House of Commons

Treasury Committee

Administration and expenditure of the Chancellor's departments, 2006–07

Seventh Report of Session 2007–08

Report, together with formal minutes

Ordered by the House of Commons to be printed Tuesday 26 February 2008

HC 57
[Incorporating HC 1029–i, 1030–i, Session 2006–07]
Published on Friday 7 March 2008
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

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A list of Reports of the Committee in the current Parliament is at the back of this volume.

Committee staff

The current staff of the Committee are Colin Lee (Clerk), Sîan Jones (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young and Jay Sheth (Committee Specialists), Phil Jones (Committee Assistant), Caroline McElwee (Secretary), Tes Stranger (Senior Office Clerk) and Laura Humble (Media Officer).

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Overview

The Treasury Committee reports for the first time on its annual scrutiny of the Chancellor's departments, in this Report. It is essential for the success of Government that the Chancellor's departments carry out their role effectively. Therefore whilst other Government departments may sometimes fail to give a good account of their performance, we look to the Chancellor's departments, the engine of Government spending, to demonstrate clear progress against their targets. Sadly in some areas the Chancellor's departments fail to lead by example.

Treasury as a central department

Reviewing the Treasury as a central department, we welcome the steps that have been taken in response to a call for "greater inclusiveness and humility" in the Treasury's dealings with others. We recommend that a summary of the results of the annual surveys of stakeholder opinion and the Treasury's response to stakeholders be published in the Treasury's annual reports. We recommend that the Treasury set itself a target to ensure that the Public Service Agreements finalised as part of the next Spending Review in 2009 or 2010 include a clear statement about the resources to be allocated across Government to the delivery of each Agreement. We criticise the Treasury's failure to meet its objective for the appointment of professionally–qualified Finance Directors in all departments by December 2006 and recommend that a relevant accountancy qualification be described as an essential criterion in all future advertisements for posts of departmental Finance Directors.

Value for Money

Over the Treasury Group as a whole, we discuss the new Value for Money Delivery Agreements across Government, a feature of the efficiency programme, intended to give further detail about individual departmental efficiency programmes; we view the Treasury Group's own document as disappointing. We explore the issue of measuring service quality and recommend that the Government, state how it proposes to measure that the quality of service of the Treasury Group during the period from 2008–09 to 2010–11 and how it will identify whether efficiency savings have led to any detrimental effects on quality of performance. We recommend that the Government put in place arrangements for the Cabinet Office to perform the role of challenge and oversight in relation to the Treasury Group's own efficiency programme.

Royal Mint

We welcome the Royal Mint's return to profitability and explore the methods the Mint used to improve its financial performance, but raise concerns regarding its ambitious government profitability target for next year.

Office of Government Commerce

In respect of the OGC, we discuss its reduced role following the publication of Transforming Government Procurement. We highlight the importance of accurate annual reporting and raise concerns that OGC failed to publish a regular annual report. We explore the development of Gateway review process and the background to the forthcoming High Court case. And we reiterate our view that the exclusion of OGCbuying.solutions from the headcount reductions under the efficiency programme detracts from the overall credibility of the headcount statistics.

HM Revenue and Customs

In evaluating HMRC's progress, we discuss the Department's continued areas of weakness. We also discuss the surprising 60% increase in senior civil servants bonus payments over this period of poor performance and headcount reductions. We note the worrying conclusions of HMRC's recent Capability Review and raise concerns that the headcount reduction under the efficiency programme has significantly reduced the quality of service. We discuss the progress made towards HMRC's Public Service Agreement targets and raise concerns about the slippage of a number of targets. We highlight the problems experienced in VAT registrations and note that the confusion surrounding HMRC's continued failure to meet its target of processing VAT receipts. We find that progress to improve the administration of tax credits has been poor—with complaints to the Adjudicator's office still increasing 5 years after the scheme was brought in.

1 Introduction

The Sub-Committee's scrutiny programme

1. The Treasury Sub–Committee undertakes a regular scrutiny programme of the administration and expenditure of the Chancellor's departments. In addition to annual hearings with HM Treasury itself and HM Revenue & Customs (HMRC), the Sub–Committee has regularly taken evidence from the Office for National Statistics, the Statistics Commission, the Office of Government Commerce (OGC), National Savings & Investments, the Debt Management Office (DMO), the Royal Mint, the Adjudicator's Office, the Government Actuary's Department and the Valuation Office Agency. The hearings that the Sub–Committee has held in the last Parliament and in the present Parliament are summarised in Table 1.

Table 1: Sub-Committee scrutiny sessions, 2001–02 to 2007–08

Department or body	2001–02 reports	2002–03 reports	2003–04 reports	2004–05 reports	2005–06 reports	2006–07 reports
Adjudicator's Office		Oct 03				Nov 07
Debt Management Office		Jun 03			Jan 07	
Government Actuary's Dept	Jul 02				Nov 06	
HM Revenue & Customs:				Oct 05	Nov 06	Dec 07
Inland Revenue	Jun 02	Jun 03	Jun 04			
Customs & Excise	Jun 02	Jun 03	Jul 04			
HM Treasury		Sep 03	Feb 05†	Nov 05	Oct 06	Nov 07
National Savings & Investments	Jan 03			Oct 05	Feb 07	
Office for National Statistics	Oct 02	Oct 03	Oct 04	Nov 05	#	
Office of Government Commerce		Jan 04	*Apr 04**		May 06	Oct 07
Royal Mint	Nov 02	Nov 03			Nov 06	Oct 07
Statistics Commission	Oct 02	Sep 03 May 03*	Sep 04	Nov 05	#	
Valuation Office Agency				Oct 05†	Jan 07	

* Appointment hearing for new Chairman/Director/Chief Executive
† Part of a wider meeting
\# Inquiry into *Independence for statistics* published July 2006; scrutiny of 2005–06 annual reports therefore not undertaken

2. Previously in this Parliament, we have not reported specifically on the Sub-Committee's scrutiny programme. In April 2007, the Liaison Committee remarked that it was "vitally

important" that those select committees that did not then report regularly on their scrutiny of expenditure should take steps to do so.[1] Partly in the light of this, we have decided to report on the Sub–Committee's scrutiny of administration and expenditure issues in the Chancellor's departments in 2006–07.

3. There are too many departments for the Sub–Committee to take evidence from all of them every year. In examining administration and expenditure issues in 2006–07, the Sub–Committee chose to concentrate on the OGC, the Royal Mint, the Office of the Adjudicator, HM Treasury and HMRC. As part of the work leading to this Report, the Sub-Committee has taken evidence from Mr Nigel Smith, the Chief Executive of the OGC, Mr David Barrass, then Deputy Master and Chief Executive of the Royal Mint and his successor, Mr Andrew Stafford, Mr Nicholas Macpherson, the Permanent Secretary to the Treasury, Dame Barbara Mills DBE, the Adjudicator and Mr Dave Hartnett, Acting Chairman of HMRC. The Sub–Committee concluded its inquiry by taking evidence from Rt Hon Jane Kennedy MP, Financial Secretary to the Treasury, and Angela Eagle MP, Exchequer Secretary to the Treasury, on themes and issues arising from the previous scrutiny sessions. We are grateful to all those who assisted the Sub–Committee in the course of its inquiry.

Relevant documents

4. The scrutiny sessions the Sub–Committee has held have been based largely on the published Reports and Accounts of the Treasury, HMRC and other bodies subject to examination.[2] In preparing this Report, we have also drawn upon the following relevant documents and information:

- Correspondence between the then Financial Secretary to the Treasury and the Chairman of this Committee relating to a pilot study of a merged Departmental Annual Report and Resource Accounts, which is published with this Report;[3]
- Correspondence between Mr Macpherson and the Chairman of this Committee relating to the Treasury's Public Service Agreements (PSAs) and Departmental Strategic Objectives (DSOs), which we published with a previous Report;[4]
- Memoranda and supplementary information submitted to us by the Treasury and HMRC relating to the Winter Supplementary Estimates for 2006–07, which is published with this Report;[5]

1 Liaison Committee, First Report of Session 2006–07, *Annual Report for 2005–06*, HC 406, para 32

2 HM Treasury, *Annual Report and Accounts 2006–07*, June 2007, HC (2006–07) 518; HM Revenue & Customs, *Departmental Report 2007*, May 2007, Cm 7107; The Royal Mint, *Annual Report and Accounts 2006-07*, June 2007, HOC (2006-07) 543

3 Ev 74–75

4 Treasury Committee, First Report of Session 2007–08, *The 2007 Comprehensive Spending Review*, HC 55, Ev 21–34

5 Ev 76–81; Ev 92–95

- The Capability Reviews of the Treasury and HMRC, which were published in December 2007;[6]
- The Autumn Performance Reports of the Treasury and HMRC, which were published in December 2007;[7] and
- The Treasury's *Value for Money Delivery Agreement* and *Departmental Strategic Objectives*, also published in December 2007.[8]

The approach of this Report

5. We have chosen to be selective in the issues which we examine in this Report. We or the Sub–Committee may return to some issues covered in evidence in subsequent work. In particular, data losses by HMRC, a matter raised in the sessions with HMRC and the Ministers, will be examined during a separate inquiry by the main Committee.

6. The first four chapters of this Report relate principally to the Treasury itself, along with the Royal Mint and the OGC. The next chapter examines the Treasury Group's resources, and the performance of Royal Mint. Chapter 3 looks at the role of the Treasury at the centre of Government. Chapter 4 explores the work of the OGC. Chapter 5 concentrates on aspects of the Treasury's performance in relation to its PSA targets, and also examines the Treasury's new DSOs. Chapter 6 explores HMRC's performance in relation to the efficiency programme and its PSA targets, and also examines HMRC's new Departmental Strategic Objectives.

6 Cabinet Office, *Capability Review of HM Treasury*, December 2007; Cabinet Office, *Capability Review of HM Revenue and Customs*, December 2007.

7 HM Treasury, *Autumn Performance Report: Progress Report on HM Treasury Public Service Agreement Targets*, December 2007, Cm 7256; HM Revenue & Customs, *Autumn Performance Report,* December 2007

8 HM Treasury, Value for Money: Delivery agreement and asset management strategy, December 2007; HM Treasury, HM Treasury Group Departmental Strategic Objectives —2008–2011, December 2007

2 The Treasury Group's own resources

Overall expenditure trends

7. Although the Treasury is an important and powerful Department of State, its budget is small by comparison with most Government departments. The total expenditure within Departmental Expenditure Limits (DEL) of the Treasury Group—which includes the DMO, the OGC, the coinage and grants awarded to the Statistics Commission and four Parliamentary bodies[9]—in 2006–07 was £202 million, less than 0.25% of expenditure within DEL by the Department of Health in the same year, and little more than one tenth of the expenditure of a relatively small department such as the Foreign and Commonwealth Office.[10]

8. Although relatively low in comparison with most departments, the Treasury Group's expenditure within DEL is currently at high levels compared with both the recent past and the near future. Mr Macpherson told the Sub–Committee in October 2006 that, at the turn of the decade, "there was a deliberate decision to increase the size of the Treasury, partly reflecting a period of vacancies, partly reflecting a new, bigger workload".[11] The Treasury Group's DEL budget has risen from £134 million in 2001–02 to £228 million in 2007–08.[12]

9. This period of budgetary expansion is intended to be at an end. In January 2007, the Treasury's Board set out a vision for the Department as "a smaller organisation" which would be "agile, prioritising its resources, streamlining processes and working flexibly across traditional boundaries".[13] At the time of the 2006 Budget, the Treasury finalised a spending settlement for the Comprehensive Spending Review period which will see the Treasury's DEL budget fall by 5% a year on average in real terms in 2008–09, 2009–10 and 2010–11.[14] The Group's DEL budget is projected to fall to £208 million by 2010–11.[15] Mr Macpherson emphasised that "the Treasury is going to get a whole lot smaller in the coming period", but was confident that "we can do that whilst continuing to maintain the same level of service, if not improve it".[16] He went on to say of the settlement:

> I think there is probably just about enough fat. I would be quite worried if you came back to us next year and said, 'Actually, Parliament decided that we had to have a

9 The Commonwealth Parliamentary Association, the British-American Parliamentary Group, the Inter-Parliamentary Union and the British-Irish Parliamentary Union; from 2008–09, these bodies will be funded by the House of Commons Commission: HC (2006–07) 518, para 7.28, p 93

10 HC (2006–07) 518, Table 7.3, p 90. Comparative expenditure totals within DEL are taken from HM Treasury, *Public Expenditure Statistical Analyses 2007*, April 2007, Cm 7091, Table 1.12, p 21

11 HC (2005–06) 1659–i, Q 7

12 HC (2006–07) 518, Table 7.3, p 90

13 *Ibid.*, para 1.13, p 24. For the timing of the vision, see *Capability Review of HM Treasury*, p 5.

14 *Budget 2006*, Box 6.3, p 136

15 HC (2006–07) 518, Table 7.3, p 90

16 Q 201

10% reduction', I would start worrying. This is an ambitious target, I think we can deliver it, but the risks would increase if you went much further faster.[17]

Under-spending and End-Year Flexibility

10. In recent years, the initial limits on Treasury Group DEL spending arising from Spending Review settlements have not proved over-ambitious, insofar as there have been significant under–spends reported for each year since 2002–03 in the Treasury Group's Resource Accounts, as shown in Table 2.

Table 2: Treasury Group expenditure outturns compared with limits set, 2002–03 to 2006–07

(1) Year	(2) Initial limit on expenditure £ million	(3) Outturn of expenditure £ million	(4) Difference between (2) and (3) £ million	(5) Difference (4) as percentage of initial limit (2) %
2002–03[18]	388.68	359.37	29.31	7.5
2003–04[19]	298.64	291.56	7.08	2.3
2004–05[20]	317.05	267.06	49.99	15.0
2005–06[21]	320.45	296.23	24.22	7.5
2006–07[22]	323.94	297.00	26.94	8.3

Sources: to be provided by Justine, along with outstanding figures

11. Mr Macpherson acknowledged that the Treasury Group had shown "a tendency to under-spend".[23] He drew attention to the importance of accounting adjustments, including impairments and early redundancy costs, in explaining some of the under-spends.[24] In October 2006, Ms Mary Keegan, then the Treasury's Finance Director, explained that the largest under-spend, in 2004–05, had been largely due to revaluation of the Treasury's property and the sale of part of the former Treasury building to HMRC.[25]

12. Mr Macpherson said that the Treasury was working intensively both to improve forecasting of expenditure and to encourage parts of the Group to spend the money allocated to them.[26] The Treasury's departmental annual report published in June 2007

17 Q 225

18 HM Treasury Resource Accounts 2002–03 [HC 999 July 2003] Summary of resource outturn –p 17

19 HM Treasury Resource Accounts 2003–04 [HC 920 July 2004] Summary of resource outturn –p 17

20 HM Treasury Resource Accounts 2004–05 [HC 93 June 2005] Summary of resource outturn –p 18

21 HM Treasury Resource Accounts 2005–06 [HC 1344 June 2006] Statement of Parliamentary Supply –p 38

22 HM Treasury Resource Accounts 2006–07 [HC 518 June 2007] Statement of Parliamentary Supply –p 117

23 Q 194

24 Qq 194, 200

25 HC (2005–06) 1659–i, Q 95

26 Q 194

indicated that the Group planned to spend its DEL allocation of £228 million in full,[27] but in November 2007 Mr Macpherson told the Sub-Committee that he expected another under-spend in 2007–08.[28]

13. As part of the new regime for planning and controlling public expenditure introduced in 1998, Government departments are allowed to carry forward resources and capital not used at the end of the financial year for use in future years under the system of End-Year Flexibility (EYF).[29] Partly in consequence of the successive under–spends that we have noted, the Treasury has built up a very substantial stock of DEL EYF. The Treasury's total DEL EYF stock carried forward from 2006–07 to 2007–08 amounts to £238,726,000, comprised of £58,798,000 saved from administration costs, £115,416,000 from other resources and £64,512,000 from capital.[30] The Treasury's DEL EYF stock exceeds its annual DEL budget, and—as a proportion of annual DEL expenditure—is more than that of most Government departments, as Table 3 demonstrates.

27 HC (2006–07) 518, para 7.7, p 86

28 Q 199

29 Treasury Committee, Second Report of Session 2005–06, *The 2005 Pre-Budget Report*, HC 739, para 65

30 HM Treasury, *Public Expenditure 2006–2007 Provisional Outturn*, July 2007, Cm 7156, Table 6, p 15

Table 3: DEL EYF carried forward from 2006–07 to 2007–08 as a percentage of planned expenditure within DEL for 2007–08: selected departments

(1) Department	(2) DEL EYF carried forward from 2006–07 to 2007–08 £'000	(3) Total in (2) as percentage of April 2007 DEL plans for 2007–08
HM Treasury	238,726	106
HM Revenue & Customs	158,188	3
Department for Education and Skills	3,426,991	5
Department of Health	5,808,244	6
Ministry of Defence	2,846,854	8
Foreign and Commonwealth Office	218,208	12
Department for International Development	90,605	2
Department for Culture, Media and Sport	262,011	14
Department for Work and Pension	848,675	11
Northern Ireland Office	603,351	52

Sources: Column 2: HM Treasury, Public Expenditure 2006–2007 Provisional Outturn*, July 2007, Cm 7156, Table 6, pp 14–15; Column 3: our calculations, based on HMT - HMT DAR 2007, Table 7.2, p.88; HMRC - HMRC DAR 2007, Annex E, Table 1, p. 66; and other source needed*

14. The Treasury told us in November 2007 that it had no plans to draw down any EYF stock in 2007–08.[31] Any use of EYF would increase the Treasury's DEL.[32] The Treasury Group's DEL totals include expenditure on the Civil List. Expenditure for Her Majesty The Queen's Civil List has been fixed at £7.9 million a year until 31 December 2010.[33] Mr Macpherson told us in December 2007 that some of the EYF stock might be utilised in 2010–11 to fund the effects of the Civil List renegotiation in the event that it could not be accommodated within 2010–11 DEL provision.[34] Such an increase is unlikely to make significant inroads into EYF stock exceeding £238 million. **Significant under-spends in successive years have seen the Treasury Group build up exceptionally large stocks of End-Year Flexibility, exceeding the Group's annual budget within Departmental Expenditure Limits. On the assumption that the Treasury will wish to set an example to other departments through continued restraint on Departmental Expenditure Limits expenditure in the period covered by the Comprehensive Spending Review, there**

31 Ev 78

32 *Ibid.*

33 HC (2006–07) 518, para 7.26, p 93

34 Ev 81

appear to be few prospects for this stock to be deployed to a significant extent for the Group's expenditure within Departmental Expenditure Limits. We recommend that, in its response to this Report, the Government state whether there are any circumstances in which the Treasury Group's Departmental Expenditure Limits End–Year Flexibility stock might be used for purposes other than expenditure within the Group's Departmental Expenditure Limits.

The Gershon efficiency programme in the Treasury Group

15. The Treasury Group's under–spending against the limits set in the 2004 Spending Review has, by its own account, been enabled in part by the efficiency measures introduced since that Spending Review in response to the Gershon review.[35] The Sub–Committee conducted an inquiry into the efficiency programme in the Chancellor's departments in mid-2007, and we reported on that subject in July.[36] The Treasury Group was set a target for monetary savings with an annual value of £18.7 million by 2007–08, of which £11.9 million was to come from the Treasury, £5.8 million from OGC and OGCbuying.solutions and £1 million from the DMO. The target was adjusted in June 2006, with £1 million of the Treasury target and £0.5 million of the OGC target reallocated to a combined target of £1.5 million savings from Group Shared Services (GSS).[37] By September 2007, the Treasury had reported savings of £10.4 million, nearly meeting its revised target of £10.9 million. The OGC and DMO had met their final targets, and OGCbuying.solutions had exceeded its target. All savings were reported as "final".[38]

16. The GSS programme seeks to merge the Treasury and OGC teams dealing with information services and facilities, human resources, internal audit, and finance and procurement. On 1 April 2007, 68 OGC corporate service staff transferred to GSS.[39] The aim is to reduce spending on these areas by 20%,[40] and Mr Macpherson told the Sub–Committee in November 2007 that the GSS programme had already "driven out quite substantial savings across the Group".[41] By the end of September 2007, savings with an annual value of £2 million had been reported, against an initial target of £1.5 million by the end of 2007–08.[42] Further savings resulting from the GSS programme are expected beyond 2007–08.[43]

17. The Treasury Group has also achieved efficiency savings through the rationalisation of its estate, most notably the decision to vacate the OGC's headquarters in Trevelyan House,

35 HC (2006–07) 518, para 7.7, p 86

36 Treasury Committee, Eighth Report of Session 2006–07, *The efficiency programme in the Chancellor's departments*, HC 483

37 HC (2006–07) 483–I, para 112 and Table 8

38 Cm 7256, Table 1, p 32. Savings under the Gershon efficiency programme can be classified as final, interim or preliminary.

39 HC (2006–07) 518, paras 6.56–6.57, p 81

40 Capability Review of HM Treasury, p 24

41 Q 199

42 Cm 7256, Table 1, p 32

43 HC (2006–07) 518, para 7.62, p 99

Great Peter Street, and move OGC staff to the Treasury's building at 1 Horse Guards Road. Mr Macpherson said that this move had not only delivered large savings, but had also resulted in improved communication between the OGC and the Treasury.[44]

18. The OGC has recently undertaken a programme of restructuring, following the launch of *Transforming Government Procurement* in January 2007. The OGC has a target to reduce its workforce to 250 by April 2008 under the efficiency programme.[45] In response to our Report on the Efficiency programme in the Chancellor's departments, the Government stated that its policy for the location of posts in the new OGC would be based on the business need of the location of individual posts, market availability and value for money.[46] OGCbuying.solutions has relocated 22 posts from London: 15 to Liverpool and 7 to Norwich. The Treasury itself has relocated 10 posts from London to Norwich, 5 posts as part of Group Shared Services.[47]

19. We note that the Government excluded OGCbuying.solutions from the calculations for headcount reductions under the efficiency programme due to its Trading Fund status and role as an enabler of wider efficiency savings across Government. As we stated in our Report on the efficiency programme, we believe that there is a risk that the practice of excluding certain categories of staff increases from the calculations for headcount reductions detracts from the overall credibility of the headcount statistics.[48] **OGCbuying.solutions' role or status does not provide sufficient justification for its exclusion from the calculations for headcount reductions. We therefore reiterate our view that there is a risk that the practice of excluding certain categories of staff increases from calculations of headcount reductions for the purposes of the efficiency programme detracts from the overall credibility of the headcount statistics.**

20. As part of the Gershon efficiency programme, the Treasury was set a target to reduce its staff by 150.[49] The baseline from which progress against this target is measured is now 1,371, following a series of adjustments to reflect staff transfers.[50] When Mr Macpherson gave oral evidence in mid-November, the Treasury's headcount was 1,165, so that a reduction of 206 posts had already been achieved.[51] Mr Macpherson told the Sub-Committee that he had no plans to fill vacant posts and bring the staff complement up to that baseline, choosing rather to carry the vacancies forward in anticipation of the further savings needed in the period beyond 1 April 2008.[52] There would be no incentive to fill the

44 *Ibid.*, para 6.58, p 81; Q 204

45 Treasury Committee, First Special Report of 2007-08, *Government response to Committee's Eighth Report of Session 2006-07*, HC 62, para 19

46 *Ibid.*

47 *Ibid.*

48 Treasury Committee, Eighth Report, *The efficiency programme in the Chancellor's departments*, HC 483-I, 23 July 2007, para 121

49 HC (2006–07) 483–I, Table 9

50 Q 188; HC (2006–07) 483–I, para 117

51 Qq , 188–189

52 Qq 199, 218

vacant posts to assist in meeting subsequent efficiency targets in the welcome absence of formal headcount reduction targets from 2008–09 onwards.[53]

Efficiency in the Treasury Group, 2008–09 to 2010–11

21. In December 2007, the Treasury published a Delivery Agreement for the efficiency savings that the Treasury Group plans to make between 2008–09 and 2010–11. The Group is committed to delivering £30 million of savings over that period, equivalent to a nominal saving of 4.1% of the Group's DEL expenditure per annum.[54] The document provides a savings target for each of the three years.[55] Five main methods of achieving the savings are identified:

- A restructuring of the Treasury's directorates to release savings and reduce headcount;
- Further development of Group Shared Services;
- Further rationalisation of the Treasury estate;
- A reduction in the OGC headcount; and
- A refinement of the DMO's procedures to increase automation and reduce support costs.[56]

Most of the savings are due to come from within the Group's administration budget, reflecting the possibility that expenditure on some demand–led programmes might increase.[57]

22. The Value for Money Delivery Agreements across Government are a new feature of the efficiency programme for the period from 2008–09 to 2010–11, intended to give further detail about individual departmental efficiency programmes,[58] and thus with the potential to address concerns expressed by us previously relating to lack of clarity about baselines, measurement methodologies and service quality.[59] **In view of the extent to which Value for Money Delivery Agreements were portrayed by the Government as a new departure in reporting on efficiency, we view the Treasury Group's own document as disappointing.** There are three weaknesses in particular that need to be addressed.

23. First, the Treasury's Delivery Agreement fails to provide any breakdown of the targeted efficiency savings between the methods of achieving those savings that have been identified, even though comparable information on the division of the savings target

53 Treasury Committee, First Report of Session 2007–08, *The 2007 Comprehensive Spending Review*, HC 55, para 27

54 HM Treasury Value for Money Delivery Agreement, para 1.7, p 4

55 *Ibid.*, Table 1, p 7

56 *Ibid.*, para 1.9, p 5

57 *Ibid.*

58 HC (2007–08) 55, para 21

59 Treasury Committee, Sixth Report of 2006–07, *The 2007 Comprehensive Spending Review: prospects and processes*, HC 279, para 64

between organisations within the Treasury Group and by workstream within the Treasury itself is available in relation to the Gershon efficiency programme.[60] **We recommend that, in its response to this Report, the Government set out the efficiency targets for each organisation within the Treasury Group and for further savings from estate rationalisation and Group Shared Services for each year over the period from 2008–09 to 2010–11.**

24. Second, the document fails adequately to deal with the issue of measuring service quality. As we noted earlier, Mr Macpherson told the Sub–Committee that he was confident that the Treasury could cope with the proposed budgetary reduction "whilst continuing to maintain the same level of service, if not improve it".[61] The Delivery Agreement acknowledges the risk that

> Pressure of CSR07 reductions leads to loss of talent, and failure to recruit and retain in the future appropriately skilled workforce, with a detrimental impact on Treasury Group performance.[62]

However, there is no indication as to how such a detrimental impact would be measured. **We recommend that the Government, in its response to this Report, state how it proposes that the quality of service of the Treasury Group during the period from 2008–09 to 2010–11 be measured, and whether there are arrangements in place to identify whether efficiency savings have led to any detrimental effects on quality of performance.**

25. Finally, the issue of external challenge is not tackled in the Delivery Agreement. Prior to 1 April 2007, the OGC oversaw the efficiency programme across Government, and was in a position to provide external challenge relating to the efficiency performance of the Treasury itself. In the future, the responsibility for challenging departments about their efficiency programmes will fall to the Treasury itself, a matter that we consider more generally in the next chapter.[63] The Delivery Agreement appears to envisage monitoring of the Treasury Group's efficiency programme only from within the Treasury.[64] **Even if formal responsibility for general oversight of the efficiency programme across Government is separate from management of the Treasury's own programme, we consider it unsatisfactory that the role of oversight and challenge be undertaken from within the same organisation. We recommend that the Government put in place arrangements for the Cabinet Office to perform the role of challenge and oversight in relation to the Treasury Group's own efficiency programme.**

60 See, for example, Cm 7256, paras B.4–B.13, pp 33–34

61 See paragraph 9.

62 HM Treasury Value for Money Delivery Agreement, Table 2, p 13

63 See paragraphs 45-61.

64 HM Treasury Value for Money Delivery Agreement, paras 3.3–3.5, 4.2, pp 11, 13

The Royal Mint

Background

26. The Royal Mint is a trading fund and executive agency which employs around 800 people, based in Llantrisant, Wales. The Chancellor of the Exchequer is the Master of the Mint. The Royal Mint Board comprises a non-executive chairman, three non-executive directors, the chief executive/Deputy Master and five executive directors. As a trading fund, the Royal Mint operates on commercial lines and is legally required to manage its funded operations so that the revenue of the fund is sufficient to meet its outgoings and that any operating loss in one year is made good in subsequent years. The Royal Mint's relationship with the Treasury is more complex than that between the Treasury and many of the other Chancellor's departments. The Treasury is both the Mint's owner and one of its main customers, for UK circulating coins. Our predecessors last reported on the work of the Royal Mint in 2001, and the Sub–Committee has subsequently scrutinised its work through regular evidence sessions.[65] On 6 June 2007, the Treasury announced that Andrew Stafford would replace David Barrass as Chief Executive; David Barrass having been interim Chief Executive since 16 January 2006.[66] Andrew Stafford commenced his role on 15 October 2007. We took evidence from Mr Stafford and Mr Barrass on 10 October.[67]

Royal Mint's overall financial performance

27. In June 2007, the Royal Mint published results for the 2006–07 financial year which reported an operating profit before exceptional items of £8.7 million, an increase of £7.6 million on the previous year and, its highest operating profit for nine years. Retained profit for that year was reported at approximately £1.2 million compared to a loss of £1.6 million in 2005–06. This significant improvement was achieved after charging £6.4 million of exceptional items, which related to the implementation of the business improvement programme. Mr Barrass told us that the Royal Mint was now "an organisation that is absolutely fit for purpose",[68] which had re-established its position as the world's leading exporting Mint.[69]

28. As shown in Table 4 below, the Royal Mint made a profit of £1,238,000 last year; a significant contrast to the losses made in the previous two years.

65 Treasury Committee, Eighth Report, Session 2000–01, *Royal Mint,* HC 239

66 HMT Press Release 2007-93, 10 September 2007

67 Qq 1–88.

68 Q 6

69 Q 66

Table 4: Royal Mint's annual profit or loss, and performance against the Average Rate of Return target, 2004–05 to 2006–07[70]

	2006-07	2005-06	2004-05
Profit/(loss) [£k]	1,238	(1,600)	(3,245)
ARR[1] Achieved	3.0%	(1.7%)	(4.3%)
ARR[2] Target	2.9%	2.9%	4.9%

[1]: The average rate of return on net assets is calculated by expressing profit as a percentage of average net assets. Profit for this calculation is taken as the retained profit plus long-term loan interest. Net assets are taken as the average of the opening and closing balance sheet capital employed plus long-term loans outstanding.

[2] Target set by Treasury

Mr Barrass attributed the improvement in part to the introduction of more efficient working practices and lower operating costs. He told us that it "been very hard work"[71] to return the Royal Mint to a profitable organisation, but that the organisation "had moved to … a very commercial, vibrant Royal Mint".[72] The operational performance and financial savings due to the restructuring programme should aid profitability in the coming financial period.[73]

29. The Royal Mint appears on course to continue its recent turnaround; Mr Barrass told the Sub-Committee that he expected the Mint's profit in 2007-08 "to do better than last year".[74] He was also confident that the Mint was in a strong position to recover previous losses in the next two years, stating that "we really are cooking on gas down there".[75] The Royal Mint exceeded its Average Rate of Return [ARR] target (3% of average net assets) set by the Treasury for 2006-07, by 0.1%. We note that in the next financial year the target rate will increase to 7.2%. The Royal Mint's Annual Report states that "due to the hedging policy of the Royal Mint the full impact of these metal price rises has yet to be realised"[76], and that such rises would be likely to increase the Mint's working capital requirements by £5 million.[77] Mr Barrass told the Sub-Committee that the ARR target for 2007-08 was a "good challenging target" and that he was confident that the Royal Mint would "over achieve against that quite substantially".[78] The Exchequer Secretary told the Sub-Committee that the "Royal Mint is in a much healthier position now than it has been in for some years".[79] **We recognise that considerable work has been undertaken in the last year**

70 Based on data from Annual Report, pp 12–13.

71 Q 27

72 *Ibid.*

73 Q 31

74 Q 55

75 Royal Mint, *Annual Report 2006-07*, Chairman's Statement, p 3

76 *Ibid.*, p 10

77 *Ibid.*

78 Q 59

79 Q 622

to enable the Royal Mint to improve its financial performance and congratulate all those concerned. We note that more work will need to be done to enable the Mint to meet its Average Rate of Return target set by the Treasury for 2007–08.

Better Working Programme

30. In August 2006, the Royal Mint announced a *Better Working Programme* as part of a wider effort to make long-term improvements to the performance of the organisation; an initiative aimed at modernising the organisation structure and reviewing many of the Mint's working methods. The Programme identified opportunities to increase productivity in all areas of the business. The Mint implemented initiatives to improve sales performance and purchase behaviour, and to increase output.[80] The Programme, led by Mr Barrass, incorporated significant staff input and union co–operation.[81] The programme resulted in a reduction in the number of employees; we note that all reductions were achieved wholly on a voluntary basis. Mr Barrass was pleased to report that "the real good news from a social perspective is that there were no compulsory redundancies, we had the unions with us all the way through".[82]

31. The new structure increased the focus on the individual business units. The changes also focused on the development of the Royal Mint brand, as a valuable world class brand. [83] Mr Barrass told us that the Royal Mint brand was immensely powerful: "it was almost a sleeping giant two years ago before we did the branding work that we have done". [84]

Staff turnover

32. During 2006–07, there was considerable change to the Mint's Board membership and governance structures. Four board level posts within the Mint changed staff during the year, with a new (interim) Director of Finance, Director of Marketing, Director of Collector Coin Sales and Chairman being appointed. The interim Chief Executive (who remained in post throughout 2006-07) and interim Director of Finance were due to leave in 2007–08.[85] In addition to the appointment of a new Non-Executive Chairman in March 2007, the terms of office of two Non-Executive Directors, who acted as the Chairmen of the Audit Committee and Remuneration Committee respectively, came to an end in March 2007.[86] Mr Barrass told us that the changes in the senior management team, some the result of retirement, had been "a huge opportunity".[87] The Royal Mint employed interim

80 Letter from the Financial Secretary to the Treasury to the Committee Chairman, 25 October 2006

81 *Ibid.*

82 Q 38

83 Royal Mint Annual Report 2006-07, Chairman's Statement, p 3

84 Q 66

85 Report by the Comptroller and Auditor General on the Accounts, contained within the Royal Mint Annual Report 2006-07, p 40

86 *Ibid.*

87 Q 28

managers—"guys who are very talented, very skilled"[88]—to support Mr Barrass in the turn-around.

33. As a result of the Better Working Programme, seventy-two permanent staff left the Royal Mint either through early retirement or voluntary redundancy. Mr Barrass told the Sub-Committee that there had not been a target to reduce the headcount, the programme had "looked at every process that goes on in the Royal Mint and we addressed each one individually and looked at how we could improve that process; and in some places we were able to cut out total workflows that had been there 20, 25 years and were no longer adding any value to the Royal Mint and eliminate them".[89] The Exchequer Secretary concluded that "great efficiencies have been made".[90]

34. The Comptroller and Auditor General raised concerns in his report on the Royal Mint's accounts for 2006–07 that "significant staff turnover at senior levels, in particular during a time of business transformation, carries with it risks in terms of governance and control".[91] That report further noted that the Mint continued to face challenges in cementing its improved operational performance and finalising the senior management team. We were told that a permanent management team had not been established in order to allow the new Chief Executive, Mr Stafford, the opportunity of "replacing those guys in a structured way over the next perhaps six or nine months and bring on board the team that he wants to work with".[92] A permanent management team will provide stability for the Mint going forward.

Circulating Coin and Collector Coin business

35. The Mint reported that it continued to meet the obligations of its contract with HM Treasury to supply domestic United Kingdom coin. 2006–2007 saw a 12% increase in demand to 1.6 billion coins. The enhanced flexibility within the organisation meant the additional volumes were accommodated effectively. Mr Barrass told the Sub–Committee that:

> The nature of the circulating business is that it is a tender-driven operation and overseas monetary authorities will come into the worldwide market maybe for a six-month period, buy hundreds of millions of coins and then we will not see them for two years … So, if you look back over the years on our accounts, you will see that overseas UK mix going up and down depending on which tenders have come to the market.[93]

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88 Report by the Comptroller and Auditor General on the Accounts, contained within the Royal Mint Annual Report 2006–07, p 40

89 Q 37

90 Q 622

91 *Ibid.*

92 Q 28

93 Q 47

36. The Circulating Coin business also improved its profitability with a contribution of £7.3 million, a 78% increase on the 2005–06 results. Mr Barrass said that he had "moved the philosophy of the Mint away from a volume-driven manufacturer to a profit–making manufacturer".[94] The Collector Coin business had a very successful year with significant growth in both the business to customer and wholesale market areas. Profitability increased by 129% compared with 2005–06 figures, generating a £9.7 million contribution compared to £4.3 million in 2005–06.

Service Level Agreement

37. The Treasury contracts with the Royal Mint as a customer, under a Service Level Agreement, for the manufacture and distribution of United Kingdom circulating coin. The Comptroller and Auditor General has consistently commented, in his annual report on Royal Mint's Accounts, that the outcome of negotiations over the Service Level Agreement would be important for the Mint's future profitability.[95] The Treasury worked with the Mint in 2005 to identify improvements in the arrangements for the production and distribution of UK circulating coinage.[96] The Treasury noted that the manufacturing price set under the service level agreement would affect the value of efficiencies counted under the core Treasury's programme workstream, which might therefore not reach its originally planned level, but the core Treasury's overall contribution was met.[97] The largest factor in the negotiations on the Service Level Agreement, resulting in an increase of £11.5 million in the Estimate, was metal prices.[98]

38. The new Service Level Agreement with the Royal Mint was agreed in October 2007 and covers the period April 2006 to March 2009.[99] Mr Barrass told the Sub-Committee that the Mint had taken a long time to negotiate the new contract because it wanted to "bring all aspects of that contract in line with the way we do business with third party customers" and that he believed that "it would be wrong to look at that contract as simply a price-driven contract".[100] The main change in the new agreement is for the cost of the coinage to be paid on manufacture rather than on issue. This arrangement will bring the Treasury in line with the Mint's other customers. The Service Level Agreement also covered an agreement that the Mint would pay a royalty fee for the right to produce UK collector coins. The Exchequer Secretary told the Sub–Committee that the Treasury was confident that it would be able to make most of the required £2.9 million efficiency programme savings from the renegotiation of SLA.[101] **We note that the new Service Level Agreement**

94 Report by the Comptroller and Auditor General on the Accounts, contained within the Royal Mint Annual Report 2006-07, p 40

95 *Ibid.*, p 31

96 HM Treasury, Efficiency Technical Note 2005, extract from Table 2, p 6

97 HC (2006–07) 483–ii, para 13

98 Letter from Permanent Secretary to the Treasury, to the Sub-Committee, on the 2006-07 Spring Supplementary Estimate, 16 April 2007, p 2

99 Ev 81

100 Q 24

101 Q 621

is intended to enable the Treasury to achieve £2.9 million programme-based efficiency savings and we will return to this issue in the Autumn to see if these savings are achieved.

Future prospects for vesting the Mint as a Government-owned company

39. In December 2004, the Chancellor of the Exchequer announced an intention that the Royal Mint's business operations would be vested in a Companies Act company, wholly owned by Government. The Mint's 2006–07 report stated that work on vesting was well–advanced, but had been placed on hold pending the recruitment of the new Chief Executive and the next stage in the Royal Mint's strategic development.[102] The Sub–Committee discussed progress towards vesting the Mint in 2006 with Mr Barrass. He was clear that the Mint at that time was not operating on a suitably profitable basis:

> The vesting process will take the Royal Mint from a trading fund status to a wholly owned government limited company status and ... to exist they have to be ... financially viable and to have a financially viable future. Clearly, coming off the back of two years' losses and quite a lot of cash consumption, it would have been crazy to vest at that time until we have got the business on a sustainable, profitable basis.[103]

40. Mr Barrass explained that vesting the company was critical to the development of a commercially viable mint as it would "allow us to react much more quickly to market forces, it will allow us to take much quicker commercial decisions".[104] He said that whilst the Royal Mint had previously not been in a position to be vested, its recent success had placed it "in a position where we can drive straight through that gate".[105] **We welcome the Mint's ambition to develop its business by establishing itself as a corporate entity separate from Government, and we agree that it will benefit from a standard company governance framework. The Mint is clearly in its strongest and most viable position for some time and we look to its new Chief Executive to take the vesting process forward successfully.**

Financial reporting

41. In reporting on its own performance in 2006–07, the Treasury for the first time combined its departmental annual report and its Resource Accounts in a single document. This is part of a pilot project to bring financial data and explanatory text together.[106] We agreed to this pilot on the understanding that the publication of the combined document would not be delayed beyond mid-June.[107] The combined document contains a useful

102 Royal Mint, *Annual Report 2006-07*, p 9

103 HC (2006–07) 1679–I, Qq 27–29, 68

104 *Ibid.*

105 Q 79

106 Ev 73–74, HC (2006–07) 518, Context, p 7

107 Ev 74–75

discussion of the different sets of financial information available,[108] and facilitates some rationalisation of material, so that, for example, reporting of expenditure by objectives is contained within the Resource Accounts and not repeated within the departmental report.[109] One consequence of the merger of the separate documents has been the disappearance of separate chapters on the OGC and the DMO. We discuss the adequacy of separate reporting by the OGC later in this Report.[110] **Provided that adequate arrangements are put or remain in place for reporting on the performance of the Office of Government Commerce and the Debt Management Office, and subject to the response to the specific recommendations in the remainder of this chapter, we view the pilot for combining the resource accounts and the departmental annual report of the Treasury Group as offering an opportunity for continued improvement in the quality of financial reporting by the Group in future.**

42. In its 2005–06 departmental annual report, the Treasury published for the first time a table allocating its resource budget by objective.[111] That table included a planned allocation of resources by objective for what was then the coming year—2006–07—but the equivalent table in the Treasury's 2006–07 document does not include planned spending by objective in 2007–08, an omission that might be related to the rationalisation of material between the departmental annual report and the resource accounts.[112] Mr Macpherson told the Sub-Committee that the Treasury's own financial reporting had become "pretty good" over the preceding seven years or so, having been "pretty poor" previously.[113] A Financial Management Review Update for the Treasury Group in 2006 recognised that "there is more to do to improve links between targets, performance goals, risks and financial budgets".[114] Ms Louise Tulett, the Treasury's Director of Finance, Procurement and Operations, told the Sub-Committee that

> in our own internal business planning we are trying to make much stronger links between resource allocation and the outcome-based internal objectives. We are trying to get away from just having an organisational approach and looking more at the outcome focus … We align our resources to our objectives.[115]

We are disappointed that the Treasury's annual report and accounts for 2006–07 do not include forward plans for expenditure linked to objectives comparable to the information provided in the departmental report for 2005–06. We recommend that such information for the period 2008–09 to 2010–11 be included within the annual report and accounts for 2007–08. The Treasury's capacity to include such plans and then to report on performance in relation to such plans will be an important indicator

108 HC (2006–07) 518, para 7.9 and Table 7.1, p 87

109 *Ibid.*, p 120

110 See paragraphs 69.

111 HM Treasury, *Departmental Report 2006*, May 2006, Cm 6830, Table 2a, p 98; HC (2005–06) 1659–i, Q 97

112 HC (2006–07) 518, p 120

113 Q 229

114 Capability Review of HM Treasury, p 24

115 Q 210

of the extent of the Treasury's success in seeking to raise the standards of its own financial management and reporting.

43. The Treasury Group's Resource Accounts for 2006–07 include overall figures on staff costs,[116] as well as information on the range of total remuneration of individual members of senior management.[117] Mr Macpherson confirmed that, as a matter of policy, the proportion of pay made in the form of bonuses was increasing over time.[118] The Sub–Committee asked Treasury witnesses why separate information was not available about bonus payments as a proportion of total pay in the Resource Accounts. The Treasury subsequently provided a table distinguishing base pay costs from bonuses, together with information on the bonuses paid to senior management, and Mr Macpherson agreed to consider whether such information could be included in future reports.[119] The information provided by the Treasury demonstrates that, in relation to the Treasury itself, bonus payments are not rising at an unexpected rate, but this is a matter we expect to continue to monitor. **We recommend that information on bonus payments as a proportion of total Treasury Group remuneration, divided between organisations, and on bonus payments to individual members of the Executive Board be included in future reports and accounts.**

44. In the Treasury's 2006 Departmental Report, a significant range of information was provided about the Group's staff by grade, including information on the Group's success in increasing the numbers of women at the most senior levels.[120] None of the equivalent information on staffing by grade appears in the 2006–07 Annual Report and Accounts. **We recommend that the Treasury reinstate information on staffing by grade, including the gender and diversity of staffing by grade, in future Reports and Accounts.**

116 HC (2006–07) 518, p 117

117 *Ibid.*, pp 107–110

118 Q 170

119 Qq 169–175; Ev 81-82

120 Cm 6830, pp 57–59

3 The Treasury as a central department

The challenge

45. In the "vision" which the Treasury Board agreed in January 2007, the department's future role at the centre of government was described as follows:

> In 2011, the Treasury will continue to be at the heart of government: a strong, respected and professional economics and finance ministry. As a department, it shall provide consistently accurate and rigorous analysis and honest advice. It will actively encourage open debate, giving weight to the evidence and listening to, and challenging, its wide range of stakeholders. Stakeholders will view the Treasury as competent and prudent, as well approachable, understanding and collaborative.[121]

46. The Capability Review of the Treasury published by the Cabinet Office in December 2007 suggested that the Treasury still had some way to fulfil this vision. That Review concluded that "the Department needs to take early steps to tackle what is perceived by many to be a pressing need for greater inclusiveness and humility in its dealings with others".[122] In response, Mr Macpherson accepted that "a strong internal culture has the potential to impact both positively and negatively in our dealings with our stakeholders".[123] The published Review outlined several steps that the Treasury was taking in relation to this challenge:

- The Treasury and the Cabinet Office are jointly developing a compact, setting out how the centre of government and departments will work together in partnership, including best practice on both sides;[124]
- In response to a call in the Review for "a clearer and more formal approach to stakeholder engagement and management" and the construction of "a more open and consultative environment that listens and responds to stakeholder concerns",[125] the Treasury will, by mid–2008, develop and begin to implement a "coordinated stakeholder engagement strategy" across the Department;[126] and
- Following a proposal in the Review to "consider a more structured and regular assessment of its reputation amongst its principal stakeholders",[127] the Treasury will "undertake annual surveys of stakeholder opinion … and commit to address issues

121 HC (2006–07) 518, para 1.13, p 24

122 Capability Review of HM Treasury, p 26

123 *Ibid.*, p 5

124 *Ibid.*, pp 6, 23

125 *Ibid.*, p 26

126 *Ibid.*, p 7

127 *Ibid.*, p 26

raised within the surveys and report back to stakeholders on what we have done to improve".[128]

47. The Exchequer Secretary drew the Sub-Committee's attention to the many positive aspects of the Capability Review, characterising it as "an extremely good Capability Review".[129] However, she also agreed about the importance of Treasury officials demonstrating "a practical as well as an intellectual grasp of what is going on", drawing attention to efforts being made to raise staff skills across the Department.[130]

48. **The Treasury's roles in allocating and controlling public spending and in acting as a guardian of propriety and economy in public services mean that it will never be universally popular amongst other Government departments and other stakeholders. While we would not wish the Treasury to become too inhibited in performing its role at the centre of Government, we welcome the steps that the Treasury is taking in response to the call in the Capability Review for "greater inclusiveness and humility" in the Treasury's dealings with others. We recommend that a summary of the results of the annual surveys of stakeholder opinion and the Treasury's response to stakeholders be published in the Treasury's annual reports. We further recommend that a summary of quantitative evidence from the survey conducted as part of the Capability Review be published in the Government's response to this Report, to serve as a baseline for measuring progress in the subsequent, annual surveys. We recommend that the Treasury take steps to address concerns expressed in the Capability Review to bolster the depth and breadth of their officials' practical experience.**

Managing the efficiency programme

49. With effect from 1 April 2007, the team within the OGC responsible for monitoring the efficiency programme across Government was transferred to the Public Spending Directorate of the Treasury.[131] The transfer reflected the Treasury's view that the Government could "mainstream efficiency as part of routine departmental financial management".[132] In June 2007, we noted that, prior to April 2007, the OGC had acted as an agency outside the Treasury mainstream to support and monitor the efficiency programme and that there were "signs of a reversion to a more traditional Treasury approach in the future".[133] We recommended that the Government "ensure that a coherent framework for the verification and reporting" of efficiency savings be established for the period beyond March 2008 and set out the details of such a framework in publishing the 2007 Comprehensive Spending Review.[134]

128 *Ibid.*, p 7

129 Q 537

130 Q 539

131 HC (2006–07) 518, para 5.4, p 64; HC (2006–07) 279, para 75

132 HM Treasury, *Transforming Government Procurement*, January 2007, para 2.17, p 20

133 HC (2006–07) 279, para 77

134 *Ibid.*, para 78

50. At the time of publication of the Comprehensive Spending Review, no additional information was provided about the proposed role of the Treasury in the central management and monitoring of the efficiency programme for the period from 2008–09 to 2010–11. The Treasury's Departmental Strategic Objectives issued in December 2007 provide little more information, stating that:

> Departments are responsible for ensuring delivery of their … Value for Money … commitments. The Treasury's role is one of support and challenge in helping them to deliver.[135]

Mr Macpherson indicated in evidence to the Sub-Committee in November 2007 that the Treasury would not allow savings to be recorded as efficiency savings unless departments could prove to the Treasury that service standards had at least been maintained,[136] but the Government has not yet responded to our recommendation that it clarify whether this practice will continue beyond March 2008.[137]

51. Our own uncertainty about the exact role of the Treasury in relation to the post-2008 efficiency programme appears to be shared in part by others. The Capability Review of the Treasury stated:

> Other government departments and stakeholders are particularly unclear about [the Treasury's] role in securing better value for money in other government departments and how this will operate in practice.[138]

We are not convinced that the Treasury's Public Spending Directorate is suitably placed to play an effective role in supporting and challenging departmental efficiency programmes. It is not evident that a role in questioning the validity of claimed efficiency savings is compatible with the task of ensuring that public spending limits are adhered to. The Capability Review of the Treasury demonstrates that our uncertainty is shared by others. We recommend that the Treasury clarify its own role in relation to the efficiency programme for the period from 2008 to 2011 in a swift response to this Report.

Financial management in Government

52. One of the Treasury's objectives is to "achieve world-class standards of financial management in government".[139] The Sub–Committee has considered progress in relation to this objective by examining three specific issues—the quality and timeliness of departmental Resource Accounts, the position of qualified Finance Directors in Government departments and the relationship between objective-setting and resource allocation.

135 HM Treasury Group Departmental Strategic Objectives — 2008–2011, para 2.23, p 12

136 Q 221

137 HC (2007–08) 55, para 25

138 Capability Review of HM Treasury, p 25

139 HC (2006–07) 518, p 70

53. Audited Resource Accounts may only be published when they have been laid before the House of Commons in final form by the Comptroller and Auditor General on a day when the House of Commons is sitting. The Treasury has long held the objective of securing that all departmental Resource Accounts for the preceding financial year are laid before the House before the Summer recess, thus preventing a long delay before publication.[140] There has been substantial progress in this direction: in 2005–06, 42 of 49 departmental Resource Accounts were laid before the Summer recess, compared with 25 in 2004–05 and 10 in 2003–04.[141] In 2006–07, the proportion rose further to 47 departmental Resource Accounts out of a total of 51 published before the Summer recess.[142] Progress in improving the quality of such Accounts, measured by the number of qualified audit opinions, has been less steady, with six qualified Accounts in 2005–06, compared with two in 2004–05, four in 2003–04 and eight in 2002–03.[143] **We welcome progress by the Treasury, other Government departments and the National Audit Office towards the objective of laying all Resource Accounts before the House of Commons before the Summer recess. We look forward to further progress on the quality of such Accounts measured by the number of qualified Accounts.**

54. In seeking progress in professionalizing financial management within Government, one measure that the Treasury has used has been progress in appointing professionally–qualified Finance Directors in departments. In 2003, only 20% of those Directors were professionally–qualified. By the autumn of 2005, this proportion had risen to 60%, and Ms Keegan told the Sub–Committee then that her objective was for all departments to have professionally–qualified Finance Directors by December 2006.[144] In October 2006, she told the Sub–Committee that the only two significant spending departments without professionally–qualified Finance Directors were the Foreign & Commonwealth Office and the Ministry of Defence, but she also indicated that recruitment processes for both posts were underway.[145] In those circumstances, it was somewhat surprising that, in June 2007, the Treasury reported that the Ministry of Defence had yet to appoint a professionally–qualified Finance Director.[146] Mr Macpherson assured the Sub-Committee that he had raised the issue with his counterpart in the Ministry of Defence, and the Treasury has apparently received an undertaking that the next Finance Director of the Ministry of Defence will be professionally–qualified.[147] **We expect the Government, in its response to this Report, to explain why the Treasury's objective for the appointment of professionally-qualified Finance Directors in all departments by December 2006 was not met. We further recommend that a relevant accountancy qualification be described**

140 HC (2005–06) 691–i, Q 127

141 HC (2006–07) 518, para 5.47, p 71

142 Cm 7256, p 27

143 HC (2006–07) 518, Table 5.1, p 72

144 HC (2005–06) 691–i, Q 108

145 HC (2005–06) 1659–i, Q 99

146 HC (2006–07) 518, para 5.47, p 71

147 Qq 271-272; Uncorrected transcript of oral evidence taken before the Committee of Public Accounts on 3 December 2007, HC 151–I, Qq 193-196

as an essential criterion in all future advertisements for posts of departmental Finance Directors.

55. As part of what it terms the "finance professionalism agenda", the Treasury has stated that it will promote the development of the finance community in government by "strengthening the capability and capacity of finance professionals" and "supporting and enabling departmental Finance Directors and other senior finance professionals to improve financial and performance management through government".[148] The increasing professionalisation of the finance function within Government as a whole should lead to greater demands upon the Treasury in its relationships with Finance Directors and other senior finance professionals. The Capability Review of the Treasury found that "Other government departments' finance directors, in particular, are looking for greater collaboration and support in capability building, joint problem-solving and sharing best practice".[149] **We recommend that the Treasury identify a method of measuring its success in its own role in supporting improvements in financial management across Government, such as the annual survey of stakeholder opinion, and report on performance against that measure in future department annual reports.**

56. One clear indicator of progress by the Treasury and Government as a whole in financial management would be the establishment of a clear linkage between the objectives the Government sets for itself and the allocation of resources. Mr Macpherson believed that the quality of the process in this area had "improved hugely" in the previous seven years:

> I think departments have far greater focus on their priorities and, consistently with the Better Financial Management agenda, we are getting far better at understanding how our resources break down across the PSA set.[150]

We have previously expressed concern that the Delivery Agreement accompanying the 2007 PSA relating to Child Poverty provides insufficient information about the linkage between targets and the resources available to meet those targets.[151] The Sub-Committee put it to Mr Macpherson that, despite claimed progress, there were few signs of resources being linked to individual PSA Agreements announced at the time of the publication of the 2007 Comprehensive Spending Review. He replied that the nature of departmental responsibilities made it inevitable that some resource reporting would be on a departmental basis and he conceded, based on his own experience at the Treasury, that "there is always a tendency to plan around organisation rather than objective". However, he hoped that, "over time, we can strengthen both planning and reporting around the PSA itself. I think the [2007] CSR was a step improvement."[152]

148 HM Treasury Group Departmental Strategic Objectives —2008–2011, para 2.9, p 8

149 Capability Review of HM Treasury, p 23

150 Q 207

151 HC (2007–08) 55, paras 59–64

152 Q 208

57. The new performance management framework announced as part of the 2007 Comprehensive Spending Review, which we have considered in detail in previous Reports, was intended to distinguish more clearly than previous frameworks between the Government's "over-arching and main priorities"—expressed in cross–departmental PSAs—and the Government's "business as usual"—expressed in Departmental Strategic Objectives.[153] The extent to which further progress is still required after these changes is hinted at in the call in the Capability Review of the Treasury for the Treasury to "clarify the overall performance management framework for government and then work with departments to implement it in a consistent and risk-based way".[154] **We are disappointed by the absence of any meaningful information in Delivery Agreements accompanying the new Public Service Agreements for the period from 2008–09 to 2010–11 about linkages between delivery against outcome indicators and the resources to be applied to each Public Service Agreement. This indicates that there is still some considerable room for improvement in financial and performance management within Government. We recommend that the Treasury set itself a target to ensure that the Public Service Agreements finalised as part of the next Spending Review in 2009 or 2010 include a clear statement about the resources to be allocated across Government to the delivery of each Agreement.**

Financial reporting

58. In the 2007 Budget, the Government announced that, from 2008–09, Government "accounts will be prepared using International Financial Reporting Standards (IFRS), adapted as necessary for the public sector".[155] One of the Treasury's priorities for 2007–08 identified in its 2006–07 departmental annual report was to publish a new *Government Financial Reporting Manual* based on IFRS.[156] In June 2007, the Treasury stated that the new Manual was due by the end of 2007, following consultation with the Financial Reporting Advisory Board (FRAB) and others.[157] In October 2007, we learned that some important issues were not yet resolved between FRAB and the Treasury,[158] and, in mid-November, Mr Macpherson's evidence to the Sub-Committee hinted at possible delays to the timetable for implementing IFRS:

> We are committed to applying IFRS. There is an issue around precisely how quickly you can do it, but we are committed to doing that; we are having discussions about it and I am confident that we can do it.[159]

153 HC (2006–07) 279, paras 88–95; HC (2007–08) 55, paras 28–37

154 Capability Review of HM Treasury, p 27

155 *Budget 2007,* para 6.59, p 154

156 HC (2006–07) 518, para 5.54, p 73

157 HM Treasury, Memorandum to the Committee of Public Accounts and the Treasury Committee: Response by HM Treasury to the Annual Report of the Financial Reporting Advisory Board

158 HC (2007–08) 55, Ev 40

159 Q 231

In early January 2008, the Exchequer Secretary said the following about the timetable for implementation:

> Work has certainly been done to shift towards this accounting standard in line with the announcements that were made at the Budget. There is a great deal of work still left to do, but it appears to be on track in terms of the announcements that were made at the Budget … It has all got to be done for the start of the new financial year, and that is the target that people are working to.[160]

59. One of the outstanding issues as yet unresolved is the treatment of Private Finance Initiative (PFI) assets under IFRS as applied in the United Kingdom public sector.[161] At the time of the 2007 Budget, we were told that around 54% of PFI liabilities and devolved administrations were off-balance sheet.[162] By September 2007, the proportion off–balance sheet had risen to 58%.[163] In March 2007, Treasury officials were non-committal on the likely impact of the switch to IFRS on the effects of PFI assets and liabilities on public sector balance sheets.[164] In December, the Sub–Committee was told that

> No accounting standard yet exists which sets out how the public sector should treat PFI. Until this standard is finalised and agreed with external accounting bodies it is not possible to calculate the balance sheet impact of the move to IFRS.[165]

Mr Macpherson nevertheless told the Sub-Committee that his "guess" was that the application of IFRS would increase public sector net debt.[166]

60. The Treasury's timetable for the changeover of central Government accounts to IFRS, as modified with the approval of FRAB, is for this to take place in 2008–09. In this context, the absence of final confirmation of the accounting rules that will apply is striking. In certain areas, particularly the National Health Service, knowledge of the accounting rules is required to calibrate the funding system and therefore the delays in finalising the PFI accounting rules may pose operational problems in 2008–09 because of the relationship between budgeting, accounting and financial duties such as statutory break-even requirements.[167] If the changeover does lead to reduced timeliness in 2008–09, or to a significant increase in the number of audit qualifications, or both, this might put at risk the latest timetable for the publication of the first Whole of Government Accounts in 2008–09.[168] The accounting rules also may have implications for the calculation of performance against the Sustainable Investment Rule. **We will continue to examine the implications of**

160 Qq 612, 615

161 HC (2007–08) 55, Ev 40

162 Treasury Committee, Fifth Report of Session 2006–07, *The 2007 Budget*, HC 389–I, para 35

163 Ev 82, para 7

164 HC (2006–07) 389–I, para 35

165 Ev 82, para 8

166 Q 274

167 Audit Commission, Health IFRS Briefing Paper 3: Managing the transition to international financial reporting standards, December 2007

168 HC (2006–07) 389–I, para 34

the implementation of International Financial Reporting Standards for Government accounting and for the national accounts.

Financial authorisation and the "line of sight" initiative

61. In June 2007, we drew attention to the disjunction between the resources of Government that the House of Commons is formally expected to authorise through the Estimates process and the spending totals set out in Spending Reviews. We recommended that the Government set itself the ambition of moving to a new system of authorisation linked more closely to the system for the planning and control of public expenditure.[169] The Government responded swiftly and positively, announcing in *The Governance of Britain* Green Paper in early July 2007 its commitment to moving to a system of more consistent reporting on departmental budgets set in Spending Reviews, in annual Estimates and in resource accounts.[170] However, in October 2007, the Treasury indicated that there would be a process of consultation and that changes were unlikely to be implemented before 2009–10 at the earliest.[171] Mr Macpherson told the Sub–Committee in November:

> I am pleased to say that the Prime Minister made a commitment at the time he was appointed to a better line of sight from accounts through to estimates and so on and we are definitely on the case … There is potentially a win-win here, where Parliament can secure better assurance about how money is spent and we can have a more efficient accounting system. We are not there yet, but we really want to make progress.[172]

The Chief Secretary wrote to the Chairman of this Committee on 19 December indicating that a Steering Committee and Project Board for the initiative had been established, and that planning and consultation was underway with a view to implementation from 2010–11 onwards.[173] **We welcome the Government's positive response to our recommendation relating to improved alignment of parliamentary authorisation of public expenditure and the planning and control processes for such expenditure within Government. We look forward to examining progress of this "line of sight" initiative as it develops and, as part of this examination, we expect to consider whether the proposed timetable for implementation could be expedited.**

169 HC (2006–07) 279, paras 109–110

170 Ministry of Justice, *The Governance of Britain*, Cm 7170, July 2007, paras 109–111, pp 35–36

171 HM Treasury, *Supply Estimates: a guidance manual*, October 2007, para 1.47, p 18

172 Q 230

173 Ev 75

4 The work of the Office of Government Commerce

History of the Office

62. The Office of Government Commerce (OGC) is an office of HM Treasury, responsible for improving value for money by driving up standards and capability in procurement, from commodities buying to the delivery of major capital projects, in order to maximise the use of 60% of Government spending and a £30 billion property estate. The OGC was created in 1999 following the completion of a review of civil procurement in central Government by Sir Peter Gershon, the then Managing Director of Marconi Electronic Systems and a member of the Board of GEC plc. The review concluded that different Departments applied different approaches and practices to the procurement of essentially similar requirements. The lack of consistency meant that there was a wide gap between best and worst practice in Government.[174] That review identified a number of weaknesses in Government procurement, concerning organisation, process, people and skills, measurement, and the contribution of the "centre" of Government. To deal with these weaknesses, the Gershon Report recommended that a common strategic framework should be established within which all central government departments would conduct their procurement activities.[175] The Government accepted the recommendations and the OGC was set up in 2000 with Sir Peter as its first Chief Executive.

63. The OGC has introduced a number of initiatives:

- Gateway Reviews—independent review of IT-enabled programmes and projects at critical points in their lifecycle;
- the Successful Delivery Toolkit—an online guide to procurement policy, tools and good practice;
- the Successful Delivery Skills Programme and the Programme and Project Management Specialism—to develop and promote professional delivery and project management skills in departments, and;
- the promotion of Centres of Excellence within departments to support specific programmes and projects by providing oversight and advice, and working to enhance skills and capacities.

64. The OGC also takes on responsibility for delivery of major capital programmes and projects. The OGC is principal adviser to the Major Projects Review Group (MPRG)[176] on

174 Treasury Committee, Third Report of 2001–02, *The Office of Government Commerce*, HC 851, para 2

175 Sir Peter Gershon, *Review of Civil Procurement in Central Government*, April 1999

176 MPRG was established under *Transforming government procurement* and is tasked to scrutinise major projects at key stages in their lifecycle. HM Treasury, *Transforming government procurement,* January 2007, p 4.

project deliverability and procurement, and will help departments any specific issues raised as conditions of the project gaining MPRG approval.[177]

Transforming Government Procurement

65. In January 2007, the Government published plans intended to fundamentally change the role of the OGC through "an outcome-based and whole-life value approach … to encourage more innovative solutions to problems" in a document entitled *Transforming Government Procurement.*[178] That document assigned to the OGC responsibility for delivering high-quality public services and best value for money through central procurement. This is the first major restructuring of the Government's procurement policy since the OGC was established. The document highlighted the central importance of procurement in delivering high–quality public services and best value for money. The OGC is expected to achieve this transformation by:

- Setting procurement standards and monitoring performance and capability;
- Developing a cadre of skilled procurement professionals across Government;
- "Driving value for money through collaborative procurement" [179];
- Playing a stronger role in the successful delivery of major projects; and
- Improving management and use of the Government estate.

66. *Transforming Government Procurement* stated that the OGC would have new powers to assist in the implementation of the new strategy requiring departments to use OGC frameworks and collaborative deals. Mr Nigel Smith, Chief Executive of the OGC, told the Sub-Committee that he was unsure of the status of the new powers; he "could not really say whether they are legal powers, but certainly the powers relate to ... collaborative procurement".[180] Mr Smith was clear, however, "that powers are really not the issue. I believe what is the issue is getting a common grip of what needs to be done across government, and that will be through engaging the spending departments in getting those targets achieved."[181]

67. In the OGC's document, *Transforming Government Procurement–the first 100 days*, the OGC explained that, using the new powers, Peter Fanning, then acting Chief Executive of OGC, had written to Permanent Secretaries requiring their compliance with the first two new pieces of policy advice: the use of 12 existing frameworks and collaborative deals

177 HM Treasury, *Annual Report and Accounts 2006–07*, para 5.27

178 HM Treasury, *Transforming Government Procurement,* January 2007, Box 2.1, p13

179 OGC, *Transforming Government Procurement—the first one hundred days*, July 2007, pp 3, 6

180 Q 110

181 *Ibid.*

which the OGC considered to offer value for money for departments; and the use of OGC's Property Benchmarking Service.[182]

68. Mr Smith told the Sub–Committee that, whilst the OGC was no longer responsible for most of the efficiency programme, it still remained responsible for relocation because "it is so crucial to engage the property and management of the property estate in the relocation discussion".[183]

The OGC's annual reporting mechanism

69. The OGC has recently departed from the accepted government practice of publishing an annual report. In 2005–06 the OGC published its own report and had a separate section within the Treasury's departmental report. We were concerned that it failed to publish an annual report for 2006–07 and only appeared in the Treasury's Annual Report in relation to reporting on one of the PSA targets. Mr William Jordan, Deputy Chief Executive of OGC, told the Sub–Committee that it was OGC's "intention to publish each year a report on the activity of OGC" and the OGC would "publish a report in January on the anniversary of *Transforming Government Procurement*".[184] However he conceded that "there was a year that went by without an OGC annual report."[185] **We view the failure of the Office of Government Commerce to publish an annual report in 2006–07 as unacceptable. We expect the Office to report on its performance on an annual basis in future.**

OGC Gateway reviews

70. The Gateway Review process has the highest profile of all the OGC initiatives and has been described the initiative with the "most promise, bringing more rigorous scrutiny and oversight to IT–enabled programmes and projects, and providing the means to highlight risks sufficiently early for senior management to take recovery action".[186] The Gateway process is now mandatory across Central Civil Government departments and Executive Agencies and others such as the Ministry of Defence, the NHS and local government have adopted the process on a voluntary basis.[187] There is evidence, however, that the Gateway Review process is still not taken seriously enough by departments, with the same issues and shortcomings repeatedly highlighted by reviews, projects still entering the process too late, and the need for intervention by the OGC to make sure that final gateway assessments of the overall success of a project are made by departments.[188]

182 OGC, *Transforming Government Procurement –the first one hundred days*, July 2007, pp 3, 6

183 Q 153

184 Q 94

185 Q 95

186 http://www.foi.gov.uk/guidance/exguide/gateway-review.pdf, p 2

187 Information Tribunal, Decision of 2 May 2007, p 4

188 *Ibid.*

71. The OGC Gateway Process examines a programme or project at critical stages in its lifecycle to provide assurance that it can progress successfully to the next stage; the process is based on techniques that lead to more effective delivery of benefits together with more predictable costs and outcomes. It is designed to be applied to delivery programmes and procurement projects, including those that procure services, property/construction, IT–enabled business change and procurements using framework contracts.[189] In brief, the philosophy of the Gateway process is that an independent review team should come in, conduct a quick peer review, and leave behind a short, clear and sometimes blunt report that can be put it to immediate use.

72. Some programmes are more important than others. Some are deemed "mission–critical", such as the Identity Cards programme, because they are essential to the successful delivery of a legislative requirement, a key departmental target, or a major policy initiative announced or owned by the Prime Minister or a Cabinet Minister. Also additionally "mission-critical" is used to define programmes or projects whose failure would have major implications for a delivery of a key public service or national security.

73. In June 2002, the Red, Amber, Green status (RAG Status) was introduced to prioritise review recommendations. Red means that immediate action must be taken. Amber means that action must be taken before the next review. Green means that the recommendation is considered beneficial to the project but not essential for its success. The overall RAG status of a review is derived from the RAG status given to the individual recommendations: one or more reds produces an overall RAG status of red; no reds but one or more ambers produces an overall RAG status of amber; and no reds or ambers produces an overall RAG status of green.[190]

74. Since April 2003, a project or programme given an overall red RAG status in consecutive reviews triggers what is known as a "double red" Gateway procedure. The Chief Executive of the OGC sends a letter to the Permanent Secretary of the Department concerned, with a copy (since June 2005) to the National Audit Office (NAO). Since February 2006 the NAO has passed on information about "double reds" to the Chairman of the Committee of Public Accounts. The Tribunal was provided with evidence that Gateway Reviews, of which there have been several thousand conducted since the process was introduced, have succeeded in improving the extent to which government projects are delivered on time, to quality and to budget. This has produced substantial benefits: it is claimed that Gateway Reviews saved the Exchequer some £1.5 billion between 2003 and 2005.

75. **We are concerned that the current arrangements for highlighting a project assessed by a Gateway review as "double red" fail to address the wider ranging issues regarding the continued failure of the Government properly to manage such a project. In response to this Report, we expect the Government to set out how projects that receive a "Double-red" Gateway Review will formally be held to account.**

189 http://www.foi.gov.uk/guidance/exguide/gateway-review.pdf

190 Information Tribunal, Decision of 2 May 2007, p 7

76. We have previously explored the adequacy of the risk assessment undertaken by Government departments. In 2006, Mary Keegan, the then Managing Director, Government Financial Management, told the Sub-Committee that "the improvement of… risk management never stops. One is never satisfied with where one gets to".[191] **Whilst we recognise that Gateway Reviews have been used as corrective instrument to realign a failing project, we would like to know what pre-emptive action the Government takes to ensure that risk management is properly utilised in the planning of projects subject to a Gateway Review. We will return to this issue in the Autumn.**

77. We were aware that the OGC had refused to release documents relating to the Gateway Reviews of ID cards and the NHS IT programme. The Information Tribunal has twice upheld the ruling of the Information Commissioner that the OGC should release documents relating to Gateway Reviews on the ID Card scheme and the NHS IT programme, and in its last ruling stated that "we find it difficult to accept that the OGC is really convinced by the arguments put forward … on their behalf".[192] Mr Nigel Smith and the Exchequer Secretary both told the Sub-Committee that the decision to appeal against the Information Commissioner's ruling was the decision of government, not of the OGC.[193] The Exchequer Secretary told us that:

> there are two sections of the FOI Act that we believe are engaged by the requests that have been made for Gateway Review information and information also on the NHS IT system. The first one is section 33(1)(b), which is audit functions, and the second one is 35(1)(a), which is formulation of government policy. ...These are arguments that the High Court is going to have to deal with. There is, indeed, a hearing due to take place on 4 and 5 March.[194]

78. The Sub–Committee was told that "there is a genuine worry... that the Gateway Reviews could be harmed if there was a general perception that they could be in the public domain quickly after they were done.[195] It is not appropriate for us to comment on a case before the High Court but we will look at their decision with interest.

OGCbuying.solutions

79. OGCbuying.solutions, the OGC's executive agency, was created to provide central access to more than 500,000 products and services, through a range of frameworks as well as a number of managed services, including telecommunications, e-mail and web services, energy and eCommerce. It plays an important role in OGC's delivery of the procurement target, providing procurement services to help public sector organisations, and their private sector agents and contractors, achieve value for money from procurement.[196] In the

191 HC (2005–06) , 1659–i Q 93

192 Q 560

193 Q 557

194 Q 558

195 Q 559

196 HM Treasury, *Annual Report and Accounts 2006-07*, para 5.28

publication of *Transforming Government Procurement* OGCbuying.solutions was described as a key player helping both Government and the wider public sector enjoy increased efficiency savings through its approach to collaborative procurement.[197]

80. The work of OGCbuying.solutions focuses on two main areas, namely Framework Agreements, delivered under the Catalist brand, and Managed Services; "Catalist is a set of pre-tendered framework contracts with a range of suppliers, from which public sector customers can access 500,000 goods and services with ease."[198] OGCbuying.solutions receives a commission for procurement through the framework agreements; on average these commissions are 0.7%. Ms Alison Littley, Chief Executive of OGCbuying.solutions, told the Sub-Committee that buying.solutions "only get commission on frameworks that are utilised".[199]

81. The Committee of Public Accounts reported in June 2007 that OGC's procurement role needed to improve.[200] It was concerned that although OGCbuying.solutions operated 180 framework agreements, over 90% of customer sales were undertaken using only 25% of these agreements. It was also recognised that the requirement for OGCbuying.solutions to raise revenue as a trading fund acted as a disincentive for it to promote activities such as the Government Procurement Card and Memoranda of Understanding which could provide wider value to public procurement, but did not yield a direct return to the business.

82. The Committee of Public Accounts reported that it was of significant concern that "at present 47% of central government organisations were not using the Microsoft Memorandum of Understanding for purchasing software licences, and 22% are not using the Government Procurement Card".[201] OGCbuying.solutions acknowledged that it had insufficient high level commercial expertise to negotiate consistently good deals with suppliers which its customers want to use.[202] The Committee of Public Accounts also noted that 63% of central government organisations and 73% in the wider public sector consider that OGCbuying.solutions do not consult their organisations enough when letting new framework agreements and managed services. It also concluded that OGCbuying.solutions' suppliers were not given enough information to understand their performance and how to improve it. OGCbuying.solutions needed to improve its supplier performance monitoring system so that it gathered comprehensive customer feedback on supplier performance. OGCbuying.solutions met its value for money performance target in each of the last three years, but the Committee of Public Accounts noted that OGCbuying.solutions had the potential to increase its annual value for money savings by at least £500 million.[203]

197 HM Treasury, *Transforming Government Procurement,* January 2007, p 25

198 HM Treasury, *Annual Report and Accounts 2006–07*, para 5.29

199 Q 123

200 Committee of Public Accounts, Assessing the value for money of OGCbuying.solutions, June 2007, HC (2006–07) 275, pp 5–7

201 *Ibid.*

202 *Ibid.*

203 *Ibid.*

5 The Treasury Group's performance against objectives

Introduction

83. The Treasury Group has eight objectives set out in its departmental annual report relating to the period from 2005 to 2008, some of which are linked to PSA targets.[204] Performance against some of these objectives, notably the objective relating to the maintenance of a stable macroeconomic environment, is regularly considered during our scrutiny of Budgets and Pre-Budget Reports. Other aspects of performance against objectives have been considered in previous chapters.[205] In this chapter, we examine aspects of the Treasury's performance in relation to its objectives and PSA targets in more detail. We also examine changes to the Treasury's performance framework arising from the establishment of new Departmental Strategic Objectives.

International objectives and measurement issues

84. One of the Treasury's current PSA targets is to ensure that "90% of all eligible Heavily Indebted Poor Countries (HIPC) committed to poverty reduction that have reached Decision Point by end 2005 receive irrevocable debt relief by end 2008".[206] The Treasury stated that 28 countries had reached Decision Point by end 2005, of which 22—79%—had reached Completion Point and were thus in receipt of irrevocable debt relief, and drew attention to World Bank and IMF estimates that a further four countries were expected to complete the initiative by the end of 2008, so that the Treasury was on course to meet the target.[207] The Treasury stressed that those countries still to receive irrevocable debt relief were post-conflict and fragile States, while some remained in conflict, so that continued close support and flexibility from the United Kingdom and the international community will be necessary in order to achieve irrevocable debt relief for all.[208]

85. The removal of existing international debt burdens does not itself guarantee debt sustainability for the countries concerned, particularly if inappropriate new borrowing is taken on by those countries, as Mr Macpherson acknowledged.[209] The Treasury stated that it was "working with our international partners to promote debt sustainability, including through responsible borrowing and lending practices".[210] Particular problems arise with so–called "vulture funds", whereby private firms buy up defaulted debt and seek full

204 HC (2006–07) 518, pp 13, 21–22

205 See paragraphs 52–57 relating to financial management in Government and paragraphs 62–67 relating to OGC and procurement savings.

206 HC (2006–07) 518, para 2.21, p 31

207 Ev 83, Cm 7256, p 20

208 HC (2006–07) 518, para 2.48, p 34; Ev 84

209 Qq 241–242

210 Ev 84

payment through court proceedings in third–party States. Mr Macpherson assured the Sub–Committee that this was a matter that the Treasury took "very seriously" and viewed as "an area of considerable concern".[211] Subsequently, the Treasury stated that it was working to prevent debts being sold to vulture funds in the first place and to limit the damage from cases already underway. However, it noted that any legislative action would not apply retrospectively to debts already purchased by such funds, and also stated that it had no plans at present to bring forward legislation.[212]

86. Another Treasury objective with a multilateral dimension involves "working with our European (EU) partners to achieve structural reforms in Europe, demonstrating progress towards the Lisbon Goals by 2008".[213] One of the aims of the Lisbon strategy was to increase employment across the EU to 70% by 2010. At 64.4% in 2006, EU 27 employment remains well below this target and the Treasury has stated that "it is clear that the Lisbon Goals will not be realised in full".[214] Mr Macpherson pointed to the need for further "structural labour market reform" and thought that, taken as a whole, the EU was "behind the curve" in relation to employment.[215]

87. In its new Departmental Strategic Objectives for the period from 2008 to 2011, the Treasury re–states its commitment to pursue "increased productivity and efficiency in the EU, international financial stability and increased global prosperity". However, beyond the new PSA relating to accelerated progress towards the Millennium Development Goals, the Treasury has eschewed measurable outcome indicators for this element of its Objective, considering that:

> Due to the nature of the Treasury's primarily influencing role in this area, it is difficult to set quantitative outcomes. The Treasury intends to monitor our performance in influencing the policy debate and the international structures we use to make progress on our objectives by taking as our milestones the outcomes of key events, including EU and international finance ministers meetings; the annual debate on Lisbon by the Spring European Council; the National Reform Programmes; and the Commission's Annual Progress Report on Lisbon.[216]

88. The Exchequer Secretary subsequently expanded upon the general problems of identifying measurable outcome indicators in relation to the new Departmental Strategic Objectives:

> The NAO are involved on the efficiency savings side jointly with HMT about how you define and measure performance in these ways. That does not mean to say that for some particular indicators or some DSOs, which are very general, that there is a very easy and quick way of measuring them. Some of this is uncharted territory in

211 Qq 236–240

212 Ev 84-85

213 HC (2006–07) 518, para 2.21, p 31

214 Cm 7256, p 22

215 Q 243

216 HM Treasury Group Departmental Strategic Objectives —2008–2011, para 2.34, p 14

> terms of how you measure inputs and outputs. To some extent, in the difficult areas there will be a feeling of a way forwards. Some ways of measuring and accounting are not as easy as the National Accounts or measuring inflation, so there is going to be a range of things that are easy and crisp to see and measure and tick or not, and then there are going to be those areas where it is a lot more complex. All we can do in the public service is try to work transparently with other organisations, including the NAO, to evolve a way of measuring performance in a way that is adequate and does not set up perverse incentives.[217]

89. **We accept that a number of the outcomes set out in the Treasury's Public Service Agreements for the period from 2004 to 2008 and in its Departmental Strategic Objectives for the period from 2008 to 2011 are not subject to easy measurement. We also accept that the Treasury's own direct influence in relation to some of its international objectives will be necessarily limited. However, this reinforces the importance of external scrutiny and audit of Treasury performance. We note that the Treasury proposes to monitor its performance in influencing the policy debate and the international structures it uses to make progress on its objectives by taking as its milestones the outcomes of specified key events. We recommend that the Treasury arrange for independent monitoring to be included within assessments of those key international events relevant to the Treasury's international objectives. We further recommend that the Government clarify, in its response to this Report, whether data sources used for the purposes of measuring performance in relation to Departmental Strategic Objectives will be the subject of audit by the National Audit Office.**

Regional economic growth

90. The Treasury's PSA 6 for the period to 2008 relates to regional economic growth and states that the Treasury will:

> Make sustainable improvements in the economic performance of all English regions by 2008 and over the long term reduce the persistent gap in growth rates between the regions, demonstrating progress by 2006.[218]

In evidence to the Sub-Committee in November 2005, Mr Macpherson described this target, which was also in the targets set under the 2002 Spending Review, as "a departure for the Treasury, which historically … has not taken regional development as seriously as it should have".[219] In October 2006, he stated that he was encouraged that, in 2003 and 2004, "underperforming regions" had the highest growth rates, while noting that the revival of the financial services industry might make further gains more difficult to achieve.[220] The Treasury's departmental annual report in June 2007 noted that data on regional nominal Gross Value Added per capita showed that "the poorer performing regions narrowed the

217 Q 603

218 HC (2006–07) 518, para 3.22, p 45

219 HC (2005–06) 691–i, Q 60

220 HC (2005–06) 1659–i, Q 60

gap in growth rates with London, the South East and East in 2005".[221] The Treasury's Autumn Performance Report published in December 2007 stated that, during the period from 2002 to 2005 as a whole, "the bottom six regions (North West, North East, Yorkshire and the Humber, West Midlands, East Midlands and the South West) grew at the same average annual rate (2.1%) as the top three (London, South East and the East of England)".[222]

91. In November 2007, Mr Macpherson stated that "we are making some progress on this regional target", but stressed that there were lags in the provision of relevant data so that "it is terribly early days".[223] An additional complicating factor relates to economic cycles. The Treasury has stated that there is evidence to suggest that the top three regions are ahead of others in their economic cycle.[224] In the 2006–07 departmental annual report, the Treasury stated that "a full assessment of trends in regional economic activity and disparities can only be fully determined when a full economic cycle is complete".[225] The Autumn Performance Report uses similar phraseology, but refers to the need for "the current economic cycle" to be complete.[226] We find the reference to the "current" economic cycle in a document published in December 2007 somewhat puzzling in view of the fact that, in the 2007 Pre-Budget Report, the Government indicated that output had passed through trend towards the end of 2006.[227] **We recommend that, in its response to this Report, the Government confirm that progress in relation to the Treasury's PSA 6 target for regional growth will be measured in relation to the economic cycle which the Government expects to have concluded in 2007. We further recommend that, in reporting on the ending of that cycle, the Government includes an analysis of the economic cycle in each region of England as well as for the United Kingdom as a whole.**

Child poverty

92. In early December 2007 we published a Report on the 2007 Comprehensive Spending Review in which we considered in detail the role and performance of the Treasury in relation to the Government's target to halve child poverty by 2010–11 and eliminate it by 2020–21.[228] We stated that we remained to be convinced that the division of departmental responsibilities relating to child poverty—with the Treasury having formal lead responsibility for meeting the target while a coordinating Child Poverty Unit was located within the Department for Children, Schools and Families—would not accentuate the possible tension between the 2010–11 target and the final target to eradicate child poverty.[229] We expressed concern that the Government might have drawn back from a

221 HC (2006–07) 518, para 3.29, p 45

222 Cm 7256, p 16

223 Q 261

224 Cm 7256, p 16

225 HC (2006–07) 518, para 3.29, p 45

226 Cm 7256, p 16

227 HM Treasury, *Pre-Budget Report and Comprehensive Spending Review 2007*, para B.6, p 158

228 HC (2007–08) 55, paras 38–64

229 *Ibid.*, para 50

whole-hearted commitment to meeting the 2010–11 target. We called for the Government to initiate a debate on the possible trade-off between the 2010–11 and 2021–21 targets or to "rededicate itself to meeting the 2010–11 target, making clear at the earliest opportunity available both that the necessary resources are available within the Comprehensive Spending Review settlement and that the Government is committed to deploying those resources".[230]

93. Later that month, the Treasury published its Autumn Performance Report which formally acknowledged for the first time that there had been "slippage" in relation to the 2010–11 target. This slippage was the result of the increase in the number of children in households with relative low-income by 100,000 between 2004–05 and 2005–06. That document also stated that, "in the light of this, the Government has redoubled efforts to meet the 2010 target".[231] We asked the Financial Secretary to the Treasury about the significance of the statement in the Autumn Performance Report. Her answer appeared to indicate that the phrase was a reference to measures already taken or announced, including within the 2007 Pre-Budget Report, rather than a comment that presaged further action.[232]

94. The success of the Government's strategy to reduce child poverty depends in part on the effectiveness of measures to encourage into work parents of children in poverty. This in turn depends upon financial support available for childcare. The Financial Secretary told the Sub–Committee that she was exploring reasons behind the relatively low take-up of the childcare element of tax credit and the regional differences in that take–up.[233] **We recommend that the Government, in its response to this Report, set out its provisional analysis of the work currently being undertaken to analyse the reasons for low take-up of the childcare element of tax credit and the reasons for regional differences in take up.**

The Treasury's new Departmental Strategic Objectives

95. From 1 April 2008, the Treasury's existing PSA targets will be succeeded not only by the two PSA targets for which it has lead responsibility and by the seven other PSA targets for which it is a delivery partner, but also by new Departmental Strategic Objectives, which are intended to encapsulate the "mainstream, core functions of the department" and which were published in December 2007.[234] We initially considered the value of these new Objectives on a cross–government basis in June 2007, when we also recommended that departments consult relevant select committees about their proposed Departmental Strategic Objectives.[235]

96. The Treasury consulted us on two occasions between late June 2007 and late September about its draft Departmental Strategic Objectives and the accompanying outcome

230 HC (2007–08) 55, para 64

231 Cm 7256, p 18

232 Q 565

233 Q 570

234 HC (2007–08) 55, para 33; HM Treasury Group Departmental Strategic Objectives — 2008–2011

235 HC (2006–07) 279, paras 92, 95, 103

indicators. The Chairman of the Committee replied on each occasion, and we published the entire correspondence in early December.[236] Mr Macpherson welcomed the comments that the Chairman provided.[237] In his response to a draft of the document, the Chairman had noted the absence of an outcome indicator relating to the aim of "supporting … stable … financial markets", and the final document responded by the inclusion of such an indicator. The Treasury is now committed to measuring its performance in this area through "assessments of UK financial stability and risk management against international comparisons".[238] **We welcome the consultation that the Treasury has initiated with this Committee in relation to its Departmental Strategic Objectives for the period from 1 April 2008 to 31 March 2011, which we trust will serve as a precedent for the continued future development of the performance management framework. We welcome the inclusion of a performance indicator for the Treasury's work on supporting stable financial markets. We recommend that the Government, in its response to this Report, set out the timetable for the commissioning of a first assessment of UK financial stability and risk management against international comparisons. We further recommend that all such assessments be commissioned from an organisation outside Government, such as the International Monetary Fund, and be published.**

97. During the consultation process, and in taking evidence on the 2007 Comprehensive Spending Review and Pre–Budget Report, we explored the significance of the decision to move the objective of meeting the fiscal rules from a PSA target to part of one of the Treasury's Departmental Strategic Objectives. We were assured that this switch did not represent an attempt to reduce the importance of the fiscal rules.[239] A related issue is the interpretation of the sustainable investment rule in the new economic cycle. We have previously pointed out that the rule as formulated only made it clear that the Government was seeking to maintain net public sector debt below 40% of GDP in each and every year of the economic cycle that began in 1997, and called for clarification of the rule in the new economic cycle.[240] In the relevant Departmental Strategic Objective for the period from 2008–09 to 2010–11, the rule is formulated as the maintenance of public sector net debt below 40% of GDP "over the economic cycle".[241] **We recommend that the Government clarify, in its response to this Report, whether it is committed to maintaining net public sector debt below 40% of GDP in each and every year of the economic cycle that is expected to have begun in 2007.**

236 HC (2007–08) 55, Ev 21–34

237 HC (2007–08) 55, Ev 34, Q 210

238 HC (2007–08) 55, Ev 32; *HM Treasury Group Departmental Strategic Objectives—2008–2011*, para 2.26, p 12

239 HC (2007–08) 55, para 34; *ibid.*, Ev 32, 33

240 HC (2006–07) 389–I, para 33

241 HM Treasury Group Departmental Strategic Objectives —2008–2011, para 2.3, p 7

6 HM Revenue & Customs

Background

98. In March 2004, the Government announced that it intended to bring together the functions of HM Customs & Excise and the Inland Revenue. HM Revenue & Customs (HMRC) came into existence on 18 April 2005. The Department serves approximately 29.5 million taxpayers, an estimated two million employers and one million companies, as well as 70 million accounts in the national insurance system. When established in 2005, HMRC employed 95,000 full time equivalent staff across around 600 offices and in 2005-06 collected almost £400 billion in receipts. The Department is responsible for collecting the bulk of tax revenue as well as paying tax credits, policing the national minimum wage, collecting student loan repayments and strengthening the UK's frontiers. During its first year, the Department's IT systems issued 16.5 million income tax self assessment statements, 1.4 million corporation tax notices to file, six million personal pension statements to employers and processed 9.7 million annual tax codings reviews.[242]

Capability Review

99. The Capability Review of HMRC carried out under the Cabinet Office auspices and published in December 2007, noted that staff within HMRC had the ambition to improve, but the senior leadership needed to do more to "energise the department with this vision and to clarify what it means for staff".[243] The Review further noted that the senior leadership has not been successful in "injecting pace, confidence and dynamism throughout the Department".[244] The Review stated that at senior level, "the SCS survey also shows a need for improvement. 17% of staff held the view that senior management is effective at leadership and 22% (compared to the 34 per cent Civil Service benchmark) report confidence in the management of the Department. 41 per cent (compared to the 56 per cent Civil Service benchmark) say the SCS inspire staff with a positive vision."[245]

100. The HMRC Capability Review showed that eight out of ten areas assessed required development, four urgently. The weakest area was leadership. The Exchequer Secretary highlighted the positive aspects of the Capability Review, stating "Government had earned a strong reputation with stakeholders for the strength of its analysis and forecasting, for the intelligence of the staff and the experience and astute nature of the staff who work there, their intellectual capacity".[246]

242 National Audit Office, *HM Revenue & Customs: ASPIRE—the re-competition of the outsourced IT services,* HC 938, 19 July 2006, executive summary, para 2

243 Cabinet Office, *Capability Review of HM Revenue and Customs*, December 2007, pp 20–22

244 *Ibid.*

245 *Ibid.*

246 Q 537

101. **We are concerned that eight out of ten areas assessed under the Capability Review of HMRC require development. We expect HMRC to resolve these issues and we will scrutinise HMRC's progress in the autumn.**

HMRC's efficiency programme

102. The spending allocations for the Chancellor's departments for the period from 2004–05 to 2007–08 were announced in the 2004 Spending Review. The total budget of the HMRC was to rise, from £4,582 million in 2005–06 to £4,891 million in 2007–08. Within the 2004 Spending Review, HMRC was set a monetary saving target of £507 million to be achieved by 31 March 2008.

103. In December 2007, HMRC published its Autumn Performance Report (APR) which set out progress made towards PSA and efficiency targets. HMRC reported that "we are on track to deliver our 2004 Spending Review Efficiency targets … we expect to exceed our financial savings target of £507 million from 31 March 2008".[247] It also reported that it had met the departmental target of eliminating 12,500 full time equivalent posts by March 2008, eight months ahead of schedule. As at 30 September 2007 the department had already exceeded its reduction target, having cut 13,940 staff. In response to the Committee's Report on the efficiency programme, the Government reported that HMRC has counted its efficiency savings in gross terms in accordance with the basis on which targets were set in SR04. [248]

104. HMRC commonly uses two forms of reporting: the "In Year" basis, as required by the OGC's reporting structure, and the "Full Year" basis, which is used by HMRC, and which takes into account the full year worth of each staff reduction. This means that for those staff members who are made redundant during the year, the full year basis includes the full annual salary costs, rather than the part-year costs which would be saved at the end of the year in which the contract was terminated. Table 5 sets out information provided by HMRC on its monetary savings on both bases as at 30 September 2007

Table 5: Achievement of HMRC against its monetary savings target under the efficiency programme as at 30 September 2007

In Year Result (£'m)	Full Year Result (£'m)	Full-year Target 2008 (£'m)
439	521	507

Source: HMRC Autumn Performance Report, p. 28

The 2007 APR notes that, of the In Year savings, £388 million are classified as "final", while £51 million of the savings are classified as "interim". The majority of these monetary savings have been achieved through the headcount reduction programme.

247 HM Revenue & Customs, Autumn Performance Report 2007, pp 26–27

248 Treasury Committee, First Special Report of 2007–08, *The efficiency programme in the Chancellor's department: Government Response to the Committee's Eighth Report of Session 2006–07*, HC 62, p 14

105. In addition to its monetary savings target under the 2004 efficiency programme, HMRC also achieved 3,325 reallocations and was therefore on target to meet its commitments under the Gershon programme. The department explained that its reason for exceeding the headcount reduction target was to prepare for the monetary savings targets set under the 2007 Comprehensive Spending Review.[249]

106. According to the Government response to our Report on the Efficiency Programme, of the £311 million (in-year) savings at 31 March 2007, 62% related to headcount reductions.[250] This compares to the original plan for headcount reductions to account for 75% of the monetary savings.[251] HMRC also has a target of £32.4 million in monetary savings to be achieved from the closure and consolidation of the HMRC estates. As at 30 September 2007, the department had closed, part-vacated or sub–let 145 properties since the merger, yielding £22.8 million saved in running costs. The remainder of the department's monetary savings have come from better procurement practices.

107. Mr Hartnett, acting Executive Chairman of HMRC, told the Sub–Committee that HMRC was exceeding the headcount target "at 31 October 2007 ... we had a gross reduction of nearly 17,500; redeployment of 3,300 and something; and a net position of 14,122".[252] He defended HMRC's approach to the efficiency target stating that HMRC had re–engineered business processes to ensure that the headcount reduction enabled "a constant improvement in the quality of our performance". [253] Mr Mike Eland, Director-General, Law Enforcement and Compliance, HMRC, explained that HMRC used a variety of methods to monitor the quality of its performance "we have time measures, accuracy measures and things like that that we can use; we also do satisfaction surveys; and increasingly we are trying to use focus groups".[254]

Pay and bonuses

108. During 2006-07, the total revenue accruing to HMRC was £436.9 billion, an increase of £31.7 billion (+7.8 %) on the previous year. This was mainly attributed to an increase in Income Tax and NICs receipts and to a lesser extent VAT, Corporation Tax and Stamp Duty. However, higher bonus-related payments and reduced contracting out from the State Second Pension scheme were also believed to have boosted receipts.[255] We were told that 2006–07 was the first year that bonus payments were made under the new integrated HMRC performance pay arrangements. The Exchequer Secretary told the Sub–Committee that the increase was due to "a pay assimilation exercise. It cost around about £60 million and occurred as a result of the merger of Inland Revenue and Her Majesty's Customs and

249 HC (2007–08) 62, para 14

250 *Ibid.*

251 HM Revenue & Customs, Efficiency Technical Note 2005, Annex A-1

252 Q 471

253 Q 469

254 Q 470

255 HM Revenue & Customs Departmental Annual Report 2006–07, p 74

Excise. That pay assimilation exercise removed the different pay and grading structures".[256] The new arrangements were aimed at rewarding individual performance, through bonus payments, thereby driving up performance within the department. HMRC's bonus pot for staff below SCS is currently 0.8% of performance management bonuses paid.

Table 6: HMRC end of year performance management bonuses paid (financial year) £m

	2006-07	2005-06
SCS	1.7	1.5
Others	17.2	9.7
Total	18.9	11.0

Table 7: Number of HMRC bonuses

	2006-07	2005-06
SCS	220	311
Others	37959	35605

These figures show that in 2006–07 the average bonus payment made to SCS staff was £7,727, a 60% increase on the 2005–06 bonus payments. By comparison, "Other" HMRC staff had an average bonus of £453 in 2006–07.

109. The number of HMRC permanent staff has decreased by 4.8% due to headcount reductions; however, the cost of those staff, as detailed in HMRC Resource Accounts, has increased by 1.1%. We were concerned by the rise in "Other Staff" (a term which would include fixed–term contractors and consultants): While the number of permanent staff has been decreasing, the number of other staff has increased by 9% between 2005–06 and 2006–07. We further note that spending on "Other staff" has increased by approximately £17.1 million which is a surprising 25% increase on 2005-06. Mr Hartnett explained that staff bonuses were not detailed explicitly in HMRC resource accounts as "the bonuses would be shown in overall remuneration and in the remuneration for individuals who are named in the accounts and in the general line in the accounts for remuneration". The Financial Secretary explained that "2006–07 ..was the first year of paying bonuses under HMRC, the increase in the bonus pot was planned growth,… it was achieved by allocating funding to non–consolidated pay rather than to consolidated pay increases. It was a quite deliberate pay strategy adopted by the new organisation, aimed at increasing the

256 Q 518

proportion of pay which was non-consolidated and, therefore, directed towards performance and aimed to improve performance across the organisation".[257]

110. The Financial Secretary defended the fact that so many HMRC staff qualified for a bonus in a period of maladministration and data losses, stating that HMRC had "some absolutely superb staff working for it. Quite clearly there are areas where their performance needs to improve, but you could not say that across the whole piece performance was failing, and they have some staff who are very deserving indeed of the bonuses that they have been paid".[258] **We recommend that in all future departmental accounts the payments of bonuses be listed alongside other remuneration. Whilst we accept that a rise in staff bonuses can be party attributed to pay assimilation that occurred as a result of the merger of Inland Revenue and Her Majesty's Customs and Excise, we ask the Government to explain why, in a year of poor performance and ongoing headcount reductions, Senior Civil Service grade staff have received on average a 60% increase in their bonus payments.**

HMRC core objectives

111. HMRC agreed its current set of Public Service Agreements (PSAs) with HM Treasury as part of the 2004 Spending review. The PSAs set out what HMRC is expected to achieve in return for Government funding. The current PSAs cover the period 2005–06 to 2007-08. For the next Spending Review period (2008–09 to 2010–11), HMRC has developed a set of Departmental Strategic Objectives, which we consider later in this chapter.[259]

112. HMRC currently has three objectives, which are underpinned by ten PSA targets. Table 8 summarises the performance against these PSA reported in HMRC's Spring Departmental Report:

Table 8: HMRC performance against the SR 2004 PSA targets

Performance	Ahead	On course	Slippage	Not yet assessed
Number of PSA targets	1	3	6	0

Objective I: Tax collection

PSA 1 – VAT losses

113. The PSA 1 is to reduce the scale of VAT losses to no more than 11% of the theoretical liability by 2007–08. The difference between the VAT collected and the total theoretical

257 Q 518

258 Q 519

259 See paragraph 144.

VAT that could be collected, is commonly known as the VAT gap. The Autumn Performance Report and Departmental Annual Report 2007 stated that there had been Slippage on achieving this target. HMRC's assessment for 2006–07 showed a decrease in the VAT gap of 0.3%, from 14.5% of the theoretical liability in 2005–06 to 14.2% in 2006–07; in absolute terms, the VAT gap decreased from £13.4 billion to £12.8 billion[260]). The target for 2007–08 is 11%, which indicates that HMRC still has a considerable way to go to achieve its PSA target; in financial terms, there needs to be a £2.9 billion (or 22%) reduction in the tax gap for the target to be reached. According to the Autumn Performance Report 2007 "estimates released in the 2007 Pre-Budget Report showed that attempted Missing Trader Intra-Community Fraud [MTIC] fraud fell by around £1.5 billion in 2006-07"; this is a reduction of approximately 30%. The PBR also claimed that "these reduced estimates demonstrate the success of the Government's strategy for tackling MTIC fraud".[261] **The considerable reduction in Missing Trader Intra–Community Fraud has not had a marked effect on the VAT loss figures. We recommend that the Government, in its response to this Report, explain how it has evaluated its 'success' in tackling MTIC fraud. We further recommended that the Government explain in that response why there has been slippage on the reduction of VAT losses and how it intends to improve its performance in this area.**

PSA 2 –cigarettes, sprits and oils: illicit market shares

114. PSA 2 challenges HMRC to reduce the illicit market share for cigarettes to 13%; to reduce the illicit market share for spirits, by at least half; and to hold the illicit market share for oils in England, Scotland and Wales to no more than 2%. The Autumn Performance Report 2007 and Departmental Annual Report 2007 stated that HMRC was on course to meet this target. For cigarettes and spirits, the 2007 Departmental Annual Report did not provide specific percentages for the illicit market share, but instead produced a wide range of potential results which could have indicated anything from incipient abject failure to outstanding success. In contrast, the 2007 Autumn Performance Report 2007 has actual figures which enable a better assessment of HMRC's progress against the target indicators.

115. It appears that the "on course" assessment is justified on the basis of the figures provided. For cigarettes, the 2005–06 result—which is the latest assessment—is 13% and is therefore directly on target. For spirits, the 2005–06 results are 5% representing a 2% improvement on the 2002–03 baseline of 7%, but there is still a further 2% reduction required to meet the target of 3%. For oils, the 2005 assessment is 2% and is therefore directly on target. The 2007 Departmental Annual Report notes that there has been good progress on curbing cigarette smuggling both at the frontier and inland, particularly through working with Trading Standards bodies on counterfeit tobacco. However it warns that organised crime continues to target this area and the incentive to smuggle remains

260 HM Revenue and Customs , *Measuring Indirect Tax Losses 2007*, para 2.6. This document was published alongside the 2007 Pre-Budget Report.

261 *Pre-Budget Report and Comprehensive Spending Review 2007*, para 5.105, 92, p 92

high. It also states that "intelligence indicates that organised criminal groups are focusing their attention on alcohol".[262]

PSA 3—Reducing tax and national insurance underpayment

116. The third PSA focuses on the reduction of underpayment of direct tax and National Insurance contributions due by at least £3.5 billion a year. The Departmental Annual Report 2007 stated that the target was now "On course". However, the Autumn Performance Report 2007 suggested that progress towards this target had slipped, The commentary in the 2007 Autumn Performance Report on this PSA target states that HMRC is "broadly on track" which seems to contradict its own "Slippage" headline assessment of performance. The commentary also discusses three projects aimed at further reducing underpayment of these taxes. In the Departmental Annual Report, a £2.9 billion reduction was forecast for 2006–07, but the "actual" figure for the Autumn Performance Report 2007 is £2.25 billion. Moreover, a footnote (Footnote 4, p. 23) states that "this figure is provisional ahead of implementation of legislative measures", implying that the £2.25 billion figure is itself a forecast and dependent on the success of proposed legislation.

PSA 4: Self-assessment tax returns

117. PSA 4 requires HMRC to increase the percentage of Self Assessment returns filed on time to at least 93%. Both the Autumn Performance Report 2007 and Departmental Annual Report recorded this target slipping in 2007. The figure in the Autumn Performance Report 2007 has dropped from 89.2% in 2006–07 to 86% in September 2007. This latest figure represents a decrease of 4.6 percentage points from the original baseline figure for 2005–06 (90.6%). Thus, from the reporting date HMRC had only 6 months to reverse this worsening trend, and the filing date for Self Assessment was the end of January. The commentary on the PSA targets grudgingly admits that the target will not be reached but claims that this is part of a conscious decision to obtain the greatest value for money:

> In recent years, significant resource has been put into raising the Self Assessment (SA) filing rate … Raising SA performance further, by even a small margin, is unlikely to enable the target to be reached and will require the movement of resource from other activities which are of greater value and which provide better returns on investment. We have therefore focused more on value for money/cash to bank by moving to an explicit strategy of recognising value and risk, rather than seeking to simply improve still further the overall SA filing rate. This … will mean that the current PSA target 4 will not be reached.[263]

118. On the issue of filing self assessment online, Mr Hartnett told the Sub-Committee that "We have recently surveyed … our customers, on the on-line service we provide for self assessment, and 71 per cent were very satisfied, or better, with what we were doing".

262 HM Revenue & Customs, *Autumn Performance Report* 2007, p 16

263 HM Revenue & Customs, *Departmental Report 2007: Integrating and growing stronger*, May 2007, p 27

However, this was before the online self assessment system crashed at 9am on the 31st January deadline date, forcing HMRC to extend the deadline by another 24 hours.[264] **We recommend that the Government, in its response to this Report, explain why the Self-Assessment filing rate has decreased if "significant resource" has been put into it, and clarify what other activities the Self-Assessment resource has been focused on. We further recommend that the Government explain what effect the online system crash in late January 2008 will have on HMRC's assessment of performance against this PSA target in the 2008 Departmental Annual Report.**

Overall issues for tax collection PSA targets

119. Section 1 of the Autumn Performance Report 2007 gives details of how HMRC has been working towards a better understanding of tax receipts, as part of its intelligence-led approach to compliance and tax collection. The Autumn Performance Report 2007 also details how new systems and process allow for an improved assessment of the scale of losses for large companies and the extent of avoidance, while HMRC has developed a sophisticated understanding of the impact of its own compliance activities. This contrasts with the fact that three of the four "tax collection" PSAs are assessed as suffering slippage; particularly as there must be considerable doubt on whether two of the four targets (PSA 1 and PSA 4) can be achieved by the end of 2007–08. **We are concerned that the current VAT gap, the direct tax and National Insurance underpayments, and the deterioration in the Self-Assessment filing performance may be linked to the headcount reduction under the efficiency programme. We expect the Government response to this Report to provide further evidence of the Government's position if the Government continues to maintain that this is not the case. We also recommend that the Government response explain how the Government will ensure that any further efficiency savings are not made at the cost of further deterioration in HMRC's performance.**

Objective II: the customer experience

120. All of the PSA targets grouped under this objective were assessed as suffering "slippage" in the 2007 Departmental Annual Report and continue to be assessed as such in the Autumn Performance Report 2007. For each of the three PSA targets in this section, the "slippage" assessment is due to lagging performance on one of the two or three indicators for that PSA, whilst the others would be assessed as "on course" or ahead of target. As such, the analysis below deals with each of the "slippage" indicators, rather than looking at the specifics of each PSA target.

121. For PSA5, the "slippage" assessment relates to the indicator of an 80% response rate of individuals and businesses who said that they achieved success at the first point of contact. The commentary notes that the November 2006 figure of 74.1% is only 2.4% higher than the baseline, and that the 2005 result showed a drop to 71.2%—below the original baseline. As such, it admits that the target represents "a very significant challenge". The other indicator for PSA5, which has exceeded its target, appears to be based on information from

264 See February 2008: The Daily Telegraph, The Financial Times , The Guardian and The Times

HMRC, rather than feedback from the customer, and it is therefore potentially less objective. Mr Harnett told the Sub-Committee that "HMRC had sought independent evaluation of its contact centres, and had been reassured that 90 per cent of taxpayers using contact centres were satisfied or better with the service we are providing".[265] **We remain concerned that HMRC's headcount reductions, office closures and consequent move towards contact centres have proved a source of frustration to customers. We recommend that the Government, in its response to this Report, provide further information on the reasons for the slippage on PSA 5, and ask HMRC to publish the evaluation that it commissioned detailing the level of customer satisfaction with the new contact centres.**

122. For PSA6, the indicator showing slippage is "to increase to 85% the proportion of individuals who find their Self-Assessment statements of account, PAYE coding notices and Tax Credit Award Notices easy to understand".[266] This indicator has actually decreased since the baseline year of 2004—from 77.6% to 76.7%. The Autumn Performance Report notes that all planned changes to the forms have already been implemented and the further changes were not possible in the time remaining, so meeting the target will be "very challenging".[267] **We note that HMRC plans to take no further action to improve performance under PSA 6 and therefore suggest that the description is changed from "very challenging" to "impossible", because it is clear that HMRC will fail to achieve the target.**

123. The indicator suffering slippage for PSA7 is that of achieving 50% of VAT returns filed online. The baseline in March 2004 was 0.2% and this has risen to an average of 12% for August–October 2007. The commentary states that the target is now expected to be met in 2010, in line with the revised timetable announced in Budget 2007. **We recommend that the Government, in its response to this Report, explain why the target for 50% of VAT returns to be filed online has been postponed until 2010. Furthermore, the last three years have seen an increase to only 12% of VAT returns filed online, therefore we expect HMRC's plans to ensure that the 50% target is reached by this later date.**

VAT Registration

124. Eight Key Indicators make up the HMRC's three targets under Objective II: *Improve customer experiences, support business and reduce the compliance burden*. Key Indicator 4 states that HMRC must demonstrate a measurable improvement in new and growing businesses' ability to deal correctly with their tax affairs. This includes increasing the proportion of applications for VAT registration that are complete and accurate to at least 50% by 2007-08.[268] This Indicator combines a target to improve accurate completion of VAT registration forms with filing on time targets for Income Tax Self-Assessment and

265 Q 514

266 HM Revenue & Customs Autumn Performance Report, December 2007, p 18

267 *Ibid.*

268 HM Revenue & Customs, *Departmental Report 2007: Integrating and growing stronger*, May 2007, p 46

Pay As You Earn (PAYE), as a measure of the impact of targeted support and education for those joining the tax regimes and those taking on their first employees.[269]

125. HMRC stated in its Autumn Performance Report that "significant improvements in the ability of businesses to provide complete and accurate VAT registration applications have resulted from a review of the criteria for complete VAT registration applications and a revised registration application form and guidance introduced in December 2006".[270] However, HMRC reported that it had taken "necessary steps to tackle VAT fraud, various additional process and IT problems"[271] and that these steps coupled with an increase in VAT registration applications had contributed to a backlog in registering new businesses during in the first half of 2007–08. Mr Hartnett told the Sub-Committee that "a huge number of new companies were registered in January, February and March this year in advance of the managed service company provisions which came in the budget … with some firms of advisers registering as many as 15,000 companies in very short order".[272]

126. In its Spring Departmental Report HMRC reported slippage on the target for the processing of VAT receipts.[273] In June 2007, the then Financial Secretary to the Treasury told the Sub-Committee that "On each and every one of those 12 measures [of service quality] … HMRC has been able to demonstrate … that there has been no deterioration in service".[274] The Financial Secretary did not accept that the headcount reductions had contributed to the slippage.[275] However, during November 2007, the media reported that new businesses were experiencing significant delays as HMRC processed their VAT registration forms.[276] The Exchequer Secretary stated that, between February and July 2007, fewer than 20 per cent of applications were processed within HMRC's target of 14 working days.[277]

127. In July 2007, HMRC implemented an action plan to address this backlog of applications; the plan included putting extra staff in place to deal with registrations and improving IT systems.[278] Mr Hartnett was confident that HMRC would "achieve its target of processing target 70 per cent of VAT registrations within 14 days" by 31 January 2008.[279] He said that "Business has told us how important it is for us to get VAT registration firmly back on track, and we are determined to do that".[280]

269 *Ibid.*

270 HM Revenue & Customs Autumn Performance Report, December 2007, p 18

271 HM Revenue & Customs, *Departmental Report 2007: Integrating and growing stronger*, May 2007, p 46

272 Q 496

273 HM Revenue & Customs, *Departmental Report 2007: Integrating and growing stronger*, May 2007, p 18

274 HC (2006–07) 569–ii, Qq 357, 379

275 *Ibid.*

276 For example: The Observer, '"Efficiency drive" leaves the Revenue floundering', 28 October 2007; Independent on Sunday, 'Companies angry over VAT chaos', 4 November 2007.

277 HC Deb, 23 October 2007, Col 256W

278 HM Revenue & Customs Autumn Performance Report, December 2007, page 18

279 Q 491-492

280 *Ibid.*

128. **There have been considerable problems with delays in VAT registration for small businesses. We have repeatedly been assured that the headcount reductions and efficiency programme as a whole would not cause a decline in the quality of HMRC's services. We ask the Government to explain why there has been a deterioration of service in relation to VAT registrations and what measures it will take to bring HMRC back on course.**

Objective III: Frontier protection

129. The key PSA target relating to HMRC's frontier protection objective is that of PSA 8: "By 2007–08 to improve our capability to intervene at the frontier." This target has changed in its assessment, going from "Slippage" in the 2007 Departmental Annual Report to an "On course" rating in the Autumn Performance Report 2007. This is the only area of the PSA target where the performance indicators have changed for seizures of Cocaine, Heroin, and Products of Animal Origin.[281]

130. The figures for number of seizures and kilograms seized were greater in the 2007 Departmental Annual Report than previously, but these figures represented a full year's statistics, whereas the Autumn Performance Report 2007 only had results for the preceding six months. However, an analysis of the half-year figures shows that for nearly all indicators (i.e. seizures and amounts seized for each of the three categories), the department has not reached the halfway point for the targets for 2007–08. A comparison with the 2006 Autumn Performance Report shows that in 2006 HMRC was in a better position than in 2007 and still failed to achieve the target for 2006–07. Hence, it appears that the assessment of PSA8 as "On course" is not justified by the half-yearly position or based on historical experience. **We recommend that the Government, in its response to this Report, explain why HMRC's 2007 Departmental Annual Report assesses PSA8 as "On course" when the Department has not reached the halfway point to achieve the March 2008 target and does not appear to have improved upon the 2006–07 Autumn Performance Report results when the same target was viewed as suffering from "Slippage".**

Tax credit administration

Overview

131. In June 2006 we published a comprehensive Report on the administration of tax credits arising from a Sub–Committee inquiry. We supported the principle of tax credits and were encouraged that they were providing financial assistance to so many people, particularly families with children. Tax credits succeeded both in achieving a significantly higher rate of take-up than was the case under previous regimes and in creating incentives for people to seek work. We concluded that it was crucial that HMRC continued to push ahead with the fundamental shift in its departmental culture that was already, of necessity,

[281] HM Revenue & Customs, *Departmental Report*, 2007, p 47

underway. The difficulties associated with administering the tax credits regime have detracted from the regime's successes and have had real impacts on the lives of some claimants.[282]

132. In 2007, HMRC reported that 6 million families and 10 million children continued to benefit from tax credits. The Tax Credit Office (TCO) now routinely delivers a decision to most claimants within 4 weeks of an overpayment being disputed. TCO has managed to halve the number of complaints on hand at any one time and most claimants will now get a reply in less than 6 weeks. In addition, 2006-07 TCO's accuracy figure is around 97% against a target of 95%.[283]

133. HMRC Contact Centres undertook a change programme in 2006–07. During the period Contact Centres handled 23 million tax credit calls, a 1.3 million increase from 2005–06. HMRC reported that it answered over 99% of callers on the day they phoned in 2006–07 compared to 98.1% in 2005–06. In 2006–07, the number of callers who received an engaged or busy tone was reduced by almost 60% compared with 2005–06.

134. The Adjudicator's office investigate and help to resolve complaints from individuals and businesses that remain unhappy about the way that their affairs have been handled by a number of government departments including HM Revenue & Customs. Adjudicator's Annual Report 2007 noted that the most significant development was a further large increase in tax credits complaints. As a result, 80% of all complaints handled by the office in 2006–07 concerned tax credits. And the office in total settled 1419 investigations against 926 last year.[284] Dame Barbara Mills told us that "a programme of work was underway within HMRC that should, over time, deliver significant improvements". However the Adjudicator's Office reported a "very large, increase in the number of tax credits complaints coming to us."[285]

135. **We are concerned that five years after the introduction of tax credits, the number of complaints referred to the Adjudicator's office has significantly increased. We expect HMRC to make significant improvements to their administration of tax credits as a matter of urgency.**

Code of Practice 26

136. The majority of tax credits complaints that are referred to the Adjudicator's office following the HMRC's refusal to write off an overpayment. HMRC's published guidance setting out the circumstances in which it will write off overpayments of tax credits is in Code of Practice 26—"What happens if we have paid you too much tax credit?".

282 HC 811–I

283 HM Revenue & Customs, *Departmental Report*, December 2007, p 25

284 The Adjudicator's Office, *Annual Report 2007*, p 15

285 *Ibid.*, Foreword

Overpayments can arise because of errors by the claimant, errors by HMRC or a combination of both.[286]

137. There are two principal ways in which claimant error can arise: firstly, the claimant may have completed the claim form incorrectly or failed to inform the Tax Credit Office (TCO) of changes of household circumstances; secondly, HMRC may fail to add or correct new information in its system when it has been provided by the claimant or there may be a HMRC computer system error. The difference between these causes of overpayments is important. If they arise because of claimant error, the overpayments cannot be written off under Code of Practice 26, unless the hardship provisions apply. If they arise because of HMRC error, they can be written off if the claimant could have "reasonably believed" their award was correct. The Adjudicator's Annual Report notes however that in many cases establishing "reasonable belief" is a high hurdle to get over. The tax credits system places a responsibility on claimants to report changes in circumstances and check the personal details shown on their award notices. The reasonable belief test in Code of Practice 26 reflects this. This approach in turn, however, places an onus on HMRC to ensure its communications are of a sufficiently high standard to ensure claimants know what they need.[287]

138. Ms Walker told the Sub-Committee that HMRC had issued a new version of the Code of Practice in April 2006 which sought to redefine the term "reasonable belief". The guidance clarified the fact that HMRC did not expect claimants to be able to check the whole of the calculation of their payment but they were expected to check that HMRC had properly recorded things such as "how many children you have, what your income is, that kind of thing—and that you would check that what goes into the bank account matches what we have told you is going to go into the bank account". Ms Walker was clear that the new Code of Practice went further than the previous guidance stating "these are the things we are expecting you to check … If you have checked those and they are correct and we have still made a mistake, we will not refuse to write it off".[288]

139. **We welcome HMRC decision to revise code of practice 26 following our concerns raised in our Report in the administration of tax credits. We expect HMRC to continue to work closely with the Adjudicator to ensure that all tax credit guidance is clear and fair.**

Tax credit payment

140. HMRC paid a net £18.7 billion in tax credits during 2006–07. The Comptroller and Auditor General estimated that year end adjustments to awards meant that HMRC had overpaid £1.7 billion and underpaid £549 million in 2005–06. During the scheme's first three years, HMRC calculated that these adjustments, and other small changes to entitlement after the finalisation of awards, have resulted in a debt of £6.0 billion. HMRC

286 *Ibid.*, p 15

287 HM Revenue & Customs, *Departmental Report 2007: Integrating and growing stronger*, May 2007, para 2.3

288 Qq 440, 443–444

also identified £600 million from in year adjustments to 2006–07 awards and is expected to identify further overpayments for 2006–07 once awards are finalised. By the end of March 2007 the Department had collected £2.0 billion of this debt and written off £0.7 billion. £3.9 billion of overpayments remain to be collected by the Department. It has provided for £1.6 billion in respect of doubtful debts.[289]

141. In June 2007, the Department completed its testing of 2004-05 awards, based on 4,500 random enquiries. As a result of this, the Department estimates that claimant error and fraud resulted in between £1.04 billion to £1.30 billion (7.3 to 9.1 per cent of the final value of awards) being paid to claimants to which they were not entitled. The levels in 2003–04 were £1.06 billion to £1.28 billion (8.8 to 10.6 per cent). It also estimates that claimant error resulted in between £200 million to £350 million (1.4 to 2.4 per cent) not being paid to claimants to which they were entitled. The levels in 2003–04 were £190 million to £280 million (1.6 to 2.3 per cent).

142. The Comptroller and Auditor General noted that it was important that the Department's work provided an accurate view of levels of error and fraud. In 2006–07 the Department carried out 137,930 checks on claims it assessed as higher risk. It has identified incorrect payments made of £151 million and prevented incorrect payments of £291 million (£250 million and £447 million in 2005-06). The reduction on 2005-06 is primarily due to fewer attacks by organised fraudsters, following the closure of the tax credit internet site in December 2005. He reported that HMRC was is developing a framework for validating the identity of individuals and will only re–open the tax credit internet system once this work is complete, which is unlikely to be before July 2008.[290]

Expansion of call centres

143. HMRC reported that an expansion of Contact Centres was required to maintain service levels against the increasing gap between caller volumes and contact centre capacity for handling tax credit queries and to provide the improved service.[291] The Chief Secretary agreed that £30,000,000 should be allocated to the expansion of call centre capacity. This expansion was approved in the CSR07 settlement letter dated 22nd March 2006 which included the agreement that £30million would be made available to HMRC for this expansion. The timescale for expansion was very short. A major peak in demand in between July and September required additional capacity to be in place by July 2006. A new site was fitted out at Liverpool and two existing sites were expanded.[292]

HMRC's Departmental Strategic Objectives

144. Table 9 shows how HMRC's Departmental Strategic Objectives for the period from 2008–09 to 2010–11 compare with its objectives for the preceding years.

289 Comptroller and Auditor General's report on HM Revenue & Customs 2006–07 Accounts, para 6, 9–11

290 Comptroller and Auditor General's report on HM Revenue & Customs 2006-07 Accounts, paras 6, 9-11

291 Ev 94–95, p 3

292 HM Revenue & Customs, 2006–07 Spring Supplementary Estimate Memorandum, p 5

Table 9: HMRC's current departmental objectives and new DSOs

2007 Pre-Budget Report, Annex D16, paras D16.3, D16.5, HMRC's Departmental Strategic Objectives for the CSR07 period	HMRC 2007 Departmental Report, extracts from PSA targets, pp. 35-37
Objective I: Improve the extent to which individuals and businesses pay the tax due and receive the credits and payments to which they are entitled;	Objective I [PSA1–PSA4]: Improve the extent to which individuals and businesses pay the amount of tax due and receive the credits and payments to which they are entitled.
Objective II: Improve customers' experience of HMRC and improve the UK business environment.	Objective II [PSA5–PSA7]: Improve customer experience, support business and reduce the compliance burden.
Objective III: Reduce the risk of the illicit import and export of material which might harm the UK's physical and social well-being.	Objective III [PSA8–PSA10]: Strengthen frontier protection against threats to the security, social and economic integrity and environment of the United Kingdom in a way that balances the need to maintain the UK as a competitive location in which to do business.

We noted earlier that this Committee was consulted on the Treasury's Departmental Strategic Objectives. There was no equivalent consultation on HMRC's Objectives. We have also not been supplied with detailed information on the outcome indicators to be used for these new objectives. In the absence of such information, it is not possible to assess how far the performance management framework for HMRC has changed for the years from 2008–09 onwards. **We regret the failure of HM Revenue & Customs to consult this Committee about its new Departmental Strategic Objectives and the accompanying outcome indicators. We expect to assess the changes to HMRC's performance management framework when fuller information is available.**

Conclusions and recommendations

1. Significant under-spends in successive years have seen the Treasury Group build up exceptionally large stocks of End-Year Flexibility, exceeding the Group's annual budget within Departmental Expenditure Limits. On the assumption that the Treasury will wish to set an example to other departments through continued restraint on Departmental Expenditure Limits expenditure in the period covered by the Comprehensive Spending Review, there appear to be few prospects for this stock to be deployed to a significant extent for the Group's expenditure within Departmental Expenditure Limits. We recommend that, in its response to this Report, the Government state whether there are any circumstances in which the Treasury Group's Departmental Expenditure Limits End. Year Flexibility stock might be used for purposes other than expenditure within the Group's Departmental Expenditure Limits. (Paragraph 14)

2. OGCbuying.solutions' role or status does not provide sufficient justification for its exclusion from the calculations for headcount reductions. We therefore reiterate our view that there is a risk that the practice of excluding certain categories of staff increases from calculations of headcount reductions for the purposes of the efficiency programme detracts from the overall credibility of the headcount statistics. (Paragraph 19)

3. In view of the extent to which Value for Money Delivery Agreements were portrayed by the Government as a new departure in reporting on efficiency, we view the Treasury Group's own document as disappointing. (Paragraph 22)

4. We recommend that, in its response to this Report, the Government set out the efficiency targets for each organisation within the Treasury Group and for further savings from estate rationalisation and Group Shared Services for each year over the period from 2008–09 to 2010–11. (Paragraph 23)

5. We recommend that the Government, in its response to this Report, state how it proposes that the quality of service of the Treasury Group during the period from 2008–09 to 2010–11 be measured, and whether there are arrangements in place to identify whether efficiency savings have led to any detrimental effects on quality of performance. (Paragraph 24)

6. Even if formal responsibility for general oversight of the efficiency programme across Government is separate from management of the Treasury's own programme, we consider it unsatisfactory that the role of oversight and challenge be undertaken from within the same organisation. We recommend that the Government put in place arrangements for the Cabinet Office to perform the role of challenge and oversight in relation to the Treasury Group's own efficiency programme. (Paragraph 25)

7. We recognise that considerable work has been undertaken in the last year to enable the Royal Mint to improve its financial performance and congratulate all those concerned. We note that more work will need to be done to enable the Mint to meet its Average Rate of Return target set by the Treasury for 2007–08. (Paragraph 29)

8. We note that the new Service Level Agreement is intended to enable the Treasury to achieve £2.9 million programme-based efficiency savings and we will return to this issue in the Autumn to see if these savings are achieved. (Paragraph 38)

9. We welcome the Mint's ambition to develop its business by establishing itself as a corporate entity separate from Government, and we agree that it will benefit from a standard company governance framework. The Mint is clearly in its strongest and most viable position for some time and we look to its new Chief Executive to take the vesting process forward successfully. (Paragraph 40)

10. Provided that adequate arrangements are put or remain in place for reporting on the performance of the Office of Government Commerce and the Debt Management Office, and subject to the response to the specific recommendations in the remainder of this chapter, we view the pilot for combining the resource accounts and the departmental annual report of the Treasury Group as offering an opportunity for continued improvement in the quality of financial reporting by the Group in future. (Paragraph 41)

11. We are disappointed that the Treasury's annual report and accounts for 2006–07 do not include forward plans for expenditure linked to objectives comparable to the information provided in the departmental report for 2005–06. We recommend that such information for the period 2008–09 to 2010–11 be included within the annual report and accounts for 2007–08. The Treasury's capacity to include such plans and then to report on performance in relation to such plans will be an important indicator of the extent of the Treasury's success in seeking to raise the standards of its own financial management and reporting. (Paragraph 42)

12. We recommend that information on bonus payments as a proportion of total Treasury Group remuneration, divided between organisations, and on bonus payments to individual members of the Executive Board be included in future reports and accounts. (Paragraph 43)

13. We recommend that the Treasury reinstate information on staffing by grade, including the gender and diversity of staffing by grade, in future Reports and Accounts. (Paragraph 44)

14. The Treasury's roles in allocating and controlling public spending and in acting as a guardian of propriety and economy in public services mean that it will never be universally popular amongst other Government departments and other stakeholders. While we would not wish the Treasury to become too inhibited in performing its role at the centre of Government, we welcome the steps that the Treasury is taking in response to the call in the Capability Review for "greater inclusiveness and humility" in the Treasury's dealings with others. We recommend that a summary of the results of the annual surveys of stakeholder opinion and the Treasury's response to stakeholders be published in the Treasury's annual reports. We further recommend that a summary of quantitative evidence from the survey conducted as part of the Capability Review be published in the Government's response to this Report, to serve as a baseline for measuring progress in the subsequent, annual surveys. We recommend that the Treasury take steps to address concerns expressed in the

Capability Review to bolster the depth and breadth of their officials' practical experience. (Paragraph 48)

15. We are not convinced that the Treasury's Public Spending Directorate is suitably placed to play an effective role in supporting and challenging departmental efficiency programmes. It is not evident that a role in questioning the validity of claimed efficiency savings is compatible with the task of ensuring that public spending limits are adhered to. The Capability Review of the Treasury demonstrates that our uncertainty is shared by others. We recommend that the Treasury clarify its own role in relation to the efficiency programme for the period from 2008 to 2011 in a swift response to this Report. (Paragraph 51)

16. We welcome progress by the Treasury, other Government departments and the National Audit Office towards the objective of laying all Resource Accounts before the House of Commons before the Summer recess. We look forward to further progress on the quality of such Accounts measured by the number of qualified Accounts. (Paragraph 53)

17. We expect the Government, in its response to this Report, to explain why the Treasury's objective for the appointment of professionally-qualified Finance Directors in all departments by December 2006 was not met. We further recommend that a relevant accountancy qualification be described as an essential criterion in all future advertisements for posts of departmental Finance Directors. (Paragraph 54)

18. We recommend that the Treasury identify a method of measuring its success in its own role in supporting improvements in financial management across Government, such as the annual survey of stakeholder opinion, and report on performance against that measure in future department annual reports. (Paragraph 55)

19. We are disappointed by the absence of any meaningful information in Delivery Agreements accompanying the new Public Service Agreements for the period from 2008–09 to 2010–11 about linkages between delivery against outcome indicators and the resources to be applied to each Public Service Agreement. This indicates that there is still some considerable room for improvement in financial and performance management within Government. We recommend that the Treasury set itself a target to ensure that the Public Service Agreements finalised as part of the next Spending Review in 2009 or 2010 include a clear statement about the resources to be allocated across Government to the delivery of each Agreement. (Paragraph 57)

20. We will continue to examine the implications of the implementation of International Financial Reporting Standards for Government accounting and for the national accounts. (Paragraph 60)

21. We welcome the Government's positive response to our recommendation relating to improved alignment of parliamentary authorisation of public expenditure and the planning and control processes for such expenditure within Government. We look forward to examining progress of this "line of sight" initiative as it develops and, as part of this examination, we expect to consider whether the proposed timetable for implementation could be expedited. (Paragraph 61)

22. We view the failure of the Office of Government Commerce to publish an annual report in 2006–07 as unacceptable. We expect the Office to report on its performance on an annual basis in future. (Paragraph 69)

23. We are concerned that the current arrangements for highlighting a project assessed by a Gateway review as "double red" fail to address the wider ranging issues regarding the continued failure of the Government properly to manage such a project. In response to this Report, we expect the Government to set out how projects that receive a "Double-red" Gateway Review will formally be held to account. (Paragraph 75)

24. Whilst we recognise that Gateway Reviews have been used as corrective instrument to realign a failing project, we would like to know what pre-emptive action the Government takes to ensure that risk management is properly utilised in the planning of projects subject to a Gateway Review. We will return to this issue in the Autumn. (Paragraph 76)

25. We accept that a number of the outcomes set out in the Treasury's Public Service Agreements for the period from 2004 to 2008 and in its Departmental Strategic Objectives for the period from 2008 to 2011 are not subject to easy measurement. We also accept that the Treasury's own direct influence in relation to some of its international objectives will be necessarily limited. However, this reinforces the importance of external scrutiny and audit of Treasury performance. We note that the Treasury proposes to monitor its performance in influencing the policy debate and the international structures it uses to make progress on its objectives by taking as its milestones the outcomes of specified key events. We recommend that the Treasury arrange for independent monitoring to be included within assessments of those key international events relevant to the Treasury's international objectives. We further recommend that the Government clarify, in its response to this Report, whether data sources used for the purposes of measuring performance in relation to Departmental Strategic Objectives will be the subject of audit by the National Audit Office. (Paragraph 89)

26. We recommend that, in its response to this Report, the Government confirm that progress in relation to the Treasury's PSA 6 target for regional growth will be measured in relation to the economic cycle which the Government expects to have concluded in 2007. We further recommend that, in reporting on the ending of that cycle, the Government includes an analysis of the economic cycle in each region of England as well as for the United Kingdom as a whole. (Paragraph 91)

27. We recommend that the Government, in its response to this Report, set out its provisional analysis of the work currently being undertaken to analyse the reasons for low take-up of the childcare element of tax credit and the reasons for regional differences in take up. (Paragraph 94)

28. We welcome the consultation that the Treasury has initiated with this Committee in relation to its Departmental Strategic Objectives for the period from 1 April 2008 to 31 March 2011, which we trust will serve as a precedent for the continued future development of the performance management framework. We welcome the inclusion of a performance indicator for the Treasury's work on supporting stable financial markets. We recommend that the Government, in its response to this Report, set out the timetable for the commissioning of a first assessment of UK financial stability and risk management against international comparisons. We further recommend that all such assessments be commissioned from an organisation outside Government, such as the International Monetary Fund, and be published. (Paragraph 96)

29. We recommend that the Government clarify, in its response to this Report, whether it is committed to maintaining net public sector debt below 40% of GDP in each and every year of the economic cycle that is expected to have begun in 2007. (Paragraph 97)

30. We are concerned that eight out of ten areas assessed under the Capability Review of HMRC require development. We expect HMRC to resolve these issues and we will scrutinise HMRC's progress in the autumn. (Paragraph 101)

31. We recommend that in all future departmental accounts the payments of bonuses be listed alongside other remuneration. Whilst we accept that a rise in staff bonuses can be party attributed to pay assimilation that occurred as a result of the merger of Inland Revenue and Her Majesty's Customs and Excise, we ask the Government to explain why, in a year of poor performance and ongoing headcount reductions, Senior Civil Service grade staff have received on average a 60% increase in their bonus payments. (Paragraph 110)

32. The considerable reduction in Missing Trader Intra Community Fraud has not had a marked effect on the VAT loss figures. We recommend that the Government, in its response to this Report, explain how it has evaluated its 'success' in tackling MTIC fraud. We further recommended that the Government explain in that response why there has been slippage on the reduction of VAT losses and how it intends to improve its performance in this area. (Paragraph 113)

33. We recommend that the Government, in its response to this Report, explain why the Self-Assessment filing rate has decreased if "significant resource" has been put into it, and clarify what other activities the Self-Assessment resource has been focused on. We further recommend that the Government explain what effect the online system crash in late January 2008 will have on HMRC's assessment of performance against this PSA target in the 2008 Departmental Annual Report. (Paragraph 118)

34. We are concerned that the current VAT gap, the direct tax and National Insurance underpayments, and the deterioration in the Self-Assessment filing performance may be linked to the headcount reduction under the efficiency programme. We expect the Government response to this Report to provide further evidence of the Government's position if the Government continues to maintain that this is not the case. We also recommend that the Government response explain how the Government will ensure that any further efficiency savings are not made at the cost of further deterioration in HMRC's performance. (Paragraph 119)

35. We remain concerned that HMRC's headcount reductions, office closures and consequent move towards contact centres have proved a source of frustration to customers. We recommend that the Government, in its response to this Report, provide further information on the reasons for the slippage on PSA 5, and ask HMRC to publish the evaluation that it commissioned detailing the level of customer satisfaction with the new contact centres. (Paragraph 121)

36. We note that HMRC plans to take no further action to improve performance under PSA 6 and therefore suggest that the description is changed from "very challenging" to "impossible", because it is clear that HMRC will fail to achieve the target. (Paragraph 122)

37. We recommend that the Government, in its response to this Report, explain why the target for 50% of VAT returns to be filed online has been postponed until 2010. Furthermore, the last three years have seen an increase to only 12% of VAT returns filed online, therefore we expect HMRC's plans to ensure that the 50% target is reached by this later date. (Paragraph 123)

38. There have been considerable problems with delays in VAT registration for small businesses. We have repeatedly been assured that the headcount reductions and efficiency programme as a whole would not cause a decline in the quality of HMRC's services. We ask the Government to explain why there has been a deterioration of service in relation to VAT registrations and what measures it will take to bring HMRC back on course. (Paragraph 128)

39. We recommend that the Government, in its response to this Report, explain why HMRC's 2007 Departmental Annual Report assesses PSA8 as "On course" when the Department has not reached the halfway point to achieve the March 2008 target and does not appear to have improved upon the 2006–07 Autumn Performance Report results when the same target was viewed as suffering from "Slippage". (Paragraph 130)

40. We are concerned that five years after the introduction of tax credits, the number of complaints referred to the Adjudicator's office has significantly increased. We expect HMRC to make significant improvements to their administration of tax credits as a matter of urgency. (Paragraph 135)

41. We welcome HMRC decision to revise code of practice 26 following our concerns raised in our Report in the administration of tax credits. We expect HMRC to continue to work closely with the Adjudicator to ensure that all tax credit guidance is clear and fair. (Paragraph 139)

42. We regret the failure of HM Revenue & Customs to consult this Committee about its new Departmental Strategic Objectives and the accompanying outcome indicators. We expect to assess the changes to HMRC's performance management framework when fuller information is available. (Paragraph 144)

Formal minutes of the Treasury Sub-Committee

Tuesday 26 February 2008

Members present

Mr Michael Fallon, in the Chair

Nick Ainger
Mr Graham Brady
Jim Cousins
Mr Philip Dunne
Mr John McFall
Mr Andrew Love
Mr George Mudie
John Thurso
Mr Mark Todd
Peter Viggers

Administration and expenditure of the Chancellor's departments, 2006–07
Draft Report (*Administration and expenditure of the Chancellor's departments, 2006–07*), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 28 read and agreed to.

Paragraph 29 read, amended and agreed to.

Paragraph 30 to 47 read and agreed to.

Paragraph 48 read, amended and agreed to.

Paragraphs 49 to 74 read and agreed to.

A paragraph—(*Mr Mark Todd*)—brought up, read the first and second time and inserted (now paragraph 75).

Another paragraph—(*Mr Mark Todd)*—brought up, read the first and second time and inserted (now paragraph 76*)*.

Paragraph 75 to 93 (now paragraph 77 to 95) read and agreed to.

Paragraph 94 *(*now paragraph 96*)* read, amended and agreed to.

Paragraphs 95 to 142 (now paragraphs 97 to 144) read and agreed to.

Summary read and agreed to.

Resolved, That the Report, as amended, be the First Report of the Sub-Committee to the Committee.

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

[Adjourned to a day and time to be fixed by the Chairman.

Formal minutes of the Treasury Committee

Tuesday 26 February 2008

Members present

Mr John McFall, in the Chair

Mr Michael Fallon
Nick Ainger
Mr Graham Brady
Jim Cousins
Mr Philip Dunne
Mr Andrew Love
Mr George Mudie
John Thurso
Mr Mark Todd
Peter Viggers

*****

Administration and expenditure of the Chancellor's departments, 2006-07

Draft Report from the sub-committee (*The Administration and expenditure of the Chancellor's departments, 2006-07*), brought up and read.

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

Paragraphs 1 to 144 read and agreed to.

Summary read and agreed to.

Resolved, That the Report, be the Seventh 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 (Select committees (reports)).

Written evidence was ordered to be reported to the House for printing with the Report.

*****

[Adjourned till Tuesday 4 March at 9.30 am.

Witnesses

List of written evidence

List of Reports from the Treasury Committee during the current Parliament

Session 2007–08

		Report
First Report	The 2007 Comprehensive Spending Review	HC 55
Second Report	The 2007 Pre-Budget Report	HC 54
Third Report	The Work of the Committee in 2007	HC 230
Fourth Report	Climate change and the Stern Review: the implications for Treasury policy	HC 231
Fifth Report	The run on the Rock	HC 56
Sixth Report	Financial Stability and Transparency	HC 371

Session 2006–07

		Report
First Report	Financial inclusion: the roles of the Government and the FSA, and financial capability	HC 53
Second Report	The 2006 Pre-Budget Report	HC 115
Third Report	Work of the Committee in 2005–06	HC 191
Fourth Report	Are you covered? Travel insurance and its regulation	HC 50
Fifth Report	The 2007 Budget	HC 389
Sixth Report	The 2007 Comprehensive Spending Review: prospects and processes	HC 279
Seventh Report	The Monetary Policy of the Bank of England: re-appointment hearing for Ms Kate Barker and Mr Charlie Bean	HC 569
Eighth Report	Progress on the efficiency programme in the Chancellor's department	HC 483
Ninth Report	Appointment of the Chair of the Statistics Board	HC 934
Tenth Report	Private equity	HC 567

Eleventh Report	Unclaimed assets within the financial system	HC 533
Twelfth Report	The Monetary Policy Committee of the Bank of England: ten years on	HC 299
Thirteenth Report	Financial inclusion follow-up: saving for all and shorter term saving products	HC 504
Fourteenth Report	Globalisation: prospects and policy responses	HC 90

Session 2005–06

		Report
First Report	The Monetary Policy Committee of the Bank of England: appointment hearings	HC 525
Second Report	The 2005 Pre-Budget Report	HC 739
Third Report	The Monetary Policy Committee of the Bank of England: appointment hearing for Sir John Gieve	HC 861
Fourth Report	The 2006 Budget	HC 994
Fifth Report	The design of a National Pension Savings Scheme and the role of financial services regulation	HC 1074
Sixth Report	The administration of tax credits	HC 811
Seventh Report	European financial services regulation	HC 778
Eighth Report	Bank of England Monetary Policy Committee: appointment hearing for Professor David Blanchflower	HC 1121
Ninth Report	Globalisation: the role of the IMF	HC 875
Tenth Report	Independence for statistics	HC 1111
Eleventh Report	The Monetary Policy Committee of the Bank of England: appointment hearings for Professor Tim Besley and Dr Andrew Sentance	HC 1595
Twelfth Report	Financial inclusion: credit, savings, advice and insurance	HC 848
Thirteenth Report	"Banking the unbanked": banking services, the Post Office Card Account, and financial inclusion	HC 1717

Oral evidence

Taken before the Treasury Committee

(Treasury Sub-Committee)

on Wednesday 10 October 2007

Members present:

Mr Michael Fallon, in the Chair

Mr Graham Brady	Mr George Mudie
Mr Philip Dunne	John Thurso
Ms Sally Keeble	Mr Mark Todd
John McFall	Peter Viggers

Witnesses: **Mr David Barrass,** Deputy Master and Chief Executive (until 15 October), and **Mr Andrew Stafford,** Deputy Master and Chief Executive (from 15 October), Royal Mint, gave evidence.

Q1 Chairman: Mr Stafford, can I welcome you to the Sub-Committee. Can you introduce yourself and your colleague formally, please?
Mr Stafford: Yes, I am Andrew Stafford. I am the new Chief Executive of the Royal Mint, taking up my appointment with effect from next Monday, and David Barrass is the interim Chief Executive, still holding the post until I take over on Monday.

Q2 Chairman: I need to ask you what I will ask the new Chief Executive of the OGC. Mr Barrass has been Interim Chief Executive for nearly two years now, I think. Why has it taken two years for you to arrive, Mr Stafford?
Mr Stafford: It is fair to say that the process has been rigorous. I was only originally approached about taking up the appointment three months ago, so I cannot comment on what went on in the process prior to that time, obviously. David has obviously been running the business very successfully on an interim basis and I accepted the appointment less than two months ago and take it up with effect from 15 October.

Q3 Chairman: Your recent experiences seem to involve managing quite a lot of businesses which were then sold to other companies. Should we read anything into that about the future of the Royal Mint?
Mr Stafford: I do not think it has any bearing on Royal Mint. What I would say is clearly any business I have run I have run for the best interests of the stakeholders concerned and in both private equity and plc environments I have been able to realise the excellent finance performance on behalf of the stakeholders. My role in coming to the Royal Mint is, obviously, to do a similar job on behalf of the Government.

Q4 Chairman: You have not been put in to sell it off?
Mr Stafford: Absolutely not.

Q5 Chairman: What do you see as your priorities from Monday?
Mr Stafford: Starting on Monday, my priorities will be to build on the outstanding performance that David has achieved in the last 12 months in improving the profitability of the business through changing working practices, building the business through its the domestic and international markets and improving the overall operating performance of the business, and my task is to build on the successful platform that David has built.

Q6 Chairman: As you are still the Chief Executive would you like to add to that?
Mr Barrass: I am. No, I wish Andrew the best of luck as of Monday. It is nice of him to recognise that he has a very strong platform, which I think he has. I think we have an organisation that is absolutely fit for purpose now.

Q7 Chairman: We understand that. Mr Barrass, I have to ask you about your own remuneration which, according to the annual report, appears to have been organised through a service provider. Is that right?
Mr Barrass: That is correct.

Q8 Chairman: What does that mean and what proportion of the remuneration that is listed here goes to the service provider?
Mr Barrass: What you have in the annual report is not actually remuneration, it is my total costs. That is the costs of all my expenses, basically, and the fee that is paid to an agency that provides my services to the Royal Mint.

Q9 Chairman: That is the bit I am trying to get to. It seems that, with respect to both you and the interim finance director, your remuneration was paid to a service provider?
Mr Barrass: That is correct.

Q10 Chairman: Why was that?
Mr Barrass: It is normal with interim managers, which is what the finance director and I both are, professional interim managers, to be approached for

10 October 2007 Mr David Barrass and Mr Andrew Stafford

assignments through a third-party agency, and that agency then, in my case, handles the billing directly with the customer, in this case the Royal Mint, and then has a separate back-to-back agreement with myself.

Q11 Chairman: This is public money. What proportion of this remuneration ends up with a service provider rather than you?
Mr Barrass: I do not have the exact billing as regards the service provider, but I can find that out for you.

Q12 Chairman: Is it 10% or 20%?
Mr Barrass: Of the total amount?

Q13 Chairman: Yes?
Mr Barrass: Something in the region of 25%.

Q14 Chairman: Twenty-five per cent goes to the service provider?
Mr Barrass: Yes.

Q15 Chairman: These contracts with the service provider—I understand it was interim—are they profit-based? Was it dependent on you getting the Royal Mint back into profit?
Mr Barrass: Absolutely not, it is on a day by day basis. If you remember, last year I did describe myself as here today and gone tomorrow, and it was literally on that sort of basis. So I am charged on a daily basis. The meter runs, for example, five days a week.

Q16 Chairman: It does not seem a very efficient way of doing it, but that is because they could not find a new chief executive?
Mr Barrass: It was not just that they could not find a new chief executive, I think they were looking for specific characteristics to make an event happen at the Royal Mint in a fairly tight window and in private industry, and now, I think, we can demonstrate a good case study in the public industry, an effective way of doing that, is to bring a well-targeted interim manager in for a specific period, not on a results basis but with a clear objective in mind as to what that interim manager has to achieve during his time in post.

Q17 Chairman: But it all took a bit longer than you expected?
Mr Barrass: Very much so. My original contract was for five to seven months.

Q18 Mr Mudie: Could you tell us the name of your service provider?
Mr Barrass: EIM Interim Management.

Q19 Mr Mudie: Thank you. Where are we with this SLA agreement?
Mr Barrass: We now have an SLA agreement with the Treasury with effect from 1 April 2007.

Q20 Mr Mudie: So 1 April this year?
Mr Barrass: Yes.

Q21 Mr Mudie: Was it retrospective or last year were you paid on the previous year?
Mr Barrass: Last year we rolled over the previous years.

Q22 Mr Mudie: So you have now got one?
Mr Barrass: Yes.

Q23 Mr Mudie: According to the Treasury when they gave us evidence, they reckoned they had saved over one and a half million pounds renegotiating that service level agreement. Were they successful?
Mr Barrass: I think that is a question best placed at the Treasury.

Q24 Mr Mudie: But you are leaving!
Mr Barrass: I know and I am leaving on good terms with the Treasury, I hope. Even if I had the number comparable to that Treasury number, it would be wrong to give you it in isolation. The reason that the SLA negotiation has taken as long as it has is that it is not just about price. What I have tried to do (and it has taken a long time to get there) is bring all aspects of that contract in line with the way we do business with third party customers, and so it would be wrong to look at that contract as simply a price-driven contract.

Q25 Mr Mudie: What sort of proportion of increase did you get compared to the last SLA?
Mr Barrass: The last SLA contained a formula for annual price increases, which I believe was minus two. What we have for this year and for next year—it is a two-year SLA that we have in place—is a fixed price change but also some other terms and conditions that are changing as well.

Q26 Mr Mudie: I remember at some stage we had some difficulty getting the details and you gave it to us in writing because of the confidentiality. Was this what we were talking about then?
Mr Barrass: No, it was not.

Q27 Mr Mudie: This year you returned to profit. How did you manage that, apart from making 70-odd good workers retire?
Mr Barrass: If I can answer that by not falling into the mantrap. First, I did not make anyone retire, they were all volunteers, 100%, man and woman. How did we turn the Mint round? It has been very hard work, but what we have moved to is an organisation that now has a very clear commercial focus from the very top all the way down through the business. We have the top tiers of management, who all individually recognise the P&L impact, the balance sheet impact and cash impact of every decision that they make and we are now in a position where they get appropriate reporting in a timely fashion to inform them on their business decisions. So we have now got a very commercial, vibrant Royal Mint.

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Q28 Mr Mudie: We noticed from the annual report that you have had a pretty serious turn-over of senior management. Could you tell us about the effect? How it has settled down.
Mr Barrass: The effect, as I predicted last year, was not so much a risk as a huge opportunity. I was unlucky enough to lose my finance director within weeks of joining and I replaced him with an interim, Mr Allred. Some of the others have resulted from retirement. We had one director retire, then we had another take early retirement under the restructuring, but what that has given me is an opportunity, and what I have done is bring in interim managers that bring in guys who are very talented, very skilled, to support me in the turn-around. The reason I have brought in interim managers rather than permanent guys is that, knowing that we were about to appoint a new CEO, Andrew, as it turns out, it now gives Andrew the opportunity of replacing those guys in a structured way over the next perhaps six or nine months and bring on board the team that he wants to work with. So, by the end of six or nine months, we should have Andrew's team of full-timers fully in place. I think it has been a huge opportunity for the Royal Mint.
Mr Mudie: One of my colleagues wants to ask a question on something I have asked.

Q29 Ms Keeble: It was about your efficiency savings programme, which was 2.9 million?
Mr Barrass: I am not sure what the 2.9 million would refer to.

Q30 Ms Keeble: According to the Treasury evidence, it expects to find most of the 2.9 million efficiency savings from the agreement with you. What figure would you put for your efficiency savings then?
Mr Barrass: I am not sure of the context in which the Treasury gave you the numbering. Certainly in terms of the benefits that we have got from the Better Working Programme that we introduced, the savings are significantly higher than that, and I mean significantly higher.

Q31 Ms Keeble: What are they? Would you like to run through them? Presumably from the Treasury point of view they were putting what their targets were and you are putting what you can achieve through increased efficiency. So, if you can save more than the Treasury says you should, it would be very interesting to know what you think you can achieve and how you achieve it?
Mr Barrass: I am happy to do that but I would want to avoid any confusion that my savings were part of a Treasury pool of savings, because my savings end up coming through in terms of profit and then through dividends which end up in a different Treasury pocket, so to speak, but we are looking at significant savings in these three areas. The manpower area—the 72 good men who volunteered to leave us—in terms of purchase efficiencies, which are very significant for us, we have had some huge success with those and in terms of sales benefits in organising the sales area in a different way and we are getting a much bigger effect from those as well, and we have not got a final number yet. We are still implementing a lot of those changes, they are still coming through, and I would expect them to continue to come through over the next six months. Some of these are very long burn. Some of the purchasing savings, for instance, we want to have captured come Christmas, although we have a very good idea as to what they are.

Q32 Ms Keeble: Can you give us a percentage to the efficiency savings that you have achieved, just so that we can get some idea?
Mr Barrass: It is very difficult, because it is a volume driven business. I guess if you are looking for a straight percentage, it is probably easier to look at the number of heads that we started with and the number of heads that we finished with. It might not be an exact way of getting there, but when we started the Better Working Programme at the beginning of August we had 924 heads at the Royal Mint, both casuals and permanents. That was at the beginning of August 2006. By the end of 2007, in September, we had 743 employees, but some of that will be volume-related because the volumes change in our business all the time.

Q33 Ms Keeble: How about in your procurement and working practices. You identified that there were savings there as well. How did you achieve those and how would those project on?
Mr Barrass: Basically we have taken every line of our purchasing spend and challenged it, even the areas where people told us we could never make any savings. Off the top of my head, we are probably looking at 15–20% savings on purchases.

Q34 Ms Keeble: That leads on to a couple of points. In terms of the staffing issue, in quite a short space of time it is very big reduction in workforce?
Mr Barrass: Yes.

Q35 Ms Keeble: It would be very interesting perhaps if we can have a note as to how you achieved that in terms of agreements and whether you had projections as to the number of staff you wanted to shed. You know, the kind of human resources strategies that you had put in place and the agreements and so on. Perhaps we could have that in a note.
Mr Barrass: I am happy to give you that now if now would be good for you.
Ms Keeble: It is really if the Chairman is happy in view of the time.

Q36 Chairman: Is this voluminous?
Mr Barrass: How voluminous would you like it to be?

Q37 Chairman: We have got a lot to get through; that is all.
Mr Barrass: I will give you a two minute version and if you need more after that I will be happy to provide it. Basically, we did not have a target headcount number, we approached from the bottom up and what we did was we opened up every department

and every workforce team that we have got, both the industrial workers and the non industrial workers; and we looked at every process that goes on in the Royal Mint and we addressed each one individually and looked at how we could improve that process; and in some places we were able to cut out total workflows that had been there 20, 25 years and were no longer adding any value to the Royal Mint and eliminate them. As we went through that process, working with the workforce and with the trade unions, it was 50-week programme but we had the headcount sorted by round about week 35. We were then able to see how many heads we needed to run the processes that we were left with after we had cleaned them up.

Q38 Ms Keeble: Did you lose any days or time through industrial action?
Mr Barrass: No, we did not. The real good news from a social perspective is that there were no compulsory redundancies, we had the unions with us all the way through. I had regular monthly meetings with the trade unions, bringing them up to date with what was going on and the whole thing was really a copybook way of re-organising our workforce.

Q39 Ms Keeble: How do you expect this to go forward now? What do you expect to see? Will the savings continue or do you think you have got out of it what you can?
Mr Barrass: I think we have got two levels there. What we have done is we have taken the performance of the Mint up a real step-change, I mean a really big step-change. Because of the long burn nature of particularly some of the purchasing savings, we have got another step to make, albeit not as big as the step that we have gone through, and thereafter I would expect to see a slow incline in performance. One of the things we have done with the Better Working Programme team—that is the team that was made up of Royal Mint employees—is we have kept a core of those together in what we call the Continuous Improvement Team and even today they are chipping away and making incremental improvements to the programme.

Q40 Ms Keeble: One last thing so I can understand the nature of the purchasing. Could you give one example of the kind of change you made on the purchasing side?
Mr Barrass: Waste disposal is a big deal for me; it is quite a large ticket. We addressed what we actually needed in terms of waste disposal through a third-party, we defined it very tightly and we put it out to competitive tender and we came back with a vastly reduced bill simply by putting it out to blind competitive tender. I know you only asked for one example, but if I can give you another. We are now heavily using e-auctions for a lot of our purchases and we are finding that is an incredible way of getting good value, good quality and at a really excellent price.

Q41 Mr Mudie: Can I go back to your staffing. You would expect this from me as an old trade union official, but the accounts seem to show that you just lost production staff. Your admin staff actually increased and your sales and marketing stayed the same; so all the sacrifices came from the industrial workers it seems to me.
Mr Barrass: I am pleased to be able to tell you that that is not the case.

Q42 Mr Mudie: The figures are here.
Mr Barrass: Yes, but there are two things going on behind there. One is, when I arrived in January, as you would expect, an interim manager coming into a troubled business, I put a headcount freeze on straightaway, and that headcount freeze always hits the admin people because you cannot headcount freeze the production people because you have got to produce volume. So, when we ended the programme, we had a significant number of vacancies that were unfilled and a lot of those jobs disappeared and there was no headcount damage to it. The other thing is that on the year end numbers that you have there, there were a lot of people in the finance area, for example, who we wanted to keep on through the year-end audit and finish the accounts off because we needed their corporate knowledge, who did not leave until May or June.

Q43 Mr Mudie: All right. The Chairman's statement mentions a profit of 2.3, which I can find. Your report quotes an operating profit of 8.7. The actual accounts say a profit of 1.2. Yours is the one I cannot find, the 8.7.
Mr Barrass: The 8.7 is operating profit before exceptional items and interest.

Q44 Mr Mudie: Which is the most useful that we will have young Andrew examined against when he comes next year.
Mr Barrass: Young Andrew, as you describe him, when he arrives next year, assuming you invite him—

Q45 Mr Mudie: Oh, he will be invited.
Mr Barrass: —will still have a small number of exceptional items because they are carried over from the programme, but once you get on to an even keel and those exceptional items disappear, then really you are looking at an operating profit, less interest, and I think that is where you should be looking. Operating profit is how you run the business day to day, and that 8.7 million is absolutely my headline number, but I would also say that you have to look at interest because the interest line tells you how you are managing your balance sheet. So, when I talk to my top team, the hybrid number I talk to them about is actually the operating profit less interest, because they can affect the interest line.

Q46 Mr Mudie: We see that the collector coin business is increasing your proportion of profitability?
Mr Barrass: Yes.

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Q47 Mr Mudie: And circulating coins seem to be left behind. Why? Also, looking at your accounts, you seem to be losing overseas business in a big way. Could you comment on that and, secondly, does that not mean that you are more dependent on the Treasury business than ever before?
Mr Barrass: If I take that one first, no, we are not. The nature of the circulating business is that it is a tender-driven operation and overseas monetary authorities will come into the worldwide market maybe for a six-month period, buy hundreds of millions of coins and then we will not see them for two years. So, if you look back over the years on our accounts, you will see that overseas UK mix going up and down depending on which tenders have come to the market. One of the things I have done to protect the profitability of the Mint is I have moved the philosophy of the Mint away from a volume-driven manufacturer to a profit-making manufacturer, and so there will be some elements of overseas business that I will no longer want to have because we were never making sufficient margins.

Q48 Mr Mudie: Thank you.
Mr Barrass: That is the first part of your question.

Q49 Mr Mudie: No. Who am I to stop you there!
Mr Barrass: I am on a roll; this is my farewell! The collector side has been a huge success. I am really proud of what the guys over there have done. We have got a great team on the collector side of the business, but one of the things that we did, we had a hard look at our product array there and you may have seen in previous years' accounts a product range referred to as "classics". That classics product-line no longer exists. We have eliminated that. In my mind it was not in line with our brand strategy, it was not profitable enough and we are a much healthier business for not having that. The other thing we have done is we have focused on profitability and added value on our collector side, and so, although the turnover does not seem to have risen too much, that is because we have got a huge mix change going on there. We are taking a lot of the low profit items out from the bottom and we are adding in a lot of high profit items at the other end, and so, for something like a 5% or 6% increase in turnover, you are getting something three-figure improvement in contribution to the bottom line.

Q50 Mr Mudie: As your circulating coins has gone on, particularly in the UK, that must be the scenario. Have a look at your service level agreement. That agreement is just cutting costs, is it?
Mr Barrass: Yes, it is a more efficient operation.

Q51 Peter Viggers: Basically you are a manufacturer?
Mr Barrass: Yes.

Q52 Peter Viggers: With globalisation, with lower cost countries coming in and undercutting the market flows in higher cost countries, what is your percentage of the market at the moment to the main competitor and how do you see the situation evolving in the coming years?
Mr Barrass: We would estimate that we have about 15% of the worldwide available market. There are some areas of the world that are not available to us, like the US, who do all of their coin manufacturing in-house, but of the available market we believe we have something in the region of 15%.[1] By the nature of circulating coin, it is very highly capital intensive and so where you get countries that have a very low wage rate they do not have anything like the leverage over us that we would have in a more manpower-driven business. It is really the fixed assets that drive the business, and we all pay the same price for the fixed assets. Where do I see the market going? I see it moving technologically. We are already seeing movement away from homogenous coins, ie just a solid lump of metal, to a plated steel coin. It is much cheaper to purchase. It is not cheaper to make—it costs me more to make it at the Royal Mint—but in terms of actual metal content, steel being significantly cheaper than nickel, copper and zinc, which tend to be the constituent parts of homogenous coins, I think there is a worldwide trend away from homogeneous into plated, and then within the plated I see a movement from copper-plated, like our 1p and 2p coins are, to nickel-plated which a lot of overseas countries are now moving to. They look more acceptable, they are shiny, they do not tarnish, they look like valuable coins, although really what you have is a nickel-plated steel coin. We are very well placed to do that in the UK. We would recognise ourselves as leaders in terms of nickel-plating of circulating coin in the world right now.

Q53 Mr Brady: As a trading fund, Royal Mint, I understand, is required to break even, including covering losses from previous years. What sort of profit figure do you need to make in 2007–08 to achieve that?
Mr Barrass: I do not think we quite approach it in that way. I understand the premise of the question, and it is right, but we do not approach it that way. Being effectively a private sector man in upbringing, it is my intention to grow the profit as far as I can and not just level off when I have been paying for previous losses. One of the things that I think was a concern when our annual report was produced and people saw this wonderful profit that we made was: how sustainable is that? The answer is very sustainable. Because of the way that we have gone in and made the business much more fit for purpose than it was previously, we have addressed it on a fundamental basis, and certainly this year, and we are six months through the year now, we are in, let us say, better shape than we were a year ago at the six months stage, and I would expect in five years time, if Mr Mudie invites this young man to my right along to this Committee, on the bar chart we see in

[1] *Note by witness*: Correction: The Royal Mint has 15% of the world-wide market; the Royal Mint has 50% of the available world-wide market.

the accounts you actually see a consistent growth through there and not the higgledy-piggledy ups and downs that we have had over the last five or six years.

Q54 Mr Brady: We are halfway through the current year. What kind of profit outturn do you expect for the full year?
Mr Barrass: I do not want to hang Andrew on a specific number, but I expect to do better than last year.

Q55 Mr Brady: How long will it be, would you expect, before previous losses are recovered?
Mr Barrass: We are now making a profit that is such a multiple of the loss years that we will be there in a year two years' time. We really are cooking on gas down there.

Q56 Mr Brady: Originally the target average rate of return that was set by the Treasury was 11%.
Mr Barrass: Yes.

Q57 Mr Brady: Why was a much lower target rate set for the last year of only 2.9%?
Mr Barrass: I think if you go back to the turn of the century when the 11% target was given as a five-year target, it was an aspirational target, it was a medium-term target, and I think in any industry when you have got that end game what you need to do each year is lay the stepping stones down to take you to that, in this case, 11%. The problem is each year, as you set the next stepping stone, you have to recognise where you actually are, and if you look back over the first five years of this century you will see that sometimes we were actually further back than we had been the previous year. When it came to setting the 2.9% target the minister at the time and myself, who had only been in the job maybe six or eight weeks at the time, agreed a target that I thought was stretching but achievable. To have given me an 11% target would have been meaningless, because I would have known there was no way on this earth that I would have made it. That is the skill in target-setting, I think, and I think a target of 2.9 and an actual outturn of three, we did not do a bad job.

Q58 Mr Brady: I was not on the Committee at that point, but last year I think you said the 11% target was not an unrealistic target. Now you are saying it is an aspiration target.
Mr Barrass: No, I think it was an aspirational target back then. If you take the exceptional costs out of last year's performance—the redundancy costs and the other costs of running the Better Working Programme—the number that we actually hit last year was 12.6%. So, I think the 11%, as I did say to this Committee last year, is not an unreasonable number at all.

Q59 Mr Brady: Next year your target rate will increase, I think, 7.2%. How much of a challenge will that present or are you confident it can be achieved?
Mr Barrass: At the time we put the plan together that looked like a good challenging target. I am very confident sitting here, and again I do not want to rain on Andrew's parade, but we are going to over achieve against that quite substantially.

Q60 Mr Brady: In the annual report it is noted that, due to the hedging policy of Royal Mint, the full impact of metal price rises is yet to be realised and that these rises will be likely to increase the Mint's working capital requirements by five million. What kind of pressure is this going to put on achieving 2007–08 target?
Mr Barrass: The pressure that metal price gives us is a working capital and a balance sheet and cash flow pressure, it is not a P&L pressure, because the cost of the metal is passed straight through to the customer. What that note there is referring to, as metal prices go up, and at one point I think copper was ahead by 40%, it was up by 40% in price and nickel was up by 70% in price, and although that did not worry my P&L as such, because that gets passed through to the customer, having to hold thousands of tons of metal, that cash is all tied up. So what we were seeing was a real balance sheet pressure but no P&L or very little in the way of P&L pressure.

Q61 Mr Brady: Do you find customers delay orders, particularly overseas customers, if metal prices are high?
Mr Barrass: No, I think what it does is it drives them to look at different make-ups of coins and it will drive them away from the homogeneous into the plated-steel product.

Q62 Mr Todd: Presumably all your competitors have the same problem of purchasing inflated cost metals?
Mr Barrass: That is right.

Q63 Mr Todd: Your competitive advantage lies in your skill in doing that more effectively than they do?
Mr Barrass: Yes.

Q64 Mr Todd: Have you developed new systems for purchasing your core raw materials?
Mr Barrass: Yes, we have and we have even challenged the way that we buy nickel and copper, because everyone told us that LME prices is where you have to go and the premiums associated with them, and we have actually found a way to get reductions on those prices too. We really have left no stone unturned in terms of looking for purchasing improvements.

Q65 Mr Todd: How powerful a brand is the market?
Mr Barrass: It is now an immensely powerful brand. It was almost a sleeping giant two years ago before we did the branding work that we have done. I was recently at an international show in Milwaukee which the great and the good of numismatic industries attend and the impact our brand has had on the world has been quite remarkable.

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Q66 Mr Todd: Arguably a neglected asset?
Mr Barrass: It had been, yes. I would not be too embarrassed to describe the Royal Mint as the pre-eminent mint in the world right now.

Q67 Mr Todd: I think you are right in that. There has been a brand strategy review recently, has there not?
Mr Barrass: Yes.

Q68 Mr Todd: What has emerged from that other than what we have just discussed, which is that you have not been playing to its strengths in the past?
Mr Barrass: I think whereas it did not give us any outright surprises, it has confirmed a lot of what we would think of instinctively. What do people want from the Royal Mint? They want quality, prestige, craftsmanship and heritage. Britishness came out very high in the review and is very important to some of our overseas customers. That is certainly the case when I go on overseas exhibitions. Just the fact that we are British has such cachet, to use a French word to describe Britishness, it really does carry a lot of clout

Q69 Mr Todd: Rather aligned to that, George has already questioned you about how you rebalanced your staff and, I must admit, I was rather encouraged to see your increase in headcount in sales and marketing because I would assume that is precisely aligned to the point I made, which is that we have not been selling what we do nearly powerfully enough. Is that what the analysis showed, that you needed more resources in selling what you do?
Mr Barrass: I think it showed us where to apply ourselves and it showed us what our customers' aspirations were for us and we were able to align with those. Also, from an internal point of view, I like to treat sales as a science, not some sort of art form or witchcraft. I like it measured, I like it structured, I like journey plans for customers and to implement all of that takes headcount. The result of that, what has it bought us? I have had several nice letters sent from competitors and customers from around the world in the last few weeks, but one of them hit the nail on the head when he said that in the last couple of years he had noticed a huge rise in self-esteem of the Royal Mint as a brand?

Q70 Mr Todd: Which happens when you sell a brand properly.
Mr Barrass: If that is high praise, I will take it.

Q71 Mr Todd: You have cut your production capacity in staffing terms, is there any difficulty about dealing with a rising volume of demand in production terms? You have presumably built that into your systems?
Mr Barrass: Very much so. We now have a much more flexible approach to manufacturing. We are much, much more efficient. There are lots and lots of anecdotes, which I will not have time to share with you this afternoon, from the Better Working Programme, but one of them was, there was a particular department where we actually reduced the headcount on a Monday and by the following Friday we found production had increased despite the fact that we had taken the headcount down. We are a very efficient and effective manufacturer now.

Q72 Mr Todd: You have spent some serious money on consultants, has that all been put through your P&L? Is there some more to come?
Mr Barrass: It had not all been put through the P&L by the annual report, there is some more to come this year. It is now finished, but you will not see it until the next annual report.

Q73 Mr Todd: Because I think the declared amount is about £1.5 million or something like that.
Mr Barrass: I think it was about £1.4.

Q74 Mr Todd: There is a bit more to come through?
Mr Barrass: There is, yes.

Q75 Mr Todd: How much roughly?
Mr Barrass: In total, you would still be shy of £2 million when we finish the whole thing.

Q76 Mr Todd: So about another £600,000-ish?
Mr Barrass: Perhaps something of that order.

Q77 Mr Todd: The movement to a government owned company status was put on hold by the uncertainties over—
Mr Barrass: By me.

Q78 Mr Todd: Yes, by you but also by the financial performance of the Royal Mint at the time.
Mr Barrass: Very much so.

Q79 Mr Todd: What timetable are we now working to?
Mr Barrass: When you look at vesting, as you rightly say, the first gate you have to go through is have you got a going concern? Clearly we did not have. We are now in a position where we can drive straight through that gate. The next gate you need to get to is do you have a stable management team, especially at board level, and do they have a vision for taking the business forward? I think with Andrew's appointment on Monday we are at the first stage of that gate and we have now got to let Andrew put his management team in place and draw their own vision. He will inherit my five year plan, but he will need to develop his own vision for the business. When you have got a going concern, high levels of cash being generated, a vision and a stable management team, at that point, and not before that point, can you look at vesting the company.

Q80 Mr Todd: Can I ask Mr Stafford to comment on that because that is about the future orientation of Royal Mint in his timeframe? Where are you thinking you will be?
Mr Stafford: I think realistically we have to complete the current financial year, which will take us through to April next year. That coincides very much with David's timescale for me to review the management requirements of the business. I am inheriting a

situation where there are a number of interim senior managers. They need to be either persuaded to stay on a long-term basis or if new management is required, I will have to bring them in and realistically that will take about six months to be completed, which will coincide with the financial year end. The timescale which is realistic is to envisage us starting at the beginning of the 2008–09 financial year. Clearly that is not my decision, it is a decision for ministers as well as to the timetable for vesting, but I think that is a realistic timescale and one to which I aspire.

Q81 Mr Todd: Do you anticipate a position where the Royal Mint might face direct competition for the UK's coinage in your new status as essentially a company which must compete for its full range of products? Is that something which is in your vision for the future?
Mr Barrass: From the conversations we have had with the Treasury so far, there is a recognition that with the level of fixed assets which would be vested there would have to be a level of protection in terms of future service orders for a fairly lengthy period of time, otherwise there would be no attraction.

Q82 Mr Todd: You would think that some sort of deal in which the orders were guaranteed for a period would be a vital precondition of vesting?
Mr Barrass: It is the only way you would continue with a going concern at the point of vesting.

Q83 Mr Todd: The figures are in here, but what proportion of your turnover is—
Mr Barrass: Something in the region of 25% of our circulating coin is UK coinage.

Q84 Mr Todd: What is your turnover as a business?
Mr Barrass: Something in excess of 25%.

Q85 John Thurso: You talked a moment ago about the board having a vision to take it forward, I note from the remuneration report that your non-executives appear to be paid about £9,000 a year and the Chairman seems to get about £20,000 odd a year. Is that sufficient remuneration for the sort of quality of non-executives you need?
Mr Barrass: One, I do not think it is and you are right to raise that as a concern. The report refers to last year's remuneration. We have changed the remuneration for this year because we will be looking for new NEDs and that remuneration is very different from last year's.

Q86 Mr Todd: Do I have to wait until next year to find out or can you tell me?
Mr Barrass: I am not going to share that with you now, but it is now at a level which absolutely gives us the opportunity to bring in the right talent at NED.
Chairman: Any further questions?

Q87 Peter Viggers: You were talking about buying procedures and I wonder the extent to which you are indebted to the Office of Government Commerce for improving your buying?
Mr Barrass: All of the purchasing and all of the savings we are driving through the Better Working Programme have all been driven from in-house initiatives. Some of it came from the consultants we were using to help us implement it, some of it has come from specific interims we have brought in at a period in time to have a very rigorous attack at our purchasing base.

Q88 Peter Viggers: I wonder if you feel the Office of Government Commerce has been valuable to you?
Mr Barrass: I am not throwing any stones at the OGC at all, but on this occasion we have pretty much cut our own furrow and I think the team back at Llantrisant have done a pretty super job at it.
Chairman: We are going to leave it there. Mr Stafford, can we wish you well in your appointment. We look forward to seeing you here next autumn to report on how you are getting on. Mr Barrass, we say farewell to you. We certainly also say thank you, you certainly seem to have made a very real difference to the performance of the Royal Mint. Thank you very much.

Wednesday 10 October 2007

Members present

Mr Michael Fallon, in the Chair

Mr Graham Brady	Mr George Mudie
Mr Philip Dunne	John Thurso
Ms Sally Keeble	Mr Mark Todd
John McFall	Peter Viggers

Witnesses: **Mr Nigel Smith**, Chief Executive, **Mr William Jordan**, Deputy Chief Executive, and **Ms Alison Littley**, Chief Executive of OGCbuying.solutions, Office of Government Commerce, gave evidence.

Q89 Chairman: Mr Smith, welcome to the Treasury Sub-Committee. Could you identify yourself and your colleagues formally for the shorthand writer, please?
Mr Smith: Yes. Good afternoon. I am Nigel Smith, Chief Executive of OGC, to my right is William Jordan, my deputy, and to my left is Alison Littley, Head of OGCbuying.solutions.

Q90 Chairman: Can I ask you all to speak up this afternoon as we have a technical problem with the sound system. If you could speak up, we would appreciate it. You are the new Chief Executive. What particular qualifications do you bring to this role?
Mr Smith: I come from private industry. That is not a particular qualification, but I think I have some knowledge of basic business process which would be useful to OGC going forward.

Q91 Chairman: What do you see as your priorities for the coming year?
Mr Smith: Our priority for the coming year is to tackle two questions. What does government want? Firstly, it wants more for less in terms of more value for less money. Secondly, it wants the right projects delivered on time and to a high quality. In addition, obviously there is a separate agenda for the effective use of the Government property estate.

Q92 Chairman: The OGC has been without a permanent chief executive for nine months. Why did they take so long to find you?
Mr Smith: You would have to ask the people that recruited me; I am sorry.

Q93 Chairman: But when was it advertised? When did you apply?
Mr Smith: I was head-hunted about four or five months ago and the panel process took about two months.

Q94 Chairman: Last year the OGC published its own report and had a separate section within the Treasury's departmental report. This year there does not seem to be a separate report; there is only a very brief mention in the Treasury's report in relation to reporting on one of the targets. Why have we got less reporting on OGC now?
Mr Smith: I am afraid I cannot answer that.
Mr Jordan: We are going to report formally as part of the Treasury group in future. It is also our intention to publish each year a report on the activity of OGC, but our intention is to publish a report in January on the anniversary of *Transforming Government Procurement*.

Q95 Chairman: But that means we have missed a report for 2006–07.
Mr Jordan: I think the report we published last year covered both 2005–06 and 2006–07. I think we published last year's report to cover two years of OGC activity.

Q96 Chairman: How could you report on a year that has not finished?
Mr Jordan: I think you must be right, it must be the two previous years, but there was a year that went by without an OGC annual report.[1]

Q97 Chairman: The Information Tribunal has twice upheld the ruling of the Information Commissioner that you should release documents relating to the Gateway Reviews of the ID Card Scheme and the NHS IT programme, and its last ruling stated, "We find it difficult to accept that the OGC is really convinced by the arguments put forward on their behalf." Why are you so opposed to releasing these reviews?
Mr Smith: Can I make a personal comment about my attitude to disclosing information? Firstly, I do believe in public accountability; I also believe in private accountability; but I also believe that it is important that you maintain the integrity of the processes where you have a failure, that you have an open and robust process for investigating why the failure happened and then what you do about it.

Q98 Chairman: So, what is the answer to my question? Why are you still so opposed to releasing these reports?
Mr Smith: I do not think it is appropriate for me to talk about a court case which is coming up next year.

Q99 Chairman: Who should talk about that?
Mr Smith: I believe it was a decision of government to take the case to the High Court and that is scheduled for March of next year.

[1] See Ev 69

Q100 Chairman: But these are your documents. You are the Chief Executive?
Mr Smith: Yes, I am the Chief Executive.

Q101 Chairman: So why are you relying on the Government's decision?
Mr Smith: Well, the decision was not taken whilst I was here, so I am afraid I cannot really add anything to the reasons for it.

Q102 Chairman: I see. The OGC has been accused of actually shredding documents.
Mr Smith: Yes.

Q103 Chairman: Is that true?
Mr Smith: As I understand it, that is not true. Having read the report and also the accusation, I believe it was what is called version control, but I do not have any specific detail on that.

Q104 Chairman: The Health Secretary today made a statement on the increasing funding for the Health Service, and one part of that statement said, "Improving procurement could save one billion a year." Is that evidence based?
Mr Smith: I have not specific information about the Health Service, but what I can say is that if you have a look at the effect of procurement within the Government's overall efficiency targets, the original target was to save, I believe, £7.1 billion within an overall efficiency target of £21.5 billion. If we look at where we are today, the procurement element is at £6.9 billion, which has still got about a year to go. I can only presume that there is a significant proportion of that within the Health Service, from the Health Service, yes.

Q105 Peter Viggers: Your CV describes you as a second permanent secretary at the Treasury.
Mr Smith: Yes.

Q106 Peter Viggers: Are there other second permanent secretaries?
Mr Smith: In the Treasury? I do not believe so, but I have to say, I am not too well up on government grading.

Q107 Peter Viggers: So how will you divide your time? How much time will be taken by being a second permanent secretary at the Treasury and sitting on the Treasury Board compared with the time you are spending at the Office of Government Commerce?
Mr Smith: I anticipate it will be 95% of my time on OGC business and the Treasury Board, obviously, is once a month. That is my attendance.

Q108 Peter Viggers: The Office of Government Commerce has been described by a newspaper as a shadow of its former self. It had a very grand mission statement to improve efficiency across government and now it is a buying department. Can you summarise for us the key activities for which the OGC will now be responsible?
Mr Smith: Yes. Really there are three major areas. The first is getting better value government procurement spend from third parties. That totals about £125–150 billion. Of that about £75 billion is on common goods and services and, obviously, one of the key roles of OGC is to drive the move towards collaboration in terms of procurement right across government, the second area is within the project space, making sure the right projects are there, they are delivered on time and to budget, and the third area is the better utilisation of the Government property estate.

Q109 Peter Viggers: From being an autonomous organisation with a staff of 400 you have now been shrunk to a staff of 150 with responsibility for buying. Do you regard the OGC as still being autonomous?
Mr Smith: I believe that the OGC was previously described as an independent office of the Treasury, and that was what I was told it still is, so, yes, within the Treasury it has an autonomous, independent role. In terms of numbers, it has gone down from roughly about 500 people, about 450 people, down to 250 people by the end of this year and is projected by 2010 to go down to 190 people.

Q110 Peter Viggers: The *Transforming Government Procurement—First 100 Days* document published in July this year, I understand, refers to "new powers" to require departments to use your frameworks and collaborative deals. Are these legal powers and, if not, what is their status?
Mr Smith: I could not really say whether they are legal powers, but certainly the powers relate to comply or explain principally in the area of collaborative procurement. Could I perhaps just say, though, that my approach is that powers are really not the issue. I believe what is the issue is getting a common grip of what needs to be done across government, and that will be through engaging the spending departments in getting those targets achieved.

Q111 Peter Viggers: The substance and function of these 12 existing frameworks and collaborative deals: what do they require of departments?
Mr Smith: I think the collaborative deals you are talking about were basically existing framework deals, and these were put out to the spending departments and said, "Okay, you have got your own deals. Have a look at these deals. These deals are going to provide you with better value for money."

Q112 Peter Viggers: How do you justify telling other government departments to utilise your services when your procurement specialists, OGCbuying.solutions, have recently been criticised by the National Audit Office for lacking expertise and effectiveness?
Mr Smith: I will ask Alison to make some comment on that in a second, but I do believe that driving up capability is important, not just for the spending departments, it is also important for OGC. One of

the themes of reducing the number of people within OGC partly was to take away certain responsibility, such as the efficiency programme, but also it was to have a smaller number of higher qualified, better trained people that could actually speak with authority within the spending departments.

Q113 Peter Viggers: Three of the 12 frameworks which the OGC appears to be compelling departments to use are due to expire in the first half of 2008, and you are not encouraging departments to repeat the success of the reverse e-auction which saved £100 million. How do you explain that you are pushing departments to use frameworks which will expire but not pushing the pews of procedure which appear to be very successful?
Mr Smith: As I understand it, this was basically to kick-start the use and publicity of existing agreements. That is not the only work programme underway within OGC. We have a number of important pilots which we are engaged in at the moment, including energy, including office services and a number of others, so this was really not to be the end of the story rather the beginning.

Q114 Peter Viggers: How do you ensure that government departments use the OGC as you would wish them to? How do you encourage them to adopt your frameworks.
Mr Smith: I think, basically, we provide things which they see as useful, that we engage with the departments. We are with them the whole time. In terms of my responsibility, one of the most important ways of doing that is through the Government procurement service. At the moment I am head of profession for the procurement service and also for the PPM, which is the programme and project management profession, and I believe that actually driving increased skills and capability through the professions is one of the important ways of engaging the spending departments. As I said before, the issue of power is important to have there in the background, but if it is purely OGC telling the spending departments what to do, in my experience, in private enterprise that does not work. You have to show real value to the spending departments and in some ways perhaps the bright, silver lining, from my point of view coming in at this stage, is that, looking forward over the next three years, there is obviously going to be a tighter control on spending, there will be an even greater imperative to get benefits out of collaboration.

Q115 Peter Viggers: How do you interrelate with the Major Projects Review Group? Are they not tasked to do what OGC was tasked to do?
Mr Smith: No, I think it is complimentary to the OGC's task. If we look in the project space, there is some extremely good practice and process. The Gateway Reviews, which I knew about before I came in, in my experience, is an extremely strong process, the Major Projects Review, basically, which I sit on and is chaired by the Treasury, is the sign-off of expenditure. It is to look at three stages: firstly at the business case, secondly at the point when you put out to tender and, thirdly, when the contract is signed. I think that is a natural process that government should have. It is exactly the same process you would have in private industry. Gateway does also look at the business case. There is a gateway process that is used by the departments in developing their business case looking at the right issues—looking at risk management, looking at value for money—and then gateway follows on from the Major Projects Review, which is saying, "Yes, spending is approved for this project", and takes it right the way through until the project has been complete.

Q116 Peter Viggers: Was not the OGC as originally created intended to cover the control of major projects?
Mr Smith: Yes, it was and it still is. The Major Projects Review Group is purely to sign off the expenditure at the time that it is put out to contract.

Q117 Peter Viggers: Are you managerially responsible for the MPRG?
Mr Smith: No, I sit on the MPRG. It is a process of the Treasury chaired by John Kingman.

Q118 Peter Viggers: I find it surprising that a second permanent secretary should not be responsible for that area.
Mr Smith: That is the organisation that has been set up. I would say also, OGC provides the evaluation and assessment of the projects to that committee. I did, in fact, chair the committee on a recent MPRG two weeks into my tenure.

Q119 Mr Dunne: Have you had an opportunity yet, Mr Smith, to review the effectiveness of the framework agreements in terms of delivering best value?
Mr Smith: No, I have not, but that is on my agenda.

Q120 Mr Dunne: Because the Public Accounts Committee report into OGC buying.solutions was quite critical about the effectiveness of the whole framework regime, there are a plethora of framework agreements. Most of the procurement seems to have been directed through a smaller number of them and there are allegations from competitors that these are being used to featherbed OGC in terms of the revenue raising from the commissions achieved compared with achieving best value for the taxpayer. How would you respond to those allegations?
Mr Smith: I would like Alison to respond.
Ms Littley: It is true that as part of the PAC Report we were asked to look at the tail, if you like, of the number of frameworks. Since the PAC inquiry an internal review is underway, and we will need to stop some of the frameworks that we currently do. The dilemma we have always is that somebody uses all the frameworks, and what we have to make sure is that in stopping them, if they are not creating the best value, we make sure that the people who are

using them have other places to go and that we do not just leave organisations with no mechanism. So that is being done.

Q121 Mr Dunne: Your organisation receive a commission for procurement through the framework agreements. Is it right that that is point seven of a per cent?
Ms Littley: It is, on average, point seven from the suppliers—

Q122 Mr Dunne: Do you receive commission from procurement not using the frameworks?
Ms Littley: Sorry.

Q123 Mr Dunne: If you negotiate with another party which is outside the framework agreement, do you also get a commission from a government entity for helping with that contract?
Ms Littley: We only get commission on frameworks that are utilised.

Q124 Mr Dunne: Do you, therefore, have a commercial conflict of interest in the work that you are doing by encouraging government entities to buy through frameworks even if that is not the best value for the particular supply they are looking for?
Ms Littley: No, because the role of core OGC in terms of running the collaboration agenda, if you like, is about looking across the whole of government as to which are the most sensible and cost-effective frameworks for people to use, and, indeed, in the initial 12 that were spoken about earlier, they were not all buying.solutions frameworks, they were a mixture of frameworks that have been provided by many different organisations and the funding for core OGC has nothing to do with the funding that comes out of the frameworks from buying.solutions, which is in itself a trading fund.

Q125 Mr Dunne: What proportion of the costs of buying.solutions are covered by the commission income?
Ms Littley: We get no central funding at all, so buying.solutions has to stand on its own two feet in terms of making sure that we are offering things that other departments—

Q126 Mr Dunne: So you have a direct commercial interest in steering government purchasing through framework agreements. That is your whole raison d'etre.
Ms Littley: No, because buying.solutions does not do the steering. The OCG core department, which is funded by the Treasury department, does that. So, we are governed in the same way as—

Q127 Mr Dunne: Could one of you give me an answer to the question of what proportion of the costs if it is not buying.solutions then it is the overall OGC is covered by the commission income received from the framework agreements?
Ms Littley: None of core OGC is covered by any part of buying.solutions' income, of any buying.solutions framework commission.

Q128 Mr Dunne: Where does that commission go then: to the Treasury directly you say?
Ms Littley: There is a dividend paid to the Treasury as part of our efficiencies, so that all of buying.solutions is paid by commission, core OGC is—

Q129 Mr Dunne: Right, so all of the commission from the framework agreements goes to buying.solutions?
Ms Littley: Yes.

Q130 Mr Dunne: I have not got the accounts in front of me, I am afraid. Can you clarify how much of the costs of operating buying.solutions is covered by that commission income?
Mr Smith: All of it.
Ms Littley: All of it.

Q131 Mr Dunne: All of it.
Ms Littley: Yes.

Q132 Mr Dunne: If you generate a profit, then that goes to the Treasury through dividends?
Ms Littley: Yes.

Q133 Mr Dunne: Therefore, if there is a conflict between the procurement of some goods outside the framework agreement whereby a government entity could procure more cheaply if it did not use the framework, your organisation exists to steer them away from achieving that best value and towards purchasing through your framework agreement?
Mr Smith: Chairman, may I make a comment here? Firstly, buying.solutions is one of the possible delivery mechanisms for collaborative procurement. To put some context around that in terms of numbers, the target for buying.solutions is by 2010 to have £10 billion of collaborative agreements, saving about a billion pounds. The area which OGC's overall responsibility is for is the numbers I said before: common goods and services are 75 billion. So, you can see that buying.solutions is only tackling one small part of it. Buying.solutions works under the auspices of the OGC—there is a separate, strategic collaboration unit within OGC—and certainly there will be no direction of people to go into a particular framework which is not in their best commercial interest. As I said when I said about the powers that OGC has, the power is to comply or explain. If a department comes in—and there are other collaborative departments, for instance PASA—and says, "My deal is better", they can still use that deal and, in fact, that is good because that tells OGC there is a better deal in terms of a framework or a better direct supply deal which it can use across government. So I think there is a healthy tension between having a trading fund as part of OGC but a wider strategic interest to engender collaborative procurement.

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Q134 Mr Dunne: We have had evidence from one of your competitors, a supplier that is not subject to a framework agreement, who made a number of allegations, but one in particular is that the framework agreements are used improperly to distort competition, and to cite as a particular example a headline on the buying.solutions website on 1 October, it said, "Specialist solution supplier signs up to contract extension", and it was an extension to an existing framework agreement for a further seven years and the allegation is that in relation to this particular product range competition is now restricted until 2016 because of the extension of this contract. How would you comment on that allegation and whether or not the length of tenure of framework agreements acts to shut out innovation and competitive pressures over long periods of time?
Mr Smith: Alison.
Ms Littley: I think the balance of tenure of frameworks is a very fine balance, to be fair, in terms of how long it takes to fill a framework in terms of the OJEU process which, as you know, is quite long, but, again, buying.solutions only does a proportion of any area of spend. I do not know what the particular category is that you are talking about, but there are other opportunities through other agencies, or other departments, for suppliers to be on different frameworks. So, not being on a buying.solutions framework in no way, shape or form prohibits that supplier from providing services or commodities to the public sector.
Mr Smith: Could I perhaps make a comment. I do not know the details of this case. I would find it surprising if a framework had a length of time of ten years. That is my personal view.

Q135 Mr Dunne: Could I suggest that you have a look at your own website then.
Mr Smith: I will indeed.[2]

Q136 Mr Dunne: The name of the company is Specialist Solutions Suppliers. It is not clear from the brief here what the product categories are that they supply. One final question, if I may, Chairman. Another finding of the Public Accounts Committee was a concern that there was insufficient expertise within the senior management team and the individuals responsible for negotiating the contracts within OGCbuying.solutions. What steps are you taking to review the quality of the team and introducing private sector expertise in particular. Obviously you represent some yourself.
Mr Smith: Yes. If I can talk about OGC, I think many of the comments are related to OGC as it existed a year ago. If you look at the mix between private sector and career civil servants in OGC there is quite a large element, and certainly in terms of the collaboration area that is almost entirely private sector. I would make the point though that I do not think we should actually tar people with the same brush. The idea that private sector is good and public sector is bad is not correct, in my view. I have been here a month; I have met some extremely talented people. There may be some issues on skills and capability, there may be some issues about getting experience, but I think we can do that. We must not set up a two-status stream within OGC. There is a tremendous contribution that can be made by career civil servants in the procurement profession.

Q137 John Thurso: Mr Smith, when you were responding to the Chairman in his questions you said that one of your key objectives was more for less, I think it was. How can you ensure, in doing that, that the quality of service to tax payers is maintained?
Mr Smith: Actually what I said was more value for less, and I think that is the key. I think people's understanding of procurement is that it is buying: it is buying commodities and there is a standard commodity. It is not. Procurement covers a range of goods and services. If I can give you one example from my own experience: my daughter this year went off and worked in the care industry looking after people in their homes, people that had various physical disabilities, people that were old, people who could not do things. She worked in the care industry and the quality of service of the people she worked for was appalling. That is not value. Lowest cost is not value. It is about what service comes from that value and also right across the lifecycle. If you are talking about a car, it is not about the purchase price of a car.

Q138 John Thurso: Absolutely. As a former practitioner of the hospitality industry, I am right with you on all that, but what I am driving at is when you have not got a top line and you are in government it becomes much more difficult to measure that value, because the traditional way of measuring value in the private sector is the ability to raise your price through your brand premium or the quality of your service, or whatever, an option you do not actually have. So how do you ensure that the value is not diminished, that it does not become a least cost operation?
Mr Smith: I do believe that everything is measurable. I believe in getting the data correct and then looking at how you measure. You can measure output of service and, if you look at the way that OGC's policies are phrased, they are advice, the standards which we require spending departments to comply with. That is about actually looking at value right across the lifecycle and it will be different contract by contract, service by service, but you cannot just look at cost.

Q139 John Thurso: I am going to leave that one there because you have only been in a month, but I look forward to coming back to this next time we meet and seeing how you have got on. It was recently reported that the Government had effectively dropped the idea of merging corporate services within central government. Why was that?
Mr Smith: I cannot really comment. This is shared services?

[2] See Ev 70

Q140 John Thurso: Yes?
Mr Smith: I can make a comment about my private views and my experience in private industry and also about what I found of OGC's position, because it is now part of shared service within the Treasury for its finance, its IT and its HR service, but I cannot really comment on government—

Q141 John Thurso: I gather the Government Chief Information Officer indicated the Cabinet Office and OGC had struggled to co-ordinate cross-Whitehall agreements?
Mr Smith: In terms of shared service. I am afraid I have no knowledge of that.

Q142 John Thurso: In relation to the failure of the IT framework, the shared services agenda was one of the principle causes. Is that something you have had a chance to look into?
Mr Smith: I have certainly not had a chance to look at it. It is not within my area of responsibility. Can I say though that shared service is a common process in private industry but it is not an easy process. It has to be extremely well planned. The IT systems that support it are very complex and certainly it is not something that you would go into lightly and it takes quite a long period of time for it to settle in is my own personal experience.

Q143 John Thurso: Perhaps Mr Jordan could help us here, as he was around at the time?
Mr Jordan: I certainly was around last year, but you are aware that responsibility for efficiency of shared services was one of the main work streams transferred to the Treasury on 1 April of this year.

Q144 John Thurso: A hospital pass?
Mr Jordan: We have no up-to-date information on the position of shared services. However, I believe the current plans are around the development of Whitehall where there will be some major providers of services and other buyers of services rather than a single source of shared service supplier.

Q145 John Thurso: You have not given up; you are coming back for another go?
Mr Jordan: I believe that my colleagues across Whitehall are coming back for another go, but it will be based around two or three major providers rather than a single shared service model.

Q146 John Thurso: Last year, when discussing outsourcing, I asked Mr Barratt about the possibility of outsourcing the finance functions, but he responded that one of the key rules of outsourcing is that you do not outsource a mess, you get your own house in order and then you outsource it. Has the finance function now improved to the point that it is not a mess and it could be considered for outsourcing?
Mr Smith: Within OGC?

Q147 John Thurso: Within government generally?
Mr Smith: I am afraid I could not really comment.

Q148 John Thurso: Or within OGC?
Mr Smith: I can comment on what I found in OGC when I came in, and that is I think there were adequate financial controls. I think information systems within OGC need some improvement in terms of the finance area but they are adequate. As far as the service which we are getting from the Treasury, again, that seems adequate, although I would wish to see a very explicit service agreement where the customer, which is myself as OGC, and the supplier, which is the Treasury, have a series of metrics to monitor performance.

Q149 John Thurso: How far do you think central government is away from being able to consider outsourcing, and I am not saying it is necessarily a good thing, but being able to consider outsourcing finance activity in government departments?
Mr Smith: I have not got a feel for the finance function within government yet.

Q150 John Thurso: We noted in our recent report on the efficiency programme that, unlike the other organisations within HMT reporting unit, OGC does not appear to have set out its baseline for financial savings. Why is that?
Mr Smith: In terms of OGC's own internal efficiency programme?

Q151 John Thurso: Yes.
Mr Smith: Can I ask William.
Mr Jordan: I believe that we are using 2003–04 as the baseline year for the vast majority of our efficiency savings. But where in some instances we were not undertaking an activity in that year, started to do it in 2004–05 and subsequently made efficiency gains, we have taken 2004–05 as the baseline year.

Q152 John Thurso: I find it quite interesting: if you take a fairly new organisation within government matrix, which is the Nuclear Decommissioning Agency, which is two, three years old, whatever, it is subject to those 3% a year efficiency savings in the same way as everybody else is. How can somebody that was set up in the most efficient way possible one year later be able to deliver 3% efficiency, or is that just a built-in inefficiency that you always start with so you have got some fat to give away?
Mr Smith: I have no particular knowledge of the NDA, I have to say, but I do believe that year on year improvements in efficiency should become the norm. It is the norm in private industry, some are successful, some are not, but it should be the assumption.

Q153 John Thurso: The report I referred to also noted some confusion within departmental reporting documents on the targets and achievements from relocation out of London and

the South East. Who was originally responsible for achieving the relocation targets and how many posts have been relocated at present?
Mr Smith: The OGC has been responsible for that within the efficiency programme. The target is 20,000 by the year 2010. As we sit here today 13,300 posts have been relocated and the trajectory that I have seen is that that target will be exceeded. When I said earlier on that OGC was no longer responsible for the efficiency programme, one part of it remains with OGC and that is relocation because it is so crucial to engage the property and management of the property estate in the relocation discussion.
John Thurso: Thank you very much indeed.

Q154 Mr Todd: The project that was devised to bring together a framework IT deal, Integrated Solutions, has been dropped, I believe?
Mr Smith: I am afraid I cannot comment. I have no information, I should say.
Ms Littley: That is right; it has.

Q155 Mr Todd: Can you give us a little bit of background as to, firstly, how far it went before it was dropped, the costs involved and what were the obstacles that caused it to be dropped?
Ms Littley: I have not got the details in terms of the costs involved, but I can give you details as to why it was dropped. Following the NAO report, one of the things that we undertook to do was to review all current and up and coming frameworks and one of the things that we also had to be cognisant of was how easy it was going to be for people to use frameworks, which was one of the things that also came out of the NAO report. In looking at it as part of that review, it was felt that the spectrum of things within that framework, i.e. from buying a piece of equipment to something that was an all singing and all dancing service, was too wide and the amount of procurement capability that some organisations would need would be too difficult for them to find and therefore it was dropped.

Q156 Mr Todd: So the scope was really—
Ms Littley: Too large.

Q157 Mr Todd: —so large that it was not possible to produce a meaningful and valuable framework agreement which could actually be presented to potential suppliers?
Ms Littley: And customers, absolutely.

Q158 Mr Todd: Was that not something which might have been identified rather earlier in the process, because it sounds almost an inevitable part of offering something across a wide range of government departments, or was there originally a vision which narrowed that scope down rather more precisely?
Ms Littley: Yes, I think it was one of those things where it certainly had some scope creep.

Q159 Mr Todd: That is what I was hinting at.
Ms Littley: Yes, and I think, with hindsight, the rigor of ensuring that in future frameworks do not become too wide-ranging for everybody, if you like, which was the idea, is reviewed earlier. So I think it was an important but, as you say, probably a painful learning curve.

Q160 Mr Todd: Is that not perhaps an experience which tells us something about shared services across government as a whole? Getting a clearly defined scope that does not and yet has some value is a pretty repetitive challenge which one sees presented regularly in government. Is that not right?
Mr Smith: If I could comment generally, I believe that looking at specific requirements, if we take the ICT requirement of government, I think what you need to do is to have a look at the outcomes you are trying to get rather than specify the product which you want, and, in my experience, that is a mistake which many organisations fall into. If you look at the structure, and one of the areas I spent a lot of time since I came trying to bring myself up to speed on is, indeed, the interaction between OGC and its category management teams, which includes ICT, and the CIO Council, ie the IT experts of government: because the important thing is that you actually have a strategy for where your technology is going, you have a forward funnel of visibility and you have a link with the supply industry. One of the things that I think I have learnt over the years in IT is that if you go out and look at buying, for example, laptops you will miss a trick. What you are actually looking to do is say: "We need a service, we need an outcome", and go to the supply industry and say, "Okay, come up with innovative solutions of how you will provide a solution to that outcome." That, I think, is something which has started within OGC and, in my view, that is the way forward.

Q161 Mr Todd: So is that where OGC intends to add value in future, rather than attempting to produce all-encompassing frameworks for purchasing which, as you say, can both be restrictive and also quite often rather out of date by the time someone is able to respond to them?
Mr Smith: I think it would be a growing trend, but I think it will continue to be a mixture of product and solution which will be procured.

Q162 Mr Todd: Does this perhaps suggest that the provision of shared services across government is going to be pretty problematic unless there is a greater willingness to produce shared business cases for such shared services? Is that what your perception is at the moment?
Mr Smith: I well understand the point you are making. It is not a responsibility of OGC but if I could try and answer your question. Quite obviously if you have a process of sharing, you have the business process understood. Then you can apply solutions to that. You do not have to spend all your

time looking at interfaces, so that if you are trying to find a solution for five different organisations you have then got to make sure requirements are consistent between those five different organisations. If you have your business process combined for those five organisations, you have one solution. It is self-evident. I repeat what I said earlier, that shared services is a common practice in private industry but it is difficult to put in and it requires great rigor in terms of what you have just been saying, which is actually making sure there is an understood process.

Q163 Mr Todd: A best practice process.
Mr Smith: Yes, absolutely.

Q164 Mr Todd: And a clear business case for the project as a whole?
Mr Smith: Yes. There are processes between OGC and the CIO Council where, in fact, we are looking at these issues. It is not directly looking at shared service but it is looking at common solutions. So, I take your point.

Q165 Chairman: Mr Smith, you have been in post just over a month now. How confident are you have got to grip with range of OGC activities?
Mr Smith: I think I have a good understanding. I think there are areas of detail which I am going to learn over the next few months, but so far it is more or less what I was told was on the tin. So, yes, I am quite confident.

Q166 Chairman: When you come back here in a year's time on the basis of a proper and separate report, what is it you will expect to have achieved?
Mr Smith: Perhaps I can just say that I am no different to most chief executives that come into a new company: they have a strategic review. That is what is being undertaken at the moment. Any strategy should cover at least three years and backing up that should be a one-year business plan, and I look forward to talking to you next year about the success of whatever the objectives are in the business plan but overall OGC, if it is going to justify the money that is being spent and the confidence that has been placed in it, has to make a real difference. That is why I have come in. That is what has attracted me to come in to work in government. If I do not believe I have made a real difference—and it is through my leadership of the team, and the team will do it—then there is no purpose in me being here, I will not be here.
Chairman: Thank you. We are going to leave it there. We wish you well in your appointment. Thank you very much for your evidence today.

Wednesday 14 November 2007

Members present

Mr Michael Fallon, in the Chair

Nick Ainger	John McFall
Mr Graham Brady	John Thurso
Jim Cousins	Mr Mark Todd
Mr Philip Dunne	Peter Viggers

Witnesses: **Mr Nicholas Macpherson,** Permanent Secretary, and **Ms Louise Tulett,** Director of Finance, Procurement and Operations, HM Treasury, gave evidence.

Q167 Chairman: Mr Macpherson, can we welcome you back to the Sub-Committee. Perhaps you could introduce yourself and your colleague formally for the Shorthand Writer, please.
Mr Macpherson: Certainly. I am Nicolas Macpherson, Permanent Secretary to the Treasury, and on my left is Louise Tulett, who is Director of Finance, Procurement and Operations.

Q168 Chairman: Louise Tulett is Mary Keegan's successor? Is that right?
Mr Macpherson: Yes and no. Yes, she is Mary Keegan's successor as Treasury Finance Director. No, Mary continues to work part-time in the Treasury as Head of the Government Accountancy Service and plans to continue to do that well into the New Year.

Q169 Chairman: I think I understand that. Could I turn first to your Annual Report and Accounts and, in particular, the resource accounts, pages 107–108 onwards. Why have you not identified the number or amount of bonuses paid to senior staff there?
Mr Macpherson: We would not normally identify bonuses separately from ordinary consolidated pay, partly because bonuses are part of the standard remuneration package. I think around a third to 40% of staff get bonuses but that is contained within the overall earnings growth envelope each year.

Q170 Chairman: Is not the reason you did not declare bonuses separately that there has been an enormous increase, £13 million in 2005-2006 to over £21 million in the year we are discussing, a 69% increase to an increase of just 13% of recipients, a Parliamentary Answer you gave on 8 October? Why not declare this information honestly and openly in your account? Why does it have to be dragged out of you?
Mr Macpherson: I do not have the Parliamentary Answer in front of me but it is worth very briefly digressing about the principles informing civil service pay increases. We moved several years ago to the principle that staff can be remunerated in two ways, first, through their basic pay and secondly, through bonuses, and the bonus pot is increasing over time consistently with that. What matters is the overall increase in pay to staff in post, including bonuses, and that has been kept within a very tight increase. Also, a colleague has just passed me a piece of paper: I think you may be quoting . . . Often with these questions there is confusion because I think your question may include Her Majesty's Revenue and Customs as well, which is why I was slightly confused by it.

Q171 Chairman: The answer you gave Parliament includes the whole group. What is interesting about it is that the figure—when you say tighter control—for bonuses has jumped from £12.7 million the previous year to £21.5 million in the year we are discussing. I just want to be clear why there has been such a massive increase.
Ms Tulett: I understand that the numbers you are quoting are actually the Chancellor's Departments number and I do not believe that that is reflective of the increase in bonuses within the Treasury itself.

Q172 Chairman: So the jump from £13 million to £21.5 million is all the other bits of the Treasury, not the Treasury itself?
Ms Tulett: I do not have the actual breakdown for Treasury to hand but it is not a number I recognise . If we look at our gross pay costs within the account, I do not think you will see they are reflecting that sort of net increase. Staff costs are shown on page 117 under "Administration Costs" and you will see there that the group total for 2006–07 was £95 million against £92.6 million last year.

Q173 Chairman: Sure, but as bonuses have increased from £1 million five years ago, a very small figure, to clearly a very important part of your remuneration as a group or even in the Treasury, would it not be more helpful and more transparent to actually show a bonus line in addition to salaries, as, of course, is the practice in the commercial sector?
Ms Tulett: Our presentation is in line with the Financial Reporting Standards within government and are subject to NAO audit, so that is not a disclosure that we are required to make. However, if the Committee wish that further information, I am sure that is something we could get.

Q174 Chairman: It just seems odd that it has to be dragged out of you through a written answer rather than put into the Report.
Mr Macpherson: I would be very happy to give you information on bonuses paid within the Treasury. We would certainly consider it in relation to the Report. Just one point: I think it is fair to say, the last time I looked at some corporate accounts in the

private sector, in distinguishing wages and salaries I am not aware, if you look at Tesco's, for example, that they would distinguish bonuses from base pay across the group.

Q175 Chairman: They certainly would at a high level. For directors they do, for board level they have to.
Mr Macpherson: Board level, that is precisely my point, but across staff as a whole they would not distinguish bonuses.

Q176 Chairman: We look forward to receiving your note, and perhaps you will consider it for next year.[1] The Treasury is also responsible for co-ordinating the inter-departmental Public Service Agreement on child poverty. Why is that cross-departmental unit not set up by the Treasury? Why does it rest outside the Treasury?
Mr Macpherson: Quite simply, it is worth distinguishing the strategy in relation to the short to medium term, where, consistently with our PSA delivery agreement, which we published at CSR time, the Treasury is in the lead and chairs the relevant inter-departmental group. It is worth distinguishing the short and medium term from the long term. The group which has been set up, which is primarily going to comprise DWP and the new Children and Schools Department's officials, is focused on the long term, the commitment to abolish child poverty by 2020. Our view has always been that, in relation to the long term, public services will play a far greater role in addressing child poverty than, say, transfer payments, which the Treasury is primarily responsible for. That is reflected in this new cross-departmental unit which, as I say, will be focused very much on the long term.

Q177 Chairman: My colleagues will want to come back to that. Finally from me—I know it is a post-balance sheet event, in a way—could you just clarify for us what additional resources at the Treasury are now having to be committed to dealing with the Northern Rock issue? Is it consuming the time of a number of officials?
Mr Macpherson: Yes. We provided a note in response to the Chancellor's appearance at PBR time, which set out the number of officials allocated to Northern Rock. At this stage I think we are talking about something like 20 to 30 possibly extra staff addressing this. I should emphasise that they are not all dealing with Northern Rock; they are dealing with the wider response to the events of the autumn. This Committee I know has been very actively involved in considering the lessons from the events surrounding Northern Rock and the Chancellor is committed to legislating, so we have quite a substantial project team working through all those issues.

Q178 Chairman: The £23 billion so far advanced to Northern Rock, I think your press notice phrase is "through the Bank of England and indemnified by the Treasury"—have you yet established how that will be accounted for? Will it be entered as a contingent liability?
Mr Macpherson: At the moment—I will turn to my Finance Director in a minute—the support for Northern Rock is fully backed by Northern Rock's extensive assets. It has a good mortgage book and it would appear a pretty high-quality mortgage book. At this stage that support is fully accounted for. It would sit, I guess, on the Bank of England's balance sheet and at this stage there are no implications for the Treasury but, if there were, Louise will explain how that would be accounted for.
Ms Tulett: We will show it as a contingent liability until such point as the liability actually crystallises and at that point we would bring it into the balance sheet.

Q179 Chairman: So the extent of the liability will be quantified at 31 December in the normal way? Is that right?
Ms Tulett: Our financial year runs to 31 March.

Q180 Chairman: I thought you reported to Parliament on the contingent liabilities before the end of the calendar year.
Ms Tulett: I am sorry. I am not clear on that point. We will bring it to our resource accounts on 31 March in the appropriate manner. If there has been no crystallising event prior to 31 March, that will be a contingent liability.
Mr Macpherson: The Bank of England's accounts run to the end of February.

Q181 Mr Dunne: Mr Macpherson, you will have to forgive me but could you remind the Committee when you became Permanent Secretary?
Mr Macpherson: August 2005. It is beginning to seem like a long time.

Q182 Mr Dunne: Prior to that, were you in the Treasury for a long period before that?
Mr Macpherson: I have been at the Treasury since the mid to late Eighties.

Q183 Mr Dunne: Do you know how many staff you have in the Treasury today? It is not included in your Annual Report. You reference the website but I did not have an opportunity to look at it.
Mr Macpherson: Yes, I do know. As ever, it is always slightly irritating for you, I know, but it depends on how you define the Treasury because Treasury now comprises the core Treasury, the Debt Management Office, the Office of Government Commerce and if you add all these things together, there are something like 1,500 people at present working in those organisations, of which 1,165 work in what I term the core Treasury.

Q184 Mr Dunne: How many would there have been in the core Treasury in 1997?
Mr Macpherson: It is an interesting question, and I have had to cover this with this Committee before, because machinery of government changes complicate the issue. The biggest complication was

[1] Ev 81

the decision to take strategic tax policy out of Her Majesty's Revenue and Customs and place it in the Treasury. Also, post 1997 the decision was made to shift responsibility for insurance from DTI to the Treasury. Of late we have taken on responsibility for the Prime Minister's Delivery Unit. We have also created a group shared service function, which takes on some people who were in the Office of Government Commerce. If you take all those things into account, I would say that the Treasury is not a huge amount bigger than it was in 1997.

Q185 Mr Dunne: So you are saying if you exclude all of those extra responsibilities, the number of staff employed today is roughly the same as it was in 1997, excluding all those extra tasks?
Mr Macpherson: I would think it is in broadly the same territory, yes.

Q186 Mr Dunne: So in absolute terms, when you do include all those extra responsibilities, it has grown somewhat?
Mr Macpherson: Yes, it has. I do not have the figure for 1997 in front of me but my recollection is that it was probably round about 900.

Q187 Mr Dunne: In core Treasury?
Mr Macpherson: In core Treasury, yes.

Q188 Mr Dunne: At the beginning of the last Comprehensive Spending Review, so in 2004, do you have a similar figure?
Mr Macpherson: I should do actually, yes. For the core Treasury, on 1 April 2004, taking into account the transfers, there were 1,371 staff in the Treasury. So it is now 1,165, which suggests that numbers have fallen by over 200 over that period.

Q189 Mr Dunne: Two hundred and six.
Mr Macpherson: Yes.

Q190 Mr Dunne: Can you remind us what the 2004 Comprehensive Spending Review target was for efficiency savings?
Mr Macpherson: In staff numbers, we were set to reduce our staff numbers by about 150.

Q191 Mr Dunne: So you have exceeded that target.
Mr Macpherson: Yes, we have.

Q192 Mr Dunne: In terms of the proportion of spending of the Treasury, do you have a figure? You currently have a 5% target for the next Comprehensive Spending Review. What was the target for the previous one?
Mr Macpherson: My recollection was that in 2005–06 and 2006–07 the budget was held pretty flat, what is known in the trade as "flat cash", which means expenditure was held at the level it was, so there was a 5% real reduction over that period but, obviously, we have been seeking to drive out efficiencies not just from staff; we have been trying to do that from a whole lot of other areas, for example, better use of accommodation, trying to get efficiencies in the coinage contract and so on.

Q193 Mr Dunne: Can I make sure I understand this properly? By "cash flat" you mean there was a real decrease in spend in the Treasury of 5%, and you had a 5% target?
Mr Macpherson: That was the plan. Inevitably, when you look after the event, because in some years you do not spend as much as you have money allocated to you, the out-turn profile is different from the plan.

Q194 Mr Dunne: Indeed, if you look at the last five years, you have under-spent by between £7 million and £50 million, which ranges from 2.3% to 15% under-spend over that period on an annual basis.
Mr Macpherson: There has been a tendency to under-spend. This is common problem across departments because there is an asymmetry of incentives. If I over-spend, I am hauled before the PAC. If I under-spend, I am not. This is something we as a department on the spending side work quite intensively to try and get people (a) getting a taut estimate, to use the jargon, but (b) to ensure that people generally spend the money they are supposed to spend. In our case there have been special factors. This is not just us failing to recruit the staff to do the job. Often it is around things to do with the building and so on, where you get quite big numbers because of impairments and such like. Louise will be closer to this than myself.
Ms Tulett: I do not know if you have any specific questions about the under-spend but on page 90 of the Report we actually do set out our total resource DEL spend and you can see from there that the 2005–06, 2006–07, and 2007–08 run of numbers are against a flat cash settlement. It would have been at the time around the 228; it is really based around the 228 because of machinery of government changes.

Q195 Mr Dunne: My precise question was going to be what proportion of your budget is represented by the 2006 under-spend of £27 million. Is the right figure to look at the core Treasury funding of £131 million for that year or is it the total resources DEL of £202 million?
Ms Tulett: It is the total resources DEL figure.

Q196 Mr Dunne: So you were under-spent by approximately 12%? Would that be roughly right?
Ms Tulett: Yes.

Q197 Mr Dunne: In which case, your efficiency target of 5% would seem to be in the bag.
Ms Tulett: The 5% being?

Q198 Mr Dunne: Your efficiency savings for next year, or am I confusing percentages?
Ms Tulett: Yes. It is slightly different to that. If you look on the Report, you will see that actually we have a departmental unallocated provision of £15 million, so we are recognizing in 2007–08 that we actually need to spend some of our SR 2004 settlement to help us with our modernisation and transformation costs.

Q199 Mr Dunne: That would account perhaps for the £26 million increase in 2007–08 at a time when you are supposed to be reducing your costs.
Ms Tulett: It accounts for some of it, yes.
Mr Macpherson: We monitor this month by month but my guess is we will under-spend in 2007–08. One of the problems—not one of the problems but one of the issues which arises with the efficiency agenda is we are actually below the headcount target for 1 April 2008, and theoretically, I could now crank up recruitment and get 60 more staff but actually, at any point in time you are planning for two or three years out, and what we have tended to be doing recently is, in a sense, anticipate the effect of the CSR settlement by taking actions now. One example of that I would highlight was the decision to bring our HR, IT, accommodation services together in one place, which has driven out quite substantial savings across the group. Strictly speaking, we did not need to do that this year because we had enough provision to get by without it but at any point in time you are trying to improve the way the organisation is run and, if you can identify measures like that, it seems to me there is a strong case for getting on with it.

Q200 Mr Dunne: You are obviously in a position as a department where you are trying to be an exemplar to all the other departments, so it is not surprising to me that you are both achieving under-spends because you are seeking to encourage other departments to presumably not overshoot their budgets but, equally, it would seem to me that you should also have a reasonably ambitious efficiency savings programme if you are going to encourage other people to do it. In four out of the last five years you have achieved a £24 million or higher undershoot. It seems that either your targets have not been at all demanding or you have been doing something exceptional, or plans have changed in every year rather than just occasionally, which is the way you have been trying to characterise it.
Mr Macpherson: There is a lot of noise in the accounts from things like, if a number of people are taking early retirement or you have exit costs from voluntary early redundancies, you need to provide for that.

Q201 Mr Dunne: Indeed, initial provisions you are saying, but you would not be providing a similar amount every year for five years.
Mr Macpherson: No, but my point to you is, do not think that somehow we have given ourselves some soft settlement and we are now going to coast along. Louise and I come not quite hot-foot, because we concluded our deliberations about a week or so back, but we have been having quite tough discussions about our budget for the next three years and, let me be clear; you were talking about the staffing numbers; the Treasury is going to get a whole lot smaller in the coming period and I am confident we can do that whilst continuing to maintain the same level of service, if not improve it.

Q202 Mr Dunne: Can you give us some clues as to what areas are likely to be reduced? Is, for example, the Prime Minister's Delivery Unit, which was taken into the Treasury, as you described earlier with the change in Prime Minister, going to be taken back to Downing Street?
Mr Macpherson: No, the Prime Minister's Delivery Unit joined the Treasury at the point that the current Prime Minister left it, so I do not think they were ever formally part of the same institution. The Cabinet Office, through a certain sleight of hand, seemed to reduce the size of the Prime Minister's Delivery Unit before handing it over to us, so I do not think we will be making it much smaller because there is a critical mass that you need in a unit such as that. There are some general efficiencies which you can drive out across the board, and we will be encouraging all parts of the Treasury to raise their game in that respect. Beyond that, you have to look at what your priorities are, and so at the current time, for example, I would want the financial service area perhaps to be sharing slightly less of the pain than others. In my view, areas like macroeconomics are also important at a time of considerable uncertainty. We are seeking to prioritise but, above all, we are seeking to make improvements in areas which will not affect the front-line, to use an appalling term, capability of the Treasury because one of the biggest savings we have achieved is from moving OGC out of Trevelyan House in Great Peter Street, where they were occupying a building, to sitting on the fourth floor of the Treasury. They are now in there and that is delivering a large amount of savings, and actually resulting, I think, in a better, more effective Treasury because we can communicate better.

Q203 Mr Dunne: What lessons have you learned from implementing efficiency savings in the last CSR period which will inform your advice to other departments in doing the same in the next?
Mr Macpherson: My first one is to grasp the nettle sooner rather than later and to start with your non-pay costs, because with a service like the Treasury, our assets are our people. We have a building but we are stuck with that, so what we are trying to do is really home in on both non-pay costs, things like accommodation, getting more people into the building, renting out bits to other potential occupants, but then also, moving on from that, to look at your support services, which are important. We need to have the right staff and so on, we need to develop our staff, we need to have really good finance people. You do not have those as an end in themselves. They are basically an overhead supporting what you are doing and you need to get stuck into that. It is very difficult—we have had this discussion in this Committee before—to have a perfect measure of the output of the Treasury. We are providing a service which is quite a long way away from the sort of tangibles which you get, say, in dealing with waiting lists in the NHS, but I am reasonably confident that we are maintaining a good service and we are doing it with fewer people.

Q204 Mr Todd: The Cabinet Office are running capability reviews for departments. You have had yours.
Mr Macpherson: We are having ours and at the moment we are in the second week of intensive activity by the review team. Indeed, I think the review team may indeed have met the Chairman of this Committee, the main Committee not the Sub-Committee, and we are going to be fed back the findings, I think, in the fairly near future and I am informed that the review—although it is not my responsibility to publish the review; it is the Cabinet Office's—will be published before Christmas alongside Her Majesty's Revenue and Customs' capability review.

Q205 Mr Todd: Do you have any feel as to the methodologies used in this review from your early experience? I think there was a consultation process between departments on how this should be put together but obviously you are now seeing it in the flesh rather than on a sheet of paper.
Mr Macpherson: I have been quite impressed by the process. Inevitably, one starts off—

Q206 Mr Todd: I suppose you would have to say that!
Mr Macpherson: You would have to but, like many people, I started off with a degree of scepticism: how rigorous was this going to be? How do you make comparisons across government? Quite frankly, the nature of, say, the Treasury and the Cabinet office is different from the nature of DWP or the Department for International Development. I have been on the moderation panel, because you get traffic lights against various different headings at the end of the process, and I have been quite impressed by the rigour of the process and the commitment of the review teams. It has been the nature of the review teams that they comprise people from the private sector and the public sector and, certainly on the basis of the Treasury's one—and I do not want to anticipate their findings—they have been telling me things about the Treasury which, in one sense, you wish they would come along and say you are fantastic and they cannot think of any ways you can improve but I do not think they will come up with that because I think all organisations can improve, and I have been quite impressed by what they have had to say so far.

Q207 Mr Todd: Amongst the areas of focus of the review—this is something I want to turn to on a more general basis, which is measurement and the understanding of performance, the data that is used by management to work out what an organisation is doing and whether it is focusing its resources in the right places. If one turns to the PSA process, the Treasury has been keen to link resources to PSA targets. Do you think you have made progress generally in getting that message across and establishing those linkages?
Mr Macpherson: Undoubtedly. I have been involved one way or another in the PSA process now for something like seven years and the quality of the process has improved hugely. A good example this time round in the Spending Review was the publication of delivery agreements at the time of the Comprehensive Spending Review. I think departments have far greater focus on their priorities and, consistently with the Better Financial Management agenda, we are getting far better at understanding how our resources break down across the PSA set. I think we are moving in the right direction.

Q208 Mr Todd: You may be but you referred to the publication of the CSR. That did not link resources to individual PSA agreements, did it, which was presumably what the Treasury wished it to do?
Mr Macpherson: There are issues around accountability whereby Secretaries of State, and accounting officers, are responsible for spend in their departments, so inevitably a degree of reporting is around the departmental structure rather than the PSA but I would hope that, over time, we can strengthen both planning and reporting around the PSA itself. I think the CSR was a step improvement. If I can speak from my own experience in the Treasury, there is always a tendency to plan around organisation rather than objective. We are split up into directorates, you have various people who are responsible for those directorates and, all too often, you become focused on structures rather than objectives. I do think though that this time round we are in a much better position, not just for the PSAs—

Q209 Mr Todd: Not optimal. You may be better. You must admit, bearing in mind the emphasis you put in your opening remarks to this question on linking resources to objectives, you seemed to be rather "Oh well, we have got a way to go here" without really—
Mr Macpherson: I suppose I am trying to avoid being complacent about this.

Q210 Mr Todd: I think you are quite successfully doing that because it does not sound as if you have achieved the goal you have set.
Mr Macpherson: I think we are. I have had good correspondence with this Committee about our Departmental Strategic Objectives.[2] Part of our budgetary discussions have been about how much resource we put into each of those objectives. Louise, who is the Finance Director, and is also an active participant in our Finance Committee, may want to expand on that.
Ms Tulett: Yes. In our own internal business planning we are trying to make much stronger links between resource allocation and the outcome-based internal objectives. We are trying to get away from just having an organisational approach and looking more at the outcome focus. That is entirely consistent with the external publishing that we do. In the Report we have an example on page 120 of where we are externally report against our objectives. We align our resources to our objectives as well, so we

[2] Treasury Committee, First Report of Session 2007–08, *The Comprehensive Spending Review,* HC55, Ev 21–34.

are trying to have great synergy between that internally and externally. We put a director as a senior responsible officer.

Q211 Mr Todd: I understand what you are telling me but I have to say my impression is it is work in progress and by no means complete within either your department or in government as a whole.
Mr Macpherson: I do not think it will ever be complete until you abolish departments and create structures called the Department of the Child Poverty Target, and then you will have other problems.

Q212 Mr Todd: Can I turn finally to the areas of management information and the way in which you measure whether you are achieving what you set out to do? You will know that there have been criticisms of the way in which performance is reported and tested against objectives from both this Committee and also Public Accounts and to some extent also from the National Audit Office. Is that partly about the poverty of information resources within departments, because there has been criticism of that as well, or is it something else?
Mr Macpherson: I think part of it is around data lags but also the quality of data. Take something like the child poverty target. The ONS now report far more quickly after the year in question than they did ten years or so ago but they still report a good year after the year in question has finished. In addition to that, it is actually quite difficult in some areas of the public sector to develop intermediate indicators. There are some things which are fantastic: month by month we get the CPI. It was published earlier this week. We know precisely what the annual rate of that is—it is 2.1%. Generally, on the economic front the quality of data is pretty good. Okay, there are sometimes revisions on things like the public finances to do with how big GDP is and so on, but the data is of a very high quality. However, there are some other areas where either the data is more indifferent and is produced with a lag or really, it is almost impossible to come up with indicators which help you. The correspondence on DSOs is really instructive because this Committee came back to me, quite rightly, and said, "Hang on a second, can't you have a better measure of financial stability?" I think that is a really good point and we are going to try to do that but to develop an indicator which can give you regular management information on financial stability—there are some things I can tell, like whether the FSA are coming along and telling us that X number of institutions are at risk but it is quite difficult to come up with measures like the inflation target. We need to continue to work at that. I am not saying it is impossible but there are challenges.

Q213 Mr Todd: I understand there is an external input into the way in which you examine achievement of objectives but it is also partly about the information systems that departments and you have within your own control. Is there not some purpose in some of the comments that have been made in the past on an external audit of information systems on which your reporting is based so that there is greater confidence in the credibility of their function? Would that not actually be better for managers who are seeking to deliver objectives?
Mr Macpherson: We have been committed to external validation of data systems. Across government there has been substantial improvement there. The NAO have been involved, obviously, the whole national statistic framework is also relevant, so I think there is external validation but I am sure we should aim continually to improve.

Q214 Nick Ainger: Can I ask you about efficiency savings? In the PBR CSA report in June 2007 it was indicated that across all government departments they were on track for savings of £20 billion by June 2007 compared with the expenditure in April 2004 and in that same period there had been a net reduction of some 66,000 staff. What proportion of that £20 billion was actually those staff reductions?
Mr Macpherson: A small proportion. The £20 billion-plus Gershon targets related to the whole public sector. The staff reductions are focused effectively exclusively on the civil service. There have been some definitional changes since because you get machinery of government changes, but the workforce reductions are really quite a small component of the overall aggregate number.

Q215 Nick Ainger: In CSR 2007 there is a saving identified there through efficiency through to 2010-2011 of a further £30 billion. It is a further £30 billion? It does not take account of the £20 billion that has already been saved?
Mr Macpherson: No, it is additional.

Q216 Nick Ainger: So from this year through to 2011 there is a further £30 billion?
Mr Macpherson: Yes.

Q217 Nick Ainger: What proportion, again, do you estimate that £30 billion to be of staff?
Mr Macpherson: I would expect staff will be a component, possibly quite a big component, but much of this saving will also derive from things like better procurement, where the staffing effect is actually pretty minimal, or better use of property, which, again, is not a staffing issue. So I would be surprised if at the end of this process the size of the public sector in terms of employment was higher than it is now. Just as I was explaining earlier with the Treasury, I expect the size of the Treasury to be smaller than it is now. My view, on headcount targets is that the ones which followed the Gershon review were a good way of kick-starting the process and forcing the civil service to focus close to home on its own staffing levels. But to persist with headcount controls over a long period in my view is likely to distort decision making, encourage game playing, and so I think it is sensible to aim and to bank the Gershon cuts in the civil service but, beyond that, the key thing is living to live within the overall aggregate spending constraints, which will, given what we

know about wage pressures and so on, inevitably force people to drive out really quite big efficiency savings.

Q218 Mr Brady: You mentioned earlier in response to Mr Dunne that you are below headcount at the moment. At what point does that become a part of your efficiency saving? Is it at a future date when you remove the posts formally?
Mr Macpherson: My point there was, just focusing on the core Treasury, as I described it earlier, as of 30 September we had 1,166 staff. Our target consistent with the Gershon agenda was 1,220, so we are 56 below where we could be and still meet the Gershon target. As I said, I see absolutely no point in seeking to raise staffing levels temporarily, so I would expect us to move fairly smoothly to where we need to be consistent with our new plans through 2009–10.

Q219 Mr Brady: So those posts would count towards the £30 billion?
Mr Macpherson: No. The posts may help contribute to it but it is not central to it, and actually, the £30 billion will be primarily delivered by maintaining or, ideally, improving services whilst living within a more ambitious budget constraint.

Q220 Nick Ainger: The purpose of Gershon was to direct funds to the front line.
Mr Macpherson: Absolutely.

Q221 Nick Ainger: I know this Committee in the past has raised concern about the impact that efficiency savings are having on service delivery in certain sectors and they have been seeking improvements in the way that these efficiency savings are monitored, particularly in relation to service delivery. What do you intend to do as a department and across government to ensure that you do have quality assessment taking place of the efficiency savings that have been made and how that is improving service delivery?
Mr Macpherson: I do not want to get into an argument about whether the efficiency savings delivered so far are real or not. Suffice it to say, even the NAO acknowledge that at least 75% are pretty good quality. I happen to have inherited responsibility for the efficiency programme and the one thing which we have taken very seriously is this issue of service quality, not least because actually, if there are doubts about service quality, it undermines the credibility of the whole programme. We are in a situation now where if departments cannot prove to us that service has at least been maintained in the area in question, we will not score the savings being offered. I am keen to use a whole series of ways, for example, of ensuring that internal audit departments are far more actively involved in signing off efficiency numbers, and we will continue to encourage departments to ensure that quality is being maintained but ultimately, there is not some composite measure of quality. All one can do, I think, through this process is to set departments ambitious and stretching goals. If they achieve those goals, that is a pretty good sign that quality is being maintained but I recognise there will occasionally be tensions arising from better allocative efficiency and so on. Quite a lot of services are changing. I recognise this is a legitimate area for discussion and debate.

Q222 Nick Ainger: Is it not absolutely essential? What is the purpose of driving through efficiency savings, making people redundant and so on, if you are not certain that the changes that you have driven through are actually going to improve service delivery? That is the purpose of Gershon in the first place.
Mr Macpherson: It is really important but my point is that efficiency is not an end in itself. The end you are trying to achieve is the highest quality service possible with the minimum possible cost to the taxpayer. That is the trade-off. All I am saying is that you can get so high up with efficiency as if efficiency is your number one objective but your number one objective is improving the quality of public services. The trade-off then is what are the inputs? Are public services improving? If they are, great. Then, are inputs increasing at a similar rate? If they are, value for money or efficiency is not necessarily improving, in which case you have a problem. What I would be encouraging is both departments and people who hold departments to account to look at the outputs, look at the inputs. By all means focus in on efficiency but you can have a pretty sterile debate about what efficiency is. People can generally tell whether a service has improved or not.

Q223 Nick Ainger: Finally on this area, how would you expect the NAO to be operating in this area? Have you had any discussions at all with the NAO?
Mr Macpherson: We have regular discussions with the NAO, and the NAO are very actively involved in these issues. Generally, department by department, we have constructive relationships. We report on efficiency. The NAO are actively involved in that. The NAO attends and participates in our audit committees at the Treasury. Would you like to add anything about that?
Ms Tulett: I presume that if every department has the same relationship with the NAO that we have, they are pretty well engaged and understand the granularity of the business that the Department is conducting. We certainly see them as an important partner in that delivery, not only in terms of the external audit of the resource account but actually in understanding our business and being a critical friend in the way that we go about what we do.

Q224 Nick Ainger: Yes, but is there an ongoing monitoring? Obviously, you have your own internal processes but do you know if the NAO would be ongoing? My concern would be if significant "efficiency savings" are made, but then there is a significant detrimental impact on service delivery—and that could be not necessarily in the Health Service but in the Inland Revenue, and suddenly you are not collecting the taxes, which would have a huge impact on all of the services. The NAO may well be able to report in retrospect that something went wrong but is there a current monitoring process?

Mr Macpherson: This comes back to whether you are monitoring efficiency or outputs. I monitor revenue month by month. One of my biggest concerns in life is the public finances and, believe me, when those revenue figures come in, we are all over them like the proverbial rash. My first indicator of what is going on with the revenue is what are the revenue figures? I would be conscious that there are issues around staffing levels and so on. If as part of the review process of what is going on with revenue we conclude that actually—your point—staff have been taken out of this area and it is not real efficiency; it is just a cut which is resulting in a worse service for the taxpayer, we will get stuck in, I would hope the NAO would be supporting us in that. That is really important. Obviously, there are other factors involved with revenue, like whether the economy is turning down or whatever but these things matter. The Treasury has a really important role to monitor output across the board.

Chairman: Could I appeal for crisper answers, if possible? It is interesting stuff, but no less interesting if it could be crisper.

Q225 Peter Viggers: A 5% reduction in real terms each year is a very demanding target. Was there really so much fat in the system?

Mr Macpherson: That is a good question. I do not know. What I do know is that the Treasury did expand quite a bit at the turn of the decade, and I think when we started focusing on the Gershon agenda, we felt that there was scope to focus Treasury resources better. Coming back to my earlier discussion with Mr Dunne, we found there were quite a few things you could do which had quite a big impact. I think there is probably just about enough fat. I would be quite worried if you came back to us next year and said, "Actually, Parliament decided we had to have a 10% reduction", I would start worrying. This is an ambitious target, I think we can deliver it, but the risks would increase if you went much further faster.

Q226 Peter Viggers: It is perhaps unfortunate from your point of view that my only direct connection with the Treasury is as Joint Treasurer of the British American Parliamentary Group, where you cut our budget by 5% in consecutive years. We have fixed costs and this means cutting our programme by about 7%. How when you present your figures will you present this as an improvement in efficiency?

Mr Macpherson: I would hope that your excellent Group, for all the pressure on its budget, will continue to do the excellent things that it does. I recognise it is one of these anomalies that you are directly funded by the Treasury. I would not claim that that is necessarily an efficiency saving but it will clearly force the body to drive its resources even harder.

Q227 Peter Viggers: I raise the example of course because there must be other sections within your budget where exactly the same matters will apply. In a previous visit here Miss Keegan within your department told us that there were some areas where management reporting was not as good as in others. Can you comment on financial management reporting? Which would you hold out as beacons of strength and where do you think there are weaknesses?

Mr Macpherson: Are you talking about within the Treasury or across government?

Q228 Peter Viggers: Yes, in the Treasury.

Mr Macpherson: As Mary answered that question, I will ask Louise to answer it.

Ms Tulett: I think one of the areas that we have improved on was the point we touched on earlier, which was actually allocating resources to objectives. That is an area that in our financial management review was pointed out as being something that we ought to be more mindful of in our own internal business planning. We have actually improved our internal business planning process quite considerably, with the appointment of SROs for each of the functional areas who have oversight of the resources used in that area rather than following the traditional organisational boundaries. I do not recall any other areas of improvement internally. I think it was around that specific point.

Q229 Peter Viggers: How do you think financial reporting within the Treasury specifically compares with financial reporting in the private sector?

Mr Macpherson: I think it is really pretty good now. Mary and Louise between them have transformed it. This is a good example of professionalism in action. When I first got involved in senior management of the Treasury seven years or so ago, quite frankly, it was pretty poor. Mary and Louise, who both have extensive accounting experience, have knocked us into shape and, as the department which is responsible for finance, that is extremely important.

Q230 Peter Viggers: Discussing with other Treasury Committees, and specifically Germany, France and Portugal come to mind, they seem to have much simpler mechanisms for reporting and monitoring than we have here. The Treasury Select Committee has commented on this previously, about the opacity of Treasury accounts, government accounts. What progress has been made in aligning departmental budgets, estimates and resource accounts?

Mr Macpherson: I am pleased to say that the Prime Minister made a commitment at the time he was appointed to a better line of sight from accounts through to estimates and so on and we are definitely on the case. It is not going to be easy because, quite rightly, Parliament has strong views on these things. I think most of us would agree that estimates are slightly arcane and perhaps have less relevance than equivalent mechanisms in other parliaments. There is potentially a win-win here, where Parliament can secure better assurance about how money is spent and we can have a more efficient accounting system. We are not there yet but we really want to make progress.

Q231 Peter Viggers: Moving on to a completely different area, the private finance initiatives, some are on balance sheet and some are off balance sheet. Can you comment on the state of discussions about the treatment of PFI liabilities in the public sector under International Financial Reporting Standards? Is it likely that the IFRS-related standards will be applied in full to the public sector?
Mr Macpherson: Yes, we are committed to applying IFRS. There is an issue around precisely how quickly you can do it but we are committed to doing that, we are having discussions about it and I am confident that we can do it.

Q232 Peter Viggers: Can you give us a sense of scale of the PFI operations which are on balance sheet and off balance sheet?
Mr Macpherson: At present I cannot remember whether it is 57% and 43% and I cannot remember which one is which but it is broadly 50-50. The sums of money are something like £23 billion which is on balance sheet. I can provide the Committee with a note.[3]
I have touched on this before.

Q233 Peter Viggers: I think a note would be helpful because I think you would agree that the implication of including PFI operations on balance sheet would have reverberations within local government.
Mr Macpherson: It will do. Primarily within local government and, the Health Service.
Peter Viggers: Thank you. That would be helpful.

Q234 Nick Ainger: Can I draw your attention to page 32 of the Report on the heavily indebted poor countries, because there appears to be a change in the target that was set in 2002, when the target was described then as getting three-quarters of the then 42 HIPC countries to be receiving irrevocable debt relief by 2006 but in fact footnote 6 at the bottom of page 32 says "The SR2002 target was for three quarters of the 26 countries that had reached Decision Point by end 2002 to have reached Completion Point by 2006." Has the target changed?
Mr Macpherson: The target was revised for SR2004 because we moved further along the curve on this. It was not that we were somehow changing goal posts; it is just that things had moved on. If it would be helpful, I can give the Committee a note. We have not gone soft on ourselves. This is an ambitious target and I can explain it but not now.[4]

Q235 Nick Ainger: Perhaps it would be helpful. So far 30 have reached the decision point. That is what you say in paragraph 2.30 and therefore they are receiving the irrevocable debt relief, which is excellent news. My question is what is happening to the other twelve? What action are you taking with other government departments to bring them into a position where they can also qualify for irrevocable debt relief?
Mr Macpherson: Just to report, I think in the last few days we have made substantial progress in relation to Liberia. So we have made further progress but this is hard work. We are one country of a number, we have to work with our colleagues in the G-7, in Europe, through the international multilateral institutions, we work very closely with the Department for International Development to try to make the progress but again, if it would be helpful, I could expand the note which we propose to send you to say precisely what we have been up to.[5]

Q236 Nick Ainger: Thank you. Again, in relation to HIPCs, Oxfam have criticised the Government because they allege that the Government has not taken any action to prevent vulture funds seeking repayment from heavily indebted countries. Is the intention to bring forward legislation to prevent vulture funds actually taking action in UK courts?
Mr Macpherson: We take this issue very seriously. I am not an expert on where we are on vulture funds, I am afraid, and I can tell you where we think we are on that.

Q237 Chairman: The question is clear: is legislation planned? That is a yes or no?
Mr Macpherson: I do not know the answer to that question. If I had brought my international colleagues here, we could answer you right away. We will give you the latest view.

Q238 Chairman: But you are the Permanent Secretary. You must know what legislation is coming up.
Mr Macpherson: I try to keep abreast of these things but there are limits. Apologies.

Q239 Nick Ainger: What is your assessment of the impact that the actions by vulture funds are now having on the international efforts to write off debt? It is all very well governments being able to do this but if these vulture funds are demanding substantial sums, plus back interest . . .
Mr Macpherson: I would agree with the implication of your question, that this is an area of considerable concern. The challenge is to find solutions which will potentially solve the problem without actually having unintended consequences in terms of wider debt markets. It is tricky, and I feel guilty that I cannot give you a detailed answer but I will send you one.

Q240 Nick Ainger: When you send that reply, could you also indicate, as far as the Government is aware, which countries are being targeted by the vulture funds and whether they are the 12 HIPCs which are currently not reaching the target?[6]

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Mr Macpherson: Certainly. If we can, we will.

Q241 John McFall: Could I add to that on the back of the next question. In terms of the countries that have their debt written off, there is the opportunity for them to have bilateral arrangements and private funds coming in, and therefore the good work that has been done originally could be undermined. Do you have any ideas how you go about your business in ensuring that the debts do not pile up and then the international community finds itself back at square one?
Mr Macpherson: These things are really important. You can have indicators and you may be making progress on them but you actually have to look at the thing across the board and continue to focus on what really matters, and what really matters is the issue which you have identified. So yes, we do look at issues like that, and again, this is an area where I do not have quite as much expertise as you do.

Q242 John McFall: But I would like a note.
Mr Macpherson: Definitely.[7]

Q243 Mr Brady: Can I turn to the Lisbon goals? In 2005 we saw that the EU missed its interim employment target. Why do you think that was?
Mr Macpherson: We all have our views on trends in the European Union but different countries have pursued structural reform at different paces. There is encouraging news in terms of Lisbon of late because actually, there are real signs that the underlying rate of growth in Germany is picking up and it has been notable that employment has been increasing, and I think France has also been doing well but clearly, the EU as a whole is behind the curve. I would primarily identify structural labour market reform as much as a deficit in overall demand because, quite frankly, the world economy has been growing pretty rapidly over this period.

Q244 Mr Brady: Do you think there is any realistic chance of meeting the target in 2010?
Mr Macpherson: I think it is going to be a challenge.

Q245 Mr Brady: The Annual Report shows a slippage against the Lisbon goals and it does provide the employment indicator underlying the course. How do the most recent UK indicators for labour productivity per hour worked and per person employed compare to the levels when the targets were set?
Mr Macpherson: Rather well actually, I think it is fair to say. Labour market data came out this morning and that has revised up the overall level of employment. That may slightly affect the rates of productivity growth because you never get unambiguous good news in all these things. Looking at output per hour, which I think is what you mentioned, looking across the economy over the last few quarters, we have been getting growth in output per hour of around 2.5% for quite a long period now. There was a bit of a slowdown in 2005, when I remember the a number of people expressing concerns about the UK productivity record. Actually, we are doing rather well at productivity and we are ahead of Germany now, we are catching up with France reasonably rapidly–I think we have halved the gap since the mid-Nineties–and in relation to America, I guess the best that can be said is that we have kept track with them; their output per hour is now 14% above ours, ten years ago it was 20%. These numbers move around but I think we are pretty much matching what they are doing.

Q246 Mr Brady: If we slipped back in 2005 but seem to be making progress again now, why did we slip back and why has that changed?
Mr Macpherson: My recollection of 2005 is that there was a bit of a slowdown, the economy grew more slowly and that fed through into output per hour. I think it was noise in the system rather than anything structural. Since then growth has picked up and the interesting thing is that employment possibly has not grown quite as rapidly as some of us might have expected, and the result is higher productivity.

Q247 Mr Brady: What is the European Union doing to address the shortfall in productivity measures and what is the Treasury's contribution to that process?
Mr Macpherson: I think the European Union can provide some collective pressure to continue to press for reform, both in product, labour and capital markets, and the Treasury, whenever it attends any EU forum, I think it is fair to say, seeks to apply pressure for change.

Q248 Mr Brady: Finally, in terms of employment creation, we know that a lot of the jobs that have been created have been taken by migrant labour, which may be a positive thing for the economy or may not. Can I ask what assessment you have made of what the effect on productivity is of migrant labour? Does it improve productivity, does it have no effect or is it a negative?
Mr Macpherson: I totally understand what you are getting at but the idea that there is a homogenous group of migrants is clearly wrong. It has been part of the Government's strategy to affect migration at the high skill end and if that strategy succeeds, productivity should increase. Obviously, if you get migration as much into the low-skilled areas, it may not have such a positive effect. Personally, I would be quite surprised if it damaged productivity.

Q249 John Thurso: I would like to follow up on Graham Brady's point but first can I go back to one that Philip Dunne was making about your under-spend and that side of things? Have you ever thought of doing a zero-based budget?
Mr Macpherson: As part of the Comprehensive Spending Review we did not do a zero-based budget across the whole board because actually, my experience of that–and I remember doing quite a lot of that in the early Nineties–is that it takes you so far but you can end up wasting quite a lot of time, so we focused our zero-based reviews on certain areas, one

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of which was our corporate services, one of which was things like accommodation, and generally it has been quite helpful.

Q250 John Thurso: Given that you did it in the early Nineties, you have done it since then?
Mr Macpherson: Yes, as I said, we did it as part of this Comprehensive Spending Review.

Q251 John Thurso: How long would you leave between doing that and doing the next one, to take stock of how much you can bank?
Mr Macpherson: I do not think zero-based reviewing works every year. It probably is not even very sensible every three years but I think you ought to be aiming to do it certainly once a decade, possibly less, because you can get in the habit of just doing things just for reasons which are left in the distant past and it is always quite sensible to adapt review these things.

Q252 John Thurso: Thank you. Coming back to productivity, two of the eight objectives focus on productivity. It is clearly extremely important. The Report refers to five key drivers of productivity. What level of improvement would you consider necessary in each of the five indicators, how are you measuring those and what are you looking for?
Mr Macpherson: We published a number of indicators on the five measures and, in the increasingly large amount of paper I am sending the Committee, I can cross-refer you to those indicators.[8]
In terms of how far we are behind on each, this is one of these really difficult questions which I could not claim to be able to answer. The whole issue of what determines growth, what determines productivity, is a particularly complex issue which economists have been wrestling with ever since I can remember. I think the best strategy in relation to the drivers is actually to have a plan in relation to each and to be seeking relentlessly to improve where we are.

Q253 John Thurso: The question I am really try to ask you, and consequent on what you have just said, is how much of these two key objectives—and objectives are something an organisation seeks to achieve—are you actually capable of doing anything about?
Mr Macpherson: That is a really important point. The one area where the Treasury is uniquely placed to have a role is macroeconomic stability. I do not claim macroeconomic stability in itself is going to make a massive difference to productivity growth but you can do an awful lot of harm, in my experience, in terms of macroeconomic management. On the wider issues, the Treasury's direct levers are relatively small. We have to work in partnership with others. The Business and Enterprise Department is clearly critical but also actually the departments which deals with skills, because I suppose if you were asking me if we could just find the Holy Grail, what actually would really change productivity in this country, its skills, on things like competition we are pretty good, on innovation we are not bad. I could go on.

Q254 John Thurso: Can I suggest one or two? It is quite interesting. If you look at 3.21 on page 44 you have "Future plans include" and there is a list of five bullet points, none of which contain any reference to the regulatory and administrative environment which affects entrepreneurial activity, whereas if you go back to page 42, the very first paragraph is a bullet point which does. Clearly what the Government does in terms of regulation can either lighten or make heavier the burden. I recently read—and I have no idea of the accuracy of this—that since 1997 there have been 3,000 new regulations that business has to bear. Is that not something that you have an absolutely direct input on and you could measure that?
Mr Macpherson: We have an input. There is an organisation called the Better Regulation Executive, which now resides in the Department for Business, and it is doing work on precisely that. William Sargent, who leads it, is a member of our board and we are in regular touch with him. I agree it is really important.

Q255 John Thurso: It would be helpful, I think, in future if that were more clearly shown in the Report so I did not have to ask you these questions.
Mr Macpherson: We are always seeking to improve the Report and I will endeavour to ensure that we address it next year.

Q256 Jim Cousins: You told us earlier, Mr Macpherson, that one of the Treasury's most important roles was monitoring output across the board. I think we would all agree with you that it is quite a bold statement. When we look at child poverty, there are three indicators given for measuring that and they are clearly all different. Which of them do you see as being the key one and can you actually measure these indicators with any degree of precision, and how regularly and who is going to be bringing this data together?
Mr Macpherson: There are a number of components to that question. First, there are three measures. I think the CSR assigned a target to the measure which we have been focusing primarily on over the last six or seven years, which is the relative measure, median income, 60% of median income. That is the indicator which we have set a target for, which suggests it is *primus inter pares*. It does not mean the other ones are not important too but there is a target there. As I said earlier, the data comes in with a lag but it is the best data we have. It is, I think, reasonably informative. You do get noise around it. The only other thing we can do is. There are big trends going on, reflecting globalisation and so on, which means that, with poverty, especially with relative measures, you are running quite hard to stand still. When it comes to budgets and PBRs, through tax and benefit measures we try and assess the impact those events will have on poverty. Sometimes when the results come out you can get

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disappointed because the data does not quite support the assessments we have made at Budget time but, as I say, that is because the trends are often against us. Median income may be shifting away from the lower end. We monitor these things and we take them seriously.

Q257 Jim Cousins: How frequently, and in what form, do you propose to report on these various indicators?
Mr Macpherson: The current reporting framework provides for departmental reports and autumn performance reports. We will use these bi-annual events to report on progress. In the case of poverty, I think the next set of official figures will be in March of next year.

Q258 Jim Cousins: Just to assist the Sub-Committee in understanding those figures when they come, it would be useful to see where we are now on the three indicators which were set out.
Mr Macpherson: Certainly. The Delivery Agreement which covers child poverty—I have got all of them in front of me but I cannot find the relevant one—goes into this in quite a lot of detail because we have been making progress on measurement. We set out there where we are. The PSA Delivery Agreement 9 has quite useful data in it, but I am happy to cross-refer to it.[9]

Q259 Jim Cousins: For the reasons you have already presented to us, and I think we would agree with, these are very testing targets. What new initiatives do you visualise which are in the CSR or might be coming along that would help to deliver them?
Mr Macpherson: As I said at the beginning in relation to an earlier question, there are things you can do in the short to medium term which are around improving incentives to work, around transfer payments, for example through the tax credit system, but those will only take you so far. As important will be the whole raft of measures associated with how children grow up and develop through life, their home environment, their school environment and so on. Looking further out beyond 2010, I would attach a heavier weight to education, particularly primary education and early secondary education, than I would to more classic income distribution measures.

Q260 Jim Cousins: In terms of both the targets for child poverty and for regional growth, of course it is clear in your documentation that there are other things which have a huge bearing upon that. Trying to analyse all this as somebody from Tyneside at the present time, you have got 20 or 30 people working on Northern Rock and other things related to that, between Durham and Newcastle there are 5,500, most of them women, in not very glamorous jobs with not very glamorous incomes, but they are the sheet anchor of whole household networks and whole neighbourhoods. The CSA, which is a big employer in Tyneside, is going to cut the number of its workers by 50% by next year, ditto, mostly low paid women who have sheet anchor jobs for their households and their neighbourhoods. Her Majesty's Revenue & Customs, who are going to cut tens of thousands of jobs, ditto, concentrated in certain areas, sheet anchor jobs, mostly women, not very glamorous incomes but sheet anchor jobs. Department for Work and Pensions, 30,000 jobs going, sheet anchor jobs, mostly women, concentrated in certain neighbourhoods. Is anyone joining this all together and seeing how what one part of Government is doing to deliver efficiency targets is having an impact upon child poverty and regional economic growth?
Mr Macpherson: Certainly we are mindful of the issues you set out. In relation to public sector employment, in the context of the Lyons Review and the efficiency programme more generally, we have been focusing on the regional dimension to employment. Clearly I recognise that public sector employment is important, but my guess is that in terms of the long-term prospects for the North East it is going to be private sector employment which matters the most because in many ways that drives economic activity in a way which, for all its benefits, public sector employment does not. We do look at that. If you are saying, do we have some complex model which we can feed all these things into, I am afraid we have not achieved that level of sophistication, but these things matter.

Q261 Jim Cousins: It is just bringing all these different policies and their impacts together which I am concerned about and not having an economic model.
Mr Macpherson: The only thing I would say, which is encouraging, is that employment in the North East has grown over the last year. In terms of the regional objective, one of the successes has been the higher rate of increase in employment. There is also encouraging news about skills. Although it is terribly early days, and I do not want to overdo it because the data is less than perfect, we are making some progress on this regional target.

Q262 Nick Ainger: In Wales I have recently led a delegation to see the Financial Secretary to the Treasury about the HMRC restructuring in Wales, and one of the themes has been the lack of joined-up government, as far as we can see. An example was given where the proposal is to close an HMRC office in Newport and transfer the work to Cardiff and, at the same time, the DWP is closing an office in Cardiff and transferring its work to Newport. That is a classic example of where we have not got joined-up government at all and, as a result of that, change there would be a massive increase in the carbon footprint. Surely as a key department in government, which has got a pan-government responsibility, you should be ensuring that we do not get into these silly positions.
Mr Macpherson: We are doing our best. I am sorry if in certain areas it may appear otherwise. A good example is property and accommodation where we have been working very hard to ensure sensible

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moves, for example the ONS has been moving down to Newport. These things are difficult. We can help facilitate and provide departments with information, but what I think would be dangerous is if we returned to the highly centralised system of the 1950s and 1960s where all these things were run out of the Treasury and the Cabinet Office because, great times as no doubt those were, I am not convinced the Treasury is best equipped to manage these processes.

Q263 Nick Ainger: Who is?
Mr Macpherson: You have got to devolve these decisions. The job of the centre is to ensure those devolved decisions are taken on the basis of sensible information.

Q264 Jim Cousins: Following on from that point, and taking your point that the jobs in 20 years' time will be in the private sector and will be a different order of skills—I do mention in passing that, of course, in your own documentation you mentioned that business formation is low in areas like the north-east of England and spending on research and development, both in the public and the private sector, is extremely low in areas like that—do you not see the problem here is that jobs are being lost which are mostly held by women who have complex responsibilities, whether or not they are mothers with dependant children, they are highly likely to have complex responsibilities? In terms of where they live, they may be quite tied down to particular areas for all sorts of good reasons in terms of delivering other targets. How do you get those women to be people who are going to be high skilled employees of small, highly mobile, private sector companies in the future?
Mr Macpherson: I am under no illusion, these things are very difficult. I am also sensitive, and we as an institution are sensitive, to the issues you are raising. I am not claiming that you can wave a magic wand and it will all be all right. I also recognise the challenges you raise around business formation and R&D, these are long-standing problems and very long-standing trends. We do need to be sensitive to the implications, equally in a number of areas you have to move the way public services are delivered forward. I think some data was published earlier this week which confirms that the biggest Civil Service reductions have been in London and the South East, that is how it should be. We need to continue to monitor and work at this.

Q265 Jim Cousins: Who is looking at this? What department of Government? Where is somebody joining up these?
Mr Macpherson: In terms of the people?

Q266 Jim Cousins: Yes.
Mr Macpherson: The Cabinet Office supported by the OGC.

Q267 Jim Cousins: When you were last here I raised the issue of population estimates and what I was concerned about there was not the calculations, but simply the policy impact of it. Sadly I have been proved to be quite right in thinking that was going to be a serious issue in resource allocation, both in health and local government. Health never gets a mention, it is always local government, but it is health as well. How are you going to deal with the fact that we now admit the uncertainty about population figures and its effect upon resource distribution?
Mr Macpherson: You are right to raise it. I would not claim that the issue has got any easier. There has been a substantial debate in recent weeks about the quality of the data. We need to continue to improve that. The Treasury has a massive interest in ensuring that resources are allocated sensibly. You have identified health and local government. These formulae are always being updated, but it would be nice to have them based on as up-to-date information as possible. Even then we should be under no illusion, that getting a really strong handle on population estimates at a local level is really difficult in a world where people are shifting and moving around, coming into the country and leaving the country. Even if you had brilliant controls at the border which could count everybody in and count everybody out, there would still be big problems once people are in the country because people move around.

Q268 Jim Cousins: Yes, but the problem I am asking you to consider is not what is happening and the figures. In terms of the local authority business growth initiative there was a successful judicial review which threw the whole policy into confusion and, effectively, the business growth incentive programmes had to be parked for two years while all of that gets sorted out. Are you not facing the same kind of difficulty across much bigger spending programmes if there are judicial review challenges to the information base which is being used to inform the distribution of huge sums of money to health and local government? It is an immediate problem.
Mr Macpherson: It is an immediate problem, it is an urgent problem, and we need to address it. It would be a pity if judicial reviews prevented resources from being distributed because you are never going to get a perfect allocation of resources. We need to use the database which is improving through time and it is going to improve even further if the ONS's plans for this area are delivered. We have got to try and allocate resources on the best use of data we have got.

Q269 Chairman: The efficiency target announced of £30 billion of net savings by 2010, what would that have been if it had been gross savings?
Mr Macpherson: Almost certainly higher, but I cannot give you an exact figure.

Q270 Chairman: Can you add that to the homework you have already commissioned?
Mr Macpherson: I fear we may not be able to give you an answer, but we will try.[10]

[10] Ev 86

Q271 Chairman: Louise Tulett, we pursued with Mary Keegan this whole issue of appointing proper finance directors to the other departments and here, March 2007, you said only the MoD lacked one, have they now got one?
Ms Tulett: No, I believe they still have not. It is not part of my brief, but I believe they still have not appointed, though I think they have an undertaking to do so when the current incumbent moves on.
Mr Macpherson: We are in discussions with the MoD.

Q272 Chairman: It is a pretty big department and it seems to get into difficulty with some of its expenditure, why is that being left until last?
Mr Macpherson: We have recently raised it again with the MoD's, I think they are called, permanent under-secretaries there, but we are on the case.

Q273 Chairman: Perhaps you would convey our concern that this still seems to be one important vacancy.
Mr Macpherson: Certainly.

Q274 Chairman: On PFI, you were asked by Mr Brady, one of my colleagues, about liabilities. What is the likely impact of applying the new IFRS standards on the public sector net debt?
Mr Macpherson: I am not being deliberately unhelpful when I tell you that there is a high degree of uncertainty. This will depend on individual auditors decisions. My guess is it will increase it but, in terms of taking a long view of debt, there are a number of forces which are affecting both the numerator and the denominator and if I gave you an estimate it would be so wrong that it would be unhelpful.

Q275 Chairman: There is no working assumption in the Treasury of whether it is £10 million, £20 million or £100 million?
Mr Macpherson: No.

Q276 Jim Cousins: Could you see it as an escape route from the golden rule?
Mr Macpherson: Clearly, if there was a wholesale change you would have to consider what it meant in terms of the fiscal rules.

Q277 Jim Cousins: So the answer is yes.
Mr Macpherson: No.

Q278 Chairman: There is one particular group who have been claiming that they do need to know your decision and, of course, they are the hospital trusts. They have been arguing that they need to know by Christmas in terms of financial planning for next year. Are you going to answer them before Christmas?
Mr Macpherson: We are working with departments to ensure that they can plan with confidence.

Q279 Chairman: So they will hear by Christmas, will they?
Mr Macpherson: We are having a dialogue with the Department of Health, yes.

Q280 Chairman: Finally, there has been some recent research on the economics of the Olympics, claiming that while London's economy will benefit to the tune of some £6 billion from the award of the Olympics to three or four years after it has been held, there would be a detrimental impact on the regions of around £4 billion. Have you addressed that kind of forecast in the CSR?
Mr Macpherson: I have seen so many speculative estimates of the effects of the Olympics, I would be fairly sceptical about the estimate you have just given, although I am sure it well reflects extensive work. The Comprehensive Spending Review and the PBR factored the Olympics into it and, therefore, wider policy beyond just the Olympics was reflected in the settlement.

Q281 Peter Viggers: Mr Macpherson, on the subject of PFIs, you have undertaken to give us a note on this, but just to underline the importance of the whole issue, I have in front of me here a paper and I know the numbers are out of date. Paul Boateng, when he was a minister, answered a question and said that £20 billion of capital value of PFI projects was included on the government balance sheet, but estimated payments under PFI contracts for the 25 years from 2005 to 2006 totalled £138 billion and I have got a reference to capital economics in the paper they produced at that point. The numbers are very large indeed and I hope a note can cover those points.[11]
Mr Macpherson: Definitely. Do not worry, £138 billion will not be coming onto our balance sheet on any basis, that is just the payment. It is a different issue. That will include things like unitary charges and so on, but we will give you a note.
Peter Viggers: Thank you.
Chairman: We are going to leave it there. We look forward to quite a lengthy note on some of the issues which have been raised. Thank you both very much for appearing today.

[11] Ev 82

Wednesday 5 December 2007

Members present

Mr Michael Fallon, in the Chair

Nick Ainger
Mr Graham Brady
Jim Cousins
Mr Philip Dunne
Ms Sally Keeble
John McFall
Mr George Mudie
Mr Siôn Simon
John Thurso
Mr Mark Todd
Peter Viggers

Witnesses: **Dame Barbara Mills DBE QC**, Adjudicator, and **Mr Simon Oakes**, Head of the Adjudicator's Office, gave evidence.

Q282 Chairman: Dame Barbara, can I welcome you to the sub-committee. Could you formally identify yourself and your colleague for the shorthand writer, please?
Dame Barbara Mills: I am Barbara Mills, I am the Adjudicator, and with me is Simon Oakes, who is the Head of the Adjudicator's Office.

Q283 Chairman: The last time you came before this sub-committee you told us your accounts were held by the Inland Revenue.
Dame Barbara Mills: Yes.

Q284 Chairman: Are they now held by HMRC?
Dame Barbara Mills: Correct.

Q285 Chairman: Where do we find all this information about your accounts?
Dame Barbara Mills: We can always get it for you, as I did last time.

Q286 Chairman: Why is it not tabulated in the Revenue's Annual Report and Accounts?
Dame Barbara Mills: I am afraid I cannot tell you; I do not draw that up. I can certainly get the details for you.

Q287 Chairman: I am sorry, I cannot hear any of that. Could you speak up?
Dame Barbara Mills: Yes, certainly. I have no idea, I do not draw up their report, but I can certainly get the details provided to you, as I did last time. I am sorry, if I had known you wanted it today, I would certainly have brought them for you.

Q288 Chairman: But you are here to account for the work of your office.
Dame Barbara Mills: Exactly.

Q289 Chairman: Therefore you can understand why we would like to look at the figures.
Dame Barbara Mills: Yes. Well, we spent two million.

Q290 Chairman: Yes, but we need to know how you spent two million.
Dame Barbara Mills: Very easily at the moment, I have to tell you.

Q291 Chairman: Yes, but we would expect to see some detail.
Dame Barbara Mills: I am sorry I have not provided it for you, but I certainly will do and break it down. It has changed because of the payments for the estate. It is now dealt with in a different way. I will put in the comparisons if that helps. We are actually moving, in any event, in January, so that will change as well.[1]

Q292 Chairman: You have told us it is quite easy to spend the money. What impact has the increased number of tax credit complaints had on your office and on your resources?
Dame Barbara Mills: We have had a very large increase indeed. We have had no increase in staff and, indeed, we have not asked for it, but what we have done is to, I suppose, to use that terrible phrase, "work smarter" because we really have got to make sure that these cases are dealt with as speedily as we can deal with them. They are very, very important cases. We have had a huge increase, as you can see, and if I give you one figure which I thought was rather a dramatic figure, we have dealt with in this year, taking all our cases into account, as of last week, as many as we dealt with in the whole of last year, and we have got four months to run, so I think that that does demonstrate that we are doing a pretty good job in keeping up as best we can with the influx of cases.

Q293 Chairman: Have you asked for additional resources to handle all this?
Dame Barbara Mills: I do not think additional recourses actually would help us very much, and, no, I have not asked because I would not get them. At the moment the situation is that the Inland Revenue, or HMRC, as it now is, is having to cut back on resources, as no doubt you heard, so we are in the same situation. I think it would be unreal to ask, and what I prefer to do is to try to find better methods of working to get through the influx of cases, and that we are doing.

[1] *Note by witness*: Separate accounts are not drawn up for the Adjudicator's Office. The total expenditure incurred by the Adjudicator's Office for 2006–2007, however, was £2,479,033. Of this, £1,919,083 was in respect of paybill and £423,541 was in respect of accommodation costs. The balance of £136,409 related to other administration costs.

Q294 Peter Viggers: How well-known is the existence of your office and your availability?
Dame Barbara Mills: I hope it is well-known. I am sure you understand the system, which is complaints go through, first of all, the HMRC tiers and then come to us, and if it has not been settled satisfactorily to the complainant's agreement, or at least acceptance, by the time it gets to the second tier, they are always told about us. The difficulty with going out and just publicising ourselves is that people think they can use us as a first stop, and I do not like sending people back, and we do already sometimes get cases which come to us too early on in the procedure, but we just could not cope if we did that. We do write articles. I go out and speak. We try to publicise ourselves without, as I say, attracting the sort of work we could not deal with.

Q295 Peter Viggers: But you are satisfied that people who might wish to make a complaint or have an investigation are informed of your existence.
Dame Barbara Mills: I am satisfied about that, because I see the correspondence, I see the files.

Q296 Peter Viggers: Are you satisfied that the policies across the HMRC, the Valuation Office, the Public Guardianship and the Insolvency Office are consistent in terms of complaints?
Dame Barbara Mills: Are they consistent? Are the complaint-handling policies consistent?

Q297 Peter Viggers: Yes.
Dame Barbara Mills: Yes, I am satisfied about that. In part, particularly if I deal with the Public Guardianship Office and the Insolvency Service, they came to us later in the day, as it were, because we started off with the Inland Revenue and then Customs and Excise and we were very helpful to them, at least I hope they think that, in helping them design a system which would work well, because by that stage we had lots of experience and so we were able to help them, and I think it did go well.

Q298 Peter Viggers: How do you calibrate the settlement of a case? Let me give you an example from my own constituency where an individual's file was lost several times and, after years of being driven to driven to distraction, she was offered £50 compensation. How do you assess these matters?
Dame Barbara Mills: I am afraid I really cannot comment on the individual case, but can I just say our general principles when we deal with them. First of all, we always hope that there has been an apology early on in a case like that: because our experience is that, if there has been an apology at an early stage, it often stops the complaint escalating. People feel furious about it and if they have an apology early on it helps. One of the other things I would say when you are talking about the calibrating of money is that one of the things we often find is that complainants are not in it for the money. What they want is their problems put right, they then want to be assured that this sort of thing cannot happen again, either to them or to other people. That is very high up the complainants' interests. They are altruistic, is the way I would describe it. As far as money goes, there are lots of things that can be done. Sometimes, if it is a tax case or a Tax Credit Office case, then we can recommend, because we can only recommend, though our recommendations have always been accepted up to now, that they write that off, or we can suggest that the complainant is given some money in respect of what one would call hurt feelings, and so on. Those tend to be quite small sums. There is a whole variety of things that can be done, and that is why on one individual case, without looking at the papers, I could not say whether that was right or wrong.

Q299 Peter Viggers: You have wide experience across the public service. In your present role do you feel that you are inhibited in the sense that you cannot involve yourself in aspects of departmental policy or matters of law? Does that restrict your activities?
Dame Barbara Mills: I am not allowed to do that, but in fact there are ways of helping, if I can put that way. If we see something where a policy—it is usually the implementation of the policy, not the policy itself—is not working at all well, then we can recommend, and we work very closely with the departments in trying to improve the service that they give. I think that is one of our most valuable tasks: because we see all the things that go wrong and really, from that point of view, we have a particularly good perspective of being able to help, to suggest things that could improve.

Q300 Peter Viggers: When you make those recommendations, are they made in public or in private?
Dame Barbara Mills: The recommendation which will go to the person who is receiving our recommendation will obviously be one that that person can publicise if they want to; it is perfectly fair. Do we publicise each of our recommendations to the offices? No, we do not, but you will see them in my report.

Q301 Ms Keeble: I wanted to ask a bit more on this point because a big part of the point of having a complaints system, internal or external, is about the way in which the lessons are learned and passed on.
Dame Barbara Mills: Yes.

Q302 Ms Keeble: Can you say how that is done formally? Could you give us an example?
Dame Barbara Mills: I suppose one of the examples at the moment, because it is always helpful, I think, to choose a current one, is the difficulties there have been with the implementation of tax credits, of what is called Code of Practice 26. I imagine that you have heard about that from your constituents, if nowhere else. We have been very much involved in, I hope, helping, is the right word, with the redesign of that. It is not published yet, but it will be published, and I think that is going to be a great step forward.

Q303 Ms Keeble: Apart from personal relations, are there structural ways in which the department actually analyses the cases you have dealt with and looks structurally at what lessons are to be learned out of it?
Dame Barbara Mills: Yes; absolutely. They have had different systems during the time I have been there, because I have been there a long time now, but really what it has done is to bring altogether the methods of learning lessons and then disseminating them through the offices. Whenever I send out recommendations—I do not know if you have had any of mine, but if you have you will see that a letter has gone to whoever is the head of that part of the office to disseminate that. So I think they are disseminated. Whether everyone always follows them, of course, is something more difficult to implement, but I think on the whole, yes, but I do not see a tremendous amount of stuff coming back to me where I felt, "Two years ago we suggested this should be done and it is still not being done correctly."

Q304 Ms Keeble: Do you progress chase those?
Dame Barbara Mills: If I get another of those, yes, I would, and, of course, we get feedback from the complainants if they are not happy. For example, if we have recommended that they should receive a cheque or a payment and they do not get it, they come back to us and then we want to find out why, and it should be sent out within a certain period of time.

Q305 Nick Ainger: Dame Barbara, coming back to some of the points that Mr Viggers was making, I, along with colleagues, will have seen numerous letters from tax credit offices, either to me or directly to the constituent, telling them the sad news that, although errors were made in their case, unfortunately they must repay the overpayment. In those letters reference is made to the Adjudicator's Office, and I draw your attention to what you say in your report: "It is our role to consider whether or not the organisation has handled the complaint appropriately", and then it goes on, most importantly, to say, "and given a reasonable decision." I have never yet seen a letter to a constituent, or to myself, making reference to the Adjudicator's Office's role, giving a reasonable decision. The impression is given in those letters of a refusal to repay, or an insistence that a repayment is made, is whether the case has been handled properly, I think; so the impression is given to the constituent that if the system has worked they have not got grounds to take anything to you. Do you think those letters should be changed so that, if they feel that they have been treated unreasonably and the decision in their view is wrong, those letters from the Tax Credit Office should actually say that?
Dame Barbara Mills: Mr Ainger, if you have got specific examples, please, send them to me, because certainly they should not be put off from coming to us, and, if that is the second tier, they should have a copy or at least be referred to our powers and what we can do.

Q306 Nick Ainger: That is the point I am making, rather lamely, I am sorry.
Dame Barbara Mills: If you want to send me examples, I will certainly look into it.

Q307 Nick Ainger: I certainly would, but you were commenting earlier about the number of complaints that you have received. I think if people perceived you as a Court of Appeal, then I do think you would have to be seeking greater assistance: because people have not viewed you, certainly I have not viewed you, in that way, as someone who can look at the actual decision that has been taken.
Dame Barbara Mills: Can I say that I am not a Court of Appeal. If you go back to the legal situation, in the Court of Appeal they can overturn the decision that has been made. I can only do that if the Tax Credit Office has acted outside its rules, its procedures, and so on. This is the difficulty with the current Code of Practice 26, because, as you know, it is one of those codes of practice where it is not easy for the complainant to get the award overturned, for the reasons that are set out in that code. However, as I say, I am always hoping for a brighter future and I think that COP 26, the new one, will be much easier, it will be much fairer to implement and, although it will take a couple of years, because we always see cases which are old by the time they get to us, I think you will find a big improvement when that happens.

Q308 Nick Ainger: When you are looking at cases do you actually take into account the principles of natural justice?
Dame Barbara Mills: I cannot. I wish I could sometimes.

Q309 Nick Ainger: You cannot.
Dame Barbara Mills: No. I would very much like to sometimes, and I feel myself constrained sometimes to make a decision which perhaps I would prefer not to, but I am constrained because this is the role of the Adjudicator and, indeed, the Ombudsman by the whole question of following the procedures, and so on. If you move into the role of natural justice the difficulty is how you apply that across a very, very large number of cases, but I would very much like to do it from time to time, but I cannot.

Q310 Nick Ainger: You cannot because of—
Dame Barbara Mills: Because of my role. I am not a judge; I am not an appeal court. I can only look at what has happened. Has it been dealt with properly within the procedures and have they been followed properly? This is the difficulty. You get a procedure, which, in fact, I think is too strict, and indeed I have made lots of representations about this code of practice, and it is now going to be changed and I think be much, much fairer, and that is the best I can do really.

Q311 Nick Ainger: Does the change in the code of practice address this issue where, if it was reasonable for the claimant to understand that they were being paid too much—

Dame Barbara Mills: Yes.

Q312 Nick Ainger: Is that an issue that is addressed?
Dame Barbara Mills: It is one which I have to deal with all the time, and is very difficult because everyone thinks they are reasonable, and when they get a letter which says, "A reasonable person would have realised that this was wrong and you did not, so you have got to pay it back", it does nothing but exacerbate the situation. I think the word "unreasonable" is the most unfortunate one to use. This is not in final form, but I hope it is going to be dropped, and I think what will come out of it, I hope, is a much fairer balance between the complainants who have their obligations to read the notices that come and get back to the tax office if there is a mistake and the balance which is the reasonableness of the Tax Credit Office, which must deal with things within a perfectly reasonable (perhaps I should not use that word), within a sensible period of time to make the amendments, look at the areas, and so on. I think it will be much better.

Q313 Nick Ainger: My final question. I have got a number of cases in which it is quite clear that the claimant informed the Tax Credit Office of every change and questioned whether the figures were correct, and they were assured that over a number of years they were correct only, some years later, to be told, "No, sorry, we made a mistake", and yet the overpayment is still demanded back on the grounds that, because they were raising the possible overpayment, they must have realised that there was something wrong. I think that is wrong. What is your view about it?
Dame Barbara Mills: I think that is very difficult, and that is one of the things that we get all the time, coupled with the fact of annuality where they may be told in, say, September that it is right but, because of things which happen after that—they may get an increase in income or something like that—by the end of the year it is not right. That is another one which is very difficult for people to understand. All I can say is I hope we will get a fairer system, but, Mr Ainger, if you have got any particular cases which have stuck, as it were, at level two and have not got to me, please let us see because I would very much welcome it, because I know how much Members of Parliament care about these issues and how many letters they get. When I tell you our work load has gone up by 80%, you will see that we have got a problem on our hands, but I would invite you to send me anything that is particularly difficult.
Chairman: I am sure that will be welcome. George Mudie.

Q314 Mr Mudie: On the internet at the moment there is a new COP 26. Is it a new one, or is it just a re-run of the old one?
Dame Barbara Mills: It has been a bit of a re-run of the old one. The new one is going to be a re-run of that one too, but with some significant changes.

Q315 Mr Mudie: When can we expect that?
Dame Barbara Mills: I am not drafting it.

Q316 Mr Mudie: No, but you are involved with the Ombudsman and the departments. Mr Oakes is dying to say something.
Dame Barbara Mills: Hopefully January.
Mr Oakes: Yes, that is our understanding.

Q317 Mr Mudie: January. Which year?
Mr Oakes: Just after Christmas.
Dame Barbara Mills: 2008.

Q318 Mr Mudie: You said you did not like publicity, but in the old one, in fact I will quote it to you, but not all of it, if you still think an overpayment should be recovered, if there is no new relevant information, they say not go to you but go to a professional adviser, or the CAB, and only if you go down through the document and go on to another part of the web are you mentioned. Why are you not automatically mentioned?
Dame Barbara Mills: I do not know. I will take that up.

Q319 Mr Mudie: You should be?
Dame Barbara Mills: I should be. It is not that I do not want publicity, but what I do not want is people coming to me too early in the process.

Q320 Mr Mudie: Can I take you up on that, because in the Ombudsman's report she is now saying that she will not take cases unless they have been totally through the department's complaints procedure and you.
Dame Barbara Mills: Yes.

Q321 Mr Mudie: So you are part of the appeal procedure now. You are not going to want people going to the Ombudsman unless you take them, so they must know about you?
Dame Barbara Mills: All I can tell you is we get lots turned back from the Ombudsman nowadays. That has increased our work load tremendously. It used to be the choice of the complainant, through the Member of Parliament, that they could go straight to the Ombudsman. It is the Ombudsman who has suggested that they should come through us, first of all, and let me reassure you that 40% of the cases that we see we uphold in part or wholly, so it is not just a non existent filter, if I can put it that way.

Q322 Mr Mudie: Can I just say I was disappointed in you when you said you did not ask for more resources because you would not get them.
Dame Barbara Mills: Yes.

Q323 Mr Mudie: When I tie that to your report, where you are indicating it is taking you 21 weeks to settle a case, for somebody with this hanging over them, I do not think you are doing your customers any good by being so careful with the nation's finances. Why the hell are you not fighting to get resources to take this down? You are unfair on your staff and you are unfair on the customers.

Dame Barbara Mills: I am a realist.

Q324 Mr Mudie: Twenty-one weeks!
Dame Barbara Mills: I can go and ask but I am not going to get it, but what I would say is that for the Tax Credit Office cases we have got it down to 17 weeks, so we are getting better.

Q325 Mr Mudie: No. Your Annual Report says the year before it was 19.7, it is now up to 21, and I do not think that is a good enough answer. You are letting your customers down by not pursuing it. Twenty-one weeks for a low paid family to get a decision.
Dame Barbara Mills: I know.

Q326 Mr Mudie: Come on.
Dame Barbara Mills: I agree with you, but can I just say that a lot of that time, without causing difficulties for the people sitting behind me, is waiting for reports from the HMRC so we can get going on our case.

Q327 Mr Mudie: Take COP 26, you are giving us great hopes.
Dame Barbara Mills: Yes.

Q328 Mr Mudie: Let me clear one thing. We fought this out last time and we never got anywhere with the Revenue about it. If they make a mistake and they decide, no, you reasonably should have known, so we are going to take this overpayment, do they take hardship into consideration in those cases?
Dame Barbara Mills: My view, which is not wholly at one with—

Q329 Mr Mudie: The question is, under the code of practice it does not seem to be mentioned.
Dame Barbara Mills: It can be taken into account at the second stage, at least that is my view of it. It is not wholly in accordance with what the Ombudsman thinks. So what would happen? If you think about it, it is like any debt. First of all, do you owe the money? Secondly, if the answer to that is, no, you do not, do not bother about hardship because you have not got to pay it back. If, on the other hand, the answer is, yes, you do owe this money, then you look at the hardship. The Ombudsman prefers to run those two together, and we have tried running them together because we do not like to be out of step with the Ombudsman, but can I just tell you a new problem which has arisen which I do not think would have hit her yet, which is this: when we try to do that and we get in touch with people to tell us about hardship, they have to give details, quite intrusive details, about their personal financial position. We are now getting a lot of letters back saying, "We have not had your decision about whether we owe this money or not and we do not want to give these details until we know that result." So we are slightly going round chasing our tails because, having tried to do something which we were asked to do, we now discover it does not suit a lot of the clientele, so what do we do next? My view is that we should do it as a two-stage decision and then move over to the hardship afterwards and then it is properly considered. I cannot see any point in being intrusive into people's elf lives without—

Q330 Mr Mudie: Is hardship going to be made absolutely clear in COP 26, that it has got to be taken into—
Dame Barbara Mills: I very much hope so.

Q331 Mr Mudie: You say you very much hope so. Have you and the Ombudsman formed an alliance to try and persuade, with all your feminine charm, the Inland Revenue to put this in COP 26?
Dame Barbara Mills: Yes, I see no reason why it should not be there, let is put it that way round, but let me wait until I see the draft.

Q332 Mr Mudie: My last question. Section 18: tell us about it and how is it going to affect your work load?
Dame Barbara Mills: It has affected our work load because it has caused us to suspend cases we otherwise could have dealt with, and, of course, that adds to the time which you say is too long, and I agree with you. I think that now they are getting unsuspended (that charmless phrase which has been applied to them) and we are now able to work, so we are getting through that backlog. That is the way it has affected us.

Q333 Mr Mudie: When it broke, they were going to take three years to deal with cases. Has that suddenly disappeared?
Dame Barbara Mills: I can only tell you about the individual cases we have got sitting in our office, because those are the ones that we know are suspended. I have been dealing with quite a lot that have been unsuspended, because my impression was that they were very cautious to start with and suspended a lot of cases which perhaps need not have been suspended, but that is just my impression.

Q334 Mr Mudie: How are they freeing them up? This is where they are chasing people for overpayments but they have not done it legally.
Dame Barbara Mills: Yes.

Q335 Mr Mudie: Are they sending notices to people now belatedly saying, "We are reviewing your case in 2004"?
Dame Barbara Mills: What they are doing, as far I am aware, because I am not part of the department, what I am seeing, is that they send us lists of cases that were suspended and then they say, "These ones are unsuspended." I suspect this is because they were over cautious and put the whole lot into that lot to start with and are now realising they need not be in there and therefore we can work them.

Q336 Mr Mudie: There were reportedly 250,000.
Dame Barbara Mills: Yes. We have not got anything like that.

Q337 Mr Mudie: I know you do not, but have you heard anything on the grapevine about how many thousands?
Dame Barbara Mills: No.

Q338 Chairman: Are there any other questions for Dame Barbara? No.
Dame Barbara Mills: I will certainly send you the break downs. I am very sorry I came without them.

Q339 Chairman: We do not understand, not why you did not come without them, but why they are not actually included in any other form that we can see. That is the point here. If they are going to be buried in the HMRC accounts as a single line, then I think we would like to see your expenditure and income set out properly for us;[2] so could you send that to our clerk, please?
Dame Barbara Mills: Yes, I will. I seem to remember last time we had great difficulty in getting these figures out, not from us but, as you say, buried in a single line, but we will explain to you how it is dealt with. Also, Mr Ainger, or if anyone else has got any cases which are worrying them about this—

Q340 Mr Mudie: We will send you them.
Dame Barbara Mills: Not ones that have been through me before, please. No, seriously, one or two of the things I have heard today I find a little disturbing and we will take those up.

Q341 Chairman: Thank you very much indeed.
Dame Barbara Mills: Thank you very much.

[2] See footnote to Q291

Wednesday 5 December 2007

Members present

Mr Michael Fallon, in the Chair

Nick Ainger	Mr George Mudie
Mr Graham Brady	Mr Siôn Simon
Jim Cousins	John Thurso
Mr Philip Dunne	Mr Mark Todd
Ms Sally Keeble	Peter Viggers
John McFall	

Witnesses: **Mr Dave Hartnett CB**, acting Executive Chairman, **Mr Mike Eland CB**, Director-General, Law Enforcement and Compliance, and **Ms Sarah Walker**, Director, Benefits and Credits, HM Revenue and Customs, gave evidence.

Q342 Chairman: Mr Hartnett, welcome to the Sub-Committee. Could you identify your team formally, please?
Mr Hartnett: Yes, Chairman. Thank you. I am Dave Hartnett, Commissioner of Revenue and Customs and the acting Chairman, to my right is Mike Eland, also a Commissioner of Revenue and Customs and the Director-General responsible for enforcement and compliance, and to my left is Sarah Walker, our Director for credits and benefits.

Q343 Chairman: Could we start with the issue of data security. Mr Gray in his statement on internal controls of 3 July says there has been an increased level of issues involving data security. HMRC is taking action to improve the security of data which it holds. Were there breaches before the breaches that have been reported?
Mr Hartnett: Yes, Chairman, there were. There was an issue in 2006 when our information technology partner mislaid a disc of banking information. We notified this information to the Information Commissioner and we introduced at that stage more stringent rules. I am pleased to say the disc was found but that does not excuse the loss in a way.

Q344 Chairman: Since you were merged together, Customs and Revenue, how many cases of security breaches have there been?
Mr Hartnett: There have been quite a number.

Q345 Chairman: How many?
Mr Hartnett: Seven of some significance, but we record everything that is a security breach, so leaving a cupboard open over night we record because we set out from 2006 to learn lessons in relation to security and to tighten things up.

Q346 Chairman: Seven serious breaches?
Mr Hartnett: Seven breaches which we reported to the Information Commissioner.

Q347 Chairman: Will the Poynter Review now be looking at all losses of data in this period?
Mr Hartnett: The Poynter Review will initially focus on the loss of the child benefit data and our data security generally. Kieran Poynter has told me he aims to make us a world-class performer in the maintenance of data, so I am sure he is going to look across how we manage all our data and the issues we have had.

Q348 Chairman: Turning to the loss of the child benefit discs, what would have been the cost of desensitising the material approximately?
Mr Hartnett: I do not know the answer to that. Mr Poynter will be looking at that. I have seen speculation in the media about what would have been involved. At the moment I do not know.

Q349 Chairman: But you must know. You must be able to hazard an estimate as to what it would have cost, because that was the key point, was it not? It was too expensive to desensitise?
Mr Hartnett: No, I do not think that is right. The emails that have been released by the NAO do refer to costs, but that is not a complete story. They also refer to size considerations and the like, and the key issue around that data is it should not have left our premises anyway. There are a number of breaches of our procedures in that happening.

Q350 Chairman: I understand that, and I am not suggesting cost was the only issue involved here, but if cost had been an issue, of what order would the figure have been for you to say, “That is just too expensive for us to do”? Are we talking of 50,000, 10,000, 100,000?
Mr Hartnett: I would have thought, Chairman, it would be less than 50,000, but I do not have the precise figure.

Q351 Chairman: Can you clarify who in the HMRC finally authorised the undesensitised material to be sent on the disc? There has been this confusion as to whether it was a business manager and so on.
Mr Hartnett: I can clarify that.

Q352 Chairman: Could you clarify the grading system and who it was?
Mr Hartnett: Yes, of course. To the best of my knowledge, there was no authorisation here. The team that managed that data and were established to manage the data securely in a secure environment within our offices released the data. We have two crucial rules here that if we are letting any asset,

data, software, hardware, equipment, out of our offices, it has to be managed in a proper way and there has to be proper authority. If it is software, it has to be released outside the organisation with all appropriate protections. What happened here is that that did not happen. This is a dreadful mistake.

Q353 Chairman: I understand that, but what is the proper authority for releasing this? In what grade in your organisation is the proper authority vested?
Mr Hartnett: Here we had set up a procedure with the National Audit Office for passing data to them. The National Audit Office did not use the procedure and we did not release the data through the procedure, and that procedure worked in a team led by our child benefit process owner, a member of the senior Civil Service, who in October knew nothing of this because the process was not followed.

Q354 Chairman: But it was not, equally, copied to anybody else more senior. Is that right?
Mr Hartnett: No.

Q355 Chairman: These emails were not copied to anybody more senior.
Mr Hartnett: I have seen absolutely no evidence, other than the one email that has been commented on in the media, that anyone in the senior Civil Service at any level was copied into this.

Q356 Mr Todd: I suppose one of the puzzles to anyone who knows anything about the systems is that it was actually technically possible to do this. Not that some senior manager did not know about it; it should not have been possible for one individual member of staff to produce a file of this kind and despatch it; there should have been a built in bar in your system which required some sort of intervention to achieve that outcome. That has been a puzzle to me from the start. Can you throw any light on that?
Mr Hartnett: Mr Todd, it is a puzzle to me as well, I have to say, but let me explain what was going on here because I think it may help. I think Kieran Poynter's work really has got to help us with this. The data that was in Waterview Park in the North East was drawn off from the child benefit computer system. That is in a different building and it was needed for what we call claimant compliance, to check that we were paying child benefit in circumstances where it was due. It was brought to Waterview Park and loaded up on to a secure, stand-alone desk-top computer in a secure environment, and from that the people with access to it draw off samples for our claimant compliance people with our people saying, "This is the sort of sample I need." The emails are interesting in this context, because they show no expectation at all that the data would ever have left our offices, but I think you are onto a crucial question, and that is how on earth was it possible ever to draw down a full copy? At the moment I know it clearly was possible, but—

Q357 Mr Todd: That is an issue of system design.
Mr Hartnett: Exactly; absolutely.

Q358 Mr Todd: And also management disciplines imposed on that system design at the time someone conceded with the security requirements that should have been in place.
Mr Hartnett: Yes.

Q359 Mr Todd: So it is not just some funny software engineer who did not quite do their job?
Mr Hartnett: No, it is a design issue.

Q360 Mr Todd: It is a disciplinary issue.
Mr Hartnett: Well, it is a discipline issue within the—. Yes.

Q361 Mr Todd: Okay. I do not think it should require the Chair of PWC to tell you that actually either; it would seem obvious to most people. What sort of resources does Kieran Poynter have at his disposal to examine this issue? Is it just him and his good will?
Mr Hartnett: No, I think Kieran Poynter, I know that Kieran Poynter has various resources he can draw on. He is drawing on some of his colleagues in PWC who have expertise that will be relevant, and we will make available to him in HMRC, and I am sure the Treasury would do the same, any resources that we have that he would find useful.

Q362 Mr Todd: Presumably there is the possibility of a prosecution in this matter. Are you having to make available resources to advise some of the staff who may be interviewed by Kieran Poynter in the process of this investigation?
Mr Hartnett: Staff who need advice about their own position will, I think, obtain that advice from their trade union. Can I just explain that there is more than one inquiry under way here? We have got the Kieran Poynter inquiry looking at our systems, finding out what has happened, enabling us to make our system better for the future reporting to the Chancellor, we have a police inquiry, which is crucially focused on finding the discs, if I can put it this way, in the national interest, we then have the Information Commissioner, who will be conducting an inquiry, which could lead to a criminal sanction, and we then have the Independent Police Complaints Commission, who are our regulator established in the Commissioners of Revenue and Customs Act 2005. I know they are all talking to each other, but those are the principal inquiries underway at the minute, two of which could lead to criminal sanction.

Q363 John Thurso: HMRC is using an expensive 0845 number for its helpline. Why is that?
Mr Hartnett: Mr Thurso, we have always done that with our help lines. We aim to make the charge as—

Q364 John Thurso: Do you not think this is a slightly exceptional case, a helpline where you have lost 25 million of this people's data? There is a slight difference.

Mr Hartnett: I have two things to say. First, we wanted to use an existing helpline to make it available as fast as we could, and that we have done. The second is that the amount of traffic on the helpline has been relatively small. We have 150, 160,000 calls a day. Since the Chancellor made his statement, we have had around 35,000. If I am wrong I will give you more. I am being corrected; it is now up to 60,000 calls.[1]

Q365 John Thurso: It sounds quite a lot to me actually. Can I move on? You have written to all those whose personal data has been lost. How many instances have you had of calls or letters subsequently suggesting that the data in those letters was incorrect?
Mr Hartnett: The last number I heard was something just short of 200 approaches to us in two or three different circumstances, in a couple of cases more than one letter in the same envelope, letters being addressed to old addresses for people, but they were the only address we had, and then a small number of odd cases where letters have gone to the wrong address. I think what is really important here is that less than 200 out of 7.25 million letters. That is completely regrettable, and I apologise to all the people who have been troubled by that, but the banks and others have told us that that is a pretty good result.

Q366 John Thurso: There is a difference. If I get cheesed off with my bank I can change to another one. Unfortunately, I cannot change to whom I wish to pay tax or receive benefit, so I would suggest there is a stronger duty on you. The last question on this. Have you ascertained whether you might be in breach of the law in respect of any of the information sent in those letters of apology if they contained information relating two a third person?
Mr Hartnett: We did ask our own lawyers to look very carefully at the letter in that respect and in other respects before they were sent out and were told there were no legal issues.

Q367 Mr Brady: First of all, can I pick up on one of your earlier answers. Sixty thousand calls to the helpline. Do you have a figure for what the cost of those calls has been to the users, either as a total or—
Mr Hartnett: I do not, Mr Brady. We will see whether we can get one for you and I will write to the clerk.[2]

Q368 Mr Brady: Thank you very much. Secondly, you have made it clear that you are not in a position to say what the cost was or would have been of disaggregating the information concerned on these discs. Could you say, though, what the policy at HMRC is on the question of what cost is acceptable, what can be borne in certain circumstances?
Mr Hartnett: If I can put it initially in terms of the National Audit Office, we are obliged to provide data for the National Audit Office—they are our auditors, they have statutory authority and we would provide data whatever the cost—but if the cost was going to be very significant, I would expect senior managers to get involved and have a discussion with the National Audit Office about that.

Q369 Mr Brady: Do you have a guideline figure of what "very significant" would be in that context?
Mr Hartnett: No, but I would have thought here that to provide the data that the National Audit Office needed, if the cost had been, say, £50,000, I would have expected the process owner to become involved and also at that stage to have said, "Golly, we do not need to provide them with some of this information."

Q370 Mr Brady: Presumably there is some correlation between the level of costs that would be acceptable and the number of records concerned and the amount of information being requested?
Mr Hartnett: Yes, I think that is an important issue here, because the National Audit Office had changed their approach to auditing child benefit and, to the best of my recollection, the sort of discussion I have just described I would expect to take place had not taken place in as much detail as I would have thought necessary.

Q371 Mr Brady: In terms of the expenditure of HMRC on the provision of information for audit purposes, has the amount of expenditure or the policy changed since 2004?
Mr Hartnett: Not to my knowledge.

Q372 Mr Brady: But, again, would you be able to give us figures on that? That would be helpful.
Mr Hartnett: Of course. If we have got them you can have them.

Q373 Mr Brady: Thank you. One final thing. It has been put to me by somebody who works in the field of running and designing these big databases that it would be normally possible to execute the operation that was needed in separating information in the files very simply, that it would normally take very little input. He goes on to say that normally you could give this to an outsourcing company to do at very little cost and says it very much depends whether there has been a well drawn up contract with the outsourcing company. Is that something that you are yet in a position to give a view on and, if not, is it something that is going to be part of the Poynter Review?
Mr Hartnett: I think I can give you at least a preliminary view, if I may, and that is that when we needed to pass data to APACS—the clearing system—in order to enable them to get their members' number to protect accounts, we were able

[1] *Note by witness*: Subsequently it has been established that the estimated total number of calls handled by the Child Benefit helpline to close of business on 4 December 2007 where the caller chose "Option 1" to indicate that the call referred to the Child Benefit data loss incident was around 62,000. By comparison, HMRC estimate that they answered on average around 150,000 calls per day across all lines of business handled by their Contact Centres during 2006-07.

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to segregate the data in the way you have described without our IT supplier and quickly. It is, therefore, a matter of huge regret that we did not do that before, but I think the important issue is that those who asked for and those who provided that data had stepped outside the process that we had established.

Q374 Mr Brady: Thank you for that, but it does suggest that the contract may be perfectly sound and the system may be perfectly sound and, therefore, it would not have been particularly expensive to do the work that was necessary.
Mr Hartnett: I do not know, as I said to the Chairman earlier on, what it would have cost, but we have demonstrated that this can be done and it can be done quickly and no-one alerted me, when I asked for it to be done, that I was doing something that was going to involve significant cost.
Mr Brady: Thank you.

Q375 Mr Dunne: Mr Hartnett, in answer to Mr Brady just now you suggested it was the NAO who was changing the audit procedure in relation to their audit of child benefit. When did the responsibility for administering child benefit pass over to the HMRC from DWP?
Mr Hartnett: It passed over in 2003, but, Mr Dunne, may I correct one thing if I made a mistake earlier on, or maybe you have interpreted me in a particular way. It was the audit approach rather than the procedure. I have really no knowledge of the procedures, but it was how they were going to approach the need to check child benefit that was changing.

Q376 Mr Dunne: Was that to do with the approach that the NAO were taking to the sampling methodology to check the veracity of the payments that had been made?
Mr Hartnett: Yes. My understanding of this, and I have not spoken to the auditor, is that they wanted to be sure that we were paying child benefit in the right circumstances and wanted to think through, from a full scan of the database, how best to draw off the data to do that.

Q377 Mr Dunne: So the issue of the data loss in October in terms of putting the CDs in an envelope in a particular manner is one set of errors, but the decision as to what data should be made available to the NAO was not taken in October, it was taken in March when the NAO had discussions with the HMRC on the approach that would be taken to looking at child benefit then, and that is where this exchange of emails becomes relevant. You said to us just now that the proper authority should have been used in looking at the data, and I think you also said that you would have expected the process owner to have become involved should a significant cost have been incurred. Could you confirm whether, as we have been led to believe, the process owner for child benefit was copied into the email exchange on 13 March, in particular the email at 15:23?
Mr Hartnett: My understanding is, yes, the process owner was copied into that email and only that email.

Q378 Mr Dunne: That email refers to a meeting to be held, one presumes from reading this email, between NAO audit staff and staff within HMRC, including compliance and KAI colleagues, to discuss the data extract.
Mr Hartnett: Yes.

Q379 Mr Dunne: It also refers to the fact that an additional data scan would incur a cost to the department?
Mr Hartnett: Yes.

Q380 Mr Dunne: So the process owner, having received this email, was aware that there may be a cost to the department, was aware that other colleagues within the department were discussing the data exchange, including compliance colleagues, and presumably, even if he was not aware of the proper authorities, your compliance colleagues would have been.
Mr Hartnett: I think the crucial issue here, Mr Dunne, is what we know from the email is that it was sent. We do not know that the process owner read it or when he read it. That is one of the things we must find out. One of the very significant questions here to be answered is was the process owner in a position, having received the email, to put up his hand, if I can put it that way, and say: "Do not do this very silly thing", and that is an important question for us to know the answer to.

Q381 Mr Dunne: I agree, that is absolutely vital, but it cannot be held entirely at his door. Can you, first of all, explain who KAI Analysis are?
Mr Hartnett: Yes, Knowledge Analysis Intelligence, it is a bit of a grandiloquent phrase, they are the 600 or so people in HMRC who are our analysts—economists, statisticians, social researchers.

Q382 Mr Dunne: So in this context would you anticipate that those are the data collection people who would be actually responsible for gathering the data.
Mr Hartnett: I think they are going to be the people who provide expert advice on samples.

Q383 Mr Dunne: So they are technical people, effectively, rather than making decisions about what information should be included within a sample?
Mr Hartnett: Technical but not IT technical.

Q384 Mr Dunne: Is there some HMRC definition of compliance. What would you expect the compliance colleagues to have been looking at in this context?
Mr Hartnett: Mike may want to add something because they are broadly in this area. These are the people who are checking two things. They want to make sure we are paying child benefit to the right people and, if there were attempts to improperly obtain child benefit, they are the people who would investigate.

Q385 Mr Dunne: So would they have no responsibility for checking compliance with the department's data protection regime, for example?
Mr Hartnett: Yes.

Q386 Mr Dunne: You know who these people are who received the emails?
Mr Hartnett: I do.

Q387 Mr Dunne: Would any of those individuals have had any compliance responsibility in the context that I am describing it in terms of data protection?
Mr Hartnett: No expert, or some way on the way to being expert, responsibility for DPA.

Q388 Mr Dunne: Can we turn to the actual data itself? Are you able to tell us, without giving away public information—either tell us now or privately—the version of software on which the data was sent on to the CD?
Mr Hartnett: I am not able to tell you that. Sarah?
Ms Walker: No.
Mr Hartnett: The only thing I can tell you—and we will write to you, Mr Dunne—is how the CD was protected, which was with Winzip 8.

Q389 Mr Dunne: Winzip 8?
Mr Hartnett: Eight not nine.

Q390 Mr Dunne: Does Winzip 8 allow for automatic encryption?
Mr Hartnett: No, I think that is nine. Winzip 8 allows for compression. I am sorry, I am not a technician, but it allows for compression and password protection is my understanding.

Q391 Mr Dunne: Are you able to tell us, again without making this easy for someone who may have these CDs, whether a dictionary password was used for password protection?
Mr Hartnett: I do not know the answer to that.[3]

Q392 Mr Dunne: Would you be able to write to us privately—I do not know if we can keep that confidential—and, secondly, the number of symbols in the password? Would that be possible to provide confidentially or will that come out in the Kieran Review?
Mr Hartnett: It will come out in the Kieran Poynter Review.

Q393 Mr Dunne: I think it is important, Chairman, because if the password used in the unencrypted data was sufficiently complex, then it may have meant that the information, although not encrypted, was actually sufficiently secure to have avoided the need for HMRC to have written to 25 million people.
Mr Hartnett: But we have not written to 25 million people. We have written to 7.25 million. Can I just add one thing quickly for Mr Dunne in case it does help here? We have increased the complexity of passwords on the back of this experience so that there are normally now at least 20 symbols and sometimes will be 30.

Q394 Mr Dunne: Good. I am pleased to hear that. I have a couple more quick questions if I may. In relation to the police investigation, could you confirm whether the HMRC advised the police of the data loss and, if so, when?
Mr Hartnett: Yes, the Chancellor of the Exchequer, as I recall this, asked Mr Gray to bring in the police. The first contact with the police was the Friday, which I believe was the sixteenth, and HMRC was asked to prepare a full handover brief to carry on its own searches and there was a formal handover to the police around two o'clock on Sunday the eighteenth, from memory. If I have got any of this wrong I will come back.[4]

Q395 Mr Dunne: That is very helpful. My final question, Chairman: the Daily Telegraph today reported that there may be as many as 350 children who are under special protected measures whose information may be included in this data loss. Can you confirm whether or not that is correct and where they would have received that information, which itself would appear to be a breach of data security?
Mr Hartnett: Can I come to that in just a moment. I have had a note from behind, and I am grateful, to say the first contact with the police was actually on the Thursday and not on the Friday. I apologise for getting that wrong. I read the article in The Telegraph this morning and I read it slightly differently, if I may say so. I thought it was about witnesses in protection, and I hope you will not mind if I say very little about witnesses in protection but there are a couple of important things I can say. The first is we often will not know who they are—people, rightly, do not tell us. Sometimes we have knowledge and we have particular arrangements for dealing with it, where we have knowledge, which are very secure indeed and, if the Committee will allow, I am not going to lay out. Then the important issue is, where people are in protection and we do not know who they are, we cannot mark the file in any way, we do not know the true name and the alias, so I wondered whether that article this morning was actually raising a significant fear. It seemed as though it might be misplaced.

Q396 John McFall: Mr Hartnett, you are aware that the Main Committee may come back to this in the New Year.
Mr Hartnett: Yes.

Q397 John McFall: But it strikes me that this could be a wider problem of data exchange between government departments and agencies. Correct me if I am wrong, but was there not a letter sent on 9 November from a senior person in the NAO to HMRC apologising for the lack of arrangements in this as a result of the increased strictures of international accounting standards?

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Mr Hartnett: I do not know whether it is the letter you have in mind, Mr McFall.

Q398 John McFall: Is it dated 9 November?
Mr Hartnett: The one I have got here is dated 9 November, second director at the NAO to our child benefit processor owner, and it does raise issues like that. If I may, Chairman, very quickly bring out a couple of important points in it. The NAO rightly say they take their data protection responsibilities very seriously, but they also say the security incident we have had here has occurred solely as a result of the data request that was initiated, and they refer to redefining the direction of the audit approach and that they should have told us that; but if I can come to your question about the wider thing, the Head of the Home Civil Service, Sir Gus O'Donnell, has raised with all government departments this issue. He has brought a group of people in very senior positions together, certainly involving the chief information officers, the leaders of IT in the departments. We are contributing to that, based on the dreadful experience that we have had and that we have caused our customers, and out of that will come lessons and new procedures for everybody.

Q399 Chairman: If you have had seven serious security breaches in the two and a half years since you were set up, does that not indicate systemic failure?
Mr Hartnett: I think, Chairman, it may well do, and I put it in that way because I want to hear what Mr Poynter has got to say here, but can I explain how I and my brand new Director of Data Security are seeking to work with Kieran Poynter. We have asked him, and he has agreed, if, as soon as he has identified an issue for us, he will share that with us, and that is really important because he will not wait for his interim report, he will not wait for his final report and we will make changes as things are brought to our attention based on what he says and we will discuss these with him. It may help you for me to say something about the sort of things that I think are going to come out of this process of engagement with Mr Poynter. There is an issue for HMRC about whether the products that we design are sufficiently designed with data security in mind and there is a big issue, which I think the Committee has brought out this afternoon already, about how we supervise junior staff. I do not in any way mean junior in the pejorative sense, but how we do that. The fact that HMRC has what I will call islands of information: in the North East. For example, we have the national insurance computer, the child benefit computer, it is a very data rich area for us and probably we need to take special care there. There are issues around our people's understanding, which Mr Thurso raised, of the Data Protection Act and there are cultural issues here about how we approach data protection.

Q400 Chairman: Is this systemic failure, do you think, linked in any way to the quite considerable reduction in head count in your organisation of over 10,100 in the last three years?
Mr Hartnett: I have not seen anything here so far which says that this dreadful mistake has got anything to do with head count reduction. It has everything to do with mistake, failing to follow procedures and of the arrangements between us and the NAO which we set up not being followed.

Q401 Chairman: Bonuses for the Chancellor's departments, including HMRC, have increased from 1.8 million three years ago to 19.8 million last year. What share of that 19 million was paid in bonuses to your staff?
Mr Hartnett: To me?

Q402 Chairman: To your staff?
Mr Hartnett: To my staff. I am afraid I do not know the answer as I sit here. I will find it for you.

Q403 Chairman: Can you estimate it roughly? You are the biggest of the Treasury departments?
Mr Hartnett: It would be a wild estimate, Chairman. It is a wild estimate. Between five and 10 million.

Q404 Chairman: Why is that not shown in your accounts?
Mr Hartnett: Because the bonuses, I think, will be shown in our accounts and, again, these are not accounts that I signed off, so I am not intimately knowledgeable in the details but will be shown in remuneration.

Q405 Chairman: So why are they not shown in these accounts for the last year? Is there a line there showing the bonus figures?
Mr Hartnett: There is no specific line that I am aware of, but I would imagine the bonuses would be shown in overall remuneration and in the remuneration for individuals who are named in the accounts and in the general line in the accounts for remuneration.

Q406 Chairman: This might not matter so much if it is only one million a year for the whole organisation, but now that it has got, as you say, to ten million?
Mr Hartnett: No, it is a wild guess, Chairman.

Q407 Chairman: If it has got to ten million, then I think it ought to be shown separately, should it not?
Mr Hartnett: I will take advice on that.

Q408 Mr Simon: Following up on the Chairman's two points there but backwards, just to finish off on the bonuses, the cost of your staff has gone up by 29 million, while the number of staff has gone down by 4,000?
Mr Hartnett: Right.

Q409 Mr Simon: We are not sure if that is related to bonuses or not.
Mr Hartnett: I am not sure.

Q410 Mr Simon: Nick McPherson says that the majority of the 21.5 million bonus payments to Treasury will not be to Treasury officials, so presumably, by inclination, the majority of them will be to people like you?

Mr Hartnett: I think, Mr Simon, I have got to take this away. There are different bonus arrangements in HM Revenue and Customs for the senior civil service and for others of my colleagues, but to help you with this line of questioning I really should take it away and give you some precise figures.

Q411 Mr Simon: On the question of principle, on reflection do you think it might have been more helpful, if bonuses, as the Chairman said, seem to be growing whilst staff numbers shrink to quite big numbers, tens of millions of pounds, to publish them separately?
Mr Hartnett: I have said to the Chairman I can see that it would certainly be helpful to the Committee.[5]

Q412 Mr Simon: What you said to the Chairman is you would take advice.
Mr Hartnett: I am going to explain why I said I would take advice; it may be helpful. Most of the presentation of our accounts follows standard accounting standards. We have moved substantially into international accounting standards as well. The reason I am going to take advice is to see whether we can publish a line like that, and, if we can, we will.
Mr Simon: Excellent. Many thanks.
Chairman: We are asking this because we asked the Permanent Secretary of the Treasury how much of the bonus total, the total 21 million, I think it is, went to the Treasury?
Mr Simon: And he said, "Not me guv."

Q413 Chairman: He said the majority of it did not go to Treasury officials. You are the largest department, so we are assuming the majority of these bonus payments went to you, your staff.
Mr Hartnett: Chairman, with great apology, I say I do not know but I will find out for you.
Chairman: Thank you. Siôn, on you go.

Q414 Mr Simon: On this side we have all been admiring your performance, which is exemplary, in how to do this, but one of the things that you have disarmingly done consistently is said: "Clean hands, straight up, honest guv, I do not know", which is fair enough and which does work admirably well, but there is an element to it which is that the more you do it the less credible and convincing it becomes, and the Committee ideally, I think, would prefer answers to not answers.
Mr Hartnett: Mr Simon, I will give you an answer to every question that I can answer. Can I put in a tiny plea here? I am here to answer everything I can. I am nine and a half days into this. I appreciate it is a bit of a cop out, but, if I cannot answer today, I will give you an answer.

Q415 Mr Simon: Finally, back to the Chairman's point about the head count. Although your overall head count has been going down, at the same time your other staff, presumably short-term, fixed term contracts and consultants, have increased by 9% in number and 25% by value and cost. You said that the head count reduction has got nothing to do with mistakes, be they systemic or not, but is what is actually happening here that you are just slashing head count and costs are going up and mistakes are being made?
Mr Hartnett: I do not think that is right. Our people take pride in the job they do. They try to do a really good job. Interestingly, I came here from a meeting with our largest group of stakeholders, which are tax advisers, who probably represent 18 million of our customers, and they have been very supportive to us, they want us to do better, but they tell me that our people do a very good job. Over the last number of months, we have actually reduced the number of fixed term appointments. I think you will see a substantially smaller number of others when you see our accounts for the year to 2008.

Q416 Mr Simon: In which case, do you think that that was becoming a problem which you identified and addressed?
Mr Hartnett: I do not think it was a problem. I think it was how we have created flexibility in our organisation. Let me give you a quick example. We have a programme we call Pace Setter, which is about developing the effectiveness of our business, helping our front-line people, supporting our front-line people to do business better, developing their managers, and what we have seen in our processing areas with the Pace Setter Programme is that we can improve performance by, in the best areas, between 40 and 50%. We are getting better at what we do. We have got a way to go yet, but we are getting better.

Q417 Mr Simon: How is morale in your office in Washington?
Mr Hartnett: Morale today, I think throughout my organisation, is very low indeed on the back of this experience. The average age now in our organisation is pretty high. People have grown up in the organisation. They learnt how to manage data the day they arrived, whatever background they came from, and they feel this terribly. What is most interesting about Washington—I was there to talk to them last week with Kieran Poynter—they are absolutely determined to learn from this and, more importantly, to re-establish their reputation as a high-performing part of our business doing the public service they want to do. They are very determined.

Q418 Jim Cousins: Mr Hartnett, are you or some of the members of your team yet clear about how many people you will lose by transfer to the proposed borders agency?
Mr Hartnett: Mike.
Mr Eland: The estimate is around 4,000. The detail of the transfers is still being worked through, but it is that order of magnitude.

Q419 Jim Cousins: Mr Hartnett, that is 4,000 people transferred to the borders agency on top of the 1,200 plus who were transferred to the Serious Organised Crime Agency, and you have had to move a large

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number of people in Customs who were engaged in the detection of tobacco smuggling into dealing with—
Mr Hartnett: Missing trader fraud.

Q420 Jim Cousins: Yes, missing trader fraud. Are you satisfied that you have actually had the right human resources to investigate the kinds of activities that you should be investigating?
Mr Hartnett: Let me start, and I will ask Mike to come in. When we moved people to the Serious Organised Crime Agency (I am going to call it SOCA, if that is all right, because that is how I have got to know it) we moved function as well, and I am not going to claim, because I do not know, whether there was a perfect match between the resource needed for function and the number of people that went, but it was a pretty good match. The same will happen with borders, and with missing trader fraud—I think this Committee has heard advice on the numbers—the financial cost of missing trader fraud. We have to be an organisation that is very responsive, with expert people to deal with pressures like this, and the big strategic issue for us, Mr Cousins, is that we are moving to an approach in relation to compliance, which is the area you are raising, where we match resource to risk and we want more flexibility in our resource. Mike.
Mr Eland: Particularly on the tobacco point that you mentioned, we did move resource across to deal with the MTIC fraud problems we had, but we did that as a temporary measure. We are strengthening our criminal investigators. We have put additional resource into those, particularly to deal with the tobacco problem as well; so we are looking, as Dave said, to adopt a flexible approach where we move resource around to deal with particular problems as they arise, hopefully overcome them and then we can redeploy them back to where they came from. On the VAT MTIC side, we put in a lot of additional resource there to deal with the immediate problem which we are now beginning to move back into other VAT fraud and deal with that; so we are moving resource around.
Mr Hartnett: Can I quickly come in with a couple of examples which may help illustrate the approach. The first is we have developed a programme in relation to our top-end tax avoidance where large corporates or other large entities create a risk for the Exchequer. We have been very successful there in resolving issues, sometimes through litigation, sometimes engaging with corporates. We have taken a very tough approach that where we believe we are right on the law. We want a 100% tax, and interest where appropriate, and a penalty. It has been a new approach, along the lines of the flexibility I described, which has worked well and we have had our off-shore disclosure regime where so far people have come forward and paid us a sum over £400 million—there will be a lot more money to come out of that project—using our skilled resource to do more productive work, again, on the basis of a flexible deployment.

Q421 Jim Cousins: I think a lot of us are concerned about whether the degree of organisational change that is going on with these large-scale transfers of staff, accompanied by internal transfers of staff from one activity to another, actually leave you with the capacity to do the job that you should be doing. There are, for example, we are on record now as knowing, no fixed uniformed Customs posts anywhere in Devon and Cornwall; around the coastline of Wales, which is very large, there are only two places: Cardiff and Hollyhead. Lord Carlile in his own work on securing our borders against terrorism has expressed concern about this. Do not you have some worries about whether our borders are properly protected?
Mr Hartnett: The crucial issue here is we are matching risk to resource. I think the last time I was in front of the Committee we said that in some areas now we were much more successful. I visited our Felixstowe operation three or four weeks ago and saw that they were very successful indeed by using IT supported approaches to risk. Mike, do you want to come in again?
Mr Eland: I think we have got to tackle the threat through a combination of fixed resource and mobile resource. I do not think that purely going back to fixed resource around the coast would give us the best protection. It has got to be a balance of both. It is important that when we go down that route we are constantly testing the risk to make sure that we are not, by reducing staff in a particular area, opening up new risks, so we sent mobile teams in to test that, and we have also, I think, got to maximise the deterrent impact. I think it is in that area that we feel we can make more improvements. We can make more of a visible impact when we do send the mobile teams in. It is not just about detecting the smugglers, it is also giving some degree of public reassurance as well and, therefore, some visibility is important in that.

Q422 Mr Cousins: Is it the case that your sea and air intelligence team has been given guidance to concentrate only on Channel ports and airports, and ignore the rest?
Mr Hartnett: I am not aware of that.

Q423 Mr Cousins: Can you check that?
Mr Hartnett: Of course.[6]

Q424 Mr Cousins: What about the employment of part-time and casual staff to reinforce customs staff? Does that go on?
Mr Eland: I am not aware of that.
Mr Hartnett: I am not aware of that either.
Mr Eland: Not in a front-line capacity. There might be some case of using part-time and casual back-up in sort of back office functions, but I am not aware anywhere of any front line use.
Mr Hartnett: We do, Mr Cousins, and this is an important point here, offer part-time opportunities for people who have worked with us who may want to work part-time. We want to keep their experience.

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So I think what I would add is that I believe there will be people who work part-time, but they will be very experienced people who have grown up in our organisation.

Q425 Mr Cousins: Are any people on guarding duties working at Customs, in a Customs capacity, casual employees?
Mr Eland: Do you mean security guards at buildings?

Q426 Mr Cousins: Yes.
Mr Hartnett: I do not have the answer to that. We will find the answer for you.[7]

Q427 Nick Ainger: Mr Eland, how do you actually test that the changes in policy that you have implemented, certainly since 2003 where there was a significant withdrawal from the ports—and in my experience, I have Pembroke Dock a mile and a half from my home, so I know quite clearly what has happened, and Fishguard as well, two major ports with high volumes of passenger and vehicular traffic—have not had a detrimental impact on reducing the security of our borders?
Mr Eland: We do it in two ways, first through monitoring data, seizures and the like, to see if there is any change in performance–and second we do it through intelligence–about criminal gangs activity, to see so if we saw shifts in their activity. We also have started to do a series of risk-testing exercises where we do put mobile teams into areas where we have no coverage without any warning or opportunity to anticipate that, and test whether we find anything in terms of seizures and things in that area.

Q428 Nick Ainger: How often would that take place in a year, in a particular port? Say Fishguard or Pembroke Dock?
Mr Eland: We have done four big exercises in the last six months.

Q429 Nick Ainger: In one port in, or in a number?
Mr Eland: No. We have deliberately gone for remote areas to test precisely the worry you are articulating, and we want to build that in—or the new Border Agency I imagine will build that in as part of their programme. I think you have to do that if you are going for that mix of fixed and mobile resource.

Q430 Nick Ainger: But in the Department Report you referred to slippage in meeting the targets in relation to the seizure of illegal drugs. Is it slippage, or is it a failure?
Mr Eland: No. There has been a small reduction in the seizures, and there has been a more marked reduction in weight, but we think that those fluctuations are not such as to indicate a downturn in performance. The drugs market is volatile, and the sort of margins that we have there could be no more than just that temporary downturn.

Q431 Nick Ainger: How do you know?
Mr Eland: We do not. We keep this under monthly monitoring but there is no indication, from all those other sources and for the work we do with SOCA and ACPO, the police organisation, that there is any change in threat as a result of that.

Q432 Nick Ainger: There is a report dated 20 June 2006 in *The Times* where it quotes, "Special Branch officers expressed alarm at ports being left without cover. A senior police officer told *The Times*: 'The service is unhappy about the approach of Customs. You can have a major port with no coverage because they are mounting operations up the coast. It leaves gaps and gateways completely open'". Does ACPO still share those views?
Mr Eland: ACPO fully understands what we are trying to do in terms of this mixture of fixed and mobile staffing. One of the reasons, though, for setting up the new Border Agency is to be able to use the full range of staff at the border for a full range of activities. At the moment we are compartmentalised into different activities, and we believe by bringing everybody together in one organisation you would be able to get a broader coverage.

Q433 Nick Ainger: So are you saying that, once the Border Agency is in place, ports such as Pembroke Dock and Fishguard may actually start to see a physical presence?
Mr Eland: That is obviously not my decision but the concept is that different agencies working at the frontier at the moment have people in different places according to the risks of that organisation, so there will be different uses. Special Branch are deployed differently from Customs because they are looking for different people. By bringing everybody together and sharing a joined-up risk assessment we feel we will be able to achieve a broader coverage. That is the basic concept.

Q434 Nick Ainger: So the answer to my question is?
Mr Eland: I cannot give you a specific answer in relation to Fishguard because obviously that will be for the new Border Agency to determine.

Q435 Nick Ainger: In terms of staffing levels in the Border Agency, those that are currently Customs staff, those that are currently SOCA staff, those that are currently Immigration Service staff, as far as you are aware is there going to be a net increase in the number of staff with the Border Agency, or literally is it putting those three bodies together?
Mr Eland: SOCA is not going into the Agency, but there is no net increase planned.
Nick Ainger: Thank you.

Q436 Peter Viggers: In last year's Spring Supplementary Estimates you received £30 million for expanding call centres, and I believe there was quite a brisk operation of manning a call centre in Liverpool. In the Winter Supplementary Estimates you have come back for another £30 million. Have

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you finished your expansion of the call centre programme? What are we getting for our £60 million?
Mr Hartnett: We have finished the expansion based on the operations we have at the moment. Where our responsibility is to grow or change, then we might want to expand further. What you are getting is a very effective call centre service. If I look back two or three years, Mr Viggers, we had backlogs in calls which were quite substantial—it is not like that now. People do not necessarily get through first time every time but our measures of performance show we are doing a lot better, so you are getting a good service which compares well with services in the private sector.

Q437 Peter Viggers: One of the indicators, indicator number 5 in the 2007 Departmental Report said that by 2007–08 there was increase to at least 85% the proportion of individuals who find their statement of account/PAYE coding notices/tax credit notices easy to understand. The target was 85 and there was slippage. In 2004 it was 77.6; November 2006 was 76.7. Do you know whether those figures are improving?
Mr Hartnett: They are improving but not improving fast enough for my expectation or the expectation of HMRC. I will ask Sarah to say something in a minute in relation to tax credits. The statement account for self assessment has been a hard read in the past; it has improved; it has to improve further. It is really important. We have more to do; that is a challenging target; we are determined to get there.
Ms Walker: The tax credit award notice was improved a year or so ago following consultation with voluntary sector and other advisory bodies. It is still a complex document: it is produced from the computer system which is not particularly easy to change; however, it does now include all the information we hope people would want. We are concentrating on providing accompanying information and accompanying fact sheets that will help people to find their way around it better.

Q438 Peter Viggers: I have had a small but, because of the nature of the case, significant number of people whose cases cannot be handled on the tax credit controlling computer, they are told the computer is not capable of handling their case. Do you happen to know if this is a major problem for many people?
Ms Walker: There are still a number of people who we are paying off the computer. We have a programme of fixes being put into the system to try and fix the problems that are preventing them from being dealt with automatically. Meanwhile we have a unit in the tax credits office who deal with manual payments directly and are maintaining those people's payments.

Q439 Mr Mudie: Do you think it is significant on tax credits that the Ombudsman has now done two special reports on you on that specific subject, and she has titled the first one "Putting things right" and she has titled the one that got brought out last month "Getting it wrong". Now, if I were just to ask you how you would respond to this, it is clear that the tax credits office dealing with complaints still have some way to go in providing fit-for-purpose, complaint handling arrangements. As a result of these failings—two pages of failings—some tax credit customers on very low incomes who are living in very difficult circumstances are finding themselves in the distressing position of being unfairly required to pay back often large overpayments which were caused by official error. Now, I looked in your annual report for some admission that things had some way to go, and there was nothing in the spirit of that. In fact, the lovely Adjudicator we have just seen, in her report, says: "We have seen a number of cases where as a result of this treatment disillusioned claimants are seeking to leave the system". So these are the poorest people, the people the system is designed for, and because of the way you are operating the system people are not claiming. Now, tell me things are getting better.
Mr Hartnett: Let me start, Mr Mudie, and then let Sarah come in with some of the detail. They are getting better; they are not good enough—

Q440 Mr Mudie: They are getting better in technical matters, process matters, if you like, but the Adjudicator spends all her report relating to you on COP26 and handling complaints and the Ombudsman does the same. Now, those come down to the nonsensical argument about was it reasonable for people to know they were overpaid and, secondly, in terms of paying back, this business of hardship. Have you settled what you are doing? The Adjudicator said it would be done in January this coming year. Have you settled a new Code 26?
Mr Hartnett: Let me bring Sarah in on Code 26.
Ms Walker: Yes. The Financial Secretary said to Parliament I think at the last Treasury oral questions or the one before, that yes, we are introducing a new test, there will be a new Code of Practice 26 which will no longer refer to reasonable belief and it will be introduced by the end of January.

Q441 Mr Mudie: Has it been cleared with the Citizens' Advice Bureau?
Ms Walker: We are currently consulting with the Citizens' Advice Bureau and all other interested parties.

Q442 Mr Mudie: So it takes out reasonable doubt?
Ms Walker: Yes.

Q443 Mr Mudie: Excellent. So it is just going to be on the basis of—
Ms Walker: If I can explain what the new test is, we issued a new version of the Code of Practice back in April 2006 which sought to make it clearer what we meant by reasonable belief, which said: We do not expect you to be able to check the whole of the calculation of your payment but we do expect you to check that we have properly recorded things that you have told us about your circumstances—that is how many children you have, what your income is, that kind of thing—and that you would check that

what goes into the bank account matches we have told you is going to go into the bank account. What we are doing now is repeating that; we are saying these are the things we are expecting you to check and we are making it very clear if you have checked those then that is all you need to do. If you have checked those and they are correct and we have still made a mistake, we will not refuse to write it off.

Q444 Mr Mudie: One of the examples the Adjudicator gives is somebody who was forced to repay on the basis they were on job seeker's allowance, and apparently there are two so she filled in the incorrect one and got a notice back with the correct one, or vice versa, but there were two initials at the end of job seeker's allowance. Now, I am an MP and I did not know there were two job seekers' allowances, and certainly by reading it I would just clock the job seekers' allowance and pay no attention to two initials in brackets afterwards, and would not know what the hell that meant. Now, you are forcing them to repay. Will that sort of nonsense finish?
Ms Walker: That is a specific point we have picked up complaints from the Adjudicator on and are seeking to learn from that. We are changing the way we deal with initial claims; where people are likely to be filling in that bit of the form we offer them specific help through the helpline. We do need to know which type of job seekers' allowance they have but we realise it causes them problems, and we are specifically looking out for cases where that is an issue and offering them proactive help.

Q445 Mr Mudie: That is good. The other area is hardship. The Ombudsman, but particularly the Adjudicator, felt inhibited; in fact, I think she felt she could not rule against you or adjudicate against you on the basis of hardship, that was something that she felt the Code did not permit her to do. Now, will hardship specifically be included in the Code so that it is clear that the grounds of hardship will be a consideration? I am glad you nodded. Can I press you further, then? Will it be as sensitive? I do not know if you heard the Adjudicator when she said people were inhibited concerning the depth of questioning, which I do not think really should be necessary in terms of deciding whether people should pay money back or not. Can you tell me about that?
Ms Walker: I think there are two issues here, and I think Dame Barbara set them out quite clearly, if I may say so. There are two different issues we need to decide. One is whether there is an overpayment which needs to be paid back; the second is whether making the person pay that back would cause them hardship, because in order to establish whether it would cause hardship we do need to ask them some quite intrusive questions about their income and circumstances.

Q446 Mr Mudie: You have their income though, surely?
Ms Walker: We have details about their past income; we do not necessarily have details about their current circumstances or their outgoings. We may know their income but not their expenses, and we need to know that. What we will do is, as soon as anybody raises any suggestion that this is going to cause them hardship, we will make those inquiries, but I would also say that the Ombudsman's report does raise some questions about the way we handle hardship cases, particularly about the way we internally deal between different parts of the office. We have taken that on board and we are working now to see if we can set up some better arrangements so that we do handle those cases more sensitively and better.

Q447 Mr Mudie: The Adjudicator says discussions were used centrally at the Adjudicator's office or tax credit offices and revealed considerable confusion and an apparent diversion of understanding as to the proper application of Code of Practice 26. So as well as putting a new code in you are actually training your staff to operate that code in a more humane way?
Ms Walker: Yes. The misunderstanding I think was around this concept of reasonable belief and what "reasonable" means. We have accepted that and we are taking that concept out completely.

Q448 Mr Mudie: When we pressed Dame Barbara, maybe she was leaving the good news to you but she did not indicate, to me anyway, that the specific points you have raised that we have been playing hell about for years were going to be settled. Now, was she just being discreet, and has the Ombudsman cleared the new code?
Ms Walker: As I say, we are still consulting, the Adjudicator, the Ombudsman and the voluntary bodies, so we do not have a final version yet.

Q449 Mr Mudie: Are there any matters of policy disagreement?
Ms Walker: I do not believe there are.

Q450 Mr Mudie: Good. On financial matters, you have 3.3 billion still to pick up from past years. How much do you think you will get and when will you get it?
Ms Walker: Are you talking about overpayment?
Mr Hartnett: Tax credits or compliance?

Q451 Mr Mudie: I am on tax credits. Is there a 3 billion short somewhere else?
Mr Hartnett: No. There is another £3 billion figure in our report, but it is not short.
Ms Walker: The story about overpayments is quite complicated with the amounts of overpayments from previous years, the amounts that are still outstanding, the amounts that are still being collected. We have made provisions in our accounts for possibly uncollectable debts; those are prudent provisions which will hopefully turn out to have been over generous. We are still pursuing all outstanding tax credit overpayments.

Q452 Mr Mudie: The figures pointed to £800 million written off, recovered £2 billion, outstanding £3.3, and when I look at my figures it looks as though there is a fair amount for the first two years. In fact, it is £2 billion. Now Parliament or people in Parliament, some corners of Parliament, wanted that written off. How long will it be before you admit you are not going to be able to collect this money? It has been three years now.
Ms Walker: A large proportion of the overpayments are being collected very slowly—

Q453 Mr Mudie: You could say that!
Ms Walker: —because of limits that have been introduced. One of the elements of the 2005 PBR package was a restriction on the rate at which we deduct an overpayment from an on-going award during the same year, because we are very careful about how much we seek to make people on low incomes pay back at a time, therefore the time it will take for them to pay back overpayments does stretch out. We are not talking about money we do not know how we are going to get or that we are giving up on: this is money that will take us time, even where we are trying to collect a debt directly from the individual rather than deducting it from overpayment continuing payments.

Q454 Mr Mudie: So that 0.9, just short of a billion from 2003-4, when you see us next year that will have disappeared largely because it has been collected?
Ms Walker: A lot of it will.

Q455 Mr Mudie: Good. Lastly, because it relates to that year, on section 18 what have you got to tell us then?
Ms Walker: I can tell you as much as you like. Section 18 was a problem that we discovered during the course of this year. Certain technical ways in which we handled new information that we got after an award had been finalised, the way we were dealing with some of those cases, had not been correct. What we have done is, first of all, we have corrected the way we are making new adjustments to awards after finalisation; we have also set up a process to review 250,000 cases from previous years which need to be reviewed. In the vast majority of those cases there will be no change to affect the payments or the amount of money that those people have had: we just need to go through a new legal process to legitimise, if you like, what we have already paid them. That is, if you like, a burden for us and it is very annoying for us to have to do it, as you can imagine, but it will not affect the individual.

Q456 Mr Mudie: Why? First of all, how inaccurate is the public story of 250,000 cases taking three years to clear at a cost of£500 million?
Ms Walker: £500 million is not a correct figure at all. 250,000 cases is the number of cases that are affected and we have written to all those people. We think it will take three years to work them; we are still establishing the processes; we hope we will be able to do it quicker, but if it takes three years it will take three years. £500 million is a figure that I do not recognise.

Q457 Mr Mudie: Which figure would you suggest?
Ms Walker: We think that the amount we will have to repay to people in the sense that we have wrongly collected money from them is around £20 million.

Q458 Mr Mudie: What are staff costs?
Ms Walker: We think the total administrative costs—again we do not know for sure—is in the region of £10 million.

Q459 Mr Mudie: When you say people will not suffer, the Adjudicator did say you were clear now but that there are cases that are sterilised, if you like, that she cannot get to. Will people not suffer in those circumstances?
Ms Walker: It is true that, at the point when we identified the problem, we put a bit of a freeze on dealing with some complaint cases and dispute cases that we were dealing with at that time, so that we could identify those ones which were going to be affected by this, and as Dame Barbara said we were quite cautious on that so we put a freeze on quite a lot of our cases. We have identified the majority of those not affected by section 18, those that have been released who are now being worked normally, and we are now also going on to the complaint cases, particularly members of Parliament complaint cases that are potentially affected by section 18, and those are being worked now so we will get back to our normal timescale for handling complaints as soon as we possibly can, and we are aiming to get back to that normal timescale before Christmas.

Q460 Mr Mudie: Lastly, a mischievous question, when did you tell the Minister? Because this was put into the parliamentary arena the day of the recess on—
Ms Walker: Section 18?

Q461 Mr Mudie: —July 25 or 26. It was in a large number of written answers that were lodged, and those you always take care to look at because that is when all the bad news is put. But when did the Minister know?
Ms Walker: I do not have the date in front of me; it was very shortly before. We told Jane Kennedy—

Q462 Mr Mudie: That is such a relief. If I thought a Minister was sitting on bad news . . . !
Mr Hartnett: Chairman, may I go back very quickly to Mr Mudie's opening question which I had not finished the answer to, also in the Adjudicator's report she uses the words "recognition that we are going in the right direction". There is a significant reduction in complaints; we are absolutely not complacent. The number of upheld complaints is way too high still, but interestingly the Ombudsman as well says she has had discussions at senior levels with HMRC which convinces her that we are determined to improve but we have a long way to go.

Q463 Mr Mudie: Mr Hartnett, I do not think you should say that. Dame Barbara is a lovely person and you have a very gentle one—I am not saying this young lass is not a lovely person but she is much fiercer—but if this is the case this is a bad situation for a lot of people who should not be in that position.
Mr Hartnett: It is.

Q464 Mr Mudie: What Ms Walker has told us should alleviate that, and I look forward to next year with no Ombudsman's report and tax credit hardly on the agenda.
Mr Hartnett: We hope to get there.

Q465 Nick Ainger: Three brief questions on the COP26. First, will it be retrospective? Secondly, do you expect an increase, and if so what is the estimate of the increase, in the number of write-offs and overpayments as a result of the new COP26, and what is the estimated cost?
Ms Walker: We will apply the new rules to cases in the pipeline at the point of the change. As I said, the change in the reasonable belief test is not a big change in the sense that we had already tried to clarify the reasonable belief test by putting in that clarification before. I would hope that again, therefore, the effect of that change on our decisions would not be very great. If I could explain, in the figures I have, for the disputes that have been dealt with on overpayments since last April we have had over 100,000 disputes. Of those less than 5% have turned out to involve an error on our part but less than 300 of those 100,000 cases were failed on the basis of the reasonable belief test—300 out of 100,000—so although those clearly do cause some trouble and a lot will find their way through to the Adjudicator and the Ombudsman, the number who were being failed on the basis of the reasonable belief test was very small so the cost of changing that I would expect to be pretty small.

Q466 John Thurso: I would like to turn to the Gershon targets, if I may. The latest figures provided in the Government response to our report on the efficiency programmes state that HMRC achieved some £311 million of efficiency savings by March '07. With six months to go what is your latest figure of efficiency savings using the accepted methodology for measurement?
Mr Hartnett: I do not have one for you, Mr Thurso, at the minute. It is clearly going to be more than that: I think our efficiency programme is a good one working effectively. I do not know whether Mike has more up-to-date figures for me but at 31 October 2007, in terms of headcount of targets, we were exceeding our target; we had a gross reduction of nearly 17,500; redeployment of 3,300 and something; and a net position of 14,122. I expect that by 31 March that will have increased but I cannot say precisely by how many yet.

Q467 John Thurso: So, looking at the monetary side first, the March 2008 figure was, from memory, £507 million, so you would be confident of reaching that?
Mr Hartnett: I think we will get there.

Q468 John Thurso: You have talked about headcount reductions. Do you think it is wise to continue with the headcount reductions in the light of what has happened, and, if you felt in the light of what has happened that you would be really prudent to pause and reflect before going any further, do you feel you could do that?
Mr Hartnett: Can I go back to the answer I gave Mr Simon earlier on? The dreadful problem of the lost data impact on our customers and on our organisation I do not believe had anything at all to do with headcount reduction. What we have shown through our Pace Setter programme and working with our people to improve the efficiency of process is that we can get very significant gains out of making our processes more efficient. What we have to do, which we have started and are investing in but we need to invest much more in, is the training and development of our people and I think, if I detect your underlying concern, we reduce headcount and that creates pressures—

Q469 John Thurso: I will give you my underlying concern, and it is very straightforward having spent my life in business: basically, if you wish to make a saving, you set out to re-engineer the process and when you have designed the process to get a better outcome you put it in place and the savings flow from it. This, extraordinarily, is a saving whereby the target, the saving, the number of people, is the start point and then you go out and try and resign the business to achieve what has been pre-ordained as the saving. My concern is that therefore you will, as the savings start to bite, get into areas where, because you have not started from the point of re-engineering the business but you have started from the point of a headcount cut, you get into areas where you do start to affect the quality of the output.
Mr Hartnett: I really do not think that is quite right. We did start with a headcount target but we have re-engineered the processes with our people, and I think what is clear from that is that that re-engineering, with a constant improvement in the quality of our performance—and we agree it is part of the headcount target that there will be quality measures there—has shown that we have been able to go further with the headcount reduction, but I do want to stress, because I agree with you entirely on that, that the re-engineering has been significant across our business and is improving our performance.

Q470 John Thurso: One of the critical points on all of this, and it is a point that I discussed when HMRC have been with us before and brought it up with the previous Financial Secretary, is how you objectively measure the actual quality to the end-user—and as far as I am concerned that is my constituents, the taxpayer, rather than the Treasury or another government department—so whether you have an objective and quantity measure of the quality of service, because in the service industry you do have such things. There are ways of measuring so that you know that by doing things more cheaply or more cost effectively you have not actually diminished the service, and when you listen to the problems Mr Mudie and Mr Ainger were raising, tax credits and others, one has to ask whether there is a proper method of measuring the quality of the service. Are you content that you have that element of the equation?

Mr Hartnett: Let me just say one thing. We can improve significantly—it takes a little while—how we measure that, but we are constantly talking to our customers and their advisers about quality and using what they say to us as one of the measures.

Mr Eland: We use two groups of measures. On the customer service side we have time measures, accuracy measures and things like that that we can use; we also do satisfaction surveys; and increasingly we are trying to use focus groups, where we sit down with representatives and say: What is it that you really want to see in terms of service from us?

Q471 John Thurso: I am sure that works with the professional advisers. My worry is the person who comes to see me when they have been kept on the end of a phone and not got through, or when they have got through they have been promised they will be called back and they are not, or when they have got through they have been told they will be called back by the supervisor and they have not been called back—it is those people who have the most difficulty with the system. My theory is that is what is falling through and not being measured, and it is the most critical thing to measure.

Mr Eland: We are certainly trying to develop good measures around precisely that area, the advice centre area. We have things like time taken to answer calls and things like that. The more difficult ones are whether the advice meets the expectations and the needs of the customer, and the quality.

Q472 John Thurso: I do not want to pursue this any further but I would like to come back to it on perhaps another occasion, but there is a key principle in the private sector here which is that you can always find somebody who has ownership, and if we went back to or got to a situation where somebody in the organisation had ownership for every client out there so somebody could actually put their hand up if it went wrong, that would be a huge step forward, so I will just leave that suggestion with you.

Mr Hartnett: Can I give you a couple of examples? We have recently surveyed, for example, not agents but taxpayers, our customers, on the on-line service we provide for self assessment, and 71% were very satisfied, or better, with what we were doing and because we worry about the contact centres and we hear from members of Parliament and tax agents examples of the sort you gave to us we used an utterly independent body to get to real customers—again, I will make the distinction between taxpayers and tax agents—of our contact centres, and they came back and said that 90% of our taxpayers using contact centres were satisfied or better with the service we are providing. That is not good enough yet, but it is a start.

Q473 John Thurso: One last question. On the efficiency side, the 25 million data loss affair clearly cannot be regarded as efficient, and therefore by definition it was inefficient. How will that be accounted for and set against the efficiency gains? Will it be measured? Will those costs appear?

Mr Hartnett: I think that is a challenge for us to work out. In relation to the data loss the two elements that I and my colleagues on the executive of HMRC have been focusing on are improving data security and improving the stability of our organisation so we can focus on the service we provide to our customers. Those are the two big issues right now. The accountability issues of the sort you describe we will get to shortly but it is important for us to get there, and we will see how we work out how to do that. That is the best I can offer you right now.

Q474 John Thurso: Take it as a warning that we shall return to it and I shall probably ask you the question again.

Mr Hartnett: I understand.

Q475 Mr Cousins: What was the headcount reduction at Waterview Park?

Ms Walker: I have some figures for the child benefit office—

Q476 Mr Cousins: For Waterview Park?

Ms Walker: The staff in the child benefit office have reduced by roughly 300—

Q477 Mr Cousins: When you say the child benefit office, what are you referring to?

Ms Walker: Most of the people at Waterview Park do work for the child benefit office. There are some other units who have people in Waterview Park.

Q478 Mr Cousins: So the figures you are giving us are the headcount reductions at the child benefit office at Washington.

Ms Walker: Yes, and over the past four years there has been a reduction of around 300 staff.

Q479 Mr Cousins: What proportion of the starting figure is that?

Ms Walker: That is about 20%. It is down from 1300 to just over a thousand, but that is as a result of new ways of working and of more efficient ways of working. It is not an arbitrary cut[8].

Q480 Mr Cousins: Mr Hartnett, you were very clear that headcount reductions could not play any part in what has happened.

Mr Hartnett: I was. I do not think headcount reductions have played any part in this. This is a dreadful mistake.

[8] *Note by witness*: Staff numbers are full time equivalents.

Q481 Mr Cousins: Yes. Of course, that statement itself might be considered to be a little prejudicial to the outcomes of the inquiry, bearing in mind we have just been told there is a 20% cut in headcount at the relevant child benefit unit.
Mr Hartnett: I had no intention of the statement being prejudicial to the outcome of the inquiry. The many inquiries that are happening may well look at that. Mr Poynter so far has given me no indication he is going to look at that but he has only recently started his work.

Q482 Mr Cousins: One matter we would want assurance about is, in the light of the statements you have made here this afternoon, that Mr Poynter himself does not feel inhibited.
Mr Hartnett: I would be very surprised if Mr Poynter, Chairman of one of the major accounting firms in the United Kingdom, felt inhibited by anything I said, but I will take that issue to him when I next see him.

Q483 Mr Cousins: To lose one Chair of HMRC . . . but to lose two . . . Are you not going to overachieve your headcount reductions overall in HMRC? Are you not going to overachieve your target reductions in April 2008?
Mr Hartnett: We may well exceed the target reductions.

Q484 Mr Cousins: Do you have any idea of the scale of that over achievement?
Mr Hartnett: Something around 2000/2500—

Q485 Mr Cousins: That is the over achievement?
Mr Hartnett: That is the amount over the 12,500 net, but we have efficiencies to achieve in the next three years, and that will help us towards those efficiencies.

Q486 Mr Cousins: I asked you earlier about whether you had part-time staff employed in the security guarding capacity, and you did not know and you said you would look in to it. Fair enough. Are you engaged in an outsourcing exercise for security guarding duties?
Mr Hartnett: We have a number of private contractors providing us with security guards.

Q487 Mr Cousins: Is that number increasing? Do you have a programme to increase security guarding privatisation?
Mr Hartnett: I am just getting there, Mr Cousins. We are planning, or have been planning, to further outsource security guarding. The incident that has happened here has caused me to question that, and I want to understand on the back of Mr Poynter's work, and other work whether that outsourcing in any way increases risk.

Q488 Mr Cousins: Is it correct that one of the companies to which you were in the process of outsourcing security duties was, in fact, the Mapeley company?
Mr Hartnett: I believe that is right.

Q489 Mr Cousins: Is it correct that the outsourcing that has been already done to them was done without competitive tender?
Mr Hartnett: I do not know the answer to that.[9]

Q490 Mr Cousins: Will you let the Committee know?
Mr Hartnett: Of course.

Q491 Mr Cousins: On VAT, when are you going to achieve the target that has been set of 70% of VAT registrations within 14 days? When is that going to be achieved?
Mr Hartnett: We believe that will be achieved by 31 January. We have made very good progress and that is our target date.

Q492 Mr Cousins: The Minister has told Parliament that it may not be achieved, but you are confident it will be?
Mr Hartnett: We realise how important that is; I am certainly not aiming to say anything different from the Minister but we are determined to get there. Business has told us how important it is for us to get VAT registration firmly back on track, and we are determined to do that.

Q493 Mr Cousins: Could you let the Committee know the number of VAT registrations and the time that it takes to make the registration, including the median time and the time that is achieved within the present target?
Mr Hartnett: Yes. Of course.[10]

Q494 Mr Cousins: Do you happen to know right now what percentage of VAT registrations are being achieved within 14-day target?
Mr Eland: In October it was 45%, and we are seeing month-on-month improvements which is why we think by January we will be able to meet the target.

Q495 Mr Cousins: Could you in the information you supply to the Committee also supply the number of complaints in the comparable periods of time so we can see the relationship between the registration targets and the complaints?
Mr Hartnett: Yes.

Q496 Mr Cousins: Do you think that some of your efficiency savings will turn out to be inefficiency savings?
Mr Hartnett: That is a very difficult question to answer, Mr Cousins, because framed that way it means looking into the future, but we are constantly looking at our efficiency savings to make sure they are sensible and we are delivering the quality of service that our customer needs. But can I just drop back for a second to the question you asked me before? There are a number of factors in relation to VAT registration, and it would be helpful if you could let me know how you want me to handle these. We know that part of the reason for delay has been

[9] Ev 99
[10] Ev 99

the need to make risk assessments to prevent new registrants having an opportunity to engage in missing trade fraud, but a huge number of new companies were registered in January, February and March this year in advance of the managed service company provisions which came in in the budget in the finance bill with some firms of advisers registering as many as 15,000 companies in very short order. They are in our present statistics around VAT registration, and my question is simply do you want them in or out, because they are a special factor, not an underlying factor, in the quality of service we are providing.

Q497 Mr Cousins: I think we would want them in, but if you want to in some way separate out that particular factor, of course, I am sure you could do so.
Mr Hartnett: We will do our best.

Q498 Nick Ainger: In a submission made by the PCS unit to the HMRC office closure programme in Wales, part of it suggested that there were one million pieces of mail unopened within HMRC offices. Is that correct?
Mr Hartnett: No, it is absolutely not correct. I met the leadership of the PCS two days after I think I was asked to be acting Chairman and asked for their help with this. If there are a million pieces of unopened post we do not know where they are—

Q499 Mr Mudie: They are with the discs—sorry!
Mr Hartnett: No. Whimsy is hard for me at the moment! The important thing, Mr Ainger, is this—we do not know whether there are a million pieces of post unopened; we tell our people to open them. I spent three days back on the shop floor, I had not done it for a very long time, in Cardiff recently doing frontline work; I saw no unopened post; and I have invited both the trade unions and tax advisers to come and have a look for it, if they want to.

Q500 Nick Ainger: In response to Mr Cousins' question you were not quite sure if you were going to achieve your efficiency targets as a result of the closure programme. Where in your calculations of efficiency is the climate change agenda, because my concern is that the office closure programme that you have already started which will continue through to 2010–11 is basically a centralising programme; you are radically reducing the number of officers and centralising in certain places. The result of that means that your existing staff will now travel considerable distances compared to what they do now; that members of the public may find they have to travel more than they do now; in fact, I have had one example given to me of two offices closing or proposing to close in Wales where the carbon footprint of those offices will increase by four times. Is the climate change agenda included in your efficiency programme?

Mr Eland: In carrying out those workforce change assessments we do look at all social factors including factors like sustainability and also other factors such as are they discriminatory in any way, so that is all part of the consultation process.

Q501 Nick Ainger: In this process, because this is one of the issues which I have already highlighted with the Financial Secretary, what discussions have you had with other government departments about the co-location, and I will give you an example of why I do not think currently the procedures are working properly. You have announced you want to close your Newport HMRC office. A few weeks after that announcement DWP announced that they were closing their Cardiff office and transferring the staff to Newport, so if those two go ahead we will have the ridiculous position of staff from Newport travelling to HMRC jobs in Cardiff, and DWP staff in Cardiff travelling to DWP jobs in Newport. That is nonsensical. Have you got any comment on that?
Mr Hartnett: I have.

Q502 Nick Ainger: And how is your department, HMRC, working with other government departments to address problems like this? Co-location surely is a way forward rather than the lock, stock and barrel closure problem you are going forward with?
Mr Hartnett: Co-location is a way forward, Mr Ainger. We have in Llanishen in Cardiff physically a huge office which we can make better use of. We want to keep the expertise and experience of the people in Newport; they are very good at what they do and we would like to move them to Cardiff. I am aware of the issue you raised: I went to Newport while I was back on the shop floor in Cardiff to talk to our people, and I have asked our workforce change planners just to make sure we are doing the right thing here, but we are in constant dialogue with other departments on co-location, and in some parts of the country now we have moved into the same offices to make efficiencies for all.
Nick Ainger: I hope you do really emphasise that as an option. Certainly the current consultation is that there is no reference to co-location, no attempt has been made or referred to in these consultation documents about the fact you have examined co-location, because there are many other examples, certainly in my experience throughout Wales, where there could be co-location.

Q503 Chairman: I have a couple of wrap-up questions. When you answered Jim Cousins, I was not quite clear about future staff reductions. Paul Gray told us that for CSR07, which starts April '08, he envisaged a further reduction of twelve and a half thousand. Is that still the plan?
Mr Hartnett: I think that broadly is still the plan, yes, and what I was trying to say to Mr Cousins is this: that the plan was for 12,500 in the further period. The number over the initial target for the period 2008 helps us going forward to manage our finances.

Q504 Chairman: And will the 12,500 target for 2008 to 2010 or 2011 be voluntary?
Mr Hartnett: There may be some compulsory redundancy. We do not know at the minute because it is back to the issues Mr Ainger was raising and how we manage our estate.

Q505 Chairman: On VAT returns, in your Departmental Report you show the percentage of VAT returns filed on-line. The target is 50% by next March, and you show for March '07 the percentage is only 9.9. How are you going to meet a target of 50% in three months' time?
Mr Hartnett: With difficulty, Chairman, but for a reason that we understand fairly clearly. The VAT return now is much more straightforward and simple than it used to be.

Q506 Chairman: But are you going to meet the target?
Mr Hartnett: I do not think we will get to the 50% target by 31 March, but I do want to say is that the Carter programme, which massively increases electronic delivery into the tax system, will, through mandation, drive that number up. We will not meet the 31 March 2008 target.

Q507 Chairman: You said you were going to get 70% of the ordinary applications done within 14 days. I corresponded with Paul Graham and a company in my constituency that took three months to get a registration through, and the helpline he found completely useless, 0845 711 21114, and my office tried that helpline and also found it completely useless. It simply did not answer. Were you aware of that?
Mr Hartnett: I was not, but what I did do before I came here—because I recognise how important effective and speedy VAT registration is for business—was I talked to our directors who are responsible for this area, and they told me they were both determined and confident of getting there for 31 March.
Chairman: Do you understand the frustration of people who find the helplines themselves useless?

Q508 Mr Cousins: 31 March or 31 January?
Mr Hartnett: 31 January, Mr Cousins. I am sorry.

Q509 Chairman: Finally, your minister is the Financial Secretary?
Mr Hartnett: Yes.

Q510 Chairman: How often are you meeting her?
Mr Hartnett: At the moment nearly daily, and regularly before the data loss.

Q511 Chairman: "Regularly" is what?
Mr Hartnett: Some weeks twice, three times; other weeks maybe once.

Q512 Chairman: Thank you very much.
Mr Hartnett: May I clarify one small point for you? I did say I would go away and get an answer for Mr Thurso on call costs. My colleagues behind me have said that to put any precision into this would be very difficult because the call costs of the 0845 number will depend on the tariff of the caller, but we will go away and do our best to come up with a number.
Chairman: Thank you very much.

Wednesday 9 January 2008

Members present

Mr Michael Fallon, in the Chair

Nick Ainger	Ms Sally Keeble
Mr Graham Brady	John McFall
Mr Colin Breed	John Thurso
Jim Cousins	Mr Mark Todd
Mr Philip Dunne	Peter Viggers

Witnesses: **Rt Hon Jane Kennedy MP**, Financial Secretary, and **Angela Eagle MP**, Exchequer Secretary, HM Treasury, gave evidence.

Q513 Chairman: Financial Secretary, Exchequer Secretary, can I welcome you both to the Committee. Can you formally identify yourselves, please, for the shorthand writer?
Jane Kennedy: Jane Kennedy, Financial Secretary to the Treasury.
Angela Eagle: Angela Eagle, Exchequer Secretary to the Treasury.

Q514 Chairman: Can we begin with you, Financial Secretary? When we took evidence from David Hartnett as to whether the seven serious security breaches in two and a half years indicated systemic failure, he told us that it may well do. Do you agree?
Jane Kennedy: I agree with the point that he was making, which is that it is possible that the Poynter Review may reveal that, but we do not know yet. Having read the transcript very carefully and listened and discussed the matter with David since his discussion with you, I am quite clear that we share the same view. The Poynter Review is going to be a very thorough and in-depth inquiry into the events surrounding the loss of those two discs. We will not really know, until we get all of the information that he will provide to us, exactly what did happen and it is at that point that I assume the Select Committee, and others, will draw conclusions, and we will want to know the outcome ourselves.

Q515 Chairman: Have you as minister been asked already to authorise any changes arising from the interim report?
Jane Kennedy: I think it is important to reinforce the independence of HMRC from ministers. The relationship that I have with HMRC reminds me very much of the relationship that I had when I was the Security Minister in the Northern Ireland Office working with the Police Service of Northern Ireland, previously the Royal Ulster Constabulary, in that they were operationally independent and very fiercely defensive of that independence, and rightly so, and HMRC will make decisions in response to the recommendations that they receive and I will discuss those decisions with them, but the decisions at the end of the day are for them to make.

Q516 Chairman: It has been suggested that some of the latest problems with the efficiency programme have been connected with problems arising from the merger. Are you satisfied there is no link?
Jane Kennedy: Yes, my view very strongly is that from what we know (and, as I have said, there is still a lot more to learn about what happened) it appears that procedures were in place and the procedures were not followed. It is quite clear that it is likely the NAO should not have asked for the information in the way that they did, that HMRC should not have prepared the data in the way that they did and that they should not have sent it an insecure route, which is what they did. Simplistically, there appear at first sight to be three major breaches of procedure, and I do not believe that procedure has been weakened as a result of anything through the Efficiency Review.

Q517 Chairman: HMRC have now supplied us with details of the bonuses paid for 2006–07, showing that the bonuses totalled 18.9 million, a 72% increase over the preceding year, and that over 38,000 officials in HMRC received bonuses for last year. Did ministers authorise these bonuses?
Jane Kennedy: If you are talking about the HMRC bonuses—

Q518 Chairman: Yes.
Jane Kennedy: —again these are bonuses paid under the pay agreements that exist within HMRC under their contracts with their staff. The change in the amount of bonus paid: it might be worth me spending a minute or two describing what has happened. The prime reason for the cost increase was a pay assimilation exercise. It cost around about £60 million and occurred as a result of the merger of Inland Revenue and Her Majesty's Customs and Excise. That pay assimilation exercise removed the different pay and grading structures that had previously existed in the former two departments, and that ensured that HMRC would be legally compliant in terms of fairness with their staff in their new organisation. The bonuses paid in 2005–06 represented the last year of awarded performance pay to staff in the former two departments, Inland Revenue and Customs and Excise. Staff in the Inland Revenue used to receive bonuses under a team bonus arrangement, and Customs and Excise staff received bonuses paid to top performers only, on an individual basis. In 2006–07, which was the

first year of paying bonuses under HMRC, the increase in the bonus pot was planned growth, it was affordable within HMRC's remit and it was achieved by allocating funding to non-consolidated pay rather than to consolidated pay increases. It was a quite deliberate pay strategy adopted by the new organisation, aimed at increasing the proportion of pay which was non-consolidated and, therefore, directed towards performance and aimed to improve performance across the organisation.

Q519 Chairman: Given the performance, given the over payment of tax credits, given the mistakes and the data losses, do you not think our constituents would be rather surprised to learn that over one-third of the work force should be entitled to a performance bonus?
Jane Kennedy: I think that would be an unfair judgment to make. HMRC, as the Capability Review has found and as I found when I was privileged to go and work with them, is an organisation which has some absolutely superb staff working for it. Quite clearly there are areas where their performance needs to improve, but you could not say that across the whole piece performance was failing, and they have some staff who are very deserving indeed of the bonuses that they have been paid.

Q520 Chairman: Did you authorise them or did your predecessor authorise these bonuses?
Jane Kennedy: The agreements were made, as I said, between the Treasury and HMRC and the bonuses have been paid in accordance with those agreements.

Q521 Chairman: I understand that, but were they authorised at a ministerial level?
Jane Kennedy: They would not come to me for authorisation in that sense. I would not be asked to approve, at the ministerial level, bonuses being paid, as far as I understand, to individuals or to groups of staff within HMRC. That is a matter for them to determine, whether staff have met the—

Q522 Chairman: But you were aware there had been this big increase of over 70%?
Jane Kennedy: Certainly it was quite clear that this was part of their programme and it was planned for.

Q523 Nick Ainger: Coming on to public sector pay, the Joseph Rowntree Foundation in a recent report has indicated that they estimate, along with the figures from ONS, that there are around a million staff directly employed in the public sector that are earning £6.50, or less, an hour. Do you know how many staff in the Chancellor's department are earning less than £6.50 an hour?
Jane Kennedy: I do not know off hand.
Angela Eagle: I have not got that information to hand, but I am quite happy to get you a note on it.[1]

[1] Ev 87

Q524 Nick Ainger: Are you concerned that such a substantial number, and most of these are women, are earning less than £6.50 an hour, and what research are you undertaking to make sure that they are not actually living in poverty?
Angela Eagle: In terms of overall pay levels, it is clearly in everybody's interests that public sector pay and public sector workers are remunerated properly, and I think to that extent it is a bit difficult just to focus on those at the lower end. We need to remember that, with respect to public sector remuneration, there are also pensions benefits and other benefits of flexibility often that come with the job. And there is currently—research shows—healthy levels of recruitment and retention in the public service. That does not mean to say that there are not particular areas where there might be stresses or pressures, and we would certainly encourage government departments to keep those under review, and act appropriately if it was shown that there was difficulty in a particular area.

Q525 Nick Ainger: Part of the problem is, surely, that many of these jobs, as I said, are taken up by women and that compared with the private sector they may be as good a deal as they are going to get, but the fact remains that because their basic income is so low, we are now embarking on a pay policy which is going to limit pay rises to less than 2%, that those people, in relative terms, are actually going to be worse off, and I just wondered if there was any way of addressing that, both across government and within your department.
Angela Eagle: I think it is important to remember that in the six years from 2000 to 2006 public sector pay actually rose way beyond what CPI inflation was and that we have got more public sector workers since 1997 and many of them have had well above inflation increases in that period. Just to give you a few examples, 44% average increase for nurses, 65% for hospital doctors, 97% for ambulance staff, 39% for police officers, 41% for teachers.

Q526 Nick Ainger: Can I just stop you there. All those are earning a lot more that £6.50 an hour.
Angela Eagle: It is important to put this into context. Over the last few years, because we have had a successful, stable economy with 61 quarters of consecutive growth now, we have been able to make substantial investment into the public service, and that has included investment in more staff and better paid staff. That does not mean that any of us can be satisfied that there are even elements of low pay, but it is up to managers in the public service and the unions that represent those workers to see what they can do to try to upskill those workers, perhaps manage them into better career progression; it is up to the Government to run the economy in a stable way which enables us to provide greater levels of investment and better remunerated jobs in the public sector, and I think over the last ten years we have got a good record.

Q527 Mr Breed: Although we recognise that HMRC's head count, the number of actual people, has been decreasing overall, it is quite noticeable that the category of so-called "other staff" has actually increased by 9% and that the costs of these staff have increased by 25%. Can you explain the reasoning or how that has come about?
Jane Kennedy: By "other staff" do you mean other than HMRC's own directly employed staff?

Q528 Mr Breed: I imagine so, like fixed-term contracted people, consultants and people who, I assume, are not on full-time contracts.
Jane Kennedy: I know from the work that I have been doing on tax credits that they have employed a number of staff in some cases where they have had to recruit quickly at short notice to deal with, fix a problem that tax credit administration has come across. Then they will bring people in on a fixed-term contract or they will use agency staff, and those groups of staff have been used quite extensively from time to time, indeed are still working with the tax credit offices at the minute to help with the problem of the section 18 difficulties that we had earlier.

Q529 Mr Breed: Is it not the case then that what you have done is just reduced the number of people by reducing the jobs and you are then having to re-employ people, either on fixed-term contracts or as consultants, in order to do the work that was done by the people that you got rid of?
Jane Kennedy: That would be to assume that we would necessarily have in house—First of all, if you bring somebody in on a specialist contract it is usually because you do not have in-house the expertise and experience that you are purchasing by the use of that contract; so those will be brought in for specific purposes and they will be used to supplement, where we do not have in-house skills, but where I have seen the effective use of agency staff, it has been to help, in particular, the tax credits offices deal with the extra work that was not anticipated when the tax credit system was set up.

Q530 Mr Breed: But the whole purpose of reducing the head count was to actually save money.
Jane Kennedy: Yes.

Q531 Mr Breed: It looks as if we are actually spending more money.
Jane Kennedy: In fact, they have been saving money and, as a result—

Q532 Mr Breed: Saving money by spending more.
Jane Kennedy: We have set aside, and we will be taking forward, investment in HMRC to enable the further changes to happen. You cannot simply make an efficiency change easily without some investment, very often, either in IT to assist the staff to change to new processes or training, investment in helping staff to move to new locations, and so on, and there is about 1.5 billion, I think, set aside for the transformation programme over the next three years that will help HMRC to continue to change. And therefore, you would not necessarily, as you are going through a change process, expect all costs to go down but, notwithstanding that, HMRC have met the Gershon programme, they have achieved the targets that they were set—I can give you the figures if I took a minute to find them—and they are to be commended for doing that. Indeed, people like the Adjudicator, who works with the tax credit offices, has commended HMRC for not only maintaining their business capability throughout a period of change but for doing it in a way that has enabled them to make changes to the process as they have gone along to improve customer service.

Q533 Mr Breed: From the figures, the number of permanent staff decreased by over 4,000 in a year but the cost of those staff that left has increased by £29 million. Is that related in any way to what you were saying previously about the issue of bonuses and such?
Jane Kennedy: It is unrelated to bonuses, as far as I am aware. If you will allow me, I will check that to make sure, but I am not aware that it is anything to do with bonuses at all.[2]

Q534 Mr Breed: On the face of it, it does not seem that Gershon savings are actually being achieved by the reduction of the head count. That is the nub of the situation as far as we can see from the figures.
Jane Kennedy: We have made significant changes. Let me take a moment to find the Gershon statistics. For HMRC (because I cannot speak for the other departments) the spending review in 2004 set specific targets of £507 million and to reduce the full-time equivalent posts by 16,000 by April 2008. HMRC has already delivered the 12,500 full-time equivalent reduction, it has saved more than £507 million in annual running costs already and it is on target to meet its Lyons target objective to move 1,950 posts out of London by April 2008; so the strategic objectives have been met in terms of the Gershon plan.
Chairman: We will suspend for ten minutes. We have a lot to get through, so in ten minutes we are going to resume.
The Committee suspended for a division in the House from 2.44 p.m. to 3.04 p.m.

Q535 Mr Breed: The Minister was explaining that there was about £500 odd million of savings. I wonder if she might send the Committee a copy of that breakdown explaining that calculation. I think that would help us in terms of trying to understand how we are arriving at figures.
Jane Kennedy: Would it be in order for me to get my staff to contact the clerk to make sure exactly what figures it is you are be looking for?

Q536 Mr Breed: The calculation for the savings of £500 million, I think.

[2] Ev 87

Jane Kennedy: Okay.[3]

Q537 Mr Dunne: In the department's Capability Review published in December some of the most critical comments were actions required to do with leadership. I note, in particular, a comment on page 21, which says that some stakeholders and government departments believe that HMT would improve outcomes if it acted with greater humility and in a more open and inclusive way. What is the new ministerial team going to do to address that criticism?
Angela Eagle: We can start by being humble ourselves. I think that is quite a good start. It was, overall, an extremely good Capability Review. There are some very positive points in it. You are obviously going to concentrate on the areas of improvement, which is also important, but I think, in order to get it into perspective, it is wise to remember that the Capability Review said that the Government had earned a strong reputation with stakeholders for the strength of its analysis and forecasting, for the intelligence of the staff and the experience and astute nature of the staff who work there, their intellectual capacity. I must say that in the six months that I have been there I certainly, over and over again, more than—

Q538 Mr Dunne: I do not think there is any question about the intellectual capacity, but I am glad you raised the question of experience, because we do need to concentrate on the things that need improving rather than just rehearse—
Angela Eagle: I am going to come to that in a minute.

Q539 Mr Dunne: I am sorry, if you do not mind, I am going to continue because I have a limited amount of time to put my questions. In relation to the issue at the moment, which is the financial crisis that we are seeking to manage our way out of, we have identified, under challenges for future delivery, that the department must ensure that it has the capacity to identify future risks and the resilience to deal with them and the experienced people within the department to be able to cope with that. Under "Area for Action 1" there are several comments made that the department needs a much clearer approach to recruitment and retention. Could you, please, talk about the experience base and the relevance of the experience of senior members of the management team within HMT and are they really equipped to deal with these sorts of challenges rather than the administrative role in managing government?
Angela Eagle: Firstly, I think that the department can stand on its achievements and its economic record, its technical capability, and part of the proof of that is in the fact that we have had strong and stable economic policy, that the department is a good financial department, thought to be one of the best in the world, has an impressive international reputation, all of which came out in the Capability Review. I have also been impressed again by the exchange of expertise that happens. The Treasury does actually second out to outside organisations and have secondees in. There is also a good proportion of Treasury staff seconded in from other government departments, so I find that it does reach out both to the commercial world, the outside world, the world of international financial institutions, as well as across government, and so I am quite confident that we as a treasury do have the right sort of two-way communications and outreach with those organisations in order that we can upskill our own staff but ensure that as a Finance Department we are open to the rapid changes and innovation that is going on in international finance and corporations so that we are able to get a practical as well as an intellectual grasp of what is going on. Perhaps that needs to be strengthened, and certainly the Permanent Secretary has set out in his response to the Capability Review some of the methods by which he is planning to do that. There are different headings under which action is being taken, and you have identified one of them. Staff skills is important and updating and ensuring that we raise staff skills is important, which is why the commitment to undertake a proper skills audit and understand current skills and, by definition, perhaps some of the gaps that there are is going to be an important first response to the review. So I think the review gives us lots of things to be proud of, but lots of things to do too.

Q540 Mr Dunne: Do you know how many senior officers have prior banking experience?
Angela Eagle: I cannot give you that figure off the top of my head.[4]

Q541 Mr Dunne: Have you asked that question?
Angela Eagle: No, I have not personally asked that question.

Q542 Mr Dunne: Could I ask you to do so and kindly write a note to the Committee, because the Treasury is going to be seeking to play a larger role in the future. In the work of the tripartite, it would be reassuring to know that it has got some skills.
Angela Eagle: Certainly. I think you also need to recognise that the Bank of England has a lot of contacts here and there is a lot of, not only tripartite, but two-way communication between the tripartite authorities and the outside structures, be they commercial or otherwise.

Q543 Mr Dunne: Do any members of the new ministerial team have prior banking experience or senior financial experience?
Angela Eagle: How do you define "senior financial experience"?

Q544 Mr Dunne: I would leave it to you to define it. If anybody has any, then they would know what it was.

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Jane Kennedy: In any formal way in terms of employment or training?
Angela Eagle: I have never worked in a bank, if that is what you mean.
Jane Kennedy: I have a number of overdrafts, if that counts!
Chairman: No.

Q545 Peter Viggers: Does it worry you that scarcely anyone in the Treasury has experience in the Treasury prior to 1997?
Angela Eagle: There are advantages and disadvantages to having a young and dynamic team in terms of senior staff in the Treasury. The advantages are that you maintain the intellectual interest and you are up to date with newer ways of doing things; but some of the disadvantages might be, for example, since we have had so many quarters of consistent financial stability, that the majority of people in the bank have not actually lived through a recession.

Q546 Peter Viggers: I take that as a no.
Angela Eagle: Therefore, there are advantages and disadvantages to these things.[5]

Q547 Chairman: I think you mean in the Treasury, not in the bank.
Angela Eagle: In the Treasury. Mr Dunne got me sort of interested in banks and I was not able to get it out of my head.

Q548 Mr Todd: HMRC's Capability Review, bearing in mind that this is a public document and, therefore, is likely to have had a blanket placed over it to stifle at least some of the critical remarks, is a fairly damning critique of the leadership capabilities and ability to deliver change in HMRC. Would you agree with that? It is very complimentary about many of the individual staff within HMRC, I should say straightaway, but we are focusing here on the ability to run the organisation successfully from the top and change it to meet new challenges.
Jane Kennedy: I should, first of all, say that I do not accept that either we as a team of ministers or HMT or HMRC in their contacts with the Capability Review sought to throw a blanket over any of its findings so that the public document would be more palatable. That did not happen. As far as I was concerned, the Capability Review for HMRC could not have been better timed. When I came into the department and when I saw the Capability Review's proposals and their draft report, I was immediately able to recognise the organisation that I had been working with for the past six months, and I accept what you say. They have drawn attention to a number of proposals that they have recommended for change, they have said that there were too many different programmes of reform and change, for example, that there was insufficient clarity as to who had lead responsibility at the highest level, and so on, and I immediately recognised the organisation—

Q549 Mr Todd: Poor information flows within the department so middle management did not share necessarily the goals of the senior management; poor management information generally to allow people to evaluate whether they are achieving what they are supposed to be achieving.
Jane Kennedy: I have accepted the criticisms that the Capability Review has made, but I also take with the criticism—. I am pleased to have seen the response that HMRC have made to it and the way that they immediately accepted all of the criticisms as well as the plaudits, as they were deserved, but they put in place a plan to respond to the Capability Review. That plan is well underway to being implemented. Specifically, they have already taken steps implementing changes to the senior management team to ensure that their accountabilities are clarified and simplified, they have rearranged responsibility for managing business performance, the change in initiatives which has been brought together under the Chief Operating Officer. This was something I was very keen to see happen because, I perceive, in my experience over many years as a minister, enabling an organisation to change is a very key skill and one that needs somebody right at the top able to demonstrate and to take responsibility for leading that forward.

Q550 Mr Todd: Therefore not necessarily someone simply promoted within the organisation who may or may not have that capability according to chance.
Jane Kennedy: It would depend upon who the individual was. It is possible to promote people up from within an organisation, but very often you do have to borrow the skills from elsewhere.

Q551 Mr Todd: You will have noted the references to relatively poor morale in large parts of HMRC?
Jane Kennedy: Yes.

Q552 Mr Todd: Do you think that is a priority that should be addressed?
Jane Kennedy: Yes.

Q553 Mr Todd: How?
Jane Kennedy: I have seen in my visits and in talking to staff whenever I get the opportunity a sense of concern about perhaps the way that changes were being implemented. There is an anxiety about the LEAN process, for example, although staff that have gone through it become enthusiasts for it and then start to advocate that within the organisation. So there is a fear of change. I have seen that in other organisations too. I saw it in Jobcentre Plus as it was bringing together Benefits Agency staff and Jobcentre staff. These are all classic stages that staff go through when a very major change is taking place, and there is a big culture change happening within HMRC but, at the same time as I have seen those anxieties being expressed, I have, in particular, been very encouraged to meet staff working in the tax credit system who have increasingly been empowered by the way in which their processes are being allowed to be changed to deliver a better service for customers.

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Q554 Mr Todd: One of the critical ways that one might address several of these issues together (and it is touched on in the Capability Review and you alluded to it) is to carefully review the priorities of HMRC, to refine them and focus them on the most important things, because this is an organisation, I think we would all accept, which is under tremendous challenge at the moment, but simply overloading change on to a team who are struggling to cope with what they have got is a recipe for further disaster. Would you accept that? If so, are there some specific suggestions as to simplifications of tasks that could be undertaken?
Jane Kennedy: Yes. I think one of the responses to the loss of data was for me to ask myself and for the management team within HMRC to ask themselves: was the Efficiency Review impacting upon staff morale to the extent that you might fear that such things as security procedures might be disregarded? We do not believe that that is the case. I believe that the way forward is for the new reworked senior leadership team that David Hartnett is putting together to take forward the organisation to, if you like, advocate the process of change in a much more visionary way than perhaps it has been done in the past and to rigorously take it throughout at every level; and I can tell you they have accelerated the programme by which the most senior staff are taken out and enabled to work, if you like, on the shop floor.

Q555 Mr Todd: Does the departure of the Chief Finance Officer indicate either that Mr Hartnett is addressing issues of leadership within his team and this person is leaving as a part of that, or some change in focus in that particular function, or, perhaps, a need to address the management information gap which is highlighted within this Capability Review? What does it mean to us?
Jane Kennedy: I think it is one of a number of changes that the new Chairman, the Acting Chairman is making. I would not want to comment on a particular individual and single one person out in that way. I think the Acting Chairman has identified ways in which he wishes the senior team to change and their responsibilities to change, and he is enacting that.

Q556 Mr Todd: But on the face of it, his rather important departure was prompted as part of a change programme, was it?
Jane Kennedy: It has been part of the HMRC's response to the Capability Review specifically but also, I think, the organisation's need, following the departure of its Chairman, to fully reflect on what had happened.

Q557 Mr Brady: Can I turn to the refusal to release documents relating to the Gateway Reviews of ID cards and the NHS IT programme. Nigel Smith, the Chief Executive of the Office of Government Commerce, told us recently that the decision to appeal against the release of the documents against the Information Commissioner's ruling was the decision of government, not of the OGC. Is that correct?
Angela Eagle: Yes.

Q558 Mr Brady: Why do you feel so strongly that those documents should not be released?
Angela Eagle: There are two sections of the FOI Act that we believe are engaged by the requests that have been made for Gateway Review information and information also on the NHS IT system. The first one is section 33(1)(b), which is audit functions, and the second one is 35(1)(a), which is formulation of government policy. If we take Gateway Reviews, they are an extremely useful process. They are done in a week, very quickly. They are reliant on the candour of the person who is being interviewed and who is mainly responsible for them. There are certainly, in my view, arguments that if these Gateway Reviews were to be in the public domain quickly and publishable, then that might actually harm the effectiveness of the process. It would make it an entirely different thing to what it is now. These are arguments that the High Court is going to have to deal with. There is, indeed, a hearing due to take place on 4 and 5 March.

Q559 Mr Brady: The tribunal, when it published its report in May, referred to this as a "flood gates argument" and said that the problem seemed to be the view that, if this information was disclosed, then people would have to work on the assumption that all reports would need to be disclosed very soon after publication and goes on to say this is clearly incorrect. Also, as you will be aware, some Gateway Reviews have been published in the past. It is not always the case, but it can be done. What is it specifically about these reviews? Is it just that they are politically sensitive?
Angela Eagle: No, I do not think this is the place at the moment, just ahead of the High Court hearing, to rehearse in great detail the merits, or otherwise, of these cases. I think it will be interesting to see what the High Court does, and I think the arguments with respect to the FOI Act and the exceptions I have mentioned in section 33 and section 35 of the Act— Let us see what the High Court says, but there is a genuine worry, as I hope I have just set out, that the Gateway Reviews could be harmed if there was a general perception that they could be in the public domain quickly after they were done, and I think that is a perfectly reasonable argument to have and I would be personally extremely interested in the view that the High Court comes to, but I do not think it is appropriate to go into any greater detail at this hearing in advance of the High Court judgment.

Q560 Mr Brady: That may be a perfectly reasonable argument but it is an argument that could apply to the release of any Gateway Review. Can you confirm that there are, therefore, specific issues that relate to the NHS IT programme review and the ID card review?

Angela Eagle: No, I am not going to confirm that. I think there is an issue about formulation of government policy and having enough thinking space around when things are being done internally. And I think Nigel Smith in his evidence was talking about public accountability, and, my goodness, we all live with public accountability as politicians and it is a very good thing, but having space privately to try to do things without it being revealed is also an important part of policy formulation, and I will be extremely interested in the view that the High Court comes to. The Information Commissioner has taken one view, ministers have taken another view, let us see what the High Court does with it.

Q561 Mr Brady: We will all be very interested to hear that. As you will be aware, there were also accusations that some documents have been shredded in order to avoid the possibility of—
Angela Eagle: Yes, I saw that and investigated, and my information is that actually what happened was that the shredded documents were earlier versions that had been superseded by other versions; so it is wrong to say that there was any shredding of documents at all.

Q562 Mr Brady: Documents were shredded, but the information—
Angela Eagle: But it was an earlier version. There was a superseded version. That is what I am told. As Nigel Smith said, it is version control, not anything evil.

Q563 Mr Brady: Was any record at all kept of the earlier versions?
Angela Eagle: I have no idea.

Q564 Mr Brady: Would you be able to find out?
Angela Eagle: I could certainly investigate that for you.[6]
Mr Brady: Thank you.

Q565 Ms Keeble: I want to ask about child poverty, Jane. At the time you published the Annual Performance Report when you said that you had slipped on the target on child poverty, the Treasury also said it was redoubling its efforts to meet the 2010 target. Can you say specifically what it was doing in terms of redoubling in terms of both measures in place but also what specific plans it had?
Jane Kennedy: Yes, the combined PBR/CSR that we published last autumn made a number of announcements on financial support for families with children, and that built on a number of announcements made in Budget 2007 and, indeed, in previous budgets from 2004, as we saw a degree of plateauing in terms of the target; so we committed to raise the child element of child tax credit by £25 a year above earnings indexation from April 2008, in addition to the Budget 2007 commitment to increase the child element by £150 pounds, and it will then rise by a further £25 above indexation in April 2010, and we will then substantially as well increase the child maintenance disregard—that is, doubling the disregard in the main income-related benefits from £10 to £20 by the end of 2008 and doubling it again from £20 to £40 in April 2010. There are a whole series of steps that we outlined in the PBR. We confirmed that the in-work credit will be rolled out nationally to all lone parents at the rate of £40 a week. In London, where we acknowledge a particular problem, it will be rolled out at £60 a week from April 2008. The personal allowances and jobseekers allowance and income support for 16 to 17 year olds will increase by around about £11 per week to align that with the 18 to 24 rates, but it is not just increasing the income of the lowest income households that we are looking to improve to help lift children out of poverty, there is a whole series of other measures that the PBR announced, including work that the Department for Children, Schools and Families will take forward: rolling out the SureStart children's centres, for example; twelve and a half to 15 hours free entitlement to childcare for three and four year olds. These sound like just a long menu of all of the things that we are doing generally across the board, but in fact all of these impact on child poverty because they improve the life chances of those children from that earlier stage and, therefore, will help them later in life.

Q566 Ms Keeble: Specifically on the poverty issues, there are issues about improving some of the benefits, but in terms of getting lone parents into work there are significant issues around childcare.
Jane Kennedy: Yes.

Q567 Ms Keeble: You have not increased the childcare element, although you had the big increase previously. You had the increase in the threshold, but for a single child. That has not been increased. Have you looked at the actual cost of childcare and whether this is properly covered by the childcare element? That is the first question. The second one is: have you asked for an analysis of the type of childcare that is needed to get lone parents into work given that they are often put into marginal areas of work outside even wrap-around childcare, which is usually about eight am to six pm?
Jane Kennedy: On the childcare element, we have corresponded about this and talked about it.

Q568 Ms Keeble: I know. What you have said was that you increased the overall threshold so dramatically that nobody had actually applied for it, but you have not increased the cost per week of one child, which is £135, which actually is not that much if you look at the real cost of childcare?
Jane Kennedy: The question is a very good question and, clearly, the more lone parents we can help into work the bigger the impact on the child poverty target, the greater progress we will make towards achieving it. So I was very interested to ask what the detailed thinking was around the advice that we got on what level to set the childcare element of child tax credit at. The advice I got was quite clear that the

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amount that we now have available to be claimed covered the vast majority of claims that were being made. Indeed, there were very few using the whole—

Q569 Ms Keeble: Let me just say. The point is not about whether people who currently are on the system can make it work for them. The issue is getting people in.
Jane Kennedy: I agree.

Q570 Ms Keeble: If you are going to work stacking shelves at Tesco from eight o'clock until midnight or two in the morning the kind of childcare and the cost of it is going to be different than if you are serving at Tesco from nine o'clock to midday.
Jane Kennedy: Yes, and I have been thinking about this. Indeed, in the further work that we are doing in looking at the child poverty target and thinking around what other measures could be taken, we are looking at why, for example, there is a relatively low take-up of the childcare element anyway and we need to understand what is happening. We are working with DWP colleagues to understand what the data is around that and what evidence there is that we can draw upon. I am particularly interested in the regional differences and the pressures, for example, that there may be specifically in London, and I think the only other very poorly performing region is the East Midlands and we need to try and understand what are the factors that are affecting families with children with low incomes in those regions that mean that they are not having the same success with lifting children out of poverty, as Scotland, for example, or, indeed, my own region, the north west.

Q571 Ms Keeble: I think there is a big issue about the out of hours, but one thing I want to ask is have you looked at the IPPR proposals for changing tax credits to make them have a bit more credibility perhaps with people who are currently out of work and also to improve them for working parents, and, in particular, this issue about restructuring them so that there is more encouragement for a second adult in a two-adult household to go out to work?
Jane Kennedy: Yes. The IPPR proposals are part of the discussions that we are having on this. We are genuinely looking at all of the suggestions that are being made. There is, as you know, a very strong and well informed lobby on this. The IPPR do measure the number of working households with children which are in poverty slightly differently to us. We have three different measures. Whereas we measure child poverty by looking at the number of children in households below the 60% median income, there is a slight difference in the way we arrive at those figures with the IPPR. The number of children in relative low income households where at least one adult works has fallen and the risk of child poverty in working households where at least one adult is working has fallen too.

Q572 Ms Keeble: What do you think, for example, of their proposal for a no claw-back working tax credit so that you do not have claw-backs for the poorest households?
Jane Kennedy: I think they have a number of interesting proposals. The particular one about claw-back I am not enthusiastic about but I want to consider it further, and I am going to be talking to a number of the groups that have made suggestions, such as the IPPR, to sort of talk through in detail exactly what they mean.

Q573 Ms Keeble: How about operation of the minimum wage and the extent to which its enforcement needs to be improved, particularly for vulnerable groups such as migrant workers and also students?
Jane Kennedy: Clearly the minimum wage was set in legislation precisely so it could be enforced, and I would expect that where it is demonstrably being broken that it would be enforced. I do not know of any particular examples or concerns.

Q574 Ms Keeble: Still zero hours contracts and also having a reserve pool of very vulnerable people acts as a dampening effect on pay and employment practices at the lower end of the pay scale.
Jane Kennedy: I would want to look at that in the context of all of the pressures that are affecting the ability to meet the target.

Q575 Ms Keeble: There is information from the Joseph Rowntree Foundation that just over a million public sector employees earn right on the minimum wage. Have you looked at all at the impact of the contracting out of certain areas of work, in particular catering and cleaning, on poverty in the UK?
Jane Kennedy: I have not specifically. There have been a number of studies across government on this, but I have not commissioned any work on it. I am not surprised at the number that the Rowntree Trust has identified. I come from a public service background, I was a trade union organiser in the public sector. It does not surprise me that we still have a very significant number of public sector workers who are being paid at the very low end of the wage scale, but the whole purpose of having a national minimum wage is so that the measures that we have put in place to help low income families are not abused by employers by simply taking it back out of the wage packet, it forms a floor under which wages cannot fall. Unfortunately, there are still public sector workers who rely on the measures that we have put in place to help low income families and there are, for example, tax credit staff who receive working tax credits. These are the realities of life.

Q576 Ms Keeble: Obviously the Government's commitment on child poverty is a major historic and very noble cause but it is one which requires a lot of pressure to reach and there is a possibility of back-sliding, one of which is perhaps coming up with the very dramatic increase in food prices which forms a disproportionately large part of the spending for low

income families. Have you looked at the impact of rapid food price inflation on the well-being of low income families?
Jane Kennedy: I have not specifically, but I will ask for some work to be done on it. I would be interested in that. I am also concerned, for example, that the increase in fuel prices impacts highest on families on the lowest incomes too. So there are a number of factors, which is one of the reasons why I was pleased to see what the Chancellor said on Monday about the regulation of prices.

Q577 Ms Keeble: Housing and food, I think, are the major ones. Housing, presumably, is helped by housing benefit, but food prices, particularly fresh food, will be a major issue for income and for health.
Jane Kennedy: I will have a look at that.
Ms Keeble: You will come back on that?
Jane Kennedy: Yes.
Ms Keeble: Thank you very much.

Q578 Peter Viggers: Ministers tell us that child tax credits have brought great benefit to many families, but I know from my constituency experience, and I suspect colleagues know, that in a very significant number of cases there can be great distress caused when an over payment has been made and repayment is demanded. Can you tell us how many cases there have been where the computer has failed to cope with the case in question? That is question number one. I also have cases where, because the computer has failed, manual control has been put in and that has failed as well. How many of those are there?
Jane Kennedy: I can get for the Committee the exact figures that you are asking for, Mr Viggers, but I know that there are over 20,000 cases that are in manual payment, which means that the computer is completely unable to manage that particular household's tax credit claim and, therefore, it is processed manually by staff. That is one of the problem areas that the administration of tax credits continually presents as a challenge for us to overcome. The first question you asked was a specific question: did I know the numbers? I do not, but I will find that out for you.[7]

Q579 Peter Viggers: I am much obliged. The Code of Practice 26, which many are looking forward to, will change the rules, and it has been summarised to us in evidence by Ms Walker from your department that the questions will be asked: how many children you have, what your income is, that kind of thing, and you then check that what goes into the bank account matches what we have told you is going into the bank account and then, that having been established, the individual will have fulfilled his obligations and it will then be up to your office to administer the system correctly. That new Code of Practice 26 was intended to be introduced by the end of January. What is the programme on that, please?
Jane Kennedy: It is being used in many cases. What has needed to happen before it could be implemented properly is that the cohorts of staff that work in the divisions within the Tax Credit offices who deal with disputed payments and disputed claims needed to be trained in how to apply the new code, so there has been a short period in which they have been moving over from applying the old code (based on the reasonability test) to the new code of practice. Many of the cases are already being dealt with under the new code. We anticipate—I think I am correct—from the end of this month that all cases will be dealt with on that basis, but this is where a customer has made their claim, has received an award notice, has responded to the award notice and disputed it in some way, and then it is an on-going dispute. That is the set of circumstances under which the new code will begin to have an effect.

Q580 Peter Viggers: Does the new code reflect a significant change in HMRC policy?
Jane Kennedy: In the sense that it will no longer be the case that HMRC will make a judgment as to whether it was reasonable for you as an individual customer with a tax credit claim to appreciate that the claim was wrong, in my view, it is a significant departure, yes.

Q581 Peter Viggers: And how many cases will be involved which will be affected by this change? To what extent will it be retrospective where people have been locked into argument or dispute with the Department?
Jane Kennedy: To deal with the latter part first on the figures, again, if you will permit me, I will write to you with all of the details rather than take the time now to dig them out.[8] I invited the Adjudicator and the Ombudsman to come and talk to me about the proposed new code. I wanted to take their minds to how they thought it would be implemented and whether we had got it right, whether HMRC had got a new policy that would be better. They were both keen to see it implemented as quickly as possible. They each took slightly different views as to when they would use it themselves. I think it is sensible to take the view that going forward new disputes will all be dealt with under the new code. As I have said, there is a period right at this moment where probably by now the majority are being dealt with by the new code, but you will begin to see that hopefully the number of letters that you get not only from HMRC but from the Chairman and myself will reduce as a result of all of this, and you will begin to see the effect that this new code will have.

Q582 Peter Viggers: Again if I may draw on my own experience, correspondence with the Ombudsman and the Adjudicator is taking an increasing proportion of my workload. Are you satisfied that the system is right which has these two separate bodies, both of whom have been quite critical of the system and of the Department?

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[8] Ev 88

Jane Kennedy: Yes, I think that the process we have in place is appropriate. You have two different types of appeal. The Ombudsman, as you know, looks at the whole process of that particular case, and will look at the process rather than the decision, and I think the system that we have in place, including the appeal to a tribunal, is fair.

Q583 Jim Cousins: I am sure you will be aware of the concern about frontier protection and the comments that have been made both by the Association of Chief Police Officers and Lord Carlile about the lack of frontier protection. When we turn to the Capability Review, these very significant issues are dealt with in a single paragraph and we are told simply that the Department is on course or well ahead to meet its targets. However, the statistical information we have is far from conclusive about this. The number of searches is going down, the number of seizures of drugs is going down, plant and animal product seizures are going down, even on the limited information that we have. Are you satisfied that these matters are being properly dealt with?

Jane Kennedy: Clearly it is something that when I meet with the Chairman of HMRC, as I do very regularly, we keep under close review. I am satisfied that the changes that HMRC are making to the way in which they deploy Customs staff in their border operations is appropriate to the pressures that they see us facing as a country. It seems to me sensible that they deploy their staff towards the areas of greatest risk, which is what they are doing. I have seen the ACPO criticism. I always take criticism from police officers at any rank seriously but particularly when it comes from an organisation like the Association of Chief Police Officers. They would also acknowledge, I am sure, that they appreciate the level of co-operation that exists now with Customs in terms of the work they are doing jointly with police and other organisations to provide a joint response to the level of threat that we face. Not only a level of threat in terms of organised terrorism but organised criminal activity and the degree of smuggling and attempts to subordinate the tax system that we see Customs officers in particular seeking to tackle. I think what I am seeing is a very sensible move towards deploying resources where they are most appropriate and where they are most needed rather than have them static and tied to a post, which is not the most effective use. Police officers have been doing this for years. One of the first things I ever got involved with as a Member of Parliament was to object to the closure of a police station. I was faced with a chief constable who said simply that it was essential that we pull away from a buildings-based service to have a more flexible response to the threat that we see facing us.

Q584 Jim Cousins: That argument is based on a few general thoughts. The statistical information we have does not bear them out. The number of searches being conducted would be a crucial test of the risk-based approach and the number of searches being conducted is going down. Furthermore—and very troubling—the number of searches being carried out on particular ethnic groups is very worrying. The number of searches being carried out on people of African and Caribbean origin as a proportion of the total is very high. These are very troubling things.

Jane Kennedy: There are actually a number of areas in which Customs have been making a lot of progress. I could quote for example the success on oils on the PSA objective to reduce the illicit market share to no more than 2%. On cigarettes they have been making significant progress. There are issues around the seizure of illegal drugs where the figures would indicate that there are fewer, but those figures are actually quite difficult to analyse and there are a number of factors affecting that. SOCA are now doing a lot of that work and the work that the staff that we seconded to SOCA to do is now counted in as SOCA's seizures and progress, so we have lost out to some degree on that.

Q585 Jim Cousins: I must put it to you, do you not think the degree of structural change is such, the degree of headcount reductions is such and the failures of leadership which are identified in the Capability Review are such that there is now serious doubt about whether our frontiers are being properly safeguarded?

Jane Kennedy: No, I do not accept that. If there was no response to the concerns that the Capability Review expressed then I would be concerned, but I think that the response that we have seen has been entirely appropriate and reflects HMRC's awareness of the need to change and awareness of the need to drive through the cultural changes that one expected when two organisations came together to create one big organisation. The customs and borders function is about to change again as the borders function moves into the new Border Agency. Staff at the frontline are enthusiastic about that change. They are looking forward to working within one organisation. That will mean that the way in which we measure the progress on this will have to reflect the changes that are being made organisationally. There is a risk in all reorganisations of this nature that the function is affected and the ability to perform is affected, but I think HMRC can be given credit for the way in which overall its function has been sustained and maintained through a period of great change. I have no reason to think that they will not be able to do that as the border function moves from HMRC into a new Border Agency, so I do not share your concerns. I am not as gloomy about what you see in the figures as you are.

Q586 Jim Cousins: It is extremely important from Parliament's point of view that proper up-to-date figures are published. Are you not concerned that this risk-based approach is being used as an excuse not to report adequately to Parliament?

Jane Kennedy: No, if I thought that for a moment I would be really concerned. It is a very serious question and I will seek to reassure myself that that is absolutely not the case. I have no reason to think that it is the case at all at the minute but I will certainly have a look if you want me to.[9]

Q587 Jim Cousins: Coming to HMRC's own borders and the security guarding system that it has, the great majority of it is outsourced.
Jane Kennedy: Are we talking about their own offices?

Q588 Jim Cousins: Yes, the great majority of it is now outsourced.
Jane Kennedy: Yes.

Q589 Jim Cousins: Are you satisfied that the companies which are operating the security guarding arrangements are carrying out proper controls of the people they employ—for example checking their residency status and ensuring adequate standards of skill and quality?
Jane Kennedy: I have had no reports to the contrary.

Q590 Jim Cousins: Have you asked for reports about this?
Jane Kennedy: Not on that specific issue. It would be something I would assume was carried out as a proper management function. If I could just continue, I am aware that there have grown up a number of different historical ways in which the security of buildings is dealt with. In some parts of the country in some of the buildings—and there are about 600 offices—the security of buildings is carried out by in-house HMRC employees. HMRC are undertaking a review of that. Where they have companies undertaking it they are looking at having a single system so that the security of the buildings and premises is standardised throughout HMRC. They are looking at how it is done and in order to decide which way forward they need to understand exactly what is being done at the minute. I am expecting to have a lot more detail on that in the near future.

Q591 Jim Cousins: So while this review is going on, further moves towards outsourcing into the hands of independent contractors is on hold, is it?
Jane Kennedy: It is not on hold. It is part of the consideration. Nothing is being decided at the moment and all options are being considered.

Q592 Jim Cousins: Because, as you will know from the infamous Mapeley STEPS contract, there is a built-in arrangement which produces more outsourcing of security because it is part of the deal?
Jane Kennedy: Of the building function, yes.

Q593 Jim Cousins: Are those arrangements on hold while this review is being carried out?
Jane Kennedy: No, nothing is being frozen, nothing is static, but I am expecting that HMRC will want to consider decisions on this fairly shortly.

Q594 Jim Cousins: Does HMRC receive no reports from its contractors about the kind of people that it is employing and the number of people who may be working on very short-term contracts or on a casual basis? Is this information simply not there or is it not being asked for?
Jane Kennedy: I am not sure what the nature of the information is that you are concerned about. HMRC would collect information about its employees, as would most public sector employers.

Q595 Jim Cousins: I am not talking about its employees; I am talking about the contractors carrying out security duties at its own premises.
Jane Kennedy: But the contracts will require the contractors to make sure that their staff undergo the normal checks.

Q596 Jim Cousins: Can you assure me that those contracts prevent very casual employment of people on security guarding duties? I have information, which unfortunately I cannot disclose without putting people at risk, which suggests to me that there are a number of cases where people on very casual basis are being employed on security guarding duties, and I would like that matter looked into so that we can be satisfied that that is not the case. I am not talking about direct employees of HMRC; I am talking about the contractors.
Jane Kennedy: Yes, I understand. Are you able to share much more detail, even privately, because I would want to investigate that and seek to give you an assurance on that if I could. I can give you a general assurance as it stands that I would expect that the contracts would require the contractors to ensure that their staff were properly security checked in the same way that you would think proper in a building of this nature or when you consider the nature of the work that HMRC staff undertake.[10]

Q597 Jim Cousins: On a different matter, the slippage in VAT recovery, does that not give you some concern?
Jane Kennedy: Yes, it has been a cause for concern. What I would say to you is that HMRC should be credited for recognising the problem and then acting swiftly to address the problem. In fact, as you know and the Committee has drawn to ministers' attention several times, the performance in April last year in completing the number of low-risk registrations was woeful at 7% completed in the target of 14 days. The average time for low-risk applications exceeded 60 days and some high-risk applications were taking some 18 weeks. As I am sure the Committee knows, this is the result of several factors, not least the serious attack from missing trader fraud. A further factor was the impact of the change in the law that took out managed service companies. The legislation that changed the rules around managed service companies meant that a lot of tax advisers loaded into the system a very large number of registrations in order to try and get round the new regulations. That, combined with a loss of some

[9] Ev 88

[10] Ev 89

fixed-term contract staff from the VAT registration work and some IT problems that they experienced at that time, caused the drop in performance. They put in place a plan to address that and as a result, bearing in mind that in April they were achieving only 7% completed of low-risk cases within 14 days, by November performance was 57.5% against the 14-day target, which is a very significant improvement, and I believe they are now close to the 70% target. So at this moment in time I am quietly confident that they will achieve the target by the end of January.

Q598 Jim Cousins: Other colleagues will probably wish to pursue that point. Could I ask finally about the walk-out of staff on 31 January. What impact, if any, do you think that will have, because it is a crucial date in terms of tax returns?
Jane Kennedy: I understand that the trade union is balloting on this proposed industrial action. I hope that their members will decline to take industrial action because I would hope that they would see the damage potentially that it could cause. I am advised by HMRC that they have plans in place to make sure that business is not disrupted as a result of the industrial action and I would hope that they could resolve this without the staff having to resort to a walk-out, to a strike.

Q599 Jim Cousins: Are you not concerned that the pay situation that we may be drifting into in the public sector with the search for three-year deals may produce more industrial action or works-to-rule?
Jane Kennedy: I believe that three-year pay deals will bring more security for staff than the current annual round. I suspect that trade unions also will see the benefit of that and I hope that they will seize the opportunity to move forward into that kind of pay bargaining rather than the annual wrangling that we have at the moment.

Q600 John Thurso: Can I turn to the new departmental strategic objectives for HMRC and HMT. The new DSOs for HMRC and HMT appear to be pretty similar to the "objectives" under which the Spending Review 2004 PSA targets are grouped. What are the real changes and what changes, if any, has the new structure of DSOs actually brought about for each of the departments?
Angela Eagle: I think in general, as the Chief Secretary said in the run-up and in the aftermath of the Comprehensive Spending Review, the shift towards a much smaller set of Public Service Agreements really represents the Government's broad strategic focus and objectives cross-departmentally for the next three-year period. The Departmental Strategic Objectives are about managing individual departments so that they may feed in. It is really an evolution of the performance management and measurement system, which obviously did not exist in any great form seven or eight years ago and has been evolving, I think, in a useful way. This is the latest evolution and I think it allows for cross-departmental strategic focus of the sort that I think as ministers we have all wanted to see, with departments getting out of their individual silos. I hope these cross-departmental PSAs will assist in doing that. The Departmental Strategic Objectives are there to keep focus on departmental business which, by necessity, has to include focus on the PSAs but also includes much more.

Q601 John Thurso: One of the things that seems to have got lost in the change was HMRC's objective to reduce the compliance burden. Is there anything to be read into that?
Jane Kennedy: Not at all. The commitment to do that remains. In fact, I thought it was one of the PSA objectives. So I can reassure you that there is nothing unhelpful to be read into it.
Angela Eagle: We are in a process here where we are trying to focus and be strategic and cut the number of targets and objectives so that people can focus on the priorities. We get into a dialogue with people once we have had a dramatic reduction from 110 PSAs in SR04 to 30 PSAs now and a dramatic reduction for local government from 1,200 indicators to just 198, with more allowance and devolution to them as to how to do all of this, and the commitment to reduce data collection burdens by 30% by 2010. Then people start saying because you have reduced PSAs, my favourite PSA now is not a PSA any more so does that mean that somehow it is not as important? No, this is a different, more focused, strategic way of trying to work cross-departmentally and within local government and national government to focus on our targets.

Q602 John Thurso: I have got that and I am quite happy with the concept of going for quality as opposed to quantity, but when you change it is interesting to know what the thinking was. One of the things that strikes me is that HMRC now has three objectives. If you say very roughly—and I know this is not valid statistically—that each objective is equally important, you have got three objectives so they all represent one-third in importance, objective two is all about improving the customer experience and all of the things that relate to that. If we look at the Capability Review, one of the points that is made is that customer focus is a significant element of the vision for the Department that has not yet been translated into something that is fully understood and embraced throughout the Department and beyond. It says that many staff, partners and stakeholders are still struggling with the concept of a "customer" in relation to HMRC. How will you take on the challenge of ensuring that management actually deliver on that, because it is pretty critical to that entire objective?
Jane Kennedy: Yes I agree. It will be my role to ensure that in working with HMRC they maintain that as a very high objective. They have not been doing badly on all fronts. They have been making significant progress in their relationships with big business. There is a lot of very good press around for HMRC's changes to the way in which they have been developing some of the tax claim forms for

example. Some of the simplification work and the open way in which HMRC has been taking forward their consultation in the tax simplification process has been very helpful. Just one final point on this. One of the things that HMRC have learned as a result of all of this is that a shorter tax claim form is not necessarily simpler, that some of the tax decisions that companies have to make, for example, are complex and what they are working to do is to improve the customer interface so that the kind of question that companies might have can be quickly resolved.

Q603 John Thurso: I have a core worry to which I come back and I have often raised with your predecessors and officials in the Department, which is to have any meaning in statements of improvement, you have to have a robust way of actually measuring it. I come from a service background, that was my industry background, and it is difficult in the service industry, which is often subjective. The question I return to is: if we are to avoid a situation where here we say it is and there you say it is not, or vice versa, how do you actually put in place a robust system of measurement that genuinely can give confidence that the quality of service is either being maintained or rising or occasionally falling and therefore needs action? How can management do that?

Angela Eagle: Can I say something about the Departments' strategic objectives and the indicators that each department is working up in order to be open and transparent about how they are going to be measured. Some departments have published their DSO indicators; others are still working on them. We hope that all of them will be in the public domain by April at the latest. They then get to report on those twice a year, in their autumn performance reports and in their annual reports. The NAO are involved on the efficiency savings side jointly with HMT about how you define and measure performance in these ways. That does not mean to say that for some particular indicators or some DSOs, which are very general, that there is a very, very easy and quick way of measuring. Some of this is uncharted territory in terms of how you measure inputs and outputs. And to some extent, in the difficult areas there will be a feeling of a way forwards. Some ways of measuring and accounting are not as easy as the National Accounts or measuring inflation, so there is going to be a range of things that are easy and crisp to see and measure and tick or not, and then there are going to be those areas where it is a lot more complex. And all we can do in the public service is try to work transparently with other organisations, including the NAO, to evolve a way of measuring performance in a way that is adequate and does not set up perverse incentives.

Q604 John Thurso: Can I turn back to the question of VAT registrations. From the data that you have given us, it is clear that HMRC have significantly improved the percentage of VAT registration applications processed within 14 days. If I remember correctly, there was a ministerial response which suggested that the target would not be met by January but we have had evidence that HMRC now thinks it may. If I understood your previous answer, I think you are now reasonably confident that you will actually hit the target by 31 January.

Jane Kennedy: I am quietly confident. All of the advice I am getting is that the changes that they have made have had the effect that was desired.

Q605 John Thurso: I am glad I got that because I thought that was the point that you were actually making. Can I also ask just for the sake of clarity, you have put forward the reason for the delay as being a balloon in service company registrations.

Jane Kennedy: Yes, as one of the factors.

Q606 John Thurso: One of the factors. To what extent therefore was the Change programme and the efficiency savings responsible or did it have no responsibility at all?

Jane Kennedy: I would not want to say hand on heart that it had absolutely no impact. There was certainly a movement of some fixed-term staff away from VAT registration to other pressures within HMRC. That coincided with the other factors–the very serious and co-ordinated fraud through MTIC fraud, the impact of the new regulations surrounding managed service companies and some IT problems. They moved back–very quickly once they recognised a problem developing–into VAT registration to address that.

Q607 John Thurso: So people were moved back?

Jane Kennedy: Yes, as I understand it.

Q608 John Thurso: Is it therefore fair to say that the efficiency targets were met if the people that had been moved out to make the efficiency target had to be moved back in to get it back on track?

Jane Kennedy: About 700 compliance officers were moved out and redeployed into VAT registration, to check in particular for the MTIC fraud, so there was a specific movement of staff. I do not want to give you the wrong steer here. I cannot say that they were deliberately moved away previously as a result of efficiency changes but there was certainly a movement of staff into dealing with that problem as it was seen to arise. What I have seen of HMRC is that this flexibility within their workforce is becoming more important to them and is one of the reasons why I am supporting them in their determination to see the efficiency programme be followed through right to the full effect.

Q609 John Thurso: So we might see a situation where people are being moved round to meet the demand in whichever part of the operation it actually exists at a given time?

Jane Kennedy: In moving forward that is certainly one of the objectives. Clearly they need to retain a very high degree of specialism in certain areas, but the work that they have been doing has very quickly mitigated the problems that they were experiencing, although clearly a lot of companies have suffered over the period as a result. For example, one of the arguments put to me very often by colleagues, Members of Parliament, about their own local offices is worry about local knowledge which might have an impact on the efficiency of processing of local compliance data.

Q610 John Thurso: Careful, you might get a question about Wick!
Jane Kennedy: What I can tell you is that in terms of local compliance the yield increased by 8%, so there are no obvious signs of significant growth in non-compliance in areas other than in MTIC, so it is not a factor that is affecting compliance.

Q611 John Thurso: Do you think it is—how can I put this—prudent to continue the headcount reduction programme with the previous pace and gusto while all these bedding-in problems are going on? Would it not be wiser to perhaps relax on the reductions until each of these things have settled in?
Jane Kennedy: You have to bear in mind that HMRC still has over 88,000 staff. It is one of the few departments in government in which all of its operations are done in-house, it is very staff-intensive, and therefore it is quite proper of us as a Government to require them to review the way that they deploy their staff to ensure they are using their staff in the most effective and efficient way. You would want us to do no less. Consequently, I think there is a case for arguing that they should refocus the efficiency reviews to ensure that they are moving forward at the pace that is required and that they are considering having the people doing the work in the places where they need to be. I am convinced that one of the problems that HMRC has been facing is that it has not had people where it needed them to be and as they move forward and staff become more used to flexible ways of working that should improve. I have got to say I am an enthusiast for the LEAN process. Those staff that I have seen who have gone through it have said that it is not as bad as they thought. There is some humour about some elements of it but, by and large, they can see the benefits that it brings to the work that they do, and in particular to the customer experience. The staff that I have met are very keen to deliver a better service to the public. When you have people's employment experience changing in the way that it is, when you have businesses functioning in a global economy in the way that they are, we have to have a tax system that is as responsive as possible. We have a very high reputation internationally as a tax authority in HMRC and they are keen to maintain that.
John Thurso: I admire your enthusiasm and I look forward to asking you next year how you have got on!

Q612 Peter Viggers: I want to ask about the measurement of risk and specifically the measurement of risk between on balance sheet investments and off balance sheet investments. The world of international banking is in a measure of turmoil at the moment. The Committee was in the European Central Bank in Frankfurt earlier this week. We heard how the problem started, as everyone knows, with sub-prime mortgages, securitisation and collateralised debt obligations but it has moved through to a problem of liquidity which has put a focus on on balance sheet versus off balance sheet investments. Many of the larger international banks are now looking again at off balance sheet investments. They are realising that reputational risk causes them to bring these off balance sheet investments on balance sheet. I would like to ask about progress towards the International Financial Reporting Standard which the Chancellor of the Exchequer said in his Budget in 2007 would be in place for the first period of this CSR period, which of course is 1 April 2008. What progress has been made to moving towards IFRS please for on balance sheet/off balance sheet?
Angela Eagle: Work has certainly been done to shift towards this accounting standard in line with the announcements that were made at the Budget. There is a great deal of work still left to do, but it appears to be on track in terms of the announcements that were made at the Budget.

Q613 Peter Viggers: I did ask the Permanent Secretary of the Treasury what proportion of obligations were on balance sheet/off balance sheet and, rather engagingly, he did not actually know and he wrote us a note confirming that the proportion of public on and off balance sheet is 42% on and 58% off. Who is in charge—?
Angela Eagle: Is this PFI projects you are mainly talking about here?

Q614 Peter Viggers: I am talking specifically about PFI projects. Who is in charge of carrying this through and ensuring that the IFRS is implemented by April?
Angela Eagle: It is being done within the HMT core department, but the issue here at the moment is actually because we are world leaders in the whole PFI process itself and we actually have accounting standards for PFI in the UK, there is no direct equivalent in IFRS for public sector PFIs. Work is being done at the moment to see how IFRS standards can be translated with respect to PFI but the accounting standard and how it might operate has not been fixed yet. I know that the Department are working on the current standard with the Financial Accounting Advisory Board, who are independent, to see how it can be translated, and following decisions which will be made about that it may become a bit clearer what the implications are for PFI currently on or off balance sheet.

Q615 Peter Viggers: Can you say anything more about the timescale of this?
Angela Eagle: Again, it has all, by definition, got to be done in time for the start of the new financial year, and that is the target that people are working to. But you will remember, I am sure, from your questions to the Permanent Secretary each individual PFI project will have to be looked at by auditors. And there will have to be a definition once there is an

accountancy definition of PFI on what should be on or off balance sheet, so it is a bit difficult to speculate at this stage what the result of that will be. We are at a process in the switch where we actually do not have an accounting standard yet to apply, so that is where we are. The work is being done to translate and have an accounting standard and then work will be done cross-departmentally to look at particular PFI projects and see how they then fit into the new standard.

Q616 Chairman: Very well. Just a couple of wrap-up questions. The response to our report on the efficiency programme from CSR07 was particularly disappointing to us in that it simply repeated a lot of the initial submissions and some of the points made in oral evidence rather than addressing the issues the Committee had raised. Which of you cleared this before it was published?
Angela Eagle: We clear the bits that are relevant to our own areas, so I would have cleared the ONS bits and no doubt the Financial Secretary will have cleared the HMRC bits.

Q617 Chairman: Could I ask you Ms Eagle whether it really was the quality of response you would have expected as a former member of this Committee?
Angela Eagle: I am sorry if you were upset by the quality of the response. I wonder with respect to the ONS part for which I am responsible, are you disappointed that we did not agree with your recommendations and is it disappointment about that that is worrying you?

Q618 Chairman: No, it was the specific response to some of our points on the Gershon efficiency programme for example where the Treasury simply repeated some of the initial evidence rather than addressing the recommendations we made.
Angela Eagle: It is clearly important that we have a process that moves forward, and I will try to make certain that future responses do not simply repeat existing evidence because it is important that there is a dialogue between this Committee and the Department. Certainly I think there has been a lot of good progress made, especially around definitions and measurements for the subsequent CSR 2007 efficiency savings, which I think has been important, and we have also appreciated your views and comments on the departmental DSOs. I think it is important that we do not simply repeat evidence we have already given to you and I will try to make certain that that does not happen again in the future.

Q619 Chairman: I appreciate that, thank you. Which of you is responsible for the Royal Mint?
Angela Eagle: I am—sort of.

Q620 Chairman: Could you clear up one particular factual confusion. We were told by the Permanent Secretary that the service level agreement was in place from October but the then Chief Executive told us it was actually in place from April 2007. Which of those two is correct?
Angela Eagle: The service level agreement was unusual in that it was retrospective as well because there were some difficulties that had arisen that meant that renegotiating their entire agreement with the Treasury probably was not a good idea, but I will check that for you and write to you with a definitive agreement.[11] The issue about the confusion may be that because this, unusually, is an agreement that applies retrospectively as well as forward, that they may have got mixed up as to when it actually came into being.

Q621 Chairman: We were told back in May that you expected to find the majority of the £2.9 million programme-based efficiency savings from the renegotiation of that service level agreement. Now it has been agreed, are you going to get that level of savings?
Angela Eagle: We are certainly confident. There are some aspects of the service level agreement that we cannot predict in advance. Obviously the Treasury take on the risk of commodity prices, which forms quite a big part of the price of coinage and we also undertake to provide for the demand, which is not always entirely predictable, but within that we are confident that these savings can be achieved.

Q622 Chairman: In earlier years we have had concerns about the Royal Mint. You have been the Minister in charge now for six months. Are you satisfied that it is now back on track?
Angela Eagle: I think it has made an extremely good start. I am visiting tomorrow. I tried to visit earlier but was put off by them. I am certainly looking forward to seeing the progress that they have made, particularly in the way that they have completely re-organised their structures and their systems. I think great efficiencies have been made. They are now back in profit for the first time after a pretty torrid couple of years. They have a good new Chief Executive who will take the time from now until April to finalise his senior management team. I actually think that the Royal Mint is in a much healthier position now than it has been in for some years.
Chairman: Good. Thank you very much. Thank you both for appearing.

[11] Ev 90

Written evidence

Memorandum submitted by the Royal Mint

This memorandum responds to the Sub-Committee's requests at the hearing on 1 November 2006.

I wrote to you on 20 November 2006 concerning my promise to provide to your Committee details about the Royal Mint's bonus scheme when it was put in place.

I provided details about the bonus scheme which had operated for 2005–06, but explained that the Royal Mint's Remuneration Committee had endorsed my view that no bonus scheme should be put in place for 2006–07. This was because, as I indicated to your Committee (Questions 58 to 61),[1] setting targets for a 2006–07 bonus scheme would have been so dependent on the success of the various improvement programmes which had recently been put in place.

I noted that the Remuneration Committee would review the position again in 2007 with a view to introducing a new bonus scheme for 2007–08, and I promised to update your Committee on progress at that time.

The Remuneration Committee has now agreed that the following bonus scheme will operate for 2007–08:

— The purpose of the bonus scheme is to recognise and reward outstanding team performance against planned business targets and as such is subject to the following conditions:

— The bonus scheme will apply to Functional Managers (a group of up to 18 senior managers) and the maximum bonus payable is 15% of salary earned as a Functional Manager during the financial year.

— The bonus scheme will also apply to executive directors and the maximum bonus payable to this group is 25% of salary earned during the financial year.

— The bonus measure is retained profit excluding exceptional costs. No bonus is paid if this measure is below plan. The size of bonus increases progressively depending on the extent to which performance exceeds plan, with the maximum bonus paid if this measure exceeds plan by 20%.

— Bonuses will be paid in the month following the publication of the annual report to relevant personnel subject to them remaining in employment with the Royal Mint on 31 March 2008.

September 2007

Memorandum submitted by the Office of Government Commerce

This Memorandum responds to the Sub-Committee's requests at the hearing on 10 October.

OGC's Reporting Mechanism

At the start of the hearing the Chairman asked a number of questions about OGC's reporting mechanism [Qq 94–96].

OGC currently consolidates financial information in the HMT Departmental Report and has done so for the past five years.

Over this period, it has published a number of reports on its overall performance:

— "Corporate Brochure 2002–03"

— "Delivering Your Agenda 2003–04"

— "2005 and 2006 OGC: Key achievements, releasing resources to the front line"

— "Transforming Government Procurement—First one hundred days" (July 2007)

To clarify, the report that was sent to the Committee prior to our hearing and to which William Jordan referred in his evidence to the Committee, 2005 and 2006 OGC: Key Achievements, releasing resources to the front line, was published in December 2006 and covered the calendar years 2005–06.

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[1] Treasury Committee, Oral and Written evidence, *Royal Mint Departmental Annual Report 2005–06* HC (2005–06) 1679–i.

For the future, we intend to produce a report on OGC's performance on an annual basis. We will ensure that Committee members receive copies of these annual reports for their information.

Specialist Solutions Framework

Mr Dunne referred to evidence received by the Committee from a supplier that "framework agreements are used improperly to distort competition". He referred specifically to the Specialist Solutions framework that had been extended until 2016, and the allegation being that all competition in this product range would be restricted until this date [Q 135].

This framework was established to run for a period of four years, terminating in 2009. Orders using the framework terms are permissible within the tenure of the framework, including orders that then run beyond the effective dates of the framework. The agreed change notification removed the restriction period of five years, for which the ordered service could be provided under the contract between the service provider and the customer, after the expiry of the framework. This enabled a consistent contract term of up to seven years at any point within the framework term, rather than the original, maximum of five years beyond the expiry date of the framework. There was no extension to the actual effective dates of the framework agreement. The expiry date remains the 1 October 2009.

October 2007

Memorandum submitted by Charles Eddolls, Chief Executive, Group Supplies

My company specializes in procurement consultancy for both public and private sector and delivers very substantial cost savings for our clients through the use of commercial expertise and fully-compliant reverse auction processes. Since 2002 we have been the sole holder of contracts for these services with the Ministry of Defence and through their framework contract with us to the wider public sector. We carried out the first reverse auction ever commissioned by OGC (saving 66%) and recently were instrumental in delivering £100 million savings (43%) for our client, the Ministry of Defence, on the pan Government Office Solutions tender.

Factual Information the Committee should be Made Aware Of

1) *OGC put pressure on departments to use old contracts when better value arrangements have already been set up for pan-government use*

The OGC's website at today's date (01.10.07) has a high-profile link from its home page labelled "Implementing Transforming Government Procurement—New government procurement requirement letters". This link takes visitors to a dedicated page containing "Requirement Letters—The Office of Government Commerce periodically publishes letters setting out the new standards and requirements that central government is expected to meet, as part of the implementation of the policy set out in Transforming Government Procurement."

One of these is a letter from Peter Fanning, Acting CE of OGC dated 1 June 07 to Sir Richard Mottram KCB, the Cabinet Office PS entitled "Collaborative Procurement". It attaches details of 12 "deals" which it says should be used to channel procurement spend and requires his and other departments to seek approval in writing from OGC before setting up new arrangements elsewhere.

Two of the "deals" are for office solutions framework contracts terminating in May and June 2008 when OGC is already aware of (and has pubicised in "News 28.06.07 ref 12/07" on their website a new framework commencing 1 October 2007 which has saved Government £100 million.

It makes no sense for OGC to force departments to take up contracts nearing their expiry when better value arrangements have already been established. The news article states that the new framework procurement ". . . was the final part of a nine month long procurement process led by MoD, with assistance from the Office of Government Commerce". So they know all about it, claim credit for it, but do not promote it.

OGC compound this further in their corporate document "Transforming Government Procurement—First one hundred days" in which they state that having recommended the "12 deals" across Whitehall they are going to monitor and report their use and implementation to the Procurement Council.

2) *OGC put pressure on departments not to run competitions when an existing arrangement is in place, thereby missing substantial savings opportunities and stifling competition*

Referring to the "12 deals" the letter to Sir Richard Mottram KCB referenced in (1) above states ". . . the time has come for all colleagues to ensure that their procurement spend is channelled through suchcollaborative deals." and "If, however you think you can get better value for money by setting up new arrangements, you will now need to demonstrate that this is the case and seek OGC's approval in writing".

Departments are thus in an impossible position—they cannot demonstrate that there is better value without running a competition and they cannot run a competition without prior demonstration of better value. Thus OGC's claim (see "Transforming Government Procurement—First one hundred days in (1))" that their collaborative deals offer value for money become self fulfilling prophesies as there is nothing with which to compare.

Anyone with a modicum of commercial acumen knows that one of the main drivers of best value is competition and this OGC policy stifles competition and is therefore in breach of Regulation 19(12) of the Pubic Contracts Regulations 2006 (SI 2006 No 5) which states "The Contracting Authority shall not use a framework agreement improperly or in such a way as to prevent, restrict or distort competition".

OGC also discourage the use of independent procurement exercises with bizarre cost estimates. (See point 4).

3) *OGC's targets are not sufficiently stretching*

Government procurement comprises over £125 billion of annual spend of which £5.5 billion of procurement attributable savings have been achieved by OGC. (Ref "Transforming Government Procurement"). This represents a meagre 4.4%. A step change is needed if this is to even begin to approach the potential that exists.

OGC's executive agency, OGCbuying.solutions, is "focused on realisable savings of at least £1 billion for the taxpayer each year from 2010–11" (see "Transforming Government Procurement—First one hundred days in (1)). Bearing in mind that this target is three years away the target savings represent a mere 0.8%. This compares with the ". . . small commission (averaging less than 0.7%) [which] is collected from the suppliers for each sale they make under these frameworks". (Ref HM Treasury Annual Report and Accounts 2006–07 para 5.29 referring to Catalist).

In other words, the kick-backs which OGCb.s receives from its framework suppliers out of their charges to public sector clients is comparable with their own savings targets!

"Transforming Government Procurement—First one hundred days—Key Achievements". Example: OGC has delivered "Five collaborative deals, each involving between 15 and 80 different government organisations, to a combined value of £1.5 billion over the next four years and saving an estimated £50 million." I calculate this to be a saving of 3.3%. Not exactly a triumph considering OGC fanfare it as a "key achievement".

4) *OGC's procurement exercises are inherently inefficient and do not represent value for money*

The NAO tell me that one of the benefits of OGC's frameworks is that they are instrumental in "reducing the cost and delays associated with independent procurement exercises" (OGCbuying.solutions estimate that the cost of letting a contract under European procurement rules is in the region of £65,000. Separate analysis by the Office of Government Commerce estimates the cost at between £30,000 and £165,000 depending on the size and complexity of the project). (Ref: Mark Davis, Director, Cross-Government Studies, National Audit Office 21 September 2007, private communication).

This is staggering, considering that the minimum contract value for a central government OJEU competition is approximately £100,000. Taking the lowest estimate, OGC are saying that there is a 30% minimum on cost for operating the simplest compliant tender. If OGC and their executive agency cannot operate more efficiently than this then they have no right to be "solely responsible for the Government's procurement policy" (see "Transforming Government Procurement—First one hundred days in (1)")

For comparison purposes, my company carries out end-to-end complex procurement processes for public sector clients under a Government framework contract where we can do all the work, (other than the actual placing of the contract notice in the European Journal and signing the final contract), on a gain share percentage basis (no saving no fee) basis capped at under £30,000.

5) *OGC and their executive agency OGCbuying.solutions have a commercial interest in ensuring that their frameworks and managed services are utilised in preference to others irrespective of best value*

> "OGCbuying.solutions' operations break down into two major areas of activity, namely Framework Agreements, delivered under the Catalist brand, and Managed Services:
>
> — catalist is a set of pre-tendered framework contracts with a range of suppliers, from which public sector customers can access 500,000 goods and services with ease. A small commission (averaging less than 0.7%) is collected from the suppliers for each sale they make under these frameworks; and
>
> — managed Services are ongoing services with OGCbuying.solutions acting as the 'intelligent customer' to a range of strategic partners, on behalf of public sector customers. The economic model here varies depending on the business area, ranging from commission to traditional purchase and sale at a small margin to cover the cost of managing the service."
>
> (Ref HM Treasury Annual Report and Accounts 2006–07 para 5.29)

For every £1 billion of public sector spend diverted each year to these frameworks and managed services, OGC and their executive agency earn themselves a tidy £6–7 million and at the same time avoid having to compare their contracts with others.

6) *OGC and their executive agency do not follow guidance in the placing of contracts*

This is best illustrated by an example from the OGC's website. Recommendation 9 from the BRTF/SBC report concerning SMEs and access to the Government Marketplace states: "Where public sector procurers opt for prime contractors, they should ensure that their business case for doing so in those particular markets brings value for money. Public sector procurers should ask prime contractors during the procurement process to demonstrate their track record in achieving value for money through effective use of their supply chain—including use of small and medium-sized enterprises."

OGC's executive agency are currently running a tender for e-auction services for the public sector. In response, a company of standing, Intenda, submitted a PQQ response as prime contractor stating their intention to sub-contract part of the work to my company, an SME. In accordance with the above guidance on the OGC website, they provided details to demonstrate my company's track record in achieving value for money. After this response had been evaluated by OGC's executive agency, Intenda were told that they had failed to qualify as they had scored zero on five questions. These five questions had been fully addressed, and covered the track record of my company in providing these services. OGC's executive agency stated to Intenda that the questions were regarded by them as "not answered" because the information related to their sub-contractor, not themselves.

It is commercially naïve and against the Government's stated policy of supporting SMEs for OGC and their executive agency to exclude a company from the opportunity of competing for public sector business in this way simply because they wish to utilize the services of an SME to deliver best value.

7) *OGC and their executive agency use framework agreements improperly or in such a way as to prevent, restrict or distort competition*

This is best illustrated by today's headline example from the OGC's website (01.10.07):

"Specialist Solutions Suppliers sign up to contract extension"

> "Suppliers under the Specialist Solutions framework agreement are signing up to an improvement in the Terms and Conditions to allow for a seven year contract term. The extension will allow orders to be placed in the remaining year of the framework agreement for up to seven years."

These arrangements were already in place until 1 October 2009. They already allowed the placing of five-year contracts on the last day of the framework agreement. The Terms of this framework have now been extended to allow seven-year contracts to be placed on the last day of the framework agreement, thereby restricting competition through to October 2016. This is stated to be an "improvement".

Alistair Price of OGCbuyingsolutions, commented: "This is excellent news for customers and suppliers of the Specialist Solutions framework agreement presenting a win win situation. Use of the framework agreement is increasing and now we have removed the contract term limitation we are delighted to be offering value for money solutions into 2016".

How is this value for money to be ensured to protect the public purse? The answer lies in the guidance which accompanies the details of this arrangement, which is on OGC's website.

10. Pricing and Charging Arrangements

Pricing and Benchmarking

> 10.1 The catalogue contains pricing information from each Service Provider for each Lot. At present, the only information provided are consultancy fee rates which will give an indication of the support costs associated with any physical infrastructure required. However, because of the nature of solutions being quite specific to a particular Customer, it is very difficult to have realistic prices published. That said, at the time of writing (Feb 2007), Service Providers are being requested to provide indicative tariffs for certain elements of a solution give some idea of the pricing strategies between the different Service Providers and allow some very basic comparisons to take place. This will be supported by a series of in-depth benchmarking exercises and mystery shopping exercises that will be used by the Buying Solutions Telecoms team to ensure that trusted competitive pricing becomes the norm through this part of Catalist.

This has been reproduced in full as it is so commercially naïve as to be staggering. These arrangements appear to offer no more than open-ended "time and materials" contracts with only capped hourly rates for protection—the number of hours is whatever the supplier wishes to charge for with no requirement for competition. This is in breach of Regulation 19(12) of the Public Contracts Regulations 2006 (SI 2006 No.5) which states "The Contracting Authority shall not use a framework agreement improperly or in such a way as to prevent, restrict or distort competition".

Conclusions

Re (1) OGC should keep more up to date with market movements and new contract availability.

Re (2) OGC should not assume that any arrangement or contract they or their executive agency place must by its mere existence represent best value but be prepared to regularly challenge the arrangement or contract against changing market conditions.

Re (3) OGC's targets must be made more challenging and they must become the fiercest critics of their own efforts in a genuine striving for excellence.

Re (4) OGC should consider the marginal cost of running a competition rather than accounting fictions representing average cost of competitions. It is after all the job of public sector bodies to protect the public purse by running competitive tenders for their needs. If public sector clients lack the resources to run competitions there are countless skilled practitioners in the private sector who will do the job and fixed price quotations or gain shares are available. Competition is essential to maintaining best value against market trends and the cost would be funded many times over by the savings.

Re (5) OGC and their executive agency OGCbuying.solutions must cease to derive income from their frameworks and managed services or they will never be able to view them with true objectivity.

Re (6) OGC and their executive agency should have proper regard to Government policy and best practice, and be able to demonstrate compliance within their own activities.

Re (7) OGC and their executive agency should seriously review their need for high level commercial expertise in assessing value for money and for better legal controls to ensure compliance with public procurement regulations. These regulations are not an inconvenience—they are there to promote proper competition and protect the public purse.

October 2007

Letter from the Financial Secretary to the Treasury to the Chairman

Pilot Exercise for Merged Spring Departmental Reports and Resource Accounts—HM Treasury Participation

In an effort to examine the scope for improved annual reporting and as part of the Government's commitment to reducing the reporting burdens placed on departments, the Treasury is proposing that Departmental (spring) Reports and Departmental Resource Accounts be merged for 2007 to form one document—a Departmental Annual Report and Accounts.

In principle, a combined report has the potential to provide a better product for Parliament and the public: it would bring financial data and explanatory text together in a single, authoritative document.

The Chief Secretary wrote to the Liaison Committee on 9 November 2006 setting out our proposal to run a pilot scheme this year with a limited number of departments. The Liaison Committee expressed conditional support in January, and Treasury would like to take part with its own combined report for 2007.

Background

Departments are currently required to publish a spring Departmental report that reports to Parliament on the organisation of the Department, their aims and objectives and performance against those objectives, and the nature of their expenditure. These spring reports are typically published in early May.

In addition, Departments publish Resource Accounts. These Accounts present the operating costs and financial position of the Department, and are audited by the National Audit Office. Under the Faster Closing initiative, departments should lay their resource accounts before the Summer Recess.

Both the spring Departmental Reports and the Resource Accounts contain performance, management and financial information that looks back at past years and forward to plans. Not all the information is the same, but a large part, such as information on corporate governance, is duplicated. Merging the two documents will remove that duplication. The Treasury also believes that it has the potential to aid parliamentary scrutiny by having financial data and explanatory text in one place.

Structure of the 2007 HM Treasury Annual Report and Accounts (ARA)

Our aim is to combine the reports as deeply as possible, reducing the duplication that currently exists and providing an improved Treasury Group focus (embedding the work and contribution of the three parts of the Treasury Group—HM Treasury (or Core Treasury), the Debt Management Office (DMO) and the Office of Government Commerce (OGC)) into the main text in the body of the report. A consequence of this will be that there will no longer be a separate chapter for the OGC and DMO. We will, however, ensure that OGC and DMO information will be clearly attributed in the text of the body of the report.

Publication Timetable

Departmental Reports are usually published in mid May, with the Resource Accounts following in June/July before the Summer Recess. We have consulted the NAO about faster closing of the Resource Accounts this year and we would propose publication of the new combined report by mid June at the latest. We will of course keep you informed of any potential slippage.

My officials have made contact recently with the Scrutiny Unit. We will keep the Unit informed regarding progress on the development of the ARA.

Follow-up

We are conscious of the value Select Committees place on the spring Departmental Reports as part of their scrutiny of departments performance and wish to work closely with the Committee in evaluating the worth and workability of the pilot scheme. We would also be keen to continue official-level contact on the report on a regular basis gong forward.

Once the pilot is completed, it would be helpful if, the committee were to provide feedback to the department. This will also help to determine whether the pilot scheme should be widened in future years.

In addition to producing a single report combining financial data and underperformance and strategic information, this pilot scheme gives us an opportunity to reduce the reporting burdens placed on departments, reduce duplication in documents scrutinised by Parliament and test progress on the commitment for faster closing of accounts. The Treasury would welcome the active involvement of the Treasury Parliamentary Committee and the sub committee.

19 April 2007

Letter from the Chairman to the Financial Secretary to the Treasury

Pilot Exercise for Merged Report and Accounts

Thank you for your letter of 19 April about the proposal that the Treasury combine in a single document its 2007 spring departmental annual report with its Resource Accounts for 2006–07. My reply is written on the assumption that you are seeking the agreement of the Treasury Committee before the proposed pilot goes ahead, although your letter does not make this explicit. Our scrutiny of these matters is undertaken by our Sub-Committee and I have therefore consulted Michael Fallon as Chairman of the Sub-Committee before replying.

We can see advantages in the proposed merger of departmental annual reports and Resource Accounts into a single document. It should lead to a more coherent document which is more helpful for the purposes of parliamentary and public scrutiny. It raises the profile of Resource Accounts in the context of parliamentary scrutiny. It supports the Treasury's ambition of "faster closing" across Government, to which we are sympathetic. In addition, as matters stand, we expect the Sub-Committee's scrutiny of these matters to take place in the Autumn, which means that the delay to the departmental annual report should not unduly affect our preparations for that scrutiny.

On this basis, we are content to support the proposed pilot in respect of the Treasury in 2007, subject to three points.

The first is that our agreement is based on publication taking place by mid-June, as you propose; if you inform us of slippage to the publication timetable, we may reconsider our position.

The second point is that this Select Committee is not the only audience for the documents; there is a wider parliamentary audience, who are entitled to expect to know in advance about the timing of the publication of the departmental annual report. Accordingly, we expect you to publicise the delay to publication of the departmental annual report at an early stage.

The third point is that we expect you to ensure that there is no diminution in the quality and clarity of information available about the Office of Government Commerce and the Debt Management Office. The Sub-Committee undertakes separate scrutiny of these bodies on a regular basis and, in relation to the Office of Government Commerce in particular, there is limited information available about activities on an annual basis other than that contained in the Treasury's departmental annual report.

Assuming that you accept these points and that the pilot goes ahead, the Sub-Committee will examine its effects with interest and we will provide any feedback thereafter in an appropriate form.

I am copying this letter to Michael Fallon.

25 April 2007

Letter from the Chief Secretary to the Treasury to the Chairman

STRENGTHENING PARLIAMENT'S ROLE ON PUBLIC SPENDING: ALIGNING BUDGETS ESTIMATES AND ACCOUNTS

I wrote to you on 3 July, following publication of the "*Governance of Britain*" Green Paper (Cm 7170), with further details of the Prime Minister's announcement that the Government would simplify its financial reporting to Parliament by bringing planning Parliamentary approval and reporting of public spending on to a more consistent basis. I undertook to write to you again before the end of the year with a further report on progress in taking this project forward.

I mentioned in my earlier letter that the Government's intention was to consult widely on the detailed changes needed to achieve this major reform, which is designed to make the system of Government finance easier to understand and operate and improve government's accountability to Parliament. The process of preliminary research and analysis is now well under way, and I very much welcome the involvement of representatives from Parliament, the National Audit Office and the Financial Report in Advisor Board, as well as from across government the Steering Committee overseeing the project. The contribution of all key stakeholders will be crucial to the success of the project as the work proceeds, and I am pleased to note that both the Steering Committee and Project Board have now held successful first meetings. I also welcome the fact that my officials will be meeting with you in the New Year to discuss the project in more detail.

The inclusive approach we are adopting in taking forward the Alignment project is intended to ensure that the outcome is accepted by all parties, and is sustainable, rather than a "quick fix". This is crucial, since there is a major prize to be won. The version is to create a single, coherent financial regime, that is effective, efficient and transparent, enhances accountability to Parliament and the public, and supports delivery of the Government's fiscal framework, incentives good value for money and supports delivery of excellent public services. This will have significant benefits for Parliament and the public, as well as for Government, in terms of greater transparency, accountability and efficiency.

Looking ahead, we shall be planning detailed changes to the various frameworks during the course of 2008–09, in discussion with all key stakeholders, including Parliament, with the aim of beginning implementation planning during 2009–10. Completion of the project will depend on a number of factors, including possible legal implications; but, subject to that, the intention remains to introduce changes from 2010–11 onwards.

I am grateful for your Committee's support in taking forward this major reform, and I am confident that, together, we will be able to deliver a significant enhancement of the governance of Britain.
I am writing in similar terms to Edward Leigh, Public Accounts Committee and Alan Williams, Chairman of the Liaison Committee.

19 December 2007

Memorandum from HM Treasury

Winter Supplementary Estimates 2007–08

This memorandum provides details of changes sought in the Treasury's Winter Supplementary Estimate for 2007–08 published in "*Central Government Supply Estimates 2007–08: Winter Supplementary Estimates*" HCxxx. Further details of the work of the Treasury and its finances can be found in the "HM Treasury Annual Report and Accounts 2006–07" *HC 518*. Supply Estimates and the Treasury's Departmental Report are available from http://www.hm-treasury.gov.uk/

The purpose of this memorandum is to provide the select committee with an explanation of how the resources and cash sought in the Winter Supplementary Estimate will be applied to achieve departmental objectives and Public Service Agreement (PSA) targets. This includes information on comparisons with the resources provided in earlier years in Estimates and departmental budgets.

Summary of the Changes Sought in the Estimate

1. The Estimate seeks a net increase of £14,519,000 in resources and £17,568,000 in the net cash requirement. The changes for which approval is sought are:

— A Machinery of Government transfer of £4,028,000 from Cabinet Office following the transfer of the Prime Ministers Delivery Unit. (RfR 1);

— An increase in near cash resources of £2,000,000 to finance the Thoresen Review. (RFR 1);

— An increase of £8,491,000 for OGC to fund their voluntary early retirement and severance scheme;

— An increase in the net cash requirement of £5,000,000 for finished coinage stocks. (RfR 2).

2. The headline changes in voted totals, compared to the provision in the Main Estimate, are:

— Net Resources within RfR 1	increase of £6,028,000
— Net Resources within RfR 2	Nil
— Net Resources within RfR 3	increase of £8,491,000
— **Net total resources**	**increase of £14,519,000**
— Net Capital expenditure	Nil
— Net Cash Requirement	increase of £17,568,000

Detailed Explanation of the Changes being Sought

Request for Resources 1: Raising the rate of sustainable growth and achieving rising prosperity and a better quality of life, with economic and employment opportunities for all

Section A—Core Treasury

3. A Machinery of Government transfer was announced on 28 June transferring the Prime Ministers Delivery Unit from the Cabinet Office to HM Treasury. It was agreed that £4,028,000 in near cash DEL provision would be transferred from the Cabinet Office in the Winter Supplementary to cover the full year costs of the Unit.

4. The Estimate also seeks an increase in near cash resources of £2,000,000 to finance the Thoresen Review. The Review, led by Otto Thoresen, Chief Executive of AEGON UK, has a remit to develop a model that can meet the demands of those consumers most vulnerable to the consequences of poor financial decision-making. The provision will be funded from the Financial Inclusion Fund.

Request for Resources 3: Obtaining the best value for money from Government's commercial relationships on a sustainable basis

Section A—Office of Government Commerce

5. There is an increase in resources of £8,491,000 (£6,540,000 near cash and £1,951,000 non cash). This is to fund the OGC's voluntary early retirement and severance scheme costs arising from the Transforming Government Procurement review. The review launched a new strategy and part of the redefined remit resulted in OGC becoming a smaller, higher calibre organisation. To achieve the reduction in numbers, a programme of structural exits was instigated. The provision will be funded from the programme Departmental Unallocated Provision (DUP).

6. As explained in paragraph 14 below, these costs are exceptionally being classified as programme rather than administration costs. The programme DUP of £8,491,000 is therefore being utilised in full to finance the increase in RfR 3. The DUP provision will be split between near cash of £6,540,000 and non cash of £1,951,000.

Net Cash Requirement

7. In addition to the changes described above, the net cash requirement is being increased by a further £5,000,000 to provide funding to buy the stock of finished UK circulating coinage from the Royal Mint. In order to encourage more efficient scheduling of production, the new service level agreement between the Treasury and the Mint changes the basis on which HM Treasury pays for coinage from when coins are issued to banks to when they are produced.

Impact on the Department's Public Service Agreement

8. The increase in RfR 1 of £2,000,000 for the Thoresen review has no impact on any of the Treasury's PSA targets. Spending on the review falls under the Treasury's Objective III: Promote efficient, stable and fair financial markets, for their users and the economy.

9. The cash increase related to RfR 2 (coinage) has no impact on the Treasury's PSA targets. Spending on coinage falls under the Treasury's Objective 1: Maintain a stable macroeconomic environment with low inflation and sound public finances in accordance with the code for fiscal stability.

10. The increase in RfR 3 will contribute to the achievement of PSA target 10: Deliver a further £3 billion saving by 2007–08 in central Government civil procurement (building on the savings achieved since 2000) through improvements in the success rate of programmes and projects and through other commercial initiatives.

Departmental Expenditure Limit

11. The Supplementary Estimate increases the Resource DEL by £6,028,000 comprising £4,028,000 for the MoG transfer and £2,000,000 for the Thoresen review. The near cash total within voted resource DEL increases by £12,568,000 and the non voted element is reduced by £8,491,000. The following table shows a comparison between DEL plans between 2003–04 and 2006–07 (after changes made via Supplementary Estimates) and the outturns for those years, and the DEL for 2007–08, including the Winter Supplementary increases.

COMPARISON OF EXPENDITURE AGAINST DEPARTMENTAL EXPENDITURE LIMITS

£m

Year	*Voted*	*Non-voted*	*Total DEL*	*Outturn*	*Variance*
Resource					
2003–04	192	24	216	209	7
2004–05	217	31	247	184	63
2005–06	227	29	256	230	26
2006–07	225	21	246	209	36
2007–08	204	28	232		
Of which near cash	*192*	*39*	*231*		
Capital					
2003–04	8	—	8	4	4
2004–05	8	—	8	−20	28
2005–06	5	—	5	−9	14
2006–07	7	—	7	−1	8
2007–08	7	—	7		

The underspend against resource DEL in 2004–05 includes an exceptional gain of £8 million on the disposal of 100 Parliament Street Further analysis of Treasury group spending trends can be found in Chapter 7 of "HM Treasury Annual Report and Accounts 2006–07" *HC 518*.

Figures in the table have been adjusted to include the budget and outturn for the Prime Minister's Delivery Unit, following the transfer of that budget from the Cabinet Office, and will differ from the figures in the 2007 Departmental Report accordingly.

Departmental Unallocated Provision (DUP)

12. The Winter Supplementary Estimate includes draw down of the full amount of the programme DUP of £8,491,000. This is to finance the spending explained at paragraph 5 above. The administration DUP of £7,422,000 is not being drawn down at this time as it is being held in reserve to help fund this year's Group Shared Services restructuring costs.

End Year Flexibility

13. At present there are no plans to draw down any EYF in 2007–08. On that basis, our current EYF entitlement will be rolled forward into 2008–09 as follows.

£m

Administration	**Other resources**	**Total resource EYF**	*Of which near cash*	**Capital**	**Total EYF**
59	115	174	*181*	65	239

14. The need for use of any of the EYF entitlement will be kept under review in the context of the financial risks carried by the group (such as demand for coinage).

Administration Budget

15. The Administration Budget will increase by £6,028,000 to reflect the MoG transfer and the increase in respect of the Thoresen Review. The increase of £8,491,000 in RfR 3 for OGC structural exits would normally be classified as administration costs. However, as part of the SR04 settlement it was agreed that one-off exit costs incurred by the HM Treasury group in achieving managed staff reductions could be excluded from the department's administration budget.

COMPARISON OF ADMINISTRATION COSTS AGAINST LIMIT

£m

Year	*Voted*	*Non-voted*	*Total*	*Outturn*	*Variance*
2003–04	150	0	150	144	6
2004–05	164	0	164	135	29
2005–06	167	0	167	160	7
2006–07	167	1	168	160	8
2007–08	167	7	174		

The underspend against the Administration costs limit in 2004–05 contain the exceptional gain as referred to in the footnote to the DEL table above.

Figures in the table have been adjusted to include the budget and outturn for the Prime Minister's Delivery Unit, following the transfer of that budget from the Cabinet Office, and will differ from the figures in the 2007 Departmental Report accordingly.

12 November 2007

Letter from the Clerk of the Treasury Committee to the Permanent Secretary, HM Treasury

HMT Winter Supplementary Estimate 2007–08

The Committee has now had an opportunity to consider the Department's Winter Supplementary Estimate 2007–08 and supporting Memorandum. The Committee requests further information and explanations detailed below:

The first set of issues the Committee wish to raise relate to the contingent liability relating to Bank of England facilities for Northern Rock plc and guarantee arrangements. The liability or parts of it were referred to by the Chancellor of the Exchequer in letters to the Chairman of the Treasury Committee on 21 September and 11 October. The Committee would be grateful for answers to the following questions:

1. Has a minute been laid before the House of Commons relating to any relevant contingent liability in accordance with the guidance in paragraph 24 of Annex 5.5 to *Managing Public Money*?

2. Is the Treasury satisfied that the guidance relating to the content of such a minute in the same paragraph has been complied with in relation to that minute or any other information provided to the House of Commons, particularly in relation to the amount of the liability?

3. Has the Treasury considered providing further information on a confidential basis in accordance with the provisions of paragraph 28 of Annex 5.5 to *Managing Public Money* and, if not, why not?

4. Has the Treasury considered methods of providing the House of Commons with information on a regular basis relating to the amount of the liability and the risk that it will materialise and what has been the outcome of any such consideration?

5. Paragraph 3.48 of *Supply Estimates: a guidance manual* requires Estimates and Supplementary Estimates to include a note giving details of any contingent liabilities in force, as is also noted in paragraph 9 of Annex D to PES Paper (2004) 14. Why do the Winter Supplementary Estimates laid on 15 November 2007 make no reference in a note to the contingent liability referred to on 21 September 2007 or any subsequent contingent liability?

6. Paragraph 9 of Annex D to PES Paper (2004) 14 states that an Estimates memorandum "would add any useful information about the nature of the contingent liability and the assessment of the risk that it will materialise". Why was no such information included in relation to the contingent liability referred to on 21 September 2007 or any subsequent contingent liability in the Estimate memorandum accompanying the Winter Supplementary Estimate?

7. Does any contingent liability arise in relation to the extended guarantee arrangements offered to banks other than Northern Rock plc in certain circumstances? If the answer is in the affirmative, has this liability been notified to the House of Commons? If the answer is negative, why does the Treasury consider that no such contingent liability arises?

8. What is the Treasury's current assessment of the amount of the contingent liability or liabilities referred to in this letter and of the likelihood that it or they will materialise?

9. The final sentence of antepenultimate paragraph of the note attached to the Chancellor of the Exchequer's letter to the Chairman of the Treasury Committee of 11 October states that "the interest premium will therefore be passed to the Treasury". Has the Treasury received any payments in respect of that interest premium? In what circumstances and under what terms does the Treasury expect to receive any payments in respect of that interest premium? If any money or liability is owed by Northern Rock to HM Treasury or might fall to be owed relating to the interest premium or otherwise, what is the seniority of such debt or potential debt in Northern Rock plc's balance sheet relative to other creditors?

Secondly, the movements in RfR3 involve a transfer from "programme" Departmental Unallocated Provision (DUP) of £8,491,000, relating to staff exits from the Office of Government Commerce (OGC), under the Transforming Government Procurement programme (TGP). The Committee has noted that in the 2006–07 Spring Supplementary Estimate, there was a movement of £3 million relating to staff exits. The Committee therefore requests further detail on the staff exits planned from OGC, the number and the reason for the staff cuts. Furthermore, the Committee requests an explanation of how this current round of staff exits is related to those in 2006–07. The Committee also requests an explanation of why it has chosen to utilise Departmental Unallocated Provision for this purpose.

Thirdly, there is an increase in the Net Cash Requirement of £5 million, for finished coinage stocks, which the Memorandum explains is needed to buy the stock of finished UK circulating coinage from the Royal Mint, due to the fact that—under the terms of the new SLA with the Royal Mint—the Treasury now pays for coinage when the coins are produced, rather than when they are issued to banks. However, in the Government's response to the Eighth Report of the Committee on the Efficiency programme (published in November 2007), the Treasury stated that it could not supply further information on its savings from the Programme budget, due to the fact that the SLA was not yet concluded. The Committee would like to know whether the SLA has been completed—and, if so, when it was agreed—what issues were delaying the negotiations and the main points in the new SLA. The Committee also requests that updated information is provided to update that given in the relevant section of the Government response to its Eighth Report, Session 2006–07, *The efficiency programme in the Chancellor's departments*.

The fourth set of issues: the Committee has also noted that the stock of End Year Flexibility (EYF) which has not been used is £239 million—equal to the Departmental Expenditure Limits for 2007–08; some of this could have been utilised for some of the movements in this supplementary estimate. The Committee would like to obtain an explanation of the use which the Treasury intends to make of its EYF, particularly in the light of the terms of the 2007 Comprehensive Spending Review and the value for money savings against administration budgets.

Fifth, the Committee was not informed by Treasury that there would be a Supplementary Estimate from National Savings & Investments, and no estimate or memorandum has been received by the Committee from them. The introduction to the Supplementary Estimate does not contain enough detail to review or come to any judgement on the movement. The Committee requests that a Memorandum is submitted with full explanation of the planned £5.7 million resource and £5 million net cash requirement changes.

Sixth, the Office for National Statistics has not submitted an Estimate Memorandum to the Committee. The introduction to the Supplementary Estimate goes some way towards explaining the movements in the Estimate, but is not sufficiently detailed to enable a full review of the movements to be made. The Committee requests a complete Estimate Memorandum as set out in the Treasury guidance.

The Committee would be grateful for a response to the questions raised above by 30 November 2007. The Committee requests that the memoranda and explanations detailed above are sent without delay to the Committee.

22 November 2007

Letter from the Permanent Secretary to the Treasury to the Clerk of the Committee

Winter Supplementary Estimate 2007–08

Thank you for your letter of 22 November. I apologise for the delay in replying.

Northern Rock

I would like to address the points you raise in Questions 1 to 9 together.

The Government has kept the House regularly informed of the issues relating to Bank of England facilities for Northern Rock plc and guarantee arrangements. The Chancellor wrote to the chairs of the Treasury Select Committee and the Public Accounts Committee on 21 September and 11 October. He made a written statement to the House on 8 October, the first day that the House sat following the summer recess. He made an oral statement to the House on 11 October, appeared before the Treasury Committee on 25 October and made a further oral statement on 19 November. The Chancellor has also answered questions on both instability in the financial markets and Northern Rock plc during normal House business.

A Treasury Minute was laid on Monday 26 November. At the time that the guarantees and indemnity were granted, a formal minute was not laid. While I accept that a formal minute would have been preferable, the Chancellor was explicit about the guarantees and resulting contingent liabilities in his oral statement and letter to the chairs of the Treasury Select Committee and Public Accounts Committee, copies of which were placed in the Library of the House. I therefore consider that we have disclosed everything directly to the House—and the market—in a form that took into account the technical, commercial and policy issues. The Chancellor has committed to continuing to keep the Committee and the House informed of developments as and when appropriate. He will appear again before the Committee on 10 January 2008. We will also make a note of the contingent liability in the Spring Supplementary Estimates.

The Treasury objectives in relation to Northern Rock plc include minimising the cost to the taxpayer. The design of the arrangements and facilities, through the fee on new retail deposits, the premium rate of interest on the facility, the security of the facility against all the assets of the company and the indemnity to the Government for certain costs, reflect that principle.

Unless they are called upon, there will be no cost to the Exchequer from the guarantee arrangements, and even in those circumstances, only if liabilities exceeded assets, which is not currently the case. We are of course continuing to work with the other Tripartite authorities and the company to find a satisfactory solution which protects both the taxpayer and preserves wider financial stability. It would not be appropriate at this stage to speculate on alternative scenarios for the Treasury's contingent liability in relation to the company, which would involve second guessing highly volatile market valuations over the next few years. However, as stated above, we will continue to keep the Committee and Parliament updated and provide further information as soon as it is appropriate.

You also asked about the interest premium to be paid ultimately to the Treasury. In support of the stabilisation arrangements for the company, this fee has been rolled-up and subordinated as tier two debt.

OGC Severance and the Departmental Unallocated Provision

The OGC conducted a zero-based review as part of the Government's programme of work to support the Comprehensive Spending Review. The outcome of that review was set out in "Transforming Government Procurement" (TGP), which was published in January 2007. TOP announced the Government's intention that OGC should become a "smaller, more focused, higher calibre organisation with the skills and powers needed to drive through the necessary changes within central government".

In January, simultaneously with the launch of TGP, OGC introduced a voluntary early retirement and voluntary early severance scheme. This focused on reducing overall staff numbers to 250 by a April 2008, while retaining or—where sufficient skills to deliver the new agenda were not already present in OGC—recruiting, the skills needed to deliver TGP. The scheme has run throughout the calendar year, with some departures in financial year 2006–07, and the bulk in 2007–08.

During the course of 2006–07, the OGC incurred £3.3 million in early severance and early retirement costs. Of these, £1.8 million were incurred as a result of the scheme announced following TGP, with the balance covering severances agreed as a result of other changes within the OGC. A total of 26 people left in 2006–07 on voluntary severance or retirement terms. During the course of 2007–08, the OGC plans to spend up to £10 million on severance and early retirement. The scheme is coming to an end and the number of staff leaving under the scheme in 2007–08 will be approximately 80. Staff numbers in the OGC are forecast to be 60 lower, by April 2008, than they would have been under previously agreed headcount targets (allowing for transfers of responsibility in and out of OGC) and will decline to 190 over the CSR years.

The Departmental Unallocated Provision (DUP) was chosen to finance the OGC's staff exits because it forms part of the Treasury's DEL. When a department has a requirement for additional Supply Estimate spending, it is expected to manage the increase from within its existing DEL provision. This means either looking for savings or utilising unallocated provision before seeking to use sources of finance that would increase its DEL, such as End Year Flexibility or the DEL Reserve.

The Royal Mint

The new Service Level Agreement with the Royal Mint was agreed in October 2007 and covers the period April 2006 to March 2009. The then Chief Executive of the Mint informed the Treasury Committee that the SLA had been agreed when he appeared before them on 10 October 2007. Details of the delays to the agreement were given in the then Financial Secretary's letter of 17 May to Michael Fallon MP. The main change in the new SLA is for the cost of coinage to be paid on manufacture rather than on issue. This brings the Treasury in line with the Mint's other customers. There is also an agreement that the Mint would pay a royalty fee for the right to produce UK collector coins.

End Year Flexibility

As stated above, the department had unallocated provision within its DEL which has to be used before claiming any of our stock of EYF. Some of the EYF stock may be utilised at the end of the CSR period to fund the effect of the Civil List renegotiation in the event that it cannot be accommodated within 2010–11 DEL provision, but there are no definite plans to use the stock of EYF at present. The postion will be kept under review and a case for take up of EYF made in the event that the department cannot accommodate the need for additional funding within its DEL.

National Savings and Investments

I understand from the Chief Executive of National Savings and Investments that both the Supplementary Estimate and an accompanying memorandum have now been sent to the Committee.

Office for National Statistics

The Office for National Statistics have confirmed that an Estimates Memorandum was sent to the Committee on 14 November. I understand another copy was sent to you by Karen Dunnell's office on 23 November.

I hope that this letter provides you will all the information the Committee needs. Please do not hesitate to contact me if there are any other outstanding issues you would like addressed.

3 December 2007

Supplementary memorandum from HM Treasury

Executive Summary

1. This memorandum responds to the Treasury Sub-committee's requests at the hearing on 14 November 2007.

Staff Bonuses [Q 169–176]

2. The Committee asked about bonuses paid to HM Treasury staff. The parliamentary question referred to by the Committee outlined the total bonus payments for the more than 100,000 staff in the Chancellor's Departments (HM Treasury Group, HM Revenue and Customs, Office for National Statistics, the Royal Mint, the Government Actuaries Department and the Valuation Office Agency).

3. HM Treasury Group paid its staff bonuses worth £1.7 million in 2006–-07. Table 1 outlines the total expenditure on remuneration, including bonuses, within the Treasury Group since 2002–03 for all staff (including permanent officials and contract and agency workers). To help manage its pay budget, HM Treasury's policy has been to recognise good performance increasingly through bonuses rather than consolidated pay increases. Bonuses are paid in two circumstances: performance bonuses are linked to the annual staff appraisal system; and, special bonuses are those paid to recognise specific contributions or pieces of work during the year.

Table 1

REMUNERATION BY GROUP MEMBER

Group Member	*2002–03*	*2003–04*	*2004–05*	*2005–06*	*2006–07*
Base Pay Costs (£ thousands)	**74,195**	**78,338**	**81,194**	**91,252**	**93,513**
HM Treasury	57,479	60,692	59,906	62,790	63,251
Office of Government Commerce	13,059	13,273	16,262	22,775	23,992
UK Debt Management Office	3,657	4,373	5,027	5,687	6,270
Bonuses (£ thousands)	**845**	**991**	**1,298**	**1,376**	**1,682**
HM Treasury	627	704	972	967	1,103
UK Debt Management Office	95	134	157	167	180

4. The increase in base pay in 2005–06 is above the historical average, due to a number of factors including the creation of the new Gershon efficiency team in the OGC and increases in the pension contributions payable by government departments.

5. The Committee also enquired about the value of bonuses paid to senior members of HM Treasury. Table 2 details the bonuses received by the senior management of Treasury Group in 2006–07. Further details of senior staff remuneration are set out in the department's Annual Report and Accounts.

Table 2

BONUSES OF SENIOR MANAGEMENT

Name	*£*
N Macpherson	10,000–15,000
N Stern	0–5,000
J Cunliffe	5,000–10,000
M Keegan	10,000–15,000
J Kingman	10,000–15,000
M Neale	5,000–10,000
J Stephens	5,000–10,000
R Stheeman	5,000–10,000

FINANCIAL IMPLICATIONS OF THE PRIVATE FINANCE INITIATIVE [QQ 232, 281]

6. The Committee asked about the scale of on, and off, balance sheet PFI operations and the size of payments over the next 25 years.

BALANCE SHEET TREATMENT OF SIGNED PFI DEALS

7. As of at September 2007 there were 621 signed PFI deals with a total capital value of £56.9 billion. Of this value, £24.1 billion is on the public sector balance sheet and £32.8 billion is off the public sector balance sheet, equivalent to 42% on and 58% off.

8. The committee inquired about the balance sheet treatment of PFI deals under IFRS. No accounting standard yet exists which sets out how the public sector should treat PFI. Until this standard is finalised and agreed with external accounting bodies it is not possible to calculate the balance sheet impact of the move to IFRS.

FUTURE UNITARY CHARGE PAYMENTS

9. Unitary charge payments are monthly sums that generally cover the cost of constructing, financing and operating a PFI asset. In almost all cases these include payment for hard facilities management such as repairs and maintenance. In many cases the payments also cover additional services such as cleaning, catering and reception. The payments are linked to performance and may be deducted if agreed standards of service are not met. The payments may also be renegotiated to cover changes made to the contracted services or to reflect any change, upwards or downwards, in the real-terms cost of providing the services. For these reasons it is possible only to give an estimate of the future unitary charge payments.

10. The total, if one were to add together these future and non-comparable figures would be £180.7 billion. However, it must be emphasised that this number has little meaning. It is not illuminating to add together a figure in today's money to a figure in the money of 2030, without making any adjustment for the changing value of money over time.

11. With these caveats, Table 3 contains the latest list of estimated future unitary charge payments, as published with the Pre-Budget Report in October this year. The figures between 2007–08 and 2017–18 include estimated payments for the LUL PPP PFI contracts. These contracts contain periodic reviews every 7.5 years and therefore the service payments are not fixed after 2009–10.

Table 3

ESTIMATED FUTURE UNITARY CHARGE PAYMENTS

Projections (£ million)			
2007–08	7,043	2020–21	6,686
2008–09	7,663	2021–22	6,335
2009–10	8,133	2022–23	6,430
2010–11	8,482	2023–24	6,381
2011–12	8,664	2024–25	6,399
2012–13	8,807	2025–26	6,166
2013–14	9,001	2026–27	5,981
2014–15	9,037	2027–28	5,869
2015–16	9,147	2028–29	5,530
2016–17	9,244	2029–30	5,242
2017–18	8,635	2030–31	4,617
2018–19	6,775	2031–32	3,990
2019–20	6,861	2032–33	3,621

12. It would be incorrect to regard these future estimated unitary charge payments as additional to the balance sheet impact as recorded in the Public Sector Net Debt (PSND). This is for two reasons. First, as described in the section on balance sheet treatment of PFI, many of the liabilities are already on the public sector's balance sheet and so are also included within PSND. Second, unitary charges include payment for both the use of an asset and the associated services. It would be incorrect to consider estimates of payment for future maintenance work and other services to be the same as "debt". Payment for such work always scores as current expenditure.

HEAVILY INDEBTED POOR COUNTRIES [QQ 234, 235, 240]

13. The SR2002 PSA target in relation to the Heavily Indebted Poor Countries (HIPC) initiative was for three-quarters of all eligible HIPC countries committed to poverty reduction to receive irrevocable debt relief by 2006.[2] The technical note for HM Treasury's Public Service Agreement 2003–06, published alongside the PSA, clarified further the meaning of "eligible" stating that for those countries that are committed to poverty reduction and have reached their decision point the Department for International Development and HM Treasury would work towards ensuring that three-quarters reached Completion Point by 2006. Some 26 countries had reached Decision Point at the end of 2002, of which 21 had reached Completion Point by the end of 2006, meaning the target was met.

14. In SR2004, the PSA target was updated to continue the progress made in this area. The current target is to ensure that 90% of all eligible HIPCs committed to poverty reduction that have reached Decision Point by end 2005 receive irrevocable debt relief by end 2008. 28 countries had reached Decision Point by end 2005.[3] To date, 22 countries have reached Completion Point. Progress through HIPC can be difficult to predict accurately. However, the latest status of implementation report from the World Bank and IMF estimates[4] that up to a further 4 countries will reach Decision Point by the end of 2008. On this basis, we are on course to meet the target.

15. There has been progress since the publication of the Annual Report with regard to those countries yet to reach Decision Point (30 countries had reached Decision Point at the time the report was published). In July 2007 Afghanistan was assessed as meeting the Decision Point criteria, with the Central African

[2] The latest World Bank and IMF HIPC status of implementation report identifies a total of 41 eligible or potentially eligible HIPCs as of September 2007. This number has changed over the years of HIPC for a number of reasons, including a change in the assessment of a country's debt sustainability or because a country declared that it did not want to participate in HIPC.

[3] The number of countries that have reached Decision Point has since risen to 32 as of the end of September 2007. However, the target measures progress of the 28 that had done so by end 2005.

[4] http://siteresources.worldbank.org/INTDEBTDEPT/ProgressReports/21501008/HIPCProgressReport20070828.pdf

Republic following in September 2007. Both are now receiving interim debt relief. This brings the total number of countries at Decision Point to 32, with nine pre-decision point HIPCs still to enter the initiative. With respect to one of those countries—Liberia—there has been significant progress. A financing solution has been found at the International Monetary Fund (IMF), paving the way for Liberia to access debt relief under HIPC. The IMF has secured pledges from over 80 IMF member countries to provide approximately US $840 million in financing for debt relief for Liberia. The UK made intensive efforts to secure support for Liberia and, as well as contributing our full share of IMF internal resources, we will contribute our share of an additional G8 contribution totalling approximately $71 million.

16. Of course, ensuring that the remaining eight countries are able to enter the HIPC initiative remains a challenge for HM Treasury, DfID and our international partners. As the Annual Report notes, the majority of these countries are post conflict and fragile states, while some remain in conflict. They will need additional support to meet the standards required for HIPC and the international community will need to show flexibility where appropriate. The UK is working through its bilateral development programmes and with international partners to build peace, strengthen governance, debt and financial management and help these countries meet the standards required to benefit from debt relief.

Debt sustainability

17. HIPC and MDRI debt relief are freeing up money to support poverty reduction strategies and other development priorities. They have also introduced significant headroom for new borrowing. Achieving the MDGs will require a large increase in resources, and all forms of development financing have a role to play. Borrowing can be a good way for countries with limited domestic capital to raise finance for development priorities. When countries put the money borrowed to productive use, they benefit from faster economic growth and increased investment, delivering effective social services.

18. However, it is important to ensure that debt levels in developing countries remain at sustainable levels and new lending continues to support development. The Treasury is therefore working with our international partners to promote debt sustainability, including through responsible borrowing and lending practices.

19. As part of our commitment to debt sustainability, the UK has supported the development of a Debt Sustainability Framework by the World Bank and the IMF. This is an important tool, which both debtors and creditors can use to inform decisions related to new borrowing.

20. To help ensure that sovereign lending to developing countries is consistent with sustainable debt levels, the UK, along with the Netherlands, Sweden, Italy, the IMF and World Bank, has also been leading efforts to strengthen guidelines on government-supported lending to low-income countries. The Treasury, in an effective partnership with ECGD and DFID, has been working through the EU and the OECD to establish a framework for Export Credit Agency (ECA) supported lending to low-income countries, including Heavily Indebted Poor Countries (HIPCs). This work will help to ensure that new lending takes account of the World Bank and IMF Debt Sustainability Framework (DSF), is appropriately concessional, well targeted and used for productive purposes. Proposals have been put forward to the OECD ECA Group and we hope that they will be agreed in coming months.

21. Finally, DFID is also working with Heavily Indebted Poor Countries (HIPCs) to strengthen their debt management capacity and supporting further efforts by the World Bank in this area.

22. The Treasury will continue to support further work on debt sustainability at the international level, and we will be taking forward discussions with other finance ministries, including those of key emerging lenders, next year in the G20.

"Vulture Fund" Activity

23. The Government is concerned about the activities of so-called "vulture funds" and we are working to stop these funds profiting from poor countries. A recent World Bank and International Monetary Fund survey examined the extent of the issue. It identified 11 heavily indebted poor countries (HIPC) that had been targeted with lawsuits by a total of 46 litigating creditors. In addition, two countries reported being threatened by litigation.

24. Eight new legal actions were reported since the previous survey in 2006, of which five are against Nicaragua, two against Cameroon, and one against Ethiopia. The HIPCs facing the most litigation cases are Nicaragua, the Republic of Congo, Cameroon, and Uganda, with nine, eight, seven, and six lawsuits, respectively.

25. This information is included in the latest annual joint World Bank/International Monetary Fund status of implementation report on the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI). The report is available on the World Bank website.[5]

26. We are working to address the problem of vulture fund activity in two ways—by seeking to prevent debts being sold to vulture funds in the first place and by limiting the damage done by cases already underway.

[5] http://siteresources.worldbank.org/INTDEBTDEPT/ProgressReports/21501008/HIPCProgressReport20070828.pdf

27. To reduce the risk of debts falling into the hands of vulture funds, we are working with the World Bank to help poor countries buy off their commercial debts at the earliest possible opportunity. Under these deals, which the UK and others provide the funding for, countries buy back their debts at a deep discount to face value. The debts are then cancelled forever, and cannot be taken through a court. More than $8 billion of debts have already been cancelled in this way and we are working to make this system more effective. We are also working with Heavily Indebted Poor Countries (HIPCs) to strengthen their debt management capacity.

28. In addition, Paris Club creditors have publicly stated their commitment not to sell their claims on HIPCs to creditors that might not be willing to implement the HIPC Initiative. At the Annual Meetings of the IMF and World Bank in October, G7 Finance Ministers welcomed this step and urged all sovereign creditors not to sell claims on HIPCs. We will take forward discussions on this issue in international fora and with private sector.

29. However, in some cases, poor countries' debts are—regrettably—already in the hands of vulture funds. In considering whether to change the existing law to address these cases, account has to be taken of potential unintended negative impacts, such as undermining developing countries' access to financial markets and thereby their economic growth. Furthermore, any legislative change could not apply retrospectively to claims (ie to claims on debts that have already been bought by vulture funds)

30. We therefore have no plans at present to bring forward legislation but are instead focussing our efforts on creating a level playing field in which HIPC countries have the legal resources and expertise necessary to defend themselves. We are working with the African Development Bank to develop a legal assistance facility to help countries facing creditor litigation and ensure they have access to the best legal advice available to help them fight inflated claims. The strong defence that the Government of Zambia mounted recently, for example, reduced its liability by around $40 million.

31. The Chancellor raised the problem of vulture fund activity with G7 Finance Ministers at the Annual Meetings of the IMF and World Bank in Washington this October. In their statement, G7 Finance Ministers reiterated their concern about the problem committed to examine additional steps that might be taken to tackle this issue. In addition, the Paris Club group of sovereign creditors has also intensified its work in this area. We will continue to take forward work with our international partners to tackle this issue.

Productivity [Q252]

32. The Committee asked for an overview of the indicators used to monitor the progress on the five drivers in the Government's productivity framework.

33. Productivity growth is essential for the UK's long-term prosperity and progress is being made to narrow the gap with comparator countries. The UK continues to make progress on improving prosperity (GDP per capita), through a mixture of a strong employment performance and productivity growth. Productivity growth appears to have increased relative to previous economic cycles and there has been clear progress in closing the productivity gaps with France and Germany since 1995. The UK is also the only G7 country to have kept pace with the US's impressive performance.

34. The Government's productivity framework identifies five key drivers that underlie long-term productivity:

- (i) Competition: Competition drives productivity through a range of channels. In a competitive market, customers are able to choose from whom and what they purchase. To stay ahead of their competitors firms need to compete on quality and price, and to look for new markets to generate profits.
- (ii) Innovation: Innovation—the transformation of an idea into a new or improved product or process—has a direct and significant effect on productivity growth. Not only does successful innovation benefit those firms undertaking it, but it also tends to have 'spillover' effects that create wider benefits to the overall economy.
- (iii) Skills: The overall level of education and skills in the workforce can have a critical impact on productivity growth, particularly in more developed economies. Improved levels of skills contribute directly to improved productivity but can also have wider impacts helping to generate new innovations, technologies and ideas that benefit the whole economy.
- (iv) Investment: Increased investment will generally increase labour productivity by increasing the capital each worker can utilise. At the most fundamental level infrastructure is a necessary pre-condition to economic activity, through provision of basic utility services. More widely, transport and communication infrastructure can directly improve productivity by facilitating trade and competition in goods and services, allowing physical or electronic access to clusters of economic and social activity and influencing the location decisions of business.
- (v) Enterprise—the creation and growth of firms: increases ideas, knowledge and skills and provides incentives for others to innovate through raising competition.

35. The evidence to support these drivers is set out in detail in the Productivity in the UK series[6] and most recently in Productivity in the UK 7: Securing long-term prosperity, published on 27 November 2007. Chapter 2 of this document outlines key reforms that have addressed these drivers in the past decade. As well as increasing productivity in the private sector, improving the efficiency of the public sector is also crucial to improve overall productivity performance. This note considers the key reforms the Government has made since 1997, and the progress to date under each driver.

36. Progress on productivity and the five drivers is monitored regularly in BERR's UK Productivity and Competitiveness Indicators-Series,[7] with its most recent report published in March 2006. See the annex of this note for a list of indicators.

Performance against Child Poverty PSA Indicators [Q 258]

PSA: Halve the number of children in poverty by 2010–11, on the way to eradicating child poverty by 2020

37. The PSA has three indicators:

(i) The number of children in absolute low-income households;

(ii) The number of children in relative low income households; and

(iii) The number of children in relative low-income households and material deprivation.

38. Absolute low-income households are defined as households with incomes of less than 60% of median income held constant in real terms from a 1998–99 baseline, equivalised using the Modified OECD scale. Relative low-income households are defined as households with incomes below 60% contemporary median income, before housing costs, equivalised using the Modified OECD scale. The combined low-income and material deprivation indicator measures the number of households below 70% contemporary median income, before housing costs, equivalised using the modified scale and in material deprivation, using a prevalence weighted approach. This indicator excludes those with low incomes, who have high living standards, and includes those who would not be captured by the relative low-income measure but who face certain unavoidably high costs.

39. The baseline for relative low-income and absolute low-income indicators ie the number of households with less than 60% of 1998–99 median income, is 3.4 million children.

40. Between 1998–99 and 2005–06, the latest year of data, the number of children in households with relative low-income fell by 600,000 from 3.4 million to 2.8 million and the number of children in absolute low-income households fell by 1.8 million to 1.6 million. Therefore, the number of children in poverty using the absolute low-income measure has more than halved.

41. The Pre-Budget Report announced increasing the child element of the Child Tax Credit by £25 above standard earnings indexation in April 2008 and again in April 2010, and doubling the child maintenance disregard in main-income related benefits by the end of 2008 and again by April 2010. The announcements build on the measures announced at Budget 2007, which amounted to an investment of £1bn in the Child Tax credit. Taken together, the PBR and Budget will help lift a further 300,000 children out of poverty.

42. Data on material deprivation first became available in March 2006 for 2004–05. Between 2004–05 and 2005–06, the number of children in the UK defined as poor using the combined indicator of relative low-income and material deprivation fell by 100,000 from 2.2 million to 2.1 million.

Gross Value for Money Savings [Q 270]

43. Following the approach outlined in Sir Peter Gershon's Independent Report into Public Sector Efficiency, some efficiency savings in the Spending Review 2004 (SR04) period were scored as gross savings, and some had costs netted off. This is the basis on which the SR04 targets were set.

44. Over the past couple of years, the Committee and other key stakeholders have argued that this approach could be improved by having a tighter definition of efficiency, which netted off costs. In developing the Value for Money (VfM) framework for the Comprehensive Spending Review (CSR) period these arguments have been taken on board and a system designed where all reported VfM savings are net of both implementation and up-front costs, and in which only cash-releasing savings are scored towards the target. All costs will be fully accounted for in the year in which they fall, and departments will report a net figure in Departmental Reports and Autumn Performance Reports.

45. The gross figure for VfM savings in the CSR period would clearly be greater than the £30 billion target for net cash-releasing savings, as it would include the total cost of all initiatives; however, because of the

[6] http://www.hm-treasury.gov.uk/documents/enterprise—and—productivity/the—evidence/ent—prod—index.cfm

[7] http://www.dti.gov.uk/files/file28173.pdf

requirement for a net approach from departments for the CSR, HM Treasury does not hold detailed information about the costs of each VfM initiative. Unfortunately, as suggested during the Oral Evidence on the 14 November, it is not possible to provide a total gross figure for savings in the CSR period.

December 2007

Supplementary memorandum by HM Treasury and HM Revenue and Customs

This memorandum responds to the Sub-Committee's requests at the hearing on 9 January 2008.

How many staff in the Chancellor's departments are earning less than £6.50 an hour? [Q523]

There are no staff earning less than £6.50 per hour in the Treasury Group (HM Treasury, Office of Government Commerce, OGCbuying.solutions, and the Debt Management Office) or the Government Actuary's Department.

Table 1

STAFF IN CHANCELLOR'S DEPARTMENTS EARNING LESS THAN £6.50 AN HOUR

Department	*Staff earning less than £6.50*	*Total headcount*
HM Revenue & Customs[a]	3,400	92,238
Office for National Statistics[b]	400	4,837
Royal Mint[c]	37	750

[a] Approximate number of HMRC staff earning less than £14,251 per annum pro rata on a full-time equivalent basis, as at 1 November 2007

[b] This ONS figure includes staff outside London, and national field interviewers (including the field telephone unit), as at 31 December 2007.

[c] Royal Mint figures at 7 January 2008.

From the figures, the number of permanent staff decreased by over 4,000 in a year but the cost of those staff that were left has increased by £29 million. Is that related in any way to what you were saying previously about the issue of bonuses and such? [Q533]

HMRC's 2005–06 Accounts (HC1159) and 2006–07 Accounts (HC626) show that the average total number of full-time equivalent persons permanently employed in the core Department reduced from 90,829 to 86,436, and that the costs for these staff increased from £2,586.8 million to £2,616.1 million in those years.

In 2006–07, alongside the normal pay increases for staff, HMRC undertook a pay assimilation exercise to align the pay and grading structures inherited from the Inland Revenue and HM Customs and Excise. 2006–07 was therefore also the first year of paying bonuses as a part of the new HMRC pay arrangements.

While the loss of around 4,000 permanent staff during 2006–07 partly reduced the impact of this pay increase, 2,340 of them did not leave HMRC until the second half of the year, so that the overall savings were less than the full cost of the pay settlement.

Do you know how many senior officers have prior banking experience? [Q540]

— Nicholas Macpherson, Permanent Secretary, worked on the Barings Bank crisis and resolution, as Principal Private Secretary to the Rt Hon Kenneth Clarke QC MP, in 1995.

Managing Directors

— John Kingman, Second Permanent Secretary, and Managing Director of Public Services and Growth, was an Executive Director of the European Investment Bank from 2003–06. He also wrote extensively on banking sector issues for the Financial Times *Lex* column.

— Stephen Pickford, Managing Director of International Finance, was an Executive Director of the World Bank from 1998–2001 and has been a Director of the European Investment Back since 2007.

Financial Services/Northern Rock team

Experience in the Financial Services/Northern Rock Team includes:

— a Senior Civil Servant who worked for three years in the City for Natwest and Prudential Groups (including a period working for Egg) and as a consultant for HBOS Group 2;

— a Senior Civil Servant who worked for two years as an economist in fund management, plus 12 years as an economist covering fixed income and currency markets in investment banking.

Staff experience in the broader International Finance and Macroeconomics and Fiscal Policy Directorates includes:

— a former Managing Director of the Deutsche Bank Group;

— a current Alternate Director of the European Bank for Reconstruction and Development;

— a Qualified Chartered Accountant with over 15 years of post-qualification banking experience prior to joining the Treasury, including five years as Finance Director of Close Brothers Ltd.[8]

How many cases will be affected by new COP 26? To what extent will it be retrospective where people have been locked into argument or dispute with the Department? [Q581]

HMRC will apply the revised COP 26 to new disputed cases from the end of January and any disputed cases in the pipeline at the introduction of this change.

There were approximately 370,000 disputed overpayments in 2006–07. HMRC's current monitoring suggests that under 5% of cases were attributable to official error, of which a large majority of cases had their overpayments remitted. The changes are likely to increase the percentage of official error cases which will be remitted; they will also benefit those experiencing hardship, and those with exceptional circumstances which meant that they could not meet their responsibilities under the revised code.

Will up-to-date figures be reported adequately to Parliament as the safeguarding of the borders moves from HMRC into a new Border Agency? [Qq 585–6]

HMRC recognises the vital importance of putting in place robust and effective performance management and reporting mechanisms, both in HMRC and in the UK Border Agency (UKBA) as part of the work of creating the new agency. Two programmes have been set up to manage the transition: the first is a joint programme structure with Border and Immigration Agency colleagues to design new operating procedures at the border, together with associated organisational designs, powers, human resource procedures, information services and estates strategies. The second is an HMRC programme that will assess and manage the implications of the frontier work moving from HMRC. This will put in place the mechanisms—including operating agreements—necessary to ensure that the Government's fiscal and economic objectives to which UKBA will contribute are delivered satisfactorily in the future by UKBA. One of the programme workstreams will be looking specifically at the governance framework required for performance management and reporting.

The Minister was explaining that there was about £500 odd million of savings. I wonder if she might send the Committee a copy of that breakdown explaining that calculation [Q536]

The 2004 Spending Review set HMRC a financial target to position itself to achieve total annual efficiency savings of £507 million by the end of 2007–08. This financial target was to be realised from a combination of:

— savings arising from the release of staff; and

— savings from estates, procurement and other efficiency initiatives, such as reduction in bank charges.

As at 1 December 2007, HMRC had exceeded the target with total financial savings of £533 million.

The £507 million target included:

— £363 million expected financial savings arising from the gross reduction of 16,000 full-time equivalent posts;

— £106 million non-headcount savings;

— £38 million adjustment for inflation to 2007–08 prices (using HM Treasury rates).

8 A bank and authorised under the Financial Services and Markets Act 2004. It is regulated by the Financial Services Authority and is the parent company of a group providing a range of banking services including specialist financing, asset financing, treasury and deposit taking. Close Brothers Ltd is wholly owned by Close Brothers Group plc which itself is listed on the London Stock Exchange.

HMRC's 2004 Spending Review settlement took account of these expected financial savings, which would be recycled within the Department's budget. The savings were intended to cover the cost of redeploying 3,500 posts to front-line areas, absorption of pay and price increases, existing policy commitments and enabling investment in transition to the new integrated Department.

The majority of the £507 million target was therefore based on savings arising from staffing reductions. As set out in HMRC's Efficiency Technical Note (published December 2005), staff savings have been calculated using an appropriate average salary (including superannuation, national insurance contributions, and where applicable, allowances for additional/flexible attendance), but excluding general administration expenditure and accommodation costs. This was weighted to take account of the Departmental population by grade. This methodology was tested and reviewed in the summer of 2007 and an average salary of £27,120 was agreed with HM Treasury in September 2007.

Table 2

HMRC FINANCIAL SAVINGS ACHIEVED AT 1 DECEMBER 2007

SR04 Target		*FTE Reduction*	*Financial Savings (£m)*
Headcount			
	12,500 net FTE reduction	14,397	
	Redeployments	3,325	
	16,000 gross FTE reduction	17,722	383.2[a]
Non-Headcount			
	Procurement		112.5
	Estate		23.8
	Other		13.7
Total			**533.2**

[a] Staff reductions are measured from a 1 April 2004 baseline, whereas the starting point for calculating the financial savings is 1 April 2005

Does it worry you that scarcely anyone in the Treasury has experience in the Treasury prior to 1997? [Q545]

There are 245 members of staff that have more than 10 years experience at HM Treasury.

This represents 21.3% of total staff, and includes 20 staff at Senior Civil Service grades (37.7% of all SCS staff).

How many child tax credit overpayment cases have there been where the computer has failed to cope with the case in question? I also have cases where, because the computer has failed, manual control has been put in and that has failed as well. How many of those are there? [Q578]

There are currently around 25,000 live manual payment cases. HMRC is actively reviewing these cases and looking to carry out corrective action to enable system payment to be restored as soon as this can be safely achieved.

We are not aware of any cases which cannot be paid by the manual process if system payments cannot be made and there is tax credit entitlement. There are some cases which were previously paid manually have now reverted to system payment or are no longer paid due to nil entitlement.

Can you assure me that those contracts (for Security Guards) prevent very casual employment of people on security guarding duties? [Q596]

HMRC takes the vetting of outsourced security guarding very seriously. There is an established process in place for vetting security guards across the estate and although the process varies slightly depending on the Private Finance Initiative (PFI) service provider, they all pick up the key security check requirements which would preclude casual employment.

The Department's own Security and Business Continuity staff carry out Counter Terrorist Clearance (CTC) checks on all guards employed: these checks include background details of the applicant and their family as well as a criminal record check. In addition to this, residency checks are made, as well as references sought from previous employers.

The security companies that HMRC's estate partner, Mapeley, employ must ensure that their staff receive the appropriate Security Industry Authority (SIA) training in order to obtain the necessary accreditation which will enable them to work within the security industry: guards must be fully SIA accredited to work on an HMRC site.

Holders of non-British passports are screened in line with the requirements of the Asylum and Immigration Act 1996 which places a duty on employers to ensure that there is a lawful entitlement to live and work in the UK.

HMRC has taken up the Home Office's advice to seek further expert assistance in this sensitive area. All of the security records and checks of the Department's PFI providers are subject to scrutiny from HMRC's Internal Audit unit. Finally, each provider has their own audit programme, which is regularly monitored by HMRC Estate Management.

We were told by the Permanent Secretary that the service level agreement was in place from October but the then Chief Executive told us it was actually in place from April 2007. Which of those two is correct? [Q620]

The Service Level Agreement with the Royal Mint was agreed in October 2007, but was retrospectively applied from April 2007.

OGC question on version control: was any record at all kept of the earlier versions? [Qq 561–4]

It is standard practice across all Gateway reviews that no records of earlier versions are kept.

Working copies of Gateway reports are destroyed prior to the production of the final Gateway report to the Senior Responsible Owner (SRO) of the project being reviewed. This "version control" is to ensure that there is no confusion created between notes made during work-in-progress and the final Gateway report. Two copies of the final Gateway report are held, one by the SRO and another by OGC, electronically, and kept on file permanently.

Since the working copies of the Gateway reports are destroyed before the production of the final report on the last day of a review, documents will have been destroyed before the last day of reviews for the Identity Card Programme and the NHS.

January 2008

Memorandum from Mr Jim Tyrrell

I am writing to you because of a situation my colleagues and I find ourselves in with our employers—HM Revenue and Customs.

We are Civil Servants employed as security officers at HMRC Cumbernauld. In mid-September we were called to a meeting with senior management who informed us that HMRC were proposing to outsource our jobs to a private contractor. No tender process was going to happen but our jobs were being transferred to Mapeley, by the end of the year.

Mapeley are the company who took over all Revenue buildings in 2001. The Revenue signed the contract with what they thought was a UK Company. Unfortunately for them they later learned the contract was with a Burmuda registered tax haven company. The taxman feeding the flames of tax evasion-no wonder a scandal erupted.

The contract process to date has been problematic with threat and counter threat of legal action and Mapeley even asking at one point for more money.

Since it was announced about the jobs transfer, I have looked into Mapeley a bit (Internet, Media)

In April 2007 the share price fell from £40 to £23 in one month.

They are also £1.45 billion in debt. Can I ask you at this point, would you be thrilled at the prospect of your job, terms and conditions and future pension arrangements put in control of Mapeley. No, neither do I, or would I.

With Mapeley's record regarding it's tax haven status and the way this information was made known at the eleventh hour I would have thought that no Government Department would be rushing to give them any more work or contracts.

Prior to the contract being signed apparently the Chairman of the Revenue sent two "letters of comfort" to Mapeley's creditors and shareholders, stating the contract would be most beneficial. In accountancy terms this could be construed as underwriting the contract, I wonder if this is so.

My colleagues and I (19 of us) have approximately 400 years service between us. Regarding Mapeley with some of their background I have given you I can only ask why?

One answer of course is, regardless of efficiency or value for money, reduce the Civil Service headcount at all cost.

I am of course not one of your constituents but I am a taxpayer and a somewhat concerned and puzzled servant of our country.

The main question to me again is why? Or why them? . . . "Something in the state of Denmark . . ." maybe is not all it seems.

October 2007

Memorandum from Lisa Weatherley, on behalf of Tax Credit Casualties

Executive Summary

1. As a representative of Tax Credits overpayments victims I am requesting that the Select Committee seek information from HMRC regarding Tax Credits overpayments for 2006–07, the number of overpayment disputes received or processed during 2006–07, the end-to-end costs of processing overpayment disputes in 2006–07, the percentage of overpayment cases written off on the grounds of financial hardship in 2006–07, the number and percentage of overpayment cases successfully pursued via the Courts in 2006–07, also the number of overpayments written off as HMRC error, and at what stage they were written off.

2. With regards to HMRC administration, I am seeking an update on the implementation of the recommendations in the Parliamentary Ombudsman's report *Putting Things Right* June 2005 HC 124.

3. This information is relevant both to the tax payer and to MPs and others representing, and campaigning on behalf of, victims of Tax Credits mistakes and overpayments.

Brief Introduction

4. My name is Lisa Weatherley and I am volunteering on behalf of the organisation "Tax Credit Casualties", who represent and assist members of the public affected by Working Tax Credit and Child Tax Credit overpayments. There is information about our organisation at www.taxcreditoverpayment.pwp.blueyonder.co.uk

5. In addition, my partner is subject to a £5,000 Tax Credits overpayment demand from HMRC which we are currently in the process of disputing.

6. In brief, Tax Credit Casualties are calling for all non-fraudulent Tax Credits overpayments from April 2003 onwards to be written off, and for a reform of the Tax Credits scheme to better reflect the needs and circumstances of claimants.

7. Tax Credit Casualties are very interested in HMRC expenditure and administration in relation to Working Tax Credits and Child Tax Credits, and the recovery of overpayments of these, and I am hoping that we can contribute to, and learn from, the Select Committee meeting above.

Factual Information

8. Tax Credit Casualties request information from HMRC on the number and monetary value of Working Tax Credits and Child Tax Credits overpayments for 2006–07.

9. We request information on HMRC's expenditure for 2006–07 in relation to Tax Credits overpayments (for example the identification, notification, processing and collection of overpayments, helpline costs, legal costs, and writing off overpayments due to HMRC error and fraud).

10. We request information on HMRC and the Treasury's expenditure for 2006–07 in relation to Tax Credit overpayment disputes—from the point at which the claimant first disputes the overpayment to the point where all dispute processes are exhausted ie including the Adjudicator, Parliamentary Ombudsman and the Courts. This would include the costs of the overpayments and complaints staff at Tax Credit Offices etc.

11. We request information on the number, and percentage this represents, of Tax Credits overpayment cases written off by HMRC due to the claimants financial hardship.

12. We request information from HMRC regarding the number of Tax Credits overpayments cases taken to the courts in 2006–07, the number or percentage of these cases that were found in HMRC's favour, and the number or percentage of these cases that were found in the claimant's favour.

13. We are very concerned by the large number of Tax Credit overpayment victims being pursued by HMRC through the courts. We have evidence, and are also very concerned that Tax Credit claimants are being taken to court before they have been able to exhaust the appeals process. Furthermore, Tax Credit Casualties have evidence and are deeply concerned that, once in court, HMRC's Certificate of Debt overrides the claimants' ability to defend themselves and that Judges are claiming that they cannot overrule such a Certificate.

14. It is deeply worrying that Tax Credits overpayments are resulting in thousands of British people having County Court Judgements (CCJs) against them, and the implications this has for their ability to access financial services such as mortgages.

15. Lastly, we request an update on HMRC's implementation of the recommendations in the Parliamentary Ombudsman's report *Putting Things Right* June 2005 HC 124.

Recommendations

16. Tax Credit Casualties believe that tax payers' money, and HMRC's staff time and resources would be much better spent writing off overpayments and overhauling the Tax Credits system to minimise or eliminate overpayments, rather than spending our taxes uneconomically chasing overpayments and disputed overpayments, and maintaining an inherently unfair and unworkable system. We have also personally all been victims of HMRC's mistakes, delays, failures, lack of accountability, partiality and heavyhandedness. We therefore make the following recommendations:

17. Tax Credit Casualties recommend that HMRC, as a matter of urgency, implements recommendation 10 from the Parliamentary Ombudsman's report *Putting Things Right* June 2005 and writes off in full all non-fraudulent excess and overpayments of Tax Credits 2003–05.

18. Tax Credit Casualties recommend that HMRC implements, as soon as possible, all recommendations from the Parliamentary Ombudsman's reports on Tax Credits *Putting Things Right* June 2005 and *Getting It Wrong* October 2007.

19. Tax Credit Casualties recommend that HRMC immediately scrap the "reasonableness" component of CoP26, as HMRC have proven themselves to be incapable of administrating this in a fair, reasonable and impartial manner, and instead use an independent body to assess the source, and writing off, of Tax Credit overpayments.

20. Tax Credit Casualties recommend that HMRC invite Tax Credit Casualties representatives to attend the Tax Credits Consultations Group to help reform Tax Credits, in a transparent and accountable way, into a system that best reflects the needs and circumstances of claimants.

21. Tax Credit Casualties also seeks the support of the Sub-Committee in seeking an urgent meeting between Tax Credit Casualties and Jane Kennedy, Financial Secretary to the Treasury, to discuss, address and progress issues of Tax Credits administration and overpayment.

November 2007

Memorandum from HM Revenue & Customs

2006–07 Winter Supplementary Estimate

Estimates Memorandum

1. *Summary of changes sought in the Estimate*

The main purpose of the Winter Supplementary is to allow take up some of the HM Revenue and Customs' End of Year Flexibility (EYF) entitlement and to transfer funds in respect of a Machinery of Government (MOG) change. The changes will assist the Department both to drive forward its Change Programme, deliver efficiency savings and to stay within voted limits.

Changes in resource

RfR1:

Increases

— Take up of resource near cash EYF entitlement

The 2005–06 Public Expenditure Outturn White Paper (CM 6883) set aside £268,623,000 EYF for the Department. We have agreed with HM Treasury that we will draw down a proportion of near cash costs amounting to the **£90,000,000**.

— Transfers from other government departments

The Parliamentary Counsel Office changed their funding arrangements in 2004–05 and as a result they had to transfer baseline funding to departments to enable those departments to pay them for their legal services, which in the case of HM Revenue and Customs may relate to legal changes to the Finance Act. The baseline is being transferred to departments separately each year. Therefore, this transfer of **£1,742,000** reflects the funding due to this department for 2006–07. The payment back to the Parliamentary Counsel will be in excess of this figure.

Decreases

The introduction to the Estimate also details reductions to various elements of the Vote. The main components of this relate to transfers to other government departments.

— Transfers to other government departments

(i) the Department is transferring funding of **£87,125,000** to the Home Office in respect of Serious Organised Crime Agency (SOCA) funding of which £72,063,000 is near cash administration costs (including £279,000 in receipts); £8,050,000 is non-cash administration costs; and £7,012,000 is programme expenditure. Although this Machinery of Government change became effective from 1 April 2006, no previous funding had been transferred.

Neutral Changes

— Increased spending offset by income

To increase the levels of Programme expenditure and income by £2,500,000 resulting from additional receipts from the Recovered Assets Incentivisation Fund. This is a fund awarded to Home Office to assist in tackling money laundering and other criminal activities. Agreements are in place that secure part of the fund to Other Government Departments, for which there is a clear link in delivering the Home Office objective to tackle money laundering and asset recovery targets.

Changes in Capital

RfR1:

Increases:

— Take up of capital EYF entitlement

We have agreed with HM Treasury to draw down **£30,590,000** as announced in the 2005–06 Public Expenditure Outturn White Paper (CM6883) to support on-going merger costs of HMRC and to meet efficiency targets. The EYF will be used to deliver major investment in IT and business systems infrastructure.

Decreases:

— Transfers to other Government Departments

A Budgetary Transfer to the Home Office in respect of SOCA funding amounting to **£6,897,000**. Although this MOG change became effective from 1st April 2006 no funding had previously been transferred.

RfR2

Increases

— Take up of capital end year flexibility entitlement

— We have agreed with HM Treasury to draw down **£3,829,000**, as announced in the 2005–06 Public Expenditure Outturn White Paper (Cm 6883) in respect of the Valuation Office Agency, which will be used to deliver IT investment.

2. *Detailed explanation of the changes*

The introduction to the estimate summarises the changes to voted totals. This section provides details of the changes into specific categories.

Detailed explanation of the changes

Amount	*Description*
EYF	
£90,000,000	Take up of £90,000,000 EYF to support the on-going merger costs of HMRC
£34,419,000	Increase of £34,419,000 arising from the drawdown of capital EYF to support the costs of major investment in IT and business systems infrastructure following the creation of HMRC
£90,000,000	**Total EYF Resource Change**
£34,419,000	**Total EYF Capital Change**
Transfers from other Government departments (OGDs)	
£1,742,000	Transfer of £1,742,000 from the Cabinet Office in respect of Parliamentary Counsel Office funding.
£23,946,000	Transfer of £23,946,000 from the Department for Constitutional Affairs (DCA) to cover additional costs associated with the National Insurance Fund.
£25,688,000	**Total Resource Transfers from other OGDs**

Detailed explanation of the changes

Amount	*Description*
MOG changes transfers to another Government department	
£80,113,000	Transfer of £80,113,000 in net administration costs to the Home Office in respect of a MOG change to provide funding to SOCA.
£7,012,000	Transfer of £7,012,000 programme expenditure to the Home Office in respect of a MOG change, which provides funding to SOCA.
£6,897,000	Transfer of £6,897,000 in capital to the Home Office in respect of a MOG change, which provides funding to SOCA
£87,125,000	**Total Resource MOG transfers to an OGD**
£6,897,000	**Total Capital MOG transfers to an OGD**
Increases in gross spending offset by Appropriations-in-aid (A-in-A)	
£2,500,000	To increase the levels of Programme expenditure and income by £2,500,000 resulting from additional receipts from the Recovered Assets Incentivisation Fund.
£2,500,000	**Total Resource increase in gross spend offset by A-in-A**

3. *Impact on the Department's Public Service Agreement (PSA)*

The Department's Public Service Agreement (PSA) details what we are committed to achieving over the course of a three-year period. The Supplementary Estimate allows for the movement of funds to support that agreement with our stakeholders. Overall this Supplementary will assist in the delivery of our PSA with increased focus on our integration agenda, including capital projects and programmes. Thus supporting the Government's plans for Public Sector Departments to be more effective and efficient in delivering public services.

4. *Departmental Expenditure Limit (DEL) changes*

A note to the Estimate already provides a summary of resource and capital DEL, broken down into voted and non-voted, for the current year. In summary, the Department will be increasing Resource DEL by £28,563,000 to £4,551,506,000 and Capital DEL by £27,522,000 to £307,418,000.

5. *Departmental Expenditure Limit (DEL)*

CHANGES TO THE DEPARTMENTAL EXPENDITURE LIMIT IN 2006–07

£m

	Voted	*Non-voted*	*Total DEL*
Resource			
1 April	**4,122.3**	**400.7**	**4,523.0**
Change announced with winter supplementary estimate	4.6	23.9	28.5
Total resource Departmental Expenditure Limit	**4,126.9**	**424.6**	**4,551.5**
Capital			
1 April	**276.2**	**3.7**	**279.9**
Change announced with winter supplementary estimate	27.5	—	27.5
Total capital Departmental Expenditure Limit	**303.7**	**3.7**	**307.4**
*Less deprecation at start of year**	−196.3	—	−196.3
*Less change in deprecation at winter supplementary estimate**	7.2	—	7.2
Total Departmental Expenditure Limit	**4,241.4**	**428.3**	**4,669.8**

* Depreciation, which forms part of resource DEL, is excluded from the total DEL since capital DEL includes capital spending and to include depreciation of those assets would lead to double counting.

6. *End year flexibility*

End year flexibility	*Administration costs*	*Other resources*	*Resource* *Total DEL Resources*	*Capital* *Total Capital DEL*	*£m* *Total*
EYF entitlement set out in *Public Expenditure: Outturn* white paper (CM 6883)					
2005–06 Underspend	170.1	5.2	175.3	—	175.3
Changes to 2004–05 outturn	6.9	0.6	7.5	0.1	7.6
2005–06 EYF not taken up	45.0	55.1	100.1	34.3	134.4
Return of Lorry Road User Charge funding to HM Treasury	0.1	−14.4	−14.3	—	−14.3
2006–07 Entitlement	222.1	46.5	268.6	34.4	**303.0**
EYF draw down in winter supplementary estimate	−90.00	—	−90.00	−34.4	**−124.4**
Balance of accumulated EYF	**132.1**	**46.5**	**178.6**	**—**	**178.6**

7. *Administration Budget*

CHANGES TO THE ADMINISTRATION BUDGET IN 2006–07

	£m **Limit**
1 April	4,482.4
Change announced with winter supplementary estimate	9.9
Administration Budget	**4,492.3**

8. *Machinery of Government changes*

MACHINERY OF GOVERNMENT CHANGES

£m

Description	*RfR: section*	*Creation Date of MOG*	*Amount £000*	*Transferring Dept*	*Receiving Dept*
Transfer of administration resources to provide funding to SOCA	1: A	1/4/2006	80.1	HMRC	Home Office
Transfer of programme resources to provide funding to SOCA	1: A	1/4/2006	7.0	HMRC	Home Office
Transfer of Capital to provide funding to SOCA	1: A	1/4/2006	6.9	HMRC	Home Office

9. *Net Cash Requirement*

The net cash requirement has increased by £9,543,000, which represents a mixture of additions and reductions to the Estimate detailed above and an adjustment of −£30,616,000 in respect of changes to creditors, debtors and cash payments against prior year provisions set up in respect of Early Release costs and other general provisions.

November 2006

Letter from the Clerk of the Sub-Committee to the Chairman of HM Revenue & Customs

HMRC Winter Supplementary Estimate 2007–08

The Committee has now had an opportunity to consider the HM Revenue & Customs' Winter Supplementary Estimate 2007–08 and supporting Memorandum.

The Committee has noted the movements of £44.5 million for staff exit costs and £30 million for expansion of the call centres, in the Supplementary Estimate. It is expected that these changes and the related programmes within the Department will be pursued at the Sub-Committee's hearing at the Departmental Annual Report session on 5 December 2007.

However, the Committee has noted that the £30 million DEL Reserve claim is also included within the End Year Flexibility (EYF) figures in the Memorandum. If the amount is to be drawn down from EYF, then there would be no need for a Reserve claim, and vice versa. Hence, the Committee requests an explanation of why the £30 million figure is included as both a Reserve claim and within the EYF calculations.

On the take up of Departmental Unallocated Provision (DUP) of £15 million intended for direct tax compliance activity, the Memorandum states that the funding was part of the original spending plans, which was ring-fenced whilst a business case was developed. The Committee requests information on the following matters:

— The Memorandum states that the £15 million DUP is intended for direct tax compliance activity, but there is no further explanation as to what specific programmes or activities it will be used for. The Committee requests further information on the use of this £15 million, particularly in view of the fact that there was a specific need for a "robust business case" to justify the expenditure.

— The Memorandum states that the funding was part of the original spending plans. However, DUP—as per Treasury guidance contained in the glossary to the Memorandum—is for "unforeseen pressures", rather than for expected spending. The Committee requests clarification as to whether this was part of the original spending plans and if so, why this method was utilised because it appears to contradict the Treasury guidance.

Finally, the figures in the EYF table, under the Admin Resource and Other Resource headings do not appear to be correctly calculated: Admin Resource appears to be overstated by £3.9 million, and Other Resource appears to be understated by the same amount. Therefore, the Committee requests that the calculations on this table are either revised, or explained.

The Committee would be grateful for a response to the questions raised above by 30 November 2007.

22 November 2007

Letter from the Acting Chairman of HM Revenue & Customs to the Clerk of the Treasury Sub-Committee

Winter Supplementary Estimates 2007–08, 30 November 2007

Thank you for your letter of 22 November in which you raised a number of points regarding the supporting memorandum to HMRC's Winter Supplementary Estimate.

I hope that the responses below satisfactorily address the queries raised.

— £30 million Reserve claim

The information provided in the memorandum in respect of the Reserve claim in the Estimate and the negative Reserve claim entry in the EYE table appear to have been misunderstood. As background HMRC was allowed to draw down £30 million in each year for 2006–07 and 2007–08 in respect of the expansion of contact centres. The entry of −£30 million in the EYF table within this year's Winter Supplementary Estimate memorandum represents the return of the 2006–07 Reserve claim to the Treasury from our EYF reserves. The Reserve claim for 2007–08 is separate and as such is properly identified as a £30 million draw down of funds.

— £15 million Departmental Unallocated Provision (DUP)

The following is an answer to both questions on the draw down of £15 million DUP. The Treasury required that the £15 million funding for additional compliance staff for risk based compliance activity around the Construction Industry Sector could only be accessed by HMRC as voted provision once Treasury had approved its release. It was agreed with the Treasury that prior to their approval the funding should be scored as non-voted DUP, even though this is normally held for "unseen pressures". The release of this funding was approved after the Main Estimate was published; consequently the draw down took place at the Winter Supplementary stage.

— EYF Table

The following is a revision of the EYE table produced in the memorandum. The bottom line figures remain extant, but you will see that there is a change to the adjustments total. I apologise for the omission. The figures are those agreed with the Treasury in July.

DEL End-Year Flexibility

The 2007–08 EYE stock for HMRC was reported in the Public Expenditure Outtum White Paper 2006–07 (PEOWP) (Cm 7156). The breakdown below shows changes since the spring supplementary for 2006–07. EYE prior to this was provided in the Main Estimate Memorandum for 2007–08.

£000	*Admin Resource*	*Other Resource*	*Total Resource*	*Of which:*		*Capital*
				Near-cash	**Non-cash*	
06–07 EYF not taken up	61,404	46,517	107,921	139,460	−31,539	—
06–07 underspend	26,676	17,714	44,390	43,390	1,219	32,718
Reductions for Reserve claims	−30,000	—	−30,000	−30,000	—	—
Other adjustments	3,745	−1,125	2,620	3,159	−539	539
PEOWP (July 2007)	61,825	63,106	124,931	155,790	−30,859	33,257
Take-up in Winter Supplementary Estimate	—	−1,400	−1,400	−1,400	—	—
Balance of EYF After Winter Supplementary	61,825	61,706	123,531	154,390	−30,859	33,257

This Supplementary Estimate draws down EYF near-cash of £1,400,000 other resource, for use on administration.

* The negative values appearing in the non-cash column of figures represent an overspend in non-cash. Where this occurs the near cash total will exceed the figures in the total resource column.

The stock of EYE is to be used to:

— Enable the release of staff under our exit strategies.

— Maximise non-staff efficiency gains by centralising procurement, using flexibilities in Estates contract and making sound commercial decisions on the management of the IT contracts.

— To modernise and transform HMRC.

November 2007

Further supplementary memorandum submitted by the HM Revenue & Customs

This Memorandum responds to the Sub-Committee's requests at the hearing on 5 December.

The Committee asked if we have a figure for what the cost of calls to the Child Benefit helpline would have been to users [Q 367]

We have looked into the cost in more depth and find that we still can not provide the Committee with a figure.

The cost of calls to "non geographic" numbers such as 0845, 0870 and 0800 is dependent on several factors. Calls are charged to the customer based on the tariff arrangements they themselves have with their own telephone service provider, the device they use for the call and the location from which they call. This is customer information which HMRC does not hold and it is therefore not possible for us to estimate the cost of calls.

Our current policy is to operate customer facing helplines using 0845 prefix as the department believes this strikes the right cost balance between the customer and the public purse. HMRC does not make any money from using 0845 numbers. Using a non geographic prefix—such as 0845—allows us to:

- exploit, cost effectively, modern contact centre technology to best advantage;
- direct calls to the next available adviser anywhere in the country; and
- have shorter queues, shorter waiting times and fewer customers get engaged tones and busy messages.

The Committee asked which version of WinZip was used for compression and what was the form of the password [Q 391]

As Mr Hartnett explained in his evidence to the Committee, the data was password protected using WinZip version 8. The level of encryption is not considered sufficient to protect the data. We have now upgraded to 256 bit encryption with at least a 20 character password. Publication of any further detail about the specific password used will be considered as part of the Poynter Review, taking into account the need to prevent any further risk that data might be misused.

The Committee asked when the police were advised of the data loss [Q 394]

As the Chancellor of the Exchequer explained in his statement to the House on 20 November 2007 (*Official Report*, Column 1101), on Wednesday 14 November he instructed the then Chairman of HMRC to call in the Metropolitan Police to conduct a full investigation. The Chairman formally notified the Police on Thursday 15 November.

The Committee asked for details of staff bonus payments for 2005–06 and 2006–07 [Qq 401–11]

END OF YEAR PERFORMANCE MANAGEMENT BONUSES PAID (FINANCIAL YEAR)

	2006–07	*2005–06*
£m		
SCS	1.7	1.5
Others	17.2	9.7
Total	18.9	11.0
Number of bonuses		
SCS	220	311
Others	37,959	35,605

2006–07 was the first year that bonus payments were made under the new integrated HMRC performance pay arrangements. These arrangements are aimed at rewarding individual performance, through bonus payments, thereby driving up performance within the department. HMRC's bonus pot for staff below SCS is currently 0.8%.

The Committee asked whether any guidance has been given to the intelligence teams to concentrate on the Channel ports [Q 422–3]

Our intelligence officers have not been given guidance to concentrate only on ports and airports approved for international arrivals and departures. We have officers who specialise in securing intelligence in respect of unapproved ports and airports. The intelligence is used for law enforcement activities within HMRC and by the police.

The Committee asked for details of employment, including part-time and casual employment, for security at buildings [Q 426]

Of the 227 security guards employed by HMRC, including day security, we have only 9 fixed term appointment (FTA)/agency staff (just under 4%) engaged in security activities. Additionally FTA staff are not allowed to take up guarding activities until they have been cleared by the Counter Terrorist Check vetting procedure. There are no part-time security staff.

The Committee asked whether the contract given to Mapeley for security staff was subject to competitive tender [Q 489]

The Estates PFI contract, which includes the provision of security guarding services, was subject to full competitive tender. At the time that this contract was let, the former Departments took the decision to retain any existing in-house security guarding. The buildings covered by in-house arrangements are relatively few in number because the majority of the Department's buildings are secured by external security providers. There are a total of 120 buildings on the estate which have guards providing security and of these, 22 sites have in-house security guards.

The Committee asked for statistics on VAT registration targets, performance and complaints [Q 493]

2007	*August*	*September*	*October*	*November*
Applications received	21,891	19,947	21,219	23,181
% processed in 14 days[9]	14.4%	19.75%	45.45%	57.57%
Average time to process (days)[10]	42	39	28	18
Number of cases unstarted	30,905	25,619	5,862	1,756
Number of complaints received	155	115	100	71

January 2008

[9] Percentage of cases processed in the month that were processed in 14 days.
[10] Average time to process a case processed this month.

Printed in the United Kingdom by The Stationery Office Limited
3/2008 382510 19585