House of Commons

Business & Enterprise Committee

Funding the Nuclear Decommissioning Authority

Fourth Report of Session 2007–08

Report, together with formal minutes, oral and written evidence

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The Business & Enterprise Committee

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The current staff of the Committee are: Eve Samson (Clerk), David Slater (Second Clerk), Robert Cope (Committee Specialist), Ian Townsend (Inquiry Manager), Anita Fuki (Committee Assistant), Lorna Horton (Committee Secretary) and Jim Hudson (Senior Office Clerk).

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Spring Supplementary Estimate

1. Before Supplementary Estimates are considered by the House the Department for Business, Enterprise and Regulatory Reform (BERR) sends us a memorandum setting out the changes that will occur and the reasons for them. As one of our core tasks is to examine the Department's expenditure we examine these memoranda carefully and usually ask for further information or press certain points in writing.

2. The 2008 Spring Supplementary Estimate for BERR asked for an additional £400 million to be made available to the Nuclear Decommissioning Authority (NDA) for the financial year 2007/08. Of this total, £256 million of near cash[1] was raised from the Department's End Year Flexibility (EYF),[2] £97 million was claimed from the Reserve and £47 million of capital was allocated from other projects and Regional Selective Assistance.[3]

3. We received the memorandum from the Department on 12 February 2008. It was very surprising to receive so late in the financial year a supplementary estimate for such a significant sum—around 10% of BERR's total Departmental Expenditure Limit (DEL)—and we considered it important to examine this estimate urgently, before the House voted the money. We held an evidence session with Sir Brian Bender, Permanent Secretary of the Department, Mark Clarke, its Director General of Finance and Strategy, and William Roberts, the NDA's Director of Finance and Resources. As discussed later, £303 million of the £400 million requested in the Estimate related to a dispute over the accounting treatment of waste substitution income. The remaining £97 million was a drawdown of the EYF allocated to the NDA to cover uncertainty over income. In neither case was there evidence of mismanagement or loss of funds. As such we saw no need to report before the Supplementary Estimates were considered. Nonetheless, a number of very important issues were raised and we have reported on these as quickly as possible.

4. The NDA is funded by a combination of commercial income and grant-in-aid. For 2007/08 its budget is set at £2,790 million; of this, £1,420 million was intended to be ring-fenced grant-in-aid[4] and £1,370 million commercial income, chiefly from reprocessing but also including income from waste substitution.[5]

1 "Near cash" generally refers to any expenditure that will eventually crystallise as a cash payment. Technically it is not simply cash as for instance accrued expenditure (i.e. expenditure which has been incurred on a service but not yet spent) is included in near cash. However near cash excludes non-cash items such as depreciation, cost of capital charges and movements in provisions.

2 End Year Flexibility is under-spend from previous years which the Treasury has allowed a department or body to spend in subsequent years.

3 Ev 17 para. 11

4 The grant is made to the Department, but is ring-fenced so it can only be spent on the NDA.

5 National Audit Office, *The Nuclear Decommissioning Authority: Taking forward decommissioning* HC (2007–08) 238 para. 1.11, 1.13

Waste Substitution Income

5. Since the 1970s the UK has been commercially reprocessing spent nuclear fuel from overseas customers. This reprocessing gives rise to recovered radioactive material and radioactive waste. The waste can be classified as low, intermediate or high-level waste depending on the level of radioactivity. As part of the contract, this waste is returned to the original customer for storage.

6. Waste substitution contracts are agreements between the NDA and the overseas customer. Rather than return the waste originally received from the customer (which would include large quantities of low and medium-level waste), an agreement is reached whereby the customer pays the NDA over and above the original contract to receive an equivalent amount (in terms of radioactivity) of high-level waste only.[6] Rather than dealing with large physical quantities of waste of different grades, the recipient country has to deal with a far smaller quantity of material.

7. In 2004 the then Department of Trade and Industry issued a consultation paper on the waste substitution of intermediate level waste. As a result of this consultation a policy document was issued which identified four advantages to the UK of the process—broad environmental neutrality, the earlier return of overseas waste, a six-fold reduction in shipments of waste overseas and additional revenue which would, the document guaranteed, be spent on nuclear clean-up of existing nuclear sites.[7] It is the accounting treatment of this latter revenue which has led to the current issue. **We emphasise that none of the issues raised in this short report should have any consequences for the construction of new nuclear power stations. Separate special funding arrangements are being developed for their decommissioning.**

Shortfall in the NDA's Budget

8. Mr Roberts told us that the NDA expected to invoice a total of £601 million worth of waste substitution income for the whole of the 2007/08 financial year. He told us that, at the time of the evidence session, a total of £430 million had been invoiced and the "vast majority" of this money had been received and paid into the Consolidated Fund.[8]

9. For the financial year 2007/08 Mr Roberts told us that the NDA originally expected to spend £160 million of waste substitution income. However, plant failures and lower production than expected at the Thorp and Sellafield plants meant that the NDA's income from other sources was lower than expected. A further £143 million therefore had to be budgeted from waste substitution income. In total the NDA therefore expected to spend a total of £303 million of waste substitution income in the financial year 2007/08.[9]

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6 Q12

7 Department of Trade and Industry, (2004) *Intermediate Level Radioactive Waste Substitution*, http://www.berr.gov.uk/files/file30058.pdf

8 Q17

9 Q6

10. It is clear that in drawing up its budget for 2007/08 the NDA had assumed that income from waste substitution would be recognised[10] in full upon receipt, and therefore would be immediately available to meet the NDA's budgetary needs.[11] According to Mr Clarke, upon finalisation of the waste substitution contracts, in December 2007, it emerged that "on the balance of probabilities" this would not be the case.[12] Instead, the Treasury would require waste substitution contracts to be considered additions to the existing reprocessing contracts the NDA had with its clients—the majority of which were signed by its predecessors in the 1970s—rather than separate contracts in their own right. As a result, income from waste substitution would, under Treasury accounting conventions, have to be recognised, and therefore spent, gradually over the lifetime of the original contracts as the NDA performs its decommissioning services.[13]

11. At the time of writing the accounting treatment of these contracts remains under discussion.[14] If waste substitution contracts were to be considered additions to the existing reprocessing contracts then the NDA might have to spread the receipts across the entire lifetime of the original reprocessing contract—i.e. until 2050. This would lead to a major shortfall in the 2007/08 accounts and it was because of this possibility that the NDA asked the Department for an additional £303 million as part of the Spring Supplementary Estimate in addition to the £97 million EYF drawdown already planned.[15] However, the NDA continues to argue that, unlike its reprocessing contracts, waste substitution is not a long-term agreement but the one-off sale of a right to receive waste in a more convenient form. As such, it believes that waste substitution income should be considered separately from the reprocessing contracts and recognised immediately in their budgets.[16]

12. **The National Audit Office (NAO), in its January 2008 report into the NDA, identified uncertainty as to whether the waste substitution income budgeted for would actually be forthcoming in the 2007/08 period.**[17] **It seems that this uncertainty has been resolved and the money has been raised;**[18] **we are therefore surprised that the NDA was suddenly told by the Treasury that—owing to a technical accounting issue—it might not be able to spend it.**

13. **We believe this issue could and should have been addressed earlier. The nature of waste substitution income has been known since the 2004 consultation, if not earlier, and we find it unlikely that the relationship of these contracts to the original reprocessing contracts became clear only immediately before contracts were finalised in December 2007.**

10 Recorded as income for budgetary purposes, thereby allowing the money to be spent.

11 Q30

12 Q21

13 Q21

14 Q4

15 Q30; the remaining £97 million is discussed in paragraph 19.

16 Ev 17 para. 11; Q21, Q35

17 NAO para. 3.11

18 See paragraph 8.

NDA Derogation

14. In its first full year of operation—the financial year 2005/06—the NDA was granted a derogation[19] from normal Treasury budgeting guidelines which allowed it to recognise income from Thorp, Magnox reprocessing and MOX on a cash basis, rather than accruing it over time. The Permanent Secretary was clear that this derogation did not expressly cover waste substitution because at that stage there was no income coming in from such contracts.[20] Sir Brian told us that the derogation was:

> put in place between the Treasury and the Department and NDA to give the NDA time to be able to understand the accounting treatment of particular items given their magnitude, complexity and unpredictable nature.[21]

15. The derogation expired in April 2006 and has not subsequently been renewed. The Supplementary Estimate Memorandum strongly implied a link between the expiry of the derogation in April 2006 and the requirement for the additional funds.[22] Mr Roberts told us, however, that waste substitution contracts were not considered as a possible subject for the derogation at the time it was made, nor was the derogation referred to by the NDA when setting the 2007/08 budget.[23] Despite the implications of the Supplementary Estimate Memorandum, the role of the derogation in bringing about this chain of events is therefore unclear. What is clear, however, is that if such a derogation had existed for 2007/08, and had applied to waste substitution income, the Department would not have had to raise the £303 million from other sources.

16. **The previous existence of a derogation allowing the NDA to recognise the income from some long-term contracts upon receipt suggests that the NDA, the Treasury and the Department should already have been alert to the fact that the accounting treatment of long-term contracts might need to be considered. We are therefore surprised and disappointed that when this issue reappeared, albeit in a different context, everyone appears to have been caught unawares.**

17. **The 2005/06 derogation could have been the basis for a solution that would not have involved spending £256 million of the Department's accumulated EYF and claiming on the reserve. We would like to know if this was considered as an option once the issue came to light and, if it was rejected, for what reason. Given the references to the derogation in the Estimate Memorandum we would like to know whether any party wrongly assumed that the derogation still applied and if not—as seems likely from the evidence we received—why the Estimate Memorandum made reference both to the derogation and the date of its expiry in April 2006.**

19 Exemption

20 Q23

21 Q26

22 Ev 17, para. 11, see below for a further discussion of the memorandum.

23 Q32

Spring Supplementary Estimate Memorandum

18. The Committee originally learned of this issue through two communications from the Department—the Spring Supplementary Estimate Memorandum and a letter from the Permanent Secretary to the Public Accounts Committee.

19. The Memorandum, submitted to the Committee on 12 February 2008, explains that the additional £400 million granted to the NDA had come about because "the basis upon which the NDA has been recognising income for budgeting purposes *has not been appropriate* since April 2006".[24] This statement was later qualified and elaborated upon by the Permanent Secretary's letter, in which he stated that the shortfall came about "in large part" because of a potential issue with the accounting treatment of waste substitution income.[25] In fact, as we have seen, only £303 million of the £400 million Estimate claim related to waste substitution contracts; we were told that the remaining £97 million was always intended to be a drawdown of the NDA's own EYF to address the uncertainties over its commercial income stream.[26]

20. Mr Roberts strongly disputed the claim in the Memorandum that the NDA's accounting had "not been appropriate".[27] The Memorandum also implied that the accounting treatment issue (which it misleadingly associates with all reprocessing rather than just waste substitution contracts) had been settled, which, as we have seen is not the case.[28]

21. **The Spring Supplementary Estimate Memorandum did not give an entirely accurate picture of the situation. Accuracy in such documents is always essential, but for such a large request for additional funding at such a late stage in the financial year, this is particularly regrettable. These differences between the Memorandum's version of events and what we were told in evidence suggest poor communication between the Department and the NDA, which might have played some part in the situation occurring in the first place. We expect that future Estimates Memoranda will be drawn up after close consultation between the parties involved.**

Impact on the NDA

22. The provision of the £303 million in the Spring Supplementary Estimate means that the accounting treatment of waste substitution income should not impact on decommissioning. However, there is a question mark over the Government's commitment to spend waste substitution income on decommissioning. Sir Brian told us that if it was decided that such income had to be spread over the period until 2050 then there was a

24 Ev 17 para. 11, emphasis added.

25 Letter to be published by PAC

26 Q6; the Permanent Secretary also identified in evidence a negligible portion of the £303 million which may relate to other contracts; NAO para. 3.20, footnote 30

27 Q21

28 Q4, Q19

possibility that the "timing of being able to implement that commitment" might be affected.[29]

Impact on the Department

23. Sir Brian told us that, on a the worst case scenario, the impact of this situation on the Department would be some loss of "cushioning" due to the spending of available End Year Flexibility.[30] There is also the potential for future loss of flexibility caused by the requirement to pay back the £97 million reserve claim from future under-spend to the Treasury and the disturbing fact that £32 million of Regional Selective Assistance appears to have been diverted to help fund the NDA's extra money.[31]

24. Sir Brian told us that the Treasury had agreed to insulate the Department's budget for 2008/09 and subsequent years from the NDA so that spending plans in the rest of the Department would be shielded from resulting uncertainty.[32]

25. **We recognise that, due to the provision in the Spring Supplementary Estimate, there has been relatively little impact on the NDA, despite the sums of money involved. We are concerned, however, that accounting uncertainty had the potential to impact drastically upon the NDA's funding of decommissioning of existing nuclear liabilities. We urge the Government to resolve this issue as soon as possible in a way which will not delay future spending on decommissioning.**

26. **Sir Brian told us that the precise sequence of events that led up to the requirement for an additional £303 million is the subject of a review within the Department, HM Treasury, the NDA and the Shareholder Executive. We look forward to receiving the Permanent Secretary's promised note outlining its findings and any action to be taken. In particular, we would like to know exactly when and how this issue came to light, what advice the Department gave to the NDA, what advice the Treasury gave to the Department, what grounds there were for the Treasury's apparent insistence on spreading this income over several years and what action will be taken to ensure that such issues are identified sooner in future.**[33]

Wider Issues

27. Although there has been no loss of funds due to the problems with accounting treatment, we believe that this incident shows up fundamental problems with the funding structure of the NDA. There are also indications of a wider failure of communication between BERR, the Treasury and the NDA.

29 Q49

30 Q63

31 HM Treasury, *Central Government Supply Estimates 2007-08: Spring Supplementary Estimates* HC (2007–08) 273 p 331

32 Q64

33 Q34

Communication between the Department and the NDA

28. Sir Brian told us that the arrangements between BERR and the Government had changed in autumn 2007, firstly with an increase in the total amount of resources spent on managing the relationship and secondly by increasing the involvement of the Shareholder Executive.[34] In total there are now eight BERR officials working with the NDA—five in the Shareholder Executive and three in the Department's Energy Group—as well as half the time of a head of management.[35] Sir Brian told us the additional resources were unrelated to the accounting issue and added "if I had 100 people looking at it a year ago it might not have helped."[36]

Funding the NDA

29. Mr Clarke told us that the NDA's CSR settlement for the next three years is 20% higher than the settlement up to now, which means it will increase by, on average, 5% per annum in real terms over the next three years.[37] The grant-in-aid portion of the NDA's income already represents a very sizeable proportion of the Department's annual budget—42% of the original DEL for the 2007/08 financial year.

30. It is likely that this public funding will have to increase still further. As our predecessor committee said in 2006 "we remain to be convinced that the assets transferred to the NDA will in practice make a significant contribution to paying for nuclear decommissioning."[38] Even if the revenue from these assets were to prove sufficient for the original estimates of the NDA's liabilities, these have steadily increased. In June 2003 the estimated remaining lifetime costs of the NDA's sites were £56 billion; by March 2007 this had risen to £73 billion.[39] Moreover the NDA's commercial income is not only volatile but will decline over time as its work is completed. In 2020 work at Sellafield is expected to end; in 2022 the Springfields site will go offline. In the words of Mr Roberts this will be "the end of all the income we [the NDA] have from the commercial assets."[40]

31. **Public funding for the NDA will almost certainly have to increase significantly in the coming years over and above current plans. If nuclear decommissioning is going to be carried out as planned this has major implications for the Department for Business, Enterprise and Regulatory Reform, which already spends over 40% of its Departmental Expenditure Limit on the NDA.**

32. **We welcome the assurance given by the Permanent Secretary that the Department's budget will be insulated from the NDA for 2008/09 and subsequent years and look for further specific assurances from Government that NDA funding requirements will not**

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34 An agency of BERR that manages the Government's relationship with companies it has shareholdings in, such as Royal Mail.

35 Q37-Q38

36 Q39

37 Q53

38 Trade & Industry Committee's Sixth Report of Session 2005-06, *The Work of the NDA and UKAEA*, HC (2005–06) 1028, para. 16

39 NAO fig. 8, para. 2.8

40 NAO para. 1.14; Q45, Q58

impact on other areas of the Department's work. Government departments that have experienced funding problems in one area of their activities have often had to make reductions in other unrelated areas.[41] **The scale of the NDA as a proportion of BERR's overall budget makes such a prospect completely unacceptable in this case.**

33. The volatility of the NDA's commercial income was identified as a particular problem, both by the NAO and in the evidence we received. The NAO stated that many of the NDA's most pressing challenges "reflect, in part, uncertainties inherent in its [the NDA's] reliance on commercial income earned from ageing and unreliable facilities."[42] £240 million of the Supplementary Estimate resulted either indirectly from technical issues at the NDA's facilities or volatility in commercial income.[43]

34. Sir Brian also said that, in view of the unpredictable nature of the NDA's income, having the NDA constrained by three-year spending review settlements "does not help" and told the Committee this was one area he was looking at with the Treasury.[44] The NAO agreed—concluding that:

> The Authority has not had sufficient flexibility in its budget to cope with the level of volatility and uncertainty it has faced with its commercial income, and urgent expenditure commitments, in particular at Sellafield.[45]

35. Sir Brian told us that he believed that a "credible and sustainable" solution had been found to fund the NDA for the next Comprehensive Spending Review period—that is until 2010.[46] All agreed, however, that the present funding model is not sustainable in the longer term.[47] In Sir Brian's view "the saving grace is I do not think there is a car crash in the next two or three years and therefore we have time to plan the avoidance strategy."[48]

36. At present, spending on decommissioning is monitored through the Nuclear Decommissioning Funding Account. This account contains no money but is used to keep track of what money is spent on decommissioning.[49] In 2003, in its Report on the draft Nuclear Sites and Radioactive Substances Bill, the then Trade and Industry Committee recommended that the British Nuclear Fuels (BNFL) Nuclear Liabilities Investment Portfolio be put into a segregated fund, which the Government would contribute to annually, to guarantee the monies for decommissioning.[50] Under the current system there is no funding 'pot' from which the NDA can draw other than the Consolidated Fund.[51]

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41 See for example the Environment, Food & Rural Affairs Committee's Second Report of 2006-7, *Defra's Departmental Report 2006 and Defra's budget*, HC132

42 NAO pg.26

43 £97m from EYF (see para 3), and £143m originally allocated from waste substitution income (see para 9)

44 Q44

45 NAO Summary para. vi

46 Q54

47 Q57

48 Q59

49 Q56

50 Trade and Industry Committee's Seventeenth Report of Session 2002-03*: The Nuclear Decommissioning Authority: Pre-legislative Scrutiny of the Draft Nuclear Sites and Radioactive Substances Bill:* HC 968 para. 59

51 Q57

37. **We believe the NDA's funding model is unsustainable. We note the Department's assurances that a solution has been found for the current Comprehensive Spending Review period. However, in view of the volatile—and declining—nature of the NDA's commercial income we are sceptical about how watertight such an assurance can be. Nuclear decommissioning is too important to be left to the mercy of changing priorities in the Treasury and uncertain commercial income; as the Permanent Secretary acknowledged, a new system of funding is needed, and work on this needs to begin urgently.**

Conclusions and recommendations

Waste Substitution Income

1. We emphasise that none of the issues raised in this short report should have any consequences for the construction of new nuclear power stations. Separate special funding arrangements are being developed for their decommissioning. (Paragraph 7)

Shortfall in the NDA's Budget

2. The National Audit Office (NAO), in its January 2008 report into the NDA, identified uncertainty as to whether the waste substitution income budgeted for would actually be forthcoming in the 2007/08 period. It seems that this uncertainty has been resolved and the money has been raised; we are therefore surprised that the NDA was suddenly told by the Treasury that—owing to a technical accounting issue—it might not be able to spend it. (Paragraph 12)

3. We believe this issue could and should have been addressed earlier. The nature of waste substitution income has been known since the 2004 consultation, if not earlier, and we find it unlikely that the relationship of these contracts to the original reprocessing contracts became clear only immediately before contracts were finalised in December 2007. (Paragraph 13)

NDA Derogation

4. The previous existence of a derogation allowing the NDA to recognise the income from some long-term contracts upon receipt suggests that the NDA, the Treasury and the Department should already have been alert to the fact that the accounting treatment of long-term contracts might need to be considered. We are therefore surprised and disappointed that when this issue reappeared, albeit in a different context, everyone appears to have been caught unawares. (Paragraph 16)

5. The 2005/06 derogation could have been the basis for a solution that would not have involved spending £256 million of the Department's accumulated EYF and claiming on the reserve. We would like to know if this was considered as an option once the issue came to light and, if it was rejected, for what reason. Given the references to the derogation in the Estimate Memorandum we would like to know whether any party wrongly assumed that the derogation still applied and if not—as seems likely from the evidence we received—why the Estimate Memorandum made reference both to the derogation and the date of its expiry in April 2006. (Paragraph 17)

Spring Supplementary Estimate Memorandum

6. The Spring Supplementary Estimate Memorandum did not give an entirely accurate picture of the situation. Accuracy in such documents is always essential, but for such a large request for additional funding at such a late stage in the financial year, this is particularly regrettable. These differences between the Memorandum's version of events and what we were told in evidence suggest poor communication between the

Department and the NDA, which might have played some part in the situation occurring in the first place. We expect that future Estimates Memoranda will be drawn up after close consultation between the parties involved. (Paragraph 21)

Impact on the Department

7. We recognise that, due to the provision in the Spring Supplementary Estimate, there has been relatively little impact on the NDA, despite the sums of money involved. We are concerned, however, that accounting uncertainty had the potential to impact drastically upon the NDA's funding of decommissioning of existing nuclear liabilities. We urge the Government to resolve this issue as soon as possible in a way which will not delay future spending on decommissioning. (Paragraph 25)

8. Sir Brian told us that the precise sequence of events that led up to the requirement for an additional £303 million is the subject of a review within the Department, HM Treasury, the NDA and the Shareholder Executive. We look forward to receiving the Permanent Secretary's promised note outlining its findings and any action to be taken. In particular, we would like to know exactly when and how this issue came to light, what advice the Department gave to the NDA, what advice the Treasury gave to the Department, what grounds there were for the Treasury's apparent insistence on spreading this income over several years and what action will be taken to ensure that such issues are identified sooner in future. (Paragraph 26)

Funding the NDA

9. Public funding for the NDA will almost certainly have to increase significantly in the coming years over and above current plans. If nuclear decommissioning is going to be carried out as planned this has major implications for the Department for Business, Enterprise and Regulatory Reform, which already spends over 40% of its Departmental Expenditure Limit on the NDA. (Paragraph 31)

10. We welcome the assurance given by the Permanent Secretary that the Department's budget will be insulated from the NDA for 2008/09 and subsequent years and look for further specific assurances from Government that NDA funding requirements will not impact on other areas of the Department's work. Government departments that have experienced funding problems in one area of their activities have often had to make reductions in other unrelated areas. The scale of the NDA as a proportion of BERR's overall budget makes such a prospect completely unacceptable in this case. (Paragraph 32)

11. We believe the NDA's funding model is unsustainable. We note the Department's assurances that a solution has been found for the current Comprehensive Spending Review period. However, in view of the volatile—and declining—nature of the NDA's commercial income we are sceptical about how watertight such an assurance can be. Nuclear decommissioning is too important to be left to the mercy of changing priorities in the Treasury and uncertain commercial income; as the Permanent Secretary acknowledged, a new system of funding is needed, and work on this needs to begin urgently. (Paragraph 37)

Formal Minutes

Tuesday 1 April 2008

Members present:

Peter Luff, in the Chair

Mr Adrian Bailey	Anne Moffat
Mr Lindsay Hoyle	Mr Mike Weir
Miss Julie Kirkbride	Mr Anthony Wright

Draft Report (*Funding the Nuclear Decommissioning Authority*), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 37 read and agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available in accordance with the provisions of Standing Order No. 134.

[Adjourned till to-morrow at 9.00am

Witnesses

List of written evidence

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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