



Treasury Minutes on the Fourth and the Sixth Reports from the Committee of Public Accounts 2006-2007

- 4th Report: Gas Distribution Networks: Ofgem's role in their sale, restructuring, and future regulation
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**Presented to Parliament by the Financial Secretary
to the Treasury by Command of Her Majesty
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FOURTH AND THE SIXTH REPORTS FROM THE
COMMITTEE OF PUBLIC ACCOUNTS, SESSION 2006-
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Fourth Report

Office of Gas and Electricity Markets (Ofgem)

Gas distribution networks: Ofgem's role in their sale, restructuring, and future regulation

1. In June 2005, National Grid sold four of its eight gas distribution networks (GDNs) for £5.8 billion. Ofgem concluded that the potential benefits for customers from the sales were likely to be £325 million over the period 2008 to 2023. The savings are the estimated effect of Ofgem's new ability to compare the costs and performance of four independently owned companies. Ofgem predicted that 80 per cent of the £325 million would come after 2013. However, in addition to these savings, it estimated there was potential for further cost savings of £830 million, regardless of whether the sales took place.

2. On the basis of the C&AG's Report, the Committee took evidence from Ofgem on:

- its approval of the sales;
- the approach to setting prices for the gas networks; and
- its role in overseeing the infrastructure of the gas networks.

PAC conclusion (i): Ofgem approved the sales on the basis that they did not result in a net detriment to consumers, rather than because they would bring benefits to consumers. Ofgem should take a less restrictive view and focus on getting the best deal for consumers, which is its primary statutory duty.

3. Ofgem's powers and duties, including its principal objective to protect the interests of consumers, are defined by Parliament. Ofgem is careful to operate within the regulatory framework set by Parliament, and its scope for exercising discretion in carrying out its activities is therefore limited. In normal circumstances Ofgem has no role in approving corporate transactions, other than providing advice to the Office of Fair Trading (OFT) in the course of its merger investigations. Approval from Ofgem is required, however, for the sale or transfer of certain assets out of a regulated company.

4. The transaction proposed by National Grid involved the transfer of all the relevant assets out of the then licensee and into new licensed companies, which were subsequently to be sold. Ofgem's approval was, therefore, required for the transfer to take place. Ofgem's decision to approve the sales, if they would not result in a net detriment to customers, was taken on the basis of legal advice, which suggested that if Ofgem applied a different test, the decision would be likely to be challenged successfully in the courts by an interested party. More generally, it is important to note that Ofgem will seek to maximise the benefits to consumers arising from the sales through the use of comparative analysis in future price control reviews.

PAC conclusion (ii): As part of its sales approval process, Ofgem introduced unnecessary additional changes to the way gas networks operate. Ofgem subsequently decided to defer these reforms, known as gas exit reforms, until at least September 2007. On future projects, it should be confident that its proposed tasks are central to the fulfillment of its objectives and, therefore, that the regulatory burden imposed on the industry is justified.

5. Ofgem accepts the Committee's recommendation. In the course of the sales process, Ofgem sought to strike a balance between its desire to capture the benefits for consumers as soon as possible, and the industry's wish to be able to concentrate on the restructuring which arose from National Grid's decision to sell four of its GDNs. In light of industry's concerns Ofgem concluded that a staged implementation of reforms was preferable and, for that reason, it decided to defer the gas exit reforms. Ofgem agrees that it must ensure the regulatory burden imposed on the industry is justified, as part of its commitment to the principles of better regulation.

PAC conclusion (iii): The project team launched 13 consultations and 387 documents within 16 months, thus placing a heavy consultation burden on the gas industry which struggled to respond. Ofgem should explain the full consultation burden at the outset of projects and minimise burdens by co-ordinating the methods and timings of consultation – for example, by using workshops to engage more directly with stakeholders and by grouping separate documents from across the organisation.

6. Ofgem accepts the Committee's recommendation. During the course of the GDN sales, Ofgem had to strike a balance in its approach to consultation. On the one hand, the industry understandably wanted to keep to a minimum the workload that would be placed on them. On the other hand, industry parties wanted to be involved in the process, and could have challenged Ofgem in the courts, if the process was not sufficiently inclusive and transparent.

7. Extensive use was made of workshops as well as traditional models of consultation. Furthermore, since the GDN sales were carried out, Ofgem has launched 'Project Paperless', a complete review of its documents in order to improve their quality, relevance, quantity and timeliness. In June 2005, Ofgem said that it expected to reduce the number of documents it produced by 20 per cent, by March 2006, compared with the previous year. In fact, it reduced the number of documents produced by 25 per cent compared with 2004-05. Ofgem considers that these changes will lead to significant improvements in the accessibility of its written product, which, Ofgem agrees, is essential in enabling effective consultation.

PAC conclusion (iv): Ofgem did not evaluate fully the range of sale outcomes. Ofgem evaluated the costs and benefits of the proposed sales, assessing the impact of the number of networks sold and variations to the timing of cost savings. But it could have improved its analysis by modelling whether each of its assumptions was realistic in the light of experience. Ofgem's cost-benefit analysis needs to be consistent with the Treasury Green Book and, in particular, the likelihood of different scenarios needs to be assessed.

8. Ofgem shares the Committee's view of the importance of cost-benefit analysis and of the value of the Treasury Green Book. Furthermore, Ofgem considers that its record in applying the Green Book is one of the strongest of any Government department. Ofgem notes that the Green Book constitutes best practice and that the final decision in each situation rests with the Accounting Officer. In the case of the GDN sales, Ofgem's analysis was sufficient to demonstrate that there would be no net detriment to consumers.

PAC conclusion (v): Before the sales, Ofgem had no independent source of information to benchmark whether National Grid was efficient. It was, therefore, difficult to regulate the company effectively and set stretching targets to reduce costs.

9. Ofgem agrees with the Committee's conclusion. The ability to make comparisons drives customer benefits in two key ways. First, it generates comparative information that the regulator can use to set more challenging price controls as a result of reduced information asymmetry than would otherwise be the case. Second, it introduces new management teams, and therefore the potential to increase efficiency savings by generating greater innovation within the industry, facilitating the transfer of best practice, and allowing economies of scope to be captured with other utility networks owned by the same corporate group.

PAC conclusion (vi): There is the potential for cost savings of £830 million across the gas networks between 2008 and 2023. Ofgem calculated that there was the potential to operate the networks more efficiently regardless of whether the sales proceeded. It should make clear to the owners of gas networks that it intends to set a challenging price control in 2008, using efficiency savings of at least 3 per cent per annum as a starting assumption.

10. Ofgem accepts the Committee's findings. There is potential for substantial savings regardless of the GDN sales. Ofgem's approval of the sales was based on the incremental net benefit that could come from comparative analysis. However, to assess these incremental benefits, Ofgem had to make an assumption about the base level, which could be achieved in the absence of the sales. The figure of 3 per cent was an assumption. It was not the result of detailed analysis, which can only be done in a full price control review.

11. Ofgem has made clear that it will set a challenging price control in 2008. This will include doing the work properly to see what level of efficiency assumption is appropriate. This work is already underway.

PAC conclusion (vii): Ofgem's ability to bring forward the delivery of benefits is dependent upon the quality of information it collects on the performance of the network owners. Having several comparators is only beneficial if Ofgem is able to establish clear, reliable and comparable data. It should target its approach to information gathering, focusing on cost and performance.

12. Ofgem accepts the Committee's recommendation. The quality of information is crucial in order to set an effective price control. Ofgem made clear at the outset of the 2007-08 price control review that having clear, reliable and comparable data would be a pre-requisite and that it would be a priority of the review to put in place appropriate arrangements to safeguard this. The Committee's recommendation is, therefore, already the focus of a large part of the existing work on the review and it will form an important part of the final proposals.

PAC conclusion (viii): Ofgem expects that 80 per cent of the consumer benefits arising from independent ownership will come after 2013. With rising energy prices, consumers need to see the benefits of the sales well before then. Ofgem, therefore, needs to establish coherent and reliable datasets as a priority, if possible using comparable information for the 2008 price control.

13. Ofgem accepts the Committee's recommendation and is determined to ensure that, wherever possible, benefits from the sales can be captured in the 2008-2013 price control. Ofgem will also put in place data reporting processes to ensure that benefits can be maximized at future reviews.

14. Ofgem is already aware of benefits arising from the GDN sales in areas other than cost efficiency. One example is the debate on network extensions, where the new managements have already introduced new ideas to facilitate potential activity in this area.

PAC conclusion (xi): Ofgem delayed the next price control until 2008, thereby deferring the possibility of bringing early benefits to consumers. It should consider more carefully the costs and benefits of extending the future duration of price controls by quantifying the consequences of such decisions in terms of the likely impact on prices.

15. Ofgem accepts the Committee's recommendation that it should consider carefully the costs and benefits of extending the future duration of price controls by quantifying the consequences of such decisions in terms of the likely impact on prices. Ofgem considers, however, that its decision to delay the gas distribution review by one year was in the interests of consumers. The decision was made following a consultation in 2003, which also delayed the full reviews for the Scottish electricity transmission companies by two years and that for National Grid Electricity Transmission by one year. It was felt that these changes would provide a more balanced workload for the industry and for Ofgem, consistent with PAC conclusions (ii) and (iii).

16. This decision was reviewed once it became clear that National Grid intended to proceed with the sales. However, reverting to the original timetable would have involved conducting the review during 2006 based on financial data for 2005-06, the year in which the transaction completed. Ofgem concluded that this would not have provided a basis for maximizing benefits to customers at this stage.

PAC conclusion (x): Past capital expenditure on the networks has led to problems with reliability, and 39 per cent of the gas network needs to be replaced. Ductile iron pipes introduced in the 1970s are vulnerable to corrosion and hence leakage. Ofgem should ensure that future capital expenditure is incurred by the network owners on the basis of costs over the whole life of the relevant asset, and not just the up-front capital cost.

17. Ofgem accepts the Committee's recommendation. Price controls provide incentives on the companies to reduce costs as a whole. Where appropriate, companies may do this by trading off operating and capital expenditure to deliver the least cost outcome over time.

Sixth Report

Department for Work and Pensions

Gaining and retaining a job: the Department for Work and Pensions' support for disabled people

1. More than 1 million of the 2.7 million people on incapacity benefits say they want to work. In 2004-05, the Department for Work and Pensions spent around £320 million funding a number of programmes and schemes to help disabled people find and stay in employment and there are more than 500 providers contracting with Jobcentre Plus to deliver one or more of the disability programmes. The Department's programmes have arisen over a number of years stretching back to the end of the Second World War. The Department is currently undertaking a review of its disability related programmes and wants to introduce more clarity and greater simplification in what is provided.

2. Remploy is one of these programmes and is funded by a block grant from the Government. Remploy operates a number of different businesses, including 83 factories. It also operates a job placement and support service. The Department commissioned a review of Remploy to inform ministerial consideration of its future configuration.

PAC conclusion (i): There are 6.7 million disabled people of working age, of whom around 50 per cent are in employment. Barriers preventing many disabled people from taking up a job include employer attitudes and misconceptions, lack of awareness of the support that is available, health conditions, local labour market conditions and a lack of adjustments to work premises. In addition, disabled people may need additional support to overcome a lack of confidence and self-belief from having been out of work.

3. The Department agrees that disabled people and people with health conditions face a wide range of barriers to employment and the Department has an important role to play in helping these people to overcome these barriers. As part of its Public Service Agreement targets¹ the Department is committed to increase the employment rate of disabled people, taking account of the economic cycle. Between spring 1998 and spring 2006, the employment rate of disabled people increased from 38.1 per cent to 47.4 per cent and the gap between the employment rate of disabled people and the whole of the working-age population reduced from 35.1 per cent points to 27 per cent.

4. In pursuit of this aim the Department offers support to disabled people in a number of different ways. Jobcentre Plus offers a range of programmes to help people to gain skills and confidence as well as more specialised provision relevant to their health condition or disability. Disability Employment Advisers provide specialist support for people with a disability and signpost people towards the most appropriate provision that will help them move into or remain in employment. The new Pathways to Work programme, which will be available nationally by 2008, builds on this approach, ensuring that incapacity benefit claimants have the opportunity to find out about the range of support available.

¹ http://www.hm-treasury.gov.uk/media/658/F3/sr04_psa_ch15.pdf

PAC conclusion (ii): The Department has a confusing suite of six programmes, which have grown up over the last 60 years. The distinction between the different programmes and schemes is sometimes artificial and the current review of provision should pinpoint opportunities for simplification and rationalisation. An approach based around a more flexible menu of different types of support and advice would be more suitable. This tailored approach would better reflect the very varied circumstances of disabled people and would ensure a more streamlined suite of services.

5. The Department is currently reviewing the programmes that help disabled people find and keep a job and intends to publish a consultation paper in the spring. The Department intends to reduce the number of contracts and simplify processes in order to increase efficiency and improve customer service.

6. Jobcentre Plus is already looking to move to using prime contractors in programme delivery who will sub-contract to deliver a range of services. This process will continue when design and contracting for programmes is centralised within the Department in March 2007. Changes in contracting for programmes aim to make customers' experience of using these services simpler and more streamlined as well as making the administration of providers much simpler for the Department.

PAC conclusion (iii): Poor management information makes it difficult to determine whether the programmes deliver value for money. Except for the New Deal for Disabled People, the Department has patchy and inconsistent cost and outcomes data for its programmes. There is also limited information available about clients, making it hard to establish whether programmes are meeting the needs of different groups. The Department should gather detailed information on what has been spent on each programme and scheme, what has been paid to each provider and what the Department has obtained for the expenditure.

7. The Department agrees that it is important to gather good management information on its programmes and to evaluate the cost and benefits of these programmes. While it is true that the Department does not have comprehensive analysis of some of the older programmes, the Department is conducting rigorous evaluations of new programmes and changes that have been introduced. The Department will ensure that future changes are supported by improved information collection systems.

8. Given that the Department is currently reviewing its disability employment services, it would not be cost effective to undergo in depth process and IT changes on the current programmes. However, some work has already been undertaken to improve management information on programmes. In Workstep and Work Preparation, Jobcentre Plus has introduced extensive clerical collection exercises to gather local and regional performance information for contracts that deliver these programmes. In November 2006 Jobcentre Plus also introduced a new IT system for Access to Work, DiSC3, to collect more robust management information about customers and their primary disability as well as the nature of support and how quickly it is put in place.

PAC conclusion (iv): The quality of service provided to customers varies considerably across the country. In the Workstep programme for example, between 2001 and 2005, one third of the 200 or so providers with clients in supported employment have not progressed a single person. The Department should stipulate minimum standards for the services provided, adopt a risk based inspection regime of the organisations providing it and follow up rapidly on poor performance, including withdrawing contracts for continued poor performance.

9. The Department agrees that customers should receive a good quality service from all its providers and the Department is constantly striving to improve the services that are offered. Programme providers are required to meet the quality and delivery standards set out in the contract specification and are subject to contract management and monitoring, in addition to Adult Learning Inspectorate inspections and audits.

10. In July 2006, a revised Contract Management Framework was implemented by Jobcentre Plus, which focuses on a risk-based approach. More resources are targeted at those providers identified as high risk, with more frequent face-to-face reviews concentrating on performance and quality of provision. If a contractor performs badly, Jobcentre Plus's first step is to agree a performance improvement plan with the contractor. If performance fails to improve within a reasonable timescale, a "breach" notice is then issued. If delivery continues to be below the level of standard and quality required then the contract will be terminated.

PAC conclusion (v): The Department's attention has focused on helping people into work, rather than retaining a job. Most people, who become disabled, do so as adults and are likely to be in employment, when they become disabled. The Department should increase the attention given to helping people stay in work. For example, Disability Employment Advisers could be expected to spend a set proportion of their time on retention activities, which would help to save on disability benefits and reduce demand for more expensive work programmes.

11. The Access to Work programme is one of the primary ways that the Department supports disabled people remaining in work. Access to Work provides advice and funding for practical support for individuals to remove obstacles to employment that arise from a disability. Access to Work is available for people already in work and those about to start a job. The Work Preparation and Workstep programmes can also help an individual to keep their job if they become disabled or their health condition deteriorates.

12. Disability Employment Advisers already help individuals who are at risk of losing their job as a result of disability. They offer advice to employers as well as to individuals about the support and adaptations available to enable disabled people to retain their job or take up a new job. They also promote the use of the disability symbol by employers. In April 2006 Jobcentre Plus introduced new systems of monitoring adviser activity that provide more recognition for Disability Employment Advisers' wider role, including the work they undertake to keep someone in an existing job.

13. In October 2005 the Department published *Health, work and well being – Caring for our future*² a strategy for the health and well being of working age people. The Department is continuing to develop this strategy together with the Department of Health, the Health and Safety Executive and the administrations in Scotland and Wales. The strategy recognises that success will only be achieved by working closely with stakeholders, particularly employers, trade unions, the insurance industry and healthcare professionals. A progress update will be published in spring 2007, stimulating stakeholders to do more in this area.

PAC conclusion (vi): Some employers have misconceptions about the difficulties of employing disabled people. Research in 2004 suggested that one-third of employers considered employing a disabled person is a major risk. The Department should work with providers of training to challenge the misconceptions, for example by linking up employers experienced in employing disabled people with those who are not through workshops and awareness raising events, highlighting the support available to employers.

14. Jobcentre Plus Employer Account Managers discuss the benefits of employing a diverse workforce as one of a range of issues they might discuss with employers; examples of best practice and signposting to additional support are used as part of this approach.

15. The Department has identified risk aversion as a key factor in employer decision-making. However, tackling this problem is not just about challenging misconceptions, it is also about providing information, advice and tools for employers to deal with real problems that they may see as a risks.

16. Training Providers can play a role by working more closely with employers, but other intermediaries such as job brokers, engaged organisations and people should play a key role in this process, nationally and locally. Most importantly, knowledgeable disabled people themselves are often the best advocates.

17. As part of the Department's Disability Employer Engagement Strategy, it is working closely with employers, employer organisations and other key stakeholders, corporately and locally, to build and deliver an action plan. This strategy includes:

- sponsoring an employer-led event in March 2007, facilitated by disabled people with expertise in and commitment to employer engagement, to engage employers nationally and encourage them to commit to future activity;
- discussions with HR professional bodies, seeking to influence, positively, the advice currently given by experts in relation to risk;
- local employer-led pilots, developed by the National Employment Panel and led by local employer coalitions, to explore ways for employers, intermediaries and disabled people to work more closely together to increase opportunities for disabled people to get and keep jobs; and
- a communications campaign, which will support these activities by challenging some common employer assumptions and misconceptions and encouraging employers to consider the capabilities of individuals.

²http://www.dwp.gov.uk/publications/dwp/2005/health_and_wellbeing.pdf

PAC conclusion (vii): The Department contracts with hundreds of providers of services across the country. It could improve the quality and price of the services it purchases through improved benchmarking between the numerous providers, more effective competition, and better use of its bulk purchasing power to secure better deals. It should also specify a minimum standard for performance across all providers, for example, in terms of availability of training and customers having development plans in place.

18. The Department agrees that it is important to continually strive for value for money from providers. When the competition for the JSA New Deals was launched in September 2005, Jobcentre Plus introduced changes to their approach to contracting. This reduced the number of contracts awarded through aggregation across wider geographical areas and/or types of provision. The aim is to achieve better value for money for the Department and more viable packages for providers.

19. The Department will be undertaking a fundamental analysis of its funding mechanisms. This analysis will examine whether a universal move to competitive pricing, price benchmarking and differential pricing according to volumes of business would improve risk-sharing, value for money and the viability of the supply chain. This approach to pricing is being piloted in a small number of New Deal contracts and will be fully evaluated on completion in March 2008.

20. The standards of performance and requirements for the delivery of programme provision are built into the contract specification and contract signed by the provider. Improvements in the performance of the Department's providers have been achieved through better initial assessment of participants' skills and more attention to bridging gaps in those skills through personal development plans; more accurate recognition of literacy or language barriers; more realistic jobsearch programmes; greater involvement of employers and an increased focus on equality of opportunity.

PAC conclusion (viii): The Department's review of Remploy is currently being considered by Ministers and is a good opportunity to assess how to update this vital service in the interests of disabled people. A highly supportive environment is the only appropriate option for some people and Remploy has provided unique opportunities for thousands over many years. The current review of Remploy should safeguard this achievement when considering whether it is necessary to alter the profile of the business or the markets in which it operates, for example, to move from sectors in decline. It should also consider any unique circumstances facing the business, such as the cost of entering new markets, and the cost and quality of Remploy management. They should also take account of the views of those working within Remploy businesses.

PAC conclusion (ix): Remploy Interwork has proved successful at placing disabled people with mainstream employers. Remploy Interwork's long association with Remploy businesses, including factories, has enabled it to develop a unique understanding of the employer's perspective in taking on disabled people. Any reorganisation of Remploy should safeguard this valuable knowledge so that Remploy Interwork's performance is sustained.

21. In July 2006 the Minister for Disabled People published a strategic review of Remploy by PriceWaterhouseCoopers and Dr Stephen Duckworth. In response to the report the Minister ruled out both options of no change and the complete closure of the factory network.

22. The Remploy Board have been asked to work with their Trade Unions and other stakeholders to develop a five-year plan with proposals to modernise the business and support substantially larger numbers of disabled people into work. The Minister has made it clear that any such proposals must protect Remploy's disabled employees from compulsory redundancy.

23. Alan Pedder CBE retired as the Non-Executive Chair of Remploy on 3 January 2007. The new Chair, Ian Russell CBE, took up post on 12 January and will continue with the development of the modernisation plan.

24. Once the proposals are brought forward, the Government will consider whether they are able to offer the Board additional funding for modernisation and will also consider at that stage whether they need to enhance the range of skills on the Board to help them to do this.



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