Treasury Minutes on the First and Third Reports from the Committee of Public Accounts 2005-2006

1st Report:	Managing National Lottery Distribution Balances
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TREASURY MINUTES DATED 14 DECEMBER 2005 ON THE FIRST AND THIRD REPORTS FROM THE COMMITTEE OF PUBLIC ACCOUNTS, SESSION 2005-2006

First Report

Department for Culture, Media and Sport

Managing National Lottery Distribution Fund balances

PAC conclusion (i): Lottery money does no good sitting in the National Lottery Distribution Fund since the public benefit is delivered only when the money is spent in the community. Distributors should not keep money in the Distribution Fund just in case it is needed for as yet unidentified future projects when they already have applications worthy of funding and when their balances are constantly being replenished as lottery tickets continue to be sold.

1. The Department accepts this conclusion. It and all Lottery distributors agree that the full public benefit is delivered when the money is spent in the community. However, it is also important to recognise that making commitments helps projects progress, for example by levering in partnership funding, thus producing some benefit from the start.

2. Distributors need to meet existing commitments and to make new commitments with confidence. At the end of September 2005 Lottery distributors had made commitments that exceeded the NLDF balance by £1.2 billion, the equivalent of more than 10 months' income.

3. The Department and distributors are not complacent and recognise that Lottery proceeds should be passed more quickly to projects. However, as well as seeking to deliver as much benefit in the community as early as possible, distributors also have to be mindful of the need to invest in high quality projects that meet demonstrable needs.

4. The Department welcomes the contribution the Committee has now made to the debate.

PAC conclusion (ii): Slow progress has been made in reducing the balances held in the National Lottery Distribution Fund. Not only was the overall target for balances to halve by 2004 missed by a wide margin, but the balances of some individual distributors actually increased. By May 2005 total balances had still fallen by only 31% to £2.4 billion from the level of £3.6 billion in March 2002.

5. The overall National Lottery Distribution Fund (NLDF) balance reached a high point of approximately £3.73 billion in July 1999, and since then has fallen by 38% to £2.31 billion at the end of October 2005.

6. Although the target of reducing balances by half was not met in the period specified, setting a demanding target did act as a driver for the substantial reductions achieved. The overall balance continues to fall.

7. The National Lottery Bill currently before Parliament contains a measure which would change the way in which investment earnings on the NLDF are shared between distributing bodies so as to avoid unintentionally rewarding those who hold high NLDF balances. The Bill would also create a reserve power to reallocate an excessive balance from an individual distributing body to another body to be spent on the same good cause sector. The power would be used as a last resort if a distributor had persistently failed to take steps to manage its balance to a reasonable level.

PAC conclusion (iii): A significant reduction in the overall balances depends on action by the Heritage Lottery Fund and the New Opportunities Fund. Between them these two distributors held over £1.5 billion, 64% of the total balances at May 2005. In the case of the New Opportunities Fund, which is merging with the Community Fund to create the Big Lottery Fund, the Department also has an important role to play in giving directions which allow more grant commitments to be made.

8. By 31 October 2005, BIG and HLF, which now receive 66.66% of lottery income, had combined balances of £1.65 billion, 70% of the total. This proportion is not an increase in the 64% figure to which the Committee refers, since it includes the balance of the Community Fund as well as those of HLF and NOF. BIG and HLF will necessarily hold a relatively high share of the balances, though both are reducing their balances and will continue to do so.

9. The balance held by the HLF rose to a peak of almost £1,028 million in January 2003. Since then, however, it has fallen by over 17% to £849 million.

10. The New Opportunities Fund (NOF) came into existence more recently than most other distributing bodies, and followed the same pattern by accumulating a large balance during its first few years. NOF's highest balance was £950 million, also in January 2003, since when it has fallen by almost 35% to £619 million at the end of October 2005.

11. The other predecessor body to the Big Lottery Fund, the Community Fund, built up a balance of £717 million in the first four years of the Lottery, reaching this figure at the end of November 1998. Its balance has now fallen by 77% to £163 million at the end of October 2005.

12. The Department and BIG agree that the legal merger of NOF and CF, if approved by Parliament, will allow the combined balance to be managed to a lower level than in the separate organisations. They also agree that the policy of the Department to issue broad, high level, directions will enable BIG to act flexibly and make commitments more quickly.

PAC conclusion (iv): The Department should set a new target and clear milestones for reducing the balances. For an overall target to be effective, it needs to be underpinned by targets for individual distributors. Each distributor should calculate how much money it needs to hold in the National Lottery Distribution Fund for cashflow purposes, taking account of expected levels of income and expenditure.

13. In the Department's view, its power to give financial directions under section 26(3) of the National Lottery etc Act 1993 is not broad enough to allow it to direct distributors to set targets for the reduction of their NLDF balances. Paragraph 13 of the Committee's report correctly points out that each Lottery distributor is an NDPB in its own right. However, both the Department's guidance on NLDF balance management issued in August 2003 and the NAO report of July 2004 recommended that distributors set targets for reductions in balances. The Department has encouraged distributors to comply with this. All the distributing bodies sponsored by the Department, with the exception of UK Sport whose NLDF balance is already very small, have set targets.

14. In the medium term, the Department estimates that the total NLDF balance will fall to £2.2 billion by 1 April 2006 and to £2.0 billion by 1 April 2007.

15. To achieve a broadly stable position with annual income and expenditure more or less equal, all distributors must take account of the recommendation in the July 2004 NAO report that, in the longer term, they should hold no more in the NLDF than is needed to cover short-term differences between income and expenditure.

PAC conclusion (v): To reduce their balances distributors need to be less risk averse. In deciding how much money they have available to commit to new projects, distributors face inherent uncertainties relating to future income and expenditure. Well managed risk taking would be supported by:

- **distributors assessing their capacity to commit funds to new projects and the likely impact of their decisions on their balances. To help distributors, the Department needs to provide regular and reliable projections of lottery income, which incorporate up to date assessments of the effect of the funding arrangements for the Olympics in London in 2012. Distributors themselves must judge the likely rate at which money will be spent once it has been committed to projects. Historic trends are a good starting point but distributors should also work with the organisations they fund to help them provide more reliable forecasts of their expenditure.**
- **each distributor having a clear policy on the extent to which it is prepared to commit future lottery income. Some distributors do not have explicit policies on levels of commitment and should set them. And those distributors whose policy is not to make commitments against future income should review whether this approach remains appropriate given the level of balances they currently hold.**
- **distributors making grant commitments up to the maximum allowed by the policies they have set. At the time of the National Audit Office report, according to their own policies, distributors could have made additional commitments of nearly £450 million.**

16. The Department agrees with this conclusion. Distributors agree that the level of balances can be reduced further if a higher level of risk is accepted. However, it is a matter for the Board of each NDPB to determine its risk appetite and distributors take the view that it is not clear that there is any case for Boards generally accepting more risk than is implied by their current policies. As the Committee says, these would already allow distributors to make increased commitments.

17. The Department recognises that the award of the 2012 Olympics to London is another factor that distributors will need to take into account in determining their risk policies. It issues quarterly income projections to distributors according to a timetable agreed with the Lottery operator (Camelot Group plc), the National Lottery Commission and the distributing bodies themselves. Since 2003, well before the outcome of the competition to stage the 2012 Olympics was known, these projections have included material about the impact of hypothecated Olympic Lottery Games on income to the non-Olympic good causes. In addition, each quarterly projection includes, as the July 2004 NAO report recommended, an assessment of the accuracy of previous projections. Overall, the degree of accuracy has been good.

18. The Department welcomes the mathematical model developed by the NAO with the assistance of the Heritage Lottery Fund, a revised version of which was issued on 19 October. Some distributors had already developed their own, similar models. The NAO model will help other distributors enhance their forward planning in this area. Distributors are committing more. For example, the Heritage Lottery

Fund's level of over-commitment – that is, the total by which the sum of its commitments exceeds its NLDF balance – increased from £180 million in March 2004 to £300 million in September 2005.

PAC conclusion (vi): Distributors should stop withdrawing from the National Lottery Distribution Fund more money than they need. At present some distributors draw down a standard amount each time and most over-estimate how much money they need, which can result in a loss of interest. In 2003-04 four distributors carried forward average cash balances of over £5 million in their own bank accounts at the end of each period.

19. The Department and distributors agree that they should withdraw from the National Lottery Distribution Fund no more money than they need. The Department recognises, however, that distributors are dependent to a significant extent on drawdown forecasts from grant recipients and it is difficult to make these as accurate as the Department and distributors would like them to be – particularly in the case of capital based awards. Avoiding early drawdown will maximise their investment income on Lottery funds.

20. Some distributors find it helpful to draw down weekly from the NLDF. The Arts Council England and the Heritage Lottery Fund have both recently agreed that they should also begin to draw down weekly instead of monthly. The Department is discussing the merits of a move to weekly drawdown with other distributing bodies.

PAC conclusion (vii): The successful bid to hold the Olympics in London in 2012 could have a significant impact on the distributors, and therefore the pattern of balances. The introduction of Olympic Lottery games to help fund the Olympic and Paralympic Games could result in players switching from existing Lottery games, and up to £410 million could come from changes to the shares of Lottery proceeds allocated to existing good causes. The five sports distributors are also expected to spend some £340 million on the Games.

21. We recognise the figures given by the Committee, which are correct. The Government made it clear when the London Olympic bid was launched that, should the bid succeed, National Lottery proceeds would form a significant element of the public funding package for staging the 2012 Games.

Third Report

Ministry of Defence

Major Projects Report 2004

PAC conclusion (i): The £4.8 billion of cost overruns recorded in the Major Projects Reports 2003 and 2004 will put further pressure on an already tightly-stretched defence budget….

1. The Department agrees that the cost growth recorded in Major Projects Report (MPR) 2004 is unwelcome and accepts this has an impact on other projects. Like any large organisation, however, the Department maintains a sophisticated planning process to address the many factors which affect our spending plans – which may include technical delays and changes to priorities as well as cost growth. This facilitates the management of the consequences of these factors in order to minimise their impact on the delivery of new equipment capability to the Armed Forces. The fact remains, however, that our Armed Forces have some of the best equipment in the world. The Department attaches the highest priority to ensuring that those who risk their lives on operations have what they need; our success in delivering Urgent Operational Requirements (UORs) and in managing some projects to a "gold standard" has recently been praised by the National Audit Office (NAO). But major projects are often at the cutting edge of technology and thus may contain significant risk that can result in delay or cost growth. The Department is committed to improving the management of these risks and thus improving the quality of forecasts made at key decision points, though because of the long term nature of our major equipment projects, the reduction in the level of cost-growth in which they result will only become apparent over time.

PAC conclusion (ii): The Department could not say when it expected to see consistent year-on-year improvements on the cost and time performance of the 20 major projects responsible for some 75% of annual expenditure on equipment…. The Department will need to focus particularly closely on the 20 largest projects because they represent the real management challenge and are where most money is lost.

2. The Department notes the Committee's concerns. Defence procurement can be technically difficult and complex. The risks entailed are significant and some projects within the MPR population contain risks that were not fully quantified before the main investment decision was taken. It is therefore possible that some of these risks will adversely affect future forecasts of cost and time to completion for some years to come. That does not mean that the Department should not strive to improve and we remain committed to building upon the better results indicated by the Defence Procurement Agency's (DPA) performance against its Key Targets in 2004/05. In April 2004 the Department introduced Key Stage Peer Review and Project Review and Assurance control mechanisms to provide the opportunity for a more disciplined assessment of projects across the whole of the Key Target population that, over time, will mean that projects are more mature when approved and thus face fewer problems than some projects have in the past. In the meantime the Department will continue to focus on the need to contain costs and schedules on the current population of projects.

PAC conclusion (iii): The amount of work undertaken in the assessment phase is still not sufficient to enable sensible investment decisions to be taken…. [The Department] should only approve business cases if the project can be shown to have reached the appropriate level of maturity in all aspects. The Department should develop measures of maturity for procurement strategy, supplier relationships, technical risk and finance for projects.

3. The Department acknowledges that in the past, insufficient work has been, in some cases, performed during the assessment phase to define and quantify project risk prior to Main Gate investment decisions and welcomes the Committee's acknowledgement that the effectiveness of the assessment phase cannot be judged by the amount spent in that phase. The Department has already introduced measures to ensure that projects do not progress to Main Gate unless they have achieved an appropriate level of maturity. In February 2005, the Investment Approvals Board (IAB) defined the requirements for project maturity at Main Gate and seeks evidence of this before recommending approval to Ministers. The previously mentioned Project Review and Assurance process includes an assessment of all those measures recommended by the Committee and more.

PAC conclusion (iv): The Department is seeking to design appropriate procurement strategies for complex projects, including innovative approaches such as the Alliance under which it plans to run the Carrier Strike programme…. Where Alliances are used, the Department should develop explicit criteria to select the right partners, and be ready to exclude contractors from an Alliance if they do not measure up.

4. The Department fully recognises the need to place more emphasis on confidence in the ability of suppliers to manage risks. Selection criteria include issues such as past performance and confidence in being able to work together effectively. As part of the Department's More Effective Contracting (MEC) initiative, the use of a staged approach to contract commitments offers the opportunity to review performance as part of ongoing activity with clearly defined exit/entry points linked to programme risk. Since it's introduction in 2004 we have seen a number of major projects incorporating such features, as staged contracting, use of Earned Value Management, exit/entry points and incentivisation techniques within contracts. It is also mandated that procurement strategies now address MEC and include appropriate features within programmes.

PAC conclusion (v): In the past, the Department and industry have sought to provide the most advanced capability possible to the Armed Forces…. The Department needs to be willing to sacrifice specific elements of capability on particular programmes to meet time and cost constraints, if it is to deliver timely and cost effective capability from the defence budget as a whole.

5. Trading off between performance, cost and time is a key principle of Smart Acquisition, but the Department accepts the need to define better the 'space' within which such trade-offs can be made. Key User Requirements (KURs) for new equipment capability projects will in future be expressed as being bounded between an 'objective' capability that would fully meet the military aspiration and a 'threshold' capability which represents the minimum capability required to meet operational requirements. Integrated Project Teams (IPTs) will be free to trade capability against time and cost within these bounds to ensure that the project remains within its approvals. Detailed guidance for IPTs to develop their trade space will be published on the Acquisition Management System internet web site by 31March 2006.

PAC conclusion (vi): The Department's latest programme of reform to improve defence procurement, DPA Forward, will require better joint working amongst various Departmental stakeholders to ensure success….. The Department needs to be able to evaluate the strength and consistency of the leadership of the programme at all levels using, for example, performance against targets and 360 degree reporting mechanisms.

6. The Department welcomes the Committee's support for DPA Forward. Since its inception in October 2004, the programme always had the strong support of Ministers and other senior stakeholders across the Department and the full personal commitment of the Chief of Defence Procurement and the DPA Board. The Department's overall strategy for improving defence acquisition, of which DPA Forward is a part, is being set by the Acquisition Policy Board, which is chaired by the Minister of Defence Procurement. The Defence Industrial Strategy, following its launch later this year, presents an opportunity to increase further the coherence of changes to acquisition practice across the Department and to ensure that all stakeholders work jointly together to achieve common outcomes. The overall success of DPA Forward will be measured by improvement in the DPA's performance against its Key Targets. Underlying measures are also currently being developed to assess the success of each strand of activity. Specific tools, such as 360 degree feedback mechanisms, have already been used to assess the effectiveness of the leadership provided by the DPA Board, and are routinely used, as part of well-established practice, to assess leaders across the Department.

PAC conclusion (vii): The placing of Financial Controllers in project teams should support better financial management and decision making on projects. The Department should consider whether it lacks other key skills required to deliver a complex acquisition programme, … in the light of its increasing use of innovative procurement strategies.

7. The Department welcomes the Committee's support for the establishment of Financial Controller posts. The Department already has work in train to address other key skills issues. The Department's recently launched 'acquisition values' statement notes that 'people are the key to our success' and should be equipped with the right skills, experience and professional qualifications. The Department has identified a number of senior staff to act as Skills Champions who will seek to identify the requirement for specific skill sets across the Department and will champion resourcing and development programmes to ensure those needs are met. Three other specific areas of work in support of skills issues are:

- Project Delivery Skills Programme. The Department's Acquisition Policy Board has endorsed a plan to address concerns over shortages of Project Delivery Skills. This will enable the development of the right quantity and quality of these skills via a strategy of assessment, development, incentivisation and assurance of resulting business performance improvement. Detailed plans for implementation are currently being developed. If approved, the intention is to launch a 2 year programme of improvement measures, beginning in December 2005, covering workforce planning, development and selection, the skills base, professionalism and will be subsequently incorporated within the Department's personnel plans.

- Acquisition Leadership Development Scheme (ALDS). The ALDS was established in April 2000 to support the development of acquisition leaders. It currently has 664 members (352 civilian, 297 military and 15 Defence Industry). The scheme provides a talent pool for future acquisition leaders and supports the continuous professional development for existing acquisition leaders. While the scheme has a high level of member satisfaction, it is being reviewed to further improve effectiveness, to broaden the scope of the scheme, and to ensure that it addresses identified shortfalls in key leadership competences, such as relationship management. This review should be completed in early 2006, resulting in an ongoing programme of improvements thereafter.

- Development Partners. The DPA and Defence Logistics Organisation (DLO) have established the role of "Development Partner" as a senior champion for each key specialist function. The role of Development Partners is to help determine the requirement for these skills across the two organisations and, working with Departmental Skills Champions, identify the most effective resourcing and development programmes to meet these needs. The Development Partner initiative began in the DPA in mid 2004, and was relaunched with a wider range of Development Partners representing the key functional areas across the DPA and the DLO in October 2005.

PAC conclusion (viii): This Report once again records the woeful performance of the Department in procuring defence equipment, and its inability even to follow its own, broadly sensible, procurement rules. To all appearances however, no-one is ever held responsible for these failures, and… careers… remain unaffected.

8. The Department accepts that there is still significant room for improvement in procurement practice, and is working hard to bring standards in all acquisitions up to those which are already achieved in the best managed. Such improvements are an important element of the Defence Industrial Strategy which is due to be published soon. The Department does not, however, accept the Committee's description of its performance in procuring defence equipment as 'woeful'. During the 12 months covered by the MPR 2004, the DPA delivered £3.7 billion worth of equipment to the Armed Forces. This included delivery of the Strategic Sealift cargo service 20 months ahead of schedule; delivery of new deployable accommodation for Operation TELIC a year early and the delivery an artillery locating radar system six months early. Also delivered were 24 new or updated aircraft and helicopters, four warships and support vessels and a range of new land equipment. As a further illustration the DPA took forward over 190 individual UORs at a total acquisition cost of over £510 million in support of Operation TELIC. While we accept that there have been continuing problems on some projects, the vast majority of performance targets (KURs) for projects covered by the MPR will be met. This demonstrates that we are providing our Armed Forces with the high standard of equipment that they deserve.

9. Senior acquisition executives are held accountable for their performance. It is not always possible to attribute blame to any single individual, especially where key positions have changed hands over the life of a programme. But where there is evidence of underperformance, appropriate support is provided and, if necessary, individuals have been removed from post. In such circumstances, it would be inappropriate to declare these actions publicly, but even where individuals remain in the service, our desire to manage internal management issues confidentially should not lead to the mistaken conclusion that there is no detrimental effect of such moves on people's careers.

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