HM Treasury

# Treasury Minutes

## Government response to the Committee of Public Accounts on the Sixty-Ninth to the Seventy-First reports from Session 2017-19

CP 56

March 2019

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Presented to Parliament
by the Exchequer Secretary to the Treasury
by Command of Her Majesty

March 2019

CP 56

TREASURY MINUTES DATED 7 MARCH 2019 TO THE COMMITTEE OF PUBLIC ACCOUNTS ON THE SIXTY-NINTH TO THE SEVENTY-FIRST REPORTS FROM SESSION 2017-19.



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# Government responses to the Committee of Public Accounts Session 2017-19

# Sixty-Ninth Report of Session 2017-19

## Department of Education / HM Treasury / UK Government Investments

### Sale of student loans

#### Introduction from the Committee

Government's student loan portfolio is growing rapidly. The total outstanding face value of English loans—considering accrued interest, cancellations and repayments already made—rose from £89 billion in March 2017 to £102 billion in March 2018. The Department expects it to reach £473 billion by March 2049. Government expects only 55–60% of the value of the loans to be repaid: some borrowers will not reach the threshold level of income for repayment and others will not have repaid the loan by the time it matures. The Treasury is concerned about the growth in the loan book and the resulting exposure of public finances to the risks within the portfolio. As government has a wider policy not to hold assets unless there is a policy reason for continued public ownership, in 2013 it announced a programme to sell-off a portion of its student loan book and to raise about £12 billion by 2022. In December 2017 the Government completed its first sale of loans to private investors, achieving £1.7 billion from 1.2 million loans held by over 410,000 borrowers. HM Revenue & Customs and the Student Loans Company, alongside UKGI, will continue to administer the loans and collect repayments leaving the borrowers unaffected by the sale. On 10 October 2018, the Government announced the second sale under the programme.

Based on a report by the National Audit Office, the Committee took evidence, on 10 September from the Department for Education, HM Treasury and UK Government Investments. The Committee published its report on 22 November 2018. This is the Government response to the Committee's report.

The second sale was since completed on 4 December 2018.

#### NAO and PAC Reports

- NAO report: The sale of student loans – Session 2017-19 (HC 1385)
- PAC report: The sale of student loans – Session 2017-19 (HC 1527)

#### Government responses to the Committee

**1: PAC conclusion:** ***The Treasury and the Department for Education have not made clear how this transaction decreases the long-term risk to the public finances.***

**1a: PAC recommendation:** ***Before concluding any further sales, the Treasury and the Department need to articulate how the transaction fits into the strategy for the whole loan book, and how it improves public sector finances over the long term.***

1.1 The Government disagrees with the Committee's recommendation.

1.2 The Government already has a clear policy position on the sale of student loans, which it has most recently articulated in a report to Parliament also made available on Gov.uk.[1] Selling assets, like student loans, where there is no policy reason to retain them and value for money can be secured for the taxpayer, is an important part of the Government's plan to repair the public finances. Asset sales free up resources that can then be put to use for purposes or policies with greater social or economic returns, whilst keeping within the spending limits we need to strengthen the public finances. Reducing Public Sector Net Debt (PSND) through asset sales – where there is no longer a policy reason to hold the asset and value for money can be secured – supports Government's commitment to enhancing the UK's economic resilience, improving fiscal sustainability and reducing debt interest. In considering the long-term value of the asset to Government, the Government takes into consideration not only the potential

[1] https://www.gov.uk/government/publications/sale-of-student-loans-pre-2012

revenue from the asset but also factors such as inflation, the opportunity cost of having money tied up in the asset, and the risk associated with fluctuating repayments over a long period of time.

1.3 Sales of the loans via the Government's current method also transfer substantially all the risks associated with them to the private sector. These risks are correlated with other risks the Government faces. For example, repayment income will fluctuate with wider economic performance, as will tax receipts and payment on managed expenditure like benefits. As such, selling the loans in this way reduces the Government's exposure to this fluctuation, thereby de-risking the public-sector balance sheet. The Office for National Statistics (ONS) have confirmed that these loans were declassified as assets (along with their associated risks) from the public-sector balance sheet for the first sale.

1.4 This first transaction along with the programme of sales therefore, fit into this wider strategy of improving public sector finances. Retaining the Plan 1 loans on the Government's balance sheet no longer serves a policy purpose and the Government has no plans to change, or consider changing, the terms of pre-2012 loans and has excluded them from the current review of Post-18 Education and Funding. As such, the Government set out in the October 2018 Budget a sale programme targeting £15 billion in total proceeds from the Plan 1 loan book by 2022-23.[2] The Government has not made a decision to sell post-2012 loans, the terms and conditions of which are in scope of the Post-18 Education and Funding Review.

**1b: PAC recommendation:** ***Once the education funding review is complete, the Department and the Treasury should review how the disposal strategy can most effectively decrease the long-term risk to the public finances.***

1.5 The Government agrees with the Committee's recommendation.

**Target implementation date:** within six months of the completion of the Post-18 Education and Funding Review

1.6 Once the review is complete, the Government will consider how the disposal strategy can most effectively decrease the long-term risk to the public finances.

1.7 It should be noted that Plan 1 loans, which make up the current programme of sales targeting £15 billion in proceeds by 2022-23, are excluded from the scope of the Review and will therefore be unaffected by it. It should further be noted that the current sale method transfers substantially all the risks associated with the loans to the private sector, reducing Government's exposure to fluctuating income. Selling the oldest loans in a largely closed book of loans first, is the most appropriate approach to ensure value for money. These borrowers have the longest track record of repayments, are more likely to be on an established career path and have the most data on their historic earnings. These cohorts also have the longest track record of servicing. All of this information helps Government, and the market, to more accurately estimate the value of the loans and ensure the efficient pricing test of the value for money framework is met.

1.8 The Government continues to explore options for the sale of assets, where there is no longer a policy reason to retain them and when value for money can be secured for taxpayers. This is an integral part of the Government's plan to improve the public finances. However, the Government has not made a decision to sell post-2012 loans, the terms and conditions of which are in scope of the Review.

**2: PAC conclusion:** ***The government's objective to reduce 'public sector net debt', as with previous asset sales, runs the risk of being prepared to sell at any price.***

**2: PAC recommendation:** ***Government must develop public sector finance objectives for future sales that go beyond the simple focus on reducing Public Sector Net Debt before any more asset sales are concluded to give a true picture of the value of the sale to the public purse.***

[2] https://www.gov.uk/government/publications/budget-2018-documents

2.1 The Government disagrees with the Committee's recommendation.

2.2 The Government does not sell at any price. The use of fiscal aggregates does not affect the economic rationale for the sale, which is based on a consideration of value for money and is independent of fiscal policy and fiscal treatment. Consistent with the Treasury's Green Book,[3] it involves three tests: that

i) an efficient market exists;
ii) the sale is structured to achieve efficient pricing; and
iii) the sale price exceeds the retention value or is at least broadly neutral.

The Government will only proceed with a sale if it is assessed to be value for money on its own merit.

2.3 In addition to achieving value for money, the sale must also meet three objectives set out below, only one of which involves reducing PSND:

- ensuring a sale leads to a reduction in Public Sector Net Debt (PSND) and does not significantly impact Public Sector Net Borrowing (PSNB). As a result, Government's risk exposure to the portfolio is reduced;
- ensuring a sale does not involve the terms of the loans being altered to the borrowers' detriment or have a negative impact on Higher Education policy objectives of providing access to education; and
- if taken forward, that a sale represents value for money for the taxpayer and has a reasonable expectation of being repeated.

2.4 The Government considers the full range of policy and fiscal impacts when deciding to dispose of an asset, and reducing PSND is only one consideration. It is important to note that PSND is a long-established metric with a significant back series of data and has formed the basis of Government's debt targets since 1997. It is constructed in line with internationally agreed accounting methodology, which is upheld by the Office for National Statistics. PSND is closer than other metrics to measures used by the International Monetary Fund and other institutions to ensure international comparability, and by credit rating agencies to analyse debt sustainability. Reducing PSND through asset sales – where there is no longer a policy reason to hold the asset and value for money can be secured – supports Government's commitment to enhancing the UK's economic resilience and improving fiscal sustainability.

2.5 Based on the current treatment of income-contingent repayment loans in the national accounts, Public Sector Net Financial Liabilities (PSNFL) does not recognise the impaired nature of student loans, and therefore greatly overstates what they are worth. The change in treatment announced by the ONS in December 2018 will affect the impact on various fiscal measures, including PSNFL. However, this would still not alter the economic reality or rationale for the sale, which is based on an assessment of whether the Government is better off retaining or selling the loans.

2.6 On completion of Sale 2 in December 2018, the Government set out the impact of that sale on various fiscal measures, along with the rationale for its objectives, in a report to Parliament also made available on Gov.uk.[4] Additionally, as announced in *Managing Fiscal Risks* published in July 2018, the Government has already committed to taking further steps to increase the transparency of asset sales in order to demonstrate that they represent value for money. Government will require that after each sale, departments publish the impacts of the sale on the fiscal aggregates, including the public-sector balance sheet, and disclose whether the sale was within, below or above the retention value range.

**3: PAC conclusion:** ***The uncertainty over future repayments undermines the government's ability to accurately value the loan book.***

**3a: PAC recommendation:** ***Within six months, the Department should provide the Committee with updates on: how it has tested and, if necessary, refined the model to improve its accuracy; how this affects the timing of the sale programme; and specifically whether future sales would be better deferred until the model's accuracy is tested further.***

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[3] https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent
[4] https://www.gov.uk/government/publications/sale-of-student-loans-pre-2012

3.1 The Government agrees with the Committee's recommendation.

**Target implementation date:** May 2019

3.2 The Government is happy to write to the Committee with further updates on the model and would like to reiterate Justin Manson's offer of a meeting to help members understand the modelling and assurance processes in more detail.[5] However, the Government cannot agree with the Committee's conclusions that form the basis of its recommendation. The Government is confident that its Transition-based Earnings and Repayment Model (TERM) is fit for purpose and will continue to focus on development to ensure that it remains so for future sale cohorts. Before launching the first sale, TERM had to pass rigorous internal review by the former Department for Business, Innovation and Skills' Operational Research Unit, multiple external audits, and several detailed external reviews by ratings agencies. The Government's ongoing quality assurance processes for TERM are aligned with the latest actuarial standards and there is no evidence to suggest that TERM is inaccurate.

3.3 It is also not correct to say that 'the Department has only one full data-point against which to evaluate the model'. The timings of loan repayments are volatile as they depend on a range of factors, some macro-economic and some borrower-specific. Repayments need to be assessed over a number of years to enable a reasonable comparison between the estimate and actual cashflows. In assessing TERM, Government compares historic cashflow outcomes with modelled outputs as part of the assessment of fitness of the model for each sale. Post-sale, there are two data points a year to allow Government to compare the forecast cashflows from TERM with actual cash flows. Thus far TERM has been shown to be performing well within reasonable tolerances.

**3b: PAC recommendation:** ***In developing its strategy for the loan book, the Department must ensure it has a robust sale model for estimating cash flows from both pre, and post, 2012 loans, including the effect on market value of changes to the loan terms, such as an increase in repayment thresholds.***

3.4 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

3.5 The Government agrees that there must be a robust model for estimating cash flows from loans to be sold and is confident that a robust model is in place. As set out above, there is no evidence to suggest that the model is inaccurate.

3.6 It is not correct that the Government 'has no similar model for the other loans issued either before or after 2012'. As the Committee noted in the introduction to its report, the Government launched a second sale in October 2018. The Transition-based Earnings and Repayment Model (TERM) was suitably adapted for Sale 2 well in advance of that launch, having been tested and quality assured to the same high standards as it was for Sale 1. Work had also commenced to configure TERM for Sale 3 as well as explore modelling options for the rest of the pre-2012 loan book. The Government will continue to ensure that all sales are supported by a robust model.

3.7 The Government has not made any decision to sell post-2012 loans, the terms and conditions of which are in scope of the Post-18 Education and Funding Review.

**4: PAC conclusion:** ***In deciding whether to sell, Treasury does not take sufficient account of a range of valuations, instead relying on a conservative 'retention value'.***

[5] https://www.parliament.uk/documents/commons-committees/public-accounts/Correspondence/2017-19/20181009_Letter_to_PAC_Model%20Assumptions.pdf; and https://www.parliament.uk/documents/commons-committees/public-accounts/Correspondence/2017-19/20181018-Letter-to-Chair-relating-to-Model-Inputs-Outputs.pdf

**4: PAC recommendation:** ***When deciding to sell an asset, the Treasury's Value for Money criteria should include a wider set of valuations than solely the retention value. This must include, but may not be limited to, the value the market might be prepared to pay for the assets: 1) at the point of sale, with a clear indication of any novelty discount, and 2) at points in the future, under different scenarios, as the novelty discount reduces and risks change.***

4.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

4.2 The Government's sale decision did not 'rely solely on its 'retention value'', and as both the Committee and the National Audit Office have noted[6], the Government calculated multiple valuations using different approaches to provide an additional cross check of where fair value lay, and to help determine whether the market was operating and pricing the assets efficiently. As a result, the Government agrees with the recommendation, but disagrees that it relies on a 'conservative retention value'.

4.3 Consistent with the Green Book, the Government's sale decision involved three value for money tests:

- that an efficient market exists for this asset;
- that the sale is structured and executed in such a way as to promote efficient pricing; and
- that the sale value exceeds the Government retention value or is at least broadly neutral.

4.4 In particular, the efficient pricing test looks at whether investor pricing reflects the Government's assessment of a fair market price for the asset and that the market is pricing the risk of the assets appropriately. The Government will only sell if the efficient market and efficient pricing tests, which are part of the value for money framework that Government has set out, are met for every sale.

4.5 The novelty discount does not form part of the Government's retention value, which is purely a question of whether it is better value to the Government to hold or sell the asset. However, where appropriate, the Government's assessment of a fair market price is adjusted to take account of the complexity, illiquidity and novelty of the asset. The novelty discount is not a perfectly observable value that can be easily quantified and does not automatically reduce over time. Instead, the Government expects any decrease in novelty discount to result from increased investor familiarity with the asset class. For this reason, it would be misleading to compare future prices for the notes with those received at the point of sale.

4.6 The Government's own analysis also does not show that 'it could have expected to recoup the £1.7 billion sale price in only eight years'. The outputs from the model provided to the Committee show the Government receiving £1.7 billion in undiscounted cashflows within ten years not eight. More importantly, undiscounted forecast cashflows do not represent the value of these loans to Government. Economic and financial theory and practice have long recognised that using a payback method is an incorrect way to value future cashflows. When calculating the value to Government of retaining an asset, as well as forgone future cashflows, it must also take account of inflation, the riskiness of the particular asset, the opportunity cost of having money tied up in the asset and the time value of money. This is the correct methodology and is the basis for the Government's retention value. The Government will write to the Committee to explain this point in more detail.

**5: Committee of Public Accounts conclusion:** ***We are concerned about the lack of transparency to the public and Parliament surrounding this sale.***

**5a: Committee of Public Accounts recommendation:** ***UKGI should review how it balances transparency with any perceived risks to value for money. It should write to us within six months with the outcome of its review and include an assessment of the impact of non-disclosure of investors.***

[6] https://www.nao.org.uk/wp-content/uploads/2018/07/The-sale-of-student-loans.pdf and https://publications.parliament.uk/pa/cm201719/cmselect/cmpubacc/1527/1527.pdf

5.1 The Government agrees with the Committee's recommendation.

**Target implementation date:** May 2019

5.2 UKGI has begun a review exercise with investors, market leaders and its advisors to test the commercial impacts of disclosure on Government and investors in the programme of sales of the student loan book.

5.3 UKGI will write to the Committee within six months with the outcome of its review.

**5b: PAC recommendation:** ***For this first sale the Department should at a minimum disclose publicly the number and type of investors. It should seek permission from all investors to release their names, and do so where possible. For future sales there must be a presumption to release investor names, unless there is an evidenced and quantified risk to value for money in doing so***

5.4 The Government agrees with the Committee's recommendation.

**Target implementation date:** May 2019

5.5 As above, UKGI will write to the Committee within six months with the outcome of its review regarding the disclosure of investors.

5.6 For Sale 2, the Government revised its report to Parliament to include the number and type of investors in the sale and will continue to include this information in future reports.[7] The Government would like to take this opportunity to confirm that Sale 1 saw allocations made to 36 institutional investors across the 4 notes and involved the same investor types as set out in the Sale 2 report.

[7] https://www.gov.uk/government/publications/sale-of-student-loans-pre-2012

# Seventieth Report of Session 2017–19

## Department for Transport/Cabinet Office

### Department for Transport's implementation of Brexit

#### Introduction from the Committee

The Department is responsible for preparing the transport system for when the UK leaves the EU (including maintaining transport connectivity between the UK and the EU). The Department's responsibilities cover areas of vital importance to citizens and business spanning, for example, road, rail, maritime and air access routes to Europe. The Department reports on 17 EU Exit work streams (which largely overlap with 28 internal Departmental projects), out of more than 300 being delivered across government. The 17 work streams involve projects to deliver the changes required to the transport system to enable the UK's exit from the EU. They range, for example, from managing the transport consequences of potential disruption at ports, the permit and licensing regimes that will be in force once the UK leaves the EU through to making plans for setting new car emissions targets. The Department spent £1.6 million on EU Exit work in 2016–17 and £5 million in 2017–18. It has an allocation of £75.8 million in 2018–19 and plans to spend an additional £30-£35 million on Project Brock. The Department aims to pass 66 Statutory Instruments (SIs) through Parliament by 29 March 2019, of which it regards 61 as essential. At the time we took evidence on 24 October 2018, 19 had been laid in the House.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence, on 24 October 2018, from the Department for Transport on the progress made with its preparations for the UK's exit from the EU. The Committee published its report on 28 November 2018. This is the Government response to the Committee's report.

#### NAO and PAC Reports

- NAO report: Implementing the UK's Exit from the European Union – Session 2017-19 (HC 714)
- PAC report: Department for Transport's implementation of Brexit – Session 2017-19 (HC 1657)

#### Government responses to the Committee

**1: PAC conclusion:** ***There is a significant and growing risk that the Department will not be ready if the UK exits the EU without a deal.***

**1: PAC recommendation:** ***The Department should write to the Committee before Christmas 2018 to set out progress achieved against its 28 projects, and which projects remain at greatest risk.***

1.1 The Department agrees with the Committee's recommendation.

**Recommendation implemented**

1.2 The Permanent Secretary *wrote to the Committee* on 21 December responding to this recommendation. The letter outlined the progress that the Department has made regarding its Road EU Exit Programme, including the application process for Road Haulage Permits, the Trailer Registration scheme, and the International Driving Permits project. It highlighted the progress in signing Air Service Agreements with the USA and Canada. The letter also discussed the risks that remained in delivering the Department's legislative programme and Operation Brock regarding traffic management in Kent.

**2: PAC conclusion:** ***The Department's preparations for avoiding disruption around major ports are worryingly under-developed.***

**2: PAC recommendation:** ***The Department should write to the Committee before Christmas 2018 setting out the results of any testing of Project Brock, and how wider plans to keep ports across the UK open for business have progressed.***

2.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented**

2.2 The Department disagrees with the characterisation of its preparations as 'worryingly under-developed'. The Permanent Secretary's letter of 21 December responded to this recommendation. The letter outlined the progress that had been made with the infrastructure elements of Operation Brock and the work that has been undertaken with the Kent Resilience Forum and interested parties across Whitehall. The letter also referenced the live test of the route from Manston airfield and table top exercise on the entire traffic management system that took place in early January.

**3: PAC conclusion:** ***There is a danger that the required legislation will neither be subject to proper scrutiny, nor passed in time for EU exit.***

**3: PAC recommendation:** ***As recommended in our recent report on Defra's preparations, The Cabinet Office should prioritise EU statutory instruments across government to ensure the drafting of those of highest priority is completed to the proper quality standard, and that there is time for proper parliamentary scrutiny ahead of EU Exit.***

3.1 The Government agrees with the Committee's recommendation.

**Target implementation date:** Spring 2019.

3.2 There has never been a more crucial time for secondary legislation. The Government is committed to providing time for Parliament to consider the statutory instruments that are needed to secure a functioning statute book by Exit Day.

3.3 There has been a great deal of work within Government to improve the management of secondary legislation:

- **central oversight** - The Parliamentary Business and Legislation Cabinet Committee (PBL) supported by the PBL Secretariat now oversees all secondary legislation. This centrally run process ensures better planning and monitors each department's progress on statutory instruments (SIs) including the drafting of them.

- **better management in departments** - every department has a minister responsible for secondary legislation and a senior civil servant responsible for secondary legislation. They are accountable for their department's SI programme, ensuring it is stress-tested, prioritised and drafted properly to meet the necessary timescales.

3.4 PBL Secretariat and the Department for Exiting the European Union work closely with departments to ensure that they prioritise only the essential secondary legislation to be laid in Parliament.

3.5 The Government has always said that the objective is to ensure a functioning statute book. To do this, SIs necessary for exit day have been prioritised, and other SIs with less of a time pressure, such as those relating to arrangements that can be put in place administratively without a legal basis, will be laid later in February, March 2019 or after Exit Day to allow the necessary scrutiny by Parliament of the most critical pieces of secondary legislation.

**4: PAC conclusion:** ***The Department's approach to its preparations appears complacent.***

**4: PAC recommendation:** ***The Department should make sure that it receives regular independent assurance on the progress of key projects. As part of its update to the Committee, the Department should set out how it is drawing on independent assurance that progress is being made, and the action it has taken as a result.***

4.1 The Government agrees with the Committees recommendation.

**Recommendation implemented**

4.2 Department does not agree with the PAC's conclusion that its approach has been complacent. The Department has taken steps to ensure that it receives regular independent assurance on the progress of its key projects. In November 2017 the Infrastructure and Projects Authority (IPA) conducted a 'critical friends' review of the roads programme and the Department implemented all their recommendations. In October 2018, the IPA returned to conduct more formal assurance reviews of the roads programme, specifically the systems being established to deliver International Driving Permits, Road Haulage Permits, and the new Trailer Registration scheme; and Operation Brock. The final IPA report on the roads programme was received on 24 October 2018 and on 5 November 2018 for Operation Brock. The IPA is also conducting an assurance review of the Department's work to procure additional ferry freight capacity on 15-17 January 2019. In addition, the Government's Internal Audit Agency is also embedded in the work of EU Exit Programme and attend programme boards and issue a formal management letter every two months with recommendations on how to strengthen programme delivery.

**5: PAC conclusion:** ***Too much consultation with business organisations has taken place under the cloak of non-disclosure agreements, and this secrecy hampers the ability of the business community at large to prepare.***

**5: PAC recommendation:** ***As we recommended in our recent report on Defra's preparations, the Department needs to limit the use of non-disclosure agreements to commercially sensitive discussions. It should urgently step up its communications with businesses and other stakeholders on what they need to do to prepare.***

5.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented**

5.2 The Department has sought to minimise its use of NDAs, in line with the Committee's recommendation It continues to engage with a wide range of businesses to understand their priorities and issues as we leave the European Union, both to inform our negotiating position, and our preparations in the event of there being no deal. These discussions with key organisations are keeping the business community abreast of the latest Government planning and allowing them to adjust their own preparations accordingly.

5.3 The Department makes use of non-disclosure agreements (NDAs) when structuring our engagements on preparations for leaving the EU, which is a crucial component of planning. Given the sensitive nature of some discussions, there may be limited circumstances in which the department has used NDAs to enable those conversations, thereby reaching more stakeholders than would otherwise be the case.

5.4 NDAs are also a common component of contractual arrangements that are used to protect commercial considerations of the parties involved or to protect sensitives around the development of Government policy.

5.5 It is entirely normal practice to use such agreements and they are therefore sometimes necessary for Government departments who are responsible for managing their preparations for leaving the EU.

**6: PAC conclusion:** ***The Department's continuing caution in its public communication about EU Exit means the public and businesses cannot prepare adequately if there is no deal.***

**6: PAC recommendation:** ***The Department should write to the Committee before Christmas 2018 setting out the progress made against its plans for providing the public and businesses with the information they need.***

6.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented**

6.2 The Department has sought to maximise effective communication with the public and business, as set out in the Permanent Secretary's letter to the Committee of 21 December, and has implemented the recommendation. The letter summarised the Department's engagement with transport stakeholders, including representatives from industry, and the progress with the Road Haulage and Commercial Drivers Communications Campaign.

# Seventy-First Report of Session 2017-19

## Department of Health and Social Care

### Department of Health and Social Care accounts 2017-18

#### Introduction from the Committee

The Department of Health and Social Care (the Department) is responsible for overseeing the health and care system in England. In 2017–18 the Department's budget for day to day running costs (resource departmental expenditure limit) was £121.3 billion of which it spent £120.7 billion, it had a separate capital budget (capital departmental expenditure limit) of £5.6 billion of which it spent £5.2 billion. Its Annual Report and Accounts bring together the financial results for the Department and the national and local bodies which form part of the Departmental group. The group includes around 500 individual bodies including England's 207 Clinical Commissioning Groups (CCGs), 154 National Health Service (NHS) Foundation Trusts and 80 NHS Trusts. In 2017–18 the Department reported that the NHS had achieved a broadly balanced position overall. However, 101 of the 234 NHS Providers (NHS Trusts and Foundation Trusts) were in deficit at the end of the financial year and in aggregate NHS Providers reported a deficit of £991 million. This was largely offset by a surplus of £970 million within NHS England's (NHSE) finances.

The Comptroller and Auditor General did not qualify his opinion on the 2017–18 accounts but, as in previous years, included an emphasis of matter paragraph to draw attention to the uncertainties inherent in the amount of money the Department has estimated it may need to pay out in the future for clinical negligence claims against NHS Providers.

The Committee took evidence from the Department of Health and Social Care on Wednesday 17 October 2018. The Committee published its report on 19 December 2018. This is the Government response to the Committee's report.

#### NAO and Government Report

- PAC report: Department of Health and Social Care accounts – Session 2017-19 (HC 1515)
- Department of Health and Social Care Annual Report and Accounts 2017-18

#### Government responses to the Committee

**1: PAC conclusion: The Department's focus on health spending at a national level fails to take into account regional variations in funding and the impact this has on patient care.**

**1: PAC recommendation: The Department should, by 31 January 2019, write to the Committee to outline its assessment of the impact regional funding variations have on patient care.**

1.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

1.2 The Government agrees there is regional variation in patient care. However, funding is allocated fairly, according to need, and the Department seeks assurance from NHS England and NHS Improvement that funding mechanisms take account of these regional issues.

1.3 The Department has delegated responsibility for the allocation of funding to NHS England, who are responsible for decisions on the weighted capitation formula for clinical commissioning groups (CCGs) allocations. Each CCG allocation is informed by the estimation of the relative health needs of local areas and use a set of funding formulae. The formulae are based on independent academic research and include factors statistically associated with higher or lower need per head for NHS services.

These formulae produce a target allocation, or 'fair share' for each area, based on a complex assessment of factors such as demography, morbidity, deprivation, and the unavoidable cost of providing services in different areas.

1.4 The delegated system of funding allows local decision-making and prioritisation by NHS bodies. This enables local priorities to be addressed but it can also result in variation in financial sustainability of services and quality of patient care. Both issues are addressed in the NHS Long Term Plan.

1.5 The Plan includes: a target for all NHS organisations to return to financial balance; reform to payment systems; and, accelerated turnaround processes in the 30 worst financially performing trusts. The Department will monitor progress using the five financial tests set out in the NHS Long Term Plan.

1.6 Action on unjustified variation in patient care includes programmes to: increase transparency; reduce clinical practice variations; narrow variation in health outcomes; and, reduce health inequalities.

**2: PAC conclusion: The Department's lack of a clear plan for recruiting staff after Brexit risks exacerbating existing staff shortages in the health and social care workforce.**

**2a: PAC recommendation: The Department should, by 31 January 2019, write to the Committee to outline how it will address the workforce issues affecting specific specialisms and geographical regions.**

2.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

2.2 The Department, working with its Arms-Length Bodies, has already put in place significant actions to boost the supply of nurses, ranging from increasing nurse training places, offering new routes into the profession, enhancing reward and pay packages to make nursing more attractive and improve retention, and encouraging those that have left nursing to return.

2.3 By September 2020, there will be 1,500 more undergraduate medical school places every year. Five brand new medical schools will help to deliver these places, alongside existing medical schools which have demonstrated a commitment to trainees in rural or coastal areas and increasing the number of GPs and mental health specialists.

2.4 Following publication of the NHS Long Term Plan, the Secretary of State for Health and Social Care has commissioned Baroness Harding, working closely with Sir David Behan, to develop a detailed workforce implementation plan. This will include a focus on reducing geographical and specialty imbalances and ensuring sufficient supply of nurses. Baroness Harding will present initial recommendations to Ministers in Spring 2019. A final workforce implementation plan will follow later in the year.

2.5 However, it will take time to develop a more sustainable domestic supply position and the NHS will need significant levels of international recruitment in the interim. The Tier 2 visa cap for doctors and nurses was abolished in July 2018. The Government will also be removing the Resident Labour Market Test for skilled workers. We expect that the future immigration system, giving effect to the Home Office's Immigration White Paper's proposals to prioritise both high and medium-skilled workers, will come into place in 2021.

**2b: PAC recommendation: The Department should, as soon as the Home Office's immigration white paper has been published, write to the Committee setting out how it will respond to any changes in immigration policy arising from Brexit.**

2.3 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

2.4 The Government's White Paper sets out the foundation of a single immigration system, where it is workers' skills that matter, not where they come from. This system will come into force from 2021, when the necessary preparations have been made. For the NHS, there are a number of benefits to the new system – in particular the removal of the Tier 2 visa cap and Resident Labour Market Test, as well as a reduction in the skills threshold. This will mean that all skilled roles – whether clinical or non-clinical – will benefit from the certainty that already exists for doctors and nurses, will give the NHS and social care providers the confidence that they will be able to bring in any suitably skilled migrant and enable the Government to process cases immediately. The salary threshold will be subject to a period of engagement over the course of the year before the Government brings forward legislation.

2.5 The Government will also introduce a time-limited route for temporary short-term workers of all skill levels. It is likely, however, that there could be some decrease in the flow of so called lower skilled workers from abroad. The Government will therefore redouble its efforts to promote jobs in the NHS and social care to the domestic workforce and the Department have made improving the working lives of the millions of people who work in health and social care one of our top priorities, and why it has launched recruitment campaigns for both the NHS and social care. The Government is also clear that the 167,000 European Union nationals who currently work in the health and social care sectors are able to stay in the UK after the UK leaves the EU, and from December 2018 these workers have been able to apply for settled status early as part of the testing phase of the wider scheme.

2.6 The Department will continue to engage with the health and social care sectors to ensure employers' views are taken into account in the design of the new system – in particular the practicalities of sponsorship, which the Department recognises can be a burden to some employers. In practice, it should be easier for non-European Economic Area (EEA) doctors and nurses to come to the UK as part of the new system, although it should be noted that there will be new steps for EEA doctors and nurses to take to come and work in the UK, as free movement ends. The Department will continue to monitor and analyse overall staffing levels across the NHS and adult social care, including the impact of the proposed future immigration system.

**3: PAC conclusion: The Department has failed to assess the risk Brexit poses to the supply of medical equipment, risking patient care.**

**3: PAC recommendation: The Department should write to the Committee by 31 January 2019 with details of its assessment of the impact of Brexit on the supply of medical equipment and, where necessary, what contingencies it has put in place.**

3.1 The Government disagrees with the Committee's recommendation.

**Recommendation implemented.**

3.2 The Government does not agree with the Committee's conclusion that it has failed to assess the risk posed by EU Exit to the supply of medical equipment. The Department has assessed the risks and the necessary mitigations and has for some time had a comprehensive programme in place to implement them. The most significant risk to medical supplies in general is the potential for very significantly reduced flow of goods across the 'short straits' in the event of no-deal. On behalf of the Government the Department for Transport is acting to ensure that there is sufficient roll-on, roll-off freight capacity to enable these vital products to continue to move freely into the UK from 29 March 2019.

3.3 The Government recognises that all medical supplies must be prioritised on these alternative routes – for example, away from the short straits crossings to Dover and Folkestone – to ensure that the flow of all these products will continue unimpeded after 29 March 2019. The Department is working very closely with the Department for Transport on how the prioritisation and re-routing of these vital products will work in practice.

**4: PAC conclusion: We are concerned that the Department's decision to fund pay awards through the National Tariff risks the funding not being distributed to the intended NHS providers.**

**4: PAC recommendation: The Department should, by 31 January 2019, write to the Committee to explain how funding for the pay award has been allocated.**

4.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

4.2 The National Tariff is the established 'business-as-usual' mechanism for distributing funding to providers, including for pay. The approach to direct payments to providers taken in 2018-19 was a temporary solution, put in place because the Agenda for Change (AfC) deal was agreed part way through the year and the National Tariff had already been set. The Department is simply returning to the established mechanism which has been used for previous pay awards.

4.3 Tariff prices are adjusted to take account of the unavoidable cost differences between provider based on their geographic location through the Market Forces Factor (MFF). The MFF methodology takes account of extra costs that fall on providers – over and above national pay scales – where the going rate in an area is high, including from higher vacancy and staff turnover rates. NHS England and NHS Improvement are responsible for the design of MFF and have announced their intention to implement an updated and improved MFF in 2019-20. Recently published operational planning guidance for the NHS reiterates that the underlying MFF premise of establishing a rate consistent with a specific geographical area will remain.

4.4 It is important to recognise that the tariff is intended to act as a fair playing field between different types of provider and prices are set within a legal framework set out in the Health and Social Care Act 2012. As such the tariff does not distinguish between NHS and independent sector providers. Decisions on NHS pay can have knock on consequences for the going rate in independent sector providers and wholly owned subsidiaries who are operating outside of AfC. In any complex environment such as healthcare, there will also be choices to make between a more granular and complex approach to tariff with operational and financial pragmatism. However, within the legal framework that is operating, the Department recognises the importance of minimising inappropriate leakage. The Department will keep this under review as NHS England and NHS Improvement continue to evolve the financial framework as part of the Long-term Plan.

**5: PAC conclusion: The recently launched consultation on the NHS' regulation of wholly-owned subsidiaries and pause of existing proposals is welcome but must address concerns about the use of these companies.**

**5: PAC recommendation: The Department should update the Committee on the timeline for and the outcome of NHSI's consultation on the oversight and use of wholly-owned subsidiaries by the NHS.**

5.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

5.2 On 19 September 2018, NHS Improvement, the national regulator told NHS organisations to "pause" any ongoing plans to set up subsidiary companies until revised guidance came into effect.

5.3 On 26 November 2018, NHS Improvement published new guidance[8] on the creation of subsidiaries by both NHS Foundation Trusts and NHS Trusts.

5.4 The revised regulatory framework strikes a balance between assuring NHS Improvement what would count as a sound commercial case for setting up subsidiaries and respecting NHS freedoms and the ability of the NHS to innovate.

5.5 The revised guidance does not apply to existing subsidiaries. However, trust boards should assure themselves that their existing subsidiaries meet the requirements set out in new NHS

[8] https://improvement.nhs.uk/documents/3509/Addendum_to_transactions_guidance_FINAL_CORRECTED.pdf

Improvement guidance addendum. The new framework does apply to proposals to make a material change to an existing subsidiary.

5.6 The revised guidance takes account of the consultation responses whilst giving NHS Improvement increased oversight on the creation of subsidiaries, as all proposals will now have to be reported to NHS Improvement. Those business cases which NHS Improvement deem to involve a 'significant' or 'material' transaction will be subjected to a more detailed review. NHS Improvement are committed to reviewing the process over the next year to further develop and outline the risk factors that they believe should trigger the review of a business case for a subsidiary.

**6: PAC conclusion: We are concerned that the Department's preparations for winter, and the decision to allocate additional winter funding solely to social care services, may not be sufficient to meet demand.**

**6: PAC recommendation: The Department should put in place long term solutions for winter through the integration of health and social care. This should be achieved by the time of its Government's costed 10-year social care plan, due in April 2019.**

6.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

6.2 The Government provided £420 million winter funding for 2018-19, comprised of: £145 million capital funding for hospitals to support improvements to emergency care; £36.3 million for ambulance trusts, allowing purchase of 256 new ambulances, and £240 million for local authorities to help ease winter pressures on the NHS.

6.3 Working together, the health and social care systems have achieved a 39 per cent reduction in delayed transfers of care (DTOC) attributable to adult social care since February 2017. The latest figures for November showed that overall there were 591 fewer 'DTOC beds' than at the same point last year.

6.4 The NHS Long-term Plan sets out further detail on the integration agenda, both across health services and across health and social care. This includes commitments to spreading integrated care systems (ICSs) across the country, a £4.5 billion minimum boost to primary and community health services with integrated multi-disciplinary teams to provide joined up care with an ambition for enhanced community services to free-up over one million hospital beds per day. The plan restates the commitment to tackling DTOC, by reaching 4,000 or fewer delays over the next two years. Furthermore, the new ICS accountability and performance framework will include a new 'integration index' developed with patient groups and the voluntary sector measuring patients', carers' and the public's point of view, the extent to which local health services and its partners are genuinely providing joined up, personalised and anticipatory care.

**7: PAC conclusion: The Department's current estimate of fraud within the NHS isn't yet robust enough to enable it to target specific areas to prevent loss.**

**7: PAC recommendation: The Department should, by 31 January 2019, provide the Committee with details of how it will improve its ability to target interventions at specific areas and better prevent loss. The Department must ensure that it distinguishes between what is fraud and what is error.**

7.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

7.2 NHS Counter Fraud Authority's annual Strategic Intelligence Assessment (SIA)[9] of the fraud landscape is a valuable tool for prioritising areas for further intelligence gathering, analysis of system weaknesses and targeted prevention work[10]. The Department holds the Authority to account for how its considers the SIA in its business planning. Work is underway to improve the robustness of the assessment however it will remain the case that additional work is needed for targeted interventions.

7.3 The Authority's proposed priorities for 2019-20 include Community Pharmaceutical Contractor and General Practice Fraud. For both the Authority will conduct loss assessments and data analytics to baseline fraud levels and identify cases for enforcement. These will inform prevention work including supporting system improvements and deterring fraudsters through awareness raising activity. Prevention work with national and local providers on Procurement and Commissioning Fraud is another priority.

7.4 Historic activity to reduce patient charge evasion and loss assessments informed the introduction of prescription and dental charge post-payment checks which have contributed to reductions in losses and increased cost recovery. The 2019 SIA identifies a £93 million prescription loss reduction, contributing towards the Department's March 2020 £277 million fraud reduction target. These findings have also informed the development of electronic pre-payment checks. This Real-Time Exemption Checking project aims to reduce error and enhance fraud detection.

7.5 The Department is requiring the Authority to have KPIs and targets for all priority areas, ensuring that we can measure the impact of targeted interventions - both losses prevented and costs recovered. Reduction in losses arising from error is a likely additional benefit of system improvements designed to prevent fraud. Wherever possible, the NHS Counter Fraud Authority's loss assessments seek to distinguish between these.

**8: PAC conclusion: The Department's inability to accurately forecast its exposure to clinical negligence costs in advance of the end of the financial year resulted in a £14.8 billion underspend.**

**8: PAC recommendation: The Department should create a more accurate forecast of its exposure to future clinical negligence costs. The Committee expects this to be in place in time for the supplementary estimate to avoid a similar underspend against the Department's budget in 2018–19.**

8.1 The Government agrees with the Committee's recommendation.

**Recommendation implemented.**

8.2 The Department's Annually Managed Expenditure (AME) is a non-cash budget which relates to spending on provisions (mainly clinical negligence) and impairments. An underspend against this budget is non-fiscal from an HM Government perspective and does not indicate that patients who have been harmed have not received the payments due.

8.3 The Department and NHS Resolution are committed to exploring ways in which the forecasting of future clinical negligence costs can be improved. This is important to:

- establish effective strategies and intervention to reduce future year liabilities, and;
- provide parliamentary transparency through the Parliamentary Estimate processes

8.4 In improving transparency, there is a balance to be struck between obtaining robust information to inform the parliamentary process and the value for money of commissioning additional actuarial analysis. For the 2018-19, additional consideration has been given to the in-year position to provide an improved level of detail earlier in the year to inform the Supplementary Estimate process. This included expenditure on settled negligence claims against budget, the in-year movement on provisions for known

[9] https://cfa.nhs.uk/resources/downloads/documents/corporate-publications/NHSCFA%20Strategic%20Intelligence%20Assesment%20%20-%20data%202016-17.pdf
[10] https://cfa.nhs.uk/fraud-prevention/what-is-nhs-fraud

claims and periodic payment orders, supplemented by further intelligence on the underlying reasons for claims values.

8.5 The timing of the Supplementary Estimate means a significant level of uncertainty remains given that the final provision is not determined until after the end of the financial year. When agreeing the revised budget with HMT officials and ministers, we have been clear on the assumptions and resulting range of outcomes. It is not unusual for Government Departments to have material underspends against AME budgets given the volatility and demand-led nature of the expenditure, assumptions and modelling and agreed levels of prudence, for example in 2017-18 HMT's AME underspend was c£24.9 billion.

## Treasury Minutes Archive[11]

Treasury Minutes are the Government's response to reports from the Committee of Public Accounts. Treasury Minutes are Command Papers laid in Parliament.

### Session 2017-19

Committee Recommendations: 453
Recommendations agreed: 407 (90%)
Recommendations disagreed: 46 (10%)

| Publication Date | PAC Reports | Ref Number |
|---|---|---|
| December 2017 | Government response to PAC report 1 | Cm 9549 |
| January 2018 | Government responses to PAC reports 2 and 3 | Cm 9565 |
| March 2018 | Government responses to PAC reports 4-11 | Cm 9575 |
| March 2018 | Government responses to PAC reports 12-19 | Cm 9596 |
| May 2018 | Government responses to PAC reports 20-30 | Cm 9618 |
| June 2018 | Government responses to PAC reports 31-37 | Cm 9643 |
| July 2018 | Government responses to PAC reports 38-42 | Cm 9667 |
| October 2018 | Government responses to PAC reports 43-58 | Cm 9702 |
| December 2018 | Government responses to PAC reports 59-63 | Cm 9740 |
| January 2019 | Government responses to PAC reports 64-68 | CP 18 |
| March 2019 | Government responses to PAC reports 69-71 | CP 56 |

### Session 2016-17

Committee Recommendations: 393
Recommendations agreed: 356 (91%)
Recommendations disagreed: 37 (9%)

| | | |
|---|---|---|
| November 2016 | Government responses to PAC reports 1-13 | Cm 9351 |
| December 2016 | Government responses to PAC reports 14-21 | Cm 9389 |
| February 2017 | Government responses to PAC reports 22-25 and 28 | Cm 9413 |
| March 2017 | Government responses to PAC reports 26-27 and 29-34[12] | Cm 9429 |
| March 2017 | Government responses to PAC reports 35-41 | Cm 9433 |
| October 2017 | Government responses to PAC reports 42-44 and 46-64 | Cm 9505 |

### Session 2015-16

Committee Recommendations: 262
Recommendations agreed: 225 (86%)
Recommendations disagreed: 37 (14%)

| | | |
|---|---|---|
| December 2015 | Government responses to PAC reports 1 to 3 | Cm 9170 |
| January 2016 | Government responses to PAC reports 4 to 8 | Cm 9190 |
| March 2016 | Government responses to PAC reports 9 to 14 | Cm 9220 |
| March 2016 | Government responses to PAC reports 15-20 | Cm 9237 |
| April 2016 | Government responses to PAC reports 21-26 | Cm 9260 |
| May 2016 | Government responses to PAC reports 27-33 | Cm 9270 |
| July 2016 | Government responses to PAC reports 34-36; 38; and 40-42 | Cm 9323 |
| November 2016 | Government responses to PAC reports 37 and 39 (part 1) | Cm 9351 |
| December 2016 | Government response to PAC report 39 (part 2) | Cm 9389 |

[11] List of Treasury Minutes responses for Sessions 2010-15 are annexed in the Government's response to PAC Report 52

[12] Report 32 contains 6 conclusions only.

## Treasury Minutes Progress Reports Archive

Treasury Minutes Progress Reports are the Government's response on the implementation of recommendations from the Committee of Public Accounts. Treasury Minutes Progress Reports are Command Papers laid in Parliament.

| Publication Date | PAC Reports | Ref Number |
|---|---|---|
| January 2012 | Session 2010-12: updates on 13 PAC reports | Cm 8271 |
| July 2012 | Session 2010-12: updates on 28 PAC reports | Cm 8387 |
| February 2013 | Session 2010-12: updates on 31 PAC reports | Cm 8539 |
| July 2014 | Session 2010-12: updates on 60 PAC reports<br>Session 2012-13: updates on 37 PAC reports | Cm 8899 |
| March 2015 | Session 2010-12: updates on 26 PAC reports<br>Session 2012-13: updates on 17 PAC reports<br>Session 2013-14: updates on 43 PAC reports | Cm 9034 |
| February 2016 | Session 2010-12: updates on 8 PAC reports<br>Session 2012-13: updates on 7 PAC reports<br>Session 2013-14: updates on 22 PAC reports<br>Session 2014-15: updates on 27 PAC reports | Cm 9202 |
| July 2016 | Session 2010-12: updates on 6 PAC reports<br>Session 2012-13: updates on 2 PAC reports<br>Session 2013-14: updates on 15 PAC reports<br>Session 2014-15: updates on 22 PAC reports<br>Session 2015-16: updates on 6 PAC reports | Cm 9320 |
| January 2017 | Session 2010-12: updates on 1 PAC report<br>Session 2013-14: updates on 5 PAC reports<br>Session 2014-15: updates on 7 PAC reports<br>Session 2015-16: updates on 18 PAC reports | Cm 9407 |
| October 2017 | Session 2010-12: updates on 3 PAC reports<br>Session 2013-14: updates on 7 PAC reports<br>Session 2014-15: updates on 12 PAC reports<br>Session 2015-16: updates on 26 PAC reports<br>Session 2016-17: updates on 39 PAC reports | Cm 9506 |
| January 2018 | Session 2010-12: updates on 2 PAC reports<br>Session 2013-14: updates on 5 PAC reports<br>Session 2014-15: updates on 4 PAC reports<br>Session 2015-16: updates on 14 PAC reports<br>Session 2016-17: updates on 52 PAC reports | Cm 9566 |
| July 2018 | Session 2010-12: updates on 2 PAC reports<br>Session 2013-14: updates on 4 PAC reports<br>Session 2014-15: updates on 2 PAC reports<br>Session 2015-16: updates on 9 PAC reports<br>Session 2016-17: updates on 38 PAC reports<br>Session 2017-19: updates on 17 PAC reports[13] | Cm 9668 |

[13] Contains updates on Treasury Minutes - Session 2017-19 - up to March 2018.

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