



HM TREASURY

TREASURY MINUTES

Government responses on the Fifty Second to the
Fifty Fifth and on the Fifty Seventh to Sixty First
Reports from the Committee of Public Accounts
Session 2010-12



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

February 2012

TREASURY MINUTES DATED 27 FEBRUARY 2012 ON THE FIFTY SECOND TO THE FIFTY FIFTH AND ON THE FIFTY SEVENTH TO THE SIXTY FIRST REPORTS FROM THE COMMITTEE OF PUBLIC ACCOUNTS: SESSION 2010-12

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ISBN: 9780101830522

Printed in the UK by The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office

ID P002479324 02/12

Printed on paper containing 75% recycled fibre content minimum.

Fifty Second Report

Department for International Development (DFID)

DFID financial management

Report Summary from the Committee

The Department for International Development (the Department) is one of only two Government Departments protected from overall expenditure reductions. The Government has committed to increasing the UK's aid spending to 0.7% of gross national income from 2013. The Department faces a substantial challenge to improve its financial management and secure value for money from its rapidly increasing programme budget over the next four years, while reducing its administration costs by a third.

The Department acknowledges the importance of financial management and focussing on value for money but, despite previous recommendations from this Committee, has not made enough progress to date. The Committee welcomes the planned introduction, in 2011, of a finance improvement plan. The Department must now keep up the focus on better financial management, rather than let it slip, as happened in April 2010.

The Committee were concerned that the Department does not quantify the likely level of leakage through fraud and corruption. And the Department is only considering fraud risk at the level of delivery method rather than at a country level. Management of fraud risk will require a stronger framework for ensuring money is properly spent on the ground, with effective monitoring and pro-active anti-fraud work. This is particularly important in the context of the growing budget and the expected efficiency savings in administrative expenditure.

The Department's programme budget is due to increase by a third in the next four years. The Department lacked certainty about the future split between bilateral (country to country) funding and funding to multilateral organisations (which then determine how to distribute the aid worldwide). On provisional plans, however, the proportion of the Department's spending that will go through multilaterals is set to increase. The Committee were unconvinced that an increase in funding to multilaterals would ensure value for money as the Department does not have the same visibility over the cost and performance of multilaterals' programmes as it does over its own bilateral programmes.

The Department's plans to increase spending in fragile states and in sectors where it has less experience increase the risks to value for money, especially given the Department's patchy evidence on costs and outcomes, and its poor understanding of the levels of fraud and corruption.

The Committee was concerned that the Department still has insufficient data to make informed investment decisions based on value for money. The Department was not clear about whether it needs to generate more data, or whether the data exist but need to be better collated. The Committee heard testimony from the Department that it has made progress in collecting data on primary education in developing countries and we look forward to receiving the Department's progress report. The Department, however, needs to generate similar data for all of its aid portfolio.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department for International Development on its financial management capability, its increasing focus on value for money, and the challenges it faces in managing its increasing programme budget while reducing its overall running costs.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

While most Departments are under increasing pressure to reduce expenditure, the Department for International Development's (the Department's) spending on aid is due to increase by a third in real terms over the next four years. At the same time the Department is expected to reduce its administrative expenditure by £34 million to £94 million (a real terms reduction of a third). The Department is planning to do more work to help those most in need, including in sectors in which it has less experience, and in more fragile and conflict-affected countries which pose a higher risk in terms of poor security, delivery capacity and leakage of funds through fraud and corruption. Sound financial management and a stronger focus on value for money are essential to inform the Department's investment decisions.

The Committee welcomes the Department's recognition that it needs to improve its financial management and its focus on value for money. The following recommendations are intended to help the Department tackle some of the challenges that lie ahead.

1.1 The Government welcomes the Committee's report and its findings, and the priority and focus it gives to financial management.

1.2 The Department recognises both the challenges and the responsibilities that come with the increase in its programme spending at a time when its administration costs are constrained. The Department has undertaken root and branch reviews of all its spending, putting results and value for money at the heart of its allocations. The Department developed and published a Finance Improvement Plan in September 2011 to drive forward improvement in financial management standards. The Permanent Secretary leads the implementation of this Plan.

1.3 All Departmental investments require a clear value for money assessment set within a business case format based on the Treasury good practice model. This requires a rigorous financial assessment and all approved business cases, together with all expenditure over £500, are published on the Department's website to ensure that all financial decisions are open to parliamentary and public scrutiny.

1.4 The Independent Commission for Aid Impact (ICAI) has recently reviewed the Department's actions in the area of anti-corruption and the Department has agreed to implement fully the recommendations made by the Commission. The positive steps that the ICAI report noted and which are already underway include: good examples of involving beneficiaries in monitoring programme delivery to promote greater transparency and accountability; the "new business case procedures represent a significant increase in the level of rigour with which DFID approaches the prevention of corruption in programme design"; the innovative work DFID funds in UK law enforcement to counter illicit flows into UK; and "the high priority to anti-corruption within its governance programmes".

PAC CONCLUSION AND RECOMMENDATION 2

The Department increasingly recognises the importance of financial management but has not consistently prioritised its improvement and does not have enough financial expertise in the countries in which it works. Worryingly, the Department stopped monitoring its finance plan, the Money Action Plan, in 2010 when it undertook a more fundamental review of how it allocates resources to secure impact and value for money from aid.

In order to keep financial management as a high corporate priority, the Department should set out in its 2011 finance improvement plan clear and auditable outcome measures for the plan's activities, including how it will increase financial expertise in the countries in which it works, who is responsible for delivering the plan's activities, and when targets should be achieved. It should report on progress publicly.

2.1 The Government agrees with the Committee's recommendation.

Target implementation date: September 2011

2.2 The Department published its Finance Improvement Plan in September 2011 in the light of the recommendations made by the National Audit Office (NAO). The plan draws on the Financial Management Maturity model developed by the NAO and sets out the Department's vision for financial management, describing the expectations for staff in different roles. It sets out activities, milestones and outcomes against which we will assess our progress over the next three years and be held to account. Further metrics to monitor progress are being developed. The Management Board will review progress against the plan regularly, taking corrective action if necessary.

2.3 The plan specifically identifies actions to increase finance capability in finance and non-finance roles across the Department. Currently each member of the senior civil service has a specific set of financial management objectives for the year 2011-12. In addition the plan will ensure that those staff in country offices and departments accountable and responsible for managing the Departments money has financial management objectives and finance skills to fulfil their roles. The plan also sets out how the Department will improve basic financial practices, such as budgeting, forecasting and reporting, as well as addressing specific challenges of fraud and corruption in the difficult environments in which the Department works.

PAC CONCLUSION AND RECOMMENDATION 3

The Department does not estimate levels of leakage through fraud and corruption, which undermines its ability to make informed investment decisions and gain assurance that it has appropriate and effective controls in place. Fraud investigation is reactive and reported levels of fraud are unbelievably low. The selection of aid projects is not based on a good understanding of the scale and likelihood of fraud in each country, nor how proposed project design mitigates the risks.

The Department should assess the level of leakage across each of its programmes in its 27 priority countries. It should also increase the attention given at all levels of its organisation to tackling fraud, with a stronger framework for ensuring funds are spent properly on the ground, with effective monitoring and pro-active anti-fraud work. Each project and programme business case should set out: how the Department has designed the project to reduce the risk of leakage; an assessment of any residual risk of leakage; and how this risk will be managed. Subsequent annual reviews of projects should include updated fraud risk assessments.

3.1 The Government agrees with the Committee's recommendation.

Target implementation date: May 2012

3.2 Given the environment in which the Department works and the diversity of the Department's programme, estimating losses due to fraud is difficult. The Department is working closely with the Centre for Counter Fraud Studies in Portsmouth and the National Fraud Authority to explore how to use Fraud Loss Measurement methodologies in international development. A report from the Centre will be available in early 2012.

3.3 The Department's business case guidance was strengthened in September 2011. In the business case, the Department now requires an assessment of financial risk and fraud, which describes the potential exposure to loss, fraud or corruption, and the steps to be taken to mitigate this in terms of disbursement, monitoring and reporting. It should include an assessment of the financial management and accountability systems of any partner organisations and their underlying capacity and capability.

3.4 The Department launched a new approach to Annual Project Scoring and Project Completion Reports in January 2012. Spending Departments are required to monitor on an annual basis the risk that funds are not used for the purposes intended and to summarise whether any additional checks and controls are required to ensure that UK funds are not lost, for example to fraud or corruption.

3.5 In response to the Independent Commission on Aid Impact (ICAI) report and recommendations on anti-corruption, the Department has also commissioned an internal review of improvements needed in terms of management, coherence, coordination and culture to achieve change in the Department's approach to corruption and fraud.

PAC CONCLUSION AND RECOMMENDATION 4

There is a risk that the Department will increase its funding to multilaterals and partner organisations simply because it has insufficient capacity to spend its increased budget through its own bilateral programmes. The Department is still identifying and designing many of the projects and programmes needed to reach the UK's aid target of 0.7% of gross national income by 2013. The Department plans to increase the proportion of its funding spent via multilaterals but does not have the same visibility over the cost and performance of multilaterals' programmes as it does over its bilateral programmes. Furthermore, the strategy to increase DFID spend through multilateral programmes appears to have more to do with it being easier for DFID to do this than for it to assess the viability, effectiveness and value for money of bilateral programme proposals.

The Department must be able to demonstrate that any increase in funding to multilaterals is based on a clear assessment that it will achieve value for money, and that it represents better value for money than investing in alternative bilateral programmes.

4.1 The Government agrees with the Committee's recommendation.

Target implementation date: December 2013

4.2 The Department does not plan to increase the proportion of its funding spent via core contributions to multilateral organisations, although the absolute contributions will increase in line with the growth in aid spending. The overall core multilateral contribution in 2010-11 was 43% and it is expected to be around the same percentage share in 2014-15. The precise level of multilateral contribution will be dependent on multilateral performance over the period.

4.3 The UK Multilateral Aid Review (MAR), undertaken in 2010, looked at the value for money offered by 43 of the multilateral organisations through which the UK had, up to 2010, invested aid. It provided – for the first time – a rigorous, robust and comprehensive overview of the strengths and weaknesses of each multilateral organisation.

4.4 Following the review, the UK increased funding to the organisations offering very good value for money for UK aid, defined the performance improvements the Department is seeking from the other organisations, and withdrew core UK aid funding from four UN organisations assessed as offering poor value for money – the United Nations Human Settlements Programme (UN-HABITAT), the United Nations International Strategy for Disaster Reduction (UNISDR), the United Nations Industrial Development Organisation (UNIDO) and the International Labour Office (ILO).

4.5 All of the multilateral organisations that continue to receive core funding from the UK will be reassessed in 2013. Depending on the value for money that they offer for UK aid, their funding may then be increased, maintained, or reduced. All new investments across both the multilateral and the bilateral programme will continue to be subject to rigorous review through the new business case assessment framework.

PAC CONCLUSION AND RECOMMENDATION 5

The Department channels funding through complex delivery chains, some of which have high running costs. Total running costs for the delivery chain as a whole are not known. The Department has a corporate target to reduce its running costs to 2% by 2014-15, but partner organisations and multilaterals also incur further layers of running costs, which can often be much higher.

In order to maximise the resources that get to the frontline, the Department should develop clear plans to reduce or control running costs when delivering through multilaterals and partner organisations, and set a target for total running costs for the delivery chain as a whole.

5.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: December 2013

5.2 The Department is committed to driving down unnecessary running costs across the programme and maximising the value for money from its partners. As part of the MAR assessment the Department reviewed cost and value consciousness within 43 multilateral organisations. This review considered the drivers of spending by multilateral organisations and evidence of organisations striving for economy in purchasing decisions and seeking to reduce administrative costs.

5.3 As a result of the MAR, the Department has identified cost and value consciousness as a key reform priority for the multilateral organisations. An early priority is more transparency in reporting on administrative costs as a first step towards reducing them where it is appropriate to do so. The business cases for core funding through the multilateral organisations set out the UK's priorities for reform, including through improving cost and value consciousness. In many cases this includes reducing administrative costs. Progress will be monitored and reported on annually.

5.4 The Department is working with a network of civil society organisations to promote value for money, transparency and accountability. Annual efficiency savings have been built into contracts with fund managers. The Department must balance the need to drive running costs down with the need to promote high standards of due diligence and operational financial management and reporting.

5.5 Driving down costs through the Department's commercial relationships is important. The Department has been strengthening its commercial capability as a result of an earlier Procurement Capability Review. The Department now brings more of its funding into competitive mechanisms, is implementing a more strategic approach to procurement, and monitors performance against procurement savings targets.

5.6 Given the diversity of organisational model in our partners, the Department does not believe setting a single target for total running costs would be appropriate, but will continue to strive to bring down costs on a case by case and partner by partner basis.

PAC CONCLUSION AND RECOMMENDATION 6

The Department does not have all of the data it needs to manage and prioritise effectively its aid programme, or to measure whether all its projects and programmes are value for money. The Department has introduced a new information system, but it does not provide integrated performance and financial data to support well-founded decisions.

The Department needs to develop an explicit information plan setting out how and when it will improve data coverage and quality for all its programmes, including unit costs, with clear milestones against which we can judge progress.

6.1 The Government agrees with the Committee's recommendation.

Target implementation date: December 2012

6.2 The Department is already implementing a series of changes that integrate performance, financial and workforce data for decision-making. The Department published its finalised Results Framework in November 2011. This lays out the key measures at four levels to monitor the Department's performance: progress against Millennium Development Goals, DFID results, operational effectiveness and organisational efficiency. In November 2011, the Department's Management Board agreed a new annual cycle to manage performance and resources in an integrated way and is implementing this for the Spending Review period. The Department's results and financial information will be reported publicly in the Department's annual report and accounts in June 2012.

6.3 The Department is increasing its network of statisticians to ensure that results reported are against appropriate indicators with clear methodologies, consistently applied. The Department's Business Plan includes a set of impact and input indicators, giving key information about costs and results.

6.4 At the programme or project level, the Business Case requires appropriate measures, including where relevant, unit costs, against which value for money can be assessed and monitored. In January 2012, the Department launched a new approach to annual project monitoring, which requires these initial value for money assessments to be reviewed. Business cases, annual project monitoring and completion reviews are open to public scrutiny, together with information about the project's finances, on the Department's Project Database on its website.

6.5 On a sector by sector basis, the Department is making greater use of indicators and unit costs to track the performance and cost of delivering interventions in its countries of operation. For example: the majority of its country offices with education programmes are now tracking data on cost per child and unit costs of key education inputs such as teacher salaries, classroom construction and pre-service teacher training.

6.6 The Department will explore the feasibility of drawing both results and financial data from a single integrated information technology system when assessing the priorities for improvements to the Department's finance system, ARIES, and the way it is used.

PAC CONCLUSION AND RECOMMENDATION 7

The Department says it has increased its focus on value for money and there is a clearer understanding of top level corporate priorities, but it cannot demonstrate that it has optimised value for money.

The Department must be able to demonstrate unequivocally that it allocates resources on the basis of value for money, but staff do not have the information or strong incentives to do so - particularly given the pressure to spend increased resources. Country offices protect their own budgets, and have been unwilling to release funds which could be better spent elsewhere.

The Department should develop clear and auditable mechanisms which ensure that staff in both Headquarters and country offices have value for money criteria at the heart of their decision making, and that they reallocate funding to the best possible alternative when projects are delivering weaker value for money than expected.

7.1 The Government agrees with the Committee's recommendation.

Target implementation date: January 2012

7.2 The Department has a clear ambition to increase choice and contestability in its allocation process and sees this as one of the key mechanisms to increase value for money. This is clearly demonstrated in the steady increase in the pipeline of projects that is being developed and will be reinforced in the criteria that will be used in the allocation of remaining funding for 2013-14 and 2014-15. Value for money lies at the heart of the Department's project management cycle from approval through to review and evaluation.

7.3 The business case approval process and programmes requires teams both to demonstrate and to articulate value for money. Business cases which are not able to demonstrate value for money will not be approved. The Department has strengthened the quality assurance of its spending proposals with all projects of £40 million or more being referred to the Department's new Quality Assurance Unit under the leadership of the Chief Economist before being submitted for final decision.

7.4 From January 2012 the Department introduced a new Annual Review format which requires spending teams to assess whether a project remains good value for money. If a project is judged not to be value for money, it is a requirement for the Department to state explicitly the remedial action that will be taken to address this, including potentially stopping the project. This will ensure that values for money considerations are uppermost throughout the project cycle.

Fifty Third Report

Department of Health (DH)

Managing high value capital equipment in the NHS in England

Report Summary from the Committee

In the past three years, NHS trusts in England have spent around £50 million annually on buying three specific types of high value capital equipment – Magnetic Resonance Imaging (MRI) and Computed Tomography (CT) scanners, used mainly for diagnosis, and Linear Accelerator (Linac) machines for cancer treatment. The current value of these three types of machines in the NHS is around £1 billion. Patient demand for services from these machines has increased significantly in the last decade and continues to grow.

Since 2007, the Department of Health (the Department) has devolved responsibility for procuring and managing these machines to individual trusts but this structure is not conducive to delivering value for money. Each trust makes its own assessment of demand, buys specific machines through the route of its choosing and operates the equipment as it sees fit. As the Committee have heard before, despite having no control over the actions of individual trusts, the Department remains accountable for value for money across the NHS system. The Committee continues to question whether the system provides value for money when Foundation Trusts act independently with no explicit incentive to adopt best practice nor to work together to achieve economies of scale. The Committee is concerned that the NHS is failing to optimise its purchasing power, crucial at this time when £20 billion of savings in the NHS are required by 2015.

The NHS currently has inadequate information to assess cost, performance and capacity across the system as a whole. Commissioners and trusts have no mechanism to understand the reasons for large variations that persist in the use of MRI and CT machines, as they are unable to compare their performance with other trusts. The NHS needs to make high quality, comparable data available on machine use and cost. The Committee welcomes the Department's plan to require all trusts to produce data on MRI and CT scan use. A standardised, national dataset would help trusts to compare unit costs and benchmark their performance. It would also enable commissioners to identify the large variations in utilisation across trusts and take appropriate action.

The procurement and management of high value equipment is fragmented and uncoordinated, leading to wasted resources and variable standards of services. Trusts have three main ways to purchase high value equipment: by dealing directly with suppliers; through framework agreements, managed by NHS Supply Chain; or by joining up with other trusts in collaborative purchasing arrangements. The Committee was told that framework agreements are generally a more efficient way to purchase one-off equipment orders yet one in five of these machines are bought outside framework agreements and the Department has no power to mandate trusts to use them.

Even within the framework agreement there remains much greater scope to save money by bundling orders together across trusts, as the Department showed through its Cancer Equipment Programmes of 2000-2007 which delivered savings of around £38 million through aggregating demand. NHS Supply Chain has, however, so far placed no bulk orders for any of these three types of machine the Committee looked at, despite now purchasing over 80% of such machines for the NHS. All orders have been placed individually with no aggregation to larger volumes. This is a lost opportunity to use collective buying power to get lower prices and we expect NHS Supply Chain and other collaborative procurement bodies to work with trusts to share plans on future needs and get better prices and value for money by exploiting the joint buying power.

Trusts vary in the effectiveness with which they use their machines, as demonstrated by differences in the number of scans per machine, opening hours and waiting times. For example, the average number of scans per CT machine varied from around 7,800 to almost 22,000 per year and opening hours ranged from 40 to over 100 hours per week. There are also unacceptable response times for certain conditions, for example, 50% of people who have a stroke are not getting a scan within 24 hours. Furthermore, an estimated 13% of cancer patients are not getting access to radiotherapy when it could prolong their lives. Trusts therefore need to increase the flexibility with which they manage and use equipment.

Half of the machines in use will need replacing over the next 3 years, at a cost of £460 million. The Department has not assessed whether existing machines could be used more efficiently to meet rising demand to make better use of scarce financial resources at a time when the NHS needs to find £20 billion of efficiency savings.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department, NHS Supply Chain and University College London Hospitals NHS Foundation Trust on managing high value capital equipment in the NHS in England.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The Department is not achieving best value for money when it purchases high value equipment and there is no clear accountability for maximising value in the purchase and use of such equipment. The Committee have previously raised concerns about how accountability will work in a devolved structure and in this case, find again there is no overarching accountability arrangement in place.

The Department is responsible for securing value for money in health spending, but cannot require Foundation Trusts to work together to exploit their buying power or to match capacity and demand across the NHS. At present the systems for buying and managing high value equipment are fragmented, with resources being wasted. The Department should clarify who will be accountable to the Committee for ensuring value for money in the purchase and use of high value equipment in the NHS.

1.1 The Government agrees with the Committee's recommendation.

Implementation date: December 2011.

1.2 The current accountability arrangements for the NHS, and how these will change after April 2013, subject to the passage of the Health and Social Care Bill currently before Parliament, are set out in the Department of Health Accounting Officer System Statement, which was provided to the Committee in December 2011.

1.3 Under current NHS legislation, there are different accountability arrangements for NHS foundation trusts and for NHS trusts. Under the legislation agreed by Parliament in 2003, NHS foundation trusts are not directly accountable to the Department. Each foundation trust's chief executive is designated as an Accounting Officer, with responsibilities for ensuring regularity, propriety and value for money, and is directly accountable to Parliament. The chief executives of NHS trusts are appointed as Accountable Officers by the NHS Chief Executive, and are accountable to Parliament through him. Accounting Officers and Accountable Officers in trusts are accountable for issues of probity, regularity, the management of resources against financial duties, and the stewardship of assets. This includes ensuring value for money in the purchase and use of high value equipment.

1.4 The Government's policy is that all NHS trusts should become NHS foundation trusts, by 2014 or soon after. From April 2013, the NHS Trust Development Authority will be accountable to the Department for overseeing NHS trusts, and will be responsible for the appointment of Accountable Officers in each NHS trust.

1.5 Monitor, currently the regulator of foundation trusts, will from April 2013 become a sector-wide regulator, whose main duty will be to promote value for money in the provision of healthcare services, while maintaining or improving quality. Monitor will retain specific oversight powers over foundation trusts until at least 2016; its transitional powers mean that there will continue to be a national organisation responsible for overseeing governance and value for money in the foundation trust sector. The Department will consider further what arrangements might be needed after 2016, and whether Monitor's transitional powers need to be extended.

1.6 The Department is putting in place a number of policies, in particular clinically-led commissioning, to promote quality and efficiency in NHS services. The Department believes that the combination of these policies, backed by a system of independent regulation, will provide more powerful incentives for value for money in providers than could be achieved through direct management by the Department.

PAC CONCLUSION AND RECOMMENDATION 2

The NHS lacks adequate information on MRI (Magnetic Resonance Imaging) and CT (Computerised Tomography) activity to compare performance between trusts and to drive improvements in efficiency. Large variations persist in machine use, waiting times, opening hours and access to scans. Neither trusts nor commissioners are able to compare the throughput and efficiency of their MRI or CT machines because there is no central repository of data. This compares unfavourably to radiotherapy where, since 2009, trusts have been required to contribute to a national dataset on levels of machine use.

The Department has pledged to produce a dataset by April 2012 covering the use of MRI and CT machines by trusts, and the Committee welcomes this. From 2012-13 onwards, the NHS Commissioning Board should ensure that this dataset enables local clinical commissioning groups to hold trusts to account for their performance, and to drive improvements in efficiency.

2.1 The Government agrees with the Committee's recommendation.

Target implementation date: January 2013.

2.2 Subject to finalising the necessary approvals, it is expected that both NHS trusts and NHS foundation trusts will be mandated to implement the Diagnostic Imaging Dataset from April 2012 with the first data available in summer 2012.

2.3 This dataset will provide detailed information on the provision of diagnostic imaging tests such as CT and MRI. It will have a patient rather than an equipment focus. For example, it will provide data on access to, and waiting times for, certain tests. It will not provide data on the actual CT and MRI machines, but will enable data on activity to be compared (for example: at CCG and provider level) and also combined with local intelligence in order to look at things like machine utilisation rates or productivity measures. This should stimulate debate between providers and commissioners on performance and efficiency.

2.4 The NHS Commissioning Board's overarching role is to ensure that the NHS delivers better outcomes for patients within available resources. One of the Board's functions will be to develop and oversee a comprehensive system of CCGs with responsibility for commissioning the majority of healthcare services. The Board will use information systems to track progress and it is envisaged that the Board and CCGs will use a common set of information to improve efficiency across the system. Consideration will be given to how information from sources such as the planned Diagnostic Imaging Dataset could be used to maximise efficiency.

PAC CONCLUSION AND RECOMMENDATION 3

Some trusts are not using framework agreements which would allow them to buy the same machines more cheaply. NHS Supply Chain told the Committee that it had operated framework agreements for MRI and CT since 2007 and Linac machines since 2008, but that 20% of these machines were still bought through other routes. Some trusts remain unaware, or sceptical, of the benefits of buying through framework agreements and may choose more expensive procurement routes.

The NHS Commissioning Board should require commissioners to use 'comply or explain' clauses in contracts with trusts to encourage purchasing through framework agreements unless they can articulate a clear reason to take a different approach. NHS Supply Chain must gather, quantify and promote evidence on the cost effectiveness of its framework agreements.

3.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: March 2013.

3.2 80-90% of all trusts (NHS trusts and NHS foundations trusts) now make use of framework agreements. However, a provision has been included in the NHS Operating Framework 2012-13 to the effect that trusts (other than foundation trusts) should comply with central purchasing arrangements or explain to their commissioners any decision to deviate from them. It is not intended to extend this provision to foundation trusts, who remain responsible for their own purchasing decisions.

3.3 However, the Department is already working with the Foundation Trust Network (FTN) to raise the importance of good procurement with NHS foundation trust Chief Executives and launched a 'procurement diagnostic tool' through the network in February 2011 to help Chief Executives ask themselves the right questions. This was followed up by a workshop with over 40 trust leaders in July 2011 led by the NHS Chief Executive, Sir David Nicholson. The aim of the workshop was to begin the process of agreeing the need for systemic change, at a significant pace, for procurement in the system. These discussions will be built on in April 2012 with the launch of a joint Department and NHS procurement strategy. This will include good practice and stress the importance of collaboration. The strategy will also include 'standards of procurement excellence' – these will address issues related to capital expenditure.

3.4 In addition, the NHS Commissioning Board is considering a range of tools to support effective commissioning, for example: to support clinical commissioning groups to contract better for patient care whilst achieving value for money. The Board will take the Committee's recommendation into account during their considerations.

3.5 The NHS Supply Chain (NHS SC) monitor uptake of their framework agreements, which is increasing year by year. They have estimated savings on each procurement as being between £40,000 and £120,000. These are achieved through centralising European public procedures rather than each trust or foundation trust having to comply with these procedures individually. Savings against historic prices are logged on a quarterly basis and shared with the NHS Business Services Authority. The Department is currently working with NHS SC to make sure that the NHS is given full information about the benefits of working with NHS SC to aggregate demand and the savings that can be achieved through greater use of bulk purchasing arrangements. The NHS SC has also started regular customer surveys relating to their capital procurement business that show, on the whole, very positive feedback to date.

PAC CONCLUSION AND RECOMMENDATION 4

The NHS is not taking advantage of bulk buying to achieve discounts, which is a missed opportunity to contribute towards £20 billion efficiency savings. Trusts largely base procurement decisions on their immediate requirements and do not coordinate planning with other trusts across the NHS. The Department concedes it has not done enough to get trusts to work together. NHS Supply Chain has so far placed no bulk orders for MRI, CT or Linac machines, despite having achieved volume discounts on other types of machines for example, digital mammography and ultrasound. NHS Supply Chain currently lacks information on what equipment trusts plan to buy so is unable to plan ahead to identify opportunities to bundle orders.

Commissioners should require trusts to share their plans for the replacement of high value equipment with NHS Supply Chain and / or other collaborative procurement bodies. This would enable NHS Supply Chain and others to aggregate orders across trusts to secure better prices.

4.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: March 2013.

4.2 The NHS Commissioning Board is considering what guidance is needed to support effective commissioning, for example to support CCGs to contract better for patient care whilst achieving value for money. The Board will take the Committee's recommendation into account in these considerations.

4.3 A new service is being developed by NHS Supply Chain (NHS SC), with the support of the Department, based around a combined capital planning, procurement, maintenance and finance offering for the NHS. This will involve NHS SC taking a more proactive approach. Rather than waiting

for NHS trusts and NHS foundation trusts to send them their plans, NHS SC propose to visit potential customers to discuss their needs and then help them to develop and shape their plans for a ten year period. This should result in a higher quality of capital planning across the NHS.

4.4 Participation by all trusts will be voluntary, but the greater the number of NHS trusts and foundation trusts making use of this service, the greater understanding of NHS-wide capital requirements that NHS SC will develop and the greater the opportunity for NHS SC to aggregate demand to achieve savings.

4.5 NHS SC is also actively considering the opportunities for bulk purchasing, at risk, certain types of medical equipment in order to maximise the competitiveness of their offering in response to anticipated future demand for replacement equipment. Details should be available later in the year.

PAC CONCLUSION AND RECOMMENDATION 5

NHS Supply Chain's objective to save the NHS money is at odds with how it is paid. Surprisingly, the Department's contract with Supply Chain allows it to charge trusts a percentage of the equipment purchase price, which provides little incentive to negotiate lower prices with suppliers.

The Department should consider how its contract with NHS Supply Chain might be changed so that NHS Supply Chain is financially rewarded for negotiating lower prices and generating savings.

5.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: October 2012.

5.2 The Department agrees that there is a danger that the contract with NHS Supply Chain (NHS SC) could disincentivise them to negotiate lower prices. However, the Department believes that there are already sufficient pressures in the arrangement to encourage NHS SC to deliver savings for the NHS. For example: NHS SC operates in a competitive market and is subject to an overall profit cap on its business, so although it charges suppliers a fee to pay for its services it has to ensure overall costs to the NHS are competitive or trusts will simply not use them.

5.3 The supplier charging model is a standard model in government procurement. The Government Procurement Service (GPS) has recently stated that its goal is to charge a maximum 0.5% across all its business. The Department is currently working with NHS SC to develop a pricing model for aggregated capital equipment purchasing whereby NHS SC receives, as part of its remuneration, a share of the savings it achieves through procurement. These savings will be measured against the prices last achieved for procurement of relevant equipment. The precise details of relevant benchmarks are currently being discussed.

5.4 In addition to this, NHS SC has recently established a new customer board to strengthen the engagement between NHS trust senior staff and NHS SC; understand the pressures and challenges facing the NHS; and to better utilise the scale and expertise of NHS SC to drive value for money and savings for trusts. This board should help to promote transparency and ensure that customer concerns about value for money are effectively addressed.

PAC CONCLUSION AND RECOMMENDATION 6

It is unclear if the NHS can meet growing patient demand for scans and radiotherapy services at the same time as having to deliver substantial financial savings. Trusts may need to spend £460 million within the next three years to replace worn-out machines. The Department has not assessed whether existing and new machines can be used more efficiently to meet rising demand to avoid unnecessary expenditure on under-utilised equipment at a time when substantial wider savings are needed across the NHS.

At a national level the Department, and in future the NHS Commissioning Board, should put in place the means to gauge whether capacity accurately matches needs. This should take into account the savings that could be made if machines were used more efficiently. At a local level, commissioners should secure the right capacity in the right places to meet the needs of their populations.

6.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: subject to the passage of the Health and Social Care Bill.

6.2 It is important that Trusts engage in demand and capacity planning and fully understand essential elements of service provision including activity, waiting and clearance times and equipment utilisation rates. This should be part of the dialogue between commissioners and providers within service contract discussions.

6.3 The NHS has already been supported to improve capacity planning in various ways, for example:

- in imaging, NHS Improvement and the NHS Institute have produced numerous tools to support capacity and demand planning and service redesign to optimise use of CT and MR equipment, staffing requirements, booking and scheduling issues and moving from conventional to extended working hours; and
- in radiotherapy, supported by the National Cancer Action Team (NCAT), a capacity and scenario planning tool is already available giving services a real time model to test working practices and scenarios for improvement to achieve the optimum throughputs and processes and a new radiotherapy demand model has recently been developed to help centres plan, taking account of local variation in cancer incidence, disease stage, performance status and co-morbidity.

6.4 In addition, the National Clinical Directors for both imaging and cancer continually promote best practice and provide support and advice through their networks and professional channels.

6.5 Commissioners also have a role in influencing capacity and planning for services reliant on high value equipment. They can already use:

- contracts to hold providers to account for commissioned services, for example, service specifications can: set standards and identify indicative levels of activity, information and performance requirements and outcomes that providers have to achieve; and
- financial incentives within commissioning contracts to: withhold part of payments if services are not delivered in line with contracts; encourage good practice via the best practice tariff programme; and reward innovation, linking a proportion of providers' potential income to achievement of local quality improvement goals through the Commissioning for Quality and Innovation (CQUIN) payment framework.

6.6 The NHS Commissioning Board is considering what guidance is needed to support effective commissioning, for example to support clinical commissioning groups to contract better for patient care whilst achieving value for money. The Board will take the Committee's recommendation into account in these considerations.

Fifty Fourth Report

Department for Business, Innovation and Skills (BIS)

Protecting consumers – the system for enforcing consumer law

Report Summary from the Committee

Individual consumers lose around £6.6 billion every year because of the malpractices of traders, for example by purchasing defective goods, being misled by advertising or being offered inadequate redress by traders. At least £4.8 billion is lost through malpractices which occur at a regional or national level, such as mass market scams, and unscrupulous traders who operate over large geographical areas.

The Department for Business, Innovation and Skills (the Department) has overall responsibility for policy on consumer protection. However, the majority of enforcement work, from weights and measures testing to the prosecution of rogue traders, is carried out by local authority Trading Standards Services, each with jurisdiction in only its own local area. The Office of Fair Trading enforces some laws at a national level, such as breaches of competition law, the Unfair Terms in Consumer Contracts Regulations and the regulation of consumer credit.

The enforcement of consumer law cost taxpayers £247 million in 2009-10. Local authorities spent £213 million of this on the provision of Trading Standards Services, and the remaining £34 million was spent by Central Government, to support regional and national enforcement work, including that of the Office of Fair Trading.

Despite the high cost to consumers of regional and national problems, it is not clear which of the various enforcement bodies is ultimately responsible for tackling them. Furthermore, the level of funding available to different Trading Standards Services varies widely. Some areas have as few as two Trading Standards Officers while others employ over a hundred. This results in very different levels of coverage in different areas, and there are enforcement deserts where local authorities do not spend enough money to provide an acceptable level of protection to consumers.

Taking on enforcement work which has regional or national importance can expose enforcement bodies to considerable financial risk, for example if a case goes wrong and the costs incurred by the defendant are recovered from the prosecuting body. Furthermore, the potential profitability of committing an offence can outweigh the maximum available penalty, meaning that existing penalties and powers are often insufficient to provide an adequate disincentive to would-be offenders.

The Department has limited understanding of the true cost of protecting consumers or of the success of existing interventions. The impact of doorstep crime, where traders with no registered premises go from door to door selling substandard or even non-existent services, has not been quantified despite it being a hugely important and serious issue for consumers, which has a disproportionate impact on people who are most vulnerable. Furthermore, there is no clear and complete information on how much enforcement activity actually costs. Without collecting better quality information, it is impossible for policy makers to make sure money is focussed on tackling effectively the problems that cause the most harm to consumers.

The approach to enforcing consumer protection has not kept pace with the changing nature of the problems it is intended to tackle. When the enforcement system was first offered inadequate redress by traders. At least £4.8 billion is lost through malpractices counterfeiting, established, trading was more localised and consumers tended to lose money through singular instances of malpractice, for example, by being overcharged or sold a short measure. Now, the increase in the number of companies who operate nationally and the trend towards online shopping have caused problems which are more likely to affect consumers on a regional or national level. The system for protecting consumers has not kept up with these changes and is not properly equipped to tackle new problems as they emerge.

The Department has recently consulted on reforming consumer law enforcement. It should address our recommendations in its reforms. The changes the Department makes must deliver a system fit for the modern era. Responsibility for tackling regional and national instances of malpractice or rogue

trading must be clearly designated. In particular, we are concerned about instances where companies across the same sector are engaged in the same behaviour, which can therefore cause extensive consumer detriment. Enforcement bodies must have access to sufficient resources and powers to tackle these cases.

On the basis of a report from the Comptroller and Auditor General, the Committee took evidence from the Department, the Office of Fair Trading and the Trading Standards Institute, as well as representatives of Citizens Advice and Consumer Focus, on the current arrangements for the enforcement of consumer law, and the proposed changes to the regime.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

Accountability arrangements for protecting consumers are incoherent and fragmented. The Department for Business, Innovation and Skills is accountable for overall consumer policy, but has very little control over the resources used to implement its policy as locally-funded Trading Standards Services carry out most of the enforcement work. Central Government spent £34 million, and local authorities £213 million, on consumer law enforcement in 2009–10. However, consumers suffer at least £4.8 billion of detriment from trader malpractice that extends beyond the boundaries of a single local authority - for example, companies selling goods online, or doorstep traders who travel large distances to trick people out of money in their own home - and there are no clear arrangements setting out responsibilities and accountabilities for tackling the problem.

In designing a new system the Department must clearly spell out the obligations and responsibilities of all the organisations involved, ensuring that there is clear accountability and funding for regional and national issues.

1.1 The Government agrees with the Committee's recommendation.

Target implementation date: April 2013.

1.2 The Government consulted in the summer of 2011 on proposals to improve the system that exists in the UK to empower and protect consumers. The objectives of these proposals were to:

- reduce the complexity of the consumer landscape – the network of publicly funded institutions that exist to help consumers;
- strengthen the effectiveness of enforcement of consumer rights; and
- ensure that activities that help consumers to be empowered are delivered more cost-effectively and in a way that links national and local intelligence about the problems consumers face.

1.3 To achieve this, the Government proposed to clarify the respective responsibilities of the Office of Fair Trading (OFT) and local Trading Standards services, drastically reducing areas of overlapping responsibility. A distinction would be made between market-wide enforcement (use of consumer law enforcement tools to make markets work better), which would be the sole responsibility of the OFT, and enforcement against specific companies, especially rogue traders, for individual breaches of the law, which would become the sole responsibility of local Trading Standards services.

1.4 The Government has proposed folding the OFT, together with the Competition Commission, into a single new competition authority, to be called the Competition and Markets Authority (CMA). The exact reporting and accountability arrangements for the CMA have yet to be finalised.

1.5 A national Trading Standards board (referred to in the consultation as the Trading Standards Policy Board) would also be created and funded by central Government to provide leadership and coordination of Trading Standards enforcement work crossing local authority boundaries. It would take responsibility for all enforcement against specific companies, especially rogue traders, which crosses local authority boundaries and would be accountable to the Department on how it deployed central Government funds to meet this commitment.

1.6 The Government response to the consultation is being prepared for Cabinet clearance. It is expected to be published in early Spring 2012.

PAC CONCLUSION AND RECOMMENDATION 2

The enforcement system for dealing with trader malpractices that occur at a regional and national level is inadequate, and instances of abuse fall through cracks between enforcement bodies. Some local authorities are willing to fund cases of trader malpractice that extend beyond their own boundaries. However, within the enforcement system as a whole there is very limited specific support or funding for regional problems.

The Department provided only £8 million to fund regional work in 2009-10, and that funding has now come to an end. Most local Trading Standards Services are too poorly resourced to take on regional work. Furthermore, the arrangements to determine which enforcement body takes on cases of regional or national importance are not working, especially those where cases are referred by Trading Standards Services to the Office of Fair Trading.

The Department must ensure that there are robust systems and funding available to escalate cases to the appropriate enforcement body, and that the progress of cases is assured and can be tracked through the system.

2.1 The Government agrees with the Committee's recommendation.

Target implementation date: April 2013.

2.2 The proposed clarification of responsibilities between Trading Standards services and the OFT / CMA will help avoid some of these problems. Under the proposed model Trading Standards would in future be more clearly responsible for most regional and national cases and a national board would ensure that these responsibilities are met. More central Government funding would be channelled to Trading Standards specifically to ensure that the larger national and regional cases are being prioritised. But the Government recognises that there will still be enforcement cases which might cross the boundaries between Trading Standards services and OFT / CMA responsibility.

2.3 Across this new consumer landscape, it is clear that the different bodies – in particular the Citizens Advice Service, the national Trading Standards board and the CMA – will need to work closely together to minimise duplication of effort and gaps in addressing consumer detriment. The Government believes a mechanism to share intelligence and information across the consumer and competition landscapes, which would highlight emerging risks and potential cases or areas for study, is essential. In order to achieve this, the different organisations will need to collectively identify consumer detriment and agree priorities, with mutual objectives to ensure important issues are addressed.

2.4 To achieve this, the Government plans to establish measures to ensure closer working between bodies across the landscape on issues of intelligence, enforcement and prevention of consumer detriment. These measures will provide for clearer accountability to the Minister for Consumer Affairs and set out responsibilities for the various bodies and how duplication will be avoided. All relevant bodies will be able to provide key intelligence about consumer and competition problems with a view to their being addressed effectively by the correct organisation.

PAC CONCLUSION AND RECOMMENDATION 3

The level of service available to consumers varies across the country and is inadequate in some areas. Local authorities have discretion over the level of funding they provide for Trading Standards Services. As a result, there are significant disparities in the funding with some areas not having enough resources to provide an adequate level of protection. For example, some areas have as few as two Trading Standards Officers while others employ eighty. The enforcement weaknesses in one geographical area risk allowing rogue traders to base themselves there while causing problems more widely, thereby undermining the effectiveness of the system as a whole.

The Department must put in place systems to ensure transparent monitoring so that citizens can judge whether a sufficient level of protection is being consistently provided to consumers. Transparent data will help to ensure that gaps in the enforcement system are exposed and tackled.

3.1 The Government agrees with the Committee's recommendation.

Target implementation date: December 2012.

3.2 The proposed new national Trading Standards board will have as one of its core tasks the development of much better data on the extent of Trading Standards activity around the country and the impact of its work combating local, regional and national consumer detriment. The Department will ensure that this information is gathered regularly and used to inform sound decision making and operational strategies.

3.3 The Government also notes that the OFT has undertaken work to analyse consumer detriment, developing a Fair Trading Impact Calculator. This analyses and weights the harm caused by different market practices. The Government will work closely with the OFT to enhance this calculator for use as a robust tool for all parties in the new landscape – Citizens Advice, the new national Trading Standards board and the future Competition and Markets Authority – to quantify levels of detriment before and after enforcement or compliance action. Such an agreed analytical tool will enable better monitoring of the efficacy of consumer protection work.

PAC CONCLUSION AND RECOMMENDATION 4

The powers and penalties available to enforcement bodies are too weak to address serious forms of harm to consumers. The kinds of problems experienced by consumers are changing rapidly, with, for example, a lot of goods and services now being purchased online. Enforcement bodies need to be equipped both to detect and remedy existing problems, and to prevent new problems from emerging. Under current arrangements, Consumer Focus and the Office of Fair Trading are responsible for conducting research into emerging market issues, and pursuing complex investigations into new scams. There is a particular risk where practice is common across sectors and exercised by a number of firms. Such cases cause widespread consumer detriment. This is already offering challenges to the system.

The Department's proposals to abolish Consumer Focus and scale down the Office of Fair Trading risk further reducing the available capacity to undertake this type of forward looking and important, high level work. In reducing non-departmental bodies working on consumer law enforcement, the Department must ensure that the remaining enforcement bodies have the power, expertise and money to address major and emerging forms of harm.

4.1 The Government agrees with the Committee's recommendation.

Target implementation date: April 2014.

4.2 The Government generally believes that Trading Standards services and OFT / CMA have the powers they need to undertake all types of consumer cases. The Department will shortly be consulting

on a reform of powers of enforcers to take effect in the planned consumer Bill of Rights to be introduced later in the Parliament, but in most areas, these changes are designed to clarify the law, rather than create fundamental new powers.

4.3 There are two exceptions to this. Firstly, Government is planning to clarify the law to make it possible for local authorities and regional Trading Standards teams within local authorities to enforce across local authority boundaries. This will enable the national Trading Standards body and the regional teams to allocate cases more flexibly. It will also facilitate shared services between local authorities, such that Trading Standards teams can specialise and collaborate to address consumer detriment rather than each authority having to have the full range of capacities. Such specialisation has the potential to deliver significant efficiency gains, if local authorities collaborate effectively.

4.4 Secondly, the Government is considering whether it might strengthen the effectiveness of enforcement, as opposed to the current model of injunctive action ('Stop Now Orders') or enforcement in the criminal courts. This includes looking at making alternative remedies available. For example, a civil court power to impose compensation orders, may improve consumer redress, provide further deterrent effects and reduce the costs and reputational damage associated with criminal prosecution. The Government is still at an early stage in this analysis, but should options develop will consult on its ideas in this area towards mid 2012.

4.5 Both OFT and Trading Standards services in general have the expertise to address serious forms of harm, as evidenced by the large scale cases they have taken in the past. Where specific market expertise, such as on eCrime, is required, the Government has provided funding for specialist projects. Under the landscape proposals, the national Trading Standards board will have discretion to target money where its members believe it will have the most impact, which may include funding lead authorities or centres of excellence. Where individual local authorities lack the necessary expertise, to bring a case, Trading Standards leaders would have the flexibility to deploy regional team resources to enable the case to go ahead. Ultimately the case could be brought by a neighbouring authority or perhaps by the regional team itself, or by a national centre of excellence within Trading Standards services, if necessary.

4.6 The consultation proposed that some of the OFT's consumer enforcement budget will be made available to the national Trading Standards board, enhancing the available money that can be targeted at an agreed single set of priorities, and will be used where the national Trading Standards board members see the biggest risk of consumer detriment. The Department's spending to support consumer law enforcement by Trading Standards services is also planned to increase over the current Spending Review period.

PAC CONCLUSION AND RECOMMENDATION 5

The level of financial risk taken on by enforcement bodies may discourage them from pursuing complex and difficult investigations. The Department has established a 'fighting fund' to support local authorities who pursue cases of regional or national importance, but at only £250,000, the money available is insignificant in comparison to the potential cost of these investigations. Complex cases that cause consumers serious problems can typically cost in excess of £200,000, and the Office of Fair Trading estimates that it carries about £10 million of potential liability for legal costs at any one time.

The Department must set out how it will ensure that enforcement bodies are able to pursue cases through the courts where necessary, and are not deterred from taking on large or complex investigations by the costs and risks involved.

5.1 The Government agrees with the Committee's recommendation.

Target implementation date: April 2013.

5.2 A Fighting Fund of £250,000 is intended to support local authorities in taking on large-scale cases under the current regime, in recognition of individual authorities' inability to take on liability for cases that are lengthy, expensive and in the regional or national interest. The fund has been well-utilised and activity has resulted in a number of landmark cases. The Government does, however,

recognise the limited scope of the fund, which is over-subscribed, and the need for it to be part of a more co-ordinated approach led by Trading Standards services working together.

5.3 In designing the new consumer landscape the Government has taken note of the risks faced by individual enforcement authorities when taking large cases, and in particular the impact this may have on its proposals to deliver the majority of regional and national enforcement through the Trading Standards network.

5.4 The consultation set out the Government view that the national Trading Standards board will be best placed to take decisions about the value of investing in larger cases, in line with its agreed priorities. The consultation therefore proposed that the national Trading Standards board should have discretion to retain a proportion of the money it receives from the Department in the form of an indemnity fund, which, through better understanding of consumer detriment and more efficient co-ordination of activity, may have a value considerably more than the current Fighting Fund. Drawing on this fund would still require a case proposal to be assessed by a panel in order to minimise unnecessary risk and ensure the work is an effective use of funds.

Fifty Fifth Report

HM Treasury; Department for Communities and Local Government;
Department for Education; and Department of Health

Formula funding of local public services

Report Summary from the Committee

Government departments distributed £152 billion, one-fifth of all government spending, to local public bodies in 2011-12 based on the three grants we considered in our hearing: Primary Care Trust Allocations; Dedicated Schools Grant; and the Department for Communities and Local Government's Formula Grant. These distribute funding to local public bodies in a range of sectors, including health, education, local government, police and fire and rescue services.

The formula funding systems are complex, difficult to understand, and have led to inequitable allocations. For Dedicated Schools Grant, based mainly on historical spending patterns, per pupil funding for schools with similar characteristics can vary by as much as 40%. Under Formula Grant, nearly 20% of authorities received allocations which are more than 10% different from calculated needs. These variations have arisen from multiple objectives for funding formulae, and in particular judgements on the rate of change of funding deemed reasonable.

The priorities accorded to different elements of the formulae are judgements which have a direct impact on the distribution of funds. In some cases the basis for the judgement is guided by authoritative, published independent advice. One example of this is the weighting the Department of Health applies to the health inequalities element of Primary Care Trust Allocations. In other cases, for example the weightings the Department for Communities and Local Government has applied to elements of Formula Grant, the basis for judgement lacks transparency, and external advice lacks status and influence. Only 4% of respondents to DCLG's consultation supported the current version of the model used to calculate Formula Grant.

Some of the data used by departments in calculating relative needs is inaccurate and out of date. For example, some of the indicators used to assess relative need are based on 2001 Census data, now ten years old. Although the 2011 census was recently completed, it may prove to be the last national census of its kind, and an alternative source of reliable data may need to be identified. All of the approaches to formula funding we considered are under review. These reviews provide the perfect opportunity to address the weaknesses the Committee have identified, including: building in greater transparency; ensuring greater consistency, leading to more equitable distributions; appropriate oversight and outside expertise; to share and improve upon sources of data; and to commit to moving funding between areas so that the right funding for an area's needs is achieved within a set time period.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Treasury, the Department of Health, the Department for Education and the Department for Communities and Local Government on existing approaches to formula funding across Government, and the principles that should be carried forward to new arrangements.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

Although funding formulae have been grounded in assessment of relative needs, their operation has led to inequitable allocations. Nearly 20% of all authorities funded by Formula Grant in 2011-12 received allocations which are more than 10% different from calculated needs. So public bodies in affluent areas receive more than their calculated needs, and some in more deprived areas receive less. One authority, Wokingham, received double its calculated funding needs this year.

The recommendations below address the key weaknesses we identified in the course of the Committee's hearing.

1.1 The Government welcomes the Committee's report and its findings.

PAC CONCLUSION AND RECOMMENDATION 2

Funding formulae reflect multiple objectives, not always clearly expressed or prioritised. Two of the three formulae the Committee examined do not have clearly stated, prioritised objectives and this obscures their core purpose. Even in health, where the Department has two well-specified objectives for funding, there is no clear analytical justification for the specific relative weighting given to each. Lack of clarity or prioritisation hinders assessment of the effectiveness of each formula.

Departments should identify the primary objective for formula funding models, and design their models to establish transparent, equitable allocations which achieve that objective.

2.1 The Government partially agrees with the Committee's recommendation.

2.2 Where there are multiple funding objectives, the Government agrees that Departments should aim to prioritise these objectives where possible and be explicit on the reasons for this. Most funding formulae are determined based on programmes of statistical, economic and other research. However, the complexity of the services being funded and the issues being addressed mean that there will be occasions where a clear objective solution cannot be achieved. On these occasions judgement will be needed. Departments agree that there should be clarity about where judgement has been applied.

2.3 For example, in the case of formula grant, the Government agrees it has never explicitly published objectives. The objectives of this grant are to ensure fairness, stability and predictability. The priority for the 2012-13 Local Government Finance settlement is to ensure those most dependent on Formula Grant get the smallest percentage reductions in formula grant. Formula grant covers many service areas. This can make measurement of the extent to which an objective has been achieved difficult. The principles for the Local Government Resource Review (LGRR), introducing a new Business Rates Retention system from April 2013, replacing Formula Grant, have been set out clearly by the Government in the December 2011 response to the consultation on the new scheme.

PAC CONCLUSION AND RECOMMENDATION 3

Departments constrain the extent of funding increases and decreases from one year to the next, but those short-term actions have led to long-term inequity in allocations. For the sake of stability, Departments adjust the results of needs based calculations to take account of the previous year's funding, limiting the speed at which funding can change. The cumulative effect of such adjustments, however, has led to some local bodies being funded significantly above or below needs-assessed levels for many years. Where limits are placed on how quickly funding changes each year, these limits should be seen as transitional.

Departments should commit to giving the right funding for an area's needs within a set time period.

3.1 The Government disagrees with the Committee's recommendation.

3.2 While the Government welcomes the Committee's support for the aim of ensuring stability of funding, it does not believe it is practical to set a time limit by which the needs-assessed levels should be achieved. The needs-assessed level of funding, for instance due to demographic changes, is constantly changing. This would risk destabilising some organisations and jeopardises the sustainability of funding systems.

3.3 Stability will continue to be important in the move to a fairer schools funding system. Any reform, for example, will involve transitional arrangements which would set a limit on how much schools budgets can increase or decrease from one year to the next. It will therefore take time before schools attract their allocation as indicated by any new formula. DFE has begun to consult on the extent to which decreases should be limited and plans further consultation before reaching a conclusion.

PAC CONCLUSION AND RECOMMENDATION 4

The basis for judgement in the design and operation of funding formula has not always been disclosed. Multiple objectives for funding models have increased their complexity and reduced transparency. There will always be a need for judgements to be made but those judgements should be transparent. Particularly with the Department for Communities and Local Government's Formula Grant, it is virtually impossible to follow the link between calculated needs and funding allocations. Departments do not set out clearly the basis for some of their judgements, including those related to stability, despite their significance in determining allocations.

Departments should set out publicly the basis for their judgements, and how they affect the distribution of funding relative to their primary objective.

4.1 The Government agrees with the Committee's recommendation.

4.2 The Government believes that clear distinctions should be maintained between factors requiring political judgement (collective Government decisions), and those that can or should be grounded in empirical evidence and rigorous analysis. Given the complex nature of funding formulae, for practical purposes and where insufficient evidence exists, judgements will sometimes be necessary. On these occasions, the Government agrees that clarity and transparency should be provided on where this judgement has been applied. Full details of the funding formulae, including both the underpinning research and its implementation are published by the Government. This allows for further checking and challenge on the basis and operation of the formulae which the Government welcomes as an important element of improving approaches to funding formulae.

PAC CONCLUSION AND RECOMMENDATION 5

Some of the data used to underpin calculations is inaccurate and out of date. Formula funding is based on population data, but estimates of local populations have been disputed for both local authorities and Primary Care Trusts. For the most recent settlements, a quarter of indicators used to assess need in the DCLG Formula Grant and 10% for Primary Care Trust allocations were based on data sources that are at least ten years old. For these data sources, departments seemed to accept the 'best available' data, rather than collecting more timely and accurate data.

Working with the Treasury, Departments should set standards for the accuracy and timeliness of data sources they use, focusing in particular on strengthening data where it will be central to proposed new arrangements (for example: funding clinical commissioning groups). In the longer term, they should consider how the possible replacement of the census will affect the availability of population data for formula funding.

5.1 The Government agrees with the Committee's recommendation.

5.2 Departments use the most robust and timely data that is available across all local authorities, schools or PCTs at the time of determining funding allocations. The Government accepts that some data used are quite old, but departments are open about the data they use. Data used by Departments in their formulae are referenced in the supporting documents published to provide details of funding formulae used.

5.3 The Government recognises the major implications for population and other data of the current considerations on the future of the Census and all three Departments will continue to work closely with the Office for National Statistics' 'Beyond 2011' project as it progresses.

PAC CONCLUSION AND RECOMMENDATION 6

Departments do not always act on independent advice or consult publicly when designing funding formulae. Of the three grants the Committee considered, advisory bodies for the health formula were the most independent and had the greatest influence over allocations, but the Department has not consulted publicly on changes to the formula. The other Departments ran public consultations, but their expert working groups had no formal status or funding. The operation of formula funding had not been subject to formal consideration by any of the Departmental Boards.

Departments should use independent advisory groups to provide technical expertise. These groups should have clear terms of reference and appropriate funding and support. Their processes should be transparent, and their reports, together with the Departments' responses, should be made public. Departmental Boards should oversee the management of formulae, the associated controls and funding results.

6.1 The Government disagrees with the Committee's recommendation.

6.2 The Government is committed to reducing unnecessary cost and bureaucracy. It is not convinced that providing additional funding and independent support for each Department's advisory arrangements would achieve the benefits that would justify the implementation of this recommendation. The Government also notes that formal consultations require significant resource and may not offer significant additional insight on system-wide impacts. It does not believe that the approach to engagement should be prescribed.

PAC CONCLUSION AND RECOMMENDATION 7

Approaches taken to formula funding of local public services are inconsistent across government, and arrangements to identify and promote best practices are inadequate. Although formulae will differ given the range of types of local bodies and services being funded, there are many generic issues that are relevant to all the formulae. These include: clarity and prioritisation of objectives; balancing stability with responsiveness to changing needs; quality of data; and good governance.

The Committee was surprised that the Treasury had not been more active in ensuring consistently high standards of funding practices across government. The Treasury should report back to the Committee to explain how each of the Committee's recommendations is incorporated within new funding arrangements.

7.1 The Government partially agrees with the Committee's recommendation.

7.2 The Treasury has been working with Departments on a number of relevant reforms. For example, moving to business rates retention will end the current formula grant system and change the way the system reflects changing needs while ensuring stability in funding arrangements. The Government is in the process of reforming schools funding to improve transparency and fairness and better match funding allocations to need. The Government is seeking to set the right frameworks to deliver its objectives, within which Local Authorities can make appropriate local choices. Accountability both for local spending and the frameworks set by Departments that drive funding arrangements should increasingly focus on outcomes, rather than amounts spent on different priorities.

Fifty Seventh Report

Department of Health (DH)

Oversight of user choice and provider competition in care markets

Report Summary from the Committee

Successive Governments have supported the move towards using personal budgets and markets to promote user choice and provider competition in social care. Currently, 340,000 people, or 30% of eligible care users, have a personal budget, which enables the individual to choose their care provider. The Government wants all eligible users to be offered a personal budget by April 2013. Personal budgets currently cost the taxpayer £1.5 billion each year. Individuals who fund and therefore choose their own care spend about £6.3 billion annually. The total annual expenditure on care is around £23 billion.

The Department of Health (the Department) is responsible for setting the overall policy framework for social care in England, with funding mainly coming through DCLG from the local government formula grant, which is not ring fenced. Local authorities have statutory duties to provide or fund social care for those they deem eligible by use of means testing. The Care Quality Commission, which reports directly to the Department, is the independent regulator of health and adult social care in England.

Effective oversight of the care market is essential to protect the interests of both social care users and of taxpayers. Given its policy responsibility, we look to the Department to provide this oversight. There is growing consolidation in the social care market at a regional level. Yet the Department did not have a view on what level of market share represents a risk of provider dominance, nor arrangements to protect users should a large scale provider fail. The Department told us that it has insufficient powers and information to identify or prevent providers becoming too dominant. This is particularly worrying given the recent experience of Southern Cross and the high levels of debt that some providers are carrying.

There are risks to the future functioning of the social care market from local authority budget reductions. Social care homes face inevitable increases in costs at the same time as local authorities inevitably reduce what they will pay to fund places. At present, 63% of funding of care comes from the public purse. Reducing this funding could create some degree of pressure in the market.

Most users hold personal budgets in high regard, and the early research shows that they like having choice and control. However, users need more support to obtain optimum value from their budgets. Some users are confused about what they can spend their budget on, and there are wide disparities in the level of information and support they receive across different authorities. Only around half of users find it easy to change their support, or get relevant information and advice, and around a third of users find the experience of employing personal assistants to provide their care daunting. Yet we found the procedures for users to complain or get redress when things go wrong to be inadequate. These issues must be addressed if personal budgets are to be successfully sustained.

The Department has to rely on local authorities to implement its policy of universal provision of personal budgets to eligible users by April 2013 but it cannot compel local authorities to act. In consequence there are a small number of local authorities which are dragging their feet in offering personal budgets to users. There should be a clear line of accountability on policies that are generally agreed. A more radical option might be to enshrine in law people's rights to a budget.

The Department will shortly issue a White Paper on reforming social care delivery. The changes the Department makes must address our concerns about giving users a real choice, overseeing the market to ensure competition and stability, and putting in place arrangements and contingencies to deal with major provider failure.

On the basis of a report from the Comptroller and Auditor General, the Committee took evidence from the Department on the current arrangements for the oversight of user choice and provider competition in care markets.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

There are no arrangements yet in place to oversee regional care markets, but the Department said that it was considering a range of options for overseeing the market in care. Recent trends in care markets indicate a trend towards fewer providers controlling an increasing share of the market. Care markets tend to operate at a local or regional level yet the Department looks at market dominance from a national perspective. For example, Southern Cross had a market share of around 9 % of the national care home market but held up to 30 % of the market in certain local authority areas in the North East of England. The Department has nothing in place to oversee the market at the local level to avoid certain providers becoming too dominant in a region.

The Department must specify what market share at the local level is acceptable, what arrangements will be made to keep market shares of large-scale providers under review, and what additional powers it requires in case it needs to intervene to prevent a provider becoming dominant.

1.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: White Paper - Spring 2012

1.2 It is the role of local authorities to commission care services for those that they fund and to ensure that there are sufficient services to meet the needs of their local population. It is not the role of central Government to commission services or manage local care markets.

1.3 However, Southern Cross has highlighted the risks involved when a large, national provider falls into difficulty. It also shows the risks of a local authority or a group of local authorities in a region relying on a single provider, or small number of providers, for a significant proportion of care services. The Department published *Oversight of the Social Care Market*¹ in October 2011, and is committed to exploring whether further arrangements are now required. The views received are being fed into the development of policy.

1.4 The Department is taking forward work to look at whether further market oversight is required for social care, and the nature that this may take. Part of this work is exploring what may need to be put in place at a national, regional and local level. The Department intends to outline the policy position in the forthcoming Care and Support White Paper.

PAC CONCLUSION AND RECOMMENDATION 2

There is no clarity about what will happen in cases of failure of large-scale providers. The financial difficulties experienced by the then largest care home company, Southern Cross, in 2011, and the considerable level of debt held by another large-scale provider, Four Seasons Health Care, have demonstrated that the care home market is no longer the "land of milk and honey" it once was.

There must be greater clarity over what will happen in cases of large-scale provider failure. The Department admitted to having insufficient powers, and must decide what pre-and-post failure regime powers it needs to put in place to protect care home residents, many of whom are frail and vulnerable if or when large-scale providers fail.

2.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: White Paper - Spring 2012

¹ http://www.dh.gov.uk/en/Publicationsandstatistics/Publications/PublicationsPolicyAndGuidance/DH_130438

2.2 There are currently some clear protections in place to ensure no resident – whether publicly or self funded - will be left homeless or without care in the event that a care provider fails. The NHS and Community Care Act 1990 (section 47(5)) gives local authorities the powers to step in and provide care services to anyone in urgent need. This includes not only local authority funded people, and means that a local authority should continue to provide care for any resident – whether publicly or self funded - who was unable to find or arrange care for themselves.

2.3 However, in the light of what happened to Southern Cross, the Department is currently examining whether appropriate mechanisms are in place to oversee the market and protect those reliant on vital services. The Department intends to outline the policy position in the forthcoming Care and Support White Paper.

PAC CONCLUSION AND RECOMMENDATION 3

The Department does not monitor the financial health of large-scale providers. The Department acknowledged that it was unaware of the financial difficulties at Southern Cross until the company approached it in March 2011. It is currently considering a range of options for overseeing the social care market and how it will gather better intelligence about providers and the market more widely. The Department has issued a discussion paper to inform the Social Care White Paper.

The Department must decide how it will monitor the financial health of large-scale providers so that it has early warning of difficulties and develop ways in which it might respond should problems arise, so that the interests of both social care users and the taxpayer are protected.

3.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: White Paper - Spring 2012

3.2 Although the Department does not have formal powers to monitor the financial health of care home operators, it is in regular contact and dialogue with key providers. This includes discussing their overall business position, so that the Department is aware of any issues as they arise and may consider how to respond or mitigate accordingly. It is clear from discussions with the sector that all the major care providers are supportive of measures to better understand the state of the social care market. In managing their local market, the Department also expects local authorities to be in close contact with those supplying care and support services.

3.3 Formally monitoring the financial health of care providers, particularly those with complex financial structures, calls for specialist skills. The Department is currently considering how both central and local government can acquire a greater insight in these matters, and whether more formal powers are required. The Department intends to outline the policy position in the forthcoming Care and Support White Paper.

PAC CONCLUSION AND RECOMMENDATION 4

The Department has no power to compel local authorities to implement personal budgets. 25 out of 152 local authorities failed to meet the April 2011 milestone for implementing personal budgets. These failures undermine the Department's ability to deliver its policy objective, yet the Department has no power to intervene to ensure the target for all eligible users to have personal budgets by April 2013 is achieved.

The Department should specify the actions it will take, including penalties, to ensure local authorities meet this important Government target.

4.1 The Government partially agrees with the Committee's conclusion.

Target implementation date: White Paper - Spring 2012

4.2 The Committee's conclusion is an accurate description of the Department's legal authority with respect to local authorities' uptake of personal budgets. However, in November 2010, the Department published *A Vision for Adult Social Care: Capable Communities and Active Citizens*² that included the objective for local authorities to "provide personal budgets for everyone eligible for ongoing social care, preferably as a direct payment, by April 2013". This set the challenge for local authorities to meet the Department's expectations for personal budget provision.

4.3 Although a small proportion of local authorities failed to meet the April 2011 milestone for implementing personal budgets, a September 2011 survey by the Association of Directors of Adult Social Services (ADASS)³ concluded: "*councils are generally making good progress towards universal personal budgets by 2013 and are confident they will achieve this target*". Of the 58 (33%) respondents that took part in the survey, 57 (98%) stated they have a clear strategic approach for meeting the 2013 ambition of personal budgets for all eligible people.

4.4 The Department views personal budgets as a significant, but not the only, means of personalising services for adult social care. The absence of personal budgets from the current legal framework is an indication of a statute which has lost pace with people's expectations of modern care and support, and requires reform. Indeed, the Law Commission's report on Adult Social Care⁴ recognised this and recommended that the provision of personal budgets should be put on a statutory footing.

4.5 As preparation for the forthcoming White Paper, the Department launched the *Caring for Our Future*⁵ engagement exercise from 15 September to 2 December 2011 to discuss six areas where there is the biggest potential to make improvements to the care and support system.

4.6 The discussion on personalisation⁶ found that personal budgets can be hard to access. This could be addressed by strengthening legislation to make personal budgets the norm for all people receiving community-based services. The Department is carefully considering all of the Law Commission recommendations, and intends to publish its response in Spring 2012.

PAC CONCLUSION AND RECOMMENDATION 5 and 6

5: The quality of support available to personal budget users is variable. Only around half of personal budget holders find it easy to get information and advice, and under half found it easy to choose care services or change their support. There are also wide variations in the support offered to users by different local authorities. Without sufficient, good quality information, users will not be able to exercise effective choice. In addition, around a third of users who employ a personal assistant to help with their care needs find the experience of being an employer daunting.

The Department should work with the Association of Directors of Adult Social Services to produce an action plan aimed at developing and sharing best practice to improve the individual's experience of using personal budgets, and ensure that all the different user groups receive the necessary support. Only in this way will personal budgets support individual choice and control over time.

² http://www.dh.gov.uk/prod_consum_dh/groups/dh_digitalassets/@dh/@en/@ps/documents/digitalasset/dh_121971.pdf

³ <http://www.adass.org.uk/images/stories/Policy%20Networks/Resources/Key%20Documents/Appendix%20C%20ADASS%20report%20personalisation%20survey%205.10.11%20version%202.doc>

⁴ http://www.justice.gov.uk/lawcommission/docs/lc326_adult_social_care.pdf

⁵ <http://caringforourfuture.dh.gov.uk/>

⁶ <http://caringforourfuture.dh.gov.uk/2011/12/13/7-december-meeting-with-discussion-leaders-and-ministers-presentation-materials/>

6: There is inconsistency and confusion in what users can spend personal budgets on and inadequate redress when things go wrong. Overall, evaluations suggest that most users to date have had a positive experience of personal budgets. However there has been confusion amongst some users, and inconsistency between local authorities, about what it is or is not permissible to spend their budgets on. Personal budgets should allow flexible and innovative ways of providing support to be balanced with the need for financial probity. Users also find it difficult to complain or get effective redress and have to fall back on the Local Government Ombudsman as a last resort.

The Department should provide greater clarity on what personal budget spending is permissible and develop a clear complaints process aimed at resolving problems quickly and securing appropriate redress.

5.1 The Government partially agrees with the Committee's recommendations.

Target implementation date: White Paper - Spring 2012

5.2 The Department agrees that the quality of support available to personal budget holders is inconsistent. The Department is looking at what kinds of information, advice or support would most effectively support people with personal budgets, including people who self-fund their care, carers and their families.

5.3 SharedLivesPlus (formerly the National Association of Adult Placement Schemes) worked with the Department and other bodies to produce the report *Map for Social Enterprises in Social Care*⁷ in October 2011. This report helps personal budget holders and their family carers understand rules and regulations in five key areas including new clarity on tax, employment law and registration issues for people who wish to employ a personal assistant.

5.4 The Department is already working closely with the ADASS and other adult social care sector organisations, including the Local Government Association (LGA) and the Social Care Institute for Excellence (SCIE) to develop and share best practice. In a culmination of this partnership working, the adult social care sector published the final version of its partnership agreement, *'Think Local, Act Personal'*⁸, in January 2011, following a period of consultation. The agreement recommended how councils, health bodies and providers need to work more efficiently to personalise and integrate service delivery across health and adult social care. Over 30 organisations across the sector, including local government, health, private, independent and community organisations, signed up to its key principles.

5.5 In October, *Think Local, Act Personal* published *Making It Real*⁹, a set of benchmarks of progress towards greater personalisation, co-produced with users and carers. *Making it Real* has the support of the ADASS, national provider bodies, the Care Quality Commission and the Department. The markers have been developed by people who use social care and family carers who are part of the National Co-production Advisory Group, representing a very wide range of views.

5.6 The *Think Local, Act Personal* website also acts as a repository for best practice guidance and resources, including specific advice on information and brokerage to assist local authorities make the necessary arrangements to ensure personal budget users receive an appropriate level of support.

5.7 The Department is clear that there should not be limitations on the uses of personal budgets as long as they accord with a care plan. This was set out to local authorities in the 2009 *Guidance on direct payments: For community care, services for carers and children's services*¹⁰. *Think Local, Act Personal* also recognised this as an issue and published best practice guidance in October 2011 *Re-thinking support planning: Ideas for an alternative approach*¹¹. This focused on reconsidering approaches to support planning to enable and empower personal budget holders to take control and obtain the services they require without having to go through bureaucratic local processes.

⁷ http://www.sharedlivesplus.org.uk/downloads/Map_for_Microenterprises_in_Social_Care.pdf

⁸ <http://www.thinklocalactpersonal.org.uk/>

⁹ http://www.thinklocalactpersonal.org.uk/_library/Resources/Personalisation/TLAP/MakingItReal.pdf

¹⁰ http://www.dh.gov.uk/en/Publicationsandstatistics/Publications/PublicationsPolicyAndGuidance/DH_104840

¹¹ http://www.thinklocalactpersonal.org.uk/_library/Resources/Personalisation/TLAP/Paper2Re-thinkingSupportPlanning.pdf

5.8 The Department partially agrees with the Committee regarding establishing a complaints and redress process, but considers that the Local Government Ombudsman is the correct route for individuals seeking redress after exhausting local complaints procedures. However, the Department does agree that local procedures for individuals seeking to complain are varied. As personal budgets become the norm, it is expected that local authorities handling of complaints reflects this change in practice, taking into account *Think Local, Act Personal* best-practice guidance.

5.9 The Department does accept that more can be done to strengthen the existing guidance on information, support and brokerage. The Law Commission and the Report of the Commission on Funding of Care and Support (Dilnot Review)¹² both identified access to good quality information at both a national and local level as crucial mechanisms to support the personalisation agenda. In addition, the provision of clear, comprehensive and accessible information was also one of the key findings following the *Caring for Our Future* engagement exercise, concluding in a recommendation that a universal, independent information service is established to support people to navigate their care and support needs.

5.10 The Department will therefore consider both reports and the range of evidence collected through the *Caring for Our Future* engagement exercise and intends to set out the policy and legislative proposals for information and support in the Care and Support White Paper to be published in Spring 2012.

¹² <https://www.wp.dh.gov.uk/carecommission/files/2011/07/Fairer-Care-Funding-Report.pdf>

Fifty Eighth Report

HM Revenue and Customs (HMRC)

HM Revenue and Customs: PAYE, tax credit debt and cost reduction

Report Summary from the Committee

HM Revenue & Customs (the Department) faces a huge challenge to resolve long-standing problems with the administration of PAYE and tax credits while making substantial reductions to its running costs. The Department needs to stabilise its administration of PAYE following the problems encountered after a new processing system was introduced in 2009. It also needs to recover a significant amount of outstanding tax credit debt while minimising the amount of new debt being accumulated. While £900 million extra has been allocated to tackle tax avoidance, at the same time, following the 2010 Spending Review, the Department is required to reduce its running costs by £1.6 billion over the next four years.

The Committee took evidence on two reports from the Comptroller and Auditor General which examined the Department's cost reduction programme and its administration of PAYE and tax credits. The Committee found that the Department was making concerted efforts to improve its administrative performance while reducing costs, although the Committee have concerns about how coordinated those efforts are and the Department's ability to meet all of its intended objectives.

The Department has made welcome progress in improving PAYE administration since the Committee last examination of this area in 2010. However, as a consequence of the Department's handling of the 2009 transition to the new PAYE Service, it has had to forgo up to £1.2 billion of income tax underpaid from 2004-05 to 2009-10. Under current plans, it will take until 2013 before all processing backlogs are cleared and the new PAYE Service is operating as intended. The Department needs to focus on improving data quality in particular to sustain progress in PAYE administration.

Levels of debt arising from overpaid tax credits have been rising in recent years. Without a clear plan for reducing tax credit debt, the level of uncollected debt will continue to rise to an estimated £7.4 billion by 2014-15. The Department has been forced to acknowledge that much of this debt will never be recovered from tax credit claimants, and recently wrote off some £1.1 billion of debt dating back to the introduction of the scheme.

The Department is preparing to introduce means testing to Child Benefit in 2013. However, as for tax credits, unless the Department can introduce systems that respond quickly to changes in circumstances, increasing numbers of families will find themselves receiving the wrong amounts and later being faced with repayment demands.

The Department has made plans to reduce its running costs by £1.6 billion (25% in real terms) by 2014-15. However, the Committee was concerned that its plans are overly optimistic, including the intention to achieve more than one third of new savings in the final year of the Spending Review period. Furthermore, the Department has not yet built in any contingency to allow for setbacks in the 24 projects currently included in its savings programme. The Department also needs to be clearer about how its savings measures are likely to affect taxpayer compliance, to prevent the drive for cost reduction from having a counterproductive effect on its ability to collect tax revenues.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The Department's administration of PAYE has improved, but it still has a huge backlog of records for manual reconciliation. The new PAYE Service has finally begun to realise improvements and allowed the Department to improve its performance in issuing annual codes and reconciling the bulk of end of year returns on time – although at a cost of not being able to process all changes to taxpayers' PAYE records arising in-year. The Department still has a backlog of 6.7 million records to reconcile manually for the 2008-09 and 2009-10 tax years, and will have to manually process 3-4 million more for the 2010-11 tax year.

The Department must maintain its programme to deal with the backlog by 2013 and not let it slip. It also needs to determine exactly how it will manage in-year changes going forwards, so amendments to taxpayer records are processed as people's circumstances change.

1.1 The Government agrees with the Committee's recommendation.

1.2 By the end of 2012-13, the Department aims to be up to date with PAYE so that, as a general rule, only three tax years will be open. This means that each year from April 2013 the Department will need to reconcile taxpayer accounts for the previous tax year; adjust tax codes for the current tax year to reflect changes in taxpayers' circumstances; and calculate and issue tax codes for the following tax year.

1.3 The Department had 6.7million un-reconciled taxpayer cases to deal with after running the automated end of year reconciliation process for the 2008-09 and 2009-10 tax years. These are cases where the National Insurance and PAYE Service computer system (NPS) could not reconcile the taxpayer's account automatically because more information might be required. The Department has already reconciled 98% of these cases, and is on track to complete the remainder of them by the end of March 2012.

1.4 The Department advised the Committee that around 3 to 4 million un-reconciled cases for 2010-11 will need reconciliation. This figure could change once they analyse NPS after the current automated reconciliation process ends. The Department aims to complete the work on these cases, along with any un-reconciled cases for 2011-12, during 2012-13, so that thereafter it will be up to date and will be administering PAYE in accordance with the 'three open tax years' rule.

1.5 The Department rigorously prioritises those work items that have a tax consequence for taxpayers and is conducting a review of work items generated by NPS to determine which are required now that the system is working well.

PAC CONCLUSION AND RECOMMENDATION 2

Increasing the accuracy of PAYE data is fundamental to implementing Real Time Information and stabilising the administration of PAYE. The introduction of Real Time Information (RTI) is designed to allow the Department to update records as soon as taxpayers' circumstances change, making PAYE administration more accurate and efficient in the long run.

RTI will significantly increase the amount of PAYE data collected, but it is still not clear how the Department will manage this additional data. The Department must have a clear plan for how it will use the increased volumes of data under RTI to update PAYE records. RTI is also essential for the Universal Tax Credit to function, so efficient implementation of RTI is vital.

2.1 The Government agrees with the Committee's recommendation.

2.2 RTI data will be received from employers each time an individual is paid. RTI data will be held in a data repository and will be sent automatically to other systems at the appropriate time including NPS, the Department's main PAYE system. As a result, over time, customer records and tax codes become more accurate. For individuals in Universal Credit, RTI data will be passed to DWP each time they are paid. The greater volume of data and the more regular information flows will also allow the Department to do more to level out peaks in PAYE work.

2.3 Before employers move on to RTI, their data will be aligned with the Department. This 'data cleanse' will help to minimise the number of cases which cannot be automatically processed. To ensure that improvements are sustained, the Department has put in place a data quality project to understand and address the root causes of data quality problems. Better data quality should mean that the Department can cut down some of the correction and chasing work. There will be less contact from individuals as more people's claims and tax affairs are correct; and in some cases, the Department will be able to adjust employees' tax codes in year to reflect their changing income.

PAC CONCLUSION AND RECOMMENDATION 3

The Committee are concerned that the implementation of RTI should have proper regard to employers in small- and medium-sized enterprises. Not all employers process their wages and salaries through the Bankers' Automated Clearing Services (BACS) system, and therefore providing the detailed information required under RTI could place an additional burden on them.

The Department should take advantage of the pilot phase of RTI to assess the impact on small- and medium-sized employers, and ensure that the system can be introduced without placing unnecessary burdens on them.

3.1 The Government agrees with the Committee's recommendation.

3.2 The Department is committed to assessing the impact on small and medium sized employers through the RTI pilot.

3.3 Small employers will be able to use the free Departmental Basic PAYE Tools to submit their RTI returns. There are also free products available from commercial payroll software providers in addition to the more comprehensive products, which are chargeable. The findings from the pilot will be used to update the free Basic PAYE tools and guidance and consider what additional support might be needed for small and medium sized employers.

3.4 Organisations will be required to report RTI for all individuals with income subject to PAYE, regardless of whether the income is paid by on-line payment methods such as Bacs and internet banking, or other payment methods such as cash and cheque.

3.5 The RTI interim solution will cross reference RTI to employee payment instructions sent under a Bacs Service User Number. Small employers are more likely to use remote banking, such as internet banking, to initiate payments to their employees and the RTI solution will not cross reference those payments when it is launched.

3.6 For the time being, employers will report RTI through existing channels (internet through the government gateway or Electronic Data Interchange). In the longer term, those employers who pay by direct credit may report their RTI alongside the payment instruction through a payment based channel. However, the Department will continue to provide an alternative channel, for example through Government Gateway, for those employers who choose to pay their employees in other ways.

PAC CONCLUSION AND RECOMMENDATION 4

The Department's strategy to reduce tax credit debt is not working and without new steps to improve the situation, debt levels are expected to increase to £7.4 billion by 2014-15. The Department's efforts to get people on the right tax credit award have not gone far enough, and the resulting overpayments of tax credits place unacceptable burdens of debt on many people already suffering hardship. The Department recognises it will be impossible to recover much of this tax credit debt and has recently written off £1.1 billion of debt.

The Department should focus its efforts on preventing the problem arising by minimising the number of incorrect tax credit awards it makes. It should also clarify its approach to reducing tax credit debt, including writing off debt where there is a value for money case for doing so.

4.1 The Government agrees with the Committee's recommendation.

4.2 The Department's customer strategy is to help customers get it right the first time, understand their obligations, and avoid them getting into debt. In addition, the Department is significantly reducing the opportunities for customers to make mistakes or break the rules by adapting its approach to the different needs and behaviours of different customer segments. This includes using technology, which enables tailoring of the questions asked so customers provide the right information about their circumstances at the right time. The introduction of Real Time Information from 2014-15 will afford the Department the opportunity to intervene where customers either delay or fail to advise of changes to their income, contributing to a reduction in overpayments.

4.3 The Department also wants it to be easy for customers to contact it when they need to and is improving the way it handles the 24 million telephone calls received each year. For example: between April and November 2011, improved processes meant that the number of calls handled by the Departmental contact centres were reduced by 4.65 million when compared with the same period in 2010-11. This demand management, combined with other planned improvements to the telephony infrastructure, will allow advisors to spend more time with those customers who need more help.

4.4 The Department's approach to reducing tax credit error and fraud places an increasing emphasis on the 'check first, then pay' approach, combined with activity to identify and cleanse existing error and fraud in the tax credit system. Work undertaken by Knowledge, Analysis and Intelligence (KAI) shows that most of the increase in debt in 2009-10 was a direct result of the increased error and fraud interventions. However, it is clear that as the Department improves identifying tax credit error and fraud before it enters the system, the impact on the overall debt balance will diminish.

4.5 The new tax credit debt strategy seeks to maximise value for money in collecting debt. The strategy is based upon a three-pronged approach:

- preventing debt by reducing overpayments;
- collecting more debt using a campaign based approach based on affordability, utilising debt collection agencies; and
- identifying and dealing with uncollectible debt.

4.6 As part of that strategy, the Department has identified a proportion, some £1.2 to £1.3 billion, of what is referred to as 'inactive debt', made up of old and, in the main, relatively small amounts, which analysis shows would not be cost effective to recover on a one-to-one basis. These debts are at least three years old, with some relating to tax credit awards from 2003-04, and where the Department has not received customer payments over the last 12 months.

4.7 Taking into account the Department's duty of care to tax credit claimants, all taxpayers and the public purse in terms of cost, it has determined that the most effective way of dealing with this part of the debt balance is to remit it.

PAC CONCLUSION AND RECOMMENDATION 5

Planned changes to Child Benefit may heighten the risk of incorrect payments being made. Child Benefit will be means tested from 2013. Unless the Department introduces systems that process changes to people's circumstances quickly and accurately, more families will find themselves receiving the wrong amounts and later being faced with demands for repayment. The Department has yet to decide the changes needed to the system for administering Child Benefit, pending final policy decisions to be made by HM Treasury.

In redesigning the system, the Department should take account of the experience of tax credits so that it can minimise the levels of under and overpayments that arise because of changes in claimants' circumstances.

5.1 The Government agrees with the Committee's recommendation.

5.2 The Department plans to apply lessons learnt from its experience in tax credits, NPS stabilisation and wider issues in the design and implementation of any policy changes, with a view to minimise impact on its customers wherever possible. The Department plans to monitor and evaluate the implementation of the new arrangements for Child Benefit.

PAC CONCLUSION AND RECOMMENDATION 6

The Department does not fully understand the potential impact of cost reductions on customer service and taxpayer compliance. The Department has modelled the effects of planned staff reductions on operational performance in the Personal Tax business area. It has also conducted some initial modelling which indicates that reducing resources may lead to a fall in voluntary compliance with tax rules. Small percentage changes in taxpayer compliance could have large adverse consequences on tax revenues. It would therefore be a false economy to reduce costs if that resulted in damage to the Department's ability to collect tax revenues.

The Department must extend its modelling to cover the risks and potential consequences of cost reductions on customer service and taxpayer compliance, and use the results of this modelling to inform its future approach to making cost reductions.

6.1 The Government agrees with the Committee's recommendation.

6.2 The Department recognises the importance of fully understanding the relationship between its activities, the costs of those activities, and the performance results that they deliver. The Department has developed consistent, robust ways of capturing input costs and relating them to key areas of its business. The Department's Performance Management Framework also provides a standardised set of performance measures against which to judge the value of the work that it does. This includes measures for improving compliance and the customer experience in areas such as accessibility, timeliness and accuracy.

6.3 Choices about resource use are made through the Department's business planning processes, which bring together financial and performance information. This approach ensures that resource allocation decisions are assessed for their impact on the department's objectives, and are made to achieve an optimum balance across the objectives of maximising revenues, improving the customer experience and delivering a sustainable cost base.

6.4 However, the Department accepts that it can do more to further enhance its understanding in this area. It will therefore continue to improve its modelling to better understand the connections between costs, departmental activity, and performance.

PAC CONCLUSION AND RECOMMENDATION 7

The Department's cost reduction plans appear over-optimistic and are not supported by adequate contingency plans. The Department is relying on delivering all savings as planned across the 24 projects currently in its savings programme, including making one third of the savings in the final year of the Spending Review period. It has not built in contingencies for any failures to make the required reductions, relying instead on simply speeding up the delivery of other planned savings.

The Department must demonstrate the credibility of its cost reduction programme by testing the realism of its plans, including their sensitivity to changes in the assumptions made, and ensuring adequate contingency is built in.

7.1 The Government does not agree with the Committee's conclusion, but does accept the Committee's recommendation.

7.2 The Department's track record in delivering cost reductions, for example in SR07, is proven. The Department will control its delivery of SR10 reductions through its Change Programme. The Department recognises the importance of delivering cost reductions in line with its planned trajectory and sustaining these savings throughout and beyond the Spending Review period. The Department does not, however, accept that it has to deliver additional savings of around one third in the final year of the Spending Review period. The new savings planned for 2014-15 represent 16% of the total savings required from its cost reduction projects over the whole of the Spending Review period, as sustainable savings will have been made in the three earlier years.

7.3 In line with Cabinet Office (Major Projects Authority (MPA)) guidance and best practice, the Department has developed robust governance around all aspects of its Change Programme as well as its spending on business as usual. Any potential slippage can be identified early and decisions made about how best the Department can use its available resources to manage any cost reduction issue. The MPA recently completed a *Starting Gate* review of the Department's Change Programme, with their report stating that "*the programme is in good shape at this stage.*" The Department has also established a comprehensive risks and issues process across the Change Programme portfolio. The MPA commented "as we would have expected with such a strong and professionally competent central team, there are good processes in place for logging and managing risks in the traditional way."

PAC CONCLUSION AND RECOMMENDATION 8

The scale and speed of change planned will place significant additional demands on the Department's management capacity. All of the projects have started, although some are still in planning and design phases. With a programme of this size, it needs to understand the linkages between projects and be able to respond early and in a coordinated way to any slippage. Continuity in project management is also critically important.

The Department must ensure its project management arrangements provide clear evidence on the progress of all projects against the critical path for delivery, so that it has early sight of under-delivery, understands the consequences on other projects and can respond quickly. It should also ensure that staff are held accountable for delivery against key milestones.

8.1 The Government agrees with the Committee's recommendation.

8.2 In line with best practice of the MPA, the Department has developed a portfolio plan with a high-level view of interdependencies and sequencing of projects. More detailed planning and interdependency mapping is underway, but this is at an early stage as this is a four year programme. The Department has confidence in its delivery and welcomed the October 2011 MPA report, following their *Starting Gate* review, which stated: "*There is a rigorous investment gating process to ensure that funding is only allocated to projects which contribute directly, and sufficiently, to the main targets on efficiency, yield and service improvement. Considerable thought has been put into the formal governance structures and processes. They are heavyweight, but comprehensive.*"

Fifty Ninth Report

Ministry of Defence (MOD)

The cost effective delivery of an armoured vehicle capability

Report Summary from the Committee

Armoured vehicles such as tanks, reconnaissance and personnel-carrying vehicles are essential for a wide range of military tasks. Since the 1998 Strategic Defence Review, the Ministry of Defence (the Department) has attempted to acquire the vehicles it needs through a number of procurement projects. However, none of the principal armoured vehicles it requires have yet been delivered, despite the Department spending £1.1 billion since 1998, including £321 million wasted on cancelled or suspended projects. As a result there will be gaps in capability until at least 2025, making it more difficult to undertake essential tasks such as battlefield reconnaissance.

Partly as a result of this £1.1 billion failure to yet deliver any armoured vehicles, and to meet the specific military demands of operating in Iraq and Afghanistan, the Department was provided with a further £2.8 billion from the Treasury Reserve to buy Urgent Operational Requirements (UOR) vehicles. The Department has used the faster UOR process to deliver mine-resistant vehicles for operations. However, these vehicles are expensive and are designed for specific circumstances, so will not meet the wider requirements identified in the recent Strategic Defence and Security Review (SDSR).

Delays to the delivery of the principal armoured vehicles have meant that other equipment, such as helicopters and other vehicles, have been used more frequently to undertake tasks such as battlefield reconnaissance and transporting personnel. Using helicopters and other vehicles in this way can be less effective and may divert expensive military assets from other essential tasks.

Over the past six years, the Department has removed £10.8 billion from armoured vehicle budgets up to 2021. Armoured vehicles projects have suffered more severe budget cuts than other equipment projects, largely because they involve lower levels of contractual commitment and are therefore easier to cut. This has left £5.5 billion available for the next ten years, which is insufficient to deliver all of the armoured vehicle programmes which are planned. The Department needs to be clearer about its priorities, and stop raiding the armoured vehicles chest every time it needs to make savings across the defence budget.

The Department acknowledges that it has been both indecisive and over-ambitious in setting vehicle requirements, and that the ways it has sought to procure armoured vehicles have been too complicated. The Department will need to set more realistic requirements in future if it is to deliver projects on time and to budget. We are also concerned that the Department was unable to identify anyone who has been held to account for the clear delivery failures. It is critical the Department has named senior staff with the necessary powers and sufficient time in post to take proper responsibility for and be held accountable for such projects.

The Department has yet to balance its defence budget fully and devise a plan to close capability gaps, despite having conducted the SDSR and two subsequent planning exercises. The Department needs to determine its armoured vehicle equipment priorities and deliver these as rapidly and cost-effectively as possible, including making an assessment of which of its existing vehicles should be retained after combat operations in Afghanistan cease.

On the basis of a Report by the Comptroller and Auditor General, the Committee took evidence from the Ministry of Defence on its progress in delivering armoured vehicles.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The Department has failed to deliver any vehicles from its core programmes despite spending £1.1 billion since 1998. A major contributory factor is that it has cut £10.8 billion from its armoured vehicles programme in an attempt to balance its overall equipment budget. Armoured vehicles have suffered more severe cuts than any other equipment area because lower levels of contractual commitment have made it an easy target. The Department concedes that it needs to be clear about its military priorities and not commit to projects it cannot afford, such as the original Future Rapid Effect System programme which sought to deliver 3,700 vehicles at a cost of £14 billion.

The Department should ensure that future procurement decisions are based on a clear analysis of its operational priorities, and must challenge proposals vigorously to ensure they are both realistic and affordable. Once budgets have been set, they must be adhered to.

1.1 The Government disagrees with the Committee's conclusion, but accepts the recommendation.

Target implementation date: April 2013

1.2 The majority of the £1.1 billion has been spent on vehicles which have either been delivered (over £400 million), or are in development / production (a further £400 million). This includes the Titan armoured vehicle and the Trojan and Viking armoured vehicles which have been used successfully on operations in Afghanistan, Terrier which is currently on the production line in Newcastle and Scout armoured vehicles which are due to be delivered later this decade.

1.3 The Department plans to spend £5½ billion on its core armoured vehicle programme over the next ten years. This programme will include Scout, the Warrior Capability Sustainment Programme, and in due course, a utility vehicle.

1.4 Through implementation of the *Defence Reform* proposals (*Defence Reform: an independent report into the structure and management of the Ministry of Defence*), budgets and responsibility for equipment capability will be aligned under the Service Chiefs and Commander Joint Force Command, creating stronger incentives on them to manage the financial consequences of their capability judgements and actions. This will take effect from April 2013.

1.5 The Department prioritises its equipment requirements and procurement decisions based upon Defence Strategic Direction 11 (DSD11). DSD11 provides the statement on the Department's strategic direction and informs decision making and provides direction for strategy, policy, planning, programming and finance staffs. DSD11 is structured around the Military Tasks which describe what the Government may ask the Armed Forces to undertake; and through more detailed Defence Planning Assumptions makes statements about the size of operations, how often they might be undertaken, how far away from permanent bases, with which partners and allies, and how soon forces are expected to recover from the effort involved.

1.6 The Department has learned the lessons from legacy programmes and is committed to adopting more simplified and realistic acquisition strategies for Armoured Vehicles to reduce costs, mitigate risk, and allow growth potential instead of over-specification from the outset.

PAC CONCLUSION AND RECOMMENDATION 2

The Department's inability to deliver its armoured vehicles programme has been exacerbated by over-specifying vehicle requirements and using complex procurement methods. The Department conceded these shortcomings but claimed that budgetary pressures had led it to introduce a more pragmatic and cost conscious approach: the Foxhound vehicle, for example, had been procured more simply to meet a requirement that was driven by realism. It was aiming to purchase more vehicles "off the shelf" through international competition, while seeking to retain the ability to upgrade and maintain vehicles in the UK.

The Department needs to demonstrate in future projects that its procurement culture has changed towards realistic specifications and simpler procurement routes. It should buy vehicles off the shelf through international competition where possible, having identified and assessed the consequent impact on the UK's industrial capability.

2.1 The Government agrees with the Committee's recommendation.

Target implementation date: February 2012.

2.2 The Department acknowledges that in the past it has over-specified requirements and attempted to integrate too many novel technologies at once in an attempt to deliver the best possible capability. The Department also acknowledges that some of the earlier procurement strategies were over-complex and as a result neither the Department nor Industry were able to manage them effectively.

2.3 The Department has significantly improved the way in which Armoured Vehicles are specified and procured in recent years. For example, the Scout Specialist Vehicle (Scout SV) programme has adopted a simplified acquisition strategy and pursued a modified solution of an existing and proven vehicle, reducing the costs and risks associated with a new design. The vehicle has data and power systems which enable it to be flexible to future changes in technology and advances throughout life. This offers growth potential without over-specification now.

2.4 The Government published a Green Paper on Equipment, Support, and Technology for UK Defence and Security in December 2010. Following consultation, the Government has now published a White Paper '*National Security through Technology: Technology, Equipment, and Support for UK Defence and Security*' setting out its high level policy on equipment procurement, including the future role of competition in the global market and Off-the-Shelf procurement.

2.5 The forthcoming *Materiel Strategy* will include proposals to improve the interface between the Defence Equipment & Support (DE&S) organisation and the wider Department to drive greater stability in project requirements and budgets. It will also ensure DE&S has the right level of business capability to discharge its role. This will include increased capability in project management, cost estimating, financial management, and contracting and will build on improvements already implemented, such as strengthening of the cost assurance capability, introduction of a project management licensing scheme, and the appointment of a qualified account as the Director General Resources within DE&S.

PAC CONCLUSION AND RECOMMENDATION 3

The Department has spent £2.8 billion meeting urgent operational requirements (UORs) necessitated by its failure to deliver the core armoured vehicle programmes. A failure to plan properly has led to extra money being spent outside departmental budget limits to fund essential equipment needed by troops on the front line. Meeting the UORs has meant buying more vehicles than would otherwise have been required and, compared to core vehicle programmes, they are expensive, less reliable, and will not meet the full requirements of the Strategic Defence and Security Review (SDSR).

In future, the Department must avoid introducing UORs to compensate for its own poor programme and financial management but should use them only to respond to urgent military imperatives.

requirement trades can be agreed¹³, and by improving stakeholder engagement.

PAC CONCLUSION AND RECOMMENDATION 5

The Department has yet to devise a coherent plan for delivering the equipment it needs to meet its strategic defence commitments. Despite having conducted the SDSR and two subsequent reviews, the Department has yet to reach a clear set of defence priorities which are achievable within the defence budget. The Accounting Officer assured us that the Department would not commit to expenditure if it did not have the budget to do so, and that it would stay within its budget in the 2011-12 financial year. Living within the 2011-12 budget should not mean making cuts in the short term which involve extra expenditure over time.

The Department should urgently complete the unfinished work of the SDSR to balance its budget fully, identifying the equipment required to meet its capability needs and allocating resources accordingly. In the case of armoured vehicles, it should act urgently to establish which existing vehicles it intends to retain in service, and which new vehicles it can afford to procure.

5.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: March 2012.

5.2 Since the SDSR, significant work has been undertaken by the Department to understand in detail the true cost of and risk associated with the forward programme. This work identified the need for greater contingency in forward plans and developed a series of options for a balanced and affordable programme. The Department has therefore already met this element of the Committee's Recommendation. Building on this work, the focus of *Defence Reform* and the *Materiel Strategy* is on wider reforms to the system that are needed to keep the programme affordable and deliverable.

5.3 The Department plans to spend £5½ billion on armoured vehicles over the next ten years. This programme will include Scout, the Warrior Capability Sustainment Programme, and in due course, a utility vehicle. Work is also underway to decide which of the vehicles bought under the UOR process should be retained in service once they are no longer required in Afghanistan.

PAC CONCLUSION AND RECOMMENDATION 6

There is poor accountability for long-term equipment projects, such that no-one has had to answer for this prolonged failure of management. Senior Responsible Owners do not remain in post long enough to ensure continuity on large scale programmes, making it difficult to hold anyone responsible for whether they succeed or fail. Despite having failed to deliver any principal armoured vehicles for over a decade, the Accounting Officer was unable to tell us who was responsible or whether anyone had paid the penalty for these failures.

The Accounting Officer should ensure that the lines of accountability for projects, and the way in which those responsible will be held to account, are clearly articulated and understood throughout the Department.

6.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: April 2012

6.2 As part of its examination of how individual accountability across the UK's defence programmes could be strengthened, Lord Levene's review *Defence Reform* looked at the issue of tour lengths. The review recommended that the Department should move towards a system that requires senior individuals to stay in key posts for longer than they tend to at present and should also look to align tour

¹³ where specifications and/or roles are revised to reflect changing Defence priorities or made necessary through the discovery of unachievable goals, normally technological, as the programme advances

lengths with the key outputs of the post, such as major milestones on equipment programmes. Further work is underway to identify the standard tour lengths that should apply to different categories of senior post. Alongside other benefits, this would make the audit trail for responsibility on decisions and performance more clear. Further detail on accountability is provided in TM 56.

6.3 In relation to former SROs, the Committee will appreciate that as set out in Cabinet Office guidance, paragraphs 73 to 75 of *Departmental Evidence and Response to Select Committees*¹⁴, (also known as '*the Osmotherly Rules*') Accounting Officers and senior officials cannot discuss the conduct of individual named officials when giving evidence to Parliamentary Committees.

¹⁴ *Departmental Evidence and Response to Select Committees* published in July 2005 sets out guidance on the role of civil servants appearing before parliamentary select committees and is available on the Cabinet Office website.

Sixtieth Report

Department of Health (DH)

Achievement of foundation trust status by NHS hospital trusts

Report Summary from the Committee

A vital component of a successful health service is that everybody wherever they live should have ready access to a high standard of care through a network of acute hospitals that are subject to strong clinical and financial governance. The Department of Health (the Department) sees self-governing foundation status as necessary if hospitals are to succeed in a financially demanding environment. Becoming a foundation trust requires strong governance, long-term financial viability, and a framework to secure delivery of quality services. NHS foundation trusts were first created in 2004 and, between then and the end of September 2011, 139 NHS trusts attained foundation status. The Government intends that the majority of the remaining 113 NHS trusts will become foundation trusts by April 2014. It is already clear that this will be extremely difficult to achieve.

The challenges facing those hospitals which have still to attain foundation status are more severe than previously thought. Four out of five now face financial difficulties; 78% say they have to tackle strategic issues; two thirds acknowledge they have performance and quality challenges and nearly 40% say they need to strengthen their governance and their leadership.

Creating a national network of hospital trusts which are autonomous and financially viable presents hugely difficult challenges. It remains unclear whether all the problems trusts have highlighted can be resolved. Making all trusts viable will involve reconfiguration of some services, including through mergers. It is critical that local communities are consulted on these decisions and benefit from them. Where changes are proposed, trusts will need to demonstrate how merging organisations will create healthcare benefits to local communities while addressing the root causes of the financial problems that exist. Many of these trusts are in deprived areas and solutions should not reduce access to services for vulnerable people, thereby exacerbating health inequalities.

The Committee was particularly alarmed that the healthcare system in London has been allowed to deteriorate despite its problems having been known about for many years. At least half of the acute trusts in London are not viable in their current form. The Department reassured us that none of trusts' current plans involve closing hospitals, but some trusts are in such a poor financial state it is difficult to see why other organisations would want to take them on. The Chief Executive of the NHS is only "moderately confident" that London's hospital system can be turned round, and acknowledged the unique challenges and obstacles to be overcome.

Strong leadership is urgently needed if those trusts facing clinical and financial difficulties are to meet the challenge of achieving foundation status. The flow of trusts through the 'pipeline' towards foundation trust status is already behind schedule. Decisions about changes to services, need to be taken promptly but wisely, and some trusts are still putting off difficult decisions. A particular problem is the quality of leadership, but prolonged uncertainty makes it harder to recruit good board members and clinical staff. The Department has made an explicit commitment to intervene if trusts fail to tackle problems on their own.

The cost of private finance schemes is an additional challenge for a limited number of hospitals. Analysis commissioned by the Department has identified six trusts that are unviable largely because of their PFI charges. Long term Private Finance Initiatives (PFI) deals reduce the Department's ability to establish a level playing field of financially sustainable, autonomous trusts. In many cases efficiency savings alone will not be enough to make unviable trusts financially sustainable. The Department faces a particular dilemma about how to manage the debt of these hospitals as their long term financial commitments make reconfiguration more difficult.

On the basis of a report by the Comptroller and Auditor General, the Committee took evidence from the Department of Health and the Chief Executive of the NHS, and from the Chief Executives of Ealing Hospital NHS Trust, North Middlesex University Hospital NHS Trust, and Winchester and Eastleigh Healthcare NHS Trust, about the responsibility for dealing with this huge challenge, and what is being done to protect taxpayers and patients when trusts need external help.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

Twenty hospital trusts have declared themselves unviable in their current form. In many cases, this is a consequence of a failure to face up to and resolve problems that have been evident for over a decade. Moreover, half of all trusts are not yet foundation trusts and more are likely to conclude they are unviable. A particular concern is what will happen to trusts that are unable to achieve foundation status but nevertheless provide an essential service to local people. In most of these cases, mergers and reconfigurations will be inevitable.

The Department should require each trust in difficulty to provide the local community with a clear explanation of the problems it faces and what the proposed changes will mean for patients. Trusts must consult staff and the local community on how they intend to resolve these issues.

1.1 The Government agrees with the Committee's recommendation.

Target implementation date: March 2012

1.2 Tripartite Formal Agreements (TFA) for all NHS Trusts were signed by 30 September 2011 and have been published. Clear timelines and actions are now agreed for each individual organisation. TFA's identify the key strategic and operational issues facing each NHS Trust. They set out the timetable, significant milestones and actions for submitting an application to the Department. They also describe the commitments by each party to deliver a Foundation Trust (FT) application, along with risks to delivery and risk mitigation. The agreements identify the scale of challenge and provide unprecedented clarity on what needs to be done to complete the roll out of the FT pipeline.

1.3 The application process for FT status requires each NHS Trust to conduct a 12 week public consultation on their proposals. The consultation is open to all members of the public, patients and staff, as well as statutory and voluntary bodies with an interest in the local health economy. The consultation will set out the NHS Trust's plans for FT status and the challenges faced. NHS Trusts are also required to develop a representative local membership made up of patients, staff groups and the general public. Throughout the FT application journey, this provides a forum to discuss issues.

1.4 The membership elect governors to sit on a Board of Governors who have power set out in legislation to hold an FT's Board of Directors to account. This is a powerful driver for local democracy and provides a strong voice for patient and public involvement in their local hospital. In addition, NHS Trusts are required to conduct public consultations on any significant service redesign and reconfigurations, and where appropriate, their plans will be scrutinised by the NHS Co-operation and Competition Panel.

1.5 Strategic Health Authorities (SHAs) performance manage their NHS Trusts by working with them on issues such as waiting times, healthcare-associated infection rates and other issues that really matter to patients. They help to reduce unacceptable and unjustified variations in clinical quality and safety. The Care Quality Commission also plays an important role. Subject to the passage of the Health and Social Care Bill currently before Parliament, the NHS Trust Development Authority (NTDA) will take over this function from SHAs in April 2013.

PAC CONCLUSION AND RECOMMENDATION 2

Failure of trusts to meet the commitments in their TFAs is likely to damage their financial and clinical viability and make the achievement of foundation status more difficult. Should a trust fail to carry out the actions agreed with the Department and SHAs they may be forced to shed services or to undertake mergers. Where such action is taken by necessity rather than design it seems inevitable that patients will suffer.

Sir David Nicholson made a promise that SHAs and the Department would intervene if trusts failed to deliver the commitments made in their TFAs. The Committee expects the Department to honour this promise, and to carefully monitor progress so that it can take timely and robust action to address risks to the provision of important services. The Department should report back to us by the end of 2012 on the progress of all trusts still in the pipeline and what further action it is taking to help those trusts which continue to be unviable.

2.1 The Government agrees with the Committee's recommendation.

Target implementation date: December 2012

2.2 TFAs set out a NHS Trust's journey to FT status on their own, as part of an existing FT or in another organisational form. The TFAs have been signed by the Chief Executives of the NHS Trust, their SHA and the Managing Director of Provider Development Directorate (now the Senior Responsible Owner (SRO) for the NTDA and the FT pipeline) at the Department. Additionally, the lead commissioner for the NHS Trust has also signed the agreement. These documents and the timescales and commitments made in them will be performance managed.

2.3 A performance management approach has been developed by the Department's Provider Development Directorate in conjunction with the performance function and the SHA Directors of Provider Development. Every month a series of discussions take place with each SHA, agreeing a Red, Amber, Green (RAG) rating for each NHS Trust in their area. This then combines to make a RAG rating for each SHA and an overall RAG rating for England. In addition to this, a clear escalation policy is now in place to detail the actions that will take place where agreed plans and milestones are not achieved. The whole ethos of this approach is to ensure timely and robust action is taken by all involved, to support NHS Trusts on their journey to FT status

2.4 The first red RAG rating for an NHS Trust will trigger a formal discussion between the NHS Trust and the SHA as part of the normal SHA performance processes. Following three red RAG ratings a NHS Trust enters the SHA and Department of Health element of the escalation process. This regime began in December 2011 and will continue as an ongoing mechanism to manage TFA performance and be a key element of the Single Operating Model (SOM) for provider performance management. A missed overall application submission date would automatically trigger a red rating and a move immediately to a discussion between the Department and the SHA, unless a delay of less than three months is anticipated. In such cases, the SHA and the Department will agree that the escalation approach will apply although resolution would be agreed on a case-by-case basis

2.5 As with any complex system, unseen issues or events may impact on an NHS Trust's ability to meet the agreed timeline. Notwithstanding this, the signatories to the dates will be held to account for those relevant to them under a performance monitoring process. There are specific milestones in each TFA and failure to meet milestones could lead to alternative solutions for individual organisations and could have personal impacts for senior NHS Trust leaders. SHAs have the pre-eminent performance management role with NHS Trusts and the Department will only be involved after three red RAG ratings or before if requested by the SHA.

2.6 SHAs retain the option of moving individual TFA milestones as long as the critical path and final submission date are unaffected. SHAs can request the involvement of the Department earlier than three months if they believe this is necessary, but if an NHS Trust is red rated for three months or misses its application date, the regime defines that the Department will become involved immediately.

2.7 The Department is continuing to develop and implement the first elements of the SOM that the four SHAs will adopt from January 2012. The first element of the model focuses on the development

and assurance of FT applications. The development of the model has been SHA-led with the Department and other stakeholder involvement as necessary. Further aspects of the model will focus on the Department's assurance process for FT applications, the SHA oversight of NHS Trusts, mechanisms to drive consistency and the assurance processes for major transactions. Another aspect to the model will be aligning and integrating the workstreams focussed on delivery of the FT pipeline in SHA clusters, with those focussing on the continuing performance management of NHS Trusts.

2.8 The Department will provide a report to the Committee by the end of 2012 about the NHS Trusts still in the pipeline and on progress to deliver an all FT provider landscape.

PAC CONCLUSION AND RECOMMENDATION 3

The situation in many parts of London is unacceptable and long-standing problems need to be tackled urgently. At least half of non-specialist acute hospitals in London are not viable in their current form, with some heavily indebted trusts providing poor services. The Committee remain to be convinced that combining struggling hospitals into larger trusts - as with South London – is a realistic way to create viable organisations which provide equal access to good quality healthcare to everybody.

The Department and NHS London are aware of the difficulties facing London's healthcare system, but they cannot just leave this problem to individual trusts, and they need to develop a clear strategy and appropriate support for the creation of a sustainable, safe and efficiently delivered health system, and communicate it clearly to Londoners.

3.1 The Government agrees with the Committee's recommendation.

Target implementation date: March 2013

3.2 The SHA, NHS London, currently performance manages and provides support to all NHS Trusts within London in their journey to FT status. This work is led by the Directorate of Provider Development that exists in each of the four SHAs across the country. Within London, an SHA wide analysis (*Safe and Financially Effective*) has been completed reviewing the clinical and financial sustainability of all NHS Trusts. This has examined the productivity opportunity open to all Trusts and factored in key quality metrics so that an assessment of which Trusts are viable in their current form and those where more major changes are required has been made.

3.3 This work has been shared with NHS Trusts in London who are now using this as a key element of the work to achieve FT status by demonstrating their ability to be clinically and financially sustainable for the future on their own, as part of an existing FT or in another organisational form. A number of Trusts have already identified that they are not viable in these terms and are all progressing transactions with other NHS Trusts to secure a viable future ahead of applying to become FTs. Each of these Trusts, as well as the remaining NHS Trusts in London, are following an agreed path to FT status as set out in their TFAs that have all been published locally for patients and other stakeholders.

3.4 The TFAs are a key element of the ongoing management of the FT pipeline. The performance management, agreed between all the SHAs and the Department will help to support delivery of the agreed milestones and identify corrective action when and if deadlines are not achieved. This performance process as well as the assessment of FT applications and the development of products to support NHS Trusts on their journey to FT status will continue within the Department and SHAs until April 2013 when the NTDA assumes responsibility for all NHS Trusts across the country and will then lead this work.

PAC CONCLUSION AND RECOMMENDATION 4

Reconfiguration of local services could disproportionately affect vulnerable patients, particularly those who rely on public transport. Reconfiguration will inevitably reduce the range of services provided by some hospitals. The Department will have to support otherwise unviable services in some parts of the country so that all local people have access to the healthcare they have a right to expect.

In considering how to reconfigure services the Department and the SHAs should assess carefully the impact on the local population. They should ensure they protect the interests of vulnerable people for whom travelling to hospital is difficult, so that health inequalities are not exacerbated.

4.1 The Government partially agrees with the Committee's recommendation.

Target implementation date: March 2013

4.2 The Department recognises that access to services is an important issue for patients and the public. This is why the Department is very clear that reconfiguration should be a locally-led process, so that services can be designed around the needs of patients. An objective of the Government's reform plans is therefore to allow strategic decisions to be taken at the appropriate level.

4.3 The Department disagrees that these decisions should be taken by the Department and SHAs. Subject to Parliamentary approval, the Health and Social Care Bill will help to ensure that reconfigurations are locally-led by underpinning commissioning decisions with clinical insight through the establishment of clinical commissioning groups (CCGs). CCGs will have the flexibility to collaborate with each other, providers, local government and with the NHS Commissioning Board in making decisions about the redesign and reconfiguration of services. CCGs will work with provider organisations from the outset to enable them to plan for the necessary changes. The Secretary of State's four tests for service reconfiguration will continue to ensure that changes are clinically-led and in the best interests of patients.

4.4 In planning services, CCGs will need to consider how best to secure the highest quality for their local population within available resources. CCGs should work closely with health and wellbeing boards and local HealthWatch to ensure that plans are aligned with the Joint Strategic Needs Assessment, the Joint Health and Wellbeing Strategy. They will also work with providers and effectively engage patients and local communities. When proposing to reconfigure services, it is right that commissioners and providers consider the implications for patients travelling to facilities and that any changes should not disadvantage particular groups.

4.5 Developing plans in dialogue with local authorities and patient representatives, including local Healthwatch, will help ensure these issues are taken into account. Moreover, the Health and Social Care Bill will, subject to Parliamentary approval, place a duty on the Secretary of State for Health, the NHS Commissioning Board and clinical commissioning groups to have regard to reducing health inequalities in access to, and the outcomes of, health services.

4.6 The Committee has proposed that the Department should support otherwise unviable services in some parts of the country. The Department's view is that patients should continue to have access to services whilst ensuring value for taxpayers' money and a fair playing field for providers. This is why the Health and Social Care Bill allows commissioners and providers (or if they cannot reach agreement, providers alone) to apply to Monitor (the independent FTs regulator) for a modification to the price for a service determined in accordance with the national tariff.

4.7 Monitor could approve and / or set the level of the modification under certain circumstances (using the methodology agreed between Monitor and the NHS Commissioning Board), if the provider could not, at the tariff price, cover its costs with an efficient service. Any modification would reflect strong economic arguments for the price modification. This would help ensure continuity of services where there were unavoidable additional costs of delivering a particular service, such as may be found in a rural area, and where commissioners' requirements were otherwise uneconomic to provide.

PAC CONCLUSION AND RECOMMENDATION 5

PFI is an additional challenge facing a few hospitals and PFI service charges are contributing significantly to some trusts' financial problems. Analysis commissioned by the Department has identified six trusts where their PFI contract is a major obstacle to them becoming financially viable.

The Department recognises that those financial commitments need to be met, but has not yet explained how it will support these trusts without disadvantaging others. The Department will need to ensure the long term sustainability of these hospitals whilst at the same time minimising any extra financial support it offers.

5.1 The Government agrees with the Committee's recommendation.

Target implementation date: April 2012

5.2 A number of potential solutions to this issue are being considered by the Government and the Department will work to complete this before Summer 2012.

5.3 Decisions on the application of any central funding to specific Trusts will be made in the context of each Trust's progress towards FT status. They will only be provided once the Secretary of State's tests have been met and as an integral part of their overall journey to FT status.

PAC CONCLUSION AND RECOMMENDATION 6

Nearly 40 % of trusts struggling to attain foundation trust status have identified leadership and governance as a key problem.

Strong leadership is vital for achieving foundation trust status. The Department should report back to the Committee, by the end of April 2012 on:

- **what practical steps have been taken by successful foundation trusts to engage higher calibre non executives, and to put in place more robust accountability frameworks;**
- **what action the 40 % of NHS trusts with acknowledged weaknesses have taken to address the leadership and governance problems they are facing; and**
- **what impact the new toolkit has had in helping those trusts struggling to attain foundation status.**

6.1 The Government agrees with the Committee's recommendation.

Target implementation date: April 2012

6.2 FTs are sustainable, autonomous providers with greater freedoms to innovate to provide high quality services for patients. Through membership, FTs have stronger connections with their staff and local populations to ensure that long-term plans reflect their input and needs

6.3 Good governance is the hallmark of high performing organisations. NHS Boards need to be effective at understanding their business, articulate a strong strategic vision, demonstrate robust financial control and ensure a positive culture of challenge and self improvement, with quality and excellent patient experience as its primary purpose. Strong leadership is vital by the Executives and Non-Executives of NHS Boards. High performing FT Boards are outward facing, focussed on strategic risks, evaluate themselves and on getting the right balance between Trust and challenge at Board level. Practical steps for engaging high calibre non-executives in leadership and governance improvements include conducting Board observations, capability assessments and individual development plans. There is a strong evidence base which sets out that such steps strengthens governance and leadership capability of NHS Boards.

6.4 To date, action by NHS Trusts to address issues of Board capability has been variable. There are good examples of Board Development in the NHS which includes activities such as mock board to board; establishing buddy relationships between Trust Directors and their Non-Executive Directors and Board master classes covering finance, strategy and quality governance. However, the standard, quality, cost and commitment to Board development differs substantially.

6.5 For example: some NHS Trusts have used a range of external suppliers from consultancy companies to support their activity whereas other Trusts have taken a greater 'in-house' focus, which in some cases has included support from the NHS Institute's Board Development Tool and SHA-led activities and workshops. However, despite this, leadership and governance remains a key problem for many aspirant FT – referring to the 40% of Trusts cited by the Committee. The 40% figure has been brought to the fore through the recent TFA analysis as well as last year reviews of NHS Trusts who had failed their Monitor assessments.

6.6 With responsibility for ensuring that all NHS Trusts gain FT status by 2014 now transferring to the NTDA in April 2012, a new Board Governance Assurance Framework (BGAF) (referred to above as the New Toolkit) will provide important national consistency to this salient work. The BGAF builds on the already existing good practice within high performing FTs and in the SHAs - and as part of its development – reviewed key Board effectiveness and governance good practice publications (for example: the *Intelligent Board* series, the *Healthy NHS Board*, and Monitor's *Governance Code*).

6.7 The BGAF will assist aspirant FT Boards through a combination of self and independent assessment processes to ensure that they are appropriately skilled, and prepared to achieve FT authorisation. The outputs of which include an independent report which sets out the key insights and recommendations to improve Board capability. The required development activity for each NHS Trust is nationally supported through three development modules in the areas of strategy, finance and quality governance.

6.8 With the BGAF mandatory before Trusts submit their FT application to the Department from January 2012, the independent reports from the first aspirant FTs to undertake the assessment element of the toolkit will be available in March 2012. The Department will be able to provide an early indication on the impact on the BGAF in April 2012, based on the small number of Trusts who are expected to complete the BGAF over the following three months. The independent reports will set out clearly what leadership activities are required by the aspirant FT prior their FT submission to the Department. This may include targeted work on strategy, finance and/or quality and in certain circumstances may result in recommendations for changes in the individuals and composition of the Board.

6.9 The Department understands that preparation for the Monitor assessment is a complex and time-consuming process for NHS Trusts. Alongside the key financial and quality requirements, the leadership effectiveness of individual members of the Board and their perceived ability to lead and drive a successful organisation is a critical part of the evaluation for readiness. BGAF will help individuals, Boards, SHAs and the Department gain a better understanding of the readiness of all members of a Trust Board and develop their leadership capability prior to the Monitor assessment and in line with their agreed date set out in each NHS Trusts' TFA.

Sixty First Report

HM Revenue and Customs (HMRC)

HM Revenue and Customs 2010-11 Accounts: tax disputes

Report Summary from the Committee

At 31 March 2011 HM Revenue & Customs (the Department) was seeking to resolve tax issues valued at over £25 billion with large companies, some of which included disputes over outstanding tax. The Department must collect as much outstanding tax as possible and be held properly to account for how it resolves tax disputes. The Committee has serious concerns about how the Department handled some cases involving large settlements, where governance arrangements were bypassed or overlooked until it was too late. In some cases the same officials negotiated and approved the settlements, which is clearly unacceptable.

Investigation of these specific cases has led to serious concern about systemic issues which must be addressed with the utmost urgency. There needs to be proper separation between the negotiation of tax settlements and the authorization of such settlements. And the Department must address issues of accountability so that Parliament and the public can be satisfied that best value is secured.

The Department has made matters worse by trying to avoid scrutiny of these settlements and has consistently failed to give straight answers to our questions about specific cases, which has severely hampered our ability to hold it to account for the settlements reached.

The Department has insisted on keeping confidential the details of specific settlements with large companies, even where there have been legitimate concerns about the handling of cases. Details of some cases only reached the public domain because the press secured the details. The Committee recognises the general intention of the legislation is to keep taxpayers' details confidential, but there is a provision which allows the Commissioners to authorise disclosure in certain circumstances.

Furthermore, HMRC has a clear duty to assist Parliament in its work to establish value for money and detailed information can be necessary if Parliament is to properly meet its obligations. Given the public interest in these very large settlements, it is not unreasonable that they should be subject to more specific scrutiny. As it stands, the Department's decision to withhold details from us reduces transparency and makes it impossible for Parliament to hold Commissioners to account. This situation is entirely unacceptable.

The Committee discovered that the Department's governance processes for large settlements were not applied consistently. In one case, a mistake was not picked up until too late because the Department failed to follow its own governance procedures. The C&AG told the Committee that this resulted in a loss of up to £8 million in interest forgone.

The Committee has since received evidence from a whistleblower that the total value of interest payable in respect of this particular settlement could be as high as £20 million. The Committee's understanding of how this case was settled is inhibited by the imprecise, inconsistent and potentially misleading answers given to the Committee by senior Departmental officials, including the Permanent Secretary for Tax. In particular, his evidence to the Treasury Select Committee on his relationship with Goldman Sachs is less than clear given his evidence to us that he facilitated a settlement with the company over their tax dispute.

The Committee expects far greater candour from public officials involved in administering such an important area of government, especially when there is a question about whether HMRC acted within the law and within its protocols. The Committee is concerned that whistleblowers using the provisions of the Public Interest Disclosure Act 1998 face threats of dismissal for providing important and relevant information.

The Department accepts that its governance arrangements have not provided sufficient assurance and that independent scrutiny of large settlements is needed. It has appointed two new Commissioners with tax expertise, and plans to introduce a new assessor role to permit independent review of large settlements before they are finalised. The Cabinet Secretary assured the Committee

that proposals would be submitted to the Public Accounts Committee by Christmas. The Committee welcomes these measures, but they will not by themselves guarantee proper accountability. In future, the Department needs to ensure it follows its own governance procedures and checks without exception. In particular, it needs to make sure that in all cases there is a clear separation between the roles of those negotiating and those signing off settlements.

The Committee saw little evidence of a culture of personal accountability within the Department. The Committee was told that an individual was held accountable for the mistake which led to a loss of the interest due to the Department. However, those at the top of the Department also need to take responsibility for how the overall system has been designed and operated, since that is the context in which mistakes have occurred.

The Committee has serious concerns that large companies are treated more favourably by the Department than other taxpayers. The Committee was told by the Cabinet Secretary that the relationship management approach adopted for large companies had been very successful in terms of tax collection. But for the public to have confidence in this approach, the Department's working practices must be seen to be absolutely impartial. The Department has left itself open to suspicion that its relationships with large companies are too cosy.

The Committee is also concerned that large companies appear to receive preferential treatment compared to small businesses and individuals – for example, in settling the totals due at less than the sum claimed by HMRC and in the time they are allowed to pay their tax liabilities without incurring interest charges. In order to maintain public confidence, the Department must ensure it avoids any perception of undue leniency in its dealings with large companies and must be seen to treat every taxpayer equally before the law.

The Committee welcomes the Comptroller and Auditor General's proposal to conduct further work to consider the reasonableness of the settlements reached in the specific cases where normal governance processes were not followed, and to report on whether proper legal advice was secured in a timely manner and that HMRC complied with its own published procedures and protocols. The Department has agreed to co-operate fully with this inquiry and with any subsequent hearings the Committee holds.

On the basis of a Report by the Comptroller and Auditor General, the Committee took evidence from the Cabinet Secretary and HM Revenue & Customs on tax disputes.

Government responses to the Committee's recommendations

PAC CONCLUSION AND RECOMMENDATION 1

The Department's refusal to disclose taxpayer information prevents proper scrutiny of the process for reaching tax settlements with large companies. The Committee accepts there is a need for confidentiality to protect taxpayers, but this must not be used as a cloak to protect the Department from scrutiny. It is absurd that the Committee has been forced to rely on information in the media to find out about cases that raise concerns, and of course the Committee only knows about cases on which information has been published in the media.

The Department was not able to point to an absolute statutory bar on disclosure of information about specific cases. Its withholding of information is in fact a policy decision taken by Commissioners. This approach fails to give proper regard to HMRC's duty to assist the Public Accounts Committee in examining whether or not the Department is giving best value for money. There is less justification for keeping tax information about large corporations confidential than information about individuals.

The Department must set out in greater detail its policy reasons for not disclosing information about specific corporate taxpayers. It must explain the circumstances in which it would consider disclosure and it must set out how it will fulfil its statutory obligations to account for its actions to Parliament.

1.1 The Government does not accept that Parliamentary scrutiny of tax settlements has been impeded.

1.2 Her Majesty's Revenue & Customs (HMRC) has a statutory duty of confidentiality, as set out in the Commissioners for Revenue and Customs Act 2005. Taxpayer confidentiality is a fundamental principle underpinning tax systems worldwide. Taxpayers need confidence that the information they give to HMRC will be protected in order to encourage frankness and so allow revenue to be collected efficiently. HMRC may disclose information to third parties only when it is for the purpose of carrying out the Department's functions or for the very limited circumstances specified in the Act. Ministers of successive Governments have repeatedly supported this approach.

1.3 The Government respects the extensive statutory rights of the National Audit Office (NAO) to examine books and papers. In the case of HMRC these are underpinned by a statutory gateway to disclose confidential taxpayer information to enable the NAO to evaluate the Department's performance. The Government supports this process and believes it is capable of providing the Committee with the assurances that it requires. In particular, HMRC will provide Sir Andrew Park, the retired High Court judge appointed by the NAO, with all the information he needs to carry out his review of the reasonableness of five of the largest tax settlements.

1.4 There is no express power nor any specific gateway for HMRC to disclose information directly to the Committee. Whether it can do so depends upon whether such disclosure can be said to be for the purpose of the Department's own functions. HMRC takes the view that to disclose taxpayers' confidential information in evidence to a Parliamentary Committee would be unlawful because it would hinder rather than help in the Department's function of collecting tax and therefore disclosure could not be regarded as for the purpose of the Department's functions. Ministers support this position.

PAC CONCLUSION AND RECOMMENDATION 2

The evidence of the Department's senior officials fails to give us any confidence in the way large settlements are reached. The Permanent Secretary for Tax and the Department's General Counsel and Solicitor failed to answer our questions about specific cases in a spirit of openness. Some of the evidence they provided about the exact order of events, the extent of the Permanent Secretary for Tax's personal involvement in negotiations and whether legal advice was sought and acted upon was imprecise, inconsistent and potentially misleading. Furthermore, the Permanent Secretary for Tax was less than clear and consistent in the evidence he first gave to the Treasury Select Committee and then to the Public Accounts Committee.

Accounting Officers are accountable to this Committee and the Committee expects precise, open and comprehensive answers to our questions. Any failure to do so is a failure to perform a core responsibility and should be treated as such by the Cabinet Secretary.

- 2.1 The Government does not agree that witnesses sought to mislead the Committee.
- 2.2 The Civil Service Code requires all civil servants to act with integrity, honesty, objectivity and impartiality and not to mislead Parliament or others.

PAC CONCLUSION AND RECOMMENDATION 3 to 8

3: The Department chose to depart from normal governance procedures in several cases, which allowed Commissioners to sign off on settlements that they themselves negotiated. HMRC execute hugely important functions on behalf of the taxpayer and the Government. It is absolutely necessary that the officials responsible for and engaged in this work should have the necessary skills, qualifications and experience to fulfil these vital roles. For four of the largest settlements examined by the Comptroller and Auditor General, the processes applied did not recognise the importance of clear separation between those negotiating and those approving settlements, and we are not convinced of the soundness of decisions made by Commissioners in these cases.

The Department has since put in place new governance arrangements that seek to separate the negotiation and authorisation roles. The recent appointment of two new Commissioners widens the pool of Commissioners who have the expertise to make an informed judgement in signing off settlements. However, this does not in itself guarantee there will be effective separation of roles or proper accountability for decisions reached, not least because the two new Commissioners are existing members of the Department's senior team.

The Department must ensure that its revised procedures to separate out the roles of those involved in settling tax disputes are applied to all cases without exception. The Department should report back to the Committee, as promised by the Cabinet Secretary, before Christmas.

4: Governance procedures have lacked the independence and transparency needed to provide sufficient assurance to Parliament. Tax settlements with large companies are inevitably complex and involve the exercise of judgement. Parliament needs assurance that these settlements are appropriate and good value for the taxpayer. The Committee welcomes the Department's proposals to introduce an independent assessor, or assessors, to sit alongside Commissioners, who would carry out independent review of settlement proposals. Appropriate rules need to be established which will ensure that all settlements over £100 million are assessed independently and that a random sample of those over £10 million are assessed independently each year.

It is important that the new role is demonstrably independent and increases accountability to Parliament, and should be established in statute. For speed, the Committee accepts that the role should be set up in shadow form, but it should be formalised in legislation as quickly as possible. Independent assessors should report annually to Parliament on their work, perhaps in a statement contained in the Department's annual report and accounts. This should include aggregate information on the cases in which they were involved and a report on any settlements where they have identified concerns.

5: The Department's failure to comply with its own processes resulted in a substantial amount of money being lost to the Exchequer. In one case, a mistake was not picked up until too late because the Department failed to follow its own governance procedures. The C&AG told the Committee that this resulted in a loss of up to £8 million in interest forgone. The Committee has since received evidence from a whistleblower that the total value of interest payable in respect of this particular settlement could be as high as £20 million. When the error was eventually picked up, the Department decided it would not reopen negotiations.

The Committee are astonished that in this case the decision to settle was taken without legal advice and that the Department did not even take the most basic step of making its own note of meetings with the company concerned, relying instead on the record kept by the company. The Department must ensure that it has applied all relevant governance checks to each settlement before finalising them with taxpayers. It must also consult legal advisors before settling cases in litigation and make sure it keeps its own accurate and complete records of key meetings with companies. The Committee remains concerned that the decision was taken not to reopen this case when the 'mistake' was uncovered, and the Committee were not given good reasons for HMRC not reopening this case.

6: Those at the top of the Department have not taken personal responsibility for serious errors. The failure to apply proper governance processes is the latest in a series of errors made by the Department in recent years, including the debacle over PAYE and tax credits. There appears to be little or no sense of personal accountability when things go wrong. It is right that an individual was held accountable for his role in the mistake that led to the loss of interest on a tax liability, but there also needs to be stringent accountability at the top of the Department for designing and operating a system in which such mistakes could occur.

The Committee expects leaders to take responsibility for both systemic issues and for specific mistakes, for which they are accountable.

7: The Department has left itself open to suspicion that its relationships with large companies are too cosy. The Permanent Secretary for Tax attended a significant number of informal meetings over lunch and dinner with large companies with whom HMRC was settling complex tax disputes, when formal HMRC minutes were not necessarily taken. The Committee was told this was part of the Department's overall approach to relationship management. The Committee accepts that senior tax officials need to be accessible to major stakeholders and welcomes the fact that details of hospitality are published. But this information is only meaningful if supported by transparency about the Permanent Secretary for Tax's involvement in settling disputes with these companies.

It appears that when deciding whether or not to accept hospitality, not enough attention was paid to the risk that a conflict of interest might be perceived. The Department must exercise better judgement over how it manages its relationships with large companies, to ensure it avoids the perception of conflicts of interest.

8: The Department is not being even handed in its treatment of taxpayers. It is unfair that large companies can settle their tax disputes with the advice of professionals at less than the full amount due and that they have been allowed up to 10 years to pay their tax liabilities, while small businesses and individuals on tax credits are not allowed similar leeway.

The Department has promised to look into the treatment of these groups of taxpayers in terms of its fairness and reasonableness. It should report back to us on any actions taken to address the wider policy or process issues identified as a result of its examination.

3.1 The Government agrees that public confidence in HMRC is important. The Department has strong governance processes in place for the resolution of tax disputes, but it accepts that its internal procedures can be improved to provide greater assurance of the settlements the Department reaches.

3.2 HMRC treats all taxpayers even-handedly, supporting the majority who comply with their duty to pay their taxes, and cracking down hard on those who evade or avoid. The Department resolves tax disputes in line with its published Litigation and Settlement Strategy. In most cases this is by agreement under established statutory provisions rather than through formal litigation, but the Department will not settle by an agreement for an amount which is less than it would reasonably expect to obtain from litigation.¹⁵ The Tax Tribunal's own rules support the use of appropriate alternatives to litigation in resolving disputes.

3.3 HMRC focuses its resources on cases where the potential tax liabilities are greatest. Large business tax settlements are a vital part of how the Department secures tax revenues for the country. The Department's handling of large business settlements is robust, but fair. Without them the public finances would be seriously damaged. Large businesses pay around 60% of total UK tax receipts, and account for more than half (£7.9 billion) of the £13.9 billion additional compliance revenues that the Department brought in last year. The UK's approach to large businesses is now being adopted by other tax administrations around the world.

3.4 HMRC is taking further steps to strengthen oversight and governance of tax settlements to offer greater transparency, scrutiny and accountability. A new assurance Commissioner and Second Permanent Secretary will be appointed and will be an experienced tax professional, with responsibility for assuring all proposed large settlements to ensure they secure the right tax efficiently, and in so doing, treat taxpayers even-handedly. The assurance Commissioner will also be responsible for ensuring that HMRC's internal governance procedures have been followed. The threshold for decision-making by Commissioners will be reduced so that all cases with more than £100 million tax at issue will be considered at that level. No proposals for settlement by agreement will be accepted unless the assurance Commissioner is content.

3.5 To guard against perceptions of conflicts of interest, the assurance Commissioner will have no role in the Department's engagement with taxpayers on their individual tax affairs and no line management responsibility for case-workers.

3.6 HMRC will also introduce a programme of reviews of settled cases at all levels to provide assurance that the Department's policies and procedures are being followed consistently and to identify improvements for the future. The Department's Audit and Risk Committee, which is chaired by a Non-Executive Director and includes representation from the NAO, will consider the findings of the review programme and recommend follow-up actions.

3.7 HMRC will provide more information in its annual report and accounts on tax disputes, including aggregate information on yield to the Exchequer. It will also publish a code of governance for tax disputes to provide clarity about its internal processes. This increased transparency will underpin public confidence in the effectiveness and impartiality of tax administration, whether for large cases or small.

¹⁵ <http://www.hmrc.gov.uk/practitioners/lss.pdf>



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ISBN 978-0-10-183052-2



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