



House of Commons
Treasury Committee

**Administration and
expenditure of the
Chancellor's departments
2007–08: Government
Response to the
Committee's First Report
of Session 2008–09**

**Second Special Report of Session
2008–09**

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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 Dr John Benger (Clerk), Sian Woodward (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young, Jay Sheth and Cait Turvey Roe (Committee Specialists), Phil Jones (Senior Committee Assistant), Caroline McElwee (Committee Assistant), Gabrielle Henderson (Committee Support Assistant) and Laura Humble (Media Officer).

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Second Special Report

The Treasury Committee published its First Report of Session 2008–09, Administration and expenditure of the Chancellor's departments 2007–08, on 23 January 2009, as House of Commons Paper No. 35. The Government Response to this Report was received on 2 April 2009.

Appendix: Government Response

On 23 January 2009, the Treasury Committee published its First Report of Session 2008–09, Administration and expenditure of the Chancellor's departments, 2007–08 (HC 35). This memorandum contains the Government's response to that Report.

The Treasury Group's own resources

1. We note the ongoing underspending against estimate by the Treasury Group and we are concerned that this may represent under-delivery or poor estimate preparation. We recommend that the Government takes steps to ensure that the Treasury presents an accurate estimate to parliament and delivers against the approved estimate. (Paragraph 9)

The Government accepts the Committee's recommendation, in so far that it is continuously seeking to improve its financial management practices. The Treasury aims to present estimates to Parliament that are as accurate as possible in the light of information which is available at the time they are laid. This year the Treasury has included additional scrutiny and challenge to managers' resource plans, to ensure that they reflect as accurately as possible the anticipated costs of their delivery plans, and has revised its processes for monitoring their delivery against those plans. In respect of the underspend against estimates in 2007–08, the Committee will have noted the explanation of variances between estimate and outturn in Note 3.2 to the HM Treasury Resource Accounts 2007-08 (HC 539), which were not the result of deficiencies in either delivery or estimate preparation.

2. We recommend that, in its response to this Report, the Government indicates whether any of the Treasury Group's End-Year Flexibility will be transferred to other Departments or how else it might be used. (Paragraph 10)

As outlined in the Department's Annual Report for 2007–08, the Treasury's underspend was in part a result of the over-achievement of its SR04 efficiency targets. In the light of continued uncertainty in global financial markets, and the funding required to support Sir John Chadwick's review of matters relating to Equitable Life policy holders, the Treasury needs to retain as much flexibility as possible to respond to changes in circumstances and priorities that might arise in the remaining years of the CSR period. The EYF system enables the Treasury to carry forward spending power into future years. The Government does not intend to transfer any of the Treasury's EYF to other Departments, but does require that any drawdown of EYF is taut and realistic.

3. While we recognise that the quantity of staff is not the only factor in the delivery of services, we are concerned that continued headcount reductions in the Treasury Group may now leave its constituent organisations unable to provide the required economic support and management during the economic downturn. We recommend that the Government reconsider any planned further headcount reductions in the Treasury Group in the light of the demands on the Group of the economic downturn. (Paragraph 15)

The Government accepts the Committee's recommendation, and welcomes its ongoing interest in these matters. The Treasury Group regularly reviews its resource commitments and plans in the light of changing circumstances and priorities. Since July 2008 this has included an ongoing recruitment of new staff to work on financial stability issues. Nevertheless, the Treasury Group has committed to finding significant additional cash-releasing value-for-money savings over the CSR period, and will seek to recycle those savings into priority areas where additional resources are required.

4. The nationalising transactions of 2008–09 raise some complex accounting questions for the Treasury. In order to ensure that the Treasury Group's 2008–09 Annual Report and Accounts can properly be laid before Parliament before the summer adjournment, we recommend that the Treasury engages early with the National Audit Office to agree appropriate accounting treatments for the transactions surrounding the nationalised and part-nationalised banks. (Paragraph 20)

The Government accepts the Committee's recommendation. As the Committee has noted in its report (paragraph 18), the Treasury began engaging with the National Audit Office (NAO) in February 2008 over the accounting treatment of Northern Rock. Throughout this year there has been close engagement, including regular meetings and workshops, over a range of accounting issues in respect of policy announcements made since the finalisation of the 2007–08 Accounts. This constructive engagement has continued as further developments have been announced.

5. We were disappointed to note that the Treasury Annual Report was published separately to its Resource Accounts in July 2008. We recommend that, in order to aid users of the accounts, the Treasury publishes future Annual Reports and Resource Accounts in a single, combined document prior to each summer adjournment. (Paragraph 21)

The Government acknowledges the Committee's recommendation and accepts that there are benefits to be gained from publishing a combined document prior to the summer adjournment. Working with the NAO, the Treasury Group is aiming to produce a combined document in 2009, and will keep the Committee informed as these plans progress.

6. By nationalising financial institutions, the Government has taken on responsibility for significant liabilities. In order for public scrutiny to be effectively performed, the magnitude and nature of these liabilities must be comprehensively disclosed. We recommend that the Treasury quantify and disclose the liabilities involved in the nationalisations and part-nationalisations of financial institutions. These disclosures should appear in the Treasury Group Resource Accounts, must be at least as

comprehensive as those made by major banks and should go further than meeting the minimum acceptable accounting standards. (Paragraph 23)

The Government notes the Committee's recommendation, and accepts that liabilities should be disclosed where possible. The Treasury Group's resource accounts will aim to disclose and quantify liabilities in line with appropriate accounting standards and practice, and audited by the NAO as a true and fair view. This year the accounts will also include disclosures required by Financial Reporting Standard 26 in respect of financial guarantees.

At the time of publication of the 2007-08 Resource Accounts it had not been possible to quantify certain liabilities, some of which have now been quantified and others of which will remain unquantifiable. The Treasury reported on these liabilities in its Spring Supplementary Estimates, and will continue to provide updated disclosures through its Accounts and Estimates as they become available. However, it remains likely that the 2008–09 Resource Accounts will continue to include certain unquantifiable liabilities.

The Treasury as a central department

7. We recommend that in future years the Treasury disclose the total bonus payments made to staff in their Resource Accounts. (Paragraph 24)

The Government accepts the Committee's recommendation. The Treasury is consulting stakeholders across Government on the most appropriate way to report staff remuneration in future resource accounts in preparation for revisions to the Financial Reporting Manual guidance for future years.

In the meantime, the Treasury Group's Annual Report and Accounts will include details of the performance payments made by the Treasury Group, divided by its member organisations, and on the performance pay awarded to individual members of the Treasury Board. Performance pay in this context refers to variable pay which is not consolidated into base pay and is non-pensionable.

8. We recommend that the Government ensure the Treasury is sufficiently resourced to manage its extended responsibilities arising from the economic downturn, especially those regarding financial stability. (Paragraph 28)

The Government accepts the Committee's recommendation. The Government's response to this recommendation is included in its response to recommendation 3 above.

9. Given the interest in the fully nationalised institutions of Northern Rock and Bradford & Bingley, and the Treasury's role in their governance, we recommend that the Government publishes key performance information for these institutions within the Treasury Group's own Departmental Report and Resource Accounts. (Paragraph 30)

Audited financial information on Treasury's investments is included on a non consolidated basis in the Treasury Group's resource accounts in the form of extracts from the profit and loss accounts and balance sheets of each of the organisations concerned. Future reporting on these institutions will follow the model established with the reporting on Northern

Rock plc in relevant parts of HM Treasury's Resource Accounts 2007–08 (HC 539), including the detailed additional information reported in Note 29.

10. We recommend that the Government identify and publish performance measures for UK Financial Investments and report against these measures on a six-monthly basis. (Paragraph 32)

The Government acknowledges the Committee's recommendation, and recognises the responsibility for HM Treasury to report to Parliament on the value and performance of its investments of public money that are being managed by UKFI. The Treasury is currently considering the most appropriate way to fulfil this responsibility, and will consult the Committee on its proposals later in the year.

UK Financial Investments Ltd (UKFI) will publish an annual report, which will be laid before Parliament. The first of these will be published this summer. UKFI's Chief Executive and Chairman will be available to appear before House Committees.

A framework agreement between HM Treasury and UKFI has also been agreed and published, and copies are available in the library of the House. This sets out the relationship between HM Treasury and UKFI, UKFI's objectives, and the process through which HMT will monitor UKFI's performance. It also sets out that HM Treasury will set an Investment Mandate for UKFI, with which the Company is to comply in the management of the investments, and that the company should develop a Business Plan.

UKFI's Board will be accountable for delivery of the objectives set in the Framework Agreement, and for its progress against the Investment Mandate and its Business Plan. It should be noted that HM Treasury does not believe it would be beneficial to set or to publish quantitative performance targets for UKFI, in terms of the management of its investments, as this would be tantamount to publishing UKFI's investment strategy, which, by its nature, would be highly confidential.

UKFI's objective is:

The Company should, in compliance with the Investment Mandate described in Section 4, develop and execute an investment strategy for disposing of the Investments in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. This objective includes:

- (a) consistent with HM Treasury's stated aim that it should not be a permanent investor in UK financial institutions, maximising sustainable value for the taxpayer, taking account of risk;
- (b) maintaining financial stability by having due regard to the impact of its value realisation decisions; and
- (c) promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.

As set out in the Framework Agreement, UKFI's performance will be monitored by HM Treasury, including through:

- quarterly shareholder meetings between the Chairman of the Company and senior HM Treasury representatives to provide a forum to review performance against the roles and objectives set out in the Framework Agreement;
- meetings between Directors of the Company and representatives of HM Treasury to discuss the performance of the Company; and
- quarterly reports for HM Treasury, produced by the Company, together with their annual report—the latter will be laid before Parliament.

11. The adoption of International Financial Reporting Standards will fail if the Treasury does not assert its authority and aid departments in meeting the agreed milestones. We recommend that the Government take steps to re-emphasise to all departments the importance of meeting IFRS implementation deadlines. (Paragraph 37)

The Treasury takes its role seriously in ensuring that departments are fully aware of the importance of meeting the IFRS deadlines, and has regular communications with Finance Directors of departments to ensure that, as far as practicable, departments remain on track to meet the IFRS implementation timetable.

The Treasury maintains regular contact with departments to identify issues relating to the transition to IFRS and provides technical assistance and advice to assist departments in their successful transition to IFRS accounting.

12. We recommend that the Treasury considers not only the presentation and authorisation of expenditure but also the way in which the revised documents might best facilitate parliamentary scrutiny. (Paragraph 39)

The Government is grateful to the Committee for its ongoing involvement in, and support for the alignment project. As the Committee is aware, the Government is committed to simplifying and rationalising the financial documents presented to Parliament, to improve transparency and give Parliament the opportunity for improved scrutiny, in line with the Committee's previous recommendations. We welcome the opportunity to discuss with the Committee any further changes that could be made to the documents to facilitate scrutiny.

13. We acknowledge that the requirements of the alignment project mean that it is not possible for parliament to maintain control over gross totals. We are concerned that without adequate levels of information regarding income, parliament's authority may be diminished. We recommend that the new estimates provide appropriate levels of information relating to income. We do not wish to impose an unreasonable administrative burden on the departments and hope that a pragmatic solution can be adopted. (Paragraph 41)

The Government welcomes the Committee's helpful and pragmatic approach to this important issue. Proposals on the move to net Estimates include a range of safeguards, which will ensure that Parliament has more, and better, information than at present about income. Full information about expected income levels will still be provided in the

Estimate. In addition, there will be restrictions on the categories of income that departments may retain, to ensure that proper control and accountability is provided.

The work of the Debt Management Office

14. The increase in planned gilt issuance for 2007–8, announced in Budget 2008 reportedly surprised the market. We recommend that the Debt Management Office reviews lessons learnt from this process in order to ensure the market is better prepared in future. (Paragraph 47)

The DMO liaises very closely with the gilt market over the formulation and delivery of its financing remit. The DMO believes that the effective delivery of the gilt remit—course to raise over £146 billion this financial year—is testament to the success of this relationship.

The reported surprise which occurred at Budget 2008 can be partly attributed to some commentators in the market not having allowed for the Government's replacement, during 2008–09, of the Bank of England's loan to Northern Rock plc with direct Treasury funding in order to comply with the restrictions in the Treaty Establishing the European Community on central bank financing of government undertakings.

The DMO firmly believes that it would not have been appropriate for it to have provided any indication to the market about the likely size of the future gilt financing requirement prior to the Budget statement in Parliament, and that market participants should be left to make their own assessments based on available public information.

15. We note that the forecast gilt issuance for 2008–09 has increased from £80bn to £146.6bn. These higher levels of gilt issuance, at a time when other governments will also need to raise cash, significantly increase the risk that supply of Government debt might outstrip demand and uncovered gilt auctions might result. We note the Debt Management Office's confidence in its ability to cope with the occasional uncovered auction but we seek assurances that the Government has put in place contingency plans capable of responding to repeated uncovered auctions. (Paragraph 49)

The DMO believes that gilts and government assets more generally remain the preferred risk-free asset for major UK and international investors and are in strong demand.

The DMO also believes that the current auction system is working well and has demonstrably succeeded in raising record amounts of financing for the Government in 2008–09 raising proceeds slightly over the £146.4 billion target in 2008–09 in 58 auctions.

There was, however, an uncovered auction on 25 March 2009. At that auction, £1,750 billion (nominal) of the 4.25% Treasury Gilt 2049 was offered. The cover ratio for that auction was 0.93—so not all of the gilt was sold at the auction and the residual has been temporarily lodged on the Debt Management Account pending disposal into the secondary market in due course in accordance with the DMO's Operational Notice. While disappointing, it needs to be remembered that uncovered auctions can and do occur reflecting the pricing dynamics at the specific time of the auction. Volatility in the market affects auctions but is not under Government control. Market conditions at the time of the auction were difficult and gilt market participants' risk appetite more generally is low in current conditions. An additional factor which may have constrained the ability of the

primary dealers to participate in that auction was the imminent end-financial year and the balance sheet restrictions that this implies.

Moreover, the significant increase in the financing requirement and the number of operations being scheduled do not of themselves necessarily imply that there will be an increase in the number of uncovered gilt auctions. The gilt auction held on 26 March 2009 (i.e. the day following the uncovered auction) of the 1½% Index-Linked Treasury Gilt 2022 was successful with a bid to cover ratio of 2.72 indicating strong demand for the stock on offer. Further, the two previous uncovered auctions which have occurred since the DMO became UK Government Debt Manager in April 1998, took place in financial years when gilt sales and the number of auctions was much lower than now (£14.4 billion in 8 auctions in 1999–2000 and £26.3 billion in 13 auctions in 2002–03).

That said, the DMO acknowledges that the prospect of an uncovered auction occurring again in the future cannot be ruled out. Uncovered gilt auctions are, however, not necessarily a result of there being insufficient structural demand for gilts—rather they can be seen to indicate the lack of investor demand for the specific gilt being sold on the morning of the auction itself and/or the inability of the market to establish the clearing price in a particular auction. The lack of demand may manifest itself for a variety of market reasons, outside the control of the issuer.

The DMO's Gilt Market Operational Notice¹ (paragraph 39) describes the procedures that the DMO will follow in the event of an uncovered auction—with the unsold portion of stock created and held by the DMO in an official portfolio for a specified period prior to re-sale. In circumstances where a series of auctions failed, particularly toward the end of a financial year and where it is too late either to sell unsold amounts of previously auctioned gilts (either at a separate tender or by adding stock to a further auction of the same gilt) finance would be raised by alternative methods. Where the gilt sales programme was judged to be unable to raise the required quantum of financing the Treasury bill programme offers one potential additional source of finance, but generally, cash could be raised via money market transactions (cash management operations).

16. The unprecedented increase in gilt issuance levels in 2008–09 has created pressures for the Debt Management office staff and such pressure increases the risk of mistakes being made. We recommend that the Government review the resources of the DMO in the light of its significantly increased workload. (Paragraph 51)

The Government accepts the Committee's recommendation. The Treasury Group regularly reviews its resource commitments and plans in the light of changing circumstances and priorities, as set out in the Government's response to recommendation 3 above. The Treasury Group is allocating the necessary additional resources to the DMO for 2009–10, and will continue to keep its resources under review for future years.

Pressures on DMO staff have increased not only as a result of increases in gilt issuance but also from other activities. Management and staff spend significant time helping developments across the Treasury Group. Transaction volumes in the DMO's core cash management activity have also increased sharply.

¹ Operational Notice, Debt management Office, www.dmo.gov.uk/

New initiatives requiring significant effort in the past year have included the Special Liquidity Scheme, the Discount Window Facility, the 2008 and 2009 Guarantee Schemes and the Emissions Trading Scheme auctions on behalf of DECC. The increased range, complexity and volume of the DMO's activities require more staff to manage and control as well as execute. The DMO has increased staff levels from 86 in October 2008 to 108 in February 2009 (including temporary staff, some of which are short-term agency and contract staff working on initiatives such as the Credit Guarantee Scheme).

17. We note that 2008–09 will see a dramatic increase in the workload of the Debt Management Office and thus an increased risk of control failure. We recommend that the DMO revisit controls relating to publications in order to ensure that factual errors are minimised. (Paragraph 54)

The control regime for publications is kept under review. Already key publications, including the Quarterly and Annual Reviews, Guides to gilts and Operational Market Notices are subject to internal verification in so far as factual disclosures are concerned (from persons other than those producing the initial data). Once verification has been completed the document receives sign-off from a member of the senior management (or a person designated by senior management).

In terms of the website control regime, the DMO has recruited dedicated resources to manage the website, as part of the overall records and information management function. Relevant business units within the DMO are responsible for the content production and accuracy of documents destined for publication on the website. Preparation is handled on an internal version of the website and internal controls applied between the web team and the business units for approving web publications before they are transferred onto the external, public website. The DMO is actively reviewing record and file management processes with consideration to the further workflow automation that may be introduced.

18. We note that the DMO takes an average time of 10 minutes to publish the results of its gilt auctions compared to the 2 minute publication time achieved by other countries. While the discretionary checks performed by the DMO may account for some of this disparity, we recommend that the DMO sets a target for further reducing the delay. (Paragraph 57)

The release time for gilt auctions has continued to fall in 2008–09, to an average of 7.5 minutes for auctions in the financial year to-date (and further to 6.3 minutes in Q4 to-date).

Market participants have welcomed the significant shortening of auction release times, from an average of 20 minutes in 2006–07 (the last full year before the introduction of electronic bid capture) and, in general, have not indicated a need to reduce these much further.

The DMO believes that any further reductions should not come at the expense of operational accuracy and sufficient time to exercise due diligence over the results prior to publication. These considerations are important in order for the DMO to protect the interests of both the market and the Exchequer. The DMO, therefore, has no plans for formally setting a shorter target release time for auction results, but will continue to aim to release auction results in as short a time as practical, consistent with the above priorities.

19. We note that a technical breach within the CRND function of the Debt Management Office occurred in 2007–08. Any technical breach is a serious matter. We note that in this instance the DMO has been advised that no adverse consequences resulted, and that a review of the procedures in place has been undertaken. We recommend that the DMO undertakes regular reviews of its control environment to ensure that emerging risks are mitigated where possible. (paragraph 60)

The breach has been investigated by the DMO, it is not considered likely to result in any financial repercussions, nevertheless the controls around this area have been tightened.

The dealers' procedures manual has also been updated to reflect additional controls with wording clarified to avoid any future misinterpretation and potential breaches of the terms of prospectuses.

The DMO's internal control regime is subject to continual review and development. The DMO Risk Committee meets regularly to review all operational risks and any exceptions arising.

The Treasury Group's performance against objectives

20. We are disappointed that after three years the measurement of performance against the Government's target to reduce regional inequality remains problematic. We welcome the work of the Office for National Statistics and recommend that the Government publishes the results of the work on regional deflators as soon as it becomes available. (Paragraph 64)

The Allsopp Review outlined a series of recommendations to improve the accuracy and breadth of regional statistics. In response, the ONS is working to strengthen regional GVA data, including production of a real regional GVA series. To improve and develop regional estimates, the ONS is also involved in an ongoing quality assurance process of the input data used to calculate estimates of regional GVA. The ONS will publish their findings in due course.

21. We recommend that the Treasury reviews its reporting against its child poverty target in order to ensure that users of the accounts can easily see performance against each of the three measures individually. We are concerned that, despite assurances that the Treasury has "redoubled efforts to meet the 2010 target", it may be beginning to resign itself to failure, an attitude which will not help those children still living in poverty in the UK. (Paragraph 69)

HM Treasury reports against its child poverty target in annual and autumn reports, including progress against the three indicators: relative income, absolute income and material deprivation. The Treasury is grateful for the Committee's comments on the clarity of its performance reporting, and will take them into consideration when producing this year's reports.

In the light of the wide range of changes announced at PBR 2008 coming into effect in the coming months, the PBR announced that the Government will take stock of progress towards its 2010 and 2020 child poverty target in the Budget.

22. We are concerned by the scale and amount of CSR2004 Public Service Agreements which have been missed and recommend that the Government explains why the rate of failure against targets across departments was so great. (Paragraph 72)

The Government set challenging public service targets in the 2004 Spending Review. Currently, of those assessed, the majority of these targets are 'on course', 'met' or 'ahead', while only 5% have not been met. It should be noted that the majority of these targets have not yet received final assessment, only interim assessment. The Government's view is that public services will be improved more by setting stretching targets than if less ambitious targets had been set, even though—on a simple count of targets achieved—a less ambitious approach might appear to score better.

23. We note that achievement of the Lisbon goals will not feature in any Public Service Agreement during the CSR 2007 period. We are concerned that this omission will lead to progress against the Lisbon goals being omitted from Government reporting. We recommend that the Treasury publish within its Annual Report an update on progress against the Lisbon goals. (Paragraph 74)

Two years away from the original 2010 deadline, it is clear that the Lisbon vision will not be realised. More needs to be done to meet the Lisbon Strategy's main goals of 3 per cent growth and 70 per cent employment by 2010. However, the current strategy has set the framework that drives our long-term future prosperity. Europe is in a better place than in the past to respond to the current economic downturn.

The Treasury reported on the Lisbon Goals in its 2008 Autumn Performance Report and will continue to provide updates in its future reports.

24. The 2008–09 financial year is the first year of delivery against the Departmental Strategic Objectives and Public Service Agreements arising from the CSR2007. In our review on administration and expenditure in 2008–9 we will be examining HM Treasury's performance against these targets. (Paragraph 77)

The Government notes and welcomes the Committee's ongoing interest in the Treasury's performance against its objectives.

HM Revenue & Customs

25. We are disappointed that HRMC took 12 months to replace its Chief Executive, thereby deepening the uncertainty felt by staff members already part way through a far reaching review of HMRC's operations. We recommend that the Government ensure a full permanent senior management team is in place in HMRC as soon as possible. (Paragraph 80)

The Government acknowledges the Committee's recommendation. HMRC's Capability Review recommended that the Department should explore separate roles for a Chief Executive and a Non-Executive Chairman. Following an open recruitment process, run by the Cabinet Office, the Prime Minister announced the appointment of Mike Clasper as the new Chairman of HMRC, who took up post on 1 August 2008.

Lesley Strathie was appointed as HMRC's first Chief Executive, and Principal Accounting Officer, and took up post on 10 November 2008. As Lesley took up post, Dave Hartnett (previously Acting Chief Executive Officer) became the new Permanent Secretary for Tax.

In addition, HMRC is in the process of completing its senior management team having recently appointed a Chief People Officer, Chief Finance Officer and Director General, Business Tax, and with the forthcoming appointment of a Chief Information Officer.

26. We believe that having a 'Permanent Secretary for Tax' alongside the Chief Executive and Chairman of HMRC may obscure clear lines of accountability. We recommend that HMRC publish and widely circulate clear information on the respective responsibilities of its senior management team, including responsibility for data management. (Paragraph 82)

The Non-Executive Chairman, Mike Clasper, provides leadership and direction to the department through the HMRC Board. In addition, he plays a key role for HMRC by engaging with the Department's many stakeholders.

The Chief Executive, Lesley Strathie, is accountable for running HMRC and ensuring delivery of HMRC's Strategic Objectives, and is the Principal Accounting Officer. The Permanent Secretary for Tax, Dave Hartnett, is the senior tax professional in HMRC and has a general oversight of all tax issues but he does not have line management responsibility within lines of business. These roles have been widely published on HMRC websites.

27. It is our view that HMRC's explanation of the basis for the payment to Stuart Cruickshank is wholly inadequate. We are further unconvinced that the £88,125 received by Stuart Cruickshank represents good value for the taxpayer. We recommend that the Government ensure that all departments are adhering to best practice regarding ex-gratia payments. (Paragraph 88)

The Government notes the Committee's conclusion in respect of HMRC. However, this was not an ex gratia payment: Mr Cruickshank had a 3 year fixed term contract. He and HMRC reached a negotiated settlement and he left the Department. In this particular instance, HMRC made the payment in line with Treasury guidance, having assessed that it offered the best value for money for the public sector, taking into consideration the importance of an orderly transition in HMRC's Finance team.

Managing Public Money, the Treasury's authoritative guide to ethics in the use of public funds and the standard reference for anyone using public money in public sector bodies, sets out the conditions under which public bodies may make payments outside statutory or contractual entitlements when staff leave public service employment. It confirms that such special severance payments should be exceptional, since they could be considered novel, contentious or potentially repercussive, and that they always require Treasury approval in advance. The Treasury takes this responsibility seriously and adopts a sceptical approach to proposals for such payments, requiring departments to be able to justify and defend payments in value for money terms, taking account of legal risks, and to review their HR systems where any weaknesses are identified.

28. We note the National Audit Office's assertion that, in order to maximise the benefits of its Transformation Programme, HMRC must convince staff of its benefits. The low levels of morale within the Department are startling with profound potential impacts on both the Transformation Programme and core service delivery. We will continue to monitor the efforts made by senior management to improve matters. We seek an explanation of how Ministers will monitor and report progress. (Paragraph 92)

The Government recognises the need for HMRC to improve employee engagement. Last year HMRC established a programme of initiatives to do this. Components included:

- improving the visibility of senior leadership via Town Hall events and Staff phone ins;
- working with senior managers through the Leading the Way group;
- piloting different engagement interventions in key business areas; and
- developing the skills and confidence of front line managers.

For 2009–10 all of HMRC's Directors General have an objective in their performance contracts to improve employee engagement. To support the monitoring of achievement, HMRC is piloting the Civil Service People Survey—a full census survey that focuses on engagement. More granular analysis of the results will provide a rich seam of information that will enable HMRC to target engagement activities in a more focused manner. The pilot will provide HMRC with a benchmark, and from autumn 2009 HMRC will take part in the annual Civil Service People Survey. This will provide the opportunity to assess progress and to benchmark HMRC against other government departments.

In addition to the annual Civil Service People Survey, HMRC will continue to conduct temperature check surveys of a random sample of people each month. This will allow monitoring of interventions to assess their impact, providing an opportunity to change focus quickly if necessary, to continue to improve engagement across the department.

29. We are concerned that individuals without access to the internet, notably less well off or elderly taxpayers, may face increased levels of non-filing penalty charges following the revision to the paper filing deadline. We recommend that the Government should publish any analysis available to it of the demographic profile of those facing non-filing fees following the 31 October paper filing deadline. If such evidence is not available to the Government then it should be commissioned as a matter of urgency. (Paragraph 95)

The Government acknowledges the Committee's concern. However, before the change in the deadlines, around 84% of HMRC's elderly customers usually filed before 30 September. If a return was filed by that date, HMRC guaranteed to process the return and let the customer have a tax calculation before the payment date. The changes introduced pushed this paper deadline back to 31 October, which meant that those customers who want HMRC to calculate their tax have been given an extra month in which to file.

HMRC has had extensive discussions with individual customers who pay tax under self-assessment, and appropriate Voluntary Sector representatives about the impact of the change in the paper filing deadline, and how best the groups they represent could be helped. These discussions formed the basis of HMRC's support strategy.

Research indicates that many elderly customers are comfortable using computers, and competence and confidence amongst that group increases year on year. One of the key SA segments HMRC targeted for online filing was individual customers who were older (typically, 55 plus), and had either their own businesses or consultancies, or had middle or high management experience. These groups were targeted because they were highly computer literate and regarded computers as their preferred means of communication or transactions.

The overall result of the Self Assessment deadline changes was very encouraging. The number of customers filing online rose by 50%, and the online channel processed 69% of all SA returns. 88% of SA customers filed their return on time.

There is no indication that any one customer group has been adversely affected by the changes and filed late in significant numbers. However, HMRC is looking carefully at the results to see what further research and support is necessary for vulnerable groups in future years.

30. We recommend that HMRC disclose information regarding the financial case for individual office closures in order to allow better public scrutiny of these decisions. (Paragraph 99)

The Government does not accept the Committee's recommendation. HMRC has not drawn up 'balance sheet' type business documents setting out all the costs and savings associated with closing any particular office, because that is not the basis on which closure decisions have been made. The main reason for closing an office is that there is no longer any business need to operate from there. Specific estate savings and staff costs relating to individual buildings are not the primary consideration.

To meet government efficiency and customer service targets HMRC is restructuring all its business across the UK and generally consolidating in fewer offices. The benefits from the department's Change Programme will be realised at directorate or even departmental level in terms of overall efficiency, improvements in customer service and greater compliance. These benefits cannot be realistically allocated to specific office buildings.

31. We ask the Government to update the latest progress made by HMRC against Kieran Poynter's recommendations regarding information security. (Paragraph 103)

In his published report into the circumstances that led up to the child benefit data loss, Kieran Poynter stated that HMRC had implemented 13 of his 45 recommendations which improve data security in the Department. Since the report's publication on 25 June 2008 HMRC has implemented a further 10 recommendations, and work is continuing on the remaining 22.

Of the improvements introduced already:

- HMRC has improved staff awareness on data security and assured itself that the commercial requirements of its contractors on data security reflect those in HMRC.
- HMRC has introduced clear, simple "Golden Rules" and Data Security Pocket Rule book to all staff; and mandatory data security training for all 90,000 staff from the Chairman down.

- HMRC has established clearer lines of accountability.
- HMRC has introduced improved physical & technical controls for data movements.

Therefore, HMRC remains on target to implement all 45 recommendations by 25 June 2011 using its best endeavours, and meeting the requirements of the Information Commissioner's Office (ICO) enforcement notice.

32. We are extremely concerned by the level of fraud within HMRC. We will continue to monitor the steps taken to improve controls. To assist us in this we recommend a disclosure of immediate past known fraud levels to provide a benchmark. (Paragraph 107)

The Government shares the Committee's concerns at the levels of internal fraud reported by HMRC. The Committee can be reassured that HMRC is committed to the highest levels of integrity and will not tolerate any action by its staff that puts at risk the public's trust in the department. HMRC has robust procedures in place to identify all types of fraud and pro-actively tackles threats of this nature against the organisation, and it is always updating its procedures to improve its ability to prevent fraud.

In particular:

- HMRC has a dedicated Internal Governance (IG) team to seek out attempted internal fraud. HMRC has security, detection and reporting mechanisms and an Anti Fraud Assurance Team (AFAT), which undertakes pro-active monitoring of activity on HMRC Corporate systems and the Internet to identify, detect and deter inappropriate use.
- HMRC often works with Police forces, Serious Organised Crime Agency (SOCA) and Revenue and Customs Prosecution Office (RCPO)
- HMRC staff found to have committed fraud can expect to face prosecution and dismissal.
- HMRC's IG has a dedicated intelligence team to co-ordinate, assess and disseminate information to prevent fraud from occurring; and a prevention team to take forward a programme of work educating and raising awareness of the risk of internal fraud and learning lessons.

While the Government aims to reduce levels of fraud, they need to be placed in context: HMRC is a large organisation, employing approximately 90,000 staff; those prosecuted for fraud constitute a very small percentage of this number.

The Government is currently considering the most appropriate benchmark measure against which to report levels of fraud in the future.

33. We recommend that the Government ensure the performance against agreed targets by PFI contractors is published within Departmental Annual Reports in order to enable clearer scrutiny of these recipients of public funds. (Paragraph 110)

The Government does not accept the Committee's recommendation. The performance of major projects within departments, no matter how they are procured, is clearly an

important issue. There are already scrutiny and support mechanisms in place and it would be unhelpful to place specific additional reporting burdens on departments.

34. We recommend that HMRC reviews the contracts with its IT provider in the light of the very serious errors that have recently occurred and seeks financial compensation where appropriate. We regard it as wholly unsatisfactory that people entitled to Child Trust Fund payments should not have received them owing to the poor performance of an IT contractor. We seek assurances that the contracts drawn up with the PFI companies adequately allow for appropriate compensation to the taxpayer in the event of serious performance shortcomings. (Paragraph 114)

The Government notes the Committee's recommendation. All children born since 1 September 2002, who are the subject of a child benefit award, are eligible for the Child Trust Fund (CTF), as long as they live in the UK and are not subject to immigration control. The government provides an initial contribution of £250, and children in lower income families are entitled to a top-up (supplementary) contribution of a further £250. Recipients in this category are identified from the tax credits system.

In April 2008, HMRC identified that some CTF supplementary payments had not been made for children born in tax year 2006–07, affecting around 50,000 claimants.

The root cause was identified as a coding error in the renewal function of the tax credits IT system. This error was introduced as part of the October 2006 software release which became effective in April 2007. The function failed to match some eligible cases, which resulted in them not being selected for notification to the CTF system for the supplementary payment.

HMRC's main outsourced IT contract (Aspire) is with Capgemini. This already includes a series of provisions for redress in the circumstances of poor performance. These include:

- service credits where agreed Key Performance Indicators are not met;
- mandated liquidated damages where projects are delivered late; and
- the retention of supplier margin until quality of delivery is proven.

In addition there is an overarching contractual right for HMRC to seek damages in respect of all loss or damage caused to the Department by the default of the supplier.

It is the Department's normal practice to use some or all of these provisions whenever poor supplier performance is identified.

In the case of the missed CTF payments identified in April 2008, negotiations were concluded on 12 June 2008 and an appropriate financial compensation agreed, covering the full costs associated with that error, and all of those missed payments have now been made.

35. We note that the introduction of HMRC's new IT system has been delayed by a year. We accept that postponing the 'go live' date until testing is complete is prudent. HMRC should publish the performance targets for the new system in terms of reduced open

cases and other measures so that we may better monitor its effectiveness. (Paragraph 117)

The Government welcomes the Committee's acknowledgement of the issues in this recommendation. Open cases currently occur because either the pay and tax details of an individual are not posted to their record, or if they are posted, the correct amount of tax has not been paid and the case has not 'balanced'. When the PAYE Service is implemented, the concept of 'open cases' will cease.

The PAYE Service will deliver a single record for an individual that contains details of all their employments during the year. At the end of the year employers or pension providers send us a form P14 for everyone they have employed or paid a pension to during the year. The pay and tax details will be posted on the individual's record and the PAYE Service will automatically 'reconcile' the case.

The case will either be 'balanced', or there will be an underpayment or an overpayment. In a relatively small number of cases, where the record is missing some information and requires clerical review, a work item will be created.

HMRC is currently finalising its performance framework, key performance indicators and targets for 2009 10 and will take the Committee's recommendation into account as it does so.

The work of the Valuation Office Agency

36. Low staff morale is a risk to the quality of service delivery. We note that staff satisfaction in the Valuation Office Agency is worryingly low. We will continue to monitor management's performance in improving staff morale and safeguarding the delivery of services. (Paragraph 121)

The Government acknowledges the Committee's concerns over the level of staff satisfaction within the Valuation Office Agency. VOA management attaches considerable importance to staff morale. The November 2007 survey, showing staff satisfaction falling from 68% in February 2007 to 53% in November 2007, came at a time when many staff were very unhappy at the 2007 pay offer, and had just heard about a change programme, which included office rationalisation plans. Satisfaction had already improved to 58% by June 2008.

The June 2008 survey also had a positive response in terms of staff commitment, with 70% of people agreeing that 'wherever possible they would go the extra mile to help the VOA achieve its targets'. In terms of morale, the proportion of VOA staff whose morale is 'good' or 'very good' is 45%, some 10 percentage points higher than the norm for central Government.

The VOA's independent Investors in People assessment in October 2008 identified a number of relevant areas of good practice including:

- "The various initiatives in place which are geared towards continuous improvement, and the positive way in which the greater majority have responded to these."

- “The good sense of teamwork that exists and the greater willingness now for people to be flexible in relation to their areas of work.”

The VOA will continue to build on these and the other positive initiatives identified.

37. We note the Valuation Office Agency’s recognition that its communication with businesses affected by the revaluation of statutory ports had been deficient. We hope that the Agency can apply the lesson learnt from this situation to all future revaluations. (Paragraph 127)

The Government acknowledges the Committee’s comments. The VOA recognises that a number of businesses feel they were not kept adequately informed during the course of the ports review, nor advised sufficiently early of the likely impact, and has promptly introduced measures to improve communications in the event of any future such reviews.

It has put in place special fast track arrangements related to the handling of enquiries and appeals from ratepayers where there is a significant backdated liability for rates. It has also established processes to identify changes to port properties more quickly where the rating lists may require amendment. These include improved communication with the port operators and with the affected businesses.

For the forthcoming general Revaluation of all business properties, taking effect from 1 April 2010, the VOA will be publishing draft rating lists in the autumn of 2009. At the same time summary valuations will be sent to individual businesses, explaining the basis of the proposed new assessments so that ratepayers have advance notice. This information will also be available on its website. In any accompanying publicity, the VOA will encourage ratepayers to check the information and to raise queries with the VOA, so that any necessary amendments can be made before the 2010 lists take effect.

38. We note that Port Occupier’s are facing bills for backdated business rates that do not take account of payments they have already made to Port Operators towards rates. We recommend that the Government take steps to ensure that the financial liabilities faced by Port Occupiers take such payments into account. (Paragraph 131)

The Government does not accept the Committee’s recommendation. The cumulative rateable value of the port operators has reduced from £128 million to £84 million as a result of the review, reducing the ports’ rates liability. However, the Government cannot directly intervene between the port operators and occupying businesses, as any terms concerning liabilities for rates under operator licences or agreements are a private contractual matter between the operator and the occupier.

Ministers are meeting representatives of some of the port operators to discuss the issues involved.

39. Port businesses are facing backdated charges because the Valuation Office Agency failed to identify discrepancies in the ratings at the time of the 2005 revaluation. This mistake was compounded by the VOA’s failure to communicate changes promptly and effectively with Port businesses. (Paragraph 136)

The Government does not accept that the backdated charges are a result of VOA’s failure to identify separate occupations within the ports at the 2005 Revaluation. The original

assessments in the 2005 List were produced in good faith on the basis of information provided by the port operators and their professional advisers during 2003–2004, who were consulted by VOA as part of the process of compiling the new rating lists for the 2005 Revaluation.

Where the port operators identified separate occupiers within their hereditaments, these were separately rated. The VOA had no grounds on which to conclude that its decisions were mistaken, or to consider that parts of the ports operators' holdings were in fact separately occupied. It was only as the 2005 rating lists were compiled that, through routine rating work in the port of Southampton, it was established that further properties should be separately assessed. Action was therefore taken by the VOA to amend the list, but this action was strongly disputed by the other parties, and legal and valuation argument followed: only once that appeal had been withdrawn (in April 2006, immediately prior to a hearing by the independent Valuation Tribunal), was the VOA able to satisfy itself of the correct approach in relation to certain types of port occupation.

This led the VOA to pursue detailed enquiries of the operators of all 55 major ports in England and Wales in order to ensure consistency and fairness in the entries in the rating lists. The VOA wrote to all port operators in May 2006, as soon as the review of ports was under way, with an explicit request to the operators—who were the only organisations in possession of the full list of occupiers—to let those occupiers know of the existence of the review.

It is now clear that some operators did this and others did not. In some ports, including Hull, the VOA wrote direct to a number of occupiers in late 2006. Some port businesses have been more co operative than others in providing full details of their occupational terms to the VOA. This information is crucial in establishing the rateable occupier. Nonetheless, the VOA has, with hindsight, acknowledged that its communications with the separate businesses within the ports could have been more broadly based.

40. The Government's proposal to extend payment terms for port businesses comes too late for those firms that have already ceased to operate in the face of the huge rates bills presented. It is probable that, even with an eight-year period to pay, the backdated and prospectively increased rates bills may make many firms technically insolvent. We recommend that, in recognition of the fact that the Valuation Office Agency is to blame for the situation faced by the port firms, the Government take steps to mitigate further the difficult position faced by port businesses. (Paragraph 139)

The Government does not recognise that the Valuation Office Agency is to blame for the situation faced by port businesses in what is a complicated rating issue. The original assessments in the 2005 Lists were produced in good faith on the basis of information supplied by the port operators, and discussed between them, their professional advisers, and the VOA, as outlined in the Government's response to Recommendation 39 above.

The separate assessments resulting from the ports review are a result of additional information coming to the VOA's notice, largely as a result of its own enquiries, and with varying degrees of co-operation from the parties concerned. Whilst completion of this process took longer than was desirable, the circumstances of occupation of land and buildings by the individual port businesses varied widely.

The Government has considered options to mitigate the position faced by some port businesses. The Valuation Office Agency has not been given any discretion under the established legislation on backdating rate liability, which ensures that businesses who are correctly assessed in the Rating Lists, from the date they are compiled, are not disadvantaged when compared to others which, for whatever reason, should have been, but were not, assessed for rates.

The Government has also looked carefully at the option to prescribe the rateable value at the levels published in the April 2005 list. However, it is very difficult to see how exercising such powers would assist businesses at ports, since:

- the businesses within ports would still be rated separately from the port operator as they should be and, in some instances, were prior to 1 April 2005;
- the businesses within ports would still be faced with three years' backdated liability payable immediately on top of the liability for this year and the liability which will shortly fall due for next year; and
- the power is not itself retrospective, so it would not be possible to prescribe a value for a day before the order prescribing the value was made, yet in order to deliver some benefit to the businesses, it would be necessary to prescribe a value which generated results below the market rental value—which is the basis of assessment for rating purposes.

However, none of the other 1.7 million properties on the Business Rating lists is valued other than on the statutory basis of market rental value, and there is no clear rationale for special treatment. In particular, there is no basis on which a low rateable value could be established. The Government does not consider that it would be either fair or consistent for special rules to be applied to the rating treatment of properties now separately assessed. All commercial properties are liable for business rates and should all be assessed in the same way, to ensure that the burden of contributions to funding local government is shared fairly amongst businesses around the country.

As the Government has consistently said, in the current economic conditions it is concerned about the impact of certain backdated rates liability, and there is a general case to assist businesses receiving large unexpected backdated liabilities that have to be paid immediately, as the position for over 500 port occupiers has demonstrated.

As the Committee will be aware, the Chancellor of the Exchequer announced in the 2008 Pre-Budget Report that the Government will legislate to give businesses more time to pay in certain circumstances. Legislation has been laid before Parliament so that businesses facing such bills in those circumstances will not be required to pay their backdated liability within the financial year at present, and will be able to do so in equal interest-free instalments over 8 years.

Although the recent review of ports and the subsequent separate assessment of a number of new properties within ports highlighted the issue of the impact of backdated liability, the legislative changes implemented will apply to all ratepayers occupying properties that meet the criteria, including those in ports who meet the criteria, to benefit from a schedule of payments for backdated liability.

Further details of the process—including the qualifying criteria—are set out in the Business Rates Information Letter 2/2009² now issued to all English billing authorities. A copy of that Letter is enclosed with this Memorandum. This information allows local authorities and ratepayers to prepare to make payments by instalments over 8 years.

The Government considers that the steps it has taken to allow these extended payment terms to ratepayers with certain unexpected backdated rating liabilities are an appropriate means of ensuring that those who are liable for rates can pay them, without imposing an excessive demand in a single year.

Historic trends from the 2000 lists indicate that 3,073 new assessments were added to the rating lists in 2004 05 with a back dated adjustment to their ratings assessment of at least 33 months, of which it is estimated that at least half could have been properties qualifying for the schedule of payments scheme. Based upon this historic trend the Government estimates that 1,500 properties could therefore benefit from a schedule of payment in the next year, although some businesses will choose to pay in full and not wish to take advantage of the scheme.

In accordance with legislation capping the annual increase at the September 2008 Retail Prices Index, business rates will increase by 5% from 1 April 2009. The Chancellor announced on 31 March 2009 that businesses will now be able to pay a 2% annual increase in 2009-10 and the remaining 3% over the following two years. This measure will help businesses to smooth out rates payments over the next few years and will include those businesses coming out of transitional relief or otherwise facing changes in their level of business rates in 2009-10. This measure will help port businesses, on top of the extended payment terms for backdated bills, in the same way as other businesses.

With regard to insolvency, advice from the Government's Insolvency Service indicates that, for any business, solvency will depend both on the level of assets and liabilities, and on the directors' reasonable expectations of being able to meet their liabilities as they fall due in the future. The financial affairs of each company will differ and how the backdated liability affects them will to a large extent depend upon their existing financial state. Business rates liability is not, in and of itself, an over riding reason for a company to become insolvent: under accounting rules, the debt would indeed have to be 'booked' immediately but, where an arrangement has been made to pay by instalments, companies can discount the liability, which will mitigate the impact to some extent by effectively reducing the amount shown on the balance sheet.

The work of the Government Actuary's Department

41. We are concerned that the Government Actuary's Department's estimated net expenditure position deviates so far from its actual outturn. We do not accept that the Department is justified in building in 'headroom' of some £2.8m (38%). We recommend that GAD reviews its supply estimate process and improves budgeting to ensure the validity of forecasts and estimates laid before parliament. (Paragraph 145)

2 www.local.communities.gov.uk/finance/busrats/bus2009.htm

The Government accepts the Committee's recommendation. GAD will review its supply estimate and budgeting processes.

42. We are concerned to note that prior to 2007–08 the Government Actuary's Department were operating a bonus system which made no reference at all to performance. We recommend that the Government ensures that bonus payments are performance-based and of a reasonable scale. (Paragraph 148)

The Government acknowledges the Committee's concerns, but wishes to clarify the operation of GAD's former bonus arrangements. The bonus system put in place by GAD from 1999 did include a reference to performance: only staff with a performance appraisal marking of 3 or above, on a scale of 1 to 7, received a bonus—although all staff with a marking between 3 and 7 received the same level of bonus.

In 2007 GAD refined the system to allocate different levels of bonus to each level of performance from 3 to 7. GAD has confirmed that all bonus payments are made on a reasonable scale.

43. We note the controversy surrounding the valuation of miners' pensions and recommend that the Government Actuary's Department issues a statement addressing the risk of future liabilities being faced by the ultimate guarantor of these schemes, the UK taxpayer. (Paragraph 151)

The Government accepts the Committee's recommendation. GAD will shortly begin the valuation of the miners' pension scheme and will issue a statement as part of the publication of the valuation report.

44. We note the Government Actuary's equanimity regarding the impact of Equitable Life on the reputation of Government Actuary's Department. We hope that GAD have learnt lessons from its involvement in Equitable Life and will reflect on the findings of the Health Service Ombudsman. (Paragraph 154)

The Government notes the Committee's comments. GAD has recognised that Equitable Life clearly had an impact on its reputation, but the Parliamentary and Health Service Ombudsman's report of 2008 (which considered events in the period preceding December 2001) has had no further impact on reputation, as indicated by the Government Actuary in his evidence to the Committee. The Government Actuary's clear aim is to restore the reputation of the department in government and GAD acknowledges that this can only happen if the mistakes of the past are avoided for the future, not just in relation to Equitable Life, but also in relation to other matters, as set out in GAD's strategy, and in consequence of the 2005 Morris Review of the Actuarial Profession.³

3 Morris Review of the Actuarial Profession 2005, HM Treasury, www.hm-treasury.gov.uk/