



Sajid Javid
Secretary of State for Housing, Communities
& Local Government
2 Marsham Street
SW1P 4DF

20th March 2018

Dear Sajid,

LOCAL GOVERNMENT OVERPAYMENT

1. As we have discussed, in preparing for the 2018-19 fiscal year, officials have discovered an error in the methodology used to calculate the sums due to Local Authorities participating in 100% business rate retention pilots. The methodology incorrectly applied a factor used to compensate focal authorities for the under-indexation of business rates to grants that have been rolled into pilot local authorities' budgets. These local authorities were then paid "on account" on this basis at the start of 2017-18. This has led to an overpayment to those Local Authorities of £36 million in 2017-18.
2. You have told me you are minded not to recover this funding as Local Authorities will have been operating on the understanding that the sums have already been secured and, at this late stage in the year, a sudden reduction in their funding would have a negative impact on delivering their objectives.
3. As the department's accounting officer, I need to be mindful of the public accounting rules in respect of overpayments. *Managing Public Money*¹ notes that "most organisations responsible for making payments will sometimes discover that they have made overpayments in error. In principle public sector organisations should always pursue recovery of overpayments, irrespective of how they came to be made."

¹ Annex 4.11

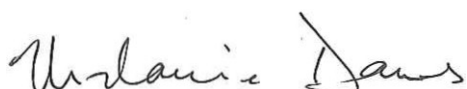
4. While the Government can ease the cash-flow burden by not requiring repayment until a later stage (for example, by deducting the amount from other payments due to the beneficiary), this does not affect the requirement to recover the overpayment.
5. Having set out the principle, *Managing Public Money* acknowledges that: "In practice, however, there will be both practical and legal limits to how cases should be handled. So each case should be dealt with on its merits." It discusses some exceptional circumstances that might apply, such as it not being cost-effective to recover the money, or where recovery would cause hardship.
6. In my view, the rules of *Managing Public Money* do not provide for an exception here. Indeed, it specifically states that overpayment of grants to persons or corporate bodies should be treated as business transactions and a full refund sought.
7. However, there may be wider public policy grounds for not recovering the money in this case:
 - while the overpayment represents a small proportion of each local authority's income, and the average impact on the local authorities concerned is -0.6% of their retained business rates, the average reduction in the benefit of being in a pool is 17.1%. In addition, 8 local authorities lose more than 25%. (Indeed, Cornwall would theoretically see a loss from being a 100% pilot, although in practice the department would ensure that they are no worse off than had they not participated, in line with the "no detriment" clause in the pilot.);
 - while the business rates retention system is set up to deal with changes in income between forecasts and outturn, and the figures that local authorities work with at the beginning of the year are generally subject to change at a similar or greater scale than this error by the time outturn is known in the following July, this new change comes at the very end of the fiscal year, after local authorities have produced revised estimates for their income based on the incorrect methodology. These authorities are likely to have spent at least some of this income on meeting challenging objectives as part of their individual devolution deals;
 - all else being equal, this particular reduction in their income is the result of a mistake by the department and not a result of the local authorities' own actions or changes in local economic growth. It was therefore not something that could have, or would have, been planned for. It may be unreasonable to expect local authorities to respond at this very late stage in the financial year.

Future Assurance

8. I am sorry for this mistake made by officials in the department, creating the need for this letter.
9. Following the 2013 Macpherson report on the quality assurance of Government analytical models, the department has put significant effort into ensuring that its production processes and quality assurance reflect best practice. However, this error demonstrates that there is clearly more we need to do. Given the importance of business rates as a tax, as a redistribution mechanism across local authorities, and as an incentive for growth, we need to ensure that the department's work is on a stronger footing for the future.
10. As we have discussed, I believe that we should commission an independent review of the internal processes and procedures that underpin the department's oversight of business rates and related systems. This should include modelling and analytical work, how officials manage the interface with policy decision-making, and resourcing and skills.

Conclusion

11. In my view, the rules of *Managing Public Money* indicate that the department should seek repayment in this case. However, there are also broader considerations, particularly given that the need for the repayments has arisen from an error by the department.
12. If you decide not to recover the overpayments I will need your written direction. I will then ensure that all necessary steps are taken to carry it out without delay. I will also alert the Comptroller and Auditor General, who will inform the Public Accounts Committee. It will then be for the committee to decide whether to investigate the matter further, for example by holding a hearing in Parliament.



MELANIE DAWES