Administration to ensure that in future fully effective appraisals are carried out before decisions are made to finance projects from the Aid Programme.

2. The (Overseas Development Administration) (the Administration) acknowledged in its evidence to the Committee that the Pergau project should have been subjected to a more thorough appraisal before a Ministerial commitment was given. In particular, an earlier and fuller visit to Malaysia would have been desirable. This was not done because of the danger that this would undermine the consortium's commercial negotiations. However, the extent of work carried out in the Administration before the March 1989 visit should not be underestimated. The Administration made full use of the Snowy Mountains Engineering Corporation feasibility report and contacts with the World Bank to assess the viability of the project and to clarify the key issues. The March 1989 visit enabled the Administration to satisfy itself on one of these—the projections for demand for electricity—leaving the issue of capital cost as the main outstanding concern.

3. The Administration has improved its procedures, in part as a result of the lessons learned from the Pergau project. New arrangements for the Aid and Trade Provision (ATP) were introduced in June 1993 following the ATP Review. These include the need for the appraisal, approval and monitoring procedures for ATP projects to be brought into line with those applied to other bilateral aid projects in order to provide the same level of assurance regarding economic soundness and sustainability. ATP projects are now submitted to the Administration's Projects and Evaluation Committee on the same basis as other bilateral aid projects.

PAC conclusion (iv): We share the Administration's astonishment that the contract price should have been increased from £316 million to £397 million . . . only two weeks after the agreement between the two Prime Ministers. . . . Since escalation costs are to be expected such information should have been considered earlier by the Administration it is most surprising and unacceptable that aid offers were then made . . . based on the £316 million estimate. . . . It is also unacceptable that this information was not available before the Government entered into what they regarded as a politically binding agreement.

4. The consortium has explained in evidence to the Foreign Affairs Committee that they were not in a position to complete detailed work on their bid before the end of March. However, as consortium representatives acknowledged on 31 March 1989, when they notified Government of the increase to £397 million, the figures for UK and EC content originally provided had been presented as maximum figures. Despite the increase, Ministers concluded that the undertaking to support

the project made in March 1989 by the then Prime Minister should be honoured. While the commercial negotiations were continuing, offers of aid were renewed on the basis of the original commitment of £316 million because a firm price (and the level of UK content in the contract) had yet to be determined. At the time, downward pressure on price was expected from the commercial negotiations and the contract price investigations.

PAC conclusion (v): We note that the Administration's first price investigation . . . was based on the contractor's earlier estimate of £316 million. . . . In our view, there should always be an up-to-date appraisal of projects before decisions to provide aid are taken.

5. The Administration confirms that its contract price investigations are carried out on as up to date information as possible. The first contract price investigation was carried out in the knowledge that the price had increased, although the basis of the price structure was not sufficiently detailed to permit a full price investigation at that time. The Administration was, however, able to identify initial savings from the information provided by the consortium. Once the price had been finalised, the Administration conducted its second investigation, which identified further savings in the provisions of the contract, including escalation.

PAC conclusion (vi): In view of the increasingly serious doubts about the project, we consider that . . . the Administration should have taken advantage of the opportunities provided by the lapses of the [aid] offer to reconsider the details of the scheme and . . . discuss with Malaysia how the project could be adjusted so as to provide better outcomes for Malaysia and for the British taxpayer.

PAC conclusion (vii): We note the Administration's view that not to have renewed the offer of aid would have been a retreat from Ministerial policy. . . . [and] politically impossible. . . . But we do not think it would have ruled out discussions on the lines we have outlined above.

6. Commercial negotiations are often lengthy and it has been normal practice to renew ATP offers unless there are specific reasons to the contrary. This was done on two occasions, since the commercial negotiations were still proceeding and a firm contract price had not yet been established.

7. After the undertaking given in March 1989, the Administration took the view that discussions on alternative ways of meeting Malaysia's power requirements would have undermined the commercial negotiations that were proceeding between the Malaysian client and the consortium. In early 1991, following the completion of the commercial negotiations, Ministers considered whether discussions should be held with Malaysia on Pergau but decided to honour the commitment made to the project.

PAC conclusion (viii): We note that the Administration implemented a number of measures following their consultants' environmental review we look to the Administration to maintain an effective watch over the project's environmental aspects.

8. The Administration welcomes the Committee's acknowledgement of the measures taken. It is monitoring closely the environmental aspects and will continue to do so until the project is operational. An environmental adviser from the Administration who visited Pergau in February 1994 confirmed that the project is not expected to cause significant long-term adverse environmental or social effects.

PAC conclusion (ix): We note the Administration's view that the second price investigation was much more detailed than the first and that the revised price of £417 million was reasonable bearing in mind the risks involved.

9. The Administration confirms its view that the final contract price was reasonable. Furthermore, this would have been significantly higher but for offsetting savings identified in the second contract price investigation.

On the decision to proceed with the project

PAC conclusion (x): we think it was right and in accordance with his responsibilities that the Accounting Officer advised Ministers that he would require a direction before spending money on this project. We accept that Ministers were given clear advice from their officials in February 1991 about the economics of the Pergau project. . . .

10. The Administration notes this conclusion.

PAC conclusion (xi): We note that, despite the view of the Administration . . . [that to support the project would not be an effective use of the aid budget] no attempt was made to establish the reasons why the client was so keen to continue with the project, when alternatives were apparently available. We are surprised at this omission.

11. The Administration was well aware that the Malaysian Government was pursuing a policy of fuel diversification and wished to diversify further into hydro-electricity. At the time, Malaysia already had considerable experience with such sources and, having had severe teething problems with gas turbines in previous years, took the view that hydro-electric sources were a more reliable option, particularly for coping with peak loads. The Administration considered that there was no need to seek further clarification since Malaysia's wish to proceed with Pergau accorded with its declared fuel diversification policy.

PAC conclusion (xii): We recognise that the provision of aid in support of the Pergau project was authorised by the Government in the light of its reading of the political, commercial and trade factors involved.

12. The proposed aid was for a valid development project which would produce much needed peak time power in an environmentally friendly and sustainable way. Within that context the Secretary of State did of course take account of political, commercial and trade factors in authorising the provision of aid.

PAC conclusion (xiii): we consider it particularly important for us to conduct . . . enquiries in those cases where the Accounting Officer's advice is overruled.

PAC conclusion (xiv): In order that our enquiries into such matters may be as fully informed as possible, we recommend that the Treasury Memorandum setting out the Accounting Officer's responsibilities be amended to provide that the Accounting Officer should communicate to the Comptroller and Auditor General without undue delay the papers relating to all cases where Ministers have issued directions on matters involving prudent and economical administration, efficiency and effectiveness

13. The Government accepts the Committee's recommendation that where a Minister issues a direction on matters of economy, efficiency and effectiveness the Accounting Officer will communicate the relevant papers to the Comptroller and Auditor General without undue delay. The Treasury Memorandum on The Responsibilities of an Accounting Officer will be amended to reflect this.

On funding arrangements

PAC conclusion (xv): While we note the Administration's concern to minimise the impact of Pergau on the Aid and Trade Provision's annual budgets, insufficient consideration was given to the cost of a variety of options

14. The Administration does not accept that insufficient consideration was given to the cost of other options. These were detailed in an inter-departmental paper submitted in February 1991 to Ministers, who concluded that the Administration should proceed with Pergau. On the forecasts then available, the ATP budget could not have funded the project by means of a mixed credit or a mixture of a soft loan and mixed credit, since either option would have meant the closing of the ATP programme to new business for some time.

PAC conclusion (xvi): . . . we would have expected the Administration to approach the Treasury to find a way for the least cost option to be chosen.

15. Future spending on the aid programme is decided as part of the Government's annual Public Expenditure Survey. Pressures on the ATP budget are taken into account at this stage.

16. The Malaysian Government issued its Letter of Award to the consortium in January 1991, after the conclusion of the relevant Public Expenditure Survey. The Government did not consider that the funding of one project justified reopening recent Survey decisions.

On the current position

PAC conclusion (xvii): We note that Ministers decided that the Government, despite the increase in price, was bound by the undertaking given earlier We also note that the Administration have appointed specialist consultants to assist them in their monitoring of this project. We note, too, the Administration's evidence that the project is going ahead well.

17. The Administration acknowledges this conclusion.

General

PAC conclusion (xviii): we may need to return to the subject in due course in the light of further developments.

18. The Administration notes this conclusion.

Eighteenth Report

Department of Trade and Industry

Insolvency Service Executive Agency: Company Director Disqualification

On the background

PAC conclusion (i): Against the background of a rise in the number of personal and corporate insolvencies from 24,000 in 1987–88 to over 81,000 in 1992–93, we are concerned that, of the 28,000 cases where unfit conduct by company directors has been detected, the Agency identified only 15 per cent of such cases as meriting an application to the courts for disqualification in the public interest.

19. In coming to a view on whether the public interest requires disqualification a range of factors has to be weighed and balanced. It is not automatically the case that each and every instance of director misconduct reported should lead to disqualification. The Courts have handed down guidelines as to what constitutes serious misconduct worthy of a disqualification order, most importantly that such misconduct must be material to the company's cause of failure. On this basis it was estimated that in the relevant period only some 4,300 companies (6,400 directors) provided a public interest basis for consideration of proceedings.

20. Following on from the issue of revised Guidance Notes on the submission of reports and returns issued to all Insolvency Practitioners in March 1993, the Agency in September 1993 introduced a system for monitoring the quality of reports received. This has enabled identification of those practitioners who submit reports alleging misconduct on the part of directors without providing any prima facie evidence of such misconduct. This allows the deficiencies in the reports to be pointed out to them in an attempt to prevent them reporting needlessly.

PAC conclusion (ii): We note that the Agency accept that they are not pursuing as many cases as they should. We regard the 1,712 disqualifications secured by the Agency between 1987–88 and 1992–93 as an inadequate response to the scale of unfit conduct revealed over that period.

21. The Committee recognised the rise in the number of personal and corporate insolvencies and this is the main reason for the Agency's inability to pursue as many cases as would have been appropriate.

22. It should be borne in mind that no regulatory agency can guarantee to take proceedings in every case where misconduct is suspected, particularly where its workload is subject to substantial short-term variations. Against the background of a declining number of compulsory insolvencies and an increase in resources for 1994–95, the Agency is planning to increase the number of proceedings taken for the disqualification of directors of failed companies where there is evidence of misconduct. To that end, Official Receivers will be placing greater emphasis on disqualification and prosecution work: this will be aided by the increased use of private sector professionals and by the strengthening of the specialist resources of the Disqualification Unit. The additional resources that have been allocated will also help the Agency to increase the number of insolvency administrations completed.

PAC conclusion (iii): Improving the standards of company stewardship is one of the most important objectives of the Agency under the Company Directors Disqualification Act 1986. We are therefore concerned to note that a survey of company directors had found that 58 per cent of them were not even aware of the Act's existence.

PAC conclusion (iv): We note the Agency's intention to increase the awareness of company directors of their responsibilities. We urge the Agency to carry forward their consideration of the various possibilities they have identified without delay, and to monitor the impact of any measures which they may introduce.

23. The Agency is working on a plan with Companies House to publicise disqualifications and directors' responsibilities. One proposal under consideration is that directors of companies who are sent filing default notices by Companies House will also receive a leaflet reminding them of their responsibilities and of the possible consequences of non-compliance including disqualification. The Agency will increase its media publicity on disqualification by the issue of regular press releases particularly at the conclusion of court proceedings.

PAC conclusion (v): We are disturbed that three quarters of those taking part in the survey of Insolvency Practitioners . . . thought that the Act was not proving successful in putting unfit directors out of action.

PAC conclusion (vi): We note that the Agency agree that this is a serious criticism of the way in which the Act is being implemented, and we urge the Agency to take this into account in the efforts they are making to improve their working arrangements with Insolvency Practitioners.

24. The Agency accepts the Committee's conclusions. It is giving greater attention in its communications with Insolvency Practitioners to Guidance Notes issued in March 1993 on the completion of returns for disqualification purposes. Improved compliance with these guidelines should result in a more focused approach by Insolvency Practitioners resulting in a larger number of their returns being able to demonstrate unfit conduct and therefore providing a surer basis for the commencement of disqualification proceedings.

On the Agency's performance

PAC conclusion (vii): We view with concern the large variations between Official Receiver offices in the recording and reporting of unfit conduct. We are also concerned that the reasons behind these variations have not been formally reviewed.

PAC conclusion (viii): We recommend that the Agency should regularly and systematically review such variations, in order to identify the reasons for them, and to take appropriate steps to secure that Official Receivers are applying the criteria for identifying unfitness as consistently as possible, and that any problems arising for example from regional workload variations are identified and addressed.

25. The Agency accepts that there were variations in reporting between individual Official Receiver offices. The extension of the role of senior provincial Official Receivers in four regions in February 1994 will result in the closer monitoring of Official Receivers and better use of available resources. The Agency continues to review the criteria and issue guidelines to Official Receivers and has held seminars for all Assistant Official Receivers in order to prepare managers for new training on investigatory procedures and practice.

26. The Agency is currently revising the format of Official Receivers reports to ensure more timely and effective reporting. It will also review its monitoring procedures both by the Agency's Inspectorate and Disqualification Unit to promote greater consistency in reporting.

PAC conclusion (ix): We note with concern that the number of detailed reports on cases from Official Receivers has fallen from 1 in 3 unfit conduct cases in 1987–88 to around 1 in 22 in 1992–93. We note the Agency's explanation that this reflects changes in standards set by the courts. In our opinion, however, this is likely to be only one contributory factor, given the large variations in reporting between Official Receiver offices which the Agency themselves attribute to inconsistencies in the application of selection criteria and to varying work pressures.

27. The variations in reporting unfit conduct are being addressed and additional resources are being allocated to Official Receivers to enable them to increase the number of detailed reports.

PAC conclusion (x): . . . we are concerned that the Agency are failing to carry out full examinations in around half of the cases which they have identified as possibly featuring unfit conduct. As a result they are unable to establish in relation to these cases whether or not disqualification is merited in the public interest.

28. The Agency is undertaking a series of initiatives to ensure that a full examination is carried out in as many cases as possible. In Insolvency Practitioner cases these include the allocation of up to 15 additional staff to the Disqualification Unit, the use of private sector solicitors and the allocation of cases to Official Receivers with investigative capacity in the Northern Region to assist in their preparations for court proceedings.

PAC conclusion (xi): We also consider it unsatisfactory that half of the 22 per cent of cases submitted by Official Receivers in 1992–93 which were rejected by the Agency were rejected because the reports were late or of insufficient quality. We note the steps being taken by the Agency to reduce the significant amount of wasted effort caused by the present high rejection rate.

29. The recently appointed Regional Managers have been given the responsibility of ensuring that cases are processed expeditiously. Official Receivers have been instructed to exercise more direct and effective supervision over investigations, and to consult the Disqualification Unit at an early stage before submission of reports. Their staff will also be attending dedicated training courses. These initiatives will combine to reduce wasted effort. The rejection rate for 1993–94 was 13 per cent.

PAC conclusion (xii): We are concerned to note that, in spite of steps being taken by the Agency, many reports from Insolvency Practitioners are still received late and incomplete. We recommend that the Agency should consider what further steps they can take to impress on all Insolvency Practitioners the importance of the timely submission of these reports.

30. The Agency issued guidelines to Insolvency Practitioners in March 1993 which emphasised the need for timeliness of reports and the importance that Insolvency Practitioners should attach to the adequacy of evidence to support allegations of unfit conduct. The Agency will continue to remind Insolvency Practitioners where they fall short of the standards set out in the guidelines and the newly constituted Joint Insolvency Monitoring Unit set up by the profession will reinforce those guidelines.

On what needs to be done

PAC conclusion (xiii): It is the task of the Department to make a careful assessment of the resources they need in order to carry out their responsibilities under the Act. If they do not do so, Ministers will lack a key element in the information they require in order to decide what resources can be given to the Agency for this work.

PAC conclusion (xiv): We are therefore very disturbed to learn that the Agency have not been providing this information. We strongly recommend that the Agency should include such appraisals in their resource bids to the Department.

31. The detailed resource requirements of the Agency are considered by the President of the Board of Trade through the MINIS system. Significant additional resources have been allocated to the Agency in the current MINIS round (1994–95).

PAC conclusion (xv): We are concerned that, once disqualification proceedings have been launched, it can take up to four years to obtain a court decision. During this time the individuals concerned are free to continue to act as directors. We recognise that much of this delay is outside the direct control of the Agency. We welcome however the steps being taken by the Agency, in concert with the Lord Chancellor's Department and the courts, to reduce the time taken to conclude court proceedings.

32. The Agency fully shares the Committee's view that it is important to reduce the time taken to conclude court proceedings and will continue to support the work of the Lord Chancellor's Department in speeding up the process of appointing additional Court officials and streamlining procedures.

PAC conclusion (xvi): We are disturbed that the record of disqualified directors maintained by Companies House is significantly incomplete. . . .

PAC conclusion (xvii): We note that the Agency are not responsible for the register but, in view of their responsibilities for the protection of the public, we urge them to pursue with the courts and with the Government agencies concerned the steps that need to be taken to secure that the register is maintained.

33. Companies House is seeking to improve the accuracy and completeness of the Register of Disqualified Directors. Under the Companies (Disqualification Orders) Regulations 1986 responsibility for notifying the existence of a Disqualification Order rests with the Courts. Companies House has taken steps to remind Courts of this responsibility and it continues to liaise with the Agency and the Lord Chancellor's Department with a view to improving procedures.

PAC conclusion (xviii): We are concerned that there are no arrangements in place to ensure that disqualified directors resign their directorships and are not appointed to new ones. This is, in our view, prejudicial to the effectiveness of the director disqualification arrangements.

PAC conclusion (xix): We note that the Agency are examining with Companies House what steps they can take to identify what other directorships are held by disqualified directors. We urge them to pursue this as a matter of urgency so that the individuals concerned can, if necessary, be reminded of their obligation to resign directorships and not to take up new ones during the period of their disqualification.

34. There is no power under current legislation to require disqualified directors to resign their directorships. However, recent computer developments mean that Companies House is now in a better position to check details of existing appointments (and new appointments) against the register of disqualifications. Where a match is found, Companies House will remind the company of the requirement to provide notification of resignation following disqualification. Failure to do so will be brought to the attention of the appropriate body responsible for prosecution for acting in contravention of the Disqualification Order.

PAC conclusion (xx): It is an important preliminary step to protecting the public and the commercial world from directors who abuse their limited liability status that all such directors can be identified. We are therefore concerned to note that in many cases where companies cease trading, but where creditors do not institute liquidation proceedings, the directors involved will not be assessed as to their conduct unless questions of possible fraud arise.

PAC conclusion (xxi): We are also concerned that in Scotland, where there are no Official Receivers, directors of some failed companies can escape any examination of their conduct because Insolvency Practitioners may refuse to handle cases with few assets. We recommend that the Agency should review their operations in Scotland with a view to identifying ways in which this serious gap can be closed.

35. The Committee's comments regarding companies which cease trading but which do not enter formal insolvency procedures are noted. However, the Government believes that the choice should rest ultimately with the creditors concerned. Specific problems identified in Scottish cases have been addressed and

a recent Court judgement on the approach to the discharge of provisional liquidations has been published and circulated to Courts. The Government does not see a need to legislate to change the system of handling liquidations in Scotland.

Nineteenth Report

HM Customs & Excise

Account Matters

On increases in Departmental expenditure

PAC conclusion (i): We note that the Department spent a total of £879 million in 1992–93, an increase in real terms of 20 per cent over the amount spent in 1988–89; and that this reflected significant increases in expenditure on information technology and major accommodation works. We note that the heavy investment in information technology and accommodation in recent years is expected to continue at a high level over the next three years.

36. The increased spend reflects changes to HM Customs and Excise's (the Department's) infrastructure and operations over the five years. Capital expenditure in 1993–94 has, as expected, fallen substantially against 1992–93 levels and is expected to reduce further still in 1994–95.

PAC conclusion (ii): We recognise that some of the Department's substantial investment in new technology was necessary to implement changes arising from the Single Market and may not result in a direct return. But other capital expenditure has been justified in terms of reduced running costs or improved revenue collection, and here we look to the Department to demonstrate that a satisfactory return has actually been achieved.

37. The return on this investment is already beginning to emerge. The Department's total costs in 1993–94 reduced in real terms over 1992–93 levels by some 5 per cent. Provisional figures indicate a fall in current expenditure of some £25 million (3 per cent).

PAC conclusion (iii): We regard it as unsatisfactory that the new VAT headquarters building at Queens Dock in Liverpool, which cost £35 million and was originally intended for 1,800 staff, is currently less than half full.

PAC conclusion (iv): We note that a further 300 staff are due to move into the new building and that the Department are considering whether other staff could also be transferred there. This review needs to be completed without delay and any surplus capacity released to Property Holdings so that it can be used by other departments.

38. The Department carried out an investment appraisal of the accommodation options following the HQ location review in 1990 and identified a new building as the optimum solution. A combination of circumstances arising from initiatives such as market testing and the deferment of part of the relocation programme due to the economic downturn resulted in leaving about 40 per cent of the accommodation at Queens Dock available for alternative use. However, a number of options have been considered by the Department and Property Holdings and decisions taken to move 490 Customs regional staff into the building in September 1994. Also, discussions are at an advanced stage to allocate the remaining space to another Government Department.

On arrears of VAT

PAC conclusion (v): We note that the Department failed to meet their 1992–93 target of reducing average daily arrears of VAT from 4.4 per cent to 4.2 per cent of the total liability for the year but that average daily arrears had since fallen to 3.7 per cent.

39. The objective for 1992–93 was set early in 1992 and, in the event, proved to be a little premature. The arrears indicator stood at 3.5 per cent at the end of February 1994. Without the beneficial effects of the change in accounting rules for VAT on imports from the EC, this figure would have stood at 4.1 per cent.

PAC conclusion (vi): We also note the disappointing early results of the Department's efforts to devise indicators which will identify more clearly their own performance on debt management. We recognise the difficulties in separating out the effects of the Department's own efforts to reduce arrears from the influence of economic factors outside their control. Nevertheless, we emphasise the importance of developing better ways to assess the Department's performance in this area, and the need for vigorous efforts to identify suitable performance indicators.

40. Whilst it is difficult to establish a single overall indicator that will identify Departmental performance separately from the performance of the economy, the range of indicators in use from April 1994 will provide a substantial basis on which to form sound judgement. Three local indicators of performance have been established relating to percentage of advised debt discharged, cost of discharge, and age of debt. Nationally, new performance indicators introduced at the same time relate to age of debt, and month end arrears. The Department is continuing to look at a range of further options which may lead to refinement of existing indicators and the creation of new ones.

PAC conclusion (vii): We are concerned to note that more than half the VAT arrears as at 30 January 1993 were over six months old. We consider that firm and demanding targets for clearing older arrears are long overdue. We note that the Department are now setting clearance targets both nationally and locally, and we look for improvements in the collection of older debts as a result.

41. Debts over six months old increased from 38 per cent in June 1992 to 53 per cent in January 1993, but fell thereafter to 38 per cent at 30 September 1993. Objectives have been set for the year 1994–95 as follows:

- Enforceable debt on hand, over seven months old, not to exceed 30 per cent of total enforceable debt on hand. (Local offices.)
- All debts older than six months not to exceed 38 per cent of all debt on hand. (National.)

PAC conclusion (viii): We recommend that the Department's performance in clearing older arrears should be closely monitored, and regular six-monthly age analyses carried out on a consistent basis, with appropriate follow-up action.

42. Regular analyses at six monthly intervals are being made. The Department will make every endeavour to ensure consistency. Records identifying the age of any specific debt have been available to local offices for some time through their debt management software system. Local managers have made good use of this facility in targeting older debts.

PAC conclusion (ix): We support the increased use of time-to-pay agreements to help traders in genuine difficulty to clear their VAT debts. We look to the Department to ensure that the time-to-pay scheme is used to its full potential and that the criteria for dealing with individual cases are applied consistently across all local offices.

43. The amount of arrears subject to time-to-pay agreements at the end of March 1994 represented over 11 per cent of debt on hand at local offices. This position is fully in line with the recommendation of the Efficiency Scrutiny. Local offices are aware of the criteria involved and every effort is being made to ensure consistent treatment. The value of arrears being accounted for on time-to-pay agreements has risen steadily from £31 million at the end of April 1992 to £83 million at the end of March 1994.

On additional VAT liability discovered on visits to traders' premises

PAC conclusion (x): We note that over the last five years the Department's visits to traders' premises have resulted in a significant increase in additional VAT liability.

PAC conclusion (xi): We are concerned, however that the Department appear to have little idea of the extent to which the increase in additional VAT liability discovered represents a more effective performance on their part or an increase in the number of traders failing to comply with the regulations. The lack of such information inevitably makes it more difficult to identify risks and to target investigative resources effectively.

44. Teams with particular expertise have been looking at specific types of businesses with considerable success. Risk associated with existing traders is assessed through experience of previous visits, as well as performance in rendering returns and payment, and such information as trade category. In this way a wealth of information is built up to assist and inform any risk analysis assessment system from which the visiting programme is constructed. A survey is currently being undertaken into the causes of underdeclarations and the results of this, which are due this year, will further inform the process.

PAC conclusion (xii): We do not underestimate the difficulties in developing reliable measures of trader compliance. Nevertheless the Department should continue their efforts to develop better indicators of the effectiveness of their visiting programme and to encourage initiatives aimed at assessing trader accuracy and Departmental effectiveness at local office level.

45. Research is continuing into the possibilities of establishing measures relating to trader compliance and tax yield which would be useful in assessing the Department's performance. This is however a long term objective and it is unlikely that a single overall measure will be found, but rather that a series of measures will, taken together, give a fair indication of how effectively the Department's visiting programme is being operated.

On controls over revenue due at import

PAC conclusion (xiii): We note that the Department have not set targets for the proportion of import consignments to be checked against supporting documents or physically inspected. We emphasise that, in the absence of such targets, the Department must take particular care to ensure consistency in approach and in levels of checking between local offices, based on careful monitoring and clear analysis of risks.

46. The Department recognises the need for local offices to adopt a consistent approach to applying documentary and physical checks to import consignments. Levels of checking may vary between offices because selection is based on risk analysis. Risk analysis by its nature takes account of local variations in type and volume of trade. The selection of a set proportion of import consignments is not determined in advance, for to do so would not reflect different risks both between types of traffic and between locations. But the rates of selection achieved are monitored through the entry processing computer system, and the results of the various computer parameters that cause selection for checking are separately analysed.

PAC conclusion (xiv): We note that the Department have not so far detected any sign of increased fraud as a result of the new Single Market arrangements. But we urge them to remain vigilant in the face of the acknowledged risks.

47. The Department is watching very carefully for new types of fraud arising as a result of the Single Market. The Department is committed to the fight against fraud and is working towards ever more effective strategies, both domestically and in the Union. This includes developing a European anti-fraud strategy and supporting the Commission's anti-fraud strategy work programme, which closely reflects the UK practice of concentration on high risk sectors and audit based controls.

PAC conclusion (xv): We are concerned at the amount of illegal cross-border trading in excise goods and support the Department's determination to stamp this out.

48. The Department is using Excise Verification Officers (EVOs) to seek out and prosecute those people who engage in smuggling alcoholic drinks and tobacco. The EVOs work closely with the Department's specialist investigation staff, VAT colleagues and other agencies including the police. The control effort is centred on the use of intelligence and in this context there has been an encouraging response to the publication of a national "hotline" number. The Department will continue to be responsive in developing its strategy of protecting the revenue and legitimate trade. It confirms its determination to act vigorously against anyone engaged in smuggling activities.

Twentieth Report

Department of the Environment

Housing Corporation: Financial Management of Housing Associations

On regulation by the Housing Corporation

PAC conclusion (i): We are concerned that . . . as many as half of all associations failed to meet the six month statutory deadline for submitting their audited accounts to the Housing Corporation. . . . We look to the Corporation to ensure the position does not deteriorate. They should be ready to step in promptly where necessary to take firm action against defaulters.

49. The Housing Corporation (the Corporation) fully accepts the need for prompt action to deal with associations which fail to submit their accounts within the six month statutory deadline. There has been a marked reduction in the number of associations failing to meet the deadline. As at 31 October 1993, the proportion of registered housing associations which were late had fallen to 7 per cent—a total of 166 associations, which, on average, owned less than 35 units each. The Corporation continues to monitor the position closely and, as indicated in its Supplementary Memorandum (PAC 53), takes firm action, including prosecution, to deal with defaulters.

PAC conclusion (ii): . . . We note the Corporation's plans to update their code of audit practice and to encourage associations to make fuller use of the external auditors; but we are concerned that for some associations this might not take effect until after the 1994–95 audit.

50. The Corporation is updating the Code of Audit Practice, in consultation with the National Federation of Housing Associations, the auditing profession and the Audit Commission. The updated Code will come into effect for associations with a financial year ending in December 1994 onwards. The Corporation is considering the practicability and implications of requiring positive compliance reporting by external auditors as part of this review.

51. The Corporation has made clear to associations in a Circular issued in March 1994 (HC 11/94) the importance which it attaches to the external auditor's formal report to an association's committee of management. Associations are required to submit to the Corporation, with their accounts, a copy of the auditor's management letter; and this forms a key part of the Corporation's annual review of the accounts. Where the external auditor's management letter draws attention to any specific weaknesses or deficiencies, the Corporation requires details of the action to be taken, as agreed by the committee of management, and will investigate if there is any cause for concern.

PAC conclusion: (iii): . . . we emphasise the importance of taking a longer-term view of associations' financial standing. . . . We support the Corporation's intention to obtain more information about associations' medium-term viability. . .

52. The Corporation's new Performance Standards which came into force from April 1994 require all associations to ensure they have viable financial plans. All but the smallest associations will be required to provide evidence that they are meeting this standard when submitting their Performance Standards Return to the Corporation. The first of these Returns, for the largest associations with a financial year ending in March 1994, are due by the end of July. A copy of the business plan is required to accompany the Return. These plans are expected to cover three years ahead.

PAC conclusion (iv): . . . The Corporation should closely examine the reasons for an association's poor performance and . . . should be prepared if necessary to withhold further allocations of funds.

53. The Corporation's Performance Standards identify the criteria against which a housing association's performance will be tested. The Standards consolidate and improve upon the Performance Criteria issued by the Corporation in June 1992.

54. The Corporation takes seriously all cases where performance of associations is found to fall below the standards. In setting out the remedial action which it expects associations to initiate, the Corporation takes account of the reasons for poor performance and the duration over which the failure has existed. The action plans agreed are monitored closely with the associations and any delays in implementing changes are viewed seriously. If it is judged appropriate, statutory supervisory action is initiated. The withholding of further allocations of funds is considered in all cases where there are causes for serious concern. Existing funding is suspended where the Corporation considers there would be a substantive risk to public funds.

PAC conclusion (v): . . . We recommend that the Corporation look again at the frequency of their coverage [of inspection visits to associations], paying particular attention to the risk of fraud and irregularity and the need to ensure the proper conduct of public business.

55. In introducing its new performance review system from April 1994, the Corporation reviewed the coverage of associations. The aim of the new system is to ensure that each year the performance of all associations is assessed. This will be achieved first by analysis of Performance Standards Returns and supporting documentation provided by associations; secondly, by investigatory visits to associations where a concern arises from analysis of the Returns or from other information available to the Corporation; and thirdly, by validation visits to a sample of associations to verify the information given in the Returns.

56. The new system is being phased in over three years. In the first year all large associations will be required to complete a Return, along with half of the medium-size associations and a third of the smallest associations. The aim is to extend the coverage to all associations by the third year. The Corporation is aware of the need to plan for the resource requirements of the new system and is building this into its corporate and operational planning processes.

57. The Corporation recognises the need to safeguard against the risk of fraud and irregularity within the activities of associations. The new Performance Standards require all committees of management to satisfy themselves that they have proper systems of internal control and that their operation and effectiveness is reviewed regularly. For all but the smallest associations, compliance with this requirement must be demonstrated in the information submitted to the Corporation in the Performance Standards Return. Any concerns arising from analysis of the Return, or of other information available to the Corporation, would result in an investigatory visit and, depending on the outcome, a remedial plan of action. Associations are also required to report to the Corporation immediately any fraud in excess of £1,000 and any fraud, whatever the value, perpetrated by a senior officer of the association.

PAC conclusion (vi): We emphasise the importance of the Corporation's scrutiny of new development schemes we now look to the Corporation to continue to improve their systems and procedures for effective regulation.

58. The Corporation recognises the need to keep its revised and enhanced system of scheme audit under review and updated whenever necessary. The system is important in monitoring the quality and probity of procurement methods employed by associations.

59. A key feature in the Corporation's new performance review system is that the effectiveness of the new arrangements will be closely monitored. The Corporation will refine and improve the system in the light of experience, so that its work in regulating the activities of associations remains effective.

PAC conclusion (vii): The Corporation need to make faster progress in developing and publishing performance indicators to enable association performance to be compared we look to the Corporation to press ahead with publication and use of performance data without further delay.

60. The Corporation recognises the importance of performance indicators in comparing and assessing the performance of associations. Performance data from the Corporation's annual statistical survey of associations is already published in respect of those associations managing more than 250 dwellings. The Corporation will shortly issue proposals for the publication of a set of indicators relating to the efficiency and standard of service provided to housing association tenants with a view to implementation by the end of 1994.

PAC conclusion (viii): We consider it important that more consideration is given to safeguarding funds and publicly funded assets in the event of an association getting into serious financial difficulties as a result of increased borrowing from the private sector. . . . The Corporation must continue to watch the position carefully to ensure that associations have the resources and experience to manage private sector borrowing satisfactorily.

61. The Department of the Environment (DOE) and the Corporation fully share the Committee's view of the importance of the need to safeguard publicly funded assets. The mixed funded regime introduced by the Housing Act 1988 exposes associations to a degree of financial risk. Associations are allowed to pledge their assets as security for private sector loans. The Government agreed at the inception of the new funding arrangements that such charges would take priority over the recovery of grant in the event of default as the only means of securing private finance for the programme. In the event of associations getting into serious financial difficulties, the Corporation has wide powers to act to protect both publicly funded assets and the position of tenants and this has enabled them to ensure that in no case since 1988 have public funds been lost.

62. The Corporation's system, introduced in October 1992, requiring all large and developing associations to provide a quarterly financial return, ensures that any emerging financial difficulties are identified at an early stage. This provides the Corporation with essential intelligence on which it is able to act quickly in the event that it finds an association is facing problems.

63. More generally, in relation to the Corporation's continuing monitoring of the performance of housing associations in the management of private finance, the study of the treasury management function within associations (referred to in the evidence given to the Committee, Q.10) has now been completed. The Corporation is drawing up proposals for taking forward the consultants' findings and recommendations in this increasingly important area.

On associations' financial management and control

PAC conclusion (ix): . . . We are concerned that there are continuing difficulties in recruitment [of members to management committees with relevant financial and management skills], and we note the Department's encouragement of ideas and proposals . . . for promoting more skills in this area without removing vital safeguards.

64. When considering applications for the registration of new associations, the Housing Corporation considers carefully the range of skills and experience among committee members. New associations must satisfy the Corporation on this point, in particular on the adequacy of their financial and management expertise.

65. As part of its promotional role, the Corporation provides discretionary grants to assist in the training of committee members of small and recently formed associations. For existing registered associations, the Corporation requires information in its new Performance Standards Return on the relevant expertise of committee members and will follow up cases where this is considered to be inadequate.

66. DOE and the Housing Corporation accept that, in the light of the developments in the financial regime in the last few years, it is timely that there should be a general re-examination within the housing association sector of issues such as the recruitment and terms of engagement of committee members. A forthcoming review, being funded by the Joseph Rowntree Foundation, should provide further information on these issues.

PAC conclusion (x): . . . We look to the Corporation to make further progress in working with local authorities and housing associations to improve the handling of housing benefit claims . . .

67. Following research, which the Corporation commissioned, into the processing of housing benefit claims of housing association tenants by local authorities, the National Federation of Housing Associations and the local authority associations have devised a standard Service Level Agreement (SLA) for use by their members. This model framework for the local negotiation of service levels and standards in the processing and administration of housing benefit for housing association tenants was launched in January 1994.

68. The Corporation is monitoring the implementation of local SLAs. Through its new Performance Standards Return it will review information from associations on the percentage of rent arrears which are due to the late payment of housing benefit.

PAC conclusion (xi): We are concerned that the Corporation have no national data on the extent to which associations have an effective system of internal audit, and we note that the National Audit Office's examination found that a high proportion [of the associations included in their sample] did not have such systems. We regard it as unacceptable that two associations [in the sample] advised by the Corporation to establish internal audit units in 1988-89 had failed to do so. We recommend that the Corporation issue firm guidelines on the need for and operation of internal audit, and closely monitor the extent to which that guidance is implemented.

69. The Corporation recognises the need for all associations to have proper arrangements for reviewing the adequacy of their internal controls. It is for an association's committee of management to determine the resources needed for the task, in the light of the size and complexity of the association's operations. The committee of management has to decide whether there should be an internal audit post or posts, or whether internal audit activities can be provided by external advisers. The Corporation has made its requirements on internal controls clear to associations in its recent circular, HC 11/94. As a minimum it requires all associations to have a designated member of staff or (for those associations with no or only very few staff) a committee member to take responsibility for the effectiveness of its internal controls.

70. In answer to Question 92 the Corporation informed the Committee that in the case of the two associations referred to in the C&AG's report, one had chosen to appoint external consultants to provide this service and the other had a nominated officer responsible for internal audit within the finance department of the association. The Corporation is satisfied that, in the circumstances of the associations concerned, proper action has been taken to address their internal audit needs.

PAC conclusion (xii): We are disturbed at the serious fraud committed at Circle 33 Housing Trust . . . We note the action now being taken by the Corporation to resolve the situation and to ensure tight controls, and that there would be no loss of public funds. Both the Department and the Corporation should continue to give close attention to risks of fraud and irregularity in associations and to pursue promptly and vigorously any cases which arise.

71. DOE and the Housing Corporation fully share the Committee's concern at the serious fraud committed at Circle 33 Housing Trust. DOE is satisfied that the Corporation acted firmly and effectively to deal with the situation. The Corporation is continuing to monitor closely the association's progress following the measures which the association took last year to address the internal control weaknesses revealed by the fraud. The Corporation is also keeping a close watch on the association's plans for repairing and improving the properties where missing funds should have been spent on major repairs and adaptations.

72. DOE accepts the need for close attention to be paid to the risks of fraud and irregularity. The Corporation's advice to associations on internal controls places quite firmly on committees of management and their external auditors the responsibility to ensure these risks are minimised by effective internal controls. The Corporation, when advised of any fraud or irregularity within associations, takes immediate steps to ensure that any underlying weaknesses are addressed. It is quite prepared to suspend allocations (as in the case of Circle 33 Housing Trust) and, where the circumstances demand it, to institute statutory supervision.

On oversight of the Housing Corporation and Housing Associations

PAC conclusion (xiii): We look to the Department to continue to ensure that proper financial systems are in place and are applied, whilst maintaining the necessary balance between their oversight responsibilities and the direct management responsibilities of the Corporation.

73. DOE agrees that its oversight of the Corporation is a key element in ensuring that there are effective systems in place to safeguard the public funds paid to housing associations. DOE will continue to exercise this oversight through the corporate plan process, through systems of stewardship reporting and in other regular dealings with the Corporation. Control systems are also considered in the context of quinquennial Financial Management and Policy Reviews, which also consider the overall management relationship between DOE and the Corporation. The next of these reviews will take place during 1995-96. It will be preceded by a Prior Options Review of the Corporation.

PAC conclusion (xiv): The Department should . . . continue to see that needs assessments are regularly compiled and updated to provide the necessary data to help ensure that available resources are targeted effectively.

74. As the Committee notes, there is no single estimate of need for social housing. To target the available resources effectively to the priority areas of need the DOE compiles a Housing Needs Index (HNI), an indicator of the relative need for capital expenditure on housing association schemes. The HNI determines the allocation of resources between regions and informs the allocation of resources made available by the Corporation to schemes in individual local authority areas. The HNI is currently being reviewed with the Corporation and the National Federation of Housing Associations and is updated annually.

75. Within each local authority area housing needs and priorities are identified by the local authority in co-operation with the Housing Corporation and housing associations. The Corporation then invite bids from associations to meet the identified local priorities, and judge these competitively on the basis of overall value for money in order to maximise housing gain from the available subsidy.

PAC conclusion (xv): We attach great importance to the safeguards the Corporation's regulatory framework provides for the proper conduct of business . . . We look to the Department to ensure the Corporation's statutory powers are developed and strengthened where necessary

76. The Housing Corporation already has wide-ranging powers under the Housing Associations Act 1985 (as amended by later legislation) to take action against an association where it considers there has been mismanagement or misconduct. The Corporation has identified some aspects of the regime which it considers could be improved to make it easier to take supervisory action in some circumstances and to obtain systematic information about the unregistered subsidiaries of registered associations. DOE has considered the Corporation's proposals and Ministers see merit in improvements to the present regime on the lines indicated to the Committee. The Corporation will be consulting on its proposals, in order to inform decisions on possible statutory changes once a suitable legislative opportunity becomes available.

PAC conclusion (xvi): . . . It is only by the National Audit Office's examination at associations that the propriety and regularity of expenditure and related issues can be directly and independently examined on Parliament's behalf and the results reported for follow-up by this Committee.

PAC conclusion (xvii): . . . in previous evidence to this Committee the Department of the Environment provided assurance that the National Audit Office would continue to have access rights at housing associations.

PAC conclusion (xviii): . . . we . . . recommend that the National Audit Office's inspection rights at housing associations should be confirmed and made a condition of grants to associations which receive a significant part of their resources from public funds or publicly funded assets. We look forward to an early agreement to that effect . . . [in view of] the enormous scale of the public expenditure handled by housing associations, the national importance of the activities in which they are engaged and the importance we place on independent demonstration that public business is being conducted properly in this area.

77. Housing associations are not public bodies, but are private and independent organisations with constitutions and rules subject to the law on charities or industrial and provident societies. Much of their activity does not derive from public funds and, since the Housing Act 1988, their new development activity has involved a substantial input from private lenders alongside public sector grants. The proper regulation of associations is essential to ensure that the public funds invested in them is safeguarded. Although DOE gave NAO access to housing associations before the 1988 Act, a new regime was then introduced which changed funding and regulatory arrangements.

78. The Corporation reports on the discharge of its responsibilities both to the Secretary of State for the Environment and, in its annual report, to Parliament. As a public body corporate, the Housing Corporation is subject to examination by the National Audit Office and consequently accounts to the Committee for its performance in the regulation of housing associations. In previous evidence to the Committee [PAC 27th Report, 1989-90] DOE emphasised the significance of the National Audit Office's access to the Housing Corporation. DOE still fully agrees that such access is appropriate.

79. DOE considers that the responsibility for ensuring that public money is properly spent and public business properly conducted in this area rests with the Housing Corporation; that therefore the Corporation should continue to account to Parliament for its performance in this regard; and that the addition of a separate body reporting to Parliament on the performance of housing associations would blur this clear line of accountability.

80. DOE agrees that in some circumstances the National Audit Office, in examining the effectiveness of the Housing Corporation, should be able to consult a sample of individual housing associations in order to inform a report on the Corporation by the C&AG. This was the basis of DOE's agreement for associations to be approached in the course of the National Audit Office's work in preparing Report HC 892. DOE is willing to establish an understanding with the National Audit Office on a more formal footing, so that, where in future the National Audit Office wishes to undertake a study of the Housing Corporation's work, the basis on which DOE will agree to seek the assistance of individual associations will be clearer.

81. DOE does however see some scope for improving the effectiveness of the scrutiny of value-for-money issues across the housing association sector in England, by the Housing Corporation being able to draw on other sources of expertise. DOE is therefore exploring the possibility of introducing a role for the Audit Commission to operate in this area as the agent of the Housing Corporation. The Audit Commission has a body of expertise in value-for-money studies across the local authority sector and should therefore be able to bring a new perspective in comparative work across the social housing sector. DOE will be exploring this proposal with the Housing Corporation and the Audit Commission over the next few months.

PAC conclusion (xix): We note that, in response to the recommendation in our 8th Report of 1993–94 about National Audit office rights of access and inspection at all non-departmental public bodies and other organisations which receive the greater part of their income from central government funds, the Government have confirmed that decisions will be taken on a case by case basis. We emphasise that . . . housing associations represent in our view a very strong case for such access.

82. The Government considers that the National Audit Act 1983 provides effective arrangements for the National Audit Office to examine non-departmental public bodies. Where it has been necessary for these arrangements to be extended, the Government has arranged for access on a case by case basis, and will continue to do this. The Government does not believe that the granting of a general power of access to the National Audit Office should be based solely on an organisation receiving the greater part of its funds from the Government. There should also be a degree of Ministerial responsibility to Parliament for that organisation, extending beyond a responsibility simply for the payment of money from voted funds. In the case of housing associations, the Government does not consider it appropriate, for the reasons given above, for the National Audit Office to have a general right of access.

Twenty-first Report

Scottish Office Industry Department

Sale of the Scottish Bus Group

PAC conclusion (i): We are . . . concerned that there was some initial uncertainty in the sale of the Scottish Bus Group as to the respective responsibilities of the Department and the Group . . . and we will expect departments to establish much more clearly defined roles and relationships in future.

83. The Scottish Office Industry Department (the Department) accepts the need for a clear definition of responsibilities in such sales. It believes that these were established in good time for the sale of the Scottish Bus Group (SBG). The respective responsibilities of the Secretary of State and the Scottish Transport Group ("the Group") were set out in section 3 of the Transport Act (Scotland) 1989 under which the disposal took place. In addition, the Department discussed the roles and relationships with the Group at an early stage and the Department established a number of flexible joint arrangements with the Group which reflected the division of responsibilities and which worked to ensure that there was proper control over the sales strategy and active monitoring of the changing circumstances of the disposal process.

PAC conclusion (ii): We note that the Scottish Bus Group company's profits fell from £9 million to £0.5 million in the period prior to the sales. The performance of the local authority passenger transport companies on the other hand improved. Although we accept that differences in route networks make precise comparisons difficult, we are concerned at the effect of this decline of Scottish Bus Group's profits on the value of companies and the prices received for them. We note that it occurred while some companies were being run by managers who subsequently bought them, with the potential duality.

PAC conclusion (iii): We note the Department's view that there was no necessary conflict of interest in allowing managers to run the companies in the period prior to their buying them

84. The Department is satisfied that the prices received for the companies accurately reflected their market value at the time of the sale. The reduction in the profits of the SBG companies during the pre-sale period was the result of declining economic activity, the problems of industrial relations suffered by certain companies, and the extreme vulnerability to competition in a deregulated market of the largely inter urban and rural route networks of the companies. These pressures were likely to have been less intense on the largely urban local authority passenger transport companies. It is also important to recognise that the Bus Group's performance in this period was part of a general downward trend in profitability which began in 1986, two years before the sale was announced.

85. The encouragement of employee participation in share ownership in the private companies was one of the objectives of the sale process and a measure of the Department's success is that management and employee bids were received in all 10 sales, 5 of which were successful. The Group recognised the possibility of a conflict of interests and took action to ensure that the subsidiary companies were managed in the interests of the Group as shareholders. There is no evidence that management/employee buy-outs affected sale prices beyond the price discount arrangements to encourage such buy-outs which were set out in the Disposal Programme.

PAC conclusion (iv): Having regard to these matters, such as the companies' inability to produce some business plans and monitoring information on time, we would have expected there to have been more positive oversight and control by the Scottish Bus Group and by the Department from the beginning of the sale period.

86. Although the Steering Group which reviewed the companies' performance in detail and assisted in the direct management of some companies was not formally established until October 1989, both the Department and the Group took an early

active role in the monitoring and steering of company management by setting up a monitoring group. This was the precursor to the Steering Group which reviewed company business plans, four weekly results and capital expenditure proposals against the targets set by the Group and represented a significant oversight of company management.

PAC conclusion (v): . . . we consider that the creation of the steering group and the increased responsibilities of the Scottish Bus Group managing director came about too late to be fully effective. With a view, therefore, to ensuring more effective management control and to maximising the value of businesses prior to sale, we recommend that in future trade sales departments should require the early appointment of a senior manager, with no interest in the buy-out and with a clear remit to improve company profitability and sale value during the pre-sale period.

87. The Department notes the recommendation. The Group Managing Director was charged with the responsibility for the strategic management of the companies before and during the disposal. The Department does not believe that an external appointment at senior executive level would have materially altered the outcome of the sale.

PAC conclusion (vi): In the case of Citylink we note that the Scottish Bus Group needed to make a £1.5 million cash injection in order to restore the company's assets to zero before selling it for £265,000. We note the Department's view that, given the nature of the company and the competition it faced at the time of the sale, they sold it at the best possible price they could achieve at the time.

PAC conclusion (vii): However we also note that, within three years, the company was sold to National Express for £5.1 million, and that the increase in the value of Citylink stemmed mainly from a change in the company's operating environment. The taxpayer might have been able to claw back some of this increased value if a share option had been included in the sale, as was done for Kelvin Central and Western Clydeside.

88. The Department considers that the price paid for Citylink reflected its value at point of sale. It was a small company with few assets, facing an intense competitive onslaught in 1989 and 1990 and it had no income stream to indicate that a return to profitability was likely under the pre-sale conditions. It was an unattractive prospect for sale on the open market, and there was a clear risk that the imposition of a share option arrangement could have inhibited, or even wholly prevented, a sale. It appears that the reduction of competition after the sale enabled Citylink to return to profitability.

PAC conclusion (viii): We are pleased to see that the former Scottish Bus Group companies have been trading successfully in the private sector, although Western and Clydeside remain unprofitable. We note that the Department believe that the bus companies have managed to reduce costs and maintain essential services.

89. The Department welcomes the Committee's recognition of the overall success of former Group companies in the private sector and points to this success as evidence that the main objective of the sale, which was to promote fair and sustained competition, has been achieved.

PAC conclusion (ix): . . . we consider that the Department should have employed the Government Actuary at an earlier stage in the sale.

PAC conclusion (x): We note that the trustees not only secured significant benefit improvements for members but generated a large surplus which will be paid into the Exchequer. To protect the taxpayer's interest in future sales where pension funds are involved we recommend that departments take early professional advice on all relevant matters such as members' benefits and the disposal of any actuarial surpluses.

90. The Department accepts that early professional advice should be taken on all relevant pension matters. The Government Actuary's Department (GAD) was appointed in April 1989 and was fully involved in all aspects of pension arrangements from that date. This enabled GAD to advise on the proposed arrangements for the pension funds and to confirm final decisions. The Department considers that the date of the appointment did not adversely affect the outcome

of these matters and, in particular, is satisfied that the entitlements of members have been safeguarded and that the position of the taxpayer was protected.

PAC conclusion (xi): We note that the sale will yield some £90 million for the Exchequer compared to an earlier expectation of £103 million. We note that there remains a balance to be remitted of some £8.7 million. As the sale was announced in January 1988, we are concerned that it will have taken over six years to bring it to a conclusion.

91. The figure of £103 million represents the gross proceeds from the sale of the bus operations. £90 million is the total surplus which will be returned to the Exchequer and takes account of such matters as the cost of the Group's investment in the subsidiary companies, the companies accumulated profits and reductions in property prices, residual taxation and contractual liabilities.

92. The Department does not consider the period of the sale, which is comparable to similar sales, to be unreasonable for a complex and successful disposal involving 10 bus companies. The six-year period included essential preparatory work to the sale, the passage of the legislation and the preparation of the disposal programme. The legislation was enacted in July 1989 and the final bus company sale was completed in late 1991. This left the disposal of other assets, particular property, to be completed. The receipts from the sales have been surrendered progressively as sales have occurred. The outstanding cash balance has been reduced to £4.8 million to cover tax, running costs and liabilities until the Group is wound up.

PAC conclusion (xii): Having regard to the fact that sale costs turned out to be more than twice the original estimate, we are surprised that the Department did not draw up more detailed figures at the outset so that they could monitor expenditure trends more effectively. We would have expected them to have revised the estimate when it clearly became inadequate and we consider that they should have consulted the Treasury again on this issue.

93. The Department considers that it was in control of the sale costs throughout the disposal process. Costs were monitored on a monthly basis and the Department was fully aware of the changing costs of the sale. These were due to decisions to incur additional costs through commissioning financial investigations to improve companies' performances and to stem losses, all aimed at enhancing the sale proceeds. The Department believes that the outturn, at some 2.2 per cent of gross sale proceeds, was fully within acceptable limits and represents good value for money.

PAC conclusion (xiii): We are concerned that £787,000 was spent on work which was not subjected to competitive tender. While we note the Department's reasons for dispensing with competition in this case, we emphasise the need for the proper control of costs in the sale of public assets. In particular we look to departments to demonstrate propriety and the achievement of value for money through competitive tendering.

94. The Department strongly endorses the Committee's view on controlling the costs of the sale of public assets and the use of competitive tendering. The Department appointed its advisers in open competition and in accordance with Treasury guidance. The £787,000 spent which was not subject to competitive tendering related to additional work connected with the main contracts which required a high degree of familiarity with the Group's business and which were inappropriate for parcelling into larger contracts for competitive tendering. The Department believes that, in these circumstances, efficiency and value for money gains were achieved through the Group's limited use of such firms.



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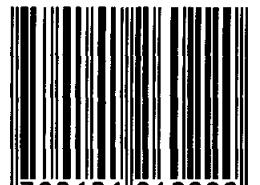
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