



House of Commons  
Committee of Public Accounts

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# Whole of government accounts 2009–10

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Sixty-seventh Report of Session  
2010–12

*Report, together with formal minutes, oral and  
written evidence*

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## Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No 148).

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### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at [www.parliament.uk/pac](http://www.parliament.uk/pac). A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

### Committee staff

The current staff of the Committee is Philip Aylett (Clerk), Lori Verwaerde (Senior Committee Assistant), Ian Blair and Michelle Garratty (Committee Assistants) and Alex Paterson (Media Officer).

### Contacts

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## Summary

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In November 2011, HM Treasury published the first audited Whole of Government Accounts (WGA), covering the year 1<sup>st</sup> April 2009 to 31<sup>st</sup> March 2010. We welcome the WGA 2009-10 as a major step forward in improving transparency and accountability. The WGA reveals, for example, that at 31 March 2010 the government's public service pensions liability was more than £1,132 billion and the present value of its future commitments under PFI schemes was £131.5 billion. The WGA also shows that the government wrote off £10.9 billion in unpaid taxes and expected to have to pay £15.7 billion for outstanding clinical negligence claims.

We were surprised to find that Treasury did not have a grip on trends in some key areas of risk or plans for managing them. For example, clinical negligence claims at 31 March 2010 accounted for 15% of provisions for future government spending. Treasury now has the potential to strengthen the management of public finances if it uses the WGA to identify influences on the government's financial position, including where it is most exposed, and uses these to better anticipate the risks that it must address. The Treasury must use this opportunity better to manage these risks.

The WGA will only serve its purpose—telling us what the government owns, owes, spends and receives – if it is timely and robust. The figures in the first audited WGA are too dated because Treasury took 20 months to prepare and publish the report. Treasury must address the issues that led the Comptroller and Auditor General to qualify his audit opinion on the WGA 2009-10. A key issue is Treasury's decision to deviate from accounting standards, by omitting Network Rail, the publicly owned banks, and various other government controlled or owned bodies from the WGA. The accounts as presented by Treasury are therefore incomplete and these are important omissions. Treasury's explanation that it excluded them to align the scope of the WGA with the statistical measures of public finances prepared by the Office for National Statistics is not convincing because the WGA is a financial statement that ought to be prepared in line with generally accepted accounting practice.

The WGA includes estimates of costs several decades into the future, such as public service pensions (£1,132 billion) and nuclear decommissioning (£56.7 billion). Interpreting the movement, year on year, for these liabilities is complicated by the instability of the discount rates used to calculate the present value of future money. For example, in 2009-10 the change of discount rate from 3.2% to 1.8% was largely responsible for a £300 billion increase in the pensions liability. The discount rate for valuing pension liabilities subsequently changed again for 2010-11, to 2.9%, which will result in continuing instability in the estimate of the pensions liabilities. The rationale for settling on a particular discount rate should be transparent so that its validity can be checked.

We have previously highlighted the need for stronger accountability systems to secure effective responsibility for cost and value for money at local levels. The financial information that Treasury received from Academies, which accounted for £1.2 billion of government spending and £2.2 billion of assets during 2009-10, was of poor quality as it included unaudited data and some Academies provided no information at all. This shows

that there is a gap in accountability. This issue is likely to grow in importance as new Academies are created, alongside Free Schools, Foundation Trusts and GP consortia.

If the WGA is to provide a solid foundation for improving the management of public money, some key principles must be followed. These are set out in **Figure 1**, and provide the context for the conclusions and recommendations in this report.

On the basis of the Whole of Government Accounts for 2009-10, and the Comptroller and Auditor General's Certificate and Report,<sup>1</sup> we took evidence from HM Treasury on the information provided in the accounts, how Treasury intends to use the WGA to improve the management of public finances, and its plans for strengthening the quality of future WGAs.

#### **Figure 1: Key principles for managing public finances within the context of Whole of Government Accounts**

In considering the recommendations made in this report, the following key principles should be considered:

- As the UK's Ministry of Finance, the Treasury is responsible for managing public sector finances and for managing financial risk.
- Timely, reliable and complete information on what the government owes, owns, spends and receives provides the foundation for managing public finances.
- The WGA will help the Treasury to drive change through its management of the public sector's balance sheet.
- Clear performance measures provide a catalyst for identifying and managing risk.

Spending Teams within Treasury are responsible for ensuring that Accounting Officers do not commit to major new programmes or projects that could put the government's overall financial position at risk, both in the short term and over time

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<sup>1</sup> HM Treasury, *Whole of Government Accounts: year ended 31 March 2010*, HC 1601 November 2011

## Conclusions and recommendations

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- 1. Treasury needs to make better use of the WGA to identify and address risks to public finances.** The WGA can assist Treasury to fulfil its role as the UK's Ministry of Finance as it identifies key factors behind the government's financial position and the risks it needs to manage. However, we found that Treasury's understanding of some aspects of the WGA was poor. This shows why the exercise is so important. For instance the Treasury showed surprise at the estimated £10.9 billion in outstanding tax and it had no knowledge of recent trends in clinical negligence claims or whether plans were in place to reduce the estimated £15.7 billion cost to taxpayers of meeting these claims. The Treasury should use the WGA specifically to identify key risks to public funds and ensure bodies included in the WGA can demonstrate that they are addressing them effectively. As the WGA shows the net liability and deficit and how these have arisen, given their size, Treasury should produce a plan setting out how it intends to reduce these and a timetable for when they will be reduced to acceptable and affordable levels.
- 2. The WGA has the potential to inform new decision-making and longer-term fiscal planning by providing the fuller and wider context for decisions involving new financial commitments.** The accounts show that the total effect of individual decisions can be very significant. For example, at 31 March 2010 the combined value of individual commitments made through PFI deals was £131.5 billion and the present value of future spending on nuclear decommissioning was £56.7 billion. These insights are important when considering the affordability of investing in new infrastructure including nuclear energy, or in considering new PFI schemes. Treasury should require its Spending Teams to confirm that decisions taken by accounting officers on new projects and programmes are affordable over time and have been made with an understanding of the comprehensive impact of individual commitments on the aggregate financial position.
- 3. The WGA needs to be unqualified if it is to be an authoritative resource for accountability and decision-making.** The Comptroller and Auditor General qualified his opinion on the WGA 2009-10 for reasons that included the inconsistent application of generally accepted accounting practice. Treasury should show how and when it intends to address and resolve each of the reasons for the qualification in future accounts. It should also take a more active role in working with government bodies whose individual accounts have been qualified to resolve the causes of the qualification.
- 4. Treasury's decision to exclude Network Rail, the government-owned banks and various other government controlled or owned organisations from the WGA is inconsistent with accounting standards and results in assets and liabilities being significantly understated.** Treasury's explanation that it excluded these organisations to align the WGA with statistical measures of public finances prepared by the Office for National Statistics is not convincing. It could not articulate why Higher Education Institutions are excluded from the WGA when Further Education Colleges are included. The WGA is a set of financial statements that should follow

generally accepted accounting practice, and Treasury did not even apply the definition used by the Office for National Statistics consistently. Treasury should prepare the WGA on a consistent basis and, in line with international financial reporting standards, include Network Rail, the publicly-owned banks and other organisations that are controlled by the government.

5. **It is difficult for users to interpret underlying trends in long term liabilities, such as pensions and nuclear decommissioning, because of inconsistency and, more importantly, volatility in the discount rates used.** Discount rates are used to calculate the present value of future money. The WGA for 2009-10 used different discount rates to estimate the cost of public service pensions and nuclear decommissioning. Even worse, the discount rate used to estimate the pensions liability changed from 3.2% to 1.8% during 2009-10, increasing the net liability by £300 billion. Treasury should be transparent in explaining its reasoning for adopting a particular discount rate and should apply that rate consistently when estimating long term liabilities and identify ways to minimise volatility in this rate.
6. **The poor quality of data supplied by Academies and the absence of sanctions shows there is a gap in accountability.** The information provided by Academies, which in 2009-10 accounted for £1.2 billion of government spending and held assets of £2.2 billion, was generally poor, and five Academies provided no information at all. This issue is likely to become more important with the creation of new Academies and other organisations that deliver local services such as Free Schools, Foundation Trusts and GP consortia. We have made recommendations in earlier reports about the importance of strong transparency and accountability when services are devolved. Treasury should ensure that local bodies, including those that are being newly established, are obliged to prepare transparent, timely and accurate information in a suitable format, and it should apply appropriate sanctions for non-compliance.
7. **The information contained in the WGA is out of date because Treasury took 20 months to prepare it, which is around three times as long as it takes other countries to prepare consolidated government accounts.** Other countries have prepared consolidated accounts in seven months or less. The time taken to prepare the WGA for 2009-10 is in part due to the WGA having a wider scope than accounts produced by other countries but we also recognise that these are the first audited accounts prepared for the whole of government. The preparation of the WGA can nevertheless be accelerated, and Treasury should develop plans with interim milestones that clearly set out how it and the organisations covered in the WGA will deliver the next WGA faster.

# 1 Achieving the WGA's full potential

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1. The WGA for 2009-10 is the first audited account of UK government income and expenditure, and recording what Government owns and owes. The accounts cover some 1,500 organisations across central government, local government, the devolved administrations, the health service and public corporations.<sup>2</sup> Treasury, which is responsible for preparing the accounts, expects that the WGA will improve transparency and accountability by providing a complete set of data that is prepared on a consistent basis and which complements existing statistical sources of information on public finances.<sup>3</sup>

2. The WGA shows that at the end of 2009-10 the government had a net liability of £1,212 billion and a deficit for the year of £164.5 billion.<sup>4</sup> The information contained in the WGA should enable Treasury to identify the main drivers of this overall financial position which, in turn, would allow it to take specific and more effective action to address emerging issues and trends and manage key financial risks across government. For example, the WGA shows that unpaid taxes are a significant issue, with £10.9 billion having been written off at 31 March 2010. Furthermore, claims for clinical negligence outstanding at 31 March 2010 could cost taxpayers £15.7 billion, or 15% of the government's total provision for future expenses arising from events that have happened in the past.<sup>5</sup> Treasury thought that the position on unpaid taxes had improved, but did not know that clinical claims recorded by the National Health Litigation Authority had increased by some 31% in 2010-11 or what plans were in place to reduce liabilities for clinical negligence.<sup>6</sup>

2. The largest individual provision in the WGA relates to the future costs of decommissioning existing nuclear facilities, particularly at Sellafield and other former nuclear power plant sites, for which a provision of £56.7 billion had been made at 31 March 2010.<sup>7</sup> Treasury told us that over the past two or three years the nuclear provision had remained in broadly the same territory.<sup>8</sup> In fact, the estimated cost of decommissioning civil nuclear sites managed by the Nuclear Decommissioning Authority, which accounts for most of the provision for nuclear decommissioning, had increased by 9% since March 2010, from £43.1 billion to £47.1 billion.<sup>9</sup>

3. The Comptroller and Auditor General told us that he would expect Treasury, as the UK's Ministry of Finance, to methodically examine the whole range of government liabilities and consider whether they are acceptable and how to manage them. Treasury admitted that there is more it could do to identify specific areas for attention.<sup>10</sup>

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2 Q 36; C&AG's report on *Whole of Government Accounts 2009-10*, para 7.5

3 C&AG's report, para 7.4

4 C&AG's report, paras 7.32-7.33

5 Qq 83, 112

6 Qq 84-87, 113

7 Qq 69, 73

8 Q 69

9 Nuclear Decommissioning Authority, *Annual Report and Accounts 2010-11*, page 23

10 Q 88

4. The WGA illustrates how individual spending commitments can accumulate to create significant liabilities for government over time. In particular, PFI deals had created future obligations of £131.5 billion at 31 March 2010, which was four times the value of the assets secured through these deals.<sup>11</sup> This shows that, when considering the affordability of investment in infrastructure projects, Treasury and individual government bodies must take into account the comprehensive and total cost of all such commitments as well as the value for money of individual transactions.<sup>12</sup>

5. The Comptroller and Auditor General qualified his audit opinion on the WGA for 2009-10. Experience in Australia, New Zealand and Canada, all of whom prepare consolidated accounts for central government, show that it is a realistic goal to receive an unqualified opinion.<sup>13</sup> There are areas where Treasury should be able to make rapid progress, for example, by including the Bank of England in the next WGA and, over time, aligning the way in which central and local government value their assets.<sup>14</sup> However, there are other areas where Treasury expects qualifications to remain for some time due to, for example, its policy decision not to follow generally accepted accounting practice when setting the boundary for the WGA. There are also on-going issues leading to the qualification of the accounts of bodies, such as the Ministry of Defence, which are included in the WGA, some of which are serious enough to cause a qualification of the WGA too.<sup>15</sup>

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11 Q 39

12 Qq 42, 48

13 Q 2

14 Q 2

15 Qq 2-5

## 2 Ensuring the Whole of Government Accounts is fit for purpose

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6. The most suitable basis for determining which organisations to include in a set of consolidated financial statements for the whole of government is generally accepted accounting practice. In setting the boundary for the WGA, Treasury chose to adopt statistical standards used by the Office for National Statistics on the grounds that it would allow international comparisons of fiscal policy.<sup>16</sup> This decision resulted in the omission from the WGA of a number of significant organisations that are controlled, funded or owned by government.<sup>17</sup>

7. One of the main omissions from the WGA was Network Rail. Treasury's position is that the government does not seek to exert control over Network Rail and, according to the Office for National Statistics, it is not a public sector body. Yet all of Network Rail's debts are guaranteed by the government and, in line with the international accounting standards, Network Rail should have been included in the WGA for 2009-10 as it is controlled by the government. Treasury has the discretion, given to it by Parliament, to incorporate Network Rail into future WGAs.<sup>18</sup>

8. Treasury also excluded a number of other organisations, notably the publicly-owned banks, even though they are classed as being owned and controlled by government under both accounting and statistical standards. For some of these organisations, such as the Bank of England and the operator of the East Coast Main Line, Treasury intends to include them in future WGAs.<sup>19</sup> However, Treasury told us that it would not include the Royal Bank of Scotland or Lloyds Banking Group because it believes it would cost several hundred thousand pounds to do so and it expects public ownership of these banks to be temporary.<sup>20</sup> Treasury's opinion on how long individual organisations will be owned by government is not, in our view, a valid basis for setting the boundary of the WGA.<sup>21</sup>

9. The exclusion of some other organisations, such as Parliament and the National Audit Office, is appropriate because they are not controlled by the Executive arm of government.<sup>22</sup> However, Treasury could not articulate why Higher Education Institutions are excluded from the WGA on the grounds of their independence from government when Further Education Colleges, which have some independence, should be included.<sup>23</sup>

10. Changes in the discount rates used to calculate the present value of future payments have had a significant effect on the liabilities reported in the WGA. For example, the net

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16 Q 9

17 Q 4

18 Qq 4-9, 13, 36

19 Qq 25, 31

20 Qq 21, 24, 28

21 Q 25

22 Q 10

23 Qq 16-20

public sector pensions liability increased by around £300 billion to £1,132 billion during 2009-10, largely as a result of the discount rate reducing from 3.2% to 1.8%.<sup>24</sup> The discount rate used to calculate pension liabilities has since changed to 2.9%, which is likely to significantly reduce the pension liability shown in the WGA in 2010-11.<sup>25</sup>

11. Treasury reviews the guidance it issues on discount rates annually. The rates used to calculate pension liabilities have changed regularly because they track changes in yields on corporate bonds.<sup>26</sup> But changes in corporate bond rates are not directly relevant to the funding of public sector pension liabilities, which will be funded out of future taxation or borrowing at gilt rates.<sup>27</sup>

12. Academies accounted for £1.2 billion of government spending during 2009-10 and £2.2 billion of assets at 31 March 2010. The information they provided to Treasury for the WGA was of insufficient quality and, because they have adopted a financial year end of 31 August rather than 31 March, was unaudited.<sup>28</sup> Five Academies submitted no information, and apparently were not sanctioned for their failure to do so.<sup>29</sup> We have previously emphasised the need for stronger accountability systems at local level, and would have expected Treasury, as Finance Ministry, to have given clear guidance to prevent such problems occurring.<sup>30</sup>

13. The increase in the number of Academies, alongside the creation of Free Schools, Foundation Trusts and GP consortia, will increase the risks to transparency and accountability.<sup>31</sup> Treasury is responsible for advising public bodies on what information they need to provide for the WGA, and told us that a framework was being established to ensure that all Academies have accounting officers who are personally responsible for ensuring compliance.<sup>32</sup>

14. The figures presented in the WGA were some 20 months out of date when they were published.<sup>33</sup> Other countries that have produced consolidated government accounts did so in seven months or less. The time taken by Treasury is partly due to the WGA for the UK being considerably wider in scope than similar accounts produced by other countries, which do not include figures for local government or states. Nevertheless, Treasury accepted that it ought to produce WGAs more quickly, and its ultimate goal is to be in a position to prepare them within nine months.<sup>34</sup>

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24 Q 52; HM Treasury, *New discount rate for valuing pension liabilities*, Public Expenditure System paper PES (2010) 03

25 Q 52; HM Treasury, *New discount rate for valuing pension liabilities*, Public Expenditure System paper PES (2010) 17

26 Qq 80, 82

27 Qq 52, 56-57

28 Qq 91, 102-103

29 Q 96

30 Qq 102, 104-105

31 Qq 94, 104

32 Q 91

33 Q 83

34 Q 36

# Formal Minutes

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**Monday 30 January 2012**

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon

Matthew Hancock

Chris Heaton-Harris

Meg Hiller

Fiona Mactaggart

Austin Mitchell

Nick Smith

Ian Swales

Draft Report (*Whole of Government Accounts 2009-10*) proposed by the Chair, brought up and read.

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

Paragraphs 1 to 14 read and agreed to.

Conclusions and recommendations 1 to 7 read and agreed to.

Summary read and agreed to.

*Resolved*, That the Report be the Sixty-seventh Report of the Committee to the House.

*Ordered*, That the Chair 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.

Written evidence was ordered to be reported to the House for placing in the Library and Parliamentary Archives.

[Adjourned till Wednesday 1 February at 3.00pm]

## Witnesses

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**Monday 5 December 2011**

*Page*

**Sir Nicholas Macpherson KCB**, Permanent Secretary, **Andrew Hudson**,  
Accounting Officer for Whole of Government Accounts, and **Karen Sanderson**,  
Deputy Director for Financial Management, HM Treasury

Ev 1

## List of printed written evidence

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1 ICAEW

Ev 16

2 HM Treasury

Ev 18

# List of Reports from the Committee during the current Parliament

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

## Session 2010–12

First Report	Support to incapacity benefits claimants through Pathways to Work	HC 404
Second Report	Delivering Multi-Role Tanker Aircraft Capability	HC 425
Third Report	Tackling inequalities in life expectancy in areas with the worst health and deprivation	HC 470
Fourth Report	Progress with VFM savings and lessons for cost reduction programmes	HC 440
Fifth Report	Increasing Passenger Rail Capacity	HC 471
Sixth Report	Cafcass's response to increased demand for its services	HC 439
Seventh Report	Funding the development of renewable energy technologies	HC 538
Eighth Report	Customer First Programme: Delivery of Student Finance	HC 424
Ninth Report	Financing PFI projects in the credit crisis and the Treasury's response	HC 553
Tenth Report	Managing the defence budget and estate	HC 503
Eleventh Report	Community Care Grant	HC 573
Twelfth Report	Central government's use of consultants and interims	HC 610
Thirteenth Report	Department for International Development's bilateral support to primary education	HC 594
Fourteenth Report	PFI in Housing and Hospitals	HC 631
Fifteenth Report	Educating the next generation of scientists	HC 632
Sixteenth Report	Ministry of Justice Financial Management	HC 574
Seventeenth Report	The Academies Programme	HC 552
Eighteenth Report	HM Revenue and Customs' 2009-10 Accounts	HC 502
Nineteenth Report	M25 Private Finance Contract	HC 651
Twentieth Report	Ofcom: the effectiveness of converged regulation	HC 688
Twenty-First Report	The youth justice system in England and Wales: reducing offending by young people	HC 721
Twenty-second Report	Excess Votes 2009-10	HC 801
Twenty-third Report	The Major Projects Report 2010	HC 687

Twenty-fourth Report	Delivering the Cancer Reform Strategy	HC 667
Twenty-fifth Report	Reducing errors in the benefit system	HC 668
Twenty-sixth Report	Management of NHS hospital productivity	HC 741
Twenty-seventh Report	HM Revenue and Customs: Managing civil tax investigations	HC 765
Twenty-eighth Report	Accountability for Public Money	HC 740
Twenty-ninth Report	The BBC's management of its Digital Media Initiative	HC 808
Thirtieth Report	Management of the Typhoon project	HC 860
Thirty-first Report	HM Treasury: The Asset Protection Scheme	HC 785
Thirty-second Report	Maintaining financial stability of UK banks: update on the support schemes	HC 973
Thirty-third Report	National Health Service Landscape Review	HC 764
Thirty-fourth Report	Immigration: the Points Based System – Work Routes	HC 913
Thirty-fifth Report	The procurement of consumables by National Health Service acute and Foundation Trusts	HC 875
Thirty-seventh Report	Departmental Business Planning	HC 650
Thirty-eighth Report	The impact of the 2007-08 changes to public service pensions	HC 833
Thirty-ninth Report	Department for Transport: The InterCity East Coast Passenger Rail Franchise	HC 1035
Fortieth Report	Information and Communications Technology in government	HC 1050
Forty-first Report	Office of Rail Regulation: Regulating Network Rail's efficiency	HC 1036
Forty-second Report	Getting value for money from the education of 16- to 18-year olds	HC 1116
Forty –third Report	The use of information to manage the defence logistics supply chain	HC 1202
Forty-fourth Report	Lessons from PFI and other projects	HC 1201
Forty-fifth Report	The National Programme for IT in the NHS: an update on the delivery of detailed care records	HC 1070
Forty-sixth report	Transforming NHS ambulance services	HC 1353
Forty-seventh Report	Reducing costs in the Department for Work and pensions	HC 1351
Forty-eighth Report	Spending reduction in the Foreign and Commonwealth Office	HC 1284
Forty-ninth Report	The Efficiency and Reform Group's role in improving public sector value for money	HC 1352
Fiftieth Report	The failure of the FiReControl project	HC 1397

Fifty-first Report	Independent Parliamentary Standards Authority	HC 1426
Fifty-second Report	DfID Financial Management	HC 1398
Fifty-third Report	Managing high value capital equipment	HC 1469
Fifty-fourth Report	Protecting Consumers – The system for enforcing consumer law	HC 1468
Fifty-fifth Report	Formula funding of local public services	HC 1502
Fifty-sixth Report	Providing the UK's Carrier Strike Capability	HC 1427
Fifty-seventh Report	Oversight of user choice and provider competition in care markets	HC 1530
Fifty-eighth Report	HM Revenue and Customs: PAYE, tax credit debt and cost reduction	HC 1565
Fifty-ninth Report	The cost-effective delivery of an armoured vehicle capability	HC 1444
Sixtieth Report	Achievement of foundation trust status by NHS hospital trusts	HC 1566
Sixty-first Report	HM Revenue and Customs 2010-11 Accounts: tax disputes	HC 1531
Sixty-second Report	Means Testing	HC 1627
Sixty-third Report	Preparations for the roll-out of smart meters	HC 1617
Sixty-fourth Report	Flood Risk Management	HC 1659
Sixty-fifth Report	DfID: Transferring cash and assets to the poor	HC 1695
Sixty-sixth Report	Excess Votes 2010-11	HC 1796
Sixty-seventh Report	Whole of Government Accounts 2009-10	HC 1696



# Oral evidence

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## Taken before the Committee of Public Accounts on Monday 5 December 2011

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon  
Stephen Barclay  
Jackie Doyle-Price  
Matthew Hancock  
Meg Hillier

Joseph Johnson  
Austin Mitchell  
Miss Chloe Smith  
Nick Smith  
James Wharton

**Amyas Morse**, Comptroller and Auditor General, National Audit Office, and **Paula Diggle**, Treasury Officer of Accounts, gave evidence. **Steven Corbishley**, Director, National Audit Office, **Ed Humpherson**, Assistant Auditor General, National Audit Office, and **Marius Gallaher**, Alternate Treasury Officer of Accounts, HM Treasury, were in attendance.

### WHOLE OF GOVERNMENT ACCOUNTS

#### Examination of Witnesses

*Witnesses:* **Sir Nicholas Macpherson KCB**, Permanent Secretary, HM Treasury, **Andrew Hudson**, Accounting Officer for Whole of Government Accounts, HM Treasury, and **Karen Sanderson**, Deputy Director for Financial Management and Reporting, HM Treasury, gave evidence.

**Q1 Chair:** Welcome everyone, and welcome to Chloe Smith, who has joined us. You are lucky, because the tradition is that you only have to come here once, whereas we have to get our brains around things twice a week. We work very closely with Treasury, I hope—I think Nick would agree—and hopefully we can contribute to the improvement of value for money for Government and the taxpayer. I also welcome the honourable John Cheyo, who is with us today from Tanzania. I hope you find our proceedings helpful, and I am sure that we can learn from you, too.

Let me begin the questioning. We want to start with some general observations and then move to some specific ones. First, generally, this Committee very much welcomes the work that has gone into producing this document. It will be hugely important to us over time. I shall ask you a broad question: how do you think the publication will, rather than just being an interesting document per se, improve the quality of decision making and financial management across Government over time?

**Sir Nicholas Macpherson:** I think that it is more than an interesting document. It will improve financial management over time. I would particularly focus on those areas covered in the accounts that, historically, have not been picked up by more traditional national accounts methods. I mention one area that has always been regarded as particularly important by this Committee, namely privately financed assets. Another area is public service pensions, which, again, have been discussed many times by this Committee.

Over time, I would expect the information contained in these accounts to inform economic decision making. It is striking that the Office for Budget Responsibility has already picked up the information in the Whole of Government Accounts. It will result

in far better understanding of some of these issues. It will make a difference. Will it make a massive difference? Well, it is in the nature of these accounts that they are produced annually with a lag. If you are in the economic policy decision-making business, you kind of need monthly figures—up-to-date figures—and my guess is that the national accounts information will continue to inform short-term policy making, but the Whole of Government Accounts will make quite a big difference to issues around longer-term sustainability. The OBR's report, which it produced in July, around the sustainability of the public finances is where it will make the most difference.

**Q2 Chair:** If the accounts are important, it is clearly important to ensure that they are unqualified accounts. I cannot remember, but there is a picture somewhere—page 47—that shows that Australia, New Zealand and Canada now have them unqualified. Actually, New Zealand had them unqualified from the word go. Obviously, they have been going longer than us, but how long are you aiming to have before we get a series of unqualified Whole of Government Accounts?

**Sir Nicholas Macpherson:** I think that there are a number of areas where we can make quite rapid progress. There will be entities that we can bring inside the accounts; for example, the Bank of England will come into them next year. In terms of accounting practice, it seems likely that local government will bring their assets on to a similar IFRS basis. There may, though, be areas where I could envisage a difference of view remaining for some time. For example, it was a decision of the previous Government, upheld by this Government—indeed, it is reflected in the original Act that legislated for

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Whole of Government Accounts—that the Treasury will determine the boundary.

So far, the Treasury Ministers' view, to ensure that there is a higher quality of debate, is to try to align the boundary as much as possible with national accounts' treatment. National accounts take the view that Network Rail is outside the public sector. Under IFRS, the National Audit Office's view is that Network Rail is within the public sector. There is no single right answer on this. National accounts are supervised by an independent body. I would argue that Sir Michael Scholar, who is chairman of the UK Statistics Authority, is just as independent as the excellent Amyas Morse, but in a sense, we have to make sense of these different views. It may be that a future Government decide to bring Network Rail within the ambit, because it is just easier. I am sure that there will be many people around this table who will think of Network Rail, if you really look at it and at all those guarantees, "Who is really in control of it?"

For the moment—not for the moment; it is Government policy—we will stick with that boundary. On that basis, I could see our continuing to be qualified for some time to come.

**Q3 Chair:** We will come back to the Network Rail issue, because a number of Members want to raise that. One issue that makes the accounts qualified is the fact that you have 29 public accounts that are qualified. If you could actually sort that lot out—some of which, such as DWP, have been qualified for ever and ever—that would give greater credibility. If you really want this to be a useful document, would it not be better to have that credibility?

**Sir Nicholas Macpherson:** I share your desire to minimise the number of qualified accounts. In some areas, that will be quite easy; in other areas it will require more work—there is a lot of work going on in the Ministry of Defence around its inventories and so on, and there are perennial issues that this Committee has in relation to social security and tax credits—but I am an optimist. I would like to see, over time, a world in which we had no qualified accounts. On the other hand, the NAO rightly has high standards, so I cannot guarantee that we will ever quite get there, but I am certain that we can get to a better place. It is the accounting officer in the individual Department who is ultimately responsible for its accounts, but the Treasury shares with you an interest in better financial management, and we will be doing what we can from our end—often working with the NAO—to try to ensure that better systems are put in place.

**Q4 Chair:** Let us come back to the issues. The key issues that the NAO identifies are the wholly owned banks and Network Rail. I then want to come back to education institutions, but let us take Network Rail first, because you mentioned it. It just seems to me totally controlled. The way that it is defined under the accounting standards, in terms of where the control lies, makes it very difficult to argue that Network Rail operates independently of Government. I know that it was a diktat made under the previous Government, not this Government, so it is not a political or partisan point that I am making, but it seems jolly difficult to

justify. All the inquiries that we have done here on Network Rail and whether or not it provides value for money suggest that the benefits of bringing it in and accounting for it properly in Government accounts go beyond the niceties of the standards, and would enable this Committee to assess value for money, so that the taxpayer and the fare payer are guaranteed better value out of massive public investment.

**Sir Nicholas Macpherson:** As I said earlier, that is a point of view that many share. The counter view, which is taken by the Office for National Statistics, is that in terms of corporate policy at Network Rail, the Government do not control it. That is why the ONS has concluded that it is not inside the public sector boundary.

**Q5 Matthew Hancock:** May I follow that up with a structural question? I can see your argument: you are caught between the ONS telling you to do it one way, and the NAO saying that it will qualify your accounts unless you do it another way. I am reminded of the headquarters of a national corporation, which was told that it would be fined by the equalities watchdog if it did not put a ramp up to the front door, and fined by English Heritage if it did. How, structurally, will you resolve that? Do you need to get the C&AG and the chairman of the ONS together, and to have a governance structure to resolve these sorts of considerations, if you are ever going to have your accounts not qualified?

**Sir Nicholas Macpherson:** I think that is a constructive suggestion that we should certainly explore. There have been times when classification has been very important to the Government of the day. Funnily enough, in the past few years I do not think that this has been so much of an issue. We did try to be helpful in the accounts to people who want to include Network Rail; if you go to pages 186 and 187, we have provided a degree of information to enable them to do so. This is an issue that people will come back to from time to time. It is a policy issue, not so much an issue for me as a mere official, but so far, the view of Government—the accounting officer is on my left—is that it stays outside the boundary.

**Q6 Joseph Johnson:** Sir Nicholas, you said that you felt that the ONS view was as independent as that of the NAO. Can I just come back to that? We were provided with an essay on the macro-fiscal role of the UK Whole of Government Accounts, which goes into some detail about the process that determined the ONS treatment of Network Rail. On page 467, it says that "the structure and form of Network Rail was design-engineered by the Treasury to be classified by ONS to the private sector via an iterative process in which the ONS was ill-advised to engage".

**Sir Nicholas Macpherson:** I was one of the guilty men—I think they generally were men—who were involved in the public spending side of the Treasury at the time when Network Rail came into existence. There certainly was some iteration at the time, because an objective was to ensure that Network Rail's classification was to all intents and purposes the same as that of Railtrack, but since then, the Office for National Statistics has itself evolved, and the

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creation of the national statistical authority has further underlined its independence. Obviously, you cannot rewrite the past, but it would be open at any point to that statistical authority to reclassify Network Rail. There are all sorts of history to all aspects of that.

**Q7 Joseph Johnson:** Can I just follow that up? I appreciate that the information that you have provided on page 187 is useful to people who want to see the impact on Network Rail. Might it have been possible to present almost a dual set of accounts—with and without? Would that have been a breach of the policy direction that you were receiving?

**Sir Nicholas Macpherson:** I think it is the sort of thing we could explore. With Network Rail, there is an issue around the boundary of the public sector that has run and run for the past decade or so, and my worry is that once you start providing shadow accounts—we could do it for the banks, the ones that the Government own most of—it all becomes complicated and difficult, but we can explore further how we can make the notes that refer to additional bodies even clearer.

**Q8 Stephen Barclay:** For the avoidance of doubt, your argument is that you indemnify all the debts of Network Rail but do not exert control over it.

**Sir Nicholas Macpherson:** My argument is that we do not seek to exert control over Network Rail, and that explains the ONS treatment. I recognise that some of its debts are guaranteed—

**Q9 Stephen Barclay:** It is not some; it is all, is it not? We had this exchange in a previous hearing. I will take you to the 41st Report's evidence. On page 34, in response to question 215, which I think Jo asked, Network Rail says: "The financial indemnity in respect of Network Rail's debt is between the Secretary of State and Network Rail...At present all debt held by Network Rail is covered by this indemnity." So, it is not some; it is all of Network Rail's debt. It seems strange that you indemnify all its debt—and you certainly do indemnify all of it, not some of it—but you do not exert control. I assume you have a say in the appointment of its chief executive.

**Sir Nicholas Macpherson:** That is a good point. Indeed, London and Continental Railways was reclassified to the public sector, and is, as I understand it, going to be included in the accounts for 2010–11. All I am seeking to explain is that we follow ONS practice for good reasons: because in making international comparisons of fiscal policy, people use the European system of accounts, and it is sensible, therefore, to publish information on that international league on a comparable basis. I do, however, understand the point that you are making.

**Q10 Matthew Hancock:** You also break away from the NAO convention by excluding some public sector bodies, such as, for example, the NAO and Parliament. I am not saying that they should not be excluded; they are perfectly reasonable cases, because they are not responsible to the Executive. You do not always precisely follow the ONS classification as your guide.

**Sir Nicholas Macpherson:** There may be small cases around the margin where we do or can break away. I would be concerned if we broke away on some of the big entities.

**Q11 Chair:** I think what we have got out of you on that is that you are going to think again about Network Rail, and that there are going to be some discussions. We hear what you say about current Government policy, but it would be helpful to have a discussion, which would give greater completeness to this.

**Sir Nicholas Macpherson:** Just to be clear, we will continue to review, year by year, what goes inside the boundary.

**Chair:** I think that you also said in response to—

**Sir Nicholas Macpherson:** In response to these various points, we will take those particularly to heart and think about them.

**Q12 Meg Hillier:** Is there a special process under the law through which you can just decide to add in Network Rail accounts, or does it have to go through Parliament?

**Sir Nicholas Macpherson:** I will ask the accounting officer to answer that question.

**Andrew Hudson:** We have discretion over the boundary, but Nick has explained the view that we have taken, after lengthy consideration, and the rationale behind it.

**Q13 Meg Hillier:** So it does not have to come back through Parliament.

**Andrew Hudson:** No.

**Q14 Chair:** I understand that these things are issues of judgment, but I was looking at the further and higher education sectors; both are outside at the moment, and the NAO argues that FE should be in.

**Sir Nicholas Macpherson:** FE has been revised back by the ONS, has it not? So, presumably, it will come back in.

**Q15 Chair:** Why is FE in and HE out? What is the justification?

**Sir Nicholas Macpherson:** I think that why HE is out goes back to the historical independence of our great universities. In the early 1960s, it was deemed that funding universities from the Department for Education would compromise their independence. The Treasury directly funded the universities until the 1960s. Since then, things have changed. I believe that the ancient structures of some of the universities are different from the rather more prosaic municipal structures of FE.

**Q16 Chair:** I understand the point about the structure, but we are not concerned about that. I have not thought about the structure of various public bodies, but I am sure that a lot of them, in history, have had odd evolutions. This issue is all about control and who underwrites the debts—those sorts of things. From the discussion before, I cannot understand the principles that underpin an attitude that says that FE colleges, which are pretty independent nowadays, should come in, but HE institutions should

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stay outside. I was seeking from you some sort of rationale.

**Sir Nicholas Macpherson:** It is interesting that the Comptroller and Auditor General has not qualified us on the basis that we have not included universities, so he must have taken a view himself.

**Q17 Chair:** You are passing the buck?

**Amyas Morse:** Yes, we did take a view, and I explained it to the Chair earlier.

**Chair:** She wasn't satisfied.

**Amyas Morse:** But that did not mean that I changed my view. I explained that there were a series of factors that we had taken into account, and I thought that I was right in saying—not having the benefit of a great deal of detail on it—that universities, generally speaking, have quite substantial amounts of estate that belong to them. To take an example, what would happen if a university decided to go private? What would the consequence of that be? Is it capable of making such a decision? Has it got the power to do that? I think the answer is yes. That is quite materially different to many other public bodies. I could see that there might be an argument along those lines, if that is helpful to you, Sir Nicholas.

**Sir Nicholas Macpherson:** It is very helpful. It is quite interesting that you have used the point about taking the decision to go private. If they are already private institutions, that should be irrelevant, but I take your point.

**Q18 Chair:** It just seems that there is an argument there and I would be interested in your thoughts. Perhaps you want to write to me on it; it does seem to me odd.

**Sir Nicholas Macpherson:** I would be happy to write to you. These are the whole of Government accounts, but in principle you could produce accounts for the whole of the UK, private and public sector. Critical to me is that everybody has to be somewhere. When we went down this route, there were some strange PFI prisons in Kilmarnock that were not on anybody's balance sheet, private or public.

**Q19 Chair:** One final question and then we will come to detailed issues that we have raised. How do you justify the wholly owned banks being outside this?

**Sir Nicholas Macpherson:** It is mainly pragmatic. To include the banks would require a massive investment in systems. They currently produce a whole lot of accounts using particular accounting principles that are different from whole of Government accounts. We worked out how much it would cost to bring them inside the public sector boundary, and it would be hundreds of thousands of pounds.

**Karen Sanderson:** Millions.

**Sir Nicholas Macpherson:** Yes. Ridiculous amounts of money. Given that our plan is not to hold on to them indefinitely—quite frankly, the sooner we can offload them the better, although that time seems to be receding into the future—there did not seem much point.

**Q20 Stephen Barclay:** Can you rely on them now? You had to seek a letter of direction after the 10 months of intensive due diligence work before you took them on. Is there still a concern? I agree that it is perhaps easier in terms of future years not to have them included, so that we can make a comparison. I see the argument for not including them, but to what extent are you fully satisfied that you can rely on the accuracy of what is there now if you were to bring them into the whole of accounts?

**Sir Nicholas Macpherson:** As I have, I think, told the Committee before, there are signs that their understanding of their balance sheet has improved, perhaps thanks to the work of this Committee, and indeed the Treasury. They are signed off by credible auditors—there is a separate question about what the audit profession should learn from the crisis—and as of now, I am reasonably confident that we understand what is going on at Lloyds bank and RBS. If it became clear that were going to own these things for 50, 30 or 20 years, I would be inclined to invest in the systems, but I would be really disappointed if we did own them for that length of time.

**Q21 Matthew Hancock:** On that narrow point, are you saying that you can't rely on their own accounts in order to consolidate into here, even if you wanted to?

**Sir Nicholas Macpherson:** No, we can rely on their accounts, but they are produced on a different basis—they are to do with things like financial years.

**Q22 Joseph Johnson:** Sir Nicholas, you are basically relying on two arguments. One is that it would cost too much to make them equivalent on an accounting basis, and two is that you hope not to hold on to them for very long and therefore there is no point. On the first argument and the cost of several hundred thousand pounds, what is that as a proportion of the total cost of generating this magnificent document?

**Sir Nicholas Macpherson:** The cost of producing this magnificent document is not that great. All Departments and public sector bodies produce accounts. Karen has led a dedicated team of six people or so, and our calculation was that the cost of all this to the Treasury would be about £500,000. There is obviously an NAO cost, and we end up with something like £1.5 million if you add in the Departments' costs. It would significantly add to the cost. Perhaps we could make RBS pay for it, but it will still come back to the taxpayer in the end. If the Treasury had to pay for it, we would have to lay off quite a lot of Treasury staff.

**Q23 Joseph Johnson:** The other argument is that you do not plan to own them for very long. That is a fairly flimsy basis on which to decide the perimeter of the accounts.

**Sir Nicholas Macpherson:** I am sympathetic, as ever, to the point you raise. We are bringing the Bank of England inside the accounts next year. We are also bringing in the so-called "bad bank" of Northern Rock and Bradford and Bingley, which is called something asset management—

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**Karen Sanderson:** Northern Rock Asset Management.

**Sir Nicholas Macpherson:** That will be in there next year.

**Karen Sanderson:** Not next year.

**Sir Nicholas Macpherson:** Sorry. The year after?

**Karen Sanderson:** We have quite a lot of work to do, because it is a significant amount of work to fair-value all the assets and liabilities. We are looking to generate a plan within the next year to look at what we have to do to bring them on as soon as we can.

**Q24 Joseph Johnson:** That is Northern Rock, or all of them?

**Karen Sanderson:** That is Northern Rock Asset Management Plc and Bradford and Bingley.

**Chair:** Hang on. Just taking the time frame of that, you are bringing them in in 2012–13, so reporting here will be in 2015.

**Karen Sanderson:** We will bring them in as soon as we can.

**Q25 Joseph Johnson:** The problem is that we are not going to get comparability if you bring bank by bank in over time. It's going to become difficult to compare these accounts from one year to the next.

**Sir Nicholas Macpherson:** There is a qualitative difference between Northern Rock Asset Management and the rest. We are going to hold Northern Rock Asset Management for a long time, mainly because you are looking at mortgages that have to burn off. That could take anything up to 25 years. It is perfectly reasonable that that is a long-term holding, whereas if we had RBS and Lloyds—I know it's moving back—in 10 years' time, I'd feel that we were not in a very positive environment.

**Q26 Austin Mitchell:** On other exclusions, I think you said, in an earlier session that we had, that the bank accounts weren't reliable, and that you didn't think that they had made sufficient allowance for possibilities of fraud and junk investments. Is that one reason for not including them?

**Sir Nicholas Macpherson:** It is the answer I was giving Mr Barclay: when we took on some parts of Royal Bank of Scotland, it became clear that the company did not understand its balance sheets.

**Q27 Austin Mitchell:** And then it was audited by a big audit house.

**Sir Nicholas Macpherson:** Yes, and not just once, but several times. They took on ABN AMRO, which is the source of many of their problems. It is a matter of public record that not much due diligence was done. That is what we are dealing with.

**Q28 Austin Mitchell:** I think the East Coast Main Line contract had folded by that stage, and you nationalised East Coast.

**Sir Nicholas Macpherson:** East Coast is coming in.

**Karen Sanderson:** In '10–11.

**Sir Nicholas Macpherson:** In the next year's accounts, it will be in.

**Q29 Austin Mitchell:** Okay. What about council housing?

**Karen Sanderson:** That's in.

**Q30 Austin Mitchell:** Because you also derive a substantial revenue by snaffling money out of housing revenue accounts, don't you? I think it was £1.6 billion in the year in question here. Both the capital cost and the revenue you filched from housing revenue accounts are included?

**Karen Sanderson:** The income that local authorities earn from housing is included in WGA.

**Sir Nicholas Macpherson:** We are not going to attach a value judgment to it, but both the assets and the income are in here.

**Q31 Austin Mitchell:** Okay. And the Humber bridge?

**Karen Sanderson:** The Humber bridge will also be in here.

**Amyas Morse:** Just a point to make, if I may. As we take these accounts more and more seriously—we do take them very seriously, and I compliment the team in the Treasury who have worked so hard on them, all the team—the scope for setting aside accounting standards on the basis of practicality is, I have to comment, going to become rather less over time. This is fine for now, but people are going to start looking at these accounts and making extensive judgments on them and be using them for analysis and so forth. It's going to get more difficult over time. I say no more than that about it, but I think it's just worth bearing that in mind. At the moment, you can understand that there is a process of winding up to it, but people would get quite short shrift in the private sector if they said, "We don't want to bother with these accounting standards." If the purpose of this is to show that we can account for Government in a roughly similar way, there may be a certain degree of pressure in that direction as time goes by.

**Sir Nicholas Macpherson:** I am sympathetic to your view, Amyas.

**Amyas Morse:** Thank you.

**Sir Nicholas Macpherson:** I do think that if you are going to produce a document such as this, the more coherent it can be, and consistent within its own terms, the better. The original Act, which reflected the will of Parliament, provided for the Treasury determining the boundary.

**Chair:** Clever old Treasury.

**Q32 Stephen Barclay:** To be fair, I suspect that was written fairly broadly, in order to save having to come back to Parliament, so to give a degree of discretion. There is a danger in misinterpreting what Parliament was intending in giving you that discretion.

I want to come on to a different point, which is the amount of time it takes to produce, which goes to how effective it is. Just looking at other countries, such as France, USA, Australia, New Zealand and Canada, all those countries produce their equivalents in seven months or less, but the UK took 19 months, so we are very much an outlier compared with those other countries. Why is it taking so long and, more to the point, when do you expect to get it to the least bad of

those equivalent countries—in other words, seven months?

**Andrew Hudson:** Perhaps I may make a couple of points on this, Mr Barclay. First, this is the first time that we have done this for real. We certainly want to produce the document more quickly in future, and next time round we would like to get it done shortly after the summer recess, and ideally in time to get it done by the end of the calendar year in question. This will be quite a tough ask for us. Clearly, we will need continued good co-operation with the NAO, because it is a substantial audit task as well.

The other point I would make is that the coverage of our document is substantially bigger than that for the other countries. Just looking at page 47, which the Chair mentioned earlier, we are covering about 1,500 bodies, and the next biggest is 200. So, in terms of eliminations and so on, that is just a much bigger task. But, clearly, the sooner we can get this out, the more useful it will be for us, yourselves and everyone else.

**Sir Nicholas Macpherson:** The critical point there is that we include local government. Other countries do not include local government or states, which makes it so much simpler.

**Q33 James Wharton:** Just on figure 2 on page 47, which shows the comparisons with other countries' accounts, one figure that jumps out at me is assets, down at the bottom. It appears that we have nearly 150% of the assets of France and nearly half the assets of the United States. On the face of it, that appears to be an unrealistic assumption. I would expect, for example, the United States to have significantly more assets in its accounts than the United Kingdom, given the size of our respective economies. What accounting differences have led to what, on the face of it, appears to be a very high asset figure in our accounts in comparison with these other nations' accounts?

**Sir Nicholas Macpherson:** I think it is primarily to do with the exclusion of the states. Federal Government actually does not have very many assets outside defence and the odd inter-state highway. All the rest would belong to states.

**Q34 James Wharton:** And France? They just do not have that many assets?

**Chair:** It's half. Look at the relation between assets and liabilities.

**James Wharton:** I appreciate that. The asset figures just seemed high, and I wondered whether there was some unusual reason for that. My perception is not that the United Kingdom has half again as many assets as the French Government would have. I just wondered whether there was a clear reason for it. I am sure, if there is something wrong, it is with their accounts and not ours.

**Karen Sanderson:** It think again it is the scope. In France, they do a central Government consolidation; they do not include any of their equivalent of local authorities.

**Sir Nicholas Macpherson:** Also, my guess is that, in the way that the health system works in France, their health service would probably count either as part of the private sector or in some strange body beyond the central Government boundary, whereas in Britain,

because you have a nationalised health system, the health assets sit squarely on the Government's balance sheet, and those would account for several hundred billion, I would think.

**Q35 Chair:** Right, I am now going to move to issues that hit you as you read this stuff—and it is fascinating reading. I will start with PFI. I think this is quite gobsmacking. If you look on page 23, we are told that the net book value of PFI assets is just under £40 billion,<sup>1</sup> but if you now look at future obligations, which is what this document enables you to do, that figure—this is March 2010—is £131.5 billion. That is over four times as much, says she, doing her arithmetic—gobsmacking. If you had known that, let us say 10 years ago, would that have changed policy direction?

**Sir Nicholas Macpherson:** I don't think it would have changed policy, because if it had been a public asset we would still have had lots of expenditure associated with the public asset. My friend Mr Hudson has appeared several times before this Committee on private finance and will know more about the subject.

**Q36 Chair:** I have to say to you, since you have been appearing at this Committee, and I look at these figures—I was a supporter of this as a mechanism for creating important assets, such as schools and hospitals—it just looks gobsmackingly, hugely, hugely expensive.

**Andrew Hudson:** It is a substantial amount. On PFI and in terms of future commitments, we have published quite a good deal of information over the years, typically at Budget time. A lot of this has been on the Treasury website, so it is not a—

**Chair:** Well, it has not been before us. We have not noticed it before.

**Andrew Hudson:** Not in quite the same way, though I remember some conversations with Mr Bacon, for one, about the liabilities and the service charges. Clearly, this has been a topic of great interest, not least to this Committee. The Government set out a few weeks ago their plans to reform PFI with a view to driving better value for money, while hanging on to some of the advantages that have come from it.

**Chair:** I hear that, although it is very unclear what that means, because looking at the Chancellor's statement last week, you say there: "The Government will, subject to affordability, consider using transparent forms of guarantee to support specific projects where this provides best value for money"—ha, ha—"for taxpayers and users." So it strikes me that having uncovered, in various reports that we have done, future liabilities associated with this sort of scheme, you are embarking on doing just the same thing in the future.

**Sir Nicholas Macpherson:** If you are going to go for one of these schemes, we would expect a really thorough investment appraisal that captures these future payments. You would want to compare it with a classic public procurement option, which would also have to include the costs of servicing a new hospital or whatever. I genuinely do not—I may be hopelessly

<sup>1</sup> The net book value of PFI assets as at 31 March 2010 was £30.9 billion

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out of touch, but I certainly do not—get any sense these days that people are going for a private finance option just to keep the thing off balance sheet, because these things primarily are on balance sheet.

**Q37 Matthew Hancock:** You said “primarily”. Are the prisons in Kilmarnock on the balance sheet now?

**Karen Sanderson:** Sorry, I can’t answer that specifically.

**Matthew Hancock:** But you specifically raised the issue of prisons in Kilmarnock—

**Sir Nicholas Macpherson:** Everything is on a balance sheet somewhere. This was an example—

**Q38 Matthew Hancock:** So why weren’t they on the balance sheet before?

**Sir Nicholas Macpherson:** Both the public sector and the private sector had come to a conclusion, independent of one another, which meant that it just did not sit anywhere.

**Q39 Matthew Hancock:** So when were they brought on to a balance sheet?

**Sir Nicholas Macpherson:** I remember this being used as an example round about 2000, but I will go away and find out. I may be the only person—

**Q40 Matthew Hancock:** Maybe you could write a note to me about it?

**Sir Nicholas Macpherson:** I will, with great pleasure.

**Q41 Chair:** Matt is interested in the past; I am more interested in how this is going to impact on the future. The whole of the schools capital programme is now going to be through PFI. There was this announcement last week of an infrastructure programme funded through pension funds. Clearly, if you are running a pension fund, you want some guarantees of return—some sweeteners—which in some way will have to be underwritten by the state. I was recently shown papers around the Liverpool hospital PFI—internal papers, which “Panorama” had got hold of—that, honestly, just demonstrated a fix in the way the public sector comparator had been done for that hospital. There is no other way of describing it. Two documents were floating around the Department of Health in which one month it was shown to be non-viable on a public sector comparison and two months later, by changing the optimism bias assumption, it suddenly became viable.

I have absolutely no confidence, as we look at the costs of these over time, that you are having regard to that in determining future policy. I cannot see that. It is all very well saying—

**Sir Nicholas Macpherson:** To come back to the prosaic issue of the whole of Government accounts, the fact that there is this number here and the fact that you are quoting from it represents progress.

**Chair:** I agree with that. You and I can agree with that.

**Sir Nicholas Macpherson:** You ask whether this is making a difference. It clearly is.

**Andrew Hudson:** And it is audited.

**Sir Nicholas Macpherson:** This is an issue of public concern. I had the privilege of watching this television

programme the other night—being a sad loser I don’t have much better things to do on a Monday night—and I was very impressed by the points a number of members of the Committee were making. I do think the governance around PFI has improved. If there is more we have to do, I hope the current consultation that the Government are doing—call for evidence, I think it is called in the trade—will make a positive difference.

**Andrew Hudson:** As to the reasons for holding discussions with pension funds, I do recall—again, at previous sessions of the Committee—there was an interest in how we could get different sources of investment to support infrastructure. Clearly we have to make sure that all these are value for money for the taxpayer, but that is in part a response to that sort of thinking, which I think we shared at the time.

**Q42 Chair:** I think we were talking about the European Investment Bank.

**Andrew Hudson:** I thought we had talked about pension funds as well.

**Mr Bacon:** Yes, we had.

**Andrew Hudson:** That was as well as—as you say, Mrs Hodge—European funding, certainly.

**Q43 Stephen Barclay:** If the governance has improved, could you at least confirm there were no PFI hospitals being managed by someone who was not full-time? That was one of the specifics at a previous hearing. We looked at how Innisfree had consolidated 24 hospitals and was using the expertise of that consolidation to drive very hard deals with a number of hospitals where they in some cases did not have anyone full-time there; there was obviously an imbalance. We raised that previously on PFI. Has it now been addressed?

**Andrew Hudson:** I cannot give a direct answer to that, but I will come back to you on it.

**Chair:** We are coming back to PFI in this Committee.

**Q44 James Wharton:** It was alluded to, of course, that there are some advantages to PFI, and one of those, some might consider, is keeping things off the books. The public sector net debt that we use is significantly lower than the net liability that these accounts show. Should we consider changing the figure that we actually use for fiscal planning, and what might the advantages of that be?

**Sir Nicholas Macpherson:** It is always important that Government keep under review the aggregates they are targeting. I remember from when I joined the Treasury, there something called the PSBR, which we all focused on. Now we focus on different metrics. But the issue is, I think, from an economic policy-making point of view, that what I would call a defect of this measure of debt is the way pension liabilities move around.

It is very striking, when you look at the pensions part of the accounts: most of the change—about £300 billion of the increase in debt—is being driven by a change in the corporate bond rate. Now, the corporate bond rate tells you something: it tells you a whole lot of things about what is going on in the economy, but it does not have direct relevance to the Government

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about funding their liabilities. I think on this problem about the valuation of pensions, if you were to pursue this metric relentlessly, you would find yourself being blown all over the place. Next year it is going to come down, because the corporate bond rate has been revised up, because it went from 3.2% to 1.8%, and it is now going to go back up to 2.7%. This will reduce the measure again.

It tells you useful information. The pension measure is interesting, but as I think we have discussed with this Committee before, it is only one of a number of potential measures of pension liabilities. It is also, quite frankly, slightly strange—although I totally understand why accounting practice only results in us consolidating the public service pension element of pensions on our liabilities. Actually, when I look at the cost of ageing, the thing that worries me the most is the cost of the state pension. Okay, you haven't got quite such a contractual obligation in paying a state pension. Successive Governments have occasionally changed the uprating formula, but they haven't changed it much. We could, although we would be qualified no doubt by my friend Amyas if we did, stick in several trillion pounds of liabilities for the cost of the future state pension.

The interesting thing—this comes back to the net debt point and reflects perfectly respectable accounting practice but is not particularly relevant to me in terms of trying to formulate fiscal policy in the Treasury—is that we do not consolidate future income streams. Unlike a company, which cannot guarantee revenue, the state has a capacity to guarantee revenue—namely, the power of taxation—and if you included on the positive side of the balance sheet against the net present value of all future pension payments, I could probably come up with a measure that showed we had no debt at all. I don't think that would be sensible and I am not advocating it, but the public sector balance sheet is a complicated business.

**Q45 Mr Bacon:** That is the most extraordinary thing I have heard in a long time, Sir Nick.

Last year in the Autumn Statement, you came out with a Green Book that said that the projections required £172 billion of extra tax revenues, and they did not emerge—they just weren't, even though you had said that they were going to be—so how much less likely is it that you can predict accurately, let alone guarantee, what they are going to be 10, 20, 30 or 40 years into the future? You can't, but what you can do is see what you have signed up to in terms of pension obligations. So, there is a fundamental asymmetry there, and you are trying to say that there isn't. It is intellectually dishonest, frankly.

**Sir Nicholas Macpherson:** No, no, Mr Bacon, sorry, I may have been insufficiently clear. I am not saying it is the same thing at all. This is a contractual obligation. Tax, for a whole range of reasons, is different, not least because all our tax has to be renewed annually by Parliament, reflecting—

**Mr Bacon:** There has to be something to tax, and that's why—

**Sir Nicholas Macpherson:** There does.

**Mr Bacon:** And that is why the predictions of tax revenue fell short last year from this year. I forget the

exact number, but now they are going to be significantly higher than expected only 12 months ago.

**Sir Nicholas Macpherson:** Absolutely, and I understand precisely what you are saying. All I am saying is that measuring debt is complicated, and using accounting treatments that result in large swings in our pension liability makes this, perhaps, a sub-optimal measure of debt for fiscal policy purposes.

**Q46 Chair:** Hang on a minute. So that we keep some order, we are going to cover now PFI and pensions, then move on to other issues. Richard, do you want to finish on that?

**Mr Bacon:** I think Sir Nick was in the middle of speaking, actually.

**Sir Nicholas Macpherson:** I was just trying to be a bit controversial for you, Mr Bacon, by making these relativist remarks. There is a spectrum of liabilities, some of which are included here and others, such as future state pension payments, which are not. I think it's a useful measure, and I am really pleased that we now have a measure of total outstanding public service pension liabilities, but I suppose what I am trying to say is that it is still a less than perfect measure of debt for fiscal policy purposes.

**Chair:** Okay. Matt, then James.

**Q47 Matthew Hancock:** On exactly that point, one thing that strikes me on public sector pensions is not only the very sharp rise in the liability that these accounts show, but also that the treatment of them is different from how they are treated in terms of when they are a cost to a Department, when the discount rate is set and not based on a corporate bond. How do you explain that inconsistency?

**Sir Nicholas Macpherson:** I got my chief micro-economist to write me a very good piece of paper. I would be happy to write to the Committee. What we are trying to do, and it reflects a conversation we had when we appeared before you on public service pensions, is, prospectively, when setting contribution rates for employers and employees, to use a discount rate that perhaps best reflects the state's ability to pay in future. That discount rate is based on the Treasury's view of long-term growth in the economy and, if I am not mistaken, we ended up with 3% plus CPI, which is something like the equivalent of money GDP growing by 5% a year, which historically is not a bad estimate. That is informing our future pension rate. IFRS is very clear, because if you have a private sector pension scheme, and you have a load of liabilities, a very good measure of the cost of providing them is the corporate bond rate, because you have a scheme which you have to invest. The problem in the public sector is most of the public pension liabilities are unfunded; they are funded out of general taxation into the future—

**Q48 Matthew Hancock:** Or borrowing at a gilt rate.

**Sir Nicholas Macpherson:** Exactly. That accounts for the anomaly. At the current time, gilt rates are very low indeed. If we were using current gilt rates to set contribution rates, they would be very much higher.

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**Q49 Matthew Hancock:** But isn't that equivalent to a corporate that might pay for pensions out of both current revenues and future borrowing?

**Sir Nicholas Macpherson:** It is an equivalent, but—

**Matthew Hancock:** So that means that the contributions—

**Sir Nicholas Macpherson:** Mr Hancock, the problem for actuaries, and indeed for Governments, is that if we were to use the gilt rate, it would be about 5%, averaging out over the last 10 years. Averaging out over the last 20 or 30 years, it would be a lot higher; it was not until the turn of the century that there was a decisive move below about 8% on long-term gilt yields.

My worry, if you were to use the gilt yield for setting future contribution rates year by year, is that they would move around considerably. Say the economy really began to pick up and gilt rates moved back to their normal level of around 5%. That would result in a doubling of contribution rates. In setting contribution rates—this is for people who have to plan their lives—you have to see through short-term movements and use long-term assumptions, and that is what actuaries do. I am not an actuary, but they spend a lot of time thinking about these things, and they quite often get it wrong, but in setting rates, you need to take a long view, and, in a sense, the discount rate we use reflects that long view.

**Q50 James Wharton:** One of the reasons that I raised the original question that has led to this discussion is that potentially one of the great advantages of producing a document like this is that you start to cut through some of the uncertainty that surrounds the debate about the state of the nation's finances and what people understand as our financial position, accepting all the complicated factors that we have touched on. With that in mind, and given the importance of informing people about what is going on—having a single source where they can get an understanding of these things—what are you doing to strengthen what the individual bodies that feed into these accounts do when they prepare their accounts to ensure that there is a consistent framework so that the document becomes better and more representative every time it is produced?

**Andrew Hudson:** I think this is part of our continuing work with Departments about the professionalism of finance functions and setting consistent standards, which is also very much a joint effort with the NAO. We have a finance transformation programme getting under way. We are aiming, as came out earlier in the conversation, to iron out inconsistencies in the way accounting standards are applied as between different bits of Government. Those Departments that have qualifications are working work hard—generally with a fairly specific programme discussed with ourselves and the NAO—to get on top of the problems, whether those are systems problems or internal processes that do not depend on IT, and to improve. This is a continuing job and one we give a lot of attention to.

**Q51 James Wharton:** A final question on that. When you were preparing this, how inconsistent did you find individual Departments? What sort of effect

has that had? One reason I ask that is that one of the important things that people who use this document will want to do is to look at trends. If next time's document is produced after you have ironed out a lot of inconsistencies, there may be significant differences, not because things have changed, but because you have brought everything into line. How significant are the differences you have found in producing this document?

**Andrew Hudson:** Karen may want to comment on this in a minute, having been closer to the discussions with individual Departments than me. But one reason the process of sorting out the eliminations of transactions between different WGA entities took a while is that there were these inconsistencies of practice. That will, in itself, be a learning experience for all concerned and will put us on a better footing for 2010–11. I will not try to pretend that we think 2010–11 will be perfect, but it will be better than 2009–10 and, with that learning plus another year's learning plus the various improvement programmes I have talked about, I am optimistic that we will get on to a footing that will be more stable and will enable people to make the sort of comparisons you are talking about.

**Karen Sanderson:** The point you make is important. That is part of the reason it has taken us so long to complete this. We have been trying to iron out the inconsistencies, so that the NAO could form a judgment about how valid the numbers were in the account. Clearly if there are a lot of inconsistencies in there, we would not be able to form an opinion as to whether it was true and fair or not. Where there are inconsistencies, we have detailed that in the document as something we need to work on going forward.

**Q52 Matthew Hancock:** You made a very reasonable case for having a flat rate in pension discount rates that does not move around with the market. Why is it right for that treatment to be inconsistent with what is in here?

**Sir Nicholas Macpherson:** What is in here is based on IFRS.

**Q53 Matthew Hancock:** So why is it right, therefore, to make corporates respond to a heavily fluctuating bond yield, while the public sector allows itself to decide what it thinks bond yields are going to be over the coming period?

**Sir Nicholas Macpherson:** Not even corporates would change their contribution rates year by year.

**Matthew Hancock:** No, but they have to deal with the balance sheet.

**Sir Nicholas Macpherson:** They do have to. One of the advantages that the state has over corporates—

**Matthew Hancock:** Is that they have this type of accounting treatment.

**Sir Nicholas Macpherson:** Is that, on the whole, states do not default. I know that we are testing that in the current world environment. But, the British state does not default.

**Karen Sanderson:** We are no different from the private sector. You set your rates for contributions in the private sector based on long-term positioning. They do not fluctuate. But, in terms of measuring the balance sheet, you will use long-term bond rates at

each year end. So, the private sector is in exactly the same position as we are.

**Q54 Mr Bacon:** Chair, may I just pick up on something Sir Nick said? You said that what is in here is based on accounting standards. That is not true, is it? It is based on accounting standards when you feel like it and not when you do not.

**Sir Nicholas Macpherson:** I think that that is very unfair.

**Mr Bacon:** But it is true.

**Sir Nicholas Macpherson:** We have tried as far as we can to reflect IFRS. In a whole lot of areas, we have failed to do so. A good example is local government roads, where my understanding is that when they finally incorporate IFRS—

**Karen Sanderson:** It is a valid policy. Historic cost accounting is valid for IFRS.

**Mr Bacon:** That is not the reason.

**Karen Sanderson:** In terms of accounting standards, we follow IFRS as far as we can. There are certain instances where accounting standards are designed for the private sector. We are looking at things like equity and so on, and it is not appropriate for the public sector.

**Mr Bacon:** The C&AG says the following very clearly on pages 39 and 49, which I just happened to be reading 30 seconds before Sir Nick said that this is based on accounting standards. That is why my ears pricked up when I heard it; I had just read the C&AG writing to the contrary. At the bottom of page 39, he states: "I consider that it would be more appropriate to assess the accounting boundary with reference to the accounting standards." That sounds reasonable to me; I am a simple man. He goes on, "By applying such accounting standards, I consider that the Account should include Network Rail." The document goes on to talk about Network Rail, publicly-owned banks, other bodies such as the Bank of England and further education institutions. There are a whole raft of things not included.

**Sir Nicholas Macpherson:** I hope I made the point earlier that Network Rail is the exception rather than the rule.

**Q55 Mr Bacon:** So what is the reason for the exclusion of further education institutions?

**Sir Nicholas Macpherson:** We have agreed on timing. We are working on it. But the Bank of England is in next year and FE is in 2012–13. We are on the case. There are special issues concerning Network Rail—

**Q56 Mr Bacon:** What was the other specialist? FE is just FE—

**Sir Nicholas Macpherson:** No, because FE is one of those things—

**Mr Bacon:** I know a lot of them have been in a mess—I have got a good one in my area; I don't know if you want to come and visit.

**Sir Nicholas Macpherson:** In the early 90s, for some reason best known to the Central Statistical Office, or whatever it was called then, it was taken into the private sector. It has recently been reclassified in the public sector.

**Q57 Chair:** They can borrow privately, can't they?

**Sir Nicholas Macpherson:** It is your earlier point about universities—these things are very complicated. Someone has to take a view and in this case we are all agreed. The Comptroller and Auditor General—his colleague, Steve Corbishley is nodding—and we are all agreed that it is on our balance sheet.

**Q58 Chair:** Okay. Page 121, nuclear decommissioning and negligence. Nuclear decommissioning—just look; horrendous. How clear are you about these figures? How certain are they?

**Sir Nicholas Macpherson:** First may I preface my remarks by saying—

**Chair:** Billions. This is £56.7 billion.

**Sir Nicholas Macpherson:** One reason this sort of thing is important—it is an interesting thought experiment. Had this information been available to the people who did the investment appraisals when the original nuclear power stations were commissioned, it would be interesting to know what they would have done. Putting it starkly in one place makes a difference.

Do we know for certain? Well, another good thing is the way that it distinguishes the liabilities that are likely to fall within one year, one to five years, or thereafter. Year by year, we are getting real information that we can use to check whether this information is right. If you look back over the past two or three years, it is striking that it is not moving about hugely but tends to remain in the same territory.

**Q59 Chair:** Meg wants to come in on this. Given our investment in nuclear power—again, that was started by the previous Government and carried on by this one—can you give us a figure of what it is going to be in 50 years' time?

**Sir Nicholas Macpherson:** Go on, Karen.

**Chair:** If you are doing a proper capital investment appraisal.

**Andrew Hudson:** No, I don't think we can.

**Q60 Chair:** Will you go away and do a note? I agree with you entirely. Had we known however many yonks ago that for the next 100 years we would be spending £56 billion on decommissioning or whatever, or getting rid of nuclear waste, would we have done it? We are now embarking—again this was started by the previous Government and continued by this one—on a massive nuclear power expansion. Have we any clue about the liability?

**Sir Nicholas Macpherson:** The important question is whether we now provide for the costs of decommissioning when we invest in nuclear. Of course we do.

**Q61 Chair:** But would you have said that 20 years ago?

**Sir Nicholas Macpherson:** I guess that in the 1950s—I am quite sure that we would not have done.

**Q62 Meg Hillier:** Can I use this as an example of how you are going to use these accounts? I think I am right in saying that the money that goes to Sellafield alone for decommissioning has, over the past few

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years, been about equivalent to the total regeneration budget per annum for the whole country. Sellafield is a very small part of Cumbria. That is quite stark—it is the bulk of the budget of the Department of Energy and Climate Change. Does seeing that figure starkly help you as the Treasury, and does it make anyone in the Government take responsibility for how that money is spent and whether it generates work and opportunities in the wider economy? If that budget is spent on Government contracts that require trickledown to smaller companies, it could generate a lot of wealth. It could, however, just be absorbed by the mother ship, the company that runs Sellafield, and not really have an impact on the wider community. That is the sort of question that you might ask if you are an ordinary member of the public and have got as far as page 121. What is the answer?

**Sir Nicholas Macpherson:** Given a choice, I would much prefer that it wasn't necessary to spend this money, but given that we are spending it, I very much hope and expect that we are spending it wisely. It would be a good topic for the Committee to investigate. I would be happy to provide a note on the extent to which we have information on that.

**Paula Diggle:** There was a hearing three or four years ago, or something like that, and one thing that was gone over was the fact that the cost varies, partly because the actual mechanism of decommissioning changes, and as the new methods come on stream, you can make better assessments. That is partly why it moves around so much.

**Q63 Meg Hillier:** In a way, there are huge challenges at Sellafield. I think three of the worst decommissioning sites in the world are at Sellafield, which is a great British engineering challenge. If it is at the cutting edge of dealing with the nastiest stuff, because of historic policy decisions over years, there is a real opportunity to develop new business. My question is, who is making sure that that money, when it is spent, will have a trickledown or direct benefit on job creation and business creation? Is it something the Treasury does? Is it something that is now on your desk to think about?

**Sir Nicholas Macpherson:** In the first instance, it would be for the Department of Energy and Climate Change and the Department for Business, Innovation and Skills to ensure that that is happening.

**Meg Hillier:** But I don't think they do at the moment. There is no requirement in contracts to do that very thing.

**Andrew Hudson:** As part of the Government's policy on public procurement, the Cabinet Office is taking steps to try to ensure that there is a more level playing field for small businesses to get involved, and I would expect those Departments and the Nuclear Decommissioning Authority to implement that. What I would say is that a lot of this work is always going to be highly specialist, so it is more difficult than in some areas to open up opportunities for small businesses and local businesses.

**Q64 Meg Hillier:** Can I drive the point home a bit further? The Treasury gives the money to the Department, and the Department gives the money to

the Nuclear Decommissioning Authority. It then goes to the business set up to run Sellafield, and then goes to the specialist contractors. By the time you get to the point where those billions of pounds are being spent, what control does the Treasury have over it?

**Sir Nicholas Macpherson:** As I occasionally have to explain to the Committee, the Treasury is a small institution consisting of 1,000 very motivated and very capable officials, and there are limits to what it can do. We could have a different Treasury. We could take a leaf out of the French book and have a far bigger Treasury with many colonised departments and so on, but you must get the right balance between strong central controls and devolved decision making. I am not claiming that the current system is perfect, but you don't want a dead hand of the Treasury interfering in every nook and cranny of public life.

**Q65 Meg Hillier:** But it is the vast bulk of the Department of Energy and Climate Change budgets—

**Sir Nicholas Macpherson:** It is a big sum of money. Returning to why this is relevant, there is a massive long-term liability associated with it. On the basis of risk-based approaches to controlling and planning public spending, we will be taking more of an interest in this area than, say, the Arts Council budget over the next 50 years.

**Amyas Morse:** We have in preparation a report on the Nuclear Decommissioning Authority's conduct of the Sellafield site and the efficiency of that, and it will come out next year. As we go towards that, it might be useful to develop some shared statistics with the Treasury on what the effect of being in the generation business for a long time may be. Because of the half-life of all the material and the need to store it for an extremely long period, there is an ever-escalating cost profile associated with that, and it might be valuable to discuss that, because there might be future implications.

**Chair:** We are very pally today.

**Q66 Matthew Hancock:** That might be an opportunity for a Committee visit. You have no need to come on that, although I'm sure you'd be very welcome.

I want to come back to discount rates. Why is nuclear decommissioning discounted at 2.2%, and pensions are discounted at 3% real, when one is a liability over perhaps 30 or 40 years for the longest surviving people, and the other is over 60 years? Are we really expecting long-term interest rates to fall sharply in 40 years and to remain low for the following 60 years? Why are there two different discount rates for both long-term liabilities?

**Karen Sanderson:** It is something that we are looking at in the Treasury. It is part of the standard and guidance that we give out to Departments about what they should use for their discount rates on such provisions, and that is something that we are assessing at the moment about whether it is appropriate to have different rates going forward.

**Matthew Hancock:** What you are saying is that you cannot defend it and it might change.

**Karen Sanderson:** We look at it annually to look at what is the most appropriate rate to use, taking into

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account the nature of these provisions, the long term and what is the best equivalent to use.

**Q67 Mr Bacon:** So in the past four years, since Helen Goodman, the Member for Bishop Auckland, raised this point when she was on this Committee and denounced your policy on discount rates, you have looked at it four times, but have still done nothing. Is that right?

**Karen Sanderson:** We look at it annually, so each year the discount rate can change to reflect the external environment.

**Q68 Matthew Hancock:** I still have not had an answer to the question. What justification can there be for having a different discount rate over about 40 years, which is about the full length of the longest public sector pensions, compared with 100 years? If a young public servant enters the Treasury at the age of 21, takes on his or her pension and lives to the average age—let us say it is a female employee—of about 85, their liability will be over a period of 65-odd years, and you are saying that the discount rates should be different for 65 years, as for 100 years, which is the stated expected liability duration of this liability. Could you provide an explanation?

**Karen Sanderson:** That is something that I will have to come back to you on. I do not have the detail.

**Q69 Matthew Hancock:** Is there any argument at all, or is it just that this is how it has always been done, and therefore this is how you do it?

**Karen Sanderson:** No, it is not.

**Sir Nicholas Macpherson:** On measuring accrued pension liabilities, we are required, as I understand it, by IFRS to use the high-quality corporate bond yield. Your point is, I think, that we have recently adopted a 3% plus CPI measure for future contribution rates for pensions, and you ask why that is different from the rate used here. The 3% one was actually adopted after these accounts. It has been adopted as part of the recent debate over the summer about pensions and so on, but I think your point is a good one, and I think we should come back to you on it.

**Matthew Hancock:** Great. The bigger-picture point is that the whole of these accounts are dependent on choice over discount rate. I might sound like a discount-rate bore, but you can entirely alter these accounts by choosing different discount rates, and your choices appear to be, in some places, inconsistent with each other.

**Q70 Chair:** Who was I going to call next?

**Stephen Barclay:** Me.

**Chair:** Yes, I think it was. We are moving on to clinical negligence.

**Q71 Stephen Barclay:** I fully accept your point that the Treasury cannot run all aspects for the Departments, but I would expect you to be focusing on the big-ticket items, one of which is clinical negligence, which is 15% of future liabilities—£15.7 billion. That is based on figures that are 20 months out of date. What are they now, what is the trend, and to what extent is the Treasury setting targets for the

Department of Health, in terms of bringing that figure down?

**Andrew Hudson:** I do not have information to hand about future trends. I do not think we set targets for the Department of Health as such. A bespoke NHS Litigation Authority is responsible for this, so we make sure, with the top management of the Department—which, as Nick has brought out, has overall responsibility for this—that this is handled professionally, with a view to minimising the overall costs via a combination of defending it robustly when we think the case should be defended, and, when we do not think it should be, settling the claim as efficiently as possible.

**Sir Nicholas Macpherson:** My guess is that it has been rising over time.

**Q72 Stephen Barclay:** With respect, I find your response very relaxed, because if you actually look at what the NHS Litigation Authority shows, new claims over the past year have gone up by 31%. That is in part because it has brought some claims forward. The actual total that it paid out has gone up by 12%. That excludes the £2.4 billion paid through periodical claims, and if you look at those claims, this year there are 930 cases, whereas two years they were running at 659 cases. That excludes GPs, who are largely picked up through insurers. When I spoke to the Medical Protection Society this afternoon, it said that claims against GPs had gone up by more than 50% during the last three years. That also excludes the private medical sector. If you speak to anyone who practises privately, they say that their insurance is going up so much that I understand that there is a real issue among gynaecologists around whether they will continue to do private work, which will have a knock-on impact. If you look across the road, where my daughter was born, the hospital actually generates significant revenues from the private suite—we did not use it—and any change to that will have a further effect.

What I am driving at is that this is an issue that has been around for some time. These figures show that it is 15% of your future liabilities. On the figure that is out of date, that is £15 billion, so it is a significant sum and it is increasing significantly, but you have not set any target, and you have not really done any feasibility, it seems, over the trend. It just seems surprising that something that is such a big chunk of your liabilities is not uppermost in your mind.

**Andrew Hudson:** Well, it is a proportion, it is important, and it is something that we would work on with the Department of Health. As a matter of fact, I am not aware whether we set the Department targets for this. It has every incentive to manage it well.

**Q73 Stephen Barclay:** Has the Treasury been discussing with the Department best practice from other countries? Sheila McLean produced a report for the Scottish Parliament—it was produced for the last Government—on the use of no-fault claims. Potentially, the number increases, but the mediation reduces the litigation costs. The litigation costs are actually significant. I found the figures here quite staggering. If you look at the NHS Litigation

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Authority's payouts, it paid out £729 million in 2010–11, of which £257 million went on legal costs. Of those legal costs, £200 million—76%—went on claimants' legal fees. We were spending four times as much on claimants' lawyers as on defendants' lawyers, and we are actually spending a very high proportion of what is paid out on legal fees. I have a copy of the report here, but it seems that nothing has been done with it. Yet that no-fault claims system is used in New Zealand and in Nordic countries such as Sweden. There are other models in other countries, such as Australia, which uses capping. That model is perhaps more politically difficult to sell, but it is another model.

Again, this sum is 15% of your future liabilities. What urgency is there around looking at best practice and challenging the Department of Health, the budget for which is ring-fenced by the Treasury, and saying, "Within your ring-fenced budget, the proportion that you are spending on clinical negligence isn't acceptable and we need to get that down"?

**Andrew Hudson:** The best thing is if I come back to you with some more detail on this issue when I have had a chance to follow it up.

**Q74 Stephen Barclay:** Could you include within that some milestones and some targets?

**Andrew Hudson:** I will come back in terms of how the thing is being managed with consideration of that, but I think the point you make about the Department's budget being ring-fenced underlines that it is actually very much in the Department's interest to manage this as economically as possible.

**Sir Nicholas Macpherson:** You have identified a generic issue, which is to do with the growth of litigation and the decline of deference, resulting in people making claims against public and private bodies. I worry about the size of this bill.

**Q75 Mr Bacon:** What is very interesting about this bill, Sir Nicholas, is that it has tripled since I have been on this Committee. The very first hearing that I ever did on this Committee in 2001 happened to be with the NHS Litigation Authority as the witness. The number was then £5 billion; it is now three times larger. You say that you are sitting back, that you have only a thousand people in the Treasury, and that it is up to the Department of Health to get on with it. Who was keeping a tab on this figure, because plainly the Department of Health is not?

**Sir Nicholas Macpherson:** I am very confident that we spend quite a lot of time looking at this. Another thing that I suspect has grown by a similar amount during your time on the Committee is the drugs bill. There are certain drivers. It is not enough just to give a top-down settlement and say, "Get on with it", although that is actually part of our approach. It is also about identifying some of the drivers of cost and then providing a challenge to the Department. There are some generic things that the Government are doing to try to discourage litigation and the "no win, no fee" brigade, who spend a lot of time advertising on daytime telly to encourage people to sue each other, but we will come back to you. I do not want

you to think that we just sit there twiddling our thumbs. We do not.

**Mr Bacon:** I have never suggested that you twiddle your thumbs.

**Sir Nicholas Macpherson:** We try to prioritise the main drivers of spending, and this clearly is not a driver.

**Amyas Morse:** I just wanted to take a generic point out of that little discussion, if I may, and it is really about whether you are practising balance-sheet management. More to the point, are you actually practising liability management? In other words, you may be worrying about one aspect of it, but have you got people in the Treasury methodically looking across the whole range of liabilities and thinking about whether they are acceptable and how to manage them properly?

**Sir Nicholas Macpherson:** On the big liabilities, that is undoubtedly so, although—coming back to my point on pensions—the guy who is in charge of pensions was very clear with me that the way the discount rate moves around is not helpful to that debate. We have identified two ones here—nuclear decommissioning and clinical negligence—that count for a lot of these particular forms of provisioning, so we do pay attention to that. My guess is that there is more that we can do, and we have discussed that in the past. If we are really going to get benefits from this, and from the move to resource accounts in Departments over the past 10 years, homing in on the balance sheet and using the spending review really to highlight specific areas can only be a good thing.

**Andrew Hudson:** Now that this is published in the public domain and will be coming out every year, I would expect that process to intensify.

**Q76 Chair:** I have to say, as somebody with a hospital that I am sure gets lots of clinical negligence claims, that it might be better to get the quality of the service right; then you do not have that problem.

**Andrew Hudson:** That is the underlying answer.

**Chair:** We should not punish the patient who has had a bad experience.

**Andrew Hudson:** The underlying answer is clearly about quality.

**Q77 Jackie Doyle-Price:** Reflecting on what you said, we are obviously very much at a starting point with this set of accounts, but coming back to the point that you keep emphasising about the Treasury being only very small, what thought have you given over time to using this as a real tool to bring some accountability to where some of these issues are starting to flow to? I am looking at your foreword and everything else, and there is no political input here, but what if it actually had a ministerial stamp on it that said, "These are the issues that are coming out of this year's accounts"? Do you not think that that would be a very powerful tool in starting to highlight some of these issues?

**Sir Nicholas Macpherson:** You are absolutely right. I think it would be a pity if the Whole of Government Accounts became a highly political set of accounts. I think it is quite important that they are quite dry and non-political, but I think the lessons from them are

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really important. We should not be waiting for Ministers; it is the job of officials to draw attention to the key messages. I hasten to add that I am quite sure that it informed the last spending review, but on some of the issues that we have been discussing, which this Committee rightly regards as important, I would fully expect the Treasury to be making these quite an important part of the next spending review process.

**Q78 Chair:** Let me move on to the next issue. I have three more questions and I think that is it. The first is on academy schools; if you look at page 62, what we find there—these are early-days academies, so this is all relative—is no accurate data and unaudited statements. Therefore, you cannot include £1.2 billion of expenditure and £2.2 billion of assets. It is a lot of money, and it will get much more. It is not a satisfactory place to be, so where do we go from here?

**Andrew Hudson:** We are already working hard on this, because, as you say, this is an area of concern, in that it is a growing area that we need to make sure we get right. I gather that the Committee met David Bell not long ago—a week ago, I believe—and that he explained the framework that he is putting in place, so that all academies will have an accounting officer and will have to comply with certain standards, and that accounting officer will have a personal responsibility to make sure that things are done properly.

**Q79 Chair:** I asked him a question that he could not answer, which was, “If they fail?”

**Andrew Hudson:** It is part of their responsibilities.

**Q80 Chair:** If they fail?

**Sir Nicholas Macpherson:** There will be consequences. It is fundamental to the management of public money that people have to be able to account for how taxpayer money is spent. I can see that there are many good things that academies could do for education, but equally, you cannot hand out money to bodies and then not have it accounted for.

**Chair:** Hear, hear.

**Sir Nicholas Macpherson:** It is the job of the Department for Education to devise a regime that is not so heavy-handed that each academy has to employ 17 accountants, but they do have to explain how the money was spent.

**Q81 Chair:** So you would agree? I agree with that entirely, and it rings alarm bells for me.

**Sir Nicholas Macpherson:** It ties in with the discussion that we have been having around accountability and devolution. We have always recognised that foundation trusts, academies and free schools are going to present the biggest challenges, but between this Committee and the Treasury, we need to work with those Departments to get a satisfactory solution.

**Q82 Matthew Hancock:** Is there a plan in place for working towards that solution?

**Sir Nicholas Macpherson:** Yes, there is.

**Q83 Austin Mitchell:** I see from page 185 that five academies did not provide any data, and 17 did not provide the right quality of data. What happens to them as a sanction?

**Sir Nicholas Macpherson:** I cannot tell you, I’m afraid, but it is not good enough. Going back to Mr Hancock’s point, we do have a plan. The Department for Education is under notice that we expect the “Clear Line of Sight” project to cover these schools, and we expect them to be consolidated in the accounts. We will continue to press for progress. I am told that there is progress, but it comes back to the point that the Chairperson raised: there need to be consequences.

**Andrew Hudson:** The transparency of publishing Whole of Government Accounts and basing the overall accounts on the “Clear Line of Sight” regime means that it is now in the public domain that these bodies did not provide the right data. Transparency is a sanction in itself, but it should not be the only one. As Nick says, there need to be consequences for people who take on the role of accounting officer in academies and then do not do the business, but the fact that it is in the public domain will, by itself, make for better discipline.

**Q84 Chair:** I bet you these academies do not even know that they are on this list.

**Andrew Hudson:** Well, if any members of the Committee have them in their constituency, this would be one means to tell them.

**Austin Mitchell:** There are none in Grimsby. You mentioned earlier that council housing is on, but the council housing that goes under large-scale voluntary transfer, which effectively gives it away to housing associations, is not on. You have to pay out on that, because they have been receiving gap funding as a kind of dowry to take on the thing. There is expenditure, but no asset.

**Karen Sanderson:** If that is the transaction, yes, we would reflect a payment made to a third party to take that on.

**Q85 Austin Mitchell:** What happens to the debt that is written off? It mystifies me. Last week, the Chancellor announced that he was writing off half the debt owing on the Humber bridge. When council houses are privatised, the debt is written off. What do you do? Do you just magic it? Does it go into a locked box where it does not pay interest, or does it just vanish? What happens?

**Karen Sanderson:** We would show in the accounts that a debtor is no longer there, and we would see it as an expense in the account.

**Q86 Austin Mitchell:** So the Humber bridge debt?

**Karen Sanderson:** When that gets written off, you will see that in due course go through the accounts.

**Andrew Hudson:** The detail, Karen, would be in the Department for Transport accounts. We would reflect it in here, probably in the management commentary or the notes, if it was.

**Austin Mitchell:** It is not getting any interest. Nobody is getting anything from it; you have just written it off.

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**Karen Sanderson:** You have to reflect the fact that that asset has no value any more, and you reflect that through the accounts by writing it down.

**Matthew Hancock:** It is a pleasure, Austin, to hear you reflecting the concerns of a true fiscal conservative.

**Q87 Joseph Johnson:** The problem with these academies that have provided no data, or that have provided data of insufficient quality, goes back to an earlier conversation that we had at a previous hearing about the tension between localism and decentralisation, and the Treasury's effective loss of control over the breakdown of your command-and-control structure. What really worries me is that what we are beginning to see here with these academies is going to be writ large when it comes to the GP commissioning consortia—the likelihood that they are going to fail to provide the data that you need to hold them to account for public money. Do you recognise that?

**Sir Nicholas Macpherson:** It is certainly a risk, and if that table gets longer and longer each year, that would be an indication that something was wrong in the system. It is something we need to keep quite a close eye on, and this Committee needs to keep quite a close eye on it.

**Q88 Mr Bacon:** You make it sound as though you are sort of expecting that that is what will happen—that the list will get longer and longer.

**Sir Nicholas Macpherson:** The reason why I hesitated—you were right; you picked up something that was going on in my head—was that inevitably we will get more and more academies. The question is whether a greater percentage of them are failing or whether it is just because you have a lot more academies. Either way, we have to understand that and follow it up.

**Karen Sanderson:** There are some timing issues as well. Academies have a 31 August year end. Whole of Government accounts has a 31 March year end. When an academy is new, by the time we do whole of Government accounts it does not yet have an audited set of statements.

**Q89 Mr Bacon:** Someone could have thought about that when they were setting up the legislation for academies. What amazes me is that there is now £1.2 billion of expenditure and £2.2 billion of assets, which are the values of the unaudited data included with the whole of Government accounts from the individual academy returns. That is a new area where you cannot pin it down. We are familiar with the EU accounts being qualified year after year—I remember making a speech on it in 2002, nine years ago, and it is still going on—we are familiar with the Department for Work and Pensions accounts, which under various names have been qualified since 1988, and now you have a new one. We had a discussion—not just the one last week—with the Department for Education, and that was quite a long time ago. The same thing, as Mr Hancock made clear, is a concern in relation to GP consortia. The fact that this would be likely to occur unless the systems were put in place at the right

time, which means at the beginning, is fairly predictable. That is where I would expect a finance ministry to be involved in giving very clear guidance to the relevant Departments to ensure that these building blocks were in place at the right time, so that these new problems did not occur. That does not seem to be what you have done, however.

**Sir Nicholas Macpherson:** We are working very closely with the Department for Education. It is in the nature of all Governments that occasionally they get quite enthusiastic about some new idea—

**Mr Bacon:** That is the whole point of an accounting officer system—

**Sir Nicholas Macpherson:** It is often driven by No. 10 Downing street—

**Q90 Mr Bacon:** Sir Nick, I know about politics, and you know about government. I know about all that; the whole point of an accounting officer system is where permanent officials paid by the taxpayer, who are not *parti pris* and who carry on when there is a change of Government, stand there and say, “Hang on, our job is to defend Mr and Mrs taxpayer. How are we going to do that with this ‘horlicks’ that you have put before us?” That is the thing that doesn't seem to happen often enough.

**Sir Nicholas Macpherson:** I completely agree with you about the role of the accounting officer.

**Mr Bacon:** I thought you were going to say that you completely agreed about the horlicks.

**Sir Nicholas Macpherson:** If the Treasury set up a structure where it could not account for how public money was spent, I would be very worried. Indeed, we have a real live test coming up with the policy of credit easing, which is much on my mind, when accounting for it. Let me reassure you we will be able to account for credit easing. You're right, but different accounting officers will, I suppose, display different enthusiasms for accounting for public money. I hold Sir David Bell in the highest regard and I'm quite sure that he is doing all he can to ensure this is accounted for.

On the point about the school year, schools are obsessed with their school years. They run themselves tightly on the basis of school years. If we were qualified simply because of the problem about the financial year, I would be disappointed. I hope we can work with the National Audit Office to find a way through on that.

**Q91 Nick Smith:** To pick up Mr Johnson's point about GP commissioning organisations, will they be sufficiently regulated to provide this information in a transparent way?

**Sir Nicholas Macpherson:** I would hope so. Primary care trusts seem to have passed the test. I don't believe it will be beyond the wit of GPs to do the same thing. I will go back to the Treasury and look into it, but I would be disappointed if they couldn't account for how they spent their money.

**Q92 Chair:** Finally, I have two questions; one is bigger than the other. The first concerns treatment of the 4G licences. Are you going to ensure they are properly treated, unlike the 3G?

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**Sir Nicholas Macpherson:** I don't accept the treatment of the 3G—we've had different advice over the years and they've shifted, but we will always—

**Q93 Chair:** Will you stick to the accounting standards in your treatment of them, which we didn't do under—

**Sir Nicholas Macpherson:** There is a genuine difference of view. It's not that we're being difficult or trying to hide anything.

**Q94 Chair:** I thought it was because you were trying to secure the money in one particular year, actually.

**Sir Nicholas Macpherson:** That goes back a long time. We didn't want you to spend it in a spending Department if you remember.

**Chair:** I do remember that.

**Sir Nicholas Macpherson:** I remember Mr Brown being very keen to ensure that didn't happen. But we will try to do the right thing.

**Chair:** Under the accounting standards.

**Sir Nicholas Macpherson:** We will try to do the right thing.

**Q95 Mr Bacon:** The hallmark will be Government bonds, will it?

**Matthew Hancock:** Won't this sort of document help with that as well?

**Sir Nicholas Macpherson:** Yes—the fact that we're discussing it.

**Chair:** We now come to the final thing that was so interesting in this document. It might be considered dry, but it had loads of gems within it.

**Q96 Matthew Hancock:** We are talking about the Whole of Government Accounts!

**Chair:** Yes, but I'm talking about the way it's presented. The tax not collected, which is on page 114, is a gobsmackingly huge, ginormous figure. I totted it up, with help, as being £105 billion.

**Nick Smith:** Blimey!

**Chair:** There is £105 billion outstanding, which is gobsmacking. Equally gobsmacking is that you've written off nearly £11 billion.

**Sir Nicholas Macpherson:** That is the one I'd be worried about. When you pay, if indeed you do pay, your self-assessment—

**Chair:** I do, I hasten to add.

**Sir Nicholas Macpherson:** Generally you pay it by the end of January. It's paid then, but it actually accrues in relation to the last year, so most of that £100 billion will be that. It's the final bit you mentioned—

**Chair:** The £10.9 billion.

**Sir Nicholas Macpherson:** That is the thing that is written off.

**Chair:** Which is a lot of money.

**Sir Nicholas Macpherson:** That is a lot of money. You're right to draw attention to that. I know this Committee regularly holds her Majesty's Revenue and Customs to account. To be fair, I seem to recollect that it has improved a bit on this front of late. Bear it in mind also that if a company goes bankrupt, obviously HMRC is the first creditor, but often you just don't get the money back, so you'll never get a zero score, but we need to work on it.

**Chair:** Okay. That's probably as good as we'll get. Does anyone have anything else to raise?

**Q97 Austin Mitchell:** What happened to the Tote? I can't find the Tote on the list.

**Sir Nicholas Macpherson:** Remember this finishes on 31 March 2010. The Tote will be reflected in the accounts for 2011–12, and Northern Rock will be reflected—

**Q98 Matthew Hancock:** The Tote of course never belonged to the Government, did it?

**Sir Nicholas Macpherson:** It is one of those strange things like the trustee savings banks. It's never clear whom they belong to.

**Q99 Chair:** It did belong to the Government—has it been sold?

**Matthew Hancock:** You obviously didn't come to my Westminster Hall debate.

**Chair:** Thank you very much. That was a very interesting session.

**Sir Nicholas Macpherson:** Thank you. I'm very pleased that the Committee has found the accounts as interesting as it has.

### Written evidence from ICAEW

#### ICAEW POLICY BRIEFING: WHOLE OF GOVERNMENT ACCOUNTS (WGA)

##### *ICAEW Policy Briefing: Whole of Government Accounts (WGA)*

Today, in line with the Autumn Statement, HM Treasury has published the first set of UK Whole of Government Accounts (WGA). This data has been released at a significant time when many countries in the Eurozone are struggling to manage their national debt and ensure global economic stability.

WGA represents a new policy tool to help the UK Government and policy makers manage national debt. It complements existing fiscal indicators such as the Office of Budget Responsibility's annual evaluation of the UK's long-term public fiscal outlook. The release of this audited information will mark the first steps towards the first full public disclosure on the health of UK public finance and can help inform future public expenditure planning.

*What is WGA?*

WGA is a consolidated set of accruals-based accounts covering around 1,500 public sector bodies; including central government, devolved administrations, the health service, local government and public corporations. Unlike the Australian and New Zealand WGAs, the UK WGA has marked the first time a country has consolidated the whole of government on an accruals basis, using the international financial reporting standards (IFRS), drawing comparisons to how a listed company would disclose accounts.

Under the previous Government, the UK made a commitment to produce WGA as part of the Government Resources and Accounts Act (2000). HM Treasury is responsible for the consolidation of WGA and has a statutory obligation to publish the first set of accounts for 2009–10 by 31 December 2011. The National Audit Office (NAO) is also required to give an opinion on WGA.

*Key WGA findings include*

- National debt—As at 31 March 2010, the Government had current borrowing and financing liabilities due to be repaid within a year of £200.9 billion, comprising National Savings and Investment products (£98.8 billion), treasury bills (£63.0 billion) and gilt edged securities (£39.1 billion). In addition, it had non-current gilt edged securities of £764.7 billion that need to be re-paid over longer periods than a year. The UK made total interest repayments of £30.7 billion in 2009–10.
- Private Finance Initiatives (PFI)—At 31 March 2010, the net book value of PFI assets was £30.9 billion and the associated liability for capital repayments was £28.1 billion. The present value of future obligations was £131.5 billion, including service charges and some life cycle replacement costs.
- Public Sector Pensions—Public service pensions formed a significant part of the Government's total liabilities, with a total net liability of £1,132.3 billion as at 31 March 2010. Policy Implications.

The publication of WGA is a tool in improving accountability, transparency and sound governance in the management of taxpayer's money. It provides a "bigger picture" view into UK public finances and supports policy makers in policy and financial planning on public expenditure including Private Finance Initiatives (PFI), health spending and public sector pensions.

At a time when the Eurozone, United States and Japan implement large scale deficit reduction plans, WGA is an example of a fiscal indicator which can support policy makers in planning and paying for future obligations (eg hospitals, infrastructure projects). More importantly, it also highlights the important role of future taxpayer's revenue in financing future obligations.

*Our view*

ICAEW Chief Executive, Michael Izza:

"As the Eurozone tackles a serious sovereign debt crisis, WGA represents a great tool to manage public sector debt. It will help MPs and policy makers understand their future financial obligations and their plans to manage these payments. It will also enable the public to see not just what they effectively own but also how their money is being spent.

Private companies now use accounting standards that translate internationally. WGA is based on these IFRS standards and can help the UK as well as other countries lead the way in transparent, accountable public sector debt and expenditure management."

ICAEW remains committed to supporting policymakers as we seek to ensure transparency, accountability and sustainability in public finances. To learn more about our policy activities on public finance or to arrange a formal briefing please contact:

29 November 2011

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**Written evidence from the Permanent Secretary, H M Treasury**

EVIDENCE TO THE PUBLIC ACCOUNTS COMMITTEE ON WHOLE OF GOVERNMENT ACCOUNTS 2009–10

At the Public Accounts Committee (PAC) hearing on Monday 5 December, I committed to provide you with further information on the following issues:

- (i) why Further Education is included in the public sector and Higher Education is not (016–20);
- (ii) if Kilmarnock prisons are on the balance sheet and if so since when (043–47);
- (iii) on governance, whether any PFI hospitals were being managed by someone working part-time (051);
- (iv) the different treatment of public sector pensions: when setting contribution rates and when including them in the accounts (056);
- (v) provisions for nuclear decommissioning resulting from investment in nuclear power (070–71);
- (vi) the reasons behind nuclear decommissioning being discounted at 2.2% and pensions discounted at 3% (078 and 81); and

(vii) the management of clinical negligence liabilities (085–86).

(i) *Why Further Education is Included in the Public Sector and Higher Education is not*

The Office for National Statistics reclassified Further Education Institutions to the public sector retrospectively in October 2010. They explained their decision in a paper “Classification of Sixth Form and Further Education Institutions” dated 13 October 2010. They also reconfirmed that Higher Education Institutions should remain as private sector bodies. In their paper, they summarised their rationale as follows:

“Specific classification guidance is provided in the European Manual on Government Deficit and Debt (MGDD) which states that, in the case of schools:

“The general government controls a school if its approval is needed for creating new classes, making significant investments in gross fixed capital formation or borrowing; or if it can prevent the school from ending its relationship with government”.

These decisions mean that all publicly funded education institutions in the UK responsible for educating people to the age of 18 are classified in the public sector.

UK Universities, which are responsible for higher education, remain classified as private sector as they enjoy considerably greater freedom over their general corporate policy compared to the Further Education sector”.

(ii) *Whether Kilmarnock Prisons are on the Balance Sheet and Since. When?*

The HM Prison Kilmarnock is on-balance. It is disclosed as an on-balance service concession arrangement in Note 18b on page 104 of the 2009–10 Scottish Government Consolidated Accounts. These accounts are included in the 2009–10 Whole of Government Accounts. Before 2009–10, Kilmarnock was recognised as off-balance sheet, following guidance and a technical note that was produced by the Treasury task force on private finance, which the Accounting Standards Board had agreed. The auditor did not disagree with that view. Indeed, at one point round the turn of the century, it was on nobody’s balance sheet.

(iii) *Whether any Private Finance Initiative Hospitals Were Being Managed by Part-Time Staff*

While the Department of Health have not collected any further information since the previous reply to the Committee in July 2011, they consider it to be important that Trusts manage all of their business affairs appropriately.

This includes PFI contracts. At the time of the July reply they wrote to the Chief Executive Officers of the Trusts that did not have at least one WTE managing their contract and reminded them of the National Audit Office’s views on the level of contract management resources. As identified by the Department of Health and Treasury in the Romford pilot, and subsequently included in the operational savings guidance published by the Treasury in the summer, excellent contract management is key to maximising value for money in contracts and we expect this will be a core focus in realising savings in operational PFI projects.

(iv) *The Different Treatment of Public Sector Pensions: when Setting Contribution Rates and when Including them in the Accounts*

Whole of Government Accounts (WGA) uses the Financial Reporting Standard 17 accounting standard, which uses AA corporate bond yields as the discount rate. This is on the assumption that the pension scheme is funded—as all private sector schemes are—and the bond yield proxies for growth in the fund.

This is a sensible concept for the private sector. But short-term variations in bond yields cause real problems for schemes, who need to worry about the long-term growth of the fund, and so even private sector schemes don’t set contribution rates on this basis.

The Treasury use corporate bond yields for WGA, simply because it is the international accounting standard and that is how WGA is compiled. Departmental resource accounts do the same thing.

But outside Local Government, public sector schemes are generally not funded. large fluctuations in the WGA liability (hundreds of billions of pounds) arise from changes in the bond yields that do not necessarily reflect the underlying ability of the state to pay future liabilities.

To set the contribution rates, the Treasury uses a different discount rate. At the March 2011 Budget, we changed this to an estimate of long-term GOP growth (CPI plus 3%, based on the Office for Budget Responsibility’s long-term numbers, but rounded). That reflects the fact that in an unfunded scheme, future liabilities are paid out of the tax base. The tax base essentially grows with GOP.

(v) *The Provisions for Nuclear Decommissioning Resulting from Investment in Nuclear Power*

With regard to the costs related to historic nuclear liabilities, each year the Nuclear Decommissioning Authority publishes the latest estimate for the nuclear provision in respect of civil nuclear sites for which it is accountable in its Annual Report and Accounts. The expenditure profile set out in the 2010–11 accounts illustrates a downward trend in expenditure over the next 50 years as sites enter into Care and Maintenance,

with subsequent increases in expenditure in the period from 2070 when final site clearance work is undertaken. This does not include the liabilities related to decommissioning the eight British Energy nuclear power stations, as these costs are to be met by the Nuclear liabilities Fund.

Mindful of past experience at managing the nuclear legacy, the Government legislated in the Energy Act 2008 (the Energy Act) to ensure that operators of new nuclear power stations will have secure financing arrangements in place to meet the full costs of decommissioning and their full share of waste management and disposal costs. The details of these decommissioning and waste financing arrangements can be found on the Department for Energy and Climate Change's website.

(vi) *Why Nuclear Decommissioning was Discounted at 2.2% and Pensions at 3%*

The accounting standards require an AA corporate bond rate for pensions and a risk free rate for provisions so we have different methodologies to determine the rates, and hence the different rates.

Pension liabilities

For pensions liabilities we need to apply a discount rate that is consistent with the requirements of International Accounting Standard (IAS) 19. This standard requires us to use a discount rate that is determined by reference to market yields on high quality corporate bonds, and so we look to use AA corporate bond redemption yields.

Provisions

For provisions, IAS 37 requires that where the effect of the time value of money is material, the amount of a provision shall be the present value of "the expenditures expected to be required to settle the obligation". The discount rate used to calculate the present value shall be a pre-tax rate that reflects current market assessments of the time, value of money and the risks specific to the liability. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted (IAS 37 paragraph 43).

The Treasury provides a recommended real discount rate to departments because most express cash flows related to provisions in current rather than nominal prices. As departments also adjust future cash flows for risk, this discount rate is "risk-free" in accordance with the standard.

To determine a risk free rate we use the yield on UK index-linked Gilts, as these are AAA rated instruments and we believe that they are the best proxy for a risk free rate. In the past we have only provided one rate ahead of each Spending Review period, in order to provide certainty for budgeting purposes and because Gilt rates have tended to be relatively stable. We are now, however, considering moving to an annual review and the provision of more than one rate as the yield curve has become considerably more volatile and has steepened sharply over the past 18 months.

(vii) *The Management of Clinical Negligence Liabilities*

The Treasury's role is to support the Department of Health and the National Health Service (NHS) to manage its budget and to ensure that its resources are targeted as effectively as possible to deliver appropriate patient care. The NHS is committed to promoting the highest possible standards of patient care and to minimise the suffering resulting from any adverse incidents. The NHS litigation Authority (NHSLA) is the Department of Health arms length body which is responsible for handling negligence claims against the NHS. It is committed to minimising the overall costs of clinical negligence by settling justified claims efficiently and defending unjustified claims robustly. Clearly it is in everyone's interests for this spending to go down and to this end the Treasury support the Department of Health in their efforts to minimise costs in this area. The Department of Health (DH) commissioned a review of the NHS litigation Authority by experts from the insurance industry to provide DH with advice on opportunities for more effective management of clinical negligence claims. DH expects to publish the report shortly.

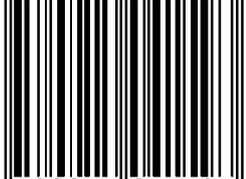
I hope this letter is helpful to you and other members of the Committee.

21 December 2011





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