



House of Commons Treasury Committee

Administration and expenditure of the Chancellor's departments, 2007–08

First Report of Session 2008–09

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

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The Treasury Committee

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

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The following members were also members of the committee during the inquiry:
Mr Philip Dunne MP (Conservative, Ludlow), Mr Siôn Simon MP, (Labour, Birmingham, Erdington)

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Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at www.parliament.uk/treascom.

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

Committee staff

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

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Summary

The Treasury Group's own resources

The economic situation is placing ever increasing demands on the Treasury Group. We question whether continued staff reductions will leave the Group able to deliver all that is expected of it. The transactions with the nationalised and part-nationalised banks raise accounting issues which we encourage the Treasury to discuss with the National Audit Office in order to ensure that the Group's 2008–09 Annual Report and Accounts can be laid together prior to the summer adjournment.

The Treasury as a central department

In order to aid public scrutiny, we recommend that the Treasury's future Departmental Reports include information on the performance of the nationalised banks. Similarly, we call upon the Government to publish an annual report on performance indicators for UK Financial Investments (UKFI). We note progress made toward implementing International Financial Reporting Standards for the Government's accounts. We note the work being undertaken to improve the transparency of Government Estimates and accounts and we encourage the Treasury to consider ways in which the revised documents might best facilitate parliamentary scrutiny.

The work of the Debt Management Office

The Debt Management Office (DMO) is facing a substantial increase in its forecast gilt issuance levels due to the financing requirements of the Government's fiscal stimulus and we recommend that the Government reviews the resource requirement of the DMO in light of this. We recommend that the Government puts in place contingency plans should the DMO face a series of uncovered auctions.

The Treasury Group's performance against objectives

The Treasury Group has reported 'slippage' against three of its ten PSAs. We recommend that improvements be made to the measurement of regional economic growth. We note that the Government continues to slip against its target to halve child poverty by 2010 and recommend that the Government improves the clarity of its disclosures against this target. We are concerned that the Lisbon goals no longer feature in any PSA and we call upon the Government to continue to report annually against them.

HM Revenue and Customs

We note the substantial changes to HMRC senior management in recent times. We are concerned that the payment made to one outgoing staff member was unnecessarily generous. In order to create stability and clear accountability within HMRC we recommend that all outstanding senior management positions are filled as soon as possible and invite HMRC to publicise the respective lines of responsibility for its top members of

staff. We recommend that HMRC discloses the financial case for the closure of individual offices to allow for proper public scrutiny of these figures. We note performance shortcomings by PFI providers of maintenance and IT services and recommend that financial compensation from the businesses involved is obtained.

The work of the Valuation Office Agency

The most significant issue for the Valuation Office Agency (VOA) is its handling of the ports revaluation. We recommend that the VOA reflect on the consequences of the deficiencies in its communications and that the Government takes into account the position of those Port Occupiers who have already made significant payments to the Port Operators towards business rates. In light of the failings of the VOA and the clear evidence that many businesses will be forced to declare themselves insolvent even under these revised arrangements, we recommend that the Government takes further steps to mitigate the position of ports businesses.

The work of the Government Actuary's Department

We recommend that the Government Actuary's Department (GAD) takes steps to improve its budgetary process. We recommend that the Government ensures all bonus schemes are performance-related. We recommend that the new Government Actuary examines the valuation of miners' pensions. Finally, we trust that the Government Actuary will acknowledge the implications of the Equitable Life situation for GAD's reputation.

1 Introduction

The Sub-Committee's scrutiny programme

1. The Treasury Sub-Committee undertakes a regular programme of scrutiny of the administration and expenditure of the Chancellor's departments. In addition to annual hearings with HM Treasury and HM Revenue & Customs (HMRC), the Sub-Committee has each year taken evidence from a rotating selection of bodies which fall under the Chancellor's remit: the Office for National Statistics, the Statistics Commission, the Office of Government Commerce (OGC), National Savings & Investments, the Debt Management Office (DMO), the Royal Mint, the Adjudicator's Office, the Government Actuary's Department (GAD) and the Valuation Office Agency (VOA). The hearings that the Sub-Committee has held in recent Parliamentary sessions are summarised in Table 1.

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

Department or body	2001–02 report	2002–03 report	2003–04 report	2004–05 report	2005–06 report	2006–07 report	2007–08 report
Adjudicator's Office		Oct 03				Nov 07	
Debt Management Office		Jun 03			Jan 07		Oct 08
Government Actuary's Dept	Jul 02				Nov 06		Oct 08
HM Revenue & Customs: <i>Inland Revenue</i> <i>Customs & Excise</i>	Jun 02 Jun 02	Jun 03 Jun 03	Jun 04 Jul 04	Oct 05	Nov 06	Dec 07	Oct 08
HM Treasury		Sep 03	Feb 05†	Nov 05	Oct 06	Nov 07	Oct 08
National Savings & Investments	Jan 03			Oct 05	Feb 07		
Office for National Statistics	Oct 02	Oct 03	Oct 04	Nov 05	#		
Office of Government Commerce		Jan 04	Apr 04*		May 06	Oct 07	
Royal Mint	Nov 02	Nov 03			Nov 06	Oct 07	
Statistics Commission	Oct 02	Sep 03 May 03*	Sep 04	Nov 05	#		
Valuation Office Agency				Oct 05†	Jan 07		Oct 08

Note: * denotes an appointment hearing for new Chairman/Director/Chief Executive; † denotes a part of a wider meeting; # denotes scrutiny of 2005–06 annual reports not undertaken due to inquiry into *Independence for statistics* published July 2006.

2. In examining the administration and expenditure of the Chancellor's Departments in 2007–08, the Sub-Committee chose to concentrate on the VOA, DMO, GAD, HM Treasury and HMRC. As part of the work leading to this Report, the Sub-Committee has taken oral evidence from officials from each of these bodies. The Sub-Committee has also

heard evidence regarding the revaluations of statutory ports¹ from the Financial Secretary to the Treasury, the Rt. Hon. Stephen Timms MP, and the Minister for Local Government, the Rt. Hon. John Healey MP. We concluded our inquiry by taking evidence from the Exchequer Secretary, Angela Eagle MP, the Financial Secretary, the Rt. Hon. Stephen Timms MP, and the Economic Secretary, Ian Pearson MP, on themes arising from our previous scrutiny sessions. We are grateful to all those who assisted the Sub-Committee in the course of its inquiry.

Relevant documents

3. The scrutiny sessions held by the Sub-Committee have been based largely on the published Reports and Accounts of the Treasury, HMRC and other bodies subject to examination.²

1 A review of the ratings of UK statutory ports, undertaken by the VOA, led to notable increases in business rate charges for many businesses and a large volume of correspondence for this Committee. More details can be found in section 7 of this report.

2 HM Treasury, *Annual Report 2007–08*, July 2008, Cm 7408; HM Treasury Resource Accounts 2007–08, July 2008, HC539; HM Revenue & Customs, *Departmental Report 2008*, July 2008, Cm 7401; The Valuation Office Agency Annual Report 2007–08, July 2008, HC 583; The Government Actuary's Department Annual Report and Resource Accounts 2007–08, July 2008, HC615; UK Debt Management Office Annual Report & Accounts 2007–08, July 2008, HC963

2 The Treasury Group's own resources

Background

4. The Treasury Group includes HM Treasury, the Debt Management Office (DMO) and the Office of Government Commerce (OGC). HM Treasury's Annual Report and Resource Accounts include information about all three group entities.³ In addition the DMO issues its own Annual Report and Accounts and the OGC issues an Annual Statement. In line with the Committee's rotating scrutiny methodology, the DMO's separate Annual Report and Accounts is considered in Section 4 of this report.

Under-spending and End-Year Flexibility

5. For the sixth consecutive year, the Treasury Group underspent against its expenditure limits. The underspend in 2007–08 was £24m (7.4%), as shown in Table 2.

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

(1) Year	(2) Initial limit on expenditure £ million	(3) Outturn of expenditure £ million	(4) Difference between (2) and (3) £ million	(5) Difference (4) as percentage of initial limit (2) %
2002–03	388.68	359.37	29.31	7.5
2003–04	298.64	291.56	7.08	2.3
2004–05	317.05	267.06	49.99	15.0
2005–06	320.45	296.23	24.22	7.5
2006–07	323.94	297.00	26.94	8.3
2007–08	331.27	306.89	24.38	7.4

Sources: HM Treasury *Resource Accounts 2002–03*, HC 999, July 2003; HM Treasury *Resource Accounts 2003–04*, HC 920, July 2004; HM Treasury *Resource Accounts 2004–05*, HC 93, June 2005; HM Treasury *Resource Accounts 2005–06*, HC 1344, June 2006; HM Treasury *Resource Accounts 2006–07*, HC 518, June 2007; HM Treasury *Resource Accounts 2007–08*, HC 539, July 2008.

6. The issue of underspending is one we have discussed with Treasury officials over a number of years. In November 2007, Nicholas Macpherson, Permanent Secretary of HM Treasury, admitted that there had “been a tendency to underspend” within the Treasury but assured us that the Department were working “intensively to try and get people (a) getting a taut estimate... but (b) to ensure that people generally spend the money they are supposed to spend”.⁴

3 The expenditure of the group includes the coinage and the grants awarded to the Statistics Commission and four Parliamentary bodies: The Commonwealth Parliamentary Association (UK branch); the British American Parliamentary Group; the Inter-Parliamentary Union and the British-Irish Inter-Parliamentary Body.

4 Treasury Committee, Seventh Report of Session 2007–08, *Administration and Expenditure of the Chancellor's Departments 2006–07*, HC 57, Ev 19, Q194

7. During our discussion of the 2007–08 performance, Mr Macpherson informed us that:

I continue to find the degree of under spending, certainly on people and pay, slightly frustrating ... I am very keen to look at whether, by either over budgeting or over recruiting, we can get closer to our spending limit.⁵

8. Supply estimates are the funds authorised for spending by Parliament and therefore represent the amounts which Parliament considers appropriate to deliver the planned public service programme. While overspending is rightly subject to scrutiny, underspending is also of concern to Parliament. Three possible conclusions can be drawn from underspending: unexpected efficiencies have been found; the original estimates were flawed; or the promised programme of services has not been delivered.

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

10. As we noted in our Report on the administration and expenditure of the Chancellor's Departments in 2006–07,⁶ repeated underspending by HM Treasury may have resulted in the accumulation of large stocks of End-Year Flexibility. In its response to our earlier Report, the Government suggested that these stocks might be used to fund the outcome of the Civil List renegotiation and to finance the Pathfinder on Money guidance work.⁷ It appears to us, however, unlikely that these elements would use up a significant amount of the Treasury's End-Year Flexibility. **We recommend that, in its response to this Report, the Government indicates whether any of the Treasury Group's End-Year Flexibility will be transferred to other Departments or how else it might be used.**

The Gershon efficiency programme in the Treasury Group

11. Following the recommendations of Sir Peter Gershon's 2004 report on public sector efficiency,⁸ the Government set a target of achieving £20bn of efficiency savings gains and 70,600 net workforce reductions across government by 2007–08. The Treasury Group has been responsible for managing this programme since its inception, although this responsibility transferred internally from OGC to the Treasury Group Shared Service in April 2007.

12. In November 2008, the Treasury reported that the Government had exceeded these targets, delivering efficiency gains of £21.5bn and net workforce reductions of 86,739 over the 2004 spending review period. Together the Chancellor's own Departments contributed

5 Q 180

6 HC (2006–07) 57, p 11

7 Treasury Committee, Ninth Special Report of Session 2007–08, *Administration and Expenditure of the Chancellor's Departments 2006–07: Government response to the Committee's Seventh Report of Session 2007–08*, HC 564, p 1

8 Gershon Report, *Releasing resources of the front line – Independent Review of Public Sector Efficiency*, July 2004

£0.68bn of efficiency gains and delivered a 16,218 headcount reduction, exceeding their combined target of £0.55bn efficiency gains and 13,350 net headcount reductions.⁹

13. The Treasury Group itself reported £26m of efficiency savings, exceeding its target of £18.7m.¹⁰ The Treasury Group also made more than double the required number of headcount reductions (316 reductions against a target of 150).¹¹ When the scale of this reported over-achievement against target was put to him, Mr Macpherson conceded that the Treasury “did overshoot a bit”¹² on its headcount reductions target and was now actively recruiting. He went on to suggest that the demands of the economic situation had stretched the Treasury, stating that “What has been striking over the last year, especially over the other weekend, is that we are really operating at our limits”.¹³

14. In November 2007, Mr Macpherson argued that in order to meet its future efficiency target “the Treasury is going to get a whole lot smaller in the coming period”.¹⁴ When we met him in October 2008, he accepted that the demands arising from the economic situation might mean that further headcount reduction plans needed to be revised:

I am keen to step back and look at how we spend our resources. At the margin, it may be that our plans for people set out on page 91 of the report—1,006 [staff members] it says ... in 2011—[perhaps] ... that number should be a little higher. Although people are our main cost, there are other ways you can reduce spending.¹⁵

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

Financial reporting

16. In 2006–07 we congratulated the Treasury on publishing a combined Annual Report and Accounts and we were assured that we could expect a combined document in 2007–08.¹⁶ Unfortunately this expectation was not met, and the Treasury Group’s Annual Report and Resource Accounts were published separately on 3 July 2008 and 16 July 2008.

17. By way of explanation for the separate publication, Mr Macpherson cited some “particularly tricky accounting issues around Northern Rock ... [and the] real possibility that we would not resolve those accounting issues with the National Audit Office this side

9 HM Treasury, *2004 Spending Review: final report on the efficiency programme*, November 2008, p 3 & 9

10 HM Treasury, *Annual Report 2007–08*, Cm 7408, July 2008, p 119

11 *Ibid.*, p 121

12 Q 228

13 Q 226

14 HC (2006–07) 57, Ev 20, Q 201

15 Q 235

16 HC (2007–08) 564, p 6

of the summer”.¹⁷ These issues were resolved and the Annual Report and Accounts were published only two weeks apart.

18. Northern Rock was taken into temporary public ownership on 17 February 2008 and the Treasury Resource accounts were published on 16 July 2008, suggesting that it took five months for HM Treasury to identify an accounting treatment of Northern Rock which the National Audit Office (NAO) would accept as true and fair.

19. It is already apparent that the Treasury Group's 2008–09 Resource Accounts will throw up a number of equally complex accounting issues: the treatment of the Government's revised equity stake in Northern Rock; the transactions with Abbey Santander and Bradford & Bingley; and its investment in the part-nationalised banks.

20. Louise Tulett, HM Treasury's Director of Finance, Procurement and Operations, told us that the accounting treatment of the Treasury's transactions with Abbey Santander and Bradford and Bingley had not yet been agreed with the NAO.¹⁸ From this we must infer that the treatment of the part-nationalisation of the banks also remains to be addressed. **The nationalising transactions of 2008–09 raise some complex accounting questions for the Treasury. In order to ensure that the Treasury Group's 2008–09 Annual Report and Accounts can properly be laid before Parliament before the summer adjournment, we recommend that the Treasury engages early with the National Audit Office to agree appropriate accounting treatments for the transactions surrounding the nationalised and part-nationalised banks.**

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

22. In its report on the Performance of HM Treasury in 2007–08, the NAO highlighted that no fewer than five liabilities relating to Northern Rock were disclosed in the Treasury's Resource Accounts as contingent liabilities but listed as 'unquantified'.¹⁹ These are shown in Table 3.

17 Q 158

18 Q 157

19 National Audit Office, *Performance of HM Treasury 2007–08*, p 12, Figure 6

Table 3 – undisclosed liabilities relating to Northern Rock

Contingent liability disclosed	Potential financial impact for the Treasury
HM Treasury announced guarantee arrangements in respect of retail and uncollateralized wholesale deposits in Northern Rock together with certain other wholesale obligations.	Unquantified
HM Treasury has indemnified the Bank of England against any deficit it should face as a result of its arrangements with Northern Rock.	Unquantified
HM Treasury has confirmed to the FSA that it will take appropriate steps to ensure that Northern Rock will continue to operate above the minimum regulatory capital requirements.	Unquantified
HM Treasury has provided guarantee arrangements for Northern Rock's new and existing Directors for the period that the company has been in temporary public ownership, indemnifying them against loss and liability incurred in pursuit of their duties.	Unquantified
In accordance with the Banking (Special Provisions) Act 2008, a Compensation Scheme was established by the Northern Rock plc Compensation Scheme Order 2008.	Unquantified (as any amounts due to shareholders would be a matter for the valuer)

Source: National Audit Office, Performance of HM Treasury 2007–08 as summarised from HM Treasury, *Resource Accounts 2007–08*, p 79, Note 27 Contingent Liabilities.

23. By nationalising financial institutions, the Government has taken on responsibility for significant liabilities. In order for public scrutiny to be effectively performed, the magnitude and nature of these liabilities must be comprehensively disclosed. We recommend that the Treasury quantify and disclose the liabilities involved in the nationalisations and part-nationalisations of financial institutions. These disclosures should appear in the Treasury Group Resource Accounts, must be at least as comprehensive as those made by major banks and should go further than meeting the minimum acceptable accounting standards.

24. We also note that the Treasury's Resource Accounts for 2007–08 included improved disclosures of senior management bonuses.²⁰ However the total amount of bonus payments made to all staff was not disclosed in the accounts. Mr Macpherson accepted that these figures could be disclosed in the accounts.²¹ **We recommend that in future years the Treasury disclose the total bonus payments made to staff in their Resource Accounts.**

20 HM Treasury, *Resource Accounts 2007–08*, HC 539, July 2008, p 35

21 Q 168

3 The Treasury as a central department

The role of the Treasury

25. As a central department the Treasury continues to lead a number of cross-government programmes including the conversion of UK public sector accounts to International Financial Reporting Standards (IFRS), the efficiency programme, the 2007 Comprehensive Spending Review and the alignment project. In addition, the period since January 2008 has seen the Treasury take on new roles and responsibilities regarding the financial services and banking sectors. We reported on the Comprehensive Spending Review in December 2007²² and plan to consider the efficiency programme in more detail during 2009. In this Section we consider the Treasury's efforts to rise to the challenges of the current economic situation and its role in the management of the nationalised banks. We also review progress towards the introduction of IFRS to UK public sector accounts and the Treasury's efforts to increase the transparency of government budgets, estimates and accounts through the 'alignment project'.

Management of Nationalised Banks

26. We have previously reported on events which culminated in the nationalisation of Northern Rock²³ and our ongoing Banking Crisis inquiry will report on the recent developments in the financial markets and the resultant impact on the taxpayer. These are not conclusions we wish to repeat or pre-judge in this Report.

27. The nationalisation of Northern Rock, and the subsequent nationalisation of Bradford & Bingley, has created governance responsibilities for the Treasury while these entities remain under temporary public ownership.²⁴ The Government's announcements of October 2008 created further responsibilities for the Government regarding the oversight of part-nationalised banks.²⁵ A new body, UK Financial Investments (UKFI), has been created to manage the investment in financial institutions on an 'arm's length basis'. The overall objective of UKFI will be to "protect and create value for the taxpayer as shareholder with due regard to the maintenance of financial stability and to act in a way that promotes competition".²⁶ It is reasonable to assume that this body will require Treasury support whilst it is being established, and Treasury oversight once it is up and running.

28. All of these developments are additional challenges for the Treasury and arguably require it to act in areas its current staff base may not be fully equipped for or familiar with. **We recommend that the Government ensure the Treasury is sufficiently resourced to**

22 Treasury Committee, First Report of Session 2007–08, *The 2007 Comprehensive Spending Review*, December 2007, HC 55

23 Treasury Committee, Fifth Report of Session 2007–08, *The run on the Rock*, January 2008, HC 56-1

24 HM Treasury, *Resource Accounts 2007–08*, HC 539, July 2008, p 80

25 "Financial Support to the Banking Industry", HM Treasury press notice, PN 100/08, 8 October 2008

26 Ev 111

manage its extended responsibilities arising from the economic downturn, especially those regarding financial stability.

29. In 2007–08, the Treasury Group's Resource Accounts contained extended disclosures concerning the acquisition of Northern Rock.²⁷ In addition, Northern Rock separately published its own six monthly results in June 2008.²⁸

30. We note that the disclosures within the Treasury's own Annual Report and Accounts focus on the Government's financial relationship with Northern Rock but do not comment on its performance under temporary public ownership.²⁹ **Given the interest in the fully nationalised institutions of Northern Rock and Bradford & Bingley, and the Treasury's role in their governance, we recommend that the Government publishes key performance information for these institutions within the Treasury Group's own Departmental Report and Resource Accounts.**

31. We expect that the UKFI will report annually to Parliament and be accountable to this Committee. While the establishment of this organisation is under way, we are concerned that the Treasury does not appear to have a clear vision of UKFI's aims and objectives, and the criteria against which its performance will be measured. The Economic Secretary, Ian Pearson, acknowledged that:

We will clearly want to look to develop performance measures but, as I say, we are very much in early days with regards to the establishment of UKFI ... It is a little bit too premature for us to give a full detailed explanation of exactly how it is going to operate and what its performance regime is going to be.³⁰

32. In order for effective oversight to occur, clear performance measures and reporting lines must be established. **We recommend that the Government identify and publish performance measures for UK Financial Investments and report against these measures on a six-monthly basis.**

27 HM Treasury, *Resource Accounts 2007–08*, HC 539, July 2008, p 80

28 Northern Rock, *Half Year Results, six months ended 30 June 2008*

29 HM Treasury, *Resource Accounts 2007–08*, HC 539, July 2008, p 80

30 Q 475

Implementation of International Financial Reporting Standards

33. The Government announced in Budget 2007 that public sector accounts would be prepared in accordance with International Financial Reporting Standards (IFRS), “adapted as necessary for the public sector” by 2008–09.³¹ The timetable for implementing IFRS has slipped since March 2007: in its response to our Report on the Chancellor's Departments in 2006–07, the Government told us that owing to the “uncertainties around the impact of the introduction of IFRS on public sector net debt” the Government is now committed to implementing IFRS only from 2009–10.³²

34. The successful introduction of IFRS by 2009–10 relies upon departments negotiating a series of ‘trigger points’ laid out by the Treasury. The first of these trigger points was 30 September 2008. By this date departments were required to submit restated IFRS-compliant 2007–08 balance sheets to the NAO.

35. We were informed that around half of departments had not met the 30 September 2008 deadline for preparing their dry-run IFRS balance sheets at the time of our meeting with Treasury officials.³³ In their written submission of 6 November 2008, the Treasury told us that by November 2008 all but five departments had submitted their restated IFRS balance sheets.³⁴ Louise Tulett admitted that the Treasury had not imposed serious sanctions on the stragglers:

colleagues have written out from central Treasury to the departments that have not delivered on their trigger point one, reminding them of the requirement to do so and trying to get as many responses as possible by the end of the current month, which will be next week. The sanction is probably fairly limited in reality.³⁵

36. Angela Eagle agreed that some departments, particular those with complex balance sheets such as the Department of Heath and the Ministry of Defence had “a most difficult task ahead of them”³⁶ but she maintained that she was “reasonably confident”³⁷ that IFRS implementation would meet the 2009–10 deadline.

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

31 HM Treasury, *Budget 2007*, para 6.59, p 154

32 HC (2007–08) 564, p 5

33 Q 269

34 Ev 76

35 Q 273

36 Q 480

37 Q 482

Financial authorisation and the alignment project

38. The alignment project aims to create greater transparency between Government budgets, supply estimates and accounts. As Angela Eagle explained:

the clear line of sight initiative is an attempt to create a simple more transparent system, to make it easier for the estimates to encompass all of the expenditure rather than just, at the moment, some of it ... I know there has been a memorandum sent to the Liaison Committee about how parliament would start to change the way it examines estimates in order to deal with the alignment project or “clear line of sight” project as it is called. It is really for parliament to decide how best it wishes to change the way it scrutinises estimates going forward. The idea of the project is to try to encompass, in a much more coherent way, in one system government expenditure.³⁸

39. We note that under current arrangements the House normally considers Estimates on three Estimates Days (Winter, Spring and Summer). On these days debate is usually confined to Estimates or aspects of Estimates which have been the subject of Select Committee reports and in practice relatively little mention of the relevant estimates themselves is made during the debate. While it is for Parliament to decide how best to scrutinise expenditure, for those estimates not relating to a Select Committee report selected for discussion there is no possibility of any debate. **We recommend that the Treasury considers not only the presentation and authorisation of expenditure but also the way in which the revised documents might best facilitate parliamentary scrutiny.**

40. Under current arrangements, Departmental Supply Estimates include both gross expenditure amounts and amounts net of the income generated by departments. This means that when Parliament votes to authorise the Estimate, it is voting to authorise both the gross and net figures directly, authorising limits on both operating and non-operating appropriations-in-aid. The alignment project intends to focus parliamentary controls on the net expenditure figure in order to “line up with budgetary controls”,³⁹ thus surrendering some elements of formal control.

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

38 Q 466

39 HM Treasury Memorandum, *Alignment (“clear line of sight”) project*, www.hm-treasury.gov.uk, p 2

4 The work of the Debt Management Office

Background

42. The Debt Management Office (DMO) was established on 1 April 1998 to “carry out the Government’s debt management policy of minimising financing costs over the longer term, taking into account risk, and to manage the aggregate cash needs of the Exchequer in the most cost effective way”.⁴⁰ HM Treasury gives the DMO an annual remit which specifies the planned annual total of gilts to be auctioned by type of gilt. This remit also sets out the planned approach to Treasury bill issuance and the amount of Treasury bills the Government plans to hold in stock at the end of the financial year.⁴¹

43. On 1 July 2002, the DMO integrated with the Public Works Loan Board (PWLB) and the Commissioners for the Reduction of the National Debt (CRND).⁴² The PWLB issues loans, primarily to local authorities for capital works. The CRND manages the investment portfolios of public bodies such as the National Insurance Fund Investment Account, the National Lottery Distribution Fund Investment Account and the Court Funds Investment Account. The objectives of investment are primarily to maintain sufficient liquid funds to meet withdrawals by the client departments and to protect the capital value of the fund.⁴³

Gilt issuance and the banking crisis

44. The Treasury’s 2007–08 remit authorised the DMO to issue gilts of £58.4bn in the year,⁴⁴ a remit which the DMO met in full.⁴⁵ In March 2008 the Treasury issued the 2008–9 remit which authorised £80bn of gilt sales, an increase of 36% on 2006–07 levels.⁴⁶ This increase in part reflected the Treasury’s awareness of its need to refinance the loan made to Northern Rock upon its novation from the Bank of England to the Treasury in August 2008.⁴⁷

45. Following the announcement of the bank recapitalisation scheme in October 2008, the DMO’s 2008–09 remit was increased from £80bn to £110bn.⁴⁸ This new remit was itself increased again, in November 2008 to £146.6bn following the measures announced in the

40 UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 5

41 HM Treasury, *Debt and Reserves Management Report 2008–09*, March 2008, p 25

42 UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 6

43 *Ibid.* p 13

44 HM Treasury, *Debt and Reserves Management Report 2007–08*, March 2007, p 21

45 UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 3

46 HM Treasury, *Debt and Reserves Management Report 2008–09*, March 2008, p 25

47 *Ibid.*, p 19

48 HM Treasury, Written Ministerial Statement, *Revisions to the 2008–09 debt management remit to finance bank recapitalisation*, 14 October 2008

Pre-Budget Report.⁴⁹ This new 2008–09 remit for gilt issuance constitutes 251% of the gilt issuance in 2006–07, a huge increase in business for an office with only 89 staff members.⁵⁰

Communication with the market

46. The Budget 2008 forecast of central government net cash requirement (CGNCR) in 2008–09 was, at £59.3bn,⁵¹ some £21.7bn higher than the forecast of CGNCR included in the Pre-Budget Report of September 2007.⁵² When the DMO's 2008–09 remit was formally announced as part of Budget 2008, it was reported that the market was surprised.⁵³ The DMO recognised that there were difficulties, as Mr Steeman explained:

the market knows that there are normally ... two fixed dates a year where the financing plans are communicated and we publish a gilt programme, which are the Budget and the PBR. That certainty is absolutely critical to the market. It is easy for me to say this in my position but I think that once Northern Rock was nationalised some commentators could potentially have put two and two together and worked out that there was going to be a not insignificant addition to the government cash-raising requirement. I am fully aware that not many did ... you are right, the market was surprised.⁵⁴

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

Coverage of gilt auctions

48. The DMO issues gilts through an auction process. The volume of bids received relative to the total debt for sale is known as the subscription rate or coverage. In 2007-8 the DMO held a number of auctions which were covered only 1.1 times.⁵⁵ When invited to comment on the risk of an uncovered auction occurring, Mr Steeman suggested that such a risk existed but that concerns would only arise if this happened repeatedly:

It is possible that we will see an uncovered auction and I made it clear to colleagues in the Treasury and to ministers that that is a distinct possibility. Personally an uncovered auction is not something I regard as anything more than a market event. An auction tells you how much demand there is for a specific piece of debt being offered at 10.30 in the morning on a very specific day. If there is an uncovered auction we have processes in place to deal with that ... I would not generally regard

49 Debt Management Office, *Pre-Budget Report 2008 Revision to the DMO's Financing Remit*

50 UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 45

51 HM Treasury, *Budget 2008*, HC228, p 29

52 HM Treasury, *2007 Pre-Budget Report and Comprehensive Spending Review*, CM 7227, p 181

53 *Derivative News*, Q1 2008, p 1

54 Q 17

55 "Result of sale by auction of £850m of 1 1.8% index-linked treasury gilt 2037", DMO Press release, 6 July 2008

an uncovered auction as a very major issue. If there were a series of uncovered auctions, I would feel less comfortable.⁵⁶

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

DMO capacity

50. The DMO's Chief Executive, Robert Stheeman noted the size of the office when discussing the increase in workload:

We are a small office; we are approximately 80 people, just less in terms of permanent staff. It is not my desire or my intention to suddenly increase staff numbers incredibly. What we want to do, if necessary—and we are going through that process right now—is to see where we need additional resources to manage operational risk, to make sure we can continue to deliver what we can ... on both sides there is a recognition that there is a primary need not just for us to deliver the remit that we have been given but to make sure that there are no mess-ups in that process.⁵⁷

Pressed by the Committee, Mr Macpherson assured us that “the Debt Management Office will have the resources to do the job”.⁵⁸

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

Financial Performance and Reporting

52. The net operating costs of the DMO in 2007–08 were £9.9m, an increase from £7.4m in 2006–07.⁵⁹ This increase in costs reflects marginal increases in costs and decreases in income.⁶⁰ Decreases in the charges levied by the CRND, together with lower levels of

⁵⁶ Q 14

⁵⁷ Q 29

⁵⁸ Q 229

⁵⁹ UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 19

⁶⁰ *Ibid.*, p 19

PWLB lending, contributed to reduced income in the year. Expenditure increased in line with the higher levels of gilt auctions.⁶¹

53. The DMO Annual Report 2007–08 discloses that the DMO achieved or substantially achieved all ten of its performance targets.⁶² One worrying failure reported concerned the inclusion of 12 factual errors in DMO publications during 2007–08.⁶³ There is a risk that factual errors published by the DMO may adversely affect the market. Mr Stheeman assured us that the errors in 2007–08 did not have any evident effect on the market:

No, they did not [affect the market], is the honest answer. There were some errors. The one which arguably could have had most of a result was in particular where we released the fourth quarter gilt auction calendar on 30 November six minutes early, but as far as we could see there was no discernible impact on the market. That was the one we felt also we should list here as being potentially one which could have moved the market.⁶⁴

In its supplementary memorandum, the DMO reported that there had been six further errors in the period April 2008 to October 2008.⁶⁵

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

55. One performance measure reported by the DMO is the timetable for issuing the results of gilt auctions. In 2007–08 the time taken for the results of gilt auctions to be issued ranged from 6 minutes to 22 minutes. The average time of 10 minutes compares with the figure of 20 minutes for 2006–07.⁶⁶ The DMO Report suggests that the significant reduction in the average time taken reflected the introduction of automated bid capture during the year.⁶⁷

56. The average of 10 minutes taken by the DMO to publish auction results is still longer than in other comparable countries: the NAO has reported that the United States, Germany and Ireland deliver auction results within 2 minutes.⁶⁸ Mr Stheeman's argued that the 10 minute delay was reasonable given the discretionary checks which the DMO performs regarding the concentration of bids and the value for money they offer the Exchequer which require "an element of time and assessment".⁶⁹ He told us that no

61 UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 19

62 *ibid.*, p 16–18

63 *Ibid.*, p 18

64 Q 49

65 , Ev 74

66 UK Debt Management Office and Debt Management Account, *Annual Report and Accounts 2007–2008*, HC 963, July 2008, p 16

67 *Ibid.*, p 17

68 National Audit Office, *The UK DMO—borrowing on behalf of government*, January 2007, para 2.23

69 Q 28

external costs were incurred in establishing a system for electronic bidding and that the internally absorbed costs were around £50,000.⁷⁰ The system, in his view, now “mitigates risk” so that DMO staff “do not make mistakes”.⁷¹

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

Commissioners for the Reduction of the National Debt

58. The Commissioners for the Reduction of the National Debt (CRND) have not actually met since 1860, but their duties are performed by the DMO.⁷²

59. The DMO reports that there was a technical breach within the CRND function during 2007–08 regarding 3.5% Conversion Loans. Mr Stheeman assured us that the DMO had received legal advice confirming that the chance of damaging consequences from the technical breach were “very minimal”.⁷³ Furthermore as Jo Whelan, Comptroller General of the CRND, told us, other reforms were in place:

We have obviously referred very carefully to the prospectus, but we have also updated the procedures for the people who are operating this on the desk and the follow-through checks in the control area.⁷⁴

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

70 Q 26

71 Q 26

72 Oral Evidence taken before the Treasury Sub-Committee on 10 January 2007, HC 190–i, Q 49

73 Q 43

74 Q 44

5 The Treasury Group's performance against objectives

Introduction

61. The 2007–08 financial year marked the end of the 2004 Spending Review period and its associated Public Service Agreements (PSAs). As at June 2008, the Treasury Group reported slippage against three of its ten PSA targets.⁷⁵ The three targets against which the Group 'slipped' were: PSA 6 on regional economic growth; PSA 7 on child poverty; and PSA 9 on supporting all Departments in achieving their PSA targets.⁷⁶ In addition the Department reported "slippage" against subsection three of PSA 8, a target which assessed delivery against the Lisbon goals on growth and employment. Each of these is considered in this section.⁷⁷

Regional Economic Growth

62. In June 2008, the Treasury reported slippage against its PSA 6: to "make sustainable improvements in the economic performance of all English regions by 2008, and over the long term reduce the persistent gap in growth rates between the regions, demonstrating progress by 2006".⁷⁸ In its response to our 2006–07 report regarding this PSA, the Government stated that:

it will not be possible to measure regional trend growth until regional price deflators can be robustly estimated. The Office for National Statistics has been developing a methodology to estimate deflators and expects to have deflators available in 2009.⁷⁹

63. In October 2008, Mr Macpherson told us that the issue of measurement remained unresolved:

Part of the problem about really understanding what is going on remains the fact that we do not have regional deflators. So we know in gross terms what is happening to the incomes per head, or the gross value-added per head, but we do not really know whether the rate price change, say, in the north-east is significantly different from London or the south-east, it just makes analysis of real trends more difficult. I think we have got to use all the data we can get hold of to understand what is happening to employment, unemployment, skill levels and so on.⁸⁰

64. We are disappointed that after three years the measurement of performance against the Government's target to reduce regional inequality remains problematic. We

⁷⁵ HM Treasury, *Annual Report 2007–08*, Cm 7408, July 2008, p 19–20

⁷⁶ *Ibid.*, p 19–20

⁷⁷ *Ibid.*, p 20

⁷⁸ *Ibid.*, p 51

⁷⁹ HC (2007–08) 564, p 16

⁸⁰ Q 185

welcome the work of the Office for National Statistics and recommend that the Government publishes the results of the work on regional deflators as soon as it becomes available.

65. The economic downturn may act to reduce regional inequality if the financial services industry, largely based in the South East, is very adversely affected. Mr Macpherson suggested to us that it was too early to tell if the present recession would lead to a narrowing of the gap between the regions..⁸¹ This is an issue we may return to in the future.

Child Poverty

66. In June 2008, the Treasury reported slippage against PSA 7: to “halve the number of children in relative low-income households between 1998–1999 and 2010–11, on the way to eradicating child poverty by 2020”.⁸² The Treasury reports that “between 1998–99 and 2006–07 the number of children in households with relative low-income fell in the UK by 600,000 from 3.4 million to 2.9 million”.⁸³ This continues the pattern of failure acknowledged in the Treasury’s 2007 Autumn Performance Report.⁸⁴

67. In its 2007–08 Annual Report, the Treasury described the three metrics used to measure performance against the child poverty target, the third of which was introduced for the CSR 2007 period (see table 4).

Table 4 – Metrics for the measurement of child poverty reduction

1	The number of children in households with income less than 60 per cent of contemporary median compared with 1998-99.
2	The number of children in households with income less than 70 per cent of contemporary median, combined with material deprivation.
3	The number of children in absolute low-income households. The level is fixed as equal to the relative low-income threshold for the baseline year of 1998-99 expressed in today's prices.

Source: HM Treasury Annual Report 2007–08, p 62

68. When challenged to defend the clarity of reporting against this target, Mr Macpherson accepted that the Treasury “needed to be clearer because we clearly have not convinced you”.⁸⁵

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

81 Q 184

82 HM Treasury, *Annual Report and Accounts 2006–07*, HC 518, July 2007, p 62

83 *Ibid.*, p 62

84 HM Treasury, *Autumn Performance Report 2007*, December 2007, CM 7256, p 8

85 Q224

Cross-Government delivery of PSA targets

70. The Treasury reported slippage against PSA target 9: “Improve public services by working with departments to help them meet their Public Service Agreement (PSA) targets”.⁸⁶ By the Treasury’s own metric, in order to meet this target “a full 100 per cent of SR 2004 PSA targets need to be met or partly met”.⁸⁷ The Department suggested that this was an “exceptionally ambitious” target and that it was “not surprising that there is some slippage in meeting it”.⁸⁸

71. The Treasury reported that, of the 80% of targets given overall assessments in the 2007 Autumn Performance Reports, some 40% had reported slippage.⁸⁹

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

Lisbon Goals

73. In June 2008, the Treasury reported slippage against its PSA 8 (iii): to “promote increased global prosperity and social justice by: working with our European Union partners to achieve structural reform in Europe, demonstrating progress towards the Lisbon goals by 2008”.⁹⁰ When questioned on the absence of the Lisbon goals from any of the CSR 2007 PSAs, Mr Macpherson stated that the goals remained an aspiration but not a target:

This is one of the more amorphous areas and, although Lisbon matters, my guess is that, in terms of what the Treasury does as a finance and economics ministry, it will be about focusing on the immediate challenges of now rather than spending all our time looking at a particular target around Lisbon.⁹¹

... It remains an aspiration and I think it is really important. It certainly informs our approach to Europe which is to try to get a more dynamic market economy but we are not going to hit that target.

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

⁸⁶ HM Treasury, *Annual Report 2007–08*, Cm 7408, July 2008, p 69

⁸⁷ *Ibid.*, p 69

⁸⁸ *Ibid.*, p 69

⁸⁹ *Ibid.*, p 69

⁹⁰ *Ibid.*, p 20

⁹¹ Q 213

New Performance Targets

75. CSR 2007 introduced a new system for performance measurement of departmental performance. In place of the 110 PSAs of the CSR04 period, there are now 30 PSAs, in addition to which each department has declared its 'Strategic Departmental Objectives'. We have previously reported on the CSR 2007 and this move towards Departmental Strategic Objectives.⁹²

76. HM Treasury has two Departmental objectives: maintaining sound public finances; and ensuring high and sustainable levels of economic growth, well being and prosperity for all.⁹³ In addition the Treasury is a delivery partner for seven PSAs and has lead responsibility for a single PSA: to halve the number of children in relative low-income households between 1998–99 and 2010–11 on the way to eradicating child poverty by 2020.⁹⁴

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

92 Treasury Committee, First Report of the session 2007–08, *The 2007 Comprehensive Spending Review*, HC 55, November 2007

93 HM Treasury, *Annual Report 2007–08*, Cm 7408, July 2008, p 21

94 HM Government, *PSA Delivery Agreement 9*, October 2007, p 17

6 HM Revenue & Customs

Background

78. Her Majesty's Revenue and Customs (HMRC) was formed in April 2005 when the Inland Revenue merged with HM Customs and Excise. The Department is responsible for administering the UK tax system, collecting revenue and paying entitlements. In 2007–08 HMRC collected £457bn of revenue and paid entitlements of £30.3bn.⁹⁵ In this section we consider developments within HMRC in the year including changes to senior management, the transformation and efficiency programme, data security arrangements, and the management of significant PFI contracts.

Senior management changes

79. During 2007–08, HMRC experienced substantial changes in the senior management team: the Chief Executive Paul Gray resigned on 20 November 2007 and the Chief Finance Officer, Stuart Cruickshank, left on 31 March 2008.⁹⁶ From November 2007, David Hartnett stepped up as Acting Chief Executive and Chairman. Mike Clasper joined as Chairman on 1 August 2008. In November 2008 Lesley Strathie joined as Chief Executive and David Hartnett moved into a new position of Permanent Secretary for Tax. The transition period, from the resignation of the Chief Executive to his successor taking up her post therefore occupied 12 months. Further to these changes, Mr Clasper informed us that a number of additional senior management appointments remained to be made:

we are just about to announce the appointment of a new head of HR and we are in the process of recruiting a new head of finance, so we are putting the top team in place in addition.⁹⁷

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

81. When challenged to defend the tripartite senior management structure, Mr Clasper sought to reassure us that the areas of responsibility were clear:

My role is to lead the board of HMRC ... Leslie Strathie ... will have the classic responsibilities of an accounting officer. She will have all of the top team of HMRC reporting to her, including direct reports from the lines of business within HMRC: personal tax, corporate tax, tax credits and benefits, and compliance. Dave [Hartnett] will take a role right across the department to ensure that the quality of the tax policy and the practices and the legislation around tax policy are of the highest standard. In order to do that, he will have our central policy unit reporting

95 HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 8

96 HM Revenue & Customs, *2007–08 Accounts*, HC 674, July 2008, p 28

97 Q 374

to him and also the people working in the areas of intelligence, information, and analysis. He will also be responsible for our relationship with the Treasury.⁹⁸

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

Payments to outgoing senior managers

83. Upon departure, both the outgoing Chief Executive and the outgoing Director of Finance received substantial payments. Following his resignation, in the aftermath of the HMRC data loss, Chief Executive Paul Gray received a “lump sum payment at date of leaving of £137,591 and monthly payments totalling £49,292 until attaining the age of 60 on 2 August 2008”.⁹⁹ Mr Hartnett stated that these payments were made under standard civil service arrangements and were “nothing special”.¹⁰⁰

84. The circumstances surrounding Mr Cruickshank’s departure from his post of Finance Director are less clear. He received a £88,125 cash payment as well as £22,000 of benefits in kind, for loss of office.¹⁰¹ Our discussion with HMRC officials left us uncertain as to the nature of his departure. Mr Hartnett suggested that Mr Cruickshank’s departure was voluntary, suggesting that:

[Mr Cruickshank] wanted to follow a portfolio career in the private sector and we and Stuart reached an agreement, on the basis of which he left.¹⁰²

85. This leaves unanswered the question of why such a significant payment was made to an individual who left of his own volition. Mr Hartnett explained that:

[Mr Cruickshank] had not indicated clearly when he wanted to go and we believed firmly at that time that we needed a chief finance officer who was absolutely committed to HMRC, not one who was planning another career, having indicated clearly he wanted to go. That is why clearly this was a negotiated arrangement.¹⁰³

86. In a supplementary submission, HMRC maintained that it was Mr Cruickshank’s lack of a clear commitment to leave that prompted their decision to enter in to negotiations and make the £88,125 payment.¹⁰⁴

87. We note that HMRC appealed to the need for ‘continuity’ at the top, yet Stuart Cruickshank’s replacement, Phillip Moore, came in on a temporary contract to allow re-

98 Q 370

99 HM Revenue & Customs, *2007–08 Accounts*, HC 674, July 2008, p 28

100 Q 381

101 Ev 79

102 Q 382

103 Q 392

104 Ev 79

appointment under the in-coming Chief Executive. So HMRC paid an individual £88,125 to leave in March 2007 in order to gain continuity in the Finance team, yet deliberately replaced this individual with a temporary contractor.

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

Transformation and efficiency

89. In 2007–08, the Department continued work on delivering its Departmental Transformation Programme (DTP), set up in 2006–07 to make the Department more efficient and customer-focused. The DTP incorporates a number of work-streams including the Workforce Change programme, the creation of new online self-assessment and PAYE forms, changes in call centre services and the provision of online portals for specific customer groups such as international traders.¹⁰⁵

90. In its report on the DPT in July 2008, the NAO noted that staff “morale remains at a low ebb”¹⁰⁶ and that in order to maximise the benefits of the programme the “Department should more actively demonstrate the benefits to staff of the changes”.¹⁰⁷ However, staff morale in the HMRC remains low. The low level of staff morale was clearly demonstrated by HMRC's own winter staff survey: some 70% of staff said that they disagreed with the statement “change is managed well in this department”;¹⁰⁸ 78% said they thought the Department was changing for the worse;¹⁰⁹ and only 13% said that considering everything they were satisfied with the Department.¹¹⁰

91. In response to these difficulties, David Hartnett accepted that HMRC “have made some mistakes, over time, in introducing some techniques which improve processing but people do not feel that they are in control of the processing”.¹¹¹ He acknowledged that:

We need people to have a sense of direction. We are in the process of doing that. We need to ensure that they have a clear sense of priorities and that we are not asking them—in some cases at the moment we are asking them but in the future we will not be asking them—to do too many things, so that there is clarity about what really counts. We do need to introduce new IT systems.¹¹²

¹⁰⁵ HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 29

¹⁰⁶ National Audit Office, *HM Revenue and Customs Transformation Programme*, July 2008, p 6

¹⁰⁷ HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 10

¹⁰⁸ *Ibid.*, p 4

¹⁰⁹ *Ibid.*, p 4

¹¹⁰ *Ibid.*, p 2

¹¹¹ Q 441

¹¹² Q 441

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

Online filing

93. As part of its programme of transformation, HMRC is committed to increasing the number of tax accounts filed online. In order further to encourage individuals to file online, the deadline for 2007–08 paper self-assessment submissions was brought forward to 31 October 2008.¹¹³ Paper submissions after 31 October are subject to an automatic £100 non-filing penalty charge. The deadline for online filing remained 31 January 2009.¹¹⁴

94. When invited to comment on the possibility of higher numbers of non-filing fees being imposed, particularly on those without access to the internet, Mr Hartnett suggested that:

We have no indication at all—and we are monitoring this very carefully—that any particular element of the population is filing late. We are heavily engaged with the representative bodies for more vulnerable people and we have picked up no intelligence yet of any significant concern that people are not able to cope.¹¹⁵

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

Workforce change and HMRC office closures

96. HMRC's Workforce Change Programme is focused on assessing opportunities for HMRC to reduce the size of its estate.¹¹⁶ A key tenet of this programme has been increasing centralisation, a consequence of which has been office closures across the country. On 4 December 2008, HMRC announced the results of its review of office clusters across the UK and the closure of 93 offices. HMRC stated that it remained “committed to avoiding compulsory redundancy or moves of home”.¹¹⁷

113 HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 42

114 HM Revenue & Customs, 'Tax return Deadlines and Penalties', www.hmrc.gov.uk

115 Q 454

116 HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 30

117 *Ibid.*

97. In defence of HMRC's decision to close a number of small offices, Mr Clasper suggested that HMRC had "considerable evidence"¹¹⁸ that smaller offices did not deliver value for money. Mr Clasper noted that

Most of the work can be done from anywhere but you do need the critical mass to do it, and that is where we have had these productivity gains. We do need to save money. If we stop what we are in the middle of, we will only have to restart it at a future date, and in the long run the uncertainty for our staff will continue for a much longer period of time.¹¹⁹

98. The Public and Commercial Services Union (PCS) reported to us that the HMRC was refusing to disclose the costs associated with individual office closures. This, PCS suggested, prevented scrutiny of the cost savings claimed by the Department.¹²⁰

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

Delivery of efficiency targets

100. By 31 March 2008, HMRC reported £0.66bn of efficiency savings against a target of £0.51bn and 18,832 headcount reductions against the target of 16,000.¹²¹ Mr Hartnett confirmed that the 2,832 posts reduced over and above the original target would be a "contribution towards the next tranche"¹²² of 12,500 headcount reductions as stated in the CSR2007 efficiency saving target.

Fraud and data security

101. By the nature of the work it performs HMRC holds large volumes of personal financial and non-financial information. The Department faces risks of abuse of this data by both staff members and outside forces. HMRC reports that nine personal-data-related incidents were formally reported to the Information Commissioner's Office in 2007–08.¹²³ The most significant of these was the loss of the child benefit data of 25 million people.

102. In the aftermath of the child benefit data loss, Kieran Poynter was commissioned to perform an independent review of information security in HMRC.¹²⁴ His report made 45 recommendations, 13 of which the Department had fully implemented by June 2008.¹²⁵

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

118 Q 444

119 Q 444

120 Ev 68

121 HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 70

122 Q 426

123 HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 16

124 Kieran Poynter, *Review of information security in HM Revenue and Customs, Final Report*, June 2008

125 HM Revenue & Customs, *Departmental Report 2008*, Cm 7402, July 2008, p 26

104. Data losses may be accidental but information security must also address the issue of fraud. The Report from the Comptroller and Auditor General noted the risk of fraud by HMRC staff, stating that:

The Department has to address the risk that its staff or Department for Work and Pensions (DWP) Jobcentre Plus staff, who also have access to the tax credits system, may abuse their access rights to provide information which could be used by organised fraudsters to make false claims. The Department's Anti Fraud Assurance Team (AFAT) has identified six cases of suspicious access to tax credits data by DWP staff since October 2006. In response, the DWP has worked closely with the Department throughout the year to investigate these cases of suspicious access, ensuring that appropriate measures are taken with staff and to address any identified control weaknesses.¹²⁶

105. Mary Aiston, Director of Governance and Security for HMRC, assured us that access controls had been reviewed since the data loss in 2007 and “long discussions”¹²⁷ had been held with DWP to ensure that appropriate controls were in place. She further informed us that:

In a recent example, where we have provided access to another government body that has a legitimate and legal reason to use it, we are also introducing monitoring so that our internal auditors can monitor access by their staff, which will also help in the fight against internal fraud.¹²⁸

106. There have been reports in the press of up to £2.3m of fraud being committed by HMRC staff members.¹²⁹ When we asked about these allegations, Mary Aiston suggested:

Any fraud incident is one too many but the figures reflect our seriousness in identifying when it is happening, tracking it down, and pursuing it with the full rigour of the law. In addition to tackling cases such as these where there is evidence of fraud, we also have quite a big programme of work aimed at fraud prevention, so that we stop this sort of thing happening in the first place.¹³⁰

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

Managing PFI contracts

108. Our review of HMRC's performance in 2007–08 highlights a number of areas in which PFI contractors appear to be delivering substandard outputs, notably in the areas of buildings maintenance and IT provision.

126 HM Revenue & Customs, *2007–08 Accounts*, HC 674, July 2008, p R16, para 2.22,

127 Q 451

128 *Ibid.*

129 *The Observer*, 12 October 2008

130 Q 450

109. With regard to buildings maintenance, we noted that accidents in the quarter up to March 2008 numbered 151, an increase of over 30% on the previous year.¹³¹ The Department appealed to previously inadequate recording systems and they assured us that there had not been “a material increase in accidents”.¹³² The Department informed us that they had become more demanding of the PFI provider of building maintenance, Mapeley. Mr Hartnett told us:

We are constantly in discussions ... with Mapeley about service and about health and safety issues, and have become more demanding — as demanding as we should have been in the past, but more demanding now.¹³³

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

111. In respect of IT provision, the review of HMRC's performance in 2007–08 highlighted two areas of failing: non-payment to Child Trust Fund recipients; and the widespread systems crash of 31 January 2008.

112. We were disappointed to note the disclosure in the HMRC accounts¹³⁴ that 50,000 children born in 2006–07, and eligible for the additional £250 Child Trust Fund payment, had not received these payments as at the end of 2008–09, an error which amounts to £12.5m unpaid endowments. In July 2008, then Economic Secretary to the Treasury, Kitty Ussher, told us that a further 80,000 children had not received payments due to them.¹³⁵ Mr Hartnett assured us that the Department had engaged with its IT suppliers to “fix that and to look generally at the system of software for the Child Trust Fund”.¹³⁶ He further noted that:

We [HMRC] have already received some compensation for IT issues. We are heavily engaged with our IT contractor about performance issues and tomorrow I will be asking to see the chief executive again because there is something else that we are concerned about.¹³⁷

113. The second major failure for HMRC was the system crash on 31 January 2008 which affected those trying to meet the deadline for tax submissions for the 2006–07 tax year. Mr Hartnett offered an explanation for this failure:

We got to the bottom of the January 2008 systems crash. The system had had its platform changed without really adequate examination of the risk of that. It will not surprise you that we have done some very vigorous discussions with our IT provider

131 Treasury Sub-Committee, *Estate Management in the Chancellor's Departments*, HC 852-I, June 2008, Ev 43

132 Q 447

133 Q 448

134 HM Revenue & Customs, *2007–08 Accounts*, HC 674, July 2008, page 8, para 6.28-9

135 Oral evidence taken before the Treasury Sub-Committee on 14 May 2008, Ev 19

136 Q 418

137 Q 420

around that issue and we have examined the whole of that system again to make sure, we believe, that it will not happen again.¹³⁸

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

Performance of HMRC IT systems

115. When HMRC's IT system is unable to cope and clerical intervention is required, an 'open case' is created.¹³⁹ We note that the number of "open" tax cases reported by HMRC is 16.2 million, a figure 5.7 million in excess of the Department's own target of 10.5 million by the end of 2007–08.¹⁴⁰ In attempting to justify so high a number, Mr Clasper told us that:

The current systems were built a long, long time ago on a regional basis. Because they were built on a regional basis and the systems do not talk to each other—and this is not recent history; this goes back decades—then people who have multiple sources of income might well be in two different regional offices which cannot be correlated by the automatic system. That creates the open cases. That has been going on for a long, long time. The problem, as David has just highlighted, is people's employment patterns have changed: they change jobs more often; people have multiple pensions, for example. We basically have our legacy systems for structural issue. We are going to solve it by combining all of the systems and making them talk to each other. The only piece of the problem that has been created by what you might describe as the failure but I would have termed a prudent delay, is the fact that the new system has been delayed a year in coming into operation ... We would have less of a backlog if we had been able to execute the new system on time.¹⁴¹

116. Mr Clasper further assured us that "Once we have got the new system in place, we need to develop a plan to clear that backlog and we have to do it in a way in which we do not add to any pressures on the staff that would result in the motivation issues that we talked of earlier".¹⁴²

117. We note that the introduction of HMRC's new IT system has been delayed by a year. We accept that postponing the 'go live' date until testing is complete is prudent. HMRC should publish the performance targets for the new system in terms of reduced open cases and other measures so that we may better monitor its effectiveness.

138 Q 458

139 HM Revenue & Customs, *2007–08 Accounts*, HC 674, July 2008, p 7, para 6.21

140 *Ibid.* p 7, para 6.21

141 Q 435

142 Q 437

7 The work of the Valuation Office Agency

Background

118. The Valuation Office Agency (VOA) is an executive agency of HMRC and was formed in 1991 following the merger of the English, Welsh and Scottish Valuation office organisations. The Agency has 4,096 staff based in 81 offices across England and Wales with an additional 5 offices in Scotland.¹⁴³ The VOA is responsible for compiling and maintaining the lists of rateable values for 1.7 million non-domestic properties and of council tax bandings for over 23 million properties in England and Wales.¹⁴⁴

Financial Performance and Reporting

119. In 2007–08, the total expenditure of the VOA was £201m, 70% of which was staff-related expenditure. This total expenditure represents a 3% reduction in expenditure in 2007–08. Due to reduced expenditure and a small (1.2%) increase in income, the VOA increased its operating surplus by £3m in 2007–08.

Staff Management

120. One of the major issues for the VOA in 2007–08 was staff morale. Failure to agree the pay settlement led to a period of industrial action. Staff satisfaction has been further eroded by restructuring discussions and potential office closures.¹⁴⁵ Andrew Hudson, Chief Executive of the Agency, informed us that morale in the department was improving with staff satisfaction increasing from 53% to 59% in June 2008.¹⁴⁶ He further asserted that:

[we] are doing all we can to achieve... [headcount reduction] by natural wastage which we have managed to do in previous restructurings without the need for compulsory redundancies.¹⁴⁷

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

143 Valuation Office Agency Annual Report and Accounts 2007–08, p 55

144 *Ibid.*, p 4

145 *Ibid.*, p 29

146 Q 112

147 Q 115

Ports

122. During the course of our review of the Administration and Expenditure of the Valuation Office Agency 2007–08 we received a high level of correspondence regarding the revaluation of UK statutory ports.

123. In 2005 a new rating list for statutory ports, based on a formula calculation, was introduced. In mid-2004, the VOA had commenced a review of arrangements in the Port of Southampton. This concluded that the formula's application to Southampton was not in line with "rating case law and precedent".¹⁴⁸ In the light of this finding, following the introduction of the new 2005 lists, the VOA undertook a review the ratings of all 55 statutory ports in the UK.¹⁴⁹ At the time of our evidence sessions, this review process was complete for all ports except Plymouth, Poole, Ramsgate and Milford Haven.¹⁵⁰ In the course of this review the VOA identified a total of 569 new rateable properties in England and 81 new properties in Wales.¹⁵¹ Businesses affected have received bills backdated to 2005.

124. The correspondence we have received suggests that these businesses are under severe financial pressure. Some businesses have already failed and others may join them in the near future. There are three main issues which concern us: the poor quality of communication by the VOA with businesses affected; the relationship between Port Operators and businesses operation within the ports (Port Occupiers); and the justification for backdating these charges.

Communication

125. One theme running through the correspondence we have received has been a perceived lack of communication by the VOA with businesses operating in the Ports.¹⁵² In response to this criticism, Mr Hudson assured us that:

As far as consultation in the past is concerned, as soon as it was clear, once the issues in Southampton had been clarified, that a major piece of work was going to be needed, we wrote to all the statutory port operators in May of 2006 and asked them not only to cooperate with us and let us have the necessary information for the work that needs to be done but also asked them to contact their occupiers because they know who they are dealing with.¹⁵³

126. It is clear that many Port Operators did not communicate with the Port Occupiers and indeed some Port Operators have alleged to us that they did not even receive the

148 Q 69

149 Ev 84

150 Q 299

151 Ev 90

152 Ev 88

153 Q 70

VOA's communications. Indeed Mr Hudson accepted that "in practice some of the people who have written in were not aware that this work was going on"¹⁵⁴ and concluded that:

With the benefit of hindsight we have learned a lesson and please God this does not come up again: if it were to, we would seek to improve our communications with the occupiers as well as the operators. That is certainly a lesson.¹⁵⁵

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

Port Occupiers and Port Operators

128. Prior to the current changes in the port rating system, the Port Operators were charged business rates. The amount they then charged to Port Occupiers was set at a level which reflected these costs.¹⁵⁶ The division of costs between the Port Operators and the Port Occupiers has been altered by the VOA's recent review and many Port Occupiers have now received their own business rate bills. The overall rateable value of Port Operators properties has fallen¹⁵⁷ but some individual Port Operators have been served with substantially increased bills.¹⁵⁸

129. The VOA has appeared keen to distance itself from any involvement in the subsequent negotiations between Port Occupiers and Port Operators. Mr Hudson stated that:

We appreciate that some are arguing that they have effectively paid the equivalent of rates through the arrangements they have had with the operators. That is a matter between them and the operator.¹⁵⁹

130. Similarly, the Minister for Local Government accepted:

[a] perceived unfairness, and some have argued this as occupiers of businesses, is they feel they have either paid their business rates or in some senses paid a contribution to their business rates as part of the fee that they pay to the port's operator. Where they see their port operator in-line for a significant rebate because their rateable value has gone down, they are facing a business rates bill on the other hand of their own for the first time.¹⁶⁰

131. We note that Port Occupier's are facing bills for backdated business rates which do not take account of payments they have already made to Port Operators towards rates.

154 Q 76

155 Q 85

156 Ev 69

157 Ev 90

158 Ev 71

159 Q 68

160 Q 297

We recommend that the Government take steps to ensure that the financial liabilities faced by Port Occupiers take such payments into account.

Backdating of charges

132. The increased rateable values of ports and their associated charges are being backdated to April 2005, the date on which the latest ratings lists came in to effect.¹⁶¹

133. For some port businesses, the backdated charges come to millions of pounds. For example Freshney Cargo Ltd faces a £2.4m backdated charge against what used to be an annual payment of £48,142 per annum.¹⁶² Numerous businesses have written to us to complain that they cannot afford to pay these charges and will be forced to cease trading.¹⁶³

134. The Minister for Local Government confirmed to us, there had been “no impact assessment that this Committee would recognise as [being] undertaken when there is a significant change of policy”¹⁶⁴ regarding the changes to port valuations.

135. The VOA accepts that it should have done more to identify earlier the required increases. David Tretton, Director of Rating at the VOA, accepted that “Perhaps with hindsight we should have done more investigative work”.¹⁶⁵

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

The Government’s solution

137. In the Pre-Budget Report 2008, the Government announced an extension in the payment period for port businesses:

To reduce the cash flow impact on businesses, given current economic difficulties, the Government will legislate to give businesses more time to pay certain backdated business rates bills issued before 31 March 2010. Businesses facing such bills will be able to pay their liability for previous years in equal interest-free instalments over 8 years, rather than immediately. Beneficiaries will include several occupiers of ports who have been affected by recent rating reviews.¹⁶⁶

138. A firm is insolvent if its liabilities are greater than its assets. Where directors continue to trade despite being insolvent they are vulnerable to charges of wrongful trading.¹⁶⁷ A

¹⁶¹ Ev 84

¹⁶² Ev 70

¹⁶³ Ev 69

¹⁶⁴ Q 348

¹⁶⁵ Q 81

¹⁶⁶ Pre-Budget Report 2008, p 71, para 41.6

¹⁶⁷ Insolvency Act 1986, Section 214, Wrongful trading

charge of wrongful trading will make directors personally liable for the debts of their companies.¹⁶⁸ We have received clear evidence that firms will be forced to declare themselves insolvent.¹⁶⁹

139. The Government's proposal to extend payment terms for port businesses comes too late for those firms which have already ceased to operate in the face of the huge rates bills presented. It is probable that, even with an eight year period to pay, the backdated and prospectively increased rates bills may make many firms technically insolvent. We recommend that, in recognition of the fact that the Valuation Office Agency is to blame for the situation faced by the port firms, the Government takes steps to mitigate further the difficult position faced by port businesses. Consideration should be given to the proposal to maintain the rateable values of premises in statutory docks and harbours at the levels published in the April 2005 rating lists until the new ratings list is published in April 2010.

168 Insolvency Act 1986, Section 213, Definition of inability to pay debts and Section 214, Wrongful trading

169 Ev 97

8 The work of the Government Actuary's Department

Background

140. The Government Actuary's Department (GAD) was established in 1919 and continues to operate as an independent actuarial consultancy working within Government but operating on commercial lines.¹⁷⁰ GAD has four main branches of actuarial work: pensions; social insurance; life insurance; and general insurance. It offers actuarial advice to UK public sector as well as overseas clients.¹⁷¹ As at 31 March 2008, GAD had 96 staff members including 42 qualified actuaries.¹⁷² On 30 September 2007, Chris Deakin retired from the post of Government Actuary. His successor, Trevor Llanwarne, joined the Department on 1 May 2008 from PricewaterhouseCoopers.

Financial Performance and Reporting

141. GAD is a repayment department which relies on fee income to cover most of its expenditure. One ongoing challenge for the Department is the maintenance of its fee income. During 2007–08, overall sales by GAD fell by 4% compared to 2006–7, largely as a result of reduced demand for GAD services from UK public sector clients.¹⁷³

142. Mr Llanwarne admitted that GAD had been losing market share and suffering a decline in income. There were, however, signs of recovery:

the income for the first six months [of 2008–09], which you will not have received yet, shows we have turned the corner and it is going up again because we are focusing on what the client is specifically asking without whatsoever reducing the quality of what we do.¹⁷⁴

143. One impact of the drop in income during 2007–08 was that GAD's net operating costs increased 70% from £396,000 in 2006–07 to £672,000 in 2007–08. The Department was also obliged to submit a supplementary estimate in February 2008.

144. The supplementary estimate submitted by GAD assumed income of £12,906,000 for 2007–08. By 31 March 2008, GAD had in fact generated only £10,093,000 of income. When challenged on the discrepancy between the income level forecast in the February 2008 estimate and actual income achieved by the end of March 2008, Kevin Down, Director of Finance at the VOA, suggested that the estimate included an amount of headroom. He suggested that the substantial discrepancy between the estimated income

170 Government Actuary's Department, *Our History*, www.gad.gov.uk

171 Government Actuary's Department, *Departmental Report and Accounts 2007–08*, HC 615, July 2008, p 2

172 *Ibid.*, p 2

173 GAD 2007–2008 Annual Report, p 14

174 Q 141

and the actual income simple reflected a historic tendency to build in 'headroom': stating that the level of "headroom is historic".¹⁷⁵

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

Staff Management

146. In its 2007–08 Annual Report, GAD disclosed that resignations and retirements in the Department had "affected ... service in some areas".¹⁷⁶ This is an area the incoming Government Actuary, Mr Llanwarne, recognised as requiring attention. He reassured us that as at October 2008 staff numbers had increased from 96 to 105 and following changes in the HR Department, GAD were "now having absolutely no problems getting recruits coming in".¹⁷⁷

147. One key factor in staff retention and morale is the management of staff performance. We note that bonus payments increased 61% to £37,00 in 2007–08. Kevin Down revealed that this increase reflected the move by GAD towards a performance-related bonus system. He stated that:

Previously every member of staff in the Department received a bonus of the same amount so it was a very small bonus. We changed that to a performance-related bonus ... In previous years, which was not performance related and made no sense at all ... What we did last year was to change the system to make the bonuses performance related so they actually relate to staff performance.¹⁷⁸

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

Miners' pensions valuation

149. The Mineworkers' Pension Scheme and British Coal Staff Superannuation Scheme together include £27bn of assets and have 350,000 members between them.¹⁷⁹ There is ongoing controversy concerning the valuation of these pension schemes. The most recent GAD valuation, of 2005–06 identified a £1.9bn surplus in these schemes. Under the terms of the privatisation of British Coal, the surplus is subject to redistribution to both members

¹⁷⁵ Q 149

¹⁷⁶ Government Actuary's Department, *Departmental Report and Accounts 2007–08*, HC 615, July 2008, p 13

¹⁷⁷ Q 130

¹⁷⁸ Q 130–132

¹⁷⁹ John Ralfe, *Financial Times*, 14 July 2008

and the Government. Since 1997 it is reported that the Government has received £3.5bn in cash.¹⁸⁰ However the Government is the guarantor of these schemes and is bound to repay funds required to satisfy the liabilities of the scheme as they crystallise.

150. There are those, such as pensions consultant John Ralfe, who contest the method of valuation used by GAD.¹⁸¹ They argue that if alternative valuation methods are employed the scheme appears to be in deficit and thus represents a liability for the British Taxpayer. As a relatively recent appointee, Mr Llanwarne admitted that he had not been involved in the valuation of the miners' pensions but he maintained that:

There is not one unique number as to what the surplus is or not. What is critical about this pension scheme is that the way in which the valuation is done is set out in specific legislation relating to it as to what you do, how you calculate the surplus and it is reasonable to do that because, unlike the private sector, where it is absolutely critical that you get things in balance between your assets and your liabilities, this one has the underlying government guarantee which makes it quite different. When someone asks whether the surplus is this or that, I will say to you that if you do your calculation on one basis you get that surplus, if you do your calculation on another basis you might get another surplus or a deficit.¹⁸²

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

Equitable Life

152. The Parliamentary and Health Service Ombudsman issued her final report in July 2008¹⁸³ which identified GAD as falling short of acceptable standards. Her determinations in respect of GAD's actions appear in the table below.

¹⁸⁰ John Ralfe, Financial Times, 14 July 2008

¹⁸¹ *Ibid.*

¹⁸² Q 137

¹⁸³ Parliamentary and Health Service Ombudsman, *Equitable Life: a decade of regulatory failure*, HC 815, 16 July 2008

Table 5: Extracted determinations of the Parliament and Health Service Ombudsman

that the failure, as part of the scrutiny process, to question and seek to resolve questions within the Society's regulatory returns for each year from 1990 to 1993, related to (i) the valuation rate of interest used to discount the Society's liabilities and (ii) to the affordability and sustainability of the Society's bonus declarations, constitutes maladministration by GAD
that the failures, when the introduction of the Society's differential terminal bonus policy was identified as part of the scrutiny of the 1993 returns, (i) to inform the prudential regulators about the policy, (ii) to raise the matter with the Society, or (iii) to seek to identify what the rationale was for the introduction of the policy and how it was being communicated to policyholders, constitutes maladministration by GAD;
that the failure, as part of the scrutiny process, to question and seek to resolve questions within the Society's regulatory returns for each year from 1994 to 1996, related to (i) the valuation rate of interest, (ii) the affordability and sustainability of bonus declarations, (iii) apparently arbitrary changes to the assumed retirement ages, and (iv) the holding of no explicit reserves for the liabilities associated with prospective liabilities for capital gains tax, for pensions mis-selling costs, and for guaranteed annuity rates, constitutes maladministration by GAD
that the failures (i) to ask for the information GAD needed in respect of the Society's 1995 returns to enable them, as part of the scrutiny process, to be sure that the Society had produced a valuation that was at least as strong as the minimum required by the applicable Regulations, and (ii) to pursue the information before them that the omitted information had led to the users of the returns misconstruing the financial strength of the Society constitutes maladministration by GAD;

Source: Parliamentary and Health Service Ombudsman, Equitable Life: a decade of regulatory failure HC 815-V, 16 July 2008, Part 5, para 6.4

153. When questioned on the potential risk to GAD's reputation resulting from the Equitable Life report, Mr Llanwarne was adamant that GAD's reputation had not been tarnished, stating:

Firstly, I do not feel it will have any impact. Secondly, we have done surveys of our clients in the few months I have been here and it is not coming out whatsoever as an issue. One of the points which is perhaps worth tabling on this is that nobody in the Department as it is was involved in doing the insurance work that related to whenever it was done. That is not to imply any criticism whatever; it is simply a matter of fact. Purely as a matter of fact, that does significantly help in terms of our relations with our current clients. We are not hitting any problems whatsoever.¹⁸⁴

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

Conclusions and recommendations

1. We note the ongoing underspending against estimate by the Treasury Group and we are concerned that this may represent under-delivery or poor estimate preparation. We recommend that the Government takes steps to ensure that the Treasury presents an accurate estimate to parliament and delivers against the approved estimate. (Paragraph 9)
2. We recommend that, in its response to this Report, the Government indicates whether any of the Treasury Group's End-Year Flexibility will be transferred to other Departments or how else it might be used. (Paragraph 10)
3. While we recognise that the quantity of staff is not the only factor in the delivery of services, we are concerned that continued headcount reductions in the Treasury Group may now leave its constituent organisations unable to provide the required economic support and management during the economic downturn. We recommend that the Government reconsider any planned further headcount reductions in the Treasury Group in the light of the demands on the Group of the economic downturn. (Paragraph 15)
4. The nationalising transactions of 2008–09 raise some complex accounting questions for the Treasury. In order to ensure that the Treasury Group's 2008–09 Annual Report and Accounts can properly be laid before Parliament before the summer adjournment, we recommend that the Treasury engages early with the National Audit Office to agree appropriate accounting treatments for the transactions surrounding the nationalised and part-nationalised banks. (Paragraph 20)
5. We were disappointed to note that the Treasury Annual Report was published separately to its Resource Accounts in July 2008. We recommend that, in order to aid users of the accounts, the Treasury publishes future Annual Reports and Resource Accounts in a single, combined document prior to each summer adjournment. (Paragraph 21)
6. By nationalising financial institutions, the Government has taken on responsibility for significant liabilities. In order for public scrutiny to be effectively performed, the magnitude and nature of these liabilities must be comprehensively disclosed. We recommend that the Treasury quantify and disclose the liabilities involved in the nationalisations and part-nationalisations of financial institutions. These disclosures should appear in the Treasury Group Resource Accounts, must be at least as comprehensive as those made by major banks and should go further than meeting the minimum acceptable accounting standards. (Paragraph 23)
7. We recommend that in future years the Treasury disclose the total bonus payments made to staff in their Resource Accounts. (Paragraph 24)
8. We recommend that the Government ensure the Treasury is sufficiently resourced to manage its extended responsibilities arising from the economic downturn, especially those regarding financial stability. (Paragraph 28)

9. Given the interest in the fully nationalised institutions of Northern Rock and Bradford & Bingley, and the Treasury's role in their governance, we recommend that the Government publishes key performance information for these institutions within the Treasury Group's own Departmental Report and Resource Accounts. (Paragraph 30)
10. We recommend that the Government identify and publish performance measures for UK Financial Investments and report against these measures on a six-monthly basis. (Paragraph 32)
11. The adoption of International Financial Reporting Standards will fail if the Treasury does not assert its authority and aid departments in meeting the agreed milestones. We recommend that the Government take steps to re-emphasise to all departments the importance of meeting IFRS implementation deadlines. (Paragraph 37)
12. We recommend that the Treasury considers not only the presentation and authorisation of expenditure but also the way in which the revised documents might best facilitate parliamentary scrutiny. (Paragraph 39)
13. We acknowledge that the requirements of the alignment project mean that it is not possible for parliament to maintain control over gross totals. We are concerned that without adequate levels of information regarding income, parliament's authority may be diminished. We recommend that the new estimates provide appropriate levels of information relating to income. We do not wish to impose an unreasonable administrative burden on the departments and hope that a pragmatic solution can be adopted. (Paragraph 41)
14. The increase in planned gilt issuance for 2007-8, announced in Budget 2008 reportedly surprised the market. We recommend that the Debt Management Office reviews lessons learnt from this process in order to ensure the market is better prepared in future. (Paragraph 47)
15. We note that the forecast gilt issuance for 2008–09 has increased from £80bn to £146.6bn. These higher levels of gilt issuance, at a time when other governments will also need to raise cash, significantly increase the risk that supply of Government debt might outstrip demand and uncovered gilt auctions might result. We note the Debt Management Office's confidence in its ability to cope with the occasional uncovered auction but we seek assurances that the Government has put in place contingency plans capable of responding to repeated uncovered auctions. (Paragraph 49)
16. The unprecedented increase in gilt issuance levels in 2008–09 has created pressures for the Debt Management Office staff and such pressure increases the risk of mistakes being made. We recommend that the Government review the resources of the DMO in the light of its significantly increased workload. (Paragraph 51)
17. We note that 2008–09 will see a dramatic increase in the workload of the Debt Management Office and thus an increased risk of control failure. We recommend that the DMO revisit controls relating to publications in order to ensure that factual errors are minimised. (Paragraph 54)

18. We note that the DMO takes an average time of 10 minutes to publish the results of its gilt auctions compared to the 2 minute publication time achieved by other countries. While the discretionary checks performed by the DMO may account for some of this disparity, we recommend that the DMO sets a target for further reducing the delay. (Paragraph 57)
19. We note that a technical breach within the CRND function of the Debt Management Office occurred in 2007–08. Any technical breach is a serious matter. We note that in this instance the DMO has been advised that no adverse consequences resulted, and that a review of the procedures in place has been undertaken. We recommend that the DMO undertakes regular reviews of its control environment to ensure that emerging risks are mitigated where possible. (Paragraph 60)
20. We are disappointed that after three years the measurement of performance against the Government's target to reduce regional inequality remains problematic. We welcome the work of the Office for National Statistics and recommend that the Government publishes the results of the work on regional deflators as soon as it becomes available. (Paragraph 64)
21. We recommend that the Treasury reviews its reporting against its child poverty target in order to ensure that users of the accounts can easily see performance against each of the three measures individually. We are concerned that, despite assurances that the Treasury has "redoubled efforts to meet the 2010 target", it may be beginning to resign itself to failure, an attitude which will not help those children still living in poverty in the UK. (Paragraph 69)
22. We are concerned by the scale and amount of CSR2004 Public Service Agreements which have been missed and recommend that the Government explains why the rate of failure against targets across departments was so great. (Paragraph 72)
23. We note that achievement of the Lisbon goals will not feature in any Public Service Agreement during the CSR 2007 period. We are concerned that this omission will lead to progress against the Lisbon goals being omitted from Government reporting. We recommend that the Treasury publish within its Annual Report an update on progress against the Lisbon goals. (Paragraph 74)
24. The 2008–09 financial year is the first year of delivery against the Departmental Strategic Objectives and Public Service Agreements arising from the CSR2007. In our review on administration and expenditure in 2008–9 we will be examining HM Treasury's performance against these targets. (Paragraph 77)
25. We are disappointed that HRMC took 12 months to replace its Chief Executive, thereby deepening the uncertainty felt by staff members already part way through a far reaching review of HMRC's operations. We recommend that the Government ensure a full permanent senior management team is in place in HMRC as soon as possible. (Paragraph 80)
26. We believe that having a 'Permanent Secretary for Tax' alongside the Chief Executive and Chairman of HMRC may obscure clear lines of accountability. We recommend that HMRC publish and widely circulate clear information on the respective

responsibilities of its senior management team, including responsibility for data management. (Paragraph 82)

27. It is our view that HMRC's explanation of the basis for the payment to Stuart Cruickshank is wholly inadequate. We are further unconvinced that the £88,125 received by Stuart Cruickshank represents good value for the taxpayer. We recommend that the Government ensure that all departments are adhering to best practice regarding ex-gratia payments. (Paragraph 88)
28. We note the National Audit Office's assertion that, in order to maximise the benefits of its Transformation Programme, HMRC must convince staff of its benefits. The low levels of morale within the Department are startling with profound potential impacts on both the Transformation Programme and core service delivery. We will continue to monitor the efforts made by senior management to improve matters. We seek an explanation of how Ministers will monitor and report progress. (Paragraph 92)
29. We are concerned that individuals without access to the internet, notably less well off or elderly taxpayers, may face increased levels of non-filing penalty charges following the revision to the paper filing deadline. We recommend that the Government should publish any analysis available to it of the demographic profile of those facing non-filing fees following the 31 October paper filing deadline. If such evidence is not available to the Government then it should be commissioned as a matter of urgency. (Paragraph 95)
30. We recommend that HMRC disclose information regarding the financial case for individual office closures in order to allow better public scrutiny of these decisions. (Paragraph 99)
31. We ask the Government to update the latest progress made by HMRC against Kieran Poynter's recommendations regarding information security. (Paragraph 103)
32. We are extremely concerned by the level of fraud within HMRC. We will continue to monitor the steps taken to improve controls. To assist us in this we recommend a disclosure of immediate past known fraud levels to provide a benchmark. (Paragraph 107)
33. We recommend that the Government ensure the performance against agreed targets by PFI contractors is published within Departmental Annual Reports in order to enable clearer scrutiny of these recipients of public funds. (Paragraph 110)
34. We recommend that HMRC reviews the contracts with its IT provider in the light of the very serious errors which have recently occurred and seeks financial compensation where appropriate. We regard it as wholly unsatisfactory that people entitled to Child Trust Fund payments should not have received them owing to the poor performance of an IT contractor. We seek assurances that the contracts drawn up with the PFI companies adequately allow for appropriate compensation to the taxpayer in the event of serious performance shortcomings. (Paragraph 114)
35. We note that the introduction of HMRC's new IT system has been delayed by a year. We accept that postponing the 'go live' date until testing is complete is prudent.

HMRC should publish the performance targets for the new system in terms of reduced open cases and other measures so that we may better monitor its effectiveness. (Paragraph 117)

36. Low staff morale is a risk to the quality of service delivery. We note that staff satisfaction in the Valuation Office Agency is worryingly low. We will continue to monitor management's performance in improving staff morale and safeguarding the delivery of services. (Paragraph 121)
37. We note the Valuation Office Agency's recognition that its communication with businesses affected by the revaluation of statutory ports had been deficient. We hope that the Agency can apply the lesson learnt from this situation to all future revaluations. (Paragraph 127)
38. We note that Port Occupier's are facing bills for backdated business rates which do not take account of payments they have already made to Port Operators towards rates. We recommend that the Government take steps to ensure that the financial liabilities faced by Port Occupiers take such payments into account. (Paragraph 131)
39. Port businesses are facing backdated charges because the Valuation Office Agency failed to identify discrepancies in the ratings at the time of the 2005 revaluation. This mistake was compounded by the VOA's failure to communicate changes promptly and effectively with Port businesses. (Paragraph 136)
40. The Government's proposal to extend payment terms for port businesses comes too late for those firms which have already ceased to operate in the face of the huge rates bills presented. It is probable that, even with an eight year period to pay, the backdated and prospectively increased rates bills may make many firms technically insolvent. We recommend that, in recognition of the fact that the Valuation Office Agency is to blame for the situation faced by the port firms, the Government takes steps to mitigate further the difficult position faced by port businesses. (Paragraph 139)
41. We are concerned that the Government Actuary's Department's estimated net expenditure position deviates so far from its actual outturn. We do not accept that the Department is justified in building in 'headroom' of some £2.8m (38%). We recommend that GAD reviews its supply estimate process and improves budgeting to ensure the validity of forecasts and estimates laid before parliament. (Paragraph 145)
42. We are concerned to note that prior to 2007–08 the Government Actuary's Department were operating a bonus system which made no reference at all to performance. We recommend that the Government ensures that bonus payments are performance-based and of a reasonable scale. (Paragraph 148)
43. We note the controversy surrounding the valuation of miners' pensions and recommend that the Government Actuary's Department issues a statement addressing the risk of future liabilities being faced by the ultimate guarantor of these schemes, the UK taxpayer. (Paragraph 151)

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

Formal minutes of the Treasury Sub-Committee

Wednesday 14 January 2009

Members present

Mr Michael Fallon, in the Chair

Nick Ainger	John Mann
Mr Graham Brady	John Thurso
Sally Keeble	Mr Mark Todd
Mr Andrew Love	Sir Peter Viggers
John McFall	

Administration and expenditure of the Chancellors departments, 2007–08

Draft Report (*Administration and expenditure of the Chancellors departments, 2007–08*), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 30 read and agreed to.

Paragraph 31 read, amended and agreed to.

Paragraph 32 to 38 read and agreed to.

Paragraph 39 read, amended and agreed to.

Paragraphs 40 to 48 read and agreed to.

Paragraph 49 read, amended and agreed to.

Paragraph 50 to 54 read and agreed to.

Paragraph 55 read, amended and agreed to.

Paragraphs 56 to 91 read and agreed to.

Paragraph 92 read, amended and agreed to.

Paragraph 93 to 106 read and agreed to.

Paragraph 107 read, amended and agreed to.

Paragraphs 108 to 116 read and agreed to.

Paragraph 117 read, amended and agreed to.

Paragraph 118 to 138 read and agreed to.

Paragraph 139 read, amended and agreed to.

Paragraphs 140 to 154 read and agreed to.

Summary read, amended and agreed to.

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

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

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

Formal minutes of the Treasury Committee

Wednesday 14 January 2009

Members present

John McFall, in the Chair

Nick Ainger	John Mann
Mr Graham Brady	John Thurso
Mr Michael Fallon	Mr Mark Todd
Sally Keeble	Sir Peter Viggers
Mr Andrew Love	

Administration and expenditure of the Chancellors departments, 2007–08

Draft Report from the Sub-Committee (*Administration and expenditure of the Chancellors departments, 2007–08*), brought up and read.

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

Paragraphs 1 to 154 read and agreed to.

Summary read and agreed to.

Resolved, That the Report, be the First Report of the Committee to the House.

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

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134 (Select committees (reports)).

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

[Adjourned till Tuesday 20 January at 9.30 am.]

Witnesses

Wednesday 15 October 2008

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Robert Stheeman, Chief Executive, **Jo Whelan**, Deputy Chief Executive and Joint Head of Policy & Markets, **Mr Jim Juffs**, Chief Operating Officer and **Ms Joanne Perez**, Joint Head of Policy & Markets, Debt Management Office Ev 1

Andrew Hudson, Chief Executive, **David Park**, Deputy Chief Executive and Director of Local Taxation and **Mr David Tretton**, Director of rating, Valuation Office Agency Ev 7

Trevor Llanwarne, Government Actuary, and **Mr Kevin Down**, Director of Finance, Government Actuary's Department Ev 14

Wednesday 22 October 2008

Nicholas Macpherson, Permanent Secretary, and **Louise Tulett**, Finance, Procurement and Operations, HM Treasury Ev 18

Wednesday 29 October 2008

Rt Hon Stephen Timms MP, Financial Secretary to the Treasury, and **Rt Hon John Healey MP**, Minister for Local Government Ev 34

Mike Clasper CBE, Chairman, **Mr David Hartnett CB**, Acting Chief Executive Officer, and **Ms Mary Aiston**, Director Governance and Security, HM Revenue and Customs Ev 44

Wednesday 26 November 2008

Rt Hon Stephen Timms MP, Financial Secretary to the Treasury, **Angela Eagle MP**, Exchequer Secretary to the Treasury and **Ian Pearson MP**, Economic Secretary, HM Treasury Ev 53

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3	Letter from A J Dixon, Managing Director, Freshney Cargo Services Ltd	Ev 69
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5	Letter from Nicholas Orbell, General Manager, Real Estate Development, Hutchinson Ports UK Ltd	Ev 71
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12	Letter from the Financial Secretary to the Treasury and the Minister for Local Government to the Chairman of the Sub-Committee	Ev 84
13	Letter from Mr Nicholas Orbell, General Manager, Real Estate Development, Hutchinson Ports UK Ltd	Ev 85
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15	Letter from Ken Kirk, Stanton Grove Limited	Ev 88
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17	Letter from Ken Kirk, Stanton Grove Limited	Ev 97
18	HM Treasury: Winter Supplementary 2008-09	Ev 98
19	HMRC: Winter Supplementary 2008-09	Ev 102
20	Letter from LD Stracey, director and Company Secretary, Stena Line	Ev 108
21	HM Treasury	Ev 109
22	Letter from the Chancellor of the Exchequer to the Chairman of the Treasury Committee	Ev 111

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Fifth Report	The run on the Rock	HC 56
Sixth Report	Financial Stability and Transparency	HC 371
Seventh Report	Administration and expenditure of the Chancellor's departments, 2006–07	HC 57
Eighth Report	Re-appointment of Dr Andrew Sentance to the Monetary Policy Committee	HC 454
Ninth Report	The 2008 Budget	HC 430
Tenth Report	Re-appointment of Mervyn King as the Governor of the Bank of England	HC 524
Eleventh Report	Counting the population	HC 183
Twelfth Report	Inherited Estates	HC 496
Thirteenth Report	Budget Measures and Low Income Households	HC 326
Fourteenth Report	Appointment of Lord Turner of Ecchinswell as Chairman of the Financial Services Authority	HC 916
Fifteenth Report	Appointment of Charlie Bean as Deputy Governor of the Bank of England	HC 917
Sixteenth Report	Appointment of Spencer Dale to the Monetary Policy Committee of the Bank of England	HC 1009

Seventeenth Report	Banking Reform	HC 1008
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Third Report	The Monetary Policy Committee of the Bank of England: appointment hearing for Sir John Gieve	HC 861

Fourth Report	The 2006 Budget	HC 994
Fifth Report	The design of a National Pension Savings Scheme and the role of financial services regulation	HC 1074
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Eighth Report	Bank of England Monetary Policy Committee: appointment hearing for Professor David Blanchflower	HC 1121
Ninth Report	Globalisation: the role of the IMF	HC 875
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Eleventh Report	The Monetary Policy Committee of the Bank of England: appointment hearings for Professor Tim Besley and Dr Andrew Sentance	HC 1595
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Thirteenth Report	“Banking the unbanked”: banking services, the Post Office Card Account, and financial inclusion	HC 1717

Oral evidence

Taken before the Treasury Committee

(Treasury Sub- Committee)

on Wednesday 15 October 2008

Members present

Mr Michael Fallon, in the Chair

Nick Ainger
Mr Graham Brady
Mr Andrew Love

John McFall
Mr Mark Todd

Witnesses: **Mr Robert Stheeman**, Chief Executive, **Ms Jo Whelan**, Deputy Chief Executive and Joint Head of Policy & Markets, **Mr Jim Juffs**, Chief Operating Officer and **Ms Joanne Perez**, Joint Head of Policy & Markets, Debt Management Office, gave evidence.

Q1 Chairman: Let us make a start. Mr Stheeman welcome back to the Sub-Committee. Could you introduce your team please?

Mr Stheeman: Certainly. On my right is Jo Whelan, the Deputy Chief Executive of the DMO and the Joint Head of Policy and Markets. Next to her is Jim Juffs, our Chief Operating Officer. Next to me is Joanne Perez who, together with Jo, is also Joint Head of Policy and Markets. I am Robert Stheeman. I am the Chief Executive.

Q2 Chairman: You have already planned some £37 billion in total of gilts and Treasury bill sales. What, in layman's terms, after the last week is the new total you are going to have to plan for?

Mr Stheeman: The original remit at the time of the Budget was set out, to be precise, as exactly £80 billion in gilts. What was announced yesterday was that we would be doing this extra £37 billion to which you have referred and that is being split into £30 billion in gilts and £7 billion in Treasury bills. We have also said that we intend to raise that amount by the end of this calendar year.

Q3 Chairman: What is the rationale for this split between £30 billion in gilts and £7 billion in bills?

Mr Stheeman: The amount employed is obviously a very large amount and we want to try to raise this within a short period of time. Given the amount we are already issuing, given the patterns of demand in the market, given also the volatility and stresses that there are in markets at the moment, we think it is right to focus on the short end of the market so that was our advice to ministers. There has been a very large flight to quality in terms of buying of government assets, safe-haven assets, over the last weeks. In addition, in terms of the market's ability to absorb paper in a very short period of time, short paper is much more easily distributed into the market at speed than long-dated or even inflation paper would be.

Q4 Chairman: It has been suggested to us that the market is fairly saturated at the moment. Are you confident of getting all this stuff away?

Mr Stheeman: We are confident. I am not complacent about that. It is certainly a record amount, but we are confident that demand exists, in particular for government assets. I say that advisedly because at the moment we have seen enormous demand over the last weeks and months for gilts. In general also it is fair to say that the gilt market has developed much greater depth over the last years. As it has grown, as liquidity has improved, it has been able to absorb ever-increasing amounts of supply from us. I am not complacent about that; I am well aware that we will be challenged in that process, but that is one of the reasons why we also advise focusing so much on the short end because that is the safest area of market for us to access.

Q5 Chairman: What is the impact of the additional public borrowing now, the additional so-called £50 billion on the average interest rate that you are likely to have to pay?

Mr Stheeman: That depends. The impact does not derive so much on the borrowing amount that we are going to have to issue; in other words, I personally do not believe that there is an easy link between the supply and the price. The market tends to be influenced and yields in the market tend to be influenced by much greater macroeconomic factors, in particular, in the short term, interest rate expectations are likely to influence the market more than our issuance would.

Q6 Chairman: Nonetheless, the additional borrowing of this order must have some impact on the average interest rate you are paying.

Mr Stheeman: It will certainly have an impact in terms of interest costs; clearly overall interest costs for Government will rise. However, in terms of the actual interest rate the one thing I would say is that there is academic evidence, analytical evidence, which suggests that when governments are in deficit and when governments are borrowing strongly, you

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tend to see, if anything, a steepening of the yield curve. In other words, longer-dated borrowing costs could potentially rise and that has been speculated about in the press. There has been academic evidence to suggest that would be the case.

Q7 Chairman: If the Government do not in the end need to buy the extra shares in RBS and HBOS Lloyds TSB because in fact private investors decide to buy them, will you not have raised an awful lot of money unnecessarily?

Mr Stheeman: We committed to raising the £37 billion and so we shall certainly do that. In the event that was not needed, we would be managing that position as part of our overall cash management operations. We continuously, every day, manage very large cash management flows in and out of the exchequer. What we would effectively be doing would be potentially reducing then some of the cash management operations or increasing them in some cases in order to be laying off the position in the market. I would also say that obviously in a few weeks' time there will be the Pre-Budget Report and if something were to be known then, in terms of your scenario that this £37 million were not needed, I would imagine that would be reflected in the PBR.

Q8 Chairman: Did you advise ministers of the implications of raising money of this order which might not in fact be needed?

Mr Stheeman: We were not directly asked to do that. We were asked to raise £37 billion specifically and that was a figure which was given to us in the remit yesterday, but was indicated to us only over the weekend. As you are probably aware, following a statement by the Chancellor on Monday, we called consultation meetings with the market participants immediately to discuss how we would raise this amount.

Q9 Mr Brady: When Bradford and Bingley was nationalised the Treasury committed to pay Abbey £4 billion. Where did you find the £4 billion?

Mr Stheeman: That came also from the cash operations to which I was referring. We have large cash positions, both positive and negative, which we turn over every day in the market and we are able to absorb those positions, but of course they will need to be refinanced.

Q10 Mr Brady: How big are those cash positions typically?

Mr Stheeman: We try to manage them down. Were we not able to manage them down in our cash management operations in advance, they would be potentially huge on certain days. We receive forecasts from the Treasury about cash profiles for the exchequer and these forecasts show that there are also very seasonal flows to government cash management. We know for instance for certain when there is going to be a gilt redemption, when we have to pay money back. We have a pretty good idea, as a result of the forecasting, when we are taking money in. Were we not to address those, you are talking about some very, very big sums which for

commercial reasons I would rather not go into too much detail on; I am happy to put some of this in writing to you if you like. What we try to do is smooth those cash flows in advance. Effectively we operate in the money markets to offset them and to make them manageable and less risky.

Q11 Mr Brady: Without wishing you to give figures you do not want to give, I suppose what I am driving at is whether you are suggesting that the £4 billion is a relatively insignificant part of that operation.

Mr Stheeman: It is probably fair to say that it would fall within the average daily turnover that we would be transacting in the market. One figure which we have made available to the public is that in the last financial year the sum total of all our transactions—I avoid the word “turnover”—the actual transactions on the debt management account in total reached £1.7 trillion. These are big numbers.

Q12 Mr Brady: Has the loan from the Bank of England associated with these transactions been transferred to the Treasury now?

Mr Stheeman: It has not yet.

Q13 Mr Brady: When do you expect that to happen?

Mr Stheeman: We are waiting to hear from the Treasury on that and that is clearly a key element, because that is something which we will eventually have to finance as well. That will also have to be taken into account, but we do not know at this stage when that will be.

Q14 Mr Brady: You indicated that you were reasonably confident that your auctions will be fully subscribed. Are you concerned though, given that in July 2008 your auction of 30-year index-linked gilts was only covered 1.1 times? Does that not give some grounds for concern?

Mr Stheeman: It is a very reasonable question. We have had, most recently just two weeks ago, an inflation-linked bond which was also only 1.1 times covered. It is possible that we will see an uncovered auction and I made it clear to colleagues in the Treasury and to ministers that that is a distinct possibility. Personally an uncovered auction is not something I regard as anything more than a market event. An auction tells you how much demand there is for a specific piece of debt being offered at 10.30 in the morning on a very specific day. If there is an uncovered auction we have processes in place to deal with that. What effectively happens—and the DMO last had an uncovered auction in 2002—is that the government debt is created on the National Loans Fund and it is acquired by the DMO on the Debt Management Account and any shortfall is funded immediately on the day by the cash operations which I just described. That is how we deal with that. I would not generally regard an uncovered auction as a very major issue. If there were a series of uncovered auctions, I would feel less comfortable, but I think it is fair to say that if you look around Europe and see what other European governments are experiencing at the moment, there has been quite a fair bit of, it is probably fair to say, friction in the process of

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distributing government debt sometimes in other markets. The way we sell our bonds is that we actually say in advance that this is a fixed amount that we are going to sell. Some other countries have a different method and they actually vary that amount according to the amount on the day.

Q15 Mr Brady: Would not an uncovered auction give rise to concern in the market at the time that you are having to fund so much?

Mr Stheeman: To a certain extent it might but I think it is a brief thing. It would be relatively swiftly absorbed; to be honest the market in its current state moves on very quickly from one event to another. Where I am not quite so sanguine is in the scenario which I just described where we would have a series of uncovered auctions. That is one I feel much less comfortable with.

Q16 Mr Brady: What are you doing or can you do to mitigate the risks of such under-subscription?

Mr Stheeman: That is why, for instance, when we heard about the £37 billion, the first thing we did was to call these consultation meetings. It is extremely important that in making the sort of decisions we are and providing advice to Treasury and ministers that we do we read market demand correctly, that we consult with our stakeholders, representatives of end investors, the primary dealers, whom we refer to as the gilt-edged market makers, the GEMMs, that we consult with them very carefully and we get their views on how we should be accessing the market to make the best possible choice.

Q17 Mr Brady: May I finally turn to the experience you had at the time of the Northern Rock nationalisation when the market was surprised by the level of gilts forecast? Could anything have been done to communicate that better to the market? Have you learned lessons from it?

Mr Stheeman: I am not trying to duck the question but from the DMO's perspective we finance the number that we are given. In fairness the market knows that there are normally—and yesterday was clearly an exception—two fixed dates a year where the financing plans are communicated and we publish a gilt programme, which are the Budget and the PBR. That certainty is absolutely critical to the market. It is easy for me to say this in my position but I think that once Northern Rock was nationalised some commentators could potentially have put two and two together and worked out that there was going to be a not insignificant addition to the government cash-raising requirement. I am fully aware that not many did; it is easy for me to say that but we were scouring some of the comments put out by City analysts and others to see whether they would actually factor that in. We did not see it at the time and you are right, the market was surprised.

Q18 Chairman: You said you had warned ministers that the next series of auctions might be uncovered. When was that warning? Was that on Monday or previously?

Mr Stheeman: No. We have obviously been seeing not just a rise in financing requirement but a deteriorating market environment effectively for the best part of a year. I have had conversations with the permanent secretary and he has told me he has certainly passed on to ministers the possibility that there will be an uncovered auction. I honestly do not believe that an isolated uncovered auction is a big issue.

Q19 Chairman: I understand that. I just wanted to be clear when you warned Treasury ministers that we might have a series of uncovered auctions. When was that warning?

Mr Stheeman: I had a conversation with the permanent secretary in the summer and I made quite clear that was a possibility and I asked him to inform ministers and he has done so.

Q20 Chairman: So that would be July.

Mr Stheeman: I believe it was possibly earlier. I know I had a conversation with him in late July on precisely this topic, but he told me then that he had already spoken to ministers so I am not quite sure when he actually made that point.

Q21 Mr Love: Apropos the discussion we have just been having, you are intending to auction a significant increase in the current financial year up to £80 billion. What are the key operational problems that you face as a result of that significant—I would not call it massive but significant—increase?

Mr Stheeman: That is a very reasonable question. The total amount forecast for gilts alone for this year will now be £110 billion.

Q22 Mr Love: It goes up daily.

Mr Stheeman: It went up yesterday. That amount compares to £58.5 billion last year and the highest before that we ever had was £62.5 billion. I am fully aware of that. The first effect is clearly one on the number of operations we have to conduct. For instance, whilst with just the £80 billion forecast we were expected to do 41 auctions, we have scheduled seven more, so there are now 48. We have to start looking for dates on which to hold auctions, we have to plan them in such a way that, if possible, they do not occur at a time when market data are being released, which could be market moving, on Monetary Policy Committee days, on days which could cause disruption. Clearly what we have been doing is looking very carefully to find dates on which we can conduct these auctions in as smooth and seamless a way as possible. That is the market side. On the operational side, one big thing we have introduced since we came here last has been to introduce a form of electronic bidding at auctions.

Q23 Mr Love: I shall come back to that.

Mr Stheeman: It is a key point for us. Frankly we would have been able to do this sort of remit under the old system but, in my opinion, only at a much higher level of demand on our resources and potentially also some operational risks. Automatic

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bid capture, as we call it, electronic bidding mitigates those risks to a large extent; it does not eliminate them but mitigates them.

Q24 Mr Love: Do you have sufficient resources to do what you have been asked to do this year and if you have not, have you spoken to the permanent secretary in relation to that?

Mr Stheeman: Yes, I have indeed.

Q25 Mr Love: You have spoken to him.

Mr Stheeman: I have spoken to him just a few weeks ago precisely on that point.

Q26 Mr Love: May I turn to the electronic bidding system? Can you indicate to us the cost of introducing that and the savings that you have indicated you think you are going to make as a result of its introduction?

Mr Stheeman: The actual cost of the system itself was zero. There was obviously a lot of internal cost in terms of time and personnel allocated. We used a system which is part of the Bloomberg system. They have an electronic bid system themselves which they use, they have tailored it to our needs. We spent the best part of a year actually designing and developing a system which suits the gilt market in particular and as a result we have introduced this. What cost savings have there been? Effectively they have mitigated risk so that we do not make mistakes and freed up resources across the Office for some of the other things we need. My colleagues inform me that we estimate the internal costs to which I referred—there were no external costs—to be in the region of up to £50,000.

Q27 Mr Love: For its introduction. How much do you think you are going to save as a result of its introduction?

Mr Stheeman: We will save not just purely in terms of administrative costs for the DMO, we are also saving, in my opinion, an enormous amount in terms of minimising operational risk and probably more importantly the turnaround time in which we get the results out to the market. It used to take us on average a little over 20 minutes to get the results of the gilt auction out to the market; now I believe that average is a little bit below 10 minutes.

Q28 Mr Love: In America it is two minutes. We always compare ourselves to the United States. You are introducing a system from Bloomberg which presumably originates in the United States, so why can we not match the United States with the two minutes?

Mr Stheeman: Because the type of auction system and policies around the auctions are fundamentally different to the US. Our auction process is discretionary. In other words, once we get the results in at 10.30 we actually study immediately who has been bidding; we have certain rules about concentration; we also want to make sure, because we have this discretion, if necessary, to reject bids that would potentially be bad value for money for the exchequer were we to accept them. All that

requires an element of time and assessment. In general the feedback we have had from the market and from our GEMMs in particular is that they value the DMO having that discretion and exercising it if necessary.

Q29 Mr Love: So it only cost you £40,000 internally to introduce this system and you are making some unspecified savings. Can you say any more about your discussions with the permanent secretary about the additional resource you are requesting?

Mr Stheeman: They are ongoing. We are a small office; we are approximately 80 people, just less in terms of permanent staff. It is not my desire or my intention to suddenly increase staff numbers incredibly. What we want to do, if necessary—and we are going through that process right now—is to see where we need additional resources to manage operational risk, to make sure we can continue to deliver what we can. I do not think personally that these are going to be very significant numbers but I am literally in the middle of discussions with the Treasury on that and it is fair to say that on both sides there is a recognition that there is a primary need not just for us to deliver the remit that we have been given but to make sure that there are no mess-ups in that process.

Q30 Mr Love: Let us talk about some of the difficulties. Currently £166 billion of gilts are held internationally. Do you see any problems with the appetite of international investors to take up the auctions you are currently projecting for this year?

Mr Stheeman: In general international investors like focusing on the short end of the market and that is particularly true for overseas central banks, which is also, frankly, one of the reasons why we have targeted the additional £37 billion at the short end. I do not have a crystal ball, I do not know how sterling is going to develop, I do not know how international investors are necessarily going to make their investment decisions over the next 12 months, but I think it is fair to say that sterling offers international investors an element of diversification away from the euro zone, away from the dollar bloc. I do not think that is going to go away for them, I do not think it is going to stop being a consideration in the choices that they make. Whether or not that will decline from £160 billion? I would think that unlikely; I think it will probably increase. What might potentially decline—though I am not saying it will, it is conceivable—is the percentage amount. We have seen consistently since 2002 an increase in percentage terms of gilts held offshore. Personally I have always wondered whether that will flatten off. It has not so far, so I am avoiding making any predictions. What is clearly true is that as our issuance has increased the market has become more liquid. As it has become more liquid it becomes more attractive to the international investor base and those things go hand in hand.

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Q31 Mr Love: Let us just talk about yields briefly. Yields have been going up in the current international climate and that is probably likely to continue. Are you sure we are getting the best value for money out of the system?

Mr Stheeman: Yes, I think we are. The reason why we are is that the market ultimately decides the price at which we sell our debt. If we are committed, as we are, to auctioning government debt, that process means that it is the market which decides and by auctioning we are effectively allowing the market to set its clearing level for our debt. The way the yield curve has behaved is that we have had for a number of years, as you are probably very well aware, in many cases an inverted yield curve in the UK, quite a strongly inverted yield curve, not least because of the pension fund demand at the long end. I mentioned earlier that when deficits rise—and I am not saying it is going to happen because the academics always get proven wrong on this—traditionally you will see the curve suddenly steepen and short rates come down. I believe that us targeting issuance to the short end, where rates have already come down dramatically over the last weeks, will indeed prove to be, in the current circumstances, a more cost-effective way of us raising debt than, for instance, had we decided to do much more at the longer end of potentially in inflation-linked debt where, because of the time that the market needs to absorb that debt in particular that could really have led to bottlenecks potentially and oversupply, which could have put an enormous amount of pressure in a short period of time on the long end. From that perspective, under the circumstances I think we have done the right thing.

Q32 Nick Ainger: May I ask some questions on the Public Works Loan Board? In the report on page five it identifies that the current limit of the outstanding loans is £55 billion and that the Treasury are now consulting with a view to raising that cap. Has the figure now been agreed and when will the new cap become law?

Mr Stheeman: I understand that the idea is to lay down a statutory instrument literally any day now to allow that cap to be raised to £70 billion.

Q33 Nick Ainger: It will go right up to £70 billion which is the statutory limit in the Act.

Mr Stheeman: That is my understanding.

Q34 Nick Ainger: Given that substantial increase does the Public Works Loan Board actually have the capacity to deal with such a substantial change from what I understand is currently just over £50 billion outstanding loan book to the £70 billion?

Mr Stheeman: I believe so. There is a link, if I may say so, between your question and the previous question about the operational capacity for us to be able to issue so many gilts. Effectively it means doing more of the same sort of operations but the staffing levels are something we are looking at closely. I believe that the capacity is there. The other thing I would say is that the disbursements for the Public Works Loan Board tend to be, because they are for

capital financing purposes primarily, on a much steadier basis. While we do see sudden spikes sometimes, in particular when yields move and local authorities look to take advantage of those moves in yields, for instance when they suddenly decline or when they are suddenly rising, in order to lock into what they think are advantageous longer-term borrowings, it has taken quite some time to get to this level. My guess is that it will continue to take some time to get to the higher level. One of the reasons why we have gone for the higher amount is to make sure that we do not have to come back soon and say we need to have a higher cap within too short a period of time.

Q35 Nick Ainger: You say the SI is going to be laid very shortly. Are you aware of what date it will actually be effective from?

Mr Stheeman: Not exactly. I was aware that it was supposed to be laid at the beginning of October; I understand we do not have a date. I am not sure when it will be effective.

Q36 Nick Ainger: In answer to a previous question you raised this issue of whether you have the capacity to deal with this. At what stage do you go back again to the permanent secretary and say that there has been such a significant change—which there clearly has been in recent weeks—that you really do need to address this capacity issue within your organisation?

Mr Stheeman: Clearly what I do not want to do and none of us wants to do is to wait for a situation where the Office is so stretched and colleagues are so under pressure that something goes wrong before we have that conversation; that is clearly not what we want to do. We are also cautious inasmuch as I do not want unnecessarily to add to overheads either. The view that I am taking in discussions with the Treasury at the moment has to be one for what we think are the sort of operational activities that we will see over the next three years. That seems to me a reasonable assumption and a reasonable base for us to be working along, not least because our administrative budget comes out of the Treasury's own parliamentary vote, so we need to discuss the context of that within the CSR context which binds the Treasury and the DMO as well. Clearly we will be talking to the Treasury about resources.

Q37 Nick Ainger: On page eight of the report you detail the major changes to the structure of the Board's interest rates which were effective from 1 November 2007. Part of those changes was a separate set of rates for early repayments by local authorities. Could I ask you whether fewer local authorities are seeking to restructure their debt as a result of the apparent increase in the cost of early completion of loan? Has there been any change since November last year?

Mr Stheeman: There has been a slight change as I understand and that also is partly the reason why we introduced the change in the first place. Early repayments of loans were potentially putting the exchequer at a disadvantage and all PWLB lendings

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are made from the National Loans Fund. It is not supposed to be a function to provide a capital market refinancing opportunity: we are supposed to be lending specifically for the purpose of long-term capital investment. There was a danger that under the old interest rate setting regime which we had that the National Loans Fund would potentially have been put at a disadvantage and we are not permitted to lend at a loss from the National Loans Fund.

Q38 Nick Ainger: Given the current circumstances, with a large number of local authorities now having such serious problems with the Icelandic banks, for example, that they may wish to seek to restructure their debt, but they are actively discouraged by these changes, is there any way that the Public Works Loan Board can actually assist local authorities who are facing, in many cases in some of the smaller authorities, very serious problems? Is there any way that you can assist them?

Mr Stheeman: Under current legislation it is quite hard for the PWLB to be the body to do that and that is the key issue for us. Because we are not permitted to lend from the National Loans Fund at a loss, it makes it quite hard for us to see how the PWLB could be the statutory body that would step in to facilitate that.

Q39 Nick Ainger: Was the situation so bad that when local authorities sought to pay off the loan early you were actually losing money or that you were not making as much money as you were if the loan had carried on for its full term?

Mr Stheeman: That was effectively the thinking behind the change. We do not aim to make money out of this. There is an administration fee and we receive the income for this, but it is not a banking facility in the sense that we are looking to make a margin of profit versus another margin. There was, however, a serious concern that effectively local authorities could be putting the National Loans Fund at a financial disadvantage and it was to avoid that situation that those changes were made.

Q40 Nick Ainger: Since the changes have come in and local authorities have actually seen their effect are you aware, for example, that the LGA have made representations about the changes and the effect they are having on local authorities in England and Wales?

Mr Stheeman: Yes, we are. We have had conversations and Jo has actually been to Scotland and had conversations with some of the local authorities to explain the rationale and the reasoning behind what we have done. I would not want to give the impression that this is something we do not care about or that we want to send a negative message. What we are trying to do is to explain the constraints under which we have to operate.

Q41 Nick Ainger: The problem is, given the particular circumstances, it is actually maybe going to cost a local authority which is facing serious difficulties even more to try to restructure their debt.

Mr Stheeman: That is a possibility.

Q42 Mr Todd: There is a reference on page 15 in your discussion of Objective 4 to a technical breach which occurred during 2007–08 in the prospectus for the 3.5% conversion loan. Can you expand on that?

Mr Stheeman: Yes. That was to do with the timing of operating part of the sinking fund for a relatively small amount of money in order to purchase bonds for the sinking fund of this particular issue. An error was made in the actual timing of that purchase according to what was in the prospectus.

Q43 Mr Todd: It says here that you took legal advice and did not consider it likely to result in any financial repercussions. What repercussions might feasibly occur?

Ms Whelan: The error was in relation to which six-month period something should have been purchased in. The financial repercussions would be if the error was sufficient to cause people who were holders of the stock some sort of damage then they might potentially want to recover that. Our legal advice was that there was a very minimal chance of damage occurring to somebody from this technical breach.

Q44 Mr Todd: Presumably the experience has led you to go through some additional proof-checking processes for your prospectuses.

Ms Whelan: Yes. We have obviously referred very carefully to the prospectus, but we have also updated the procedures for the people who are operating this on the desk and the follow-through checks in the control area.

Q45 Mr Todd: Last time I questioned you about the role of the anachronistic and actually nowadays inappropriate description of the Commissioners for the Reduction of the National Debt. Would that those people existed.

Mr Stheeman: They do exist.

Q46 Mr Todd: It is clear that is not their intent. I was looking at the reference in the accounts to the recharging to clients between 2007–08 where the one thing they are doing is reducing their charges to clients. How is that coming about?

Ms Whelan: Typically we are just trying to find more efficient ways of administering the funds, choosing transactions which cost less to process and that kind of thing, so there is a simplification really.

Q47 Mr Todd: Do those have any bottom-line delivery to the clients? I am just thinking how that would actually work. One of the beneficiaries is the Public Works Loans Board customers, presumably largely local government. What meaning would the reduction of the charge have?

Ms Whelan: The charges of the Commissioners for the Reduction of the National Debt are levied on government departments and the investment funds and are not related to the local government community. They would, for example, be the

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National Lottery Fund and so on. That is where those charges are going. The PWLB is separately levying charges on transactions they are processing.

Q48 Mr Todd: Indeed. Maybe I have misunderstood the table we have which is on page 46; I probably have. It says administration income fees and charges to PWLB customers go down from £4.3 million to £3.5 million.

Ms Whelan: Those fees are really a function of the number of transactions that the customers want to do and also the maturity and structure of the transactions they want to do.

Q49 Chairman: You have a target of making no factual errors in the material you publish on the website or in your printed documents. In fact there were 12 factual errors last year. Did any of those have any significant impact?

Mr Stheeman: No, they did not, is the honest answer. There were some errors. The one which arguably could have had most of a result was in particular where we released the fourth quarter gilt

auction calendar on 30 November six minutes early, but as far as we could see there was no discernible impact on the market. That was the one we felt also we should list here as being potentially one which could have moved the market.

Q50 Chairman: How many have there been so far this year?

Mr Stheeman: Factual errors on the website? I am not sure. If there have been some, I can supply you with those figures.¹

Q51 Chairman: We are half way through the year now.

Mr Stheeman: I think very few factual errors.

Q52 Chairman: Fewer than 12?

Mr Stheeman: I hope so.

Chairman: So do I. Thank you very much to you and your colleagues for attending this afternoon. We move into the next evidence now with the Valuation Office Agency.

¹ Ev 74

Witnesses: **Mr Andrew Hudson**, Chief Executive, **Mr David Park**, Deputy Chief Executive and Director of Local Taxation and **Mr David Tretton**, Director of Rating, Valuation Office Agency, gave evidence.

Q53 Chairman: Mr Hudson, welcome back to the Sub-Committee. Could you introduce your team please?

Mr Hudson: Good afternoon Chairman. I am Andrew Hudson, Chief Executive of the Valuation Office Agency. On my left is David Park, who is the Deputy Chief Executive and Director of Local Taxation. On my right is David Tretton, who is the Director of Rating.

Q54 Chairman: We will come to your annual report in a moment. I want to ask you first about the issue of ports ratings. Could you just bring us up to date factually first? How many ports have you now reviewed?

Mr Hudson: We are very close to concluding the review of all 55 ports. Mr Tretton can confirm whether we have actually completed all 55.

Mr Tretton: There are four ports where at the moment we are in discussion with the port operators about the question of rateability of some ferry terminals. We are very close to concluding that and would hope that the notices on those will be served on the appropriate occupiers within the next week.

Q55 Chairman: We have to deal with facts here. So it is 51 completed and four outstanding. Is that the position?

Mr Tretton: Yes.

Q56 Chairman: How much additional revenue will be gained by altering these ratings?

Mr Hudson: Overall we expect, looking at the port operators and the occupiers together, that the overall increase will go up from about £181 million to about £200 million. Perhaps I could explain.²

Q57 Chairman: Just before you explain it, could we be clear about the figures? That is an increase of £19 million.

Mr Hudson: That is correct.

Q58 Chairman: That is for one year annually or for the previous year.

Mr Hudson: No, that is an increase in the rateable value so the liability—

Q59 Chairman: The revenue. I asked you what the additional revenue would be.

Mr Hudson: I beg your pardon.

Q60 Chairman: That was the question.

Mr Hudson: The revenue will depend on a number of factors such as the existence of transitional relief and other factors which the billing authorities have to apply. Our responsibility is to set the rateable values and that is what will go up from £181 million to about £200 million.

Q61 Chairman: But you must have made some estimate of the additional revenue.

Mr Hudson: No, it is not our responsibility to make estimates of the revenue in the sense that having put the assessments in the rating list it is then a matter for local authorities to assess the liability and then to send out the bills.

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Q62 Chairman: Have you not seen any estimate of the additional revenue.

Mr Hudson: No; again, we would not seek to pull that together, it would not be for us to pull that together on a national scale.

Q63 Chairman: Have you seen any estimate?

Mr Hudson: No. We have obviously seen where some individual port occupiers have written in with what is happening to their own bills, but not in terms of any aggregate estimate of what this means for revenues.

Q64 Chairman: What kind of assessment would you do normally of the impact on an industry where you introduce a change of this nature?

Mr Hudson: We obviously appreciate the impact this has had on some businesses within the ports sector but what we have been working hard to do here is to get the correct apportionment of rateable value between the statutory designated port operators on the one hand and the port occupiers on the other hand. That is a matter of fact. Our job is to establish those facts and, in line with the legislation, get the rateable values right. As a result of the fresh information which has come to light and the work that we have done, where we have taken great care to establish the facts in discussion with the port operators, some assessments have gone up, some have gone down, others have stayed the same within the overall net increase in rateable value which we have just talked about.

Q65 Chairman: You said that you appreciate the impact but have you actually assessed the impact.

Mr Hudson: The impact will vary. It is very hard for us to judge across the sector as a whole. As far as individual firms within that sector are concerned it will vary considerably. Some assessments have gone up, some have gone down, some have stayed the same. Looking at the position for whole ports, where again we do know the position in terms of rateable value, though it is not for us then to move on to actual bills, for some whole ports the position has remained much the same, even though obviously we are well aware that for others there have been big changes.

Q66 Chairman: But you have not carried out an overall assessment of the impact on the ports industry.

Mr Hudson: No. Our job is to get the rateable values right. We certainly appreciate that for some businesses within this sector there have been considerable increases and we understand the impact that has had.

Q67 Chairman: You appreciate it, you understand it but you cannot tell us what it is.

Mr Hudson: What we cannot do is to provide an aggregate assessment across the sector because of the pluses and minuses, the interaction between the port operators and the occupiers. One of the issues in this review has been the sheer complexity of these arrangements, and hence trying to produce an

aggregate across-the-board impact of what has taken place on the sector as a whole would be difficult. What I would say is that as a result of this work we have carried out, in discussion with the parties, trying to be as open as possible about it, we now have the rateable values onto a sound footing. If people have difficulty with that, if they feel we have the rateable values wrong, they are welcome to come to discuss it with us. If those discussions still do not lead to agreement, they have a statutory right of appeal. Our job is to get the rateable values right, to provide a fair and consistent basis for the bills.

Q68 Chairman: In establishing a new rateable value you are also backdating it to April 2005, as I understand it. How fair is that on smaller businesses which may have already in fact paid their rates through port charges?

Mr Hudson: Some assessments are backdated, some are not. It is not something over which we have any discretion; it is a matter of how the legislation applies. Where it is backdated, we have looked into that very carefully to be sure of our ground. If the businesses disagree, they can discuss it, they have the right of appeal, and we have worked hard to be sure of our ground on that, where we think backdating is what is required by the legislation. We appreciate that some are arguing that they have effectively paid the equivalent of rates through the arrangements they have had with the operators. That is a matter between them and the operator.

Mr Tretton: We looked very carefully at the regulations which established the rules for backdating, realising that this would have a significant impact and we actually sought legal advice. This has been tested in the Lands Tribunal before just to establish that we were correct. In fact a consortium of the port operators approached us back in April contesting this issue and provided us with their opinion. We really felt, even though we have legal precedent, the need to double-check this with our advising solicitor, who also went to counsel and concluded that we had no option under the regulation, in the circumstances which were appertaining, but to backdate.

Q69 John McFall: I have received an awful lot of emails and letters on this issue. Whilst I accept the procedural arrangements which you have undertaken, it seems as though this is a huge problem. I have even been contacted by a number of MPs this morning: John Prescott came up to me this morning; Chris Mole spoke to me just before I came in here; Louise Ellman has spoken to me on it. There is real concern here and I think this is where economics and politics collide. We really need to try to assess this situation again. May I ask you about the change? Is it that rather than charging the port operators as a whole now the individual parts have been rated?

Mr Hudson: That is the direction of travel. It is a peculiarly complicated sector.

Mr Tretton: Might I expand? In most of the ports there is a statutory designated operator who controls all of the activities within the port, is responsible for

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all of the land. They have their assessment, or did until the new rating list came in in 2005, based on a formula which was quite straightforward, and there was no degree of debate around what went into the formula. From 2005 they were assessed on a conventional basis to reflect rental value. That made it more pertinent for us to identify in rating terms, bearing in mind that rating is based on an estimation of an annual rental income, to find out who was actually in rateable occupation. For rating the two main ingredients are an occupier and a rateable unit. Following a review at the port of Southampton, it was apparent there that, for the port operator, they were actually including in their assessment far more land and occupations than were correct in rating case law and precedent. That alerted us in fairness to other ports to look at those as well.

Q70 John McFall: Let me just give you a flavour of some of the letters I have received. For example, Leafe and Hawkes Limited in Hull are saying "Please be in no doubt that small companies such as ours will be forced out of business, if they are faced with enforcement for these huge back-dated rating demands" to 2005. They say "We are not aware of any consultation having been held in England with our industry prior to the introduction of this significantly revised government policy and wonder why this was not carried out". Freshney Cargo Services Limited of Grimsby say "I am writing to you because of a significant and potentially 'catastrophic' new threat to our business. The new Port rating system which has landed completely 'unannounced' threatens our very livelihood particularly in times of recession". They point out "This is not just about Grimsby and Immingham but being rolled out to 55 ports in the UK". Hutchinson Ports in Harwich say "... the VOA contrived financial figures for the port to arrive at a valuation without proper analysis and foundation, and in the clear expectation that the entire valuation will be reconsidered" and also say "The VOA has failed to communicate with occupiers on significant new rate assessments, proceeded over the past three years in an unacceptable manner". P&O talk about the repercussions for the local authority because Hull City Council is currently stalling the collection of business rates but it "... cannot decline to collect rates indefinitely and the difficulty facing P&O Ferries at Hull is a rates demand for the current financial year of £2.4 million, plus a backdated demand of £5 million". They ask us whether "... you will support our call for the implementation of the new system to be put on hold whilst a practicable way forward is pursued which could be brought in from 2010 in a fair and timely manner". I do not think all these people from all over the country have a coordinated message to us but there is a common theme here that consultation did not take place, that a huge account has landed on their doorstep and it has implications across the whole country. In a situation like that I think there is a need for reflection and consultation here so that we get this issue right.

Mr Hudson: May I just comment on a couple of things there. As far as consultation in the past is concerned, as soon as it was clear, once the issues in Southampton had been clarified, that a major piece of work was going to be needed, we wrote to all the statutory port operators in May of 2006 and asked them not only to cooperate with us and let us have the necessary information for the work that needs to be done but also asked them to contact their occupiers because they know who they are dealing with.

Q71 John McFall: Could you accept from me that the port authorities perhaps did not contact their occupiers?

Mr Hudson: I have certainly had some of the same correspondence though not all.

Q72 John McFall: So this is a big problem.

Mr Hudson: I understand entirely that has happened. I just want to make clear what we have done.

Q73 John McFall: I understand. We have a problem and we have to sort this problem out but you have this account landing on people's doorsteps, businesses have been threatened and the proper procedures, whilst you requested that they be followed, perhaps were not followed and this is a surprise to these people. We cannot really allow a situation like this to go on because your formal approach to it was correct in your eyes. We really need to assess this situation individually, do we not?

Mr Hudson: I appreciate clearly that this did come as a surprise to the occupiers who are writing to both you and me. As far as our job is concerned, we are statutorily obliged to produce an accurate rating list, which means once something like his has come to light and the facts are clarified—

Q74 John McFall: This is what gets the hair on the back of the necks of these small businesses standing up. What I am really asking you to do here is to reflect on the situation, keep in contact with us as a committee and see your way through this and if there is a need for this to be delayed to 2010 come out with a proposal which is acceptable. It is completely unacceptable for people to find a huge demand on their mat.

Mr Hudson: I understand the point Mr McFall. I am not sure it is within our gift as the Valuation Office Agency.

Q75 John McFall: Why is that? Tell me.

Mr Hudson: Because our responsibility is to produce an accurate list and the billing issues and wider issues—

Q76 John McFall: I would say to you as a select committee that if you are going to put demands on individual entities then you really have the responsibility to be aware that these entities know about that and that is the weakness in your case.

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Mr Hudson: We took the steps which we felt at the time were appropriate in order to spread the word on this. We were not seeking to be secretive about this and we are open to discussions with any parties who want to come to discuss it with us. I accept that in practice some of the people who have written in were not aware that this work was going on.

Q77 Chairman: You report to ministers. Who is the current minister you report to?

Mr Hudson: Our departmental minister is the Financial Secretary to the Treasury; on these sorts of local taxation issues it is Communities and Local Government and also Welsh Assembly where relevant.

Q78 Chairman: When you said to Mr McFall that it is not within your gift, you are able to advise ministers, given where we are, of the situation presumably and give ministers advice, if you saw fit to do so, that this may all need to be looked at again. You are able to do that are you not?

Mr Hudson: Yes. We are in very close touch with colleagues in Communities and Local Government and ministers are well aware of the situation.

Q79 John McFall: Did you brief ministers before you came here to tell them exactly what type of questions we would be asking because of all this flurry of information? If you did, I am surprised that ministers have not contacted us to say there is an issue here, a big political issue here and an economic issue.

Mr Hudson: Ministers are well aware of the issue and I saw a response to a question from Louise Ellman.

Q80 John McFall: We will write to the minister today on that and maybe invite the minister along here to this Committee, if that is okay. We need this sorted out. I understand from an official's point of view, from a bureaucratic point of view, that your answer is fine but it is not watertight in terms of us getting to the core of this problem.

Mr Hudson: There was an exchange on the floor of the House yesterday in oral questions.

Q81 John McFall: I am not worried about the floor of the House, I am worried about here. Mr Tretton nodded his head.

Mr Tretton: I was nodding really to say that it is really an element of what you were saying about clarity. The whole issue here is that in the ports you have a statutory port operator who controls what goes on in that port. They will grant licences, leases, all sorts of agreements with operators which are often for more than just to occupy the land. Perhaps with hindsight we should have done more investigative work although, that said, if you visit a port and look at what is there physically on the ground you are often no wiser in terms of who occupies what part of that without an instructed and informed view by the port authority.

Q82 John McFall: There is a weakness in your case.

Mr Tretton: It is very good looking back with hindsight. We believed, because it would have been in their interests—

John McFall: You have already said to me that you could have done more investigative work.

Chairman: You said you failed to investigate it properly.

Q83 John McFall: Exactly. What you said to me is on the public record.

Mr Tretton: I would not say that it was a point of physical investigation. We have made the inquiries with the port operators.

Q84 John McFall: Was it a mental investigation then?

Mr Tretton: No. If I may just get the reply out.

Q85 John McFall: Try to be coherent and concise in your answers because that helps.

Mr Tretton: The difficulty here is the relationship between the port operator and the individual occupants and that is what we sought to delineate. We did that until we realised it was wrong.

Mr Hudson: With the benefit of hindsight we have learned a lesson and please God this does not come up again; if it were to, we would seek to improve our communications with the occupiers as well as the operators. That is certainly a lesson.

Q86 Nick Ainger: When were you as an agency instructed to carry out this revaluation?

Mr Hudson: It was not a matter of being instructed: it is part of our job to make sure that the list is up to date. The sequence was that in 2004 there was an issue within the port of Southampton which we looked into and this led to a lengthy discussion on the issue which David Tretton has been talking about, the appropriate rateable value for an occupier. Our interpretation that the rateable value of that occupier ought to be increased because certain things were down to them rather than the port operator—

Q87 Nick Ainger: Let us just be clear. I am quoting here from a letter dated 10 March 2008 from Andrew Gausden the Group Valuation Officer, Sheffield Group to P&O On Board Services, so I presume it is P&O at the Zeebrugge Terminal Building. He says “Until 31 March 2005, the valuation of large ports was prescribed by statutory formula under the Docks and Harbours (Rateable Values) Order (2000)”.

Mr Hudson: That is correct.

Q88 Nick Ainger: “From 1 April 2005 the law changed and the formula rating of ports was discontinued”. When were you informed that the law had changed and that you would have to start a revaluation with effect from 1 April 2005?

Mr Tretton: It was part of the Local Government Act 2003.

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Q89 Nick Ainger: So from 2003.

Mr Tretton: Before that.

Q90 Nick Ainger: So you were aware that this revaluation needed to take place with effect from 1 April 2005 and you have just told us 10 minutes ago that you are still four short of the 55 ports that you were supposed to have revalued by 1 April 2005. Is that correct?

Mr Hudson: No.

Q91 Nick Ainger: It is not correct.

Mr Hudson: May I try to explain? The position is that we put the values in the 2005 list accurately on the basis of the information that we had at the time. Of course we knew about the change in legislation in good time. What then transpired was that following this particular investigation in Southampton we realised in this complicated area that questions of fact needed to be established in more detail than we had done before. In the discussions prior to the 2005 list being established we got information from the statutory port authorities, and both our understanding and theirs at the time was that those values were correct.

Q92 Nick Ainger: So you published your preliminary rateable values around April 2005, but it has still taken you three and a half years before you have completed—and you still have not completed—adjusting the original valuation that you placed on the ports back in 2005. Is that correct?

Mr Hudson: That is correct.

Q93 Nick Ainger: Exactly. So it has taken you three and a half years. Let us move on. You said that we need to have clarity here. You told us that overall the rateable value for all these 55 ports had gone from £181 million to around £200 million.

Mr Hudson: Yes.

Q94 Nick Ainger: A rateable value of around 10%.

Mr Hudson: Yes.

Q95 Nick Ainger: Can you explain therefore why in Pembrokeshire, with the ports of Fishguard and Milford Haven, the actual RV has gone up 221%, why in Felixstowe it has gone up 212%, why in Harwich, according to the information that we have been given, it has gone up 275% and there have been claims that some of the RV increases have been as high as 500%? How, given that information, can you claim that the RVs on all these 55 ports have only gone up on average by 10%?

Mr Hudson: Some RVs have gone up, some have come down, some have stayed the same.

Q96 Nick Ainger: Could you tell us which ports have gone down?

Mr Hudson: I am very happy to look at specific examples to check the information. I am not sure whether we can actually do that now this minute in terms of the impact on those ports.

Mr Tretton: The figure Mr Hudson was referring to is a cumulative effect on the ports overall. When you look at individuals, some have gone up significantly because they did not have an assessment in the new rating list. In fact part of their occupation was reflected in the statutory port occupier's assessment. What we have done here is redistribute that. In Hull, if you look at the statutory port occupiers and in some of the other larger ports, their assessments have reduced significantly because they were being assessed on information that was provided openly for property which in rating terms, following rating case law, they should not have been assessed for; there should have been separate assessments.

Q97 Nick Ainger: If that is correct, why are we getting, for example, the former Deputy Prime Minister John Prescott complaining rightly about huge increases for operators within ports yet you are telling us in Hull there has been a significant reduction in rateable value?

Mr Tretton: The scenario to picture is that you have a statutory port operator. If nobody else operated on that port at all—and we have some ports which are similar to that, certainly in East Anglia Felixstowe and Harwich are ones where the port operators have a wider control—all of the rating liability would be down to the statutory port operator. Many of these ports now, through licences, have granted other occupations and the circumstance you are referring to in Hull was that the assessment of part of the operator, a large operation in Hull, was assessed to the statutory port operator. When we investigated this following our findings at Southampton, it was our opinion that these redistributions should take place. We actually tested that because the operator in Southampton was none too happy having the large assessment so they challenged it. We went through legal procedures and prior to that appeal formally being heard they withdrew. We had an opinion that we needed to revisit and look at the ports but before we did that wholesale we checked out that legal opinion. In fact when we looked at the other operators, in fairness to what happened in Southampton, because they are all competitors and we do need to have a degree of fairness, when we visited a lot of the other ports, the example was that the statutory port operator was being assessed for occupation in rating terms which should have been separately assessed to an operator who has a licence to operate within that port.

Q98 Nick Ainger: I think you need to give us a lot more detail on this issue. I just cannot see how very major port operators are telling us that they are seeing huge increases and they are large operators and yet you are telling us that overall there is only a 10% increase in rateable value.

Mr Tretton: The overall impact, which is a global figure, is one which does not reflect, as you rightly say, what is happening to individual ports. In some of these cases these port operators, the large operators as such, although they may have believed they were paying rates through their agreement with

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the port operator—and that is a personal agreement between the two, we do not see that—they have not, from a rating point of view, had an entry in the valuation list which a billing authority has physically charged. Saying that they had huge rate increases—

Q99 Nick Ainger: I understand that point but you told us that overall the RV for statutory port operators pre-2005 was around £181 million. You are now telling us that from the beginning of April 2005 that it will be around £200 million. Am I right on that?

Mr Tretton: The point you made earlier about the process of a preliminary evaluation, the figures that were entered into rating lists at 1 April 2005 were the actual rating assessments for that list based on the facts that we had. They were compiled and placed before the billing authorities and it has been subsequent to that that following an alert from our investigations at Southampton that we then went to look at all of the ports to see whether or not a similar effect that we identified in Southampton was actually apparent. In some of the ports, over 55, there has been very little change in the actual assessments within the port. When we inspected, we did find some occupations there had not had an assessment that they ought to have had. I suspect these are the ones—

Nick Ainger: I am not disputing that. What I find difficult to appreciate is your claim that the rateable values have only gone up 10% and what the experience of large operators seems to indicate. You need to give us far more detail on that.

Q100 John McFall: Nick was making the point about John Prescott being concerned. If we look at the P&O letter which was sent to me, Hull City Council are deferring collecting rates. That is not doing them any good in the longer term but P&O say that the extra burden they face under the new assessment calls into question the commercial viability of future investment in Hull where they provide employment for 400 people ashore and 818 people afloat. They bring to my attention a letter which they received from VOA as late as March 2008 advising that there could be an impact on the business rates paid by the tenants. In that letter, paragraph five, they say “The port operator may have already alerted you to this” but it is not sure. Here we have a company receiving a demand in March of this year. I notice in paragraph two of the letter they have given me that the VOA say “... the recent visit to your property by a member of my staff”, so you were conducting some visits. There has to be consistency here. If you are demanding of people, you should have your staff talking to people. There is a loophole here. We will not get anywhere today with this. What I want you to do Mr Hudson is to go back to your relevant ministers and talk to them about it and see that we, as a committee, get a letter from the ministers on this issue so that we can plot the way forward. I would suggest that we keep this as a pending item on our agenda so that we get a satisfactory outcome to this problem.

Mr Hudson: I shall obviously report to the minister on the discussion we have had.

Q101 John McFall: What I am asking is that you report to the minister, you tell the minister to contact the Committee because we shall be writing to him as well on that. What I am saying is that this is an issue which is going to be taken at ministerial level now.

Mr Hudson: As I think is clear, ministers are well aware of the issue and the strength of feeling about it and the impact that it is having in certain quarters. I will of course pass on the Committee’s wishes.

Q102 Mr Todd: From an issue which sounds as though it may have been self-inflicted to some extent to one which is inflicted upon you, which is the change in the position on business rates on empty property, what sort of feedback have you found in that? Have you found a lot of applications from businesses where empty property is now being rated for some sort of relief?

Mr Hudson: We have had something like 3,500 proposals strictly speaking—appeals in colloquial language—since April, which we think are related to the changes in the regime. It is a bit hard to judge to be absolutely strict what is and what is not associated with that. So that is the number.

Q103 Mr Todd: Is that backed with any evidence of people deliberately damaging their property in such a way as to remove it from a liability for business rates if it remains empty?

Mr Park: May I just add to the first response? That is the number of formal proposals that we have had. We have also fielded quite a number of enquiries and provided some advice to people which may perhaps double the number of approaches that we have had in total. So far as our observation on the ground is concerned, no, we have seen very limited evidence of what we might call deliberate vandalism to a property. Most of the cases we have seen have been around questions of the state of disrepair such that people believe the property should not be valued to any significant degree and also we have had arguments around obsolescence, the overall letability of a property if you like, because, for whatever reason, it may have passed its normal life in terms of potential use. We are aware, though we are not directly involved, of the fact that a number of people would make approaches to billing authorities concerning liability. Sometimes they come on to us to raise a query as a result of that. Many of the contacts will have been on the payments rather than on the assessment.

Q104 Mr Todd: What sort of percentage of these applications has been successful to date? As you say, there are several technical arguments which could be presented and which lead to relief.

Mr Park: We have resolved about 25% of those so far.

Q105 Mr Todd: When you say “resolved” have you resolved them in the favour of the applicant?

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Mr Park: I was going on to say, and this is not evasive, that it is actually quite difficult to answer that question. The reason for that is that in some cases they are properties which may have been in the list for a time where people have had a right to make a proposal, to challenge the assessment, but have chosen not to do so. This may have been the occasion on which they did so. In some of those cases yes, we have made reductions, but that has not actually been because of any particular disrepair or whatever, it is simply because in that case, having looked into the matter and taken a view, we may have adjusted the value. It is not strictly related to empty property rates.

Q106 Mr Todd: Just to wind up, you will be aware that at a point where we appear to be entering into a recession there may be lots of people who will say this is an unfair levy on a property which cannot be let, for which there is no market. How are you going to address that argument that a property, while vacant, may simply not be lettable in the local context of a market for that sort of premise?

Mr Park: For us a change in empty property rating is only a matter of the timescale and extent, so it has been extended to industrial properties. The principle underlying it, as to whether something is in a state of repair to be let or obsolete, is in fact something which has always been an issue which we had to address on occasions. It is really that we are getting more cases of that nature but the principles we apply and the approach we use are no different. Clearly if something is in substantial disrepair and should not carry a significant value to it then we are quite happy to make that adjustment.

Q107 Mr Todd: Have you communicated the sort of volume of activity on this to HMRC and to the minister?

Mr Park: To our policy department: in this case, obviously Communities and Local Government. Yes, we have kept them very much in touch with what has been going on.

Q108 Chairman: How many of your council tax valuations have actually moved homes to lower bands? I have seen a figure of around 70,000 over the last 10 years have been moved into higher bands. How many have moved into lower bands approximately?

Mr Park: Ever since council tax was introduced—

Q109 Chairman: Since 1997.

Mr Park: Since 1997 I am not sure I can give you an immediate figure but we can let you have that.³

Q110 Chairman: Can you let us have note on that? Have complaints about banding increased or decreased?

Mr Park: We certainly have had a large number of enquiries over the course of the last year.

Q111 Chairman: You have to answer the questions Mr Park. Have they increased or decreased?

Mr Park: Complaints as such have not varied very much in number overall, if I take complaints as a complaint about something we have done. Enquiries for change have increased quite a bit and the number of proposals has increased significantly less.

Q112 Chairman: Mr Hudson, your staff survey revealed low staff satisfaction and in fact I think you have had a period of industrial action. Can you explain to us how that happened?

Mr Hudson: One of the main reasons was last year's pay settlement which staff found difficult. The staff survey also came shortly after we had announced some restructuring proposals and a number of offices were the subject of consultation about closure. I am glad to say that in the staff survey we took in June staff satisfaction picked up from 53% to 58%, so we are on the up. Going back to your previous point about complaints, I am glad to say that customer satisfaction is at an all time high.

Q113 Chairman: On staff morale are there more redundancies to come?

Mr Hudson: We, in common with a lot of departments, have reductions in our budget so the number of staff will continue to reduce. We are doing all we can to achieve that by natural wastage.

Q114 Chairman: So there will not be any compulsory redundancies.

Mr Hudson: We have said we will do all we can to achieve it by natural wastage.

Q115 Chairman: So there could be some compulsory redundancies.

Mr Hudson: We are doing all we can to achieve it by natural wastage which we have managed to do in previous restructurings without the need for compulsory redundancies.

Chairman: I accept that.

Q116 Nick Ainger: You told this Committee last year that you intended to reduce your staff numbers by 230 in 2007–08. Did you do that?

Mr Hudson: Yes, and we probably did a little bit more because we finished 2008 round about 4,000 or a bit short; we are now at 3,800. We continue our downward trajectory.

Q117 Nick Ainger: You also told us that you intended to reduce in this financial year by a further 190. Are you going to do that as well?

Mr Hudson: We are on track to do that.⁴

Q118 Nick Ainger: Given the pressure, not least from the port industry, on your level of work, how are you able to meet the demands of your customers?

⁴ *Note by witness:* The position on staff numbers is that, as shown in the Annual Report and Accounts (p55), the average number of full-time equivalent staff employed fell from 4,428 in 2006–07 to 4,096 in 2007–08. While no formal projections are published, the number in post at the end of September 2008 is around 3,800.

³ Ev 75

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You say you are having very high levels of satisfaction but given quite significant reductions in staff numbers how are you actually maintaining the standard of your service?

Mr Hudson: I am glad to say—and I pay tribute to our staff here—that we are improving value for money, we are sharpening up our processes, better investment in technology helps and we are able to do this. On the ports front, clearly that is a matter of pretty specialist staff rather than numbers where we are able to reduce.

Q119 Nick Ainger: That was an aside.

Mr Hudson: I wondered whether it was.

Q120 Nick Ainger: Have you taken on any more consultants in replacing? Have your costs for consultancy increased during this time of staff reduction?

Mr Hudson: Not systematically. Where we use consultants it is only where we need a particular skill or a particular job to be done that we do not feel we have the skills to do in house. No, we do not have a systematic policy of losing permanent staff and replacing them with consultants.

Q121 Nick Ainger: The figures in the report show that up to 31 March 2007 you spent £140,000 on staff consultancy and it is increased at the end of March 2008 to £246,000, an extra £100,000 on consultancy.

Mr Hudson: Yes; I am aware of that. However, these were for specific projects. Quite a lot of it is IT consultancy where, rather than make recruitments if there is something specific which needs to be done short term, it is better to bring in a consultant rather

than hire somebody permanently. Yes, in 2007–08 we spent a certain amount more on that than in 2006–07.

Q122 Nick Ainger: So it could go down in this financial year?

Mr Hudson: It could go down. Whether it will or not, I do not know, but the principles are the same.

Q123 Chairman: Your merger with The Rent Service will take effect from April. What are the recurrent savings as a result of that merger?

Mr Hudson: Next year we expect the costs to the Department for Work and Pensions of that activity to be about £28.5 million compared with £37.5 million this year. That is an estimate so there are many things wrapped up in that. The biggest difference is actually that the volume of work on housing benefit activity is reducing. The savings that we make, particularly for instance as The Rent Service is closing down all its offices so all its staff are coming into existing VOA accommodation, mean there will be economies of scale of that sort.

Q124 Chairman: So it is about £9 million.

Mr Hudson: Nine million is the reduction in the cost of that activity; part of that is because the volume is coming down.

Q125 Chairman: Are any staff from either your Agency or The Rent Service losing their jobs?

Mr Hudson: There is a reduction in staff numbers inevitably to enable us to realise that sort of saving and The Rent Service have conducted a voluntary redundancy programme to deliver that.

Mr Park: Yes, they had an early retirement scheme which has been available for people to apply to.

Chairman: We are going to leave it there. May I thank you very much?

Witnesses: **Mr Trevor Llanwarne**, Government Actuary and **Mr Kevin Down**, Director of Finance, Government Actuary's Department, gave evidence.

Q126 Chairman: Mr Llanwarne could you formally introduce yourself and your colleague please?

Mr Llanwarne: I am Trevor Llanwarne. I am the new Government Actuary, appointed from 1 May this year, and on my right is my Director of Finance Kevin Down.

Q127 Chairman: Welcome to the Sub-Committee. I am sorry we have kept you waiting slightly. This is your first appearance so perhaps you could explain to us how your previous experience has equipped you to be Chris Daykin's successor?

Mr Llanwarne: Good question. I have joined here as the Government Actuary from 1 May. My background is pensions, although I have worked in life insurance as well for 10 years. I was head of the pensions operation at PriceWaterhouseCoopers on the actuarial side and I was responsible for quality and risk for the final three years of that period. I think I have a very good overall rounding of matters actuarial and with particular reference to pensions.

Q128 Chairman: Why did they take seven months to find you?

Mr Llanwarne: I was on 12 months' notice with PWC.

Q129 Chairman: In what areas of the Government Actuary's Department do you think you are going to be able to make an immediate contribution?

Mr Llanwarne: I would hope in all areas, to be frank. Although insurance is something of which I have not had much experience for many, many years, we do do some insurance work, as you will have seen from the report, and I have managed within the first few weeks to make sure that we restructured the insurance operation so that it has started getting back on track in delivering services to clients. I appointed a new head of insurance in that period and I think it would be fair to say that it is running full steam ahead as opposed to where it was in the early stages.

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Q130 Chairman: The annual report, which I know concludes just before you started, highlights some quite serious difficulties you have had with understaffing in the Department. How are you addressing those?

Mr Llanwarne: There is a number of areas which had to be addressed. However, I can give you some updated figures because as of 31 March our total was 96 and it was about 100 a year earlier. We are already at 105 as of now. The key issue, as I saw it, was to have a properly motivated personnel department and actually address that first. We have addressed that and I believe we have a very strongly motivated head of HR and a department that is all working onside. We are now having absolutely no problems getting recruits coming in.

Q131 Chairman: So you are not struggling to recruit the right calibre of staff now.

Mr Llanwarne: No; not now. I think it is for two reasons: one is what we have done in relation to the HR department itself, but also it is certainly true that the market for actuaries is different to what it was 12 months ago. It is easier to get people now.

Q132 Chairman: Bonus payments last year increased from £23,000 to £37,000. Can you explain that?

Mr Down: That was an increase in the non-consolidated bonus payments. Previously every member of staff in the Department received a bonus of the same amount so it was a very small bonus. We changed that to a performance-related bonus.

Q133 Chairman: Every single member of staff got the same bonus. Is that right?

Mr Down: In previous years, which was not performance related and made no sense at all.

Q134 Chairman: So it was not a bonus.

Mr Down: Exactly. What we did last year was to change the system to make the bonuses performance related so they actually relate to staff performance.

Q135 Chairman: On the issue of data protection, you report no personal data-related incidents in 2007–08. Is that still the position six months on?

Mr Down: Yes, it still is.

Q136 Nick Ainger: Could I quote you from an article by John Ralfe in the *Financial Times* of 14 July 2008? This is just an excerpt about the mineworkers' pension fund. "An analysis of the actuarial valuations since privatisation, obtained under the Freedom of Information Act, shows that the huge payments to government and members are being made from fictitious surpluses. This is because the method of actuarial valuation, set down by the government actuary, understates liabilities by discounting at the 'expected return on assets', including 70% equities, not the index-linked gilt rate, which would better reflect the fact that pensions are inflation-linked and government guaranteed. On an index-linked gilt basis, there was a £0.9bn deficit at market values at the (latest) 2005–06 valuations, not the reported £1.9bn surplus. In 2002–03 the deficit

was a whopping £5.3bn at market values, rather than the reported £0.7bn deficit." I do not know whether you accept those figures but Mr Ralfe does seem to indicate that rather than miners and the Government, who take 50% of these surpluses, benefiting from genuine surpluses we are actually paying out from the core of the pension fund rather than from surpluses. Do you have anything to say about that?

Mr Llanwarne: The first thing to say is that, as you will understand, actuarial valuations in relation to the coal schemes were done by my predecessor rather than me. In getting my feet under the table the two coal schemes, the Mineworkers' Pension Scheme and what they call the BC triple S, the staff pension scheme, are two where valuations are up and coming fairly shortly. It is very important to understand a big difference between schemes like these and a lot of the public sector schemes. There is a big difference between those and the traditional private sector schemes. Although I do not know the detail of the figures you are quoting, so I would not wish to comment on that without looking at it more, I would say—and this is important—that the way private sector pension schemes are run is quite different to the way in which these schemes are run. These schemes basically have a government guarantee relative to benefits in them and therefore it is much more of an issue as to what is that balance between Government and the trustees as to where all parties want it to be. To apply traditional funded private sector approaches to schemes which are run in quite a different way and with this guarantee which you do not get in other schemes certainly is something where I would be flagging at this point that you should not be applying traditional approaches. I do not know but I do wonder whether traditional ways in relation to the private sector have been applied to these schemes which are quite different. It would be quite tough for me to go into more detail because I have not done the valuation yet and I do not know the numbers.

Q137 Nick Ainger: What Mr Ralfe seems to be arguing is that the actual surpluses are not there. Irrespective of how a particular scheme operates and whether there is a government guarantee behind it or not, his argument is that there were no surpluses and yet there was a significant distribution to members and to the Government who took 50% of those surpluses. Bearing in mind this was a direct criticism, admittedly not of you but of your predecessor and the Government Actuary's Department, was there any rebuttal? Did you issue any response to this? It is a direct criticism of your work or the Department's work.

Mr Llanwarne: I think you will understand that any rebuttals or whatever in relation to press articles—and there are quite a number of press articles; governments get into the same position more generally with press articles—would have to be done in conjunction with the trustees of the pension scheme and it would be totally inappropriate to do that independently in my view. No, there was not a rebuttal but I would say to you that if you go and

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look at any valuation report of any private sector pension scheme you will get three or four different numbers for surplus on three or four different bases. There is not one unique number as to what the surplus is or not. What is critical about this pension scheme is that the way in which the valuation is done is set out in specific legislation relating to it as to what you do, how you calculate the surplus and it is reasonable to do that because, unlike the private sector, where it is absolutely critical that you get things in balance between your assets and your liabilities, this one has the underlying government guarantee which makes it quite different. When someone asks whether the surplus is this or that, I will say to you that if you do your calculation on one basis you get that surplus, if you do your calculation on another basis you might get another surplus or a deficit and I would suggest that in relation to this, I do not think it is going to be too long before I have to sign up to a valuation on these schemes and then it may be better for you to raise those questions in relation to anything I produce at that time.

Q138 Nick Ainger: The concern is that, because there is that government guarantee, if Mr Ralfe's analysis is correct and we are paying out these surpluses not actually from surplus but from the basic underlying investment, ultimately the taxpayer, because there is that government guarantee, will have to start paying, which is something obviously we would not wish to do if errors have been made.

Mr Llanwarne: I do not think errors have been made. In a lot of these areas you have to be very careful. The taxpayer over the last 10 years has actually won. Somebody else, whom I do not know, actually did a rebuttal saying the taxpayer has gained enormously over the years from the way this has been running and if it had been done in the way John Ralfe suggested, this person wrote, the taxpayer would have been far worse off. Because this runs over many years I would suggest you do have to look at things in a wider way.

Nick Ainger: It will be interesting to see once you come up with your valuation what your estimate of the surplus is.

Q139 Mr Todd: I am not sure what the rewards of your job are but the website of the government actuaries list your illustrious predecessors and all but your immediate predecessor ended up with knighthoods and every single one of them gained some additional decoration as well, including Mr Daykin who became a Commander of the Bath or something like that; I am not familiar with these but no-one has offered me one. I note that non-monetary reward which appears to be guaranteed to the post. May I ask about the new competitive environment of the Government Actuary which succeeded the Morris review? How is that working out?

Mr Llanwarne: I think it is going well, if I am honest. I come from a private sector background, I am used to competition and I am guessing that is one of the reasons why an outsider was appointed to this, because it is a new environment. I welcome it quite

frankly because I do believe that once you are in a competitive environment you start looking much more carefully at what it is that matters to the clients. It is critical that I deliver that service to the clients as opposed to just saying—which tends to happen if there is not competition—we will be the determiner of the quality of the service. The post-Morris environment says the clients should be the big determiner of the quality and that significantly sends up the type of work we do and what we do as a result.

Q140 Mr Todd: Does the downturn in the Department's income suggest you are losing some market share?

Mr Llanwarne: We were.

Q141 Mr Todd: You were but now you are not?

Mr Llanwarne: No, the income for the first six months, which you will not have received yet, shows we have turned the corner and it is going up again because we are focusing on what the client is specifically asking without whatsoever reducing the quality of what we do.

Q142 Mr Todd: Mr Down mentioned your bonus scheme change which I must say sounded necessary. Are bonus schemes related directly to improving the market share of the Department? Are they based around that principle or income generated or what?

Mr Down: Based on the staff performance system. All members of staff receive an annual assessment and depending on the markings in that it is based on that.

Q143 Mr Todd: It is not related in any sense to the outcome of tenders you presumably make.

Mr Down: No, the current system is not.

Q144 Mr Todd: The Ombudsman produced some criticisms but again this relates to a period long before your time; criticisms of the Government Actuary's Department in the inquiry into Equitable Life. I am sure you will have read the Ombudsman's report because the Department was heavily criticised. Do you have any reaction to that outcome?

Mr Llanwarne: No, is the simple answer. The Government are going to give their response shortly.

Q145 Mr Todd: We know that.

Mr Llanwarne: It would be quite wrong for me to say anything in advance of that.

Q146 Mr Todd: Do you think this will have any effect on the reputation of the Government Actuary's Department or do you feel this was all so distant in the past that your customers will not have particular regard for that?

Mr Llanwarne: Firstly, I do not feel it will have any impact. Secondly, we have done surveys of our clients in the few months I have been here and it is not coming out whatsoever as an issue. One of the points which is perhaps worth tabling on this is that nobody in the Department as it is was involved in doing the insurance work that related to whenever it

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was done. That is not to imply any criticism whatever; it is simply a matter of fact. Purely as a matter of fact, that does significantly help in terms of our relations with our current clients. We are not hitting any problems whatsoever.

Q147 Chairman: I want to come back to Mr Down on the point about the income. In February 2008, right towards the end of the year, your spring supply estimate estimated your forecast income at £12,906,000 just a month before the year end, yet the actual outturn was £10,093,000. Why was there such underperformance?

Mr Down: This is because the figures in the supply estimate are a lot higher than the actual outturn.

Q148 Chairman: Why?

Mr Down: Historically GAD worked under what used to be called net running cost control whereby you had your gross expenditure target, you had your appropriations in aid which covered that and then

you had the net outturn below that. It was the net control total which was the target we worked towards. Within the supply estimates we need to allow some headroom because Parliament only authorises certain amounts of receipts to be appropriated in aid against expenditure. We have to allow a certain headroom within the supply estimates in case a client comes to us and there is a sudden upsurge in work in February/March time. We would not be able to do that work for the clients if we did not have that headroom. At the time when we produced the supplementary estimate our forecasts were in line with the outturn.

Q149 Chairman: But the headroom you sought was £3 million.

Mr Down: That headroom is historic; over time that figure has been there. It is the net total figure which we work towards with our spending team.

Chairman: We will leave it there. Thank you both very much.

Wednesday 22 October 2008

Members present

Mr Michael Fallon, in the Chair

Nick Ainger
Mr Graham Brady
Jim Cousins
Mr Andrew Love

John McFall
Mr Mark Todd
Sir Peter Viggers

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

Q150 Chairman: Permanent Secretary, could you introduce yourself and your colleague formally for the shorthand writer?

Mr Macpherson: I am Nicholas Macpherson, Permanent Secretary to the Treasury, and on my right is Louise Tulett, who is the Financial Director.

Q151 Chairman: We are here to review your annual report and performance over the last year. I note from page 14 that your objectives are to maintain a stable macroeconomic environment and promote efficient stable financial markets. Yet over the last year the British economy is suffering from a massive collapse in asset house prices, has been over exposed to the downturn of financial services and the financial market has been so poorly promoted that five of our banks have needed public support. Has the Treasury not failed?

Mr Macpherson: I think I would be the first to agree that it has been a very challenging year for Her Majesty's Treasury. The organisation has been having to cope with and address challenges on a very broad front. Have we succeeded or have we failed? On the positive side, I think we are moving to a far more stable situation for the banking sector following the recapitalisation of 10 days or so ago. On the wider economy, clearly we are in very difficult conditions, certainly the most difficult I have seen in a long time, and what is making those conditions particularly complicated is that this is not just an isolated set of events in the UK—if it were, the policy response would be rather easier—it is a global set of circumstances which are creating real pressures and problems right the way across the world, and you have seen that over the last week with a number of countries having to go to the IMF, Iceland being perhaps the most striking example, which is having quite big implications for us.

Q152 Chairman: But your objective was to have a stable economic environment and efficient and stable markets. This is a massive policy failure, is it not, by the Treasury?

Mr Macpherson: If you think that it would have been possible to maintain inflation at 2%, steady growth through the last year and a thriving banking sector, given the conditions which exist both in the UK and across the world, that just simply is not possible at times like this. I think the Treasury has done a good job in these circumstances but I fully

accept that conditions are very challenging. Inflation is 5%, the budget deficit has increased through the year—these are difficult circumstances. All we can do is try and ensure that policy is in the right place to deal with those conditions.

Q153 Chairman: You referred to sound public finances. You were supposed to be borrowing £43 billion this year. You have already borrowed £37 billion. Is there no upper limit on the amount of money you as accounting officer will allow ministers to borrow?

Mr Macpherson: What is driving the current public finances is a revenue effect primarily. If you look at both sides of the balance, it is a problem around revenue. As accounting officer, we are not in a world of tax-farming where I am required to go out and get a certain level of tax.

Q154 Chairman: What is the answer to my question? As far as the accounting officer role is concerned there is no upper limit over which you will not allow ministers to borrow?

Mr Macpherson: As accounting officer I have clear responsibilities in relation to both the level of spending in the Treasury and also for various key funds, like the Consolidated Fund. If we were in the business of spending money which Parliament would not permit or had not agreed to, then I would have a real problem as an accounting officer, but we are in challenging times. For example, only last week ministers came to Parliament for an out of turn supplementary estimate. These are very challenging conditions and in some places spending will be higher.

Q155 Chairman: So there is no limit on what ministers can borrow, in your view, as accounting officer?

Mr Macpherson: Ultimately, the limits are partly defined by Parliament in terms of the taxes you are prepared to raise and the spending you are prepared to agree to but also the markets, in that, ultimately, borrowing has to be financed.

Q156 Chairman: But we cannot rely on you to set the limit. The out of turn estimate that you have just referred to, you requested £4.6 billion for Bradford and Bingley and £600 million for the transfer of deposits. In the memorandum provided to us you

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explain that the net payments were actually lower—£4 billion and £595 million—because you had an off-setting payment. Why were these payments made to you by Abbey and ING and why did you request a gross rather than a net figure in the estimate?

Mr Macpherson: I will ask Louise in a minute to explain the accounting side of this, if I can home in on the substance. The money relating to Bradford and Bingley was that part of the deposits which were effectively sold to Abbey Santander, which was not covered by the Financial Services Compensation Scheme. My recollection is that there was something like £18 billion worth of deposits, £14 billion of which will be paid for by the FSCS. That leaves the remainder. We received, I think, £600 million from Abbey Santander for the branches and the deposit book, in effect, and that will obviously net out. Louise, do you want to explain why we have to get an estimate for 4.6 rather than four?

Ms Tulett: The estimate requires not only cash but also the authority to spend money, and, therefore, in keeping with normal supplementary estimates, we would have asked for the authority to spend the gross amount and then we have surrendered the receipts over to the Consolidated Fund. So the advance from the Contingencies Fund was a request not only for cash but also the expenditure authority.

Q157 Chairman: Has the accounting treatment for these two transactions been agreed with the NAO?

Ms Tulett: No, it has not yet. We are in the process of actually working through the fine detail of those and, once we have settled our proposed treatment, we will pass that to the NAO for their comment.

Q158 Mr Todd: Last year you managed to produce resource accounts for us which I think we congratulated you on. This time round you produced your resource accounts after the production of your annual report. There was a delay. Was there a reason for that?

Mr Macpherson: Yes, a very good reason. First, we welcome the fact that you welcomed what we did the previous year, which is to try and get a single report out promptly, and in the previous year that was possible to do in June. This year—it relates to the previous question about Bradford and Bingley—there were particularly tricky accounting issues around Northern Rock. We were determined to get our report out before the summer, but there was a point in July when it looked like there was a real possibility that we would not resolve those accounting issues with the National Audit Office this side of the summer. We took the decision that we had to get something out there, so we published the annual report. As it happened, within a week, we did resolve those issues, so we got the accounts out too. Personally, I would much prefer to have these things in one document—it is easier for you and it is easier for us—but we had to make that judgment. I would very much hope that we can resolve any accounting issues in good time next year to ensure that we publish a single document in the summer, but we have been in slightly new territory in the last year and it was genuine technical accounting issues which

had to be worked through, not the fact that we were not extremely open with the NAO or that the NAO somehow—

Q159 Mr Todd: Was there an issue of timeliness, because the commitments over Northern Rock were quite some time before the requirement to produce your annual report or resource accounts? There were clearly some issues to resolve, but was there a problem of timeliness in discussing the matter with the NAO?

Mr Macpherson: I think one of the problems was that Northern Rock was nationalised fairly late in the financial year. Louise, you were actually involved in these discussions.

Ms Tulett: Yes, the conversations were around not only how the investment would appear on the balance sheet but also around evaluating the guarantees that were being given. We did not end up in any particular dispute with the NAO around the treatment of these items. In fact, you will note that the departmental report's unaudited figures did not move between the departmental report and the actual accounts being published. So, even though they are called unaudited in the 2007–08 outturn, in the departmental report they are consistent with the figures that eventually appeared in the annual accounts. There was no major shift. It was not only around the accounting treatment but also around the quality and the depth of the disclosures that we were discussing, but we did not at any point have a dispute with the NAO. We wanted to make certain ourselves that the information that we presented to the NAO for audit was robust and was something that we would recommend to the accounting officer to publish, and then the NAO, quite properly, had to take a proportionate amount of time to do their due diligence around that and to come to their conclusion that that was a true and fair representation of the situation.

Q160 Mr Todd: Since the Treasury has gone further into this line of business, presumably some of the principles established, in accounting terms, have now been determined so that you do not have to go through this exercise once more. Am I right in thinking that? All organisations are slightly different, but, nevertheless, the principles, in accounting terms, are likely to be established from the first experience?

Ms Tulett: Indeed. We have learnt during the course of that, and we also, obviously, have had the advantage of these events happening a lot earlier in the financial year than the Northern Rock TPO, and, indeed, we have to appreciate the full impact of these in order to do our winter and spring supplementaries. So we are on the front foot.

Mr Macpherson: In Treasury traditionally the accounts have actually been quite simple and easy to do. We are going to be in a more complex world. We have got Bradford and Bingley, we have got a number of Icelandic banks which, like it or not, we are going to be having financial relationships at least with the administrators thereof. The recapitalisation has not actually happened yet, and some of the votes

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on those recapitalisations, in particular the one around HBOS and Lloyds TSB, will not actually take place until December. We are going to try and be ahead of the curve on this and anticipate accounting issues, but you should be under no doubt that the Treasury's accounts this time next year are going to have bigger numbers in them and they are going to be more complex numbers.

Q161 Mr Todd: I think we were thinking that might happen. Presumably you are also going to need to address some of the other aspects of the package recently announced. There are some notional liabilities, at least, involved in some of the commitments made of guaranteeing inter-bank lending, and so on, which, again, will require careful consideration in accounting terms. Have you started that?

Ms Tulett: We have, and we are very alive to those. The detail of those will be further explained in the winter and spring supplementaries as well as in the accounts.

Q162 Mr Todd: Looking at your accounts previously, those sorts of liabilities have tended to be left as noted but unquantified?

Ms Tulett: Yes.

Q163 Mr Todd: Is that the direction that is going in or is it rather too early to say?

Ms Tulett: I think you can be assured that whatever we put into our accounts, the NAO will make sure we represent a true and fair position of our situation.

Q164 Nick Ainger: In your resource accounts you have published the details of bonus payments to six senior staff out of the 16 members that are names unpublished. They are described as "senior management". Presumably they are all on the Treasury Management Board. What particular successes had those six achieved, including your good self, Mr Macpherson, to actually receive a bonus payment?

Mr Macpherson: First, we published these details for the first time, reflecting this Committee's recommendation, so I am very pleased that we have done that. Secondly, just to be clear, the bonuses relate to the year prior to which they are paid, so they would relate to achievements in the year 2006–07. I think 2006–07 was, as I recall, a reasonably successful year, meaning these bonuses will reflect performance across a range of objectives but at their heart is an outcome focus. Finally, I should just be clear what bonuses are. It has been government policy over quite a long period, in particular, for the senior Civil Service to remunerate more through what I would call variable pay, also known as a bonus, and less through consolidated pay. It is tempting to look at these and think, "Gosh, here is some addition", but actually these aspects of remuneration fall within the overall pay remit, and so, on the whole, people have been getting less money through consolidated pay and rather more through this mechanism, which also, from a value for money point of view, has the advantage that

these bonuses are not pensionable and, because they are not consolidated, any percentage increase the following year will not cover this level of remuneration.

Q165 Nick Ainger: You did not really answer my question. Obviously six out of 16 implies that 10 members of the senior management board were not performing as well as the others, and Ms Tulett is included in that.

Mr Macpherson: I am sorry, I should have explained that. Where people's bonuses are not recorded, it is because either they did not receive a bonus for performance reasons or at that point they were not a member of the Treasury Board and so they are not covered. I do not want to embarrass Louise, but I think she has been, under difficult circumstances, performing really well, so I would hope that there would be a bonus against her name the next time we publish some accounts.

Q166 Nick Ainger: But it would be helpful if actually that could be explained, because that is published in the accounts and implies that six people out of 16 have achieved their targets or have gone past their targets and the others have not done that.

Mr Macpherson: If we have not made that clear we will seek to be even clearer next year.

Q167 Nick Ainger: We are pleased that you have published what you have published, but in a parliamentary answer it has been revealed that there, in fact, have been a total of 459 bonus payments made by the Treasury in 2007–08. Why did you not disclose the details of the bonus payments made to Treasury staff as a total, which was a recommendation that we did make and which was accepted by the Government?

Mr Macpherson: If we have failed to do something which we agreed to, we certainly need to look at that. I would be very happy to look at that anyway. I would not want to get into a situation where we are publishing information about relatively junior staff, because I think there is an issue around confidentiality, but your point is a perfectly good one, which is that you need to know about how much we spend on remuneration and we need to break down what that remuneration is.

Q168 Nick Ainger: It was perfectly all right to reveal it in a parliamentary answer; presumably it is perfectly all right to put it into the accounts?

Mr Macpherson: Absolutely, and we are always seeking to improve the quality of the accounts.

Q169 Nick Ainger: Okay. Can we move on to bonus payments in the newly nationalised banks? It has been reported that Richard Pym, the Chief Executive of Bradford and Bingley, is due to receive a bonus of £300,000 for his performance in 2008. Is it the intention to pay this bonus to someone who led his institution into nationalisation?

Mr Macpherson: Richard Pym. I am trying to remember which name is which. He is the Chief Executive of Bradford and Bingley?

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Nick Ainger: Yes, now employed by the Treasury?

Q170 Mr Todd: Fairly recently, I think.

Mr Macpherson: I think the issue here is that he was recruited very recently indeed. The problem facing Bradford and Bingley as it sank towards its demise was that it was very difficult for them to recruit anybody at all. My guess is that the only basis on which they would get Mr Pym was to guarantee certain payments. We are putting governance in place around B&B and we will have to see what is a contractual commitment and what is not. I cannot give you an answer on that right now.

Q171 Nick Ainger: It is an important issue. The committee were recently in Tokyo looking at the Japanese experience, and one of the things that we were advised by those that had gone through the Japanese banking crisis 10 years ago was the need to carry public opinion with events such as nationalisation of banks, and it is not going to carry public opinion if someone who appears to have failed in their responsibilities, which has led to the demise of their institution as a publicly quoted institution which had to be nationalised, is going to receive a bonus. I hope that this is a matter which is under review, because public opinion will not accept performance-related pay for failure.

Mr Macpherson: I think you raise a really good point, and it certainly informed the announcement of recapitalisation 10 days ago. It was made very clear in that announcement that certain people would be leaving their institutions without a bonus. Public opinion does matter on this, especially when taxpayers' money is at stake, and we take the issue of remuneration very seriously and we will in any regime which is put in place for the future. The problem on these occasions—and I think it happened with some of the people on the Northern Rock Board who fell by the way side through last autumn—is where there is a contractual commitment. Some people may choose to waive that commitment, and that is, I think, an honourable thing to do, but I do not want to get into the individual circumstances of Mr Pym because these issues, at an individual level, can be quite delicate.

Q172 Nick Ainger: Just for the record, if it is decided that he should leave his post by mutual agreement, he actually stands to receive £1.5 million for ending that contract. Let us not go into the detail of that, but will that payment, if it is made in those circumstances, appear in the resource accounts for 2008–09?

Mr Macpherson: I certainly would hope that that payment would appear in Bradford and Bingley's accounts, and given that the rump of Bradford and Bingley is still operating, it will have to account very clearly for its actions. Obviously, the Treasury is accountable in terms of the framework under which Bradford and Bingley will operate from hereon, so it will be a matter of public record, and you can rightly hold us to account in terms of how remuneration operates.

Q173 Nick Ainger: But will it appear in your accounts for next year?

Mr Macpherson: I would not think so, because there was no record, for example, of the Northern Rock---. For some of this period in these accounts Northern Rock was in public ownership but we do not consolidate Northern Rock within the Treasury's accounts, but it will be very public and you can hold us and, indeed, the banks to account, because you can call the relevant people before you.

Q174 Chairman: Mr Macpherson, just to be clear, these are now, in effect, departments of the Treasury, so we would expect their accounts to be available to us or grouped with yours.

Mr Macpherson: They are nationalised industries effectively.

Q175 Chairman: Accountable to you.

Mr Macpherson: They are accountable to us. We are responsible for ensuring that there is public accountability here and that their accounts are very clear, and our accounts need to factor issues around them into our reports, just as we do now with the Bank of England, which is another nationalised bank. The Bank of England publish accounts, you require the Bank of England to appear before you and we are accountable for the governance of the Bank of England.

Q176 Chairman: I think a better parallel might be the Royal Mint. This is now a department that, effectively, reports to the Treasury, is it not?

Mr Macpherson: The Royal Mint is. The Royal Mint at present is, effectively, a Civil Service department. There is a question about whether it has converted from trading fund status into a company, at which point its status would be more relevant to the Bank of England, but I take your point.

Q177 Chairman: What I think Mr Ainger wants to know is will this information be published by you and will you be accountable for it?

Mr Macpherson: We are accountable for the governance of these banks. We have a section covering arms' length bodies in our annual report. Consistent with our responsibilities for the governance of these institutions, we have to set out our role, the framework under which we are operating, and we have to ensure clear and timely accounts to be published by the institutions in question. For example, the Bank of England publish their accounts every year, it is a matter of public record what Mervyn King is paid, it is a matter of public record what his pension is, and no doubt you cover that as and when you discuss these matters with him.

Q178 Nick Ainger: I just do not see what the problem is in publishing this information if it is available elsewhere. Why not pull it altogether so that we can actually see what has been going on in one document with all these nationalised banks?

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Mr Macpherson: We clearly need to consider how we can brigade the information in a way which is helpful to you. We are going to set up an arms' length body to manage our shareholding in these various financial institutions, and, again, I will take away your message and we will consider how best to respond.

Q179 Sir Peter Viggers: You signed off an estimate of Treasury expenditure but you substantially under spent last year. Why was that?

Mr Macpherson: I will get Louise to comment on that. Some of it, as ever, is to do with the accounting treatment of the building. When the value of the building goes up we get a negative impairment which reduces our spending. Louise, do you want to give chapter and verse?

Ms Tulett: I can. I think probably the best reference point is page 57 of the accounts, which talks about the administration costs and the non-pay expenditure, and on there you will see that there were three exceptional items, one of which was a reversal of the impairment on the building, so there was a £15 million reduction in spending there, which was the prime reason for the under spend.

Q180 Sir Peter Viggers: But last year when there was an under spend and my colleague, the honourable member for Ludlow, asked you about the under spend you quoted early retirement and exit costs from voluntary early redundancies. The Treasury has under spent for each of the last six years by substantial amounts. Were there exceptional items every year, or do you, as it were, set yourself a target and then under spend to set an example to all of us?

Ms Tulett: We have under spent over a number of years. You will find, if you look back on the history of that, that often that is because of exceptional items, such as the reversal of the impairment in the building, which by nature of the fact that it is a 31 March balance sheet is not something that you can estimate in advance because it is the market conditions prevailing at the time. I think it is also fair to say that the governance framework around the public expenditure is such that the gearing is always going to be towards an under spend or hitting exactly on target. Most organisations, I think you will find, unless they are into excess vote, will be running at an under spend of approximately 2–5% because of the nature of the incentives in the system which are to avoid an excess vote.

Mr Macpherson: I continue to find the degree of under spending, certainly on people and pay, slightly frustrating, and certainly in the coming period, with the Treasury under quite a lot of pressure, I am very keen to look at whether, by either over budgeting or over recruiting, we can get closer to our spending limit.

Q181 Sir Peter Viggers: To take a point of detail, you under spent £6.2 million on consultancy costs. Who were these consultants who were not used?

Ms Tulett: When we took the spring supplementary for 2007–08 we had entered into the territory of having to employ consultants around the Northern

Rock situation, but at that point we had not actually come to a firm agreement, either with Northern Rock or with the other tripartite bodies, that they would reimburse us with these costs. That agreement was reached, so we did not eventually have to consume any of our budget for the Northern Rock consultants. If you look at the annual accounts on page 81, you will see that we have set out there quite clearly the amount of professional fees that we incurred and how they were recovered from the tripartite and from Northern Rock, but at the spring supplementary point we had to hedge against the effect that we would not be able to recover these costs, so we did, indeed, ask for additional cover for that.

Q182 Sir Peter Viggers: Turning to PFI costs, these appear to have increased by some 18%. What has caused this price increase?

Ms Tulett: The PFI contract, when it was first agreed, actually does have an RPI clause in it, so the costs of the PFI are linked to the RPI index. This was deemed to be a good value for money deal under the NAO report that was looked at at the time, because effectively it costed the impact of RPI at its actual amount rather than building in the risk to the costings. So that is the RPI impact on the PFI deal.

Q183 Sir Peter Viggers: The Public Accounts Committee reported that only 29% of PFI project changes over £100,000 are subject to competition, despite the fact that they say there is a threat to value imposed by lack of competition. Can you assure us that all past and future changes to your own PFI contracts will be subject to competitive tender?

Ms Tulett: We can. The financing was subject to competitive tender at the time when the deal was struck, and the NAO did a report which was favourable on that. At the moment we are just entering into re-negotiation around the soft services provision, which is a competitively tendered exercise.

Q184 Jim Cousins: In the recession of the early 1990s the gap in economic performance between the various parts of Britain narrowed. Do you expect the same thing to happen in the present recession?

Mr Macpherson: I think it is too early to tell. It is tempting to think that any downturn in activity will affect the south and south-east more because of the dominance of financial services, the banking industry, and so on, and that may be the case. But when you get changes in trends, often they play themselves out in an unexpected way. We are in a period of huge uncertainty. So we are looking at that very closely, we are monitoring things like regional unemployment rates to see whether there is some divergence going on, and things will become clearer over the coming year.

Q185 Jim Cousins: There was earlier a little slippage in terms of the closure of the gap between various parts of Britain. Are you considering any special measures, on top of the ones that have already been known, that would help us to close that gap further?

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Mr Macpherson: I think we have got to keep a very close eye on this. Part of the problem about really understanding what is going on remains the fact that we do not have regional deflators. So we know in gross terms what is happening to the incomes per head, or the gross value-added per head, but we do not really know whether the rate of price change, say, in the north-east is significantly different from London or the south-east, which makes analysis of real trends more difficult. I think we have got to use all the data we can get hold of to understand what is happening to employment, unemployment, skill levels and so on. As I say, there is huge uncertainty. If things were to get worse, I think we will continually have to review both how we spend our money and where we spend our money and also consider whether you need, in a sense, to ramp up certain programmes at the expense of others; but we are not there yet, so all we can do, in a sense, is be alert and alive to the sort of potential problems you are identifying.

Q186 Jim Cousins: Bringing you straight away to an issue that very much affects Newcastle, the issue of management, the employment of Mr Hoffman as the Chief Executive of Northern Rock: does he meet all the necessary qualifications that were an issue about former Northern Rock appointments?

Mr Macpherson: We think he is well qualified. I think the combination of him and Ron Sandler means that the executive team is of a high quality. You are quite right to identify this as an issue because it is absolutely critical to the future of Northern Rock, but it is also critical to all banks to ensure that the highest quality management is in place.

Q187 Jim Cousins: There clearly are a lot of uncertainties in your accounts about Northern Rock, and one of the difficulties in resolving them is the issue of the European Commission's state aid inquiry, which may change the terms in which we are discussing this issue. Is there any evidence when this state aid inquiry into Northern Rock by the Commission will be concluded and, indeed, do we have any real evidence that it has actually started, never mind concluded?

Mr Macpherson: We have certainly got evidence that it has started.

Q188 Jim Cousins: We have had formal notice.

Mr Macpherson: My colleagues in the Treasury have been in close contact with the Commission. We are very keen to ensure that we are operating consistently with both the letter but, more importantly, the spirit of state aid; so personally I would be quite disappointed if the Commission concluded we in some way were being excessively generous to Northern Rock at the expense of other competitors. I think we are trying to tread a fine line which is consistent with competition but, equally, ensures that the Government is standing behind Northern Rock and enabling it to succeed and thrive.

Q189 Jim Cousins: Do we have any clear idea when the Commission will conclude its inquiries?

Mr Macpherson: I have not got the latest information in front of me, and I will give you a note.¹ Certainly the last time I looked at it I was reasonably optimistic that we would get an answer through the course of the autumn, but I recognise the autumn is now—

Q190 Jim Cousins: Is passing by us?

Mr Macpherson: Exactly. So why do I not ensure you get a note giving the latest view on that?

Q191 Jim Cousins: The arms' length remit that Northern Rock has (and presumably this is going to set the pattern for the other arms' length arrangements) is to deliver a business plan. In the case of Northern Rock's business plan it is to repay the taxpayer and, indeed, the Chancellor has recently told us that the taxpayer is being repaid at a very substantial rate to the extent of knocking-on two-thirds of the sum of money at issue. On the other hand, Mr Macpherson, that money came straight out of the mortgage market, which of course has an impact on other government objectives. How do you reconcile that?

Mr Macpherson: It is a problem across the board. If it is not a problem it is certainly a challenge. Obviously the strategy with Northern Rock is to reduce the size of the mortgage book. I think most of the easy wins on that front are now behind us, so I would anticipate that it will decline rather more slowly in the future compared to the immediate past. The issue really with Northern Rock, but the banks in general at the present time, with some of the reduction in mortgages—it is very difficult to tell whether it is demand or supply. At the current time why would you buy a house, if you can avoid it---. Some people have to change mortgages and so on, but buying housing in a falling market is something which quite a lot of people would want to avoid, so I think the demand for mortgages is relatively low. There is an issue of—

Q192 Jim Cousins: Do forgive me, Mr Macpherson, the decline in Northern Rock's mortgage book has not been brought about because of people selling houses but because of people redeeming their mortgages and being obliged to—

Mr Macpherson: I totally accept that, although I think Northern Rock are still seeking to sell some mortgages but are finding the going quite tough. All I want to do is refer to the deal which was struck with the bigger banks 10 days ago where they have committed to maintaining the availability of mortgage finance at the 2007 level. Obviously, whether there will be demand out there to take up that availability remains to be seen. The question I suppose—

Q193 Jim Cousins: Mr Macpherson, I am sorry to interrupt, but you will immediately see the contradiction between the arrangements with the

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other banks, which is to bring back mortgages more to their 2007 levels, and the position with regard to Northern Rock, which is to scale down the mortgage book and continue to do so.

Mr Macpherson: I suppose the issue—

Q194 Jim Cousins: There is a contradiction there, is there not?

Mr Macpherson: I do not think it is a contradiction, but there clearly is something to be explained. I suppose the issue with the Northern Rock is that, even in proportion to the Royal Bank of Scotland or whatever, very large sums of taxpayers' money have been injected into this bank. We own all the capital. Even with RBS, the maximum we would hold is 60%, but in Northern Rock it is 100%. Against that background, I think we do have to be careful about going into sort of wholesale mortgage expansion. It may be that down the track, with appropriate support from the European Commission, there are things we can do there, but the key thing, I think, from a taxpayers' perspective is ultimately to ensure that the taxpayer does not walk away with a big loss here. So we have got to be, I think, quite careful, and I think it is in the nature of banking that the more the state gets into the banking business we have got to balance the interests of the taxpayer with the interests of mortgage borrowers and, indeed, the interests of the employees and the companies themselves, and that is going to require a certain delicacy.

Q195 Jim Cousins: Indeed, these contradictions are inbuilt into that relationship, but there has to be consistency between institutions?

Mr Macpherson: Yes.

Q196 Jim Cousins: It would not be sensible to be pursuing one sort of policy with regard to a particular institution with which the Government had a substantial relationship and a different policy with a different one?

Mr Macpherson: You are right, and we need to look at this. I think where we both agree though is that to return Northern Rock to a position where it was lending large sums of money on loan-to-value relationships at 125% would be—

Q197 Jim Cousins: Mr Macpherson, that is not the issue.

Mr Macpherson: It is partly the issue.

Q198 Jim Cousins: The issue is that £18 billion has been taken out of the national stock of the mortgage pool to repay the taxpayer?

Mr Macpherson: It is, but as and when Northern Rock's finances stabilise I am sure there would be opportunities—

Q199 Jim Cousins: To revisit that.

Mr Macpherson: ---to revisit that. In an ideal world we would be ceasing to own Northern Rock altogether because it had become such a thriving institution that the private sector would want to take it forward.

Q200 John McFall: Can I pick up a point Mr Cousins said when he mentioned about the mortgage market getting back to 2007 levels? You and I know that the house purchase market has collapsed this year and the three-month arrears are up 23%. When are we going to get back to the 2007 market level? We cannot have securitisation because the money is not there for that, so let us have clarity on what we mean by this 2007 lending? Do you agree with the points I have made?

Mr Macpherson: I agree, we are not going to get large amounts of securitised lending in the current circumstances, but I do think, with the banks potentially now being much better capitalised, it is perfectly reasonable to ask them to make available products and, ultimately, funding to a much higher level than is the case at the moment. The deal mentions 2007. In 2007 obviously there was a period earlier in the year when they were all expanding and then in the latter half of the year when they were contracting, but I think that is a reasonable ask. These banks announced these proposals and they are committed to doing it, and I hope we can hold them to account and, indeed, in due course this committee might hold them to account.

Q201 John McFall: I understand that, but think we have got to be realistic, Mr Macpherson, and the fact is that, given the market has collapsed, given the three-month arrears, realistically, when are we going to get back to half that level? Let me tell you, I have spoken to quite a number of banks and institutions, and this is not me making this up, this is them telling me what the situation is you. So liquidity for banks, which is good, which is welcome, is going to be used in many other areas.

Mr Macpherson: Of course, and the other thing which is mentioned in the deals is SMEs. It is precisely because the current level of mortgages is so low, it should not be terribly difficult for them to get it higher, but whether we will ever get back to the days of 2005, 2006, early 2007---.

Q202 John McFall: But you know that we will get back to that.

Mr Macpherson: But not in the same way. The Governor of the Bank of England made the same point yesterday. It will be different. No doubt there will be new products, but we have got to encourage those banks to begin to turn the current contraction round.

Q203 John McFall: But you would not want to agree with me that we would be lucky to get back to half the levels?

Mr Macpherson: You have probably gone deeper into the analysis than I have, but I think this is going to be challenging.

Q204 John McFall: The liquidity from the Government for the money guarantees, that is good, but we have got to ensure that that gets into the system. Are you ensuring that?

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Mr Macpherson: Yes, and it is already being taken up. Some banks have already made use of the guarantees. We are very keen to make that happen. We have mentioned the figure of £250 billion, but that is very much an estimate. If we needed more we would be prepared to do more.

Q205 John McFall: If you are alert to that and keep being alert to that, because the feedback I am getting is maybe it is not getting into the system as quick as it should, good policy that it is.

Mr Macpherson: Yes. The key thing is to ensure that the banks are lining up. If they came along and sought to have massive guarantees all on the same day, it does get problematic, but I think the banks have talked amongst themselves about how they can efficiently access it and we are working very hard and the Debt Management Office which is managing this, and I think, is doing a really good job.

Q206 Chairman: To clarify, if the 2006–07 levels of housing activity were only reached on the basis of all these self-certified mortgages under 25%, why would we want to go back to them?

Mr Macpherson: I do not want to get too hung up on that. I would not want to see a repetition of some of the extravagant lending of a couple of years ago or so, and I would want all banks actually to approach these issues on the basis of rather better risk-management than they have in the past, but the fact is that the capacity of the economy continues to grow, potentially, and over time people's incomes will go up and it is not unreasonable to expect that people with decent credit records should be able to access lending in a reasonable way.

Q207 Mr Love: If I may so, Mr Macpherson, you are not doing much of a job of defending the Government's stated position of saying that the availability of finance should be at the levels of 2007. Would you agree?

Mr Macpherson: I do not know if I am here to defend, I am certainly here to explain government policy, and what I am saying is the Government wants to use its position as a potential shareholder in these institutions really to push the banks to make credit available. We are making capital available; we are making guarantees available; the Bank of England is providing liquidity. In my view, it is a perfectly reasonable ask to expect these banks to lend. What we do not want them to do is lend in an incoherent way. The challenge through this period is to keep the pressure on them to lend but also to put pressure on them to run their banking arms in a way which takes the right attitude towards risk.

Q208 Mr Love: I want to separate out the small business part of that because I think it is answered and focus on mortgages. From what the Chairman has said and indeed Mr McFall, it is likely that there will be a significant reduction in lending. It is already obvious from the statistics that have come out and from what the CML have said. How are you going

to hold them to account? How are you going to monitor whether they achieve what it is you have asked them to do?

Mr Macpherson: They made commitments in the announcements last Monday that they would make this funding available. We are going to monitor what they are up to very closely. We have also made clear that the government will appoint directors to their boards. I would expect the government appointed directors to have a role in ensuring that these issues are being discussed at board level. We have also made clear that these banks will report annually on for example what their approach to SMEs is. They have also undertaken to do things around for example repossessions and we want to ensure that we minimise some of the potential social cost of a housing downturn. In addition we are going to have this arms' length body which I hope will be playing an active role in these areas and indeed will have people whose job it will be 24 hours a day to ensure that the banks are—

Q209 Mr Love: Let us ignore the point the Chairman made about do we really want to sell mortgages in the way we did in 2007. If we do decide that we want to spend that amount of money, then you would be asking the banks to go out as they did in 2007 and sell, but all the evidence suggests that that is the last thing they are going to do. How are you going to keep them up to the mark?

Mr Macpherson: One way or another—it may not be through us—these banks are raising a great deal of capital. Some of that is obviously necessary to deal with previous bad debts but on any basis the British banking system is going to be very well capitalised from the turn of this year. It really should be in the power of the banks to make lending available, to ensure that there are products which homebuyers and businesses can access. If there is no demand there, there is probably not a huge amount we can do. Supply can create its own demand and I see this as a critical part of getting the economy back to a sensible place. Alongside that, interest rates have come down. I certainly do not want to cut across the Bank of England's independence but the market is suggesting that interest rates will come down a whole lot further in the coming period. Commodity prices have been falling extraordinarily quickly over the last six weeks or so. Purchasing power will come back. Demand will come back and the critical thing is to ensure that the supply is there to meet that demand.

Q210 Mr Love: Let me come on to the issue of repossessions. I want to pick up what Mr Cousins said earlier on. You are asking those banks that are seeking funding from the recapitalisation fund only to repossess property as a last resort; yet all the figures that are coming out suggest very strongly that Northern Rock, as a matter of policy to redeem some of the funding that you set as a priority, are repossessing at a much higher rate. Is there not a contradiction there?

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Mr Macpherson: Northern Rock have repossessed more. That is true, although I am not certain that their rate of repossession has increased. I have the figures in front of me. On 31 December last year it was 2,215; 30 June, 3,710; 30 September, 4,201. It rose by 1,500 in the first six months of the year and 500 in the last quarter which if anything suggests a slight deceleration but it is still very serious. The issue is less about how many properties the banks possess; it is more about what they do with the properties when they have ended up possessing them. For example, if they get into the rental business or, with the government's help, the shared equity business, there is a potentially easy way out. It is never easy and I do not underestimate the personal and social costs this creates but there are several things which the banks can do which go with the grain of helping the individual in question get out of the problem that they have. Then there is the approach which involves literally turfing them out of the property which creates massive problems all round. That is a potentially rich seam which we have to start mining in the coming period to ensure that there are ways in which it would result in a sensible outcome, although I would not say it is a win win, because this is hardly a victory. We have been talking to the Council of Mortgage Lenders. We are talking to banks and I am quite certain this Committee will want to come back to this issue. It will be a priority for us.

Q211 Mr Love: The chairman of Northern Rock said to us when he came before the Committee that it had a good mortgage book and we should not assume that there was a lot of sub-prime activity in there. Therefore, you would not expect their level of repossessions. We are asking all the other banks to respect the guidance that is given by the FSA to only repossess as a last resort. Are we giving that same advice to Northern Rock and are we monitoring it, or are we saying that the first priority for Northern Rock is to pay back the loans to the government?

Mr Macpherson: Northern Rock is not a special case where we want it to be more vigorous in pursuing people behind in their payments than other banks. We would expect them to operate in line with the code and I think they generally are. They did have a good mortgage book but sadly what looked like a good mortgage book a year ago in any bank looks slightly less good now and that is the challenge across the industry and the challenge for the economy. Your point is absolutely right. This is important. We are set to own a good proportion of the banks and this is an issue of huge importance. I am sure you will want to come back to this on many occasions and I think you have the Chancellor and others appearing before you very shortly.

Q212 Mr Brady: Last year when I asked you about the Lisbon goals, you agreed that it would be challenging to meet them by 2010. Given that there is no explicit target of making progress towards the goals in the CSR targets, has the government given up?

Mr Macpherson: No, it has not given up. I think the spirit of Lisbon is more important than ever. The experience of the last year is that it is even more important that Europe is making progress on productivity, employment, that it is getting a more sensible approach to regulation, that it is getting a single market really operating as a single market. And the recent experience of banking reinforces that even more. We have not given up but some of the rather optimistic targets in Lisbon—I cannot remember whether it was 1998 or 2000, but whenever it was—clearly are not going to be met.

Q213 Mr Brady: Would we not be more likely to make progress if there were some targets?

Mr Macpherson: If only setting a target would deliver the outcome. Sometimes it can when you have levers but the target we had on Lisbon goes back to an earlier phase in government targeting. From a management point of view, if you have an objective, it is kind of nice to have a target because it concentrates the mind. With things like inflation or indeed public finances, it is generally very easy to tell whether you are making progress or not. This is one of the more amorphous areas and, although Lisbon matters, my guess is that, in terms of what the Treasury does as a finance and economics ministry, it will be about focusing on the immediate challenges of now rather than spending all our time looking at a particular target around Lisbon.

Q214 Mr Brady: Lisbon remains an aspiration?

Mr Macpherson: It remains an aspiration and I think it is really important. It certainly informs our approach to Europe which is to try to get a more dynamic market economy but we are not going to hit that target.

Q215 Mr Brady: During the last year, you commissioned a report into the efficiency of the Barnett Formula which is due to be published I think in June. Has that work been completed?

Mr Macpherson: I think it is continuing.

Q216 Mr Brady: When is it going to be completed?

Mr Macpherson: I hope reasonably soon.

Q217 Jim Cousins: Not too soon?

Mr Macpherson: It is the sort of thing you might want to ask my colleagues when they come back at PBR time but I am happy to send you a note on it.²

Q218 Mr Brady: We might hope for publication before the end of the year?

Mr Macpherson: I could not say. I just do not know.

Q219 Chairman: One of the other targets is the government's child poverty target. In your report you report slippage on this target and the Child Poverty Action Group last month said it would take another three billion to get this target back on track. Are they going to get the three billion?

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Mr Macpherson: I do not know. That will be a decision for future pre-Budget reports and Budget and spending reviews. Clearly, resources are always constrained. They are likely to be rather more constrained I would imagine in the coming period but I think it is fair to say that even in the last Budget, when resources were reasonably thin on the ground, quite a lot of money was allocated to child poverty. If you look at the last three PBRs and budgets, the measures contained therein were to lift something like half a million children out of poverty compared to what otherwise would have happened. It is a challenging target. There are a lot of forces at work in a global economy which are stretching the income distribution. I think we have done quite well to make progress on child poverty. It is not just me who thinks that. There was quite a good report yesterday from the OECD which says that Britain has made some progress in this area.

Q220 Nick Ainger: I am looking at pages 62 and 63 of your annual report. The figures there certainly confused me and would confuse anybody else that was looking at this important issue. At the bottom of page 62, you say that the baseline is 3.4 million children in 1998 to 1999 in households below average income. You go on to say that between 1998–99 and 2006–07 that number fell by 600,000 to 2.9. At the top of page 63, you then go on to say that the number of children in households with incomes below the 60% median income has fallen by 1.7 million. You then go on to say in paragraph 4.36 that, taken together with the Budget measures in 2007, the PBR 2007 and the 2007 CSR and Budget 2008, there will be a further 500,000 children taken out. What is the figure? I know George Mudie was trying to get to the bottom of this some time ago. One figure you have quoted there as 1.7 million actually is halving child poverty two or three years almost before the target date of 2010–11. I do not think that has happened because you have announced that you have slippage. What are the figures so that people do understand what is happening? We have campaigning charities saying that you are failing miserably and another three billion is required to get back on track. What are the figures?

Mr Macpherson: There is no unique measure of child poverty.

Q221 Nick Ainger: We will never know whether you have delivered or not.

Mr Macpherson: You will do because we will publish figures. There are three different ways of looking at this. One is an absolute measure and we get a very nice reduction of 1.7 million. If you look at 1998–99 income levels and uprate those for inflation, there has been real, absolute progress. On the other hand, generally over time incomes go up so having an absolute measure perhaps does not do full justice to the issue. That is when you look at relative measures. The problem with relative measures is if there are forces at work which are continually stretching your income distribution. Relative measures will generally underestimate the progress you have

made. We have been happy to be judged on that. The Child Poverty Action Group quite rightly home in on the measure which is most difficult and it is that one. I used to run this part of the Treasury and we spent a lot of time talking to the poverty lobby. We had lots of conferences on measurement and we came up with a third measure which combines relative poverty, albeit at a high level, with material deprivation. One of the ways in which you really get a handle on poverty is to ask people what they think is a minimum level of income in terms of having a television, a few days off or whatever, so we have that measure as well. It is complicated and I am sorry that we have failed to—

Q222 Nick Ainger: You have a PSA target which is to halve child poverty, however it is defined, by 2010–11 and eradicate it by 2020. What you are saying is it is very difficult to define child poverty, but all people expect is that there is some consistency. Those figures I have quoted from your annual report are not consistent. They actually are misleading, not deliberately so, but they do not say, “This is how we are going to judge whether we are performing well, meeting that PSA target of halving child poverty.” Do you not think you ought to establish, perhaps with consultation with the child poverty lobby, what is a good baseline, what is a way of identifying what is child poverty and then you can judge all performance accordingly? The figure of three billion in the current circumstances is quite frightening. Politically, it is absolutely vital that that target is met. Statistically, you cannot tell me. Perhaps you can. Somebody is saying, “We know we are slipping.” The report says it is slippage.

Mr Macpherson: The reason why it is slipping is because we are not making sufficiently rapid progress on the relative measure.

Q223 Nick Ainger: Without defining what the relative measure is.

Mr Macpherson: We have done. That is the number of children in households with income of less than 60% of contemporary median compared with 1998–99. It is set out in paragraph 4.32. If we focus on one measure on its own, the risk is that we may hit that measure but you will criticise us for some other reason. That is why we have a number of indicators—three, in fact. Let me undertake to ensure that we are far clearer on this in next year’s report because it is not unreasonable to have more than one indicator but I think you do have a right for this to be explained rather better than we have done.

Q224 Nick Ainger: Quoting that 1.7 figure is totally contrary because you have achieved the target. That figure will mean you have achieved it two or three years ahead and we know that is not true.

Mr Macpherson: We need to be clearer because we clearly have not convinced you.

Q225 Chairman: Perhaps we can have a note rather than wait until next July.

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Mr Macpherson: I would be very happy to provide you with a note.³

Q226 Mr Love: I want to take us on to efficiency savings again. We are living through the biggest financial crisis since 1929; yet, over the last year, you have had a headcount reduction of 235 posts. Has that left you in a weakened position to be able to respond to the crisis that is going on out there?

Mr Macpherson: I do not think it has. Much of the reduction was in the Office of Government Commerce as part of a refocusing of that organisation. However, I would say that from here on—it goes back to my earlier point—I am really keen to ensure that the Treasury has the staff to do the job. What has been striking over the last year, especially over the other weekend, is that we are really operating at our limits. It is as much an issue of having the right sort of people at the Treasury as numbers. We are having to multitask in certain areas. This comes back to the bonus point. You may argue next year that none of us should have a bonus and you are quite entitled to do that, but there are a lot of people who have been really working at the limit, in terms of not getting any sleep and in terms of working really intensively. I am really proud of how the Treasury has worked over the last few months.

Q227 Mr Love: Could they criticise you and the senior management for forcing them into that pressurised position? Do we not get the wrong or bad decisions as a result of that pressure?

Mr Macpherson: I am happy to be held to account for that. The challenge for management is to ensure that you can get more people into the trenches while some other people go back and get a rest.

Q228 Mr Love: Do you regret the fact that your target of last year was 150 for core Treasury and yet you managed 235? What will you end up with at the beginning of next year? Will you have to take some people back on?

Mr Macpherson: We did overshoot a bit. We have been recruiting actively recently. I am optimistic. One of the few positive sides of life being rather less attractive in the City of London is that the Treasury should be able to attract some really good people to come and work there on salaries which are affordable. That is the challenge. We have recruited people recently. I am more confident than ever that I have the senior management team to deal with the current crisis. I have been really impressed by the quality of staff, but it is really important that we manage them in such a way that they do not get burnt out and can provide the right advice and do the right job.

Q229 Mr Love: The Debt Management Office reduced its staff last year by 13 according to your report. We had them with us last week and they pretty much told us that, with all the additional

money that they will have to raise on markets, they will need to take those 13 back on again. Would that be right?

Mr Macpherson: I speak to Robert Stheeman most weeks. His organisation is taking on new tasks. They are going to have to be staffed to do the job. It may be that they have to take on more people but, coming back to your original point, at a time when the financial challenges are massive, there is no point cutting corners. The Debt Management Office will have the resources to do the job.

Q230 Mr Love: I think what you have said to us so far is that you might have had to review the situation for core Treasury, certainly for the Debt Management Office who indicated that the Office of Government Commerce had already faced significant reductions. It took the bulk in proportionate terms. Yet, under the CSR, by 2011 you are going to have to make significant further additional savings. Can you do that?

Mr Macpherson: I hope by 2011 we will be in the uplands of—

Q231 Mr Love: So do we all. Hooray to that.

Mr Macpherson: It comes back to my earlier point about spending our budget. We just have to be a lot smarter in terms of getting the people into the Treasury. Obviously, if we reach a point where getting more staff is critical to what we have to do, then I would have to talk to the Chancellor of the Exchequer about that because the Treasury is a small department. There is no right number of Treasury officials. Personally, I think it is important that the Treasury remains small. I think it is key to its success and the cohesion of the organisation, but we have to keep this under review.

Q232 Mr Love: Finally, the assumption is almost universally made that the reason why the Treasury overshot in terms of efficiency savings is that it is the department that has to enforce it for everyone else. If you now throw that into reverse up to 2011, what signal does that send out to every other government department?

Mr Macpherson: That is one reason why we have to be careful about this. I am certainly not wanting to be profligate. The issues for us are really at the margin of around 30, 40 or 50 people. It is nothing big, but we have to be conscious of that. We have to set an example. Equally, there is no point in our being excessively hair shirt.

Q233 John McFall: In terms of the past few weeks I know from talking to quite a number of people in the City and elsewhere that they have been grateful for the work of the Treasury. Tom Scholar, John Kingman and Clive Maxwell are names that have been put forward, but you will remember a Northern Rock report and the criticism about the run down in the financial services department. Can you give us an assessment of that (a) in terms of the present number and (b) the number which you will be happy with eventually, because that needs strengthening. You would agree?

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Mr Macpherson: It needed strengthening. It has been strengthened. Do I need to strengthen it further? If we had the banking crisis which we had two weeks ago and it was going to be every day of the week, then we would seriously have to strengthen it. We have to keep this under review. It is both the quality of the people and the quantity. When the Northern Rock problem arose, we had Stephen Pickford both running financial services and doing the international side. Stephen is a very able guy but that was asking too much. Having Tom Scholar there who does financial services 100% of the time—you mentioned Clive Maxwell but I am also really pleased that Mridul Hegde from Brivati is also working there—especially when it is a representational role, if you have to speak to a chief executive of the bank, you need to have enough senior people to manage those relationships and I think we have a really good team there now. Equally, I think we have learnt a hell of a lot over the last year and we will continue to learn from that. I think the Treasury is in a better place but I would not claim that everything we have done has been completely brilliant over the last year.

Q234 John McFall: Why do you not invite us in, give us a nice lunch and tell us what you have learned?

Mr Macpherson: You have come into the Treasury in the past and I would like to extend an offer to invite the Committee.

Q235 Sir Peter Viggers: In November last year, you said that achieving your £30 million efficiency target would depend significantly on staff reductions. You have reduced staff considerably. Are those staff reductions you referred to last year still outstanding and have they been announced? Might there be redundancies?

Mr Macpherson: We have delivered the staff reductions. To live within our CSR plan, we really would not need to reduce staff by very much. As I mentioned just now, I am keen to step back and look at how we spend our resources. At the margin, it may be that our plans for people set out on page 91 of the report—1,006 it says here in 2011—and that number should be a little higher. Although people are our main cost, there are other ways you can reduce spending.

Q236 Sir Peter Viggers: Your value for money delivery agreement suggested that your efficiency savings in the Comprehensive Spending Review 2007 period will be calculated in a manner which excludes non-recurrence of structural costs. How does that square up with your own requirements that efficiency savings are calculated to be net of implementation costs?

Ms Tulett: I am not sure that I quite recognise the point you are making but the chart that we have on page eight of the delivery strategy clearly demonstrates how we are going to achieve our savings target against the baseline which I recognise as being the total resource envelope.

Mr Macpherson: Can we give you a note on that because I would be quite surprised if we were in breach of our own guidance.

Q237 Sir Peter Viggers: It is a very detailed point. The references I have before me are your value of the money delivery agreement 2007, page 11, and the CSR 2007, chapter three, paragraph 3.31.

Mr Macpherson: We will look into that and give you an answer.⁴

Q238 Mr Brady: The bank special liquidity scheme was established at around about the end of the financial year. We know that so far it has seen more than £100 billion of assets swallowed. Can you tell us how much more?

Mr Macpherson: No.

Q239 Mr Brady: Is that because you do not know or you cannot tell us?

Mr Macpherson: I do not want to go beyond what the Chancellor of the Exchequer said last week, not because I am trying to be unhelpful. I want to help the Committee. It is just that this is remarkably sensitive. All the information will be published in due course but at the current time people can read huge amounts into random, very large numbers.

Q240 Mr Brady: Are you able to give us any idea of the breakdown of those assets between different categories?

Mr Macpherson: No.

Q241 Mr Brady: For the same reason?

Mr Macpherson: For the same reason.

Q242 Mr Brady: In terms of the valuation of those assets, how do you go about valuing assets in the current climate?

Mr Macpherson: Sometimes with difficulty. To be eligible for the special liquidity scheme they do have to be triple A quality. This is not junk. It is reasonably high quality. My friends at the Bank of England, Mr Tucker in particular, have quite well-developed mechanisms for dealing with them applying haircuts, as they are known in the trade. If there is any doubt about the quality of the asset, there is quite a big haircut. We are very clear that the collateral is good. A recent example relating to the Lehmans collapse was where there was, through normal liquidity operations, a transaction with Lehmans and the bank managed to sell the collateral in very short order at no loss to the taxpayer. This is classic central banking territory. Mr Tucker, Mr Bailey and others I think are doing a very good job on it. I am confident and the Bank is confident that we will get our money back.

Q243 Mr Brady: We have seen a certain amount of triple A rated junk over the last year.

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Mr Macpherson: You are very right to raise that point. This is something which is extraordinarily important to us and, as accounting officer, I will be the first person to be hauled before you if we screw up. I am determined that we do not.

Q244 Mr Brady: I understand that the procedure is that, should the value of the assets fall, then there is a requirement and expectation that more assets should be put in or the Treasury bills will be returned. Has that happened at all?

Mr Macpherson: I could not tell you. I simply do not know but the Bank of England are monitoring it extremely closely.

Q245 Mr Brady: Moving on to the question of the management of the nationalised and part nationalised banks, the government is going to be appointing board members for Lloyds, HBOS and RBS. When will those appointments be made?

Mr Macpherson: The first point is that the deals have not gone through yet. They will take a bit of time. You have to remember also that effectively we are underwriting the equivalent of a rights issue. It is conceivable that if, say, the Royal Bank of Scotland share price remained way in excess of 65.5p, which I think is the striking price, then we may well end up owning a lot less because it will be in the interests of shareholders to take up the rights themselves. Until those transactions go through, it would be inappropriate to start putting people on the board but, as and when they do, we will take decisions. The critical thing here is to get high quality people on it. This is not jobs for redundant Treasury officials. Some Treasury officials would be very good at it but you need people with good commercial expertise.

Q246 Mr Brady: If the percentage of overshoot fell, you are suggesting that the number of board appointments would be fewer?

Mr Macpherson: The numbers were set out at the time. In the case of RBS, I think the number was three but it would be very odd if the private sector took up all the rights. It would be kind of odd for us to insist on having three government appointees. With all these deals, they are firm agreements but inevitably you will come back to them in the light of events.

Q247 Mr Brady: How soon after the deal is done would you expect the appointments to be made?

Mr Macpherson: I would expect these things to resolve themselves through the final part of this year. This is urgent and we need to resolve it.

Q248 Mr Brady: Can you tell us a little bit more about how you see the role of these Treasury appointed directors? What will their remit be?

Mr Macpherson: What we want is high quality people who are appointed by the government but are in a sense acting like any other member of the board, except that ultimately they are representing a very large shareholder, namely the taxpayer. I think that is how it will play itself out. These people are not delegates who we will send along with instructions

from HM Treasury, not least because we do want these organisations to be run at arms' length. I think it would be very dangerous frankly if the Treasury got seriously into the banking business. We can do many things but running banks I would not say is not necessarily our core competence. Equally, they have to have a bit of a remit from the government as a shareholder.

Q249 Mr Brady: Would you say that, whilst not being delegates, they would effectively have a remit for ensuring the implementation of the terms of the recapitalisation? For instance, borrowing should become more available; interest rate movements should be passed on?

Mr Macpherson: I think those are the sorts of issues which we would expect them to be raising, yes.

Q250 Chairman: They are not arms' length then, are they? They are there to further the government's objectives.

Mr Macpherson: This is not about micro-management. It is about setting out some broad parameters which will inform the approaches of these banks. The banks themselves have announced that they want to do these things. That is what they did last Monday. It would be perfectly reasonable I think for the directors to hold the banks to account on those issues. What we are not going to get into the business of is giving instructions week by week in much the same way as we do, say, to our executive director at the IMF, where he is very much a delegate for the UK delegation. This is going to be different.

Q251 Mr Brady: But you would formally give them a remit?

Mr Macpherson: I do not know whether we would formally give them a remit. I think that is still for consideration. The next step for us is to set up the arms' length body, give that a clear remit and take it from there. This is urgent. We are getting on with it, but the precise way it will work will have to wait for the shareholders to agree the deals. It is only once that has happened that it will start to take effect.

Q252 Mr Brady: When will the arms' length body be established?

Mr Macpherson: I hope quickly. This is one of our most urgent priorities.

Q253 Mr Brady: That can be done before the deals are finalised?

Mr Macpherson: I do not know whether we will need legislation to set up the arms' length body. Whether or not we do, I hope we will have it in shadow form very quickly. We need to appoint a chairman and chief executive and be clear what its remit is. As I speak, there are Treasury officials beavering away on that.

Q254 John McFall: What views do you have for us regarding the Lloyds/HBOS merger staying on course?

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Mr Macpherson: The agreement to inject capital last Monday was predicated on that deal, but ultimately that deal is a matter for the shareholders in question. We made clear what capital we would make available. If somebody else wanted to buy HBOS, that would be a matter for them and the shareholders. Obviously if they wanted to know what capital we would make available to any transaction, we would have to enter into a dialogue with them. We were always happy with the Lloyds/HBOS deal for financial stability reasons. I think we remain happy with it. We have waived some of the competition requirements accordingly but equally, if others want to make a better bid for HBOS, they should clearly go for it and we would want to leave it to the shareholders whilst recognising that, whatever happens, there is likely to be a need for some sort of recapitalisation.

Q255 John McFall: You see merit in the recapitalisation initiative that you have given to produce a reinforced and strengthened entity?

Mr Macpherson: Very much so. That is critical whatever happens. The deal with Lloyds and HBOS to us looks credible and sensible but ultimately we are responsible for recapitalisation and they are responsible for ownership and shareholdings. At this stage we do not own any shares in them but equally, if the deal goes through, we will own anything up to 40% of the body.

Q256 Jim Cousins: You had a most interesting exchange with Mr Brady which I think was extremely helpful to us. You used the term “remit” for the arms’ length arrangements, not the term “business plan”. Is that simply a gloss? Is a remit somehow qualitatively different from a business plan? Will that remit include issues of employment?

Mr Macpherson: I do not want to make a distinction between “remit” and “business plan”. I am quite certain we may end up needing both. I would not read too much into that. Employment is a difficult issue. You want banks to be run commercially. Imposing employment conditions can sometimes slow down the commercial operation of an organisation. I do not rule it out but at this stage I would not necessarily be ruling it in.

Q257 Jim Cousins: Can Mr Blank give an assurance about jobs in Scotland?

Mr Macpherson: He has given assurances around the Scottish dimension of HBOS.

Q258 Jim Cousins: What about the Halifax dimension?

Mr Macpherson: I do not have in front of me the assurances he has given.

Q259 Jim Cousins: Perhaps you would send them to us, would you?

Mr Macpherson: I would be happy to send them to you, in as far as I have them.⁵

Q260 Sir Peter Viggers: If these are to be Companies Act companies, then a director of a Companies Act company must abide by the rules of the Companies Act and must act in the interests of all the shareholders. It is of course proper for a shareholder nominated by a group of shareholders to take account of all interests, including those who are nominated, but if we put dual duties on these directors it is going to be extremely difficult. I suspect that this needs to be the subject of a most carefully prepared paper.

Mr Macpherson: I could not agree with you more, which is why I have been trying to avoid giving you cast iron commitments on those issues. As and when we have a body ready to go, no doubt in the interests of transparency, we will make very clear the basis on which it will work and this Committee will want to hold us to account and look carefully at it.

Q261 Mr Brady: The remit of the arms’ length body is a simpler matter, is it not?

Mr Macpherson: It should be.

Q262 Mr Brady: What do you anticipate the remit of the arms’ length body managing the government’s investment in banks to be? What should it be?

Mr Macpherson: I do not want to prejudge it. We will no doubt publish it quite soon. It would be idle for me to speculate but there is no point in having an arms’ length body unless the remit allows it to operate at arms’ length. If this is going to be a front organisation for the Treasury meddling in every nook and cranny of life in the banks, I suspect we are all finished.

Q263 Mr Brady: Principally it is going to be charged with getting the taxpayers’ money back?

Mr Macpherson: The primary interest here will be about getting the taxpayers’ money back but equally there are wider issues where, as shareholder, we will have an interest.

Q264 Chairman: It does seem an odd role that you are trying to describe. If it was truly at arms’ length, you would not need to describe or define it, would you?

Mr Macpherson: No. The Bank of England operates monetary policy at arms’ length. We give it a very clear remit. I think it can be done and indeed we are going to do it, but we can come back to this.

Q265 Mr Brady: Will the arms’ length body also manage Bradford & Bingley and Northern Rock?

Mr Macpherson: I do not think we have taken a definitive decision on that but clearly there is a *prima facie* case for that.

Q266 John McFall: When we were in Japan, in terms of failing banks there, one of the conditions which the authorities imposed was a business improvement plan. Do you have something like that envisaged? If you do, maybe it is not as arms’ length as you say it is going to be. I would like to see a business improvement plan.

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Mr Macpherson: The banks have already committed themselves to doing various things like, for example, reporting on their approach to small and medium sized enterprises. We want to learn from the Japanese experience. I met some French bankers last week. I dare say we can learn from the way they ran their nationalised banks in the 1980s. This is not a simple issue. You are quite rightly raising ways we can do this and I think we have to try and learn from others' experience to design the most sensible way forward.

Q267 John McFall: The main Committee and this Committee are all interested in this. I mentioned earlier about visiting the Treasury. It would be good if we had an opportunity for all of us on an informal basis to come along and chat to you about issues such as that.

Mr Macpherson: The Chancellor may have views of his own on this issue but I think it is really important that we can sit down and give you our take on what is going on and you can feed into that without cutting across this formal process, important as this process is.

Q268 Chairman: Nonetheless, the business improvement plan mentioned by John McFall is something that we have been considering. We realised from our trips both to Sweden and to Japan that getting into bank nationalisation is a lot easier than getting out of it. Those things do go on for a very long time unless the taxpayer or people outside the Treasury have some idea and some commitment to a timescale.

Mr Macpherson: The easy bit is making an announcement. Thank God the announcement has gone off well and the banks are looking slightly more secure as of this moment. The sheer scale of what we are now in is going to make life very different for the banks, for the economy and for the Treasury in the coming period. As you say, it is very difficult to assess how long we are going to be in this for. Obviously it would be nice if everything recovered. We could sell the shares at a profit and the taxpayer could be very happy, but we have to be prepared for this being a long road.

Q269 Chairman: Louise Tulett, the deadline for dry run IFRS balance sheets was 30 September. How many departments submitted on time?

Ms Tulett: I think it was about half of them but I do not have the number to hand. Would you like me to send you a note?⁶

Q270 Chairman: We would. What are you doing to enforce the deadline? Why is it only half? You are in charge, are you not?

Ms Tulett: I am not in charge, no. It is a colleague of mine at the Treasury.

Q271 Chairman: The Treasury is in charge of enforcing this.

Ms Tulett: Yes. It is not my portfolio.

Q272 Chairman: Why have only half done it?

Ms Tulett: I am afraid do not know the answer to that question.

Q273 Chairman: What is your sanction?

Ms Tulett: The idea of having the programme of doing the trigger points, trigger points one and two, at the end of December, is in order to have smooth progress through to the final accounts that we will be publishing on 2008–09, working with NAO colleagues so that the NAO resources are not all bunched as well when they are looking at these. As far as I am aware, colleagues have written out from central Treasury to the departments that have not delivered on their trigger point one, reminding them of the requirement to do so and trying to get as many responses as possible by the end of the current month, which will be next week. The sanction is probably fairly limited in reality. Ultimately, this is around delivering the accounts for 2008–09 in a timely manner.

Q274 Chairman: That is our concern, that this may delay the production of those accounts and the auditing of those accounts in due time.

Ms Tulett: I think that concern is shared by the Treasury as well.

Q275 Chairman: It is you, not us, that have to do something about it.

Mr Macpherson: We can. We have a number of levers. One of them has been around finance directors, holding them to account and moving on the finance directors who are not delivering.

Q276 Chairman: Last year we discussed the introduction of these departmental, strategic objectives which I think were meant to simplify performance measurement. We are a little confused now as to whether you have simply added another layer of targets and measures. Can you reassure us about that?

Mr Macpherson: No. This report was very much focused on the regime in place for SR04. Next year's departmental report will focus on our departmental strategic objectives. I am confident we will be able to tell a reasonably simple story.

Q277 Chairman: Have you finalised the measures against which you will assess the objectives?

Mr Macpherson: We have finalised the DSOs. We consulted you about them, I recall, and we have published our approach to monitoring them. I can give you further details if that would be helpful.⁷

Q278 Chairman: It would be. I just want to be clear that you are now using fewer performance measures than you were for example under CSR 2004.

Mr Macpherson: Do you mean for the Treasury in particular or across Whitehall?

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Q279 Chairman: For the Treasury in particular.

Mr Macpherson: We are going to move away from having things like targets around Lisbon because it does not quite capture what we are seeking to do as a department. We will write to you about that.

Q280 Chairman: Northern Rock has spent over the last year some £63 million on consultants' fees and various expenditures. The tripartite has spent £23 million which has been recharged to Northern Rock. How do we know whether that is good value?

Mr Macpherson: The National Audit Office may want to do a value for money study of it in due course. It is difficult to tell. You do need really good legal advice and I have to say that, on some of the things I have been involved with, our legal advisers have paid for themselves several times over. It is a buyers' market now and the sort of investment advice we were picking up the weekend before last came rather more cheaply than it did a year or so ago. Louise is involved in negotiating these contracts and value for money is going to be really important because these people can be quite expensive.

Q281 Chairman: £87 million.

Mr Macpherson: Some of this reflected a loss of control at Northern Rock in the period in particular between the run and nationalisation, where I think Northern Rock might have been able to manage itself a little better.

Q282 John McFall: Just today Northern Rock has announced that bonuses have been paid to the directors and I think the chief executive at £403,000. The only reason I am bringing it up with you is I have had four emails already from members of the public on that. Were you informed beforehand that this was taking place? Did you agree to it?

Mr Macpherson: I would have to come back to you on that. I certainly was not, which does not mean that the Treasury did not agree it. On the one hand you want to attract good people. There are big reputational risks with involving yourself in an organisation like Northern Rock. You do have to incentivise some of these guys; otherwise they simply will not do it. Coming back to your point about what the public think, you do not want people being rewarded for failure, so there is a balance to be struck there. I can come back to you on this.⁸

John McFall: I think it would be worth writing to us on that.

Q283 Nick Ainger: Following on from that and our experience in Japan, in the business improvement plans which were agreed between the banks that were nationalised and the Japanese treasury was an issue relating to remuneration packages. I do think

it is absolutely essential that we understand, first of all, that there is a business improvement plan and, secondly, that it does include things like remuneration packages for senior management.

Mr Macpherson: Central to the agreements last week was a more sensible approach to remuneration and we will obviously have to come back to you on that.

Q284 Chairman: The detail of all these agreements the Chancellor referred to in his statement was supposed to be put in the library in the House. Has that happened?

Mr Macpherson: I will check. I would assume it has because the agreements were published by the companies themselves.

Q285 Chairman: He said that the detail would be placed in the library of each House.

Mr Macpherson: I will check up on that.⁹

Q286 Chairman: You have been rather coy about the economic situation. I think you refer to it as a change to trend. The Governor last night referred to us entering a recession and the Prime Minister this morning referred to the onset of a global recession. You are in overall charge of the UK economy. Are we entering a recession?

Mr Macpherson: "Recession" is a very emotive word. The media have been determined that we should be in recession now for several months. Output was flat in the second quarter. We will get the third quarter figure on Friday, but we should be in no doubt that conditions out there are very difficult. I think the Prime Minister said that no country can insulate itself from world conditions and he mentioned Britain in that context. I would definitely be in the same place.

Q287 Chairman: Your assumption would be that we are, to all intents and purposes, in recession at the moment?

Mr Macpherson: A number of countries are already—

Q288 Chairman: I am talking about the UK.

Mr Macpherson: I would be very surprised if the British economy did not have at least one quarter—possibly more than that—of negative growth.

Q289 John McFall: We are in for a downturn?

Mr Macpherson: I think we are in for a downturn.

Q290 Jim Cousins: A downturn in inflation?

Mr Macpherson: We are going to have a downturn in inflation for sure.

Chairman: Thank you very much. You owe us quite a number of notes as a result of this afternoon. Thank you very much.

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⁹ Ev 76

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Members present

Mr Michael Fallon, in the Chair

Nick Ainger
Mr Colin Breed
Jim Cousins
Mr George Mudie

John McFall
Mr Mark Todd
Sir Peter Viggers

Witnesses: **Rt Hon Stephen Timms MP**, Financial Secretary to the Treasury and **Rt Hon John Healey MP**, Minister for Local Government, gave evidence.

Q291 Chairman: Mr Healey, can we welcome you back to the Sub-Committee. Perhaps you thought you had escaped!

John Healey: Thank you. I am delighted to be here, Mr Fallon.

Q292 Chairman: Could you formally introduce yourself and your colleague, please.

John Healey: I am John Healey. I am the Minister for Local Government. I guess you could say I am the prime client Minister in Parliament of the VOA and with me obviously is Stephen Timms.

Mr Timms: Financial Secretary at the Treasury to which HMRC reports and to which the Valuation Office Agency reports.

Q293 Chairman: Indeed. Perhaps we could start with you, Mr Timms. Two weeks ago the Valuation Office could not answer us when we asked what the total revenue increase would be for the Treasury from these revaluations.

Mr Timms: I think figures were given by the Valuation Office Agency about the aggregate increase in rateable value. I understand those figures were updated immediately before the meeting. In broad terms, I think the revenue impact is 50 pence in the pound, so we have the updated figures now for the aggregate rateable value rise. From memory, the new total is about £230 million, that is an increase of £16 million on the figure previously. That £16 million increase in aggregate rateable value corresponds roughly to an £8 million increase in revenue.

Q294 Chairman: The Agency told us rateable values would rise from £181 million to £200 million, which is an increase of £19 million. You are now saying they are going up to £230 million.

Mr Timms: A note has just been sent in on this and I now have it in front of me. The aggregate rateable values for assessments in these ports before the review, which was initiated in May 2006, totalled £195 million in England and £32 million in Wales. After the review those figures become £211 million in England and £32.5 million, so a tiny increase, in the case of Wales.

Q295 Chairman: The total increase in rateable values is £16 million and the total increase in revenue for the Treasury is only £8 million, is that right?

Mr Timms: I believe that is correct.

Q296 Chairman: Are you aware that Beverley Hughes, who was then the Minister taking through the Order in the year 2000 on the draft Docks and Harbours (Rateable Values) (England) Order which postponed the first attempt of revaluation, said: "Although the bills of individual companies will go up or down, the overall effect across the country on tax-take is neutral"?

Mr Timms: I have not seen the transcript of that particular debate. It is certainly true from the figures I have given that the overall impact on revenue is a fairly small one compared with the very significant impact on some individual businesses, but it is clearly not zero.

John Healey: Chairman, I think the aggregate figures cover two important things below that. The aggregate rateable value for both port operators and port occupiers may have risen by around £16½ million, which are the latest figures but, in fact, for port operators the rateable value is £42 million down, for businesses that occupy the ports, it is £56 million up. Although overall there may be relatively little change, as perhaps Beverley Hughes might have indicated before and Mr Timms has, nevertheless the distribution of the changes in rateable value are significantly different between port operators and port occupiers. The second thing is that across the 51 statutory ports where the listings have now been completed and notified, again it shows some very significant differences. For some ports there has been virtually no change, in places like Barrow, but in a place like Hull the rateable value for the port operator has more than halved. Thirty eight new companies are now being listed as being eligible to pay business rates separately for the first time, even though those are companies that have existed and operated in many cases in the ports for some time. The rateable value for them has clearly gone up with the additional problem given the timing of a backdated liability to pay the rates off the back of those listings and ratings.

Q297 Chairman: Which we will come to. Freshney Cargo Ltd, for example, on the Humber wrote to us after the previous session two weeks ago saying the rates on the four ports on the Humber had gone up by approximately £11 million, which would mean for the other 51 ports the increase would only be £8

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million. Somehow the Sub-Committee feels we are not getting the right figures here. You are saying there is a commensurate reduction for the port operators.

John Healey: I am not saying it is commensurate. There are three things happening here if I may say so. First of all, the rateable value of some port operators has changed significantly, Hull, Liverpool and Immingham being cases in point, Barrow in contrast not being a case in point, with the new listing following the review the VOA has conducted. The second thing that has happened is that by looking in more detail at what actually happens in the ports, the VOA have been able to identify a number of companies, many of which have operated in the ports for some time, that should have been listed separately and paying business rates separately but were not and they have now been listed for the first time. In Hull's case, there is an extra 38 companies and in Liverpool's case it is an extra 89 companies. That is why the third thing is happening here, which is the rateable value of the businesses occupying the ports, the port occupiers, in some of these ports has gone up significantly. In Hull the rateable value has gone up for the port businesses/occupiers by over £11 million; in Liverpool it is a similar amount.

Q298 Chairman: It is the occupiers who are now facing the prospect of going out of business. Are you really going to stand idly by and watch that happen?

John Healey: The problem in the perceived unfairness is two-fold here. First of all, for these pre-existing businesses which have now been listed and therefore face a business rates bill of their own for the first time, they are having this confirmed for them and the amount confirmed midway through 2008, three and a half years into the current listings period and yet their liability dates under legislation from 1 April 2005. That is the first perceived unfairness. The second perceived unfairness, and some have argued this as occupiers of businesses, is they feel they have either paid their business rates or in some senses paid a contribution to their business rates as part of the fee that they pay to the port's operator. Where they see their port operator in-line for a significant rebate because their rateable value has gone down, they are facing a business rates bill on the other hand of their own for the first time, even though for a good number what we can say now, with the hindsight the Valuation Office Agency offered you two weeks ago, is that many of these businesses should have been listed separately well before 2005 and paying business rates themselves separately before 2005.

Q299 Chairman: Having imposed this extra charge on the 55 statutory ports, are you going to go on and impose a similar reassessment on the 60-odd commercial ports?

John Healey: Can I make two points. In a sense, this is the VOA doing its job. Their job is to make sure they have full and comprehensive listings of those businesses which should be eligible for business rates in a way that we did not for these statutory ports in

2005 and arguably did not in the previous period as well. There are four ports for this work which have still not been completed and they are Plymouth, Poole, Ramsgate and Milford Haven.

Q300 Chairman: My question was, are you going to go on and extend this reassessment to the other non-statutory ports, the other 60-odd commercial ports?

John Healey: The VOA will be doing the review as part of their job of maintaining an up-to-date business rates list, but the situation in statutory ports is different. It is different because prior to 2005, and this was what you were referring to in citing the legislation which Beverley Hughes was involved in, the business rates for the port operators in the 55 statutory ports were determined by a formula rather than by the method that every other business used, including the 60 or so non-statutory ports. There is not a similar exercise required or underway for those non-statutory ports because they would have been assessed and their lists would have been maintained in the normal way by the VOA.

Q301 Chairman: That is what I want to be clear about, they are not going to be reassessed?

Mr Timms: As I think the Committee knows, the exercise on the statutory ports was triggered by an investigation at Southampton. No exercise has been triggered in the case of commercial ports and the Valuation Office Agency is not aware of any reason why there should be such an exercise.

Q302 Nick Ainger: I think it would help us because today to have had a new set of figures, a fortnight after the VOA appeared before us. We asked the officials if they could send us a breakdown of the changes which had happened with the 2005 revaluation so that we could see how the changes had happened. We were being assured that overall RVs had increased by 10% from £181 to £200 million, now you have given us different figures again. I think it would be very helpful if you could send us that full breakdown because the lists are out there, other than for the five which have still not been completed. We are being told by individuals who have been operating for many years from these ports that their percentage increase is in the region of 200% to 500%. That means other organisations within those ports are having some very, very, very substantial reductions if we are only going to get that 10% difference and so on. Can you give us that information because clearly out there port operators do not believe the figures being quoted because they see their rateable values going up so dramatically, irrespective of the backdating which we will come on to? Can you give us that assurance that we can get those figures?

John Healey: By all means.¹ This is work in progress. The updated figures which Mr Timms has given the Committee this afternoon are of a similar scale as the ones the VOA gave you two weeks ago. As I said earlier, in fact, if you and we want to understand what is going on, the aggregate figures only tell us a

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limited part of the story. The two things that are important are the differentials in rateable values between port operators and port occupiers. You will find from the latest information, which is now complete for 51 out of the 55 ports, so there are four remaining which I mentioned earlier on, virtually none, although I think there may be one or two ports, as port operators to whom you referred, have seen their rateable value increase.

Q303 Nick Ainger: By huge percentages.

John Healey: The operators, but what you will see in some ports is the rateable value of the businesses which operate and occupy premises within the ports has changed significantly.

Q304 Nick Ainger: I am sure the figures will show that and it will be helpful if we can get that.

John Healey: That will give the Committee a clearer picture.

Q305 Nick Ainger: Can we move on to the backdating issue. It is clear from the evidence we had a fortnight ago and also subsequent evidence the Committee have received, that many of the actual port occupiers, those carrying out business within the statutory ports, had not received any notification from the VOA that they were either going to now be paying business rates or that there was such a substantial increase. Why did that happen?

Mr Timms: Shall I comment on that from the VOA standpoint. I think the VOA accepted when they were at the Committee the other week that a better job should have been done on communications than was done, but I have been looking at some of the detail here. The VOA did write to all the statutory ports in May 2006: "I am writing to notify you of a forthcoming major review of port assessments in England and Wales". That letter went on to say and I am reading from it now: "The second purpose of this letter is to enable you to inform your customers that a review is to take place and the possible consequences in terms of their liability for rates. With changes to rating assessments taking effect from as early as 1 April 2005, it is inevitable that accrual of rates liability will occur for those customers affected where the port is visited later in the review programme". The intention with that letter was that the port operators would inform their tenants that there was a liability issue.

Q306 Nick Ainger: On reflection, would it not have been better to write directly or contact those companies rather than, in effect, contracting out that communication to the ports themselves?

Mr Timms: Indeed, that is a very fair point and a question I asked. That letter also requested lists of the tenants from the port operators. In the case of Hull then, a letter was sent in December of 2006 to the occupiers saying: "I am writing to notify you of a major review of ports in England and Wales which could introduce a new liability or increase your existing liability for business rates". That went to all the occupiers in Hull in December 2006.

Q307 Nick Ainger: December 2006?

Mr Timms: Yes.

Q308 Nick Ainger: We are already past the time when this was going to be implemented from April 2005.

Mr Timms: The work started in 2004 around Southampton. There was a legal challenge then from Southampton to the change that the VOA believed should be made. That legal challenge and the appeal was only dropped in April 2006, so in May 2006 the VOA then immediately wrote to all the statutory ports knowing they were all affected. That was the letter which asked the ports to inform their occupiers and asked for lists of the occupiers. It did become clear during 2006 that the compliance with that request on the part of all operators was variable. In the case of Hull, as I say, a letter went out in December 2006 from the Valuation Office in Hull to all those who by that time it had been established were occupiers of the port.

Q309 Mr McFall: Minister, you mentioned 2006, you will be aware that in Scotland the consultation exercise was undertaken in 2002 to determine the views of those affected by the change and no consultation took place in England.

Mr Timms: I have not looked at what happened in Scotland.

Q310 Mr McFall: That is a fact. The reason I say that is the Valuation Office Agency is under a statutory duty to compile and maintain an accurate ratings list. The Valuation Office Agency knew as early as 2000 that it would be required to carry out a revaluation of ports and harbours to introduce ratings on ports and harbours by conventional means for 1 April 2005, is that correct? It knew from 2000.

Mr Timms: Yes. The formula was abolished in effect by legislation with effect from 1 April 2005, but there is a separate issue here which is where the liability falls between port operators and port occupiers and, as I understand it, it was only through the exercise on Southampton in 2004 that it became clear the way things had been done previously was not right.

Q311 John McFall: We cannot get away from the fact that the Agency is under a statutory duty to compile and maintain accurate ratings, is that correct?

Mr Timms: Yes.

Q312 John McFall: We have got that but, according to the comments of Beverley Hughes, who referred to that, the VOA had begun the exercise as early as 2000 but no consultation took place in or before 2000 between the VOA and the port businesses affected by the change. That is a fact, that was misleading information. Despite knowing that it had a statutory duty to compile accurate ratings on 1 April 2005, despite knowing that they had to carry out a re-valuation of docks and harbours by 1 April 2005 and despite partly beginning the exercise prior to 16 March 2000, which was found not to be the

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case, the situation is that the VOA failed to carry out the required re-valuation of ports and harbours by 1 April 2005 as it was obliged by statute to do. That is the issue.

Mr Timms: I think John may well know more about this. My understanding is that is not correct, that work was done in time for 1 April 2005. However, there was this separate issue about the balance of obligation between the operators and the occupiers. As far as I know, that was not raised at all until the Southampton exercise in 2004 and, in fact, it is that which has caused the problems.

Q313 John McFall: Your officials admitted to me last week in questioning that consultation with those occupiers was not undertaken, unlike Scotland.

Mr Timms: Certainly there is an issue about communication.

Q314 John McFall: Minister, there is no problem in Scotland now because that consultation was taken early.

Mr Timms: I think that is a different issue. The issue here which has caused the problem is not the work that needed to be done following the abolition of the formula with effect from 1 April 2005, the problem has arisen about this question of the balance of liability between operators and occupiers which was not on the table until 2004.

Q315 John McFall: We have got to cut through that. Minister, the issue here is really simple, in Scotland in 2002 they undertook that consultation to determine the views of those affected by the change and that was not taking place in England.

Mr Timms: And in England and Wales as well.

Q316 John McFall: No, because your officials admitted to us last week.

Mr Timms: No.

Q317 John McFall: They did.

Mr Timms: The consultation also took place in England at the same time.

Q318 John McFall: Those individuals affected in the ports were not consulted, that is on the record.

John Healey: Could I try and help, if it would help the Committee.

Q319 Chairman: First of all, could I try clarify this. Mr Timms, why did this balance between occupiers and operators not arise in Scotland? Presumably it is because they were consulted properly.

John Healey: I am certainly happy to let you have a note of what happened in Scotland. My understanding is this, that they have three statutory ports, not 55, a simpler job. They have an agency which is the equivalent of the VOA in Scotland. They did, indeed, have a consultation in good time before 2005 and came to the conclusion that they were already separately and adequately identifying the businesses within the ports that should be rated separately for business rates in Scotland in a way that we thought we had in England, but—if I can

come on to the equivalent in England with the VOA—they were discharging their statutory duty to maintain a full and up-to-date ratings list. Prior to 2005, because of the use of the formula in statutory ports they did so, as far as I understand it, in this way: essentially by getting information from the port operator about the businesses operating within their port and then making their calculation both of the port operators' liability according to the old formula and then raising the business rates listing for those ports that were on the list. What happened when they started looking more carefully in Southampton was that it became clear in Southampton there was a large number of ports which were not listed separately which should have been. They were challenged in 2004. We can say, Chairman, and I think the VOA would say this for themselves, and Mr Tretton said to this Committee in hindsight they should have done more investigative work. Instead they waited until the legal proceedings had been completed two years later and then started to look seriously at what the position was in the 55 statutory ports. There is an issue that I think Mr Timms and I need to look more carefully at, which is the nature of the requirement to provide information to the VOA about the nature of businesses, because the port operators may well have been obliged to provide the VOA with information about their own operations and the businesses within their port precincts that were already listed. In other words, there was a significant number of businesses in some of these ports which were below the radar and were not picked up on the listings prior to 2005. It is only through this extensive and quite complex review that has been undertaken, but taken a long time and only started in earnest in May 2006, that we have seen these extra firms in a number of these ports rightly identified as liable to be listed in their own right and paying business rates in their own right. As I suggested to you earlier, the problem is that because of the delay in doing this work they are now presented with this listing and their bills with the backdated liability three and a half years into the operation of the current list.

Q320 Nick Ainger: That is the key. The final point is this: you have told us that individual port occupiers were not informed until May 2006, more than a year after the new regime was supposed to be introduced.

John Healey: Could I stop you, because the port operators were written to in May 2006. The port occupiers may not have been contacted in the case of Hull until December 2006 by the port operator.

Q321 Nick Ainger: You are reinforcing my case for me.

John Healey: In some cases I believe the VOA did not get returns on the information from some port operators until well into 2007.

Q322 Nick Ainger: Through no fault of their own there are literally hundreds of companies around the coast of England and Wales which, while the earliest ones were informed 13 months after the date of introduction, April 2005, and some much later than

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that, when the VOA finally got round to completing their work and informing individual companies, in some cases virtually three years have elapsed between April 2005 and in many cases April 2006. These individual companies then got in some cases huge bills. One company, Fortress Warehousing and Distribution Limited in Tilbury, went into receivership after receiving an unexpected bill of £2.4 million. P&O in Hull has been hit with a backdated bill for £5 million. Clearly, none of these companies is responsible for the situation that they found themselves in. Why do you not cancel the backdating? It is not their fault. Why do you not start it from 2009 or 2010?

John Healey: Could I pick up several points. I do not wish to be too lengthy about this. It is not their fault. They should have been able to have the information about their listing earlier. The nature of the work and the length it took means that this big delay has presented some of these companies for the first time with their separate business rates bill. I think it is unlikely, particularly for a company as big as P&O, that they would not be aware of changes in the system some years earlier, but it may also be true that particular operations in particular ports did not know the detail of their bill until then. The question is it may not have been their responsibility, clearly that rests with the work the VOA needed to do, but these properties should have been rated separately and should have been rated separately for some time. These are not new businesses, these are pre-existing businesses that have been operating without paying a rates bill for themselves for that period. They were not rated separately and the reason being it was down to incomplete information the VOA had prior to 2005, and when they drew the 2005 listings up, but filled in eventually through their review of each of these ports. Where the VOA had before been aware of these properties and these businesses, they were listed separately. In other words, the principle that these businesses should have been liable to pay business rates for themselves has existed for some time. It is the method and mechanism of the VOA confirming the information and producing the listing that gives rise then to the liability of the business rates bill that has taken this unacceptably long time to undertake.

Q323 Nick Ainger: Again, you confirm the fault lies with the VOA, that no fault lies with the individual companies. Many of those are long-established companies working in ports, particularly in the ferry business, the container business and so on, which believe that they were paying their business rates through the rent they were paying to the port, that was their understanding. As we had quoted to us today, when ministers introduced this change they said it would be revenue-neutral, so the assumption was that, while they would not be paying that part of their rent which covered their business rates, they would be paying it direct to the VOA and there would not be a huge change. Again, I keep saying through no fault of their own, what has happened is there have been these huge changes and it is being backdated. They have got no chance whatsoever to

go to their customers and say, "I'm terribly sorry we have just had this big bill through from the VOA or the local authority and we are going to have to put through backdated charges covering three years". No customer is going to pay anyone a penny for that. This is a real problem, John. People are losing their jobs, businesses are closing as a result of this. I do think from what you have told us and what your officials told us a fortnight ago that the fault lies with the VOA and you cannot in all honesty justify backdating it to April 2005.

John Healey: Could I come to the backdating in a moment, but could I say very clearly that I do not see this as a question of fault, I see it as a question of facts. At each stage the VOA was using the best information they had at the time to compile their ratings list. What has emerged as a result of the detailed work in very complex arrangements within ports in these 55 areas as the facts become clear that there is a number of businesses—as things stand it is 678 in England and Wales—that should have been rated separately and for the first time now are, but the facts have taken this long to establish. It is not a question of fault, it is a question of facts.

Q324 John McFall: Let us go on to the facts then so we have got it on the record. In 2007 and 2008 businesses in the 55 statutory ports in England and Wales were presented suddenly and unexpectedly with demands to pay significantly increased non-domestic rates on their premises. Is that correct or wrong?

John Healey: My understanding is that from the summer onwards in many of these statutory ports for the first time the VOA had established the facts and was therefore in a position to confirm the separate business rates listing for some of these companies and the collection authorities were—

Q325 John McFall: These firms were suddenly and unexpectedly faced with these demands.

John Healey: Whether it is sudden and unexpected might vary from company to company. What is true is that they would have had confirmed for the first time their listing and then the collection authorities would have raised their bill.

Q326 John McFall: As Nick says, going back to the re-valuation in 2005, I think if you were a director of any of these companies, you would say, "That is pretty sudden, knowing I have got to take back to 1 April 2005". Port businesses did not know in advance of increased liability to pay significant increased NDR backdated from 2007–08 to 1 April 2005, is that correct?

John Healey: Port businesses are no different from any other business.

Q327 John McFall: You mean retrospectively for three years?

Mr Timms: Just to comment on that, I did mention the letter that went out to Hull businesses in December 2006 alerting them.

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Q328 John McFall: This is going back to 2005. You do not get many letters through the door saying, “We made a mistake and you’re being backdated three years”.

Mr Timms: My point was simply that there was a letter drawing attention to it in 2006 not 2008.

Q329 John McFall: That being the case then, as Nick says, port businesses cannot retrospectively recover the increase in their cost from their customers as a result of this. I am addressing the facts. I want you to put that as a fact.

John Healey: What I want to say is that Mr Timms and I are trying to deal with this in two ways and I think there are distinguishable points here. The first is a view that the Committee may take differently from what we do. Is there or is there not a liability for these pre-existing companies, now that they have been listed, to pay those backdated business rates? The legislation covering these companies is no different from any other company. Mr McFall, if you had a business occupying a set of premises which you divided into two and that became apparent to the VOA a couple of years after the listings had started but you had done it before, then they would use the same system here of giving your two companies, instead of one premises, a business ratings value and that liability would be backdated to the beginning of the list. In fact, what is happening to these newly identified but pre-existing port occupiers is—

Q330 John McFall: It is a bit disingenuous, Minister.

John Healey: I try not to be disingenuous.

Q331 John McFall: From 2000 consultation should have taken place. Consultation took place in Scotland. There was not any problem about it. We have got mayhem in 55 ports in England and Wales and we are asking you to look at those facts and get something sorted out.

John Healey: I think we have dealt with the unsatisfactory way in which the facts were established and the unsatisfactory length of time that it has taken to establish. We are now dealing with the question of liability. I think the Committee may need to ask itself this, if I may say so. If I am operating a warehouse company or a factory within the precincts of a port and I happen not to have been separately liable for a business rates bill because I have been below the radar, if you like, the facts of my separate business have not been established before now but have been through this review, and you are running a business on the other side of the port perimeter doing exactly the same thing but for the same length of time have been paying business rates, there is (a) a competitive advantage you may have over me and (b) an interest that you have in making sure that if I am identified legally as now liable for these business rates that I should be expected, like any other business in any other situation, to pay those rates from the beginning of the list. What Mr Timms and I are very conscious of is the pressure, particularly on some of these smaller firms, of a big business rates bill coming three and a half years into

the ratings period with a legal requirement, as things stand, to pay in full by the end of this financial year. What we are now doing, particularly in the current economic climate but because in principle this is the right thing to look at doing, is we are looking at ways we can make the impact of having to pay those business rates for which the company is liable over a much longer period so the companies are not hit with a big bill that they have to pay in short order, some of whom—and they have said it to the Committee and said it to us—may be driven out of business if they are forced to do that according to the legislation as things stand. We have our officials working together on ways that we can soften the requirement to pay the business rates for which they are liable. As soon as we have been able to complete that work, Chairman, we will update the Committee on that. It is taking place rapidly and with a sort of urgency that Stephen Timms and I require of our officials to sort this out.

Chairman: That particular step, I am sure is welcome, but I want to bring in other members of the Committee now.

Q332 Sir Peter Viggers: I was about to ask you if it was your submission that the situation which has emerged is fair and equitable, but I think you have just answered that question by indicating that you are seeking to find ways of modifying the impact. Good.

Mr Healey: Perhaps I could make a point on that, really picking up Mr Ainger’s question earlier. One would accept that companies in the position we are describing cannot now go to their customers and ask for more money but it does occur to me that they might be able to go to their landlords, given that, as we have been told, they were under the impression that they were contributing towards the rates cost through their rental. There may be some issues there to be explored on the part of the companies involved.

Q333 Sir Peter Viggers: Looking ahead, the Valuation Office Agency informed us that they had no option under the regulations but to backdate. On that basis, do you think the regulations need to be changed?

Mr Healey: The short answer is no, because neither of us accepts that this particular group of companies should not, in the end, in principle be liable for the business rates like any other company that may be listed but pre-existing for a period well within the listings period. What seems to us important is to find ways that we can make the payment of the business rates that are due from these companies in a way that makes it as easy as possible for them to do so, given the special circumstances in which they find themselves with this Bill, three and a half years into the current listing system but a legal requirement to pay it before the end of the financial year in full.

Q334 Sir Peter Viggers: Probing your powers, port users have been advised by leading counsel that the Secretary of State still has the power to prescribe the rateable value arrangements in ports and harbours.

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This is an interpretation of the Local Government Act 2003, sections 69 and 128(6). A Select Committee is not a very good place to discuss the detail of the law but it is such an important point as to whether you have power still to prescribe the rateable value. Have you taken legal advice on that point and do you agree that you still have power to prescribe the rateable value?

Mr Healey: We still have the power, but, if I may say so, it is a red herring, because the power of prescription was to use a formula for the business rates liability of the port operators only. We have a concern, the Committee has a concern, about the position of the businesses occupying parts of the port now listed, properly listed, for the first time. Use of the formula would not help them. What cannot be done is somehow not to include now what we have clearly established as separate businesses liable to pay business rates on their own account, those, if you like, that were before the radar before 2005. We cannot suddenly put them to one side, knowing that they should be but were not previously identified as liable and listed for their own business rates payment. I am aware of that legal advice, I am aware of the wide circulation that some of the lobby groups have given to that, but I would suggest to the Committee that it will not help the businesses that are under the most pressure here, and it is, in terms of what we believe we need to do and perhaps the Committee is concerned about, something of a red herring.²

Q335 Sir Peter Viggers: Given that valuations were not prepared in a timely way, is it possible simply to say the new rates will not be imposed until 2010 when the next valuation is due?

Mr Healey: Not without changing primary legislation, as I understand it, and not without saying that this group of taxpayers is a special case, thereby risking clearly questions of state aid and thereby clearly risking questions of legal challenge from comparable companies that may be operating just outside the port's perimeter in exactly the same field and directly in competition.

Q336 Sir Peter Viggers: Just returning to the point before last, if you were to accept the situation is inequitable, do you not think that the power to prescribe would give you an opportunity to reopen the issue and go back over the imposition and seek to find a fairer solution?

Mr Healey: I do not know. I will let Mr Timms speak for himself, but we have both been Treasury ministers for some time between us. I, instinctively, am quite uncomfortable with the idea that somehow ministers are given the power to waive or alter the tax liability of an individual taxpayer, in this case a relatively small group of businesses that operate within a number of ports. We do not have the legislative power at the moment. I would not want to be a minister looking to persuade the Houses of Parliament that we should be given that power. I think it runs potentially into problems of state aid

and competition challenge. I think the best course of action, the one which we are looking hard at now, is to try to find ways of making sure that, as far as we can, this big and backdated business rates liability which does need to be paid and does need to remain can be paid in a way that does not cause these businesses undue financial pressure at this time.

Q337 Mr Mudie: The only difficulty is really that the businesses are telling you the problems they have: thousands of jobs and even the businesses themselves facing bankruptcy—and I think we actually have papers where one or two have gone down. Southampton in their evidence to us said that there was no consultation taking place in England. Stephen, you said consultation had taken place. Who is right?

Mr Timms: My understanding is that the consultation in England and Wales and Scotland took place at the same time over the question of removing the formula. That exercise, I think, was done at the same time. The difficulty we are grappling with now is this separate issue about where the liability fell between operators—

Q338 Mr Mudie: I think that is a red herring to an extent. Consultation took place in Scotland. There is no evidence—apart from you just throwing the remark in, there is no evidence in any of the evidence—that consultation took place in England. It is interesting: neither of you have looked at Scotland and what arose after that consultation. Why not?

Mr Healey: I have asked about this. As I said to the Committee earlier on, I was told that in Scotland they were dealing with three ports, they had their consultation—I think it was in 2002—and the equivalent of the VOA in Scotland, having looked at it, was satisfied that they did not face what we now realise is the case in the 55 statutory ports in Britain, but there was a large number of businesses operating in their three statutory ports—

Q339 Mr Mudie: John, before you dig yourself further in—

Mr Healey: No, I am not—

Q340 Mr Mudie: Scotland introduced a transitional dampening scheme. It was not the fact that—

Mr Healey: Mr Mudie, we had a transitional release scheme—business rates of a very similar nature, if not the same nature, as they do in Scotland. The issue in Scotland, as I understand it, was that they did not find when they came to look at the position of the three ports that there were a large number of businesses operating in those ports that should have been listed separately for business rates but were not. That is the problem that we found. In terms of your Southampton example: Southampton of course is not a statutory port so would not have been covered by the formula. The answer to your question to Mr Timms is that there were three points at which consultation over the proposal to remove the power of the Secretary of State to prescribe the formula for the 55 statutory ports. They were the *Modernising*

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Local Government Finance Green Paper in 2000, the *Strong Local Leadership* White Paper in 2001, and the consultation paper produced by the ODPM 2002, in June, alongside the Draft Local Government Bill. I can provide copies of those three consultation documents to this Committee.

Q341 Mr Mudie: You are saying that Scotland did nothing different, in terms of how this was introduced, from England, they were just fortunate. They were just small.

Mr Healey: I am saying that my understanding of the situation in Scotland—and, as I have already said to the Committee that if it is helpful we can provide a more detailed note of what was done in Scotland by the parallel agency.³

Q342 Mr Mudie: That would be helpful.

Mr Healey: —was that when they looked at the position of the three statutory ports they had there, they found that they were not facing the same situation as we now know we had in England and Wales, where there were a large number of businesses operating from within the port that were not rated, when they should have been, for their own business rates.

Mr Mudie: John, as I understand it, you are saying that one of the important things is the division between the firms and the port owner, and that it looks as though the port owner has gained and the port users are losing and the port users are saying, “Sometimes we have paid rates. In our licence or in our rent, et cetera, there is an amount for rates.” If there had been proper consultation, that would have come out and people would have known what was going on. One of your difficulties is you cannot intervene, it seems to me, because you are saying, “Why should we intervene? There are losers but there are gainers”—it is almost: “You two sort it out.”—and the gainers are saying, “On your bike,” The losers, with thousands of jobs at stake, have nowhere to go, all compounded by four years’ backdating. The revaluation is almost no complaints; it is the revaluation times four.

Chairman: Let us have the answer.

Q343 Mr Mudie: No response.

Mr Healey: What would you like me to respond to?

Q344 Mr Mudie: Your last answer to the last questioner was that you did not see it as your duty or even a good thing for you to interfere in any financial way. I am minded of the 10p tax situation, where we did intervene. We actually paid money to a considerable number of people. I think almost one million people got money on the second tranche who did not need it.

Mr Healey: Where I think Mr Timms and I see it difficult for a minister to intervene is in the potentially contractual argument that it may be legitimate for some port occupiers to have with their port operators about whether or not, as part of their licence fee or fees to operate or the “cumulo”, they

were in fact paying an element of business rates that they were not paying separately but the port’s operator paid previously under the operation of the formula.

Q345 Mr Mudie: Stephen, the VOA said there was no assessment of the impact on ports with the legislation being ceased. Jim Fitzpatrick in the House said there were assessments. Were assessments done?

Mr Timms: These are assessments of the abolition of the formula prior to 1 April 2005?

Q346 Mr Mudie: Yes.

Mr Timms: John has read out the list of consultation exercises which led up to that abolition in 2005. There certainly will have been impact assessments around the legislation that abolished the formula. It may be a question about who did these assessments, but certainly as part of the normal legislative process there would have been assessments carried out.

Q347 Mr Mudie: If there was an assessment carried out, it would either be wrong and show that there was no financial impact, or it would be right and it show that there was a financial impact.

Mr Timms: I think this comes back to the point that the difficulty arises not because of the legislation that abolished the formula with effect from 1 April 2005 but the separate issue that you were just describing about the balance of liability between the port operator and the port occupiers which has not been affected by legislation.

Mr Healey: I think it may help the Committee if we confirm more precisely the consultation and information that was used from 2000 onwards.

Q348 Chairman: Minister, we are not asking about consultation. The Minister in the House last Monday referred to an assessment being done. During transport questions, he said there was an assessment.

Mr Healey: I was going on to say that there would be no impact assessment that this Committee would recognise as undertaken when there is a significant change of policy that government normally introduces. The principal reason for that would be that in fact the VOA was simply expected and did look to carry out its statutory duties of making sure that any business that should be on the business ratings list was rated separately. The shift from the formula was simply the way that the port operator was assessed for its business rates liability. The decision, instead of to do it through an assessment of their income and expenditure as the port operator, was to move the port operator onto a basis like any other business, where its business rates liability was calculated in that way. Then all these other businesses came to light when the situation within ports, which was pretty obscure up to that point, became much clearer, and then it became clear, as a result of the few but regrettably a long time into the ratings list period, that these businesses should have been but were not separately listed.

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Q349 Mr Mudie: You are saying specifically to us that, having looked at it and seen in the number of jobs involved, the number of firms involved, the size of the amounts, that the most we will offer as a government is to discuss length of time for back payments. Nothing else. You have no other powers, or you have other powers but you are unwilling to use them. That is a straightforward question that we need to have answered.

Mr Healey: I think I have explained to the Committee on the question of backdating. If we were to accept the case that the backdated liabilities should be set to one side and waived in this particular group of companies, I have explained, first of all, that it would require primary legislation and, second, there are some reasons that mean that we do not accept that that is a case that we should pursue. However, because of the concern about the fact that they now have three and a half years' worth of business rates to pay within one financial year—a big hit for any business, big or small—we are looking hard at ways in which we can make sure that has the minimum impact on the ability to continue operating. And so it is a question of looking hard at whether we can extend, perhaps significantly, the period in which they may be required to pay those business rates which, after all, unless this Committee takes a different view, in our view certainly they are liable to pay as pre-existing businesses, and some might argue they perhaps should have been paying and should have been liable to pay in the periods before 2005 as well.

Chairman: You have been clear about that. I must protect the next session but Jim Cousins has a question.

Q350 Jim Cousins: Just a couple of tidy-up points. Mr Timms, you said in response to a point from Sir Peter Viggers that this issue was one that tenants might wish to raise with their landlords, the port operators. Is that a point you have already made formally to the port operators and their tenants?

Mr Timms: No, I have not been directly in contact with the port operators or—

Q351 Jim Cousins: Has the VOA raised that with the port operators or their tenants?

Mr Timms: I do not think that the VOA knows the details about the contractual arrangements between tenants and operators. I made the point simply because it emerged from what Mr Ainger said, that the tenants often had been under the impression that they were paying towards the operator's rates bill through the rents that they paid.

Q352 Jim Cousins: I understand that, but, Mr Timms, I would have expected, if you had put that point into the discussion—and it is an important point—that you would have given it very serious consideration before you did so.

Mr Healey: It is important point Mr Cousins, and it is one that has been—

Q353 Jim Cousins: If you would forgive me, Mr Healey, I am asking this question of Mr Timms. Have the implications of that point, that this could be an issue between tenants and landlords, been considered inside the Department?

Mr Timms: Let me comment and then I am sure John would want to add to the point. I think that can only be a matter between the tenants and the operators.

Q354 Jim Cousins: No, not really, Mr Timms, because you have put that point into discussion here this afternoon. You have been speaking, so to speak, *ex cathedra*.

Mr Timms: Perhaps, I could help.

Q355 Jim Cousins: You have created the possibility of an expectation that that will be a route to a solution. Had you considered the implications of so doing before you made the remark?

Mr Healey: Perhaps I could help Mr Cousins.

Q356 Jim Cousins: I am sorry, it was Mr Timms who made the remark and I am addressing my comments to Mr Timms.

Mr Timms: I made the remark because I think it is a point which arises immediately from the point that members of the Committee made earlier.

Mr Healey: Mr Chairman, could I say that it is a point that has been raised with the port operators. It is a point of discussion that has been started by the Transport Minister, Jim Fitzpatrick, on Monday this week.

Q357 Jim Cousins: So this is a point which is first raised as an issue by the Transport Minister in a discussion with the port operators earlier this week. What did the Transport Minister expect the port operators to do, once he had raised this point with them?

Mr Healey: He has raised this point because he wants to, and we as a government want to, encourage some discussion on this, but it is and it will remain essentially a contractual issue between port occupiers and the port within which they operate. Nevertheless, particularly when the Committee looks at the differential impact on the rating valuations between these companies operating within the ports and the port operators themselves, the Committee may well take a view, like we do, that there seems to be in some ports, in some cases, big rebates due to the port operators and a big increase in the aggregate rates bill that companies operating within those ports will now be liable for.

Mr Timms: Can I draw attention to the letter that John and I sent to Mr Fallon which does comment on this point. I do not know whether it is in front of the members of the Committee. Page 3 of that letter does raise this issue and mentions that Jim Fitzpatrick has met with the port operators.

Q358 Jim Cousins: Perhaps the information to which Mr Healey has just referred could be made available to the Committee. Perhaps the Committee

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could be kept informed as to what legal advice was taken, inside whatever department was involved, before that suggestion was raised.

Mr Timms: The point was made in a letter to Mr Fallon.

Q359 Jim Cousins: Mr Healey raised the issue of state aid. The issue of state aid presumably arises from the old prescribed rating regime, because it might be considered to have been unfavourable.

Mr Healey: No, I simply suggested to the Committee that if one were considering the case about wiping or waiving the tax liabilities of this as a particular and specified group of companies (in other words, those operating within the port perimeters that have a separate rates bill for the first time), there may well be questions of state aids, given that it would be, in effect, state support, financial support, for a clearly specified identifiable group of companies.

Q360 Jim Cousins: Was the issue of state aid ever raised about the old prescribed rating regime.

Mr Healey: No. But it was not relevant.

Q361 Jim Cousins: Has the issue of state aid ever been raised in the period since 2005?

Mr Healey: It would only be raised if one were to consider wiping clean or waiving the tax that is due from these companies that are now, for the first time, listed in the business ratings list as separately liable for a business rates bill.

Q362 Jim Cousins: Your point is that they should have been for the period running up to 2005 and were not, so there would be an issue of state aid there, would there not?

Mr Healey: That may be a view that you would take.

Jim Cousins: That may be a view, and it has never been raised.

Q363 Mr Ainger: Let us look at this issue of the relationship between the port operators and the port occupiers. You are telling us that the port operators are going to get a backdated rebate to April 2005 but the port—

Mr Healey: In some cases.

Q364 Mr Ainger: Okay.—but the port occupiers are going to get a backdated increase—yes?—

Mr Healey: In some cases.

Q365 Mr Ainger: -- to April 2005, and for that same period the port occupiers will also, in many cases, have been paying a contribution to the port operators to cover their non domestic rates. Do you think that it is fair? Bearing in mind the responsibility of this lies with the VOA's failures earlier, you should be insisting in some way, at the very least—never mind about trying to spread the increase over a few more years—that the port operators refund all the non domestic rate element of the rent to the occupiers from April 2005?

Mr Healey: I did, early on in this session, identify the two perceived unfairnesses that I think are at the heart of this. There may well be an argument that principally needs to be had between the port occupiers and the port operators, where there may be this differential. Mr Timms and I are concerned to consider the action that we have within our power to take. That is what we are doing at the moment by looking at the ways that we can make sure that the rates bill that these businesses are now faced with for the first time is, as far as possible, as straightforward to pay and has as little impact as possible on the viability of their business.

Q366 Chairman: We have to leave it there. The suggestion that you have made that you would mitigate the impact of the payments perhaps, going forward, is certainly welcome, but I would ask you on behalf of the Sub-Committee to consider again the point made by Mr Cousins and Mr Ainger. You have spoken of this entitlement of the operators to quite significant rebates. The net difference here is only £6 million overall in a vast industry. It would seem to me that ministers collectively could do much more to ensure that those reductions and rebates do find their way back to the original port occupiers.

Mr Healey: That is a discussion, as I indicated earlier, that the Transport Minister has begun with the port operators.

Q367 Chairman: Will you join in that?

Mr Healey: We will continue to work very closely with him on it.

Chairman: I look forward to hearing from you on the progress. Thank you very much.

Witnesses: Mr Mike Clasper CBE, Chairman, Mr David Hartnett CB, Acting Chief Executive Officer, and Ms Mary Aiston, Director Governance & Security, gave evidence.

Q368 Chairman: Mr Clasper, welcome to the Sub-Committee. Would you formally identify yourself and your colleagues, please.

Mr Clasper: Mike Clasper; David Hartnett; and Mary Aiston.

Q369 Chairman: Your titles might be helpful.

Mr Clasper: Chairman of HMRC; Permanent Secretary for Tax; and Director of Governance and Security.

Q370 Chairman: Previously we had Paul Gray at the Revenue & Customs and now we seem to have you as Chairman; a permanent secretary in charge of tax; and Lesley Strathie joining to do something else. Why do you have three instead of one?

Mr Clasper: I can explain the roles and then you might want to ask follow-up questions on why we need them. I think there is a good parallel from the private sector world which might explain it. My role is to lead the board of HMRC. That board will have three prime tasks. The first task will be to develop the long-term strategy for HMRC. The second task will be to hold the executive to account for delivery against a strategic plan. The third task will be to ensure that right across HMRC there are high standards of corporate governance. I will not be the accounting officer, nor will I be the person running the department on a day-to-day basis. That will be Lesley Strathie, who will have the classic responsibilities of an accounting officer. She will have all of the top team of HMRC reporting to her, including direct reports from the lines of business within HMRC: personal tax, corporate tax, tax credits and benefits, and compliance. Dave will take a role right across the department to ensure that the quality of the tax policy and the practices and the legislation around tax policy are of the highest standard. In order to do that, he will have our central policy unit reporting to him and also the people working in the areas of intelligence, information, and analysis. He will also be responsible for our relationship with the Treasury, which is obviously critical and which is best expressed in the policy partnership, where we jointly work with the Treasury to produce robust policy across HMRC's activities

Q371 Chairman: Mr Poynter, in his review into the tax discs loss, criticised what he called "muddled accountabilities". You are telling me that you have a chairman, a CEO and a permanent secretary. It seems to me even more muddled.

Mr Clasper: I would disagree. The majority of major companies in the world are moving towards a corporate governance model similar to the UK. There has been a lot of discussion on the international scene about the benefits of the independence of the board from the chief executive. It obviously increases holding the executive to account and it also ensures there is independence of strategic thinking from the executive. So there is no muddled thinking there: there are very clear rules for the board, there are very clear rules for the chief

executive. As far as line responsibility for execution in a day-to-day executional sense, that lies with the chief executive. Dave is stepping out of the way of the day-to-day execution. Dave's role is to ensure the highest quality of tax policy and the words turned into robust policy that will work in execution, but he will not have a day-to-day responsibility for the lines of business. I have talked all of this with Kieran Poynter and he is very clear that this model is a strong one. I have also had the benefit, before I came in, of the capability review looking at the whole issue of accountability and recommending this sort of approach. We have the whole of the corporate world and Kieran Poynter and the capability review all suggesting that this is the way forward, so I do not think it is muddled thinking at all.

Q372 Chairman: Which of the three is responsible for data security?

Mr Clasper: For ensuring that the policies and processes are in good shape, that is a corporate governance issue with the board. In terms of day-to-day execution, that the policies and processes are followed, that is the chief executive.

Q373 Chairman: If you lose another disc, which of the three of you is going to resign?

Mr Clasper: I think when we are talking about resignation, we need to stand back and say, "Is that adding value or not?" I often think it is an easy way to resign when there is a big problem. I think it is more important to hang around and sort it out. All of the people will take accountability for it. Whether they resign or not, I think depends on the situation, and that varies situation by situation. I do not know enough about the situation when Paul resigned to be able to say what was the principle there versus what the principle would be in a totally different situation.

Q374 Chairman: In the 2007 winter staff survey only 15% of your staff said Revenue & Customs had effective leadership. I appreciate you have only just arrived, but what are you doing to inspire more confidence in your staff?

Mr Clasper: To stand back a second, I think there have been several things of a difficult nature hitting the department. I think any large merger often leaves issues of a sense of leadership. The Inland Revenue combining with Customs was certainly a huge merger—as you know, over 100,000 people involved, 15,000 people have left to get the efficiency gains from that merger. I think there are a lot of reasons why the staff would feel, to some extent, a sense of lack of direction or whatever. We have got together as a top team and put together a very simple statement of what the department is about, what we would like to achieve in terms of greater performance, and how we want to go about achieving that and what our values are. You can get it on a very simple page. That is now starting to go public and we are going to spend the next couple of months making sure that the department has had a really good discussion around that and what that means. That goes down not just to the management

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but right to the front line staff in the business. That is the start of the process, not the end of the process. Another part of that is to sit down and look at all of the objectives that we have, of which we have many, starting to determine on which of those objectives we want to try to make transformational progress and on which of those we are happy maintaining just our current performance. The next step after that will be to prioritise certain strategic themes that will allow us to achieve the sort of progress the whole department would like. Coming out of all that and deploying it properly through all of the business, we will then, I think, move into a position where people get a clear sense of direction, what is important, and how we are going to improve towards goals that I think the whole department would feel positive about. In addition to that, you have already mentioned that it is very, very important that we have clear leadership at the top, that people know what everybody does. We have had a period of interim leaders all over the place, and we are going through that, solving it. We obviously now have the top team that is not interim, and we are moving into a position where we are just about to announce the appointment of a new head of HR and we are in the process of recruiting a new head of finance, so we are putting the top team in place in addition. Collectively, there is a lot of activity going on to give the department a sense of what counts, where we are headed, a true sense of direction, and then we will begin the process, hopefully, over time, of upgrading the leadership right across the department, because I think the whole department would admit that our leadership skills in the middle of the department are not as great as they should be.

Q375 Chairman: That 15% figure will be where at the end of your term of office?

Mr Clasper: I think you should hold me to account for that number being significantly better.

Q376 Chairman: Significant. You would not like to put a figure on it?

Mr Clasper: Of course I would not, because I have not had a time to think about it, but significantly better.

Q377 Mr Mudie: Mr Gray, your predecessor, left after the data loss. What was the total pay-off for him leaving? There is some difficulty getting exact figures.

Mr Hartnett: Mr Mudie, I will pick that up, if I may. There has been a lot of speculation but the total figure was a lump sum of £137,591. There was another figure of £49,292, which was compensation payments made under a standard Civil Service scheme until he reached age 60 and stopped, and that was paid at just over £7,000 a month. There was a payment of about £2,600 going into his pension monthly.

Q378 Mr Mudie: How long had he been working in this job?

Mr Hartnett: Paul Gray became chairman of HMRC in 2005—maybe 2006. I do not have the precise date with me.

Q379 Mr Mudie: Was he from the Civil Service?

Mr Hartnett: Yes. He had been a civil servant all his life.

Q380 Mr Mudie: That accounts for his £95,000 to £100,000 pension. Was that enhanced by his departure early?

Mr Hartnett: It was not enhanced, in the sense that it went up by reason only of his departure; it went up because of the Civil Service arrangement under which he left, the standard arrangement.

Q381 Mr Mudie: All right.

Mr Hartnett: What I am trying to say, Mr Mudie, is that there was nothing special about this.

Q382 Mr Mudie: No. That is fine. Stuart Cruickshank, why did he go?

Mr Hartnett: Stuart wanted to follow a portfolio career in the private sector and we and Stuart reached an agreement, on the basis of which he left.

Q383 Mr Mudie: He got £88,000 for leaving. If he wanted to go, why the hell did we pay him £88,000?

Mr Hartnett: We had to take a lot of legal advice around the going because of the—

Q384 Mr Mudie: No, but he wanted to go. He was breaking his contract. You were not breaking his contract.

Mr Hartnett: He did not necessarily, Mr Mudie, want to go at that time. This was a mutual agreement, negotiated by lawyers, and that was the basis on which the money was paid.

Q385 Mr Mudie: Okay. I did not know that, that he wanted to go. When did he want to go?

Mr Hartnett: I am sorry, I did not negotiate the arrangement.

Q386 Mr Mudie: I think we should have a note then.

Mr Hartnett: Happily.⁴

Q387 Mr Mudie: Because if we are paying somebody £88,000 to break their contract ... They should be paying us.

Mr Hartnett: It was, as I say, a mutual agreement. Mike may want to say something.

Q388 Mr Mudie: I could accept a mutual agreement with you if I wanted to leave a job and negotiated an £88,000 pay-off—and I am breaking a contract. He received £22,000 benefits in kind during 2007–08. What were the benefits in kind?

Mr Hartnett: There were two benefits in kind. One was a payment for legal advice and the second was something like outplacement counselling.

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Q389 Mr Mudie: I did not hear those, but we will look at them. What was the first one? Payments for ...?

Mr Hartnett: For legal advice.

Q390 Mr Mudie: What for?

Mr Hartnett: This was part of the package by which we—

Q391 Mr Mudie: He wanted to leave and break his contract, and we paid his legal advice so that he was in a position to negotiate £88,000 for going?

Mr Clasper: I do want to leap in.

Q392 Mr Mudie: No, no, you stay out of it, Michael. This happened during Dave's reign. Why did we pay his legal advice?

Mr Hartnett: Quite simply this: we got to a position with Mr Cruickshank where he had intimidated he wanted to go. We needed certainty around leadership. This was happening at the time the data discs had been lost. He had not indicated clearly when he wanted to go and we believed firmly at that time that we needed a chief finance officer who was absolutely committed to HMRC, not one who was planning another career, having indicated clearly he wanted to go. That is why clearly this was a negotiated arrangement.

Q393 Mr Mudie: He was on contract to you and he wanted to go. You surely could have negotiated a leaving date to suit the organisation, as he was under contract, or else you would have been asking him for £88,000. Why did he need to be paid by you to take legal advice on that? Or am I missing something?

Mr Clasper: I literally, obviously, cannot talk about the situation.

Q394 Mr Mudie: No, you should not, Mike. You should try to stay out of it.

Mr Clasper: No, but I might be able to help a little bit. As I understand this, this was a mutual agreement situation. Where you have somebody who both the department thinks it is the right idea to move on and he concludes after discussion with the department that it is the right idea to move on, it would make a lot of sense then to have a negotiation around that mutual agreement. I do not think he resigned, because—

Q395 Mr Mudie: Mike, you have come from the private sector. In this situation, you would call them in, "I want to leave, I want to go." "Okay, I've got you on a three year contract, you've only been here a year. I need you for three months." "Okay. Fine." Shake hands. You pay him to take legal advice on breaking his contract—

Mr Clasper: No.

Q396 Mr Mudie: -- and then pay him £88,000 of our money.

Mr Clasper: Well—

Q397 Mr Mudie: No, never mind.

Mr Clasper: No, can I just say, if somebody came in and resigned precisely as you have just said, then I think I would have behaved in exactly the way that you have just outlined. I think this was a mutual decision that the future of the two parties did not lie together. If you are in that situation, I have negotiated things which have involved compensation in the private sector. I cannot talk about the conversations themselves, because it long predates me, but I can give you examples where it has been done.

Q398 Mr Mudie: There was a second one. What was the second part I missed?

Mr Hartnett: Outplacement counselling, which was part of the negotiation. Mr Mudie, let me just add one thing, first. Remember where HMRC was: it had lost the data discs; it had lost a chairman; it had a CFO who was indicating that his future lay elsewhere but was not giving a time for resignation and there was a contract. We needed to do something here and that is why this mutual agreement was reached.

Q399 Mr Mudie: All right. I asked for some information and you were going to send it to me on Stuart Cruickshank.

Mr Hartnett: Of course.

Q400 Mr Mudie: You are going to do that. Do the contracts for your existing management board members include provisions for large payments on termination of contract, whether premature or

Mr Hartnett: This is for the non executives?

Q401 Mr Mudie: I presume so, yes.

Mr Hartnett: The arrangements with the non executives had been made over time and there were different arrangements for different non executives. Some had arrangements which provided for termination. Others had arrangements which provided for them to serve a full term. The non executives who left, every one of them I asked to leave, because I needed a different sort of non executive.

Q402 Mr Mudie: Your chief executive, will she tie the taxpayer to making large payments should she resign under adverse conditions? What contract is she under?

Mr Hartnett: A normal Civil Service contract. The same contract as Paul Gray.

Q403 Mr Mudie: Does that mean she would get £88,000 and counselling?

Mr Hartnett: No one got £88,000 and counselling, Mr Mudie.

Q404 Mr Mudie: sorry?

Mr Hartnett: No one got £88,000 and counselling. That was the total payment including the cash sum. I just wanted to be clear on that, please.

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Q405 Mr Mudie: Okay. We will leave it, because we are short of time. Going on to something that is in the press that we thought was tied to the private sector: bonus payments. Your annual accounts show a bonus payment increase from £89 million to just over £90 million.

Mr Hartnett: Indeed.

Q406 Mr Mudie: Despite headcount reductions.

Mr Hartnett: Yes.

Q407 Mr Mudie: Why?

Mr Hartnett: There are two sorts of bonuses that we think about here. The first sort are for the senior civil servants and the second sort are for everyone else in the department. Let me be clear, if I may, the bonuses paid in 2007–08 were for the year 2006–07.

Q408 Mr Mudie: I understand that.

Mr Hartnett: So we have had headcount reduction, but for the senior Civil Service, for example, the bonus arrangements are contractual and determined by the Cabinet Office and there is an upward progression in the amounts that can be paid year on year. This next round may be the last one or it may be the one after that, so there is some scope there. But our remit to pay bonuses for more junior staff comes from the pay remit we receive from the Treasury and that remit increased in relation to bonuses as well.

Q409 Mr Mudie: What sort of bonus scheme do you have for the other staff?

Mr Hartnett: It is a small proportion of pay. For the people who are immediately below the senior Civil Service, it was around—I cannot do it precisely—£1,600 a head, on average. For more junior people, it was £200 or £300.

Q410 Mr Mudie: Who is Steve Lamey, who got £40,000 to £45,000?

Mr Hartnett: Steve Lamey was hired three and a half years ago, nearly four years ago, as our chief information officer by a public competition. He has a special contract where the maximum amount of salary he can be paid is fixed to the maximum of—

Q411 Mr Mudie: Okay. Your executive committee members, all of them here, all get different amounts. Is there a bonus scheme that you can send to the Committee, or is it just: “You’ve landed the jackpot. You get your salary plus bonus”?

Mr Hartnett: No. We can send you details of the Cabinet Office arrangements.⁵

Q412 Mr Mudie: Good.

Mr Hartnett: But the reason they are different is the bonus depends on performance marking, and Mr Gray with a non executive assessed the performance of each of us.

Q413 Mr Mudie: You will send us a copy of that. Now, is there a bonus scheme for the other staff? Is that in writing?

Mr Hartnett: I do not know the answer to that; but if there is one, we will send it to you.

Q414 Mr Mudie: But you are paying it. You must know under what arrangements you are paying it.

Mr Hartnett: I am sorry, Mr Mudie, we do know that, because the pay remit set out the maximum proportion of pay that could be awarded in bonus for everyone else. There were basically three levels of performance assessment: “Top”, “Middle”, and “Needs to improve”. “Top” got one sort of percentage; “Middle” got a different sort of percentage across our organisation. About 55,000 people, which was close to the maximum number that the bonus could be applied to for those not in the SCS, received a bonus.

Q415 Mr Mudie: So you will send us a copy of that.

Mr Hartnett: Of course.

Chairman: We are going to adjourn for the division. *The Committee suspended from 4.01 pm to 4.13 pm for a division in the House.*

Q416 Chairman: Let us make a start and deal with some of these other matters. Some of these questions inevitably are directed to Mr Hartnett because he was the accounting officer.

Mr Hartnett: I understand that, Chairman.

Q417 Chairman: I know you are trying to help him but some of these have to be directed directly to Mr Hartnett. You report on Child Trust Fund payments in your report, that there was a programming error that left 50,000 children without their additional Child Trust Fund payment of £250. That error was about £12.5 million. How was it detected?

Mr Hartnett: I think we became aware from outside the department that people had not received payments that they were expecting and that put us on to it straight away.

Q418 Chairman: What action have you taken to ensure that that does not happen again?

Mr Hartnett: We have engaged with our IT suppliers to fix that and to look generally at the system of software for the Child Trust Fund. I am really sorry, I should say, that that happened.

Q419 Chairman: There was a further computing error that the then Economic Secretary to the Treasury informed us about in July 2008, after your year end, which led to the delays in payment of about £80,000 additional Child Trust Fund payments. Has that been properly disclosed?

Mr Hartnett: I believe it has. That is something we are still looking to in detail, but everyone will be paid out, and with interest.

Q420 Chairman: Will you be seeking compensation in these cases from your IT contractor?

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Mr Hartnett: We have already received some compensation for IT issues. We are heavily engaged with our IT contractor about performance issues and tomorrow I will be asking to see the chief executive again because there is something else that we are concerned about.

Q421 Jim Cousins: The Public Accounts Committee was given to understand that you were considering the possibility of further legal action against EDS and that you would be coming to a definite view about that this autumn.

Mr Hartnett: Yes.

Q422 Chairman: The autumn has arrived.

Mr Hartnett: Yes. Can I first say this, Mr Cousins: we are talking about two different IT suppliers here. I was saying to the Chairman something about our present IT supplier, which is Capgemini, but I am very happy to pick up the question on EDS. Our settlement agreement with EDS was intended to have been paid out in full by the end of December or perhaps the first week in January 2009. I asked the indulgence of the Public Accounts Committee not to press me on the detail because we are very heavily engaged with EDS at the minute around the fact that we have not been paid out and I think I said in terms that I was as exasperated as the Public Accounts Committee. If we have to go back to court to force a payment, that is exactly what we are going to do, but it will be against EDS because Capgemini have nothing to do with that and we will start the process at the end of the year.

Q423 Jim Cousins: At the end of the year?

Mr Hartnett: At the end of the year.

Q424 Jim Cousins: Will there be a formal statement to Parliament?

Mr Hartnett: Before anything becomes public, we will be reporting to the Financial Secretary what our intentions are.

Chairman: Jim, you had some questions on efficiency savings which I think we should take now.

Q425 Jim Cousins: On efficiency savings, these questions more properly belong with Mr Hartnett, bearing in mind your recent appointment, Mr Clasper. You have reported annual efficiency savings of £663 million. Almost all of those relate to staff reductions, and in fact your staff reductions as of March this year were over 15,000.

Mr Hartnett: Yes.

Q426 Jim Cousins: Which is nearly 3,000 ahead of your target. Are those 3,000 additional staff reductions simply going to be carried forward into the next round of 12,500 staff reductions or are they additional to the total number of staff reductions.

Mr Hartnett: Forgive me, Mr Cousins, I cannot remember whether it was to this Committee or to the Public Accounts Committee, but we have said before that those 3,000 are, if you like, a

contribution towards the next tranche. We had opportunities to reduce the numbers and we have taken them.

Q427 Jim Cousins: Did any of them involve compulsory redundancies?

Mr Hartnett: There has been no compulsory redundancy at HMRC that I am aware of in the last number of years.

Q428 Jim Cousins: The total number of staff reductions you are aiming at of 25,000 remains the same.

Mr Hartnett: Yes.

Q429 Jim Cousins: Your net operating costs, which were not additions on staff, went up by £192 million over your intentions.

Mr Hartnett: I think you will have to aim me at the part of the accounts for that, Mr Cousins, so I can have a look, please.

Q430 Jim Cousins: It is the Revenue & Customs resource account, page 39. The figure of net operating costs is note 3.13, the last line of that top table, and it has gone up by £192 million.

Mr Hartnett: There could be any number of reasons for that, but to do with the running costs of IT—if we try to find it—then we can see that there has been an increase in programme costs before child benefit and the Child Trust Fund, but I will happily let you have a note on the detail if that would be helpful.⁶

Q431 Jim Cousins: Yes, if you would. You will see immediately the contrast between quite large scale staff cuts, 3,000 ahead of programme, and still a net increase in operating costs, and the implication there of additional pressure on staff.

Mr Hartnett: Possibly. I think I need to let you have a note of the detail, but this is a year, as well, where we have seen huge efficiency gains in some of our processing areas of between 40% and 70%, which our staff, through our pacesetter programme and some of our other initiatives, have played a huge part in delivering.

Q432 Jim Cousins: What additional pressure on staff comes from the fact that you are handling more than 3.5 million manual accounts?

Mr Hartnett: Manual accounts in what sense?

Q433 Jim Cousins: These are the so-called “open” tax cases of which there are 3.5 million more than target. There are over 16 million.

Mr Clasper: That is right.

Mr Hartnett: Our staff are aware that they are there. They are over target. We are not bearing down on our staff at all to do more than they have done. I am sorry to be so very simple about it, which is why the number has risen, but we are planning to—

Q434 Jim Cousins: The number has risen because of the failure of your computing system.

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Mr Hartnett: No, with respect I do not think that is right. The number of open cases has arisen because people's employment patterns are generally more complicated now. That throws out more open cases. When we deliver the next big improvement to the pay-as-you-earn system, the system itself will deal with open cases from that point forward, and we will have the backlog to deal with.

Q435 Jim Cousins: The Comptroller and Auditor General took the view that the increase in the number of open cases was due to the failure of your computer system.

Mr Clasper: Can I help, because there are two parts to this. The current systems were built a long, long time ago on a regional basis. Because they were built on a regional basis and the systems do not talk to each other—and this is not recent history; this goes back decades—then people who have multiple sources of income might well be in two different regional offices which cannot be correlated by the automatic system. That creates the open cases. That has been going on for a long, long time. The problem, as David has just highlighted, is people's employment patterns have changed: they change jobs more often; people have multiple pensions, for example. We basically have our legacy systems for structural issue. We are going to solve it by combining all of the systems and making them talk to each other. The only piece of the problem that has been created by what you might describe as the failure but I would have termed a prudent delay, is the fact that the new system has been delayed a year in coming into operation and, therefore, the automatic clearances that Dave is talking about have not started to happen. One is long legacy systems, massively exacerbated by the change in lifestyle. The other is a year's delay to getting in place the system that will solve it. We would have less of a backlog if we had been able to execute the new system on time.

Q436 Jim Cousins: Let us be clear about that. We are now all in agreement and we are in agreement with the Comptroller and Auditor General that, because of that year's delay in the introduction of a new computing system, there are now three and a half million more cases being dealt with manually.

Mr Clasper: Yes, you are absolutely right.

Q437 Jim Cousins: That, of course, in turn, will produce a lot of additional pressure on staff, will it not?

Mr Clasper: Yes. Once we have got the new system in place, we need to develop a plan to clear that backlog and we have to do it in a way in which we do not add to any pressures on the staff that would result in the motivation issues that we talked of earlier.

Q438 Jim Cousins: Against the background of these difficulties with computer systems, the greater number of cases that are still being dealt with manually, and what you have referred to as lifestyle changes—people having more than one job and

having additional jobs not in the same tax office area—you are still closing tax offices. Against that background, was that a wise course of action?

Mr Clasper: Perhaps I can talk philosophically: we have to set ourselves the target of being able to do more with less, otherwise we are not going to provide taxpayer value for money. In order to be able to do more for less, you do not get there, in my experience, and nor does the department believe it, by beating staff harder with a stick to make them work harder. We have to find different ways of working. That is what the department is doing, whether it be introducing new systems so that we do not have this problem that we have just been describing through multiple jobs and multiple sources of income or also finding different ways to work. The Pacesetter Programme which I have visited up in Longbenton and in Washington is one of the best cases I have ever seen of getting staff to improve their own productivity. We have had phenomenal increases.

Mr Hartnett: In places 40% to 70%.

Mr Clasper: So people can process a lot more. Part of all of that is also having critical mass in individual offices to adopt these better IT systems and adopt these processes, as well as using what we use in the compliance area, which is risk-based targeting of activity instead of doing it randomly across people who we may want to go after who are trying to bend or break the rules. By doing all of these things, we will be able to do more from less, but a consequence of it is that very small offices, located in places in which the original reason of a geographic approach to tax has disappeared, are very, very inefficient against that long-term drive of doing more for less. That is why—unfortunately for certain individuals, and we have maximum sympathy and are trying to solve the uncertainty that creates for people—we do need to focus on a more limited number of offices so that we can get the productivity up, so that we can do more for less, without beating up the staff—if that makes sense.

Q439 Jim Cousins: I am not sure it does, because in your Transformation Programme a number of items are listed. One of them is to enable the reduction of the estate and that in the Transformation Programme shows an additional spend of £209 million and additional benefits of nil—which somewhat goes against what you have just said.

Mr Hartnett: That is for one year.

Mr Clasper: That is the first year effect.

Q440 Jim Cousins: In the first year of the Transformation Programme on tax offices, there is an additional spend of £209 million to cut tax offices and additional benefits of nil.

Mr Clasper: Yes, but, over time, there will be significant benefits. I do not know the exact numbers but you are investing in what, in effect, is a capital cost to close offices, which then will produce lower costs over time.⁷

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Q441 Mr Ainger: The National Audit Office has said in relation to the Transformation Programme that it can only be delivered with the goodwill of your staff. In the winter survey of staff, these were the responses from your staff who are going to have to deliver these changes: “Is change managed well in this department?” 10% said yes, 70% said no. “Do you feel the department is changing for the better or worse?” 78% said for the worse. “Are you satisfied with your department at the present time?” Only 13% said they were satisfied. Given those surveys, what are you going to do radically to improve moral in your staff?

Mr Clasper: I am sorry, I am probably going to repeat myself. We need people to have a sense of direction. We are in the process of doing that. We need to ensure that they have a clear sense of priorities and that we are not asking them—in some cases at the moment we are asking them but in the future we will not be asking them—to do too many things, so that there is clarity about what really counts. We do need to introduce new IT systems. This open case issue, for example, and others, is a case of a lot of grinding work because the systems are not supporting us, and we are in the process of doing that, as I have already talked about. We have some very good programmes that allow people to improve their own work, which I have seen up in Washington, Longbenton and we have in other places, where people feel empowered and have a sense that they own what they are doing. We need to do more of that. We have made some mistakes, over time, in introducing some techniques which improve processing but people do not feel that they are in control of the processing. We are going to solve that problem. There are a lot of things we have to do. Is this a start point that I would want to be at? Absolutely not. Is it the start point the department feels proud of? Absolutely not. Are we going to do a lot about it? Yes, we are.

Q442 Mr Ainger: Have you met the PCS Union to discuss what they think needs to be done?

Mr Clasper: I have met the national officers and at the sites that I have visited I have met the local officers as well. As you can imagine, there is a mixed view and some level of distrust about whether management will follow through on some of the things that I have just said. It is my job, over time, for their members to feel that we followed through, as it is of the whole team.

Q443 Mr Ainger: What evidence have you had and presented either in a report or to the trade unions that small offices are inefficient compared to large processing offices?

Mr Hartnett: We have had numerous discussions, Mr Ainger, with both our unions about that. But some of the efficiency gains that Mike was talking about earlier on are being found in our big processing centres and not in our small offices. The real issue about our small offices, which I think is implicit in what you have said, is that there are really experienced people there who are not getting the opportunity to partake in the efficiency gains in the

bigger offices and they have skills that we need. That is a real challenge for us. We talk more to the trade unions about that.

Q444 Mr Ainger: My experience in Wales is that you are going to close virtually all the offices in Wales, other than Cardiff, Swansea, Carmarthen, Wrexham, one office in North Wales and the one in Porthmadog which is there to deliver services through the medium of Welsh. Virtually all the offices that you are proposing to close are in the former Objective 1 areas of Wales, now covered by convergence funding, which is accepted as those areas that need greatest support. How do you reconcile that with the closure programme? How do you reconcile the fact that the Government have announced already that we need to maintain public expenditure through this downturn period and yet you are withdrawing from the very areas that need support?

Mr Clasper: We do need to deliver value for money for the taxpayer and we do have considerable evidence in various forms that there is a critical mass/size of office issue and it goes back again to the evolution of the tax system. Most of the work that we now do, in terms of the compliance work and the processing work and dealing with the citizen, is regional or national, when in the past it was very much local/local. Most of the work can be done from anywhere but you do need the critical mass to do it, and that is where we have had these productivity gains. We do need to save money. If we stop what we are in the middle of, we will only have to restart it at a future date, and in the long run the uncertainty for our staff will continue for a much longer period of time. On the issue of the locations of the office relative to areas of development, do you want to add anything, Dave?

Mr Hartnett: A couple of things. Mr Ainger, we have produced impact assessments. We have looked at the number of our customers who are using our offices. There has been a massive reduction there, and we are seeing huge take-up in our electronic services as well. Already this year, where we are today, a 33% increase in the number of people filing electronically their self-assessment returns.

Q445 Mr Ainger: On 30 September I had a meeting with one of your officials over the workforce change programme. I asked him the question: “Can you provide me with any statistical evidence to show that large processing plants are more efficient than small processing plants?” and I have not had a reply yet. This is the key to your whole policy. You are saying that large processing plants are far more efficient than the smaller regional offices. The trade union is telling me that in fact they believe the smaller offices are far more efficient than the larger centres. I am just awaiting some figures. You are basing your whole estate rationalisation programme on centralising in large processing plants and yet so far you have not been able to provide those with anything either in your report or certainly in the

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discussions that I have had with work performance related officials to prove that your policy is right. Can you provide us with that information?

Mr Clasper: I think we will come back to you in writing, but we do have a lot of evidence that the large processing units are much more efficient.⁸ We are also here comparing apples and pears: some of these offices have only 20 or 30 people in, of which only two or three are doing one type of work, another four or five are doing another type of work, and there is huge inefficiency in providing some of the data systems. It is not just about people productivity; it is about the total cost to the system. We have a very big charge, as you know, to reduce our real costs 5% per annum over the next three years, and so we have to deliver a much more efficient HMRC. We are all confident that one of the planks of doing it—not the only plank but one of the planks of doing it—is getting critical mass. We will have left of the order of 300 offices across the country. So we are not going to a 20,000, 50,000, everybody-in-London solution; we are collapsing into sub-regional and regional rather than every individual village.

Q446 Chairman: Not collapsing, I hope.

Mr Hartnett: Chairman, may—

Chairman: I am sorry, we have to move on now because we are running out of time. Mr Love, some short questions, please.

Q447 Mr Love: That is a contradiction in terms! In the memorandum you submitted to the Committee you indicated that accidents in the quarter up to March 2008 numbered 151, but that was over a 30% increase on a year earlier. Why has this happened and what are you doing about it?

Mr Hartnett: I think, Mr Love, we would have to plead guilty to not having a sufficiently rigorous recording system before. I am very grateful to our trade unions and our staff for really pressing this issue. I do not think that there has been a material increase in accidents; there has been a much better and more rigorous approach to reporting them.

Q448 Mr Love: Some concern has been expressed by a number of people in articles that we have received about the relationship between you and your PFI provider. Does that contribute in any way to the lack of being able to report accidents? Are you in discussions with them about improving the situation?

Mr Hartnett: We are constantly in discussions—I assume it is our properties—with Mapeley about service and about health and safety issues, and have become more demanding—as demanding as we should have been in the past, but more demanding now.

Q449 Mr Love: Does your contract allow you to be more demanding? Can Mapeley, in effect, refuse under the contract? There is some evidence to

suggest that they only do health and safety works when the Health and Safety Executive appear on the doorstep.

Mr Hartnett: Let us take that away and we will include it in the letter that we send to the Committee. I am afraid I do not know, as I sit here.⁹

Mr Clasper: They cannot be because if it is a health and safety issue then legally they cannot.

Chairman: Okay. Perhaps you would find out and let us know.

Q450 Mr Love: You investigated over £2.3 million worth of fraud amongst your staff, nine of whom ended up being convicted of criminal offences. Are you worried about the level of fraud in the department?

Mr Clasper: Of course one is always worried. Would you like to pick up the details?

Ms Aiston: Yes. Any fraud incident is one too many but the figures reflect our seriousness in identifying when it is happening, tracking it down, and pursuing it with the full rigour of the law. In addition to tackling cases such as these where there is evidence of fraud, we also have quite a big programme of work aimed at fraud prevention, so that we stop this sort of thing happening in the first place.

Q451 Mr Love: Could I ask you, finally, one specific question. DWP officials have access to tax credit records and there are those that think this may be a particular problem. What steps are you taking to ensure that those DWP members who have access to this information are not using it to defraud the system?

Ms Aiston: Following the loss in 2007, we reviewed all access of this kind and have been in long discussions with DWP to ensure that all the appropriate controls are in place to mitigate both the risk of internal fraud and other forms of data security incident, so we took that very seriously too. In a recent example, where we have provided access to another government body that has a legitimate and legal reason to use it, we are also introducing monitoring so that our internal auditors can monitor access by their staff, which will also help in the fight against internal fraud.

Q452 Sir Peter Viggers: At the interface with the taxpayer you had a PSA target for 93% of people to file their tax returns online. In 2008 only 89% of people did it. Your response to this seems to have been to move the deadline earlier to 31 October for paper filing. How do you think that will help?

Mr Hartnett: I have two things to say. First, we refined/reduced the filing population without changing the target. We took out of self-assessment over one million taxpayers whose affairs we were able to deal with more simply with a much shorter tax return. These were substantially very compliant people who filed early or, if not early, certainly on time. The target was not re-examined on that basis. It is not an excuse but it is an explanation as to why, why have we brought forward the filing time to 31

⁸ Ev 81

⁹ Ev 82

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October for paper. We are trying to incentivise people to use electronic filing. I said to Mr Ainger that it was up by 33% already this year. We have brought more support, more guidance, and more simplicity to tax returns as well.

Q453 Sir Peter Viggers: Hard copy filing tends to be used by the elderly and low income households.

Mr Hartnett: Indeed.

Q454 Sir Peter Viggers: Are there going to be more vulnerable people filing late?

Mr Hartnett: We have no indication at all—and we are monitoring this very carefully—that any particular element of the population is filing late. We are heavily engaged with the representative bodies for more vulnerable people and we have picked up no intelligence yet of any significant concern that people are not able to cope.

Q455 Sir Peter Viggers: The rate of accuracy for self-assessment tax assessments lay at 93.4% in March 2008—short of your target of 95%. What are the barriers you are failing to surmount?

Mr Hartnett: I think it is that what people have to put on returns is a bit more complicated. It was an ambitious target. We will get to the level this year or maybe next. Those are the main issues. Complicated products around investment as well.

Q456 Sir Peter Viggers: There has been a 37% jump in applications to tax tribunals. Can you explain that?

Mr Hartnett: Not as I sit here, I am afraid.

Q457 Sir Peter Viggers: In that case I will ask for a brief note, please.

Mr Hartnett: Of course.¹⁰

Q458 Sir Peter Viggers: Finally, what steps have you taken to ensure that a major systems crash, such as that which occurred in January 2008, will not occur again?

Mr Hartnett: We got to the bottom of the January 2008 systems crash. The system had had its platform changed without really adequate examination of the risk of that. It will not surprise you that we have had some very vigorous discussions with our IT provider around that issue and we have examined the whole of that system again to make sure, we believe, that it will not happen again.

Q459 Ms Keeble: On the tax credits, you have introduced a new code of practice. Can you say what the result of that has been, both in terms of fairness or perceived fairness and also in terms of further payments and write-offs? If you cannot give the figures now on the overpayments and write-offs, then perhaps you could give those figures in a note.

Mr Hartnett: Yes. I think the code of practice has made very clear who is responsible for what.

Q460 Ms Keeble: Could I just ask the other questions because we might have to finish. Perhaps you could send a note on this. If you fail to act within 30 days then overpayments are admitted by the—

Mr Hartnett: I am sorry, I cannot hear you.

Chairman: That is why we normally adjourn. I am sorry, we are going to have to leave it there. We can put that question in writing to you, perhaps before you respond on those other points, but it is not fair on the shorthand writer to continue this dialogue against the bells, I am afraid. We will make sure that question is put.

Ms Keeble: Can I ask one other question in writing.¹¹

Q461 Chairman: In writing, of course. Mr Clasper, we do wish you well in your appointment. It is an enormous task. We have seen a number of your predecessors, and so we wish you well in that. We do understand that you are accountable to this Committee and to the main Committee for the discharge of those functions, and we will, I suspect, be seeing quite a bit more of you.

Mr Clasper: I am more than happy to attend if you think it is helpful.

Chairman: Thank you very much.

¹⁰ Ev 83

¹¹ Ev 83

Wednesday 26 November 2008

Members present

Mr Michael Fallon, in the chair

Nick Ainger
Mr Graham Brady
Mr Colin Breed
Jim Cousins

Mr Andrew Love
John McFall
Mr Mark Todd
Sir Peter Viggers

Witnesses: **Mr Stephen Timms MP**, Financial Secretary to the Treasury, **Angela Eagle MP**, Exchequer Secretary to the Treasury and **Ian Pearson MP**, Economic Secretary, HM Treasury, gave evidence.

Q462 Chairman: Can I welcome the ministers to this Sub-Committee. Perhaps formally you could just introduce your team.

Mr Timms: I am Stephen Timms, Financial Secretary.

Ian Pearson: Ian Pearson, Economic Secretary to the Treasury.

Angela Eagle: Angela Eagle, Exchequer Secretary.

Q463 Chairman: I think you understand the purpose of this session, which is to examine the annual reports and accounts of the Treasury and the various supporting departments. We are not asking questions today about the Pre-Budget Report on which we are seeing the Chancellor in a week's time. Perhaps we can begin with the Treasury's objectives, Mr Timms. The stated aim is to maintain a stable macro-economic environment and promote efficient financial markets. When the Permanent Secretary appeared in front of us a couple of weeks ago he said that simply was not possible in the current climate. Do you think it is right that the country should accept that you are in no way responsible for the recession?

Mr Timms: I think it is very widely known that there has been a global shock of a scale that we have not seen for a very long time, certainly not in the lifetime of anybody here. The Governor of the Bank of England said yesterday that it was the biggest challenge since the Great War. It started in the USA but it has affected every country around the world. I went to the meeting of G20 finance ministers in Brazil a few weeks ago and it was clear that all 20 countries, developing and developed, were being affected, in many quite similar ways, by what has happened. Our responsibility is to navigate a path which gets Britain through this challenge in the best possible shape and does it in a way that is fair to everybody. In the PBR this week the Chancellor has set out how we are going to do that. We have acted in a very decisive and responsible way in responding to this enormous challenge to the whole world economy.

Q464 Chairman: You set Departmental Strategic Objectives for everybody else but your own one, 2008–11, is to ensure high and sustainable levels of economic growth. Is that going to need revising?

Mr Timms: No. The objectives have been set and our task is to deliver them. Clearly what happens is going to be affected by events in the world economy but, as I have said, we are committed to navigating a path which gets Britain through those challenges in the best possible shape.

Q465 Chairman: We are in a recession now so your objective cannot really be a high and sustainable level of economic growth, can it?

Mr Timms: We want to return to a high and stable level of economic growth as soon as we are able to and that is the whole aim of our current policy.

Q466 Mr Brady: The “clear line of sight” initiative aims to create greater transparency, in particular with improvements to published documents. Obviously this is a step in the right direction but what thought have you given to how parliamentary scrutiny of estimates might be improved?

Angela Eagle: As you have said, the clear line of sight initiative is an attempt to create a simple more transparent system to make it easier for the estimates to encompass all of the expenditure rather than just, at the moment, some of it. I know there is a great deal of work going on involving both the National Audit Office and the Treasury about how that can be done technically. I know there has been a memorandum sent to the Liaison Committee about how parliament would start to change the way it examines estimates in order to deal with the alignment project or “clear line of sight” project as it is called. It is really for parliament to decide how best it wishes to change the way it scrutinises estimates going forward. The idea of the project is to try to encompass, in a much more coherent way, in one system, government expenditure. I think that is a long overdue initiative and will certainly improve transparency.

Q467 Mr Brady: You have personal experience dealing with it from both sides of the fence. Do you have any views of your own on how parliament could do it better?

Angela Eagle: The first thing that the project is trying to do is create a much more consolidated transparent approach to government estimates so that all of the expenditure is in one place and obvious and actually calculated on the same basis so that, if we succeed in this, it would be possible to follow

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every pound through from when it is raised through to how parliament decides to approve its expenditure through to where it is spent, which would be a big improvement. I do not see any reason why the current ways of debating estimates should change but again that is a matter for parliament to decide.

Q468 Mr Brady: The Treasury has made it clear that it would welcome the involvement of this Committee in developing the “clear line of sight” project. Can you give any clarification of how the Committee might best help in that?

Angela Eagle: Again, that is a matter for the members of the Committee to decide. I am sure when I was on the Committee I would not have wanted a government minister to come here and tell the Committee how to do its job. All I can say is the best thing to do is to deliver a message that we are happy to co-operate in any way you see fit in order to have proper, transparent oversight of the way that government spends its money. The aim that we are all after with a project such as this is to ensure the most effective and efficient expenditure of government money. The National Audit Office is involved, the Public Accounts Committee is involved and it is quite right that this Committee should be involved. I am sure between all of us we will come up with a modernised, better and more transparent system.

Q469 Mr Brady: Parliament is surrendering control of net spending in that we will not be required to authorise the income in the form of appropriations in aid. What safeguards are going to be put in place to prevent government departments from abusing this absence of control?

Angela Eagle: I think the alignment project itself will ensure that on a consistent basis as the expenditure process happens there will be more obvious sight of what this money is. The best controls on that kind of expenditure and against that kind of abuse—which I do not think is something that government departments aspire to from my own experience as they do not go around conniving with each other to keep things from parliament—is to have clearer accounts which are consistent across the board, which is what the alignment project will do, and good vigorous select committees which keep an eye, as this one does, on what can sometimes look like boring accounts but are always, in my experience on the Public Accounts Committee, worth a look.

Q470 Mr Brady: Do you see a greater role for departmental Select Committees generally in following that scrutiny?

Angela Eagle: This Sub-Committee makes it one of its jobs to take a close look at the annual reports and to take a look at the autumn performance reports. Far be it from me to tell other select committees how to do their job but I think that sort of nitty-gritty is part of the day job for all select committees and I am sure they think that too.

Q471 Mr Brady: Can I turn to UK Financial Investments Limited which obviously is an increasingly important institution looking after the government’s investments in financial institutions. Which minister is going to be responsible for oversight of that body?

Ian Pearson: Paul Miners.

Q472 Mr Brady: How do you intend to monitor the performance of it within the Treasury?

Ian Pearson: As we would do on a regular basis with normal institutions. There is clearly going to be a significant level of interest in how UKFI works. You will be aware of the statements that we have published as a government. The Chancellor will take a very close interest in the work of UKFI. As is the normal course of events, there will be regular meetings between people from the UKFI and members of the Government and officials in the Treasury, which is exactly as you would expect.

Q473 Mr Brady: Do I deduce you are the Commons minister who would take the closest interest in UKFI?

Ian Pearson: The normal analogue would be that I will take Commons responsibility for this because it is to do with financial services.

Q474 Mr Brady: Given that the scale of the holdings in UKFI are already bigger than was first envisaged, and potentially might get bigger again in the future, are you confident that the structure and resources that UKFI have are sufficient?

Ian Pearson: We are talking about a very new institution. This has happened since the last Annual Report and Accounts and it is a response to the extraordinary financial circumstances that we have seen over recent months. What I can say very clearly is that we are working hard to make sure that UKFI is being set up on the right sort of basis, has the resources it needs to do the job that it needs to do to make sure that we protect the UK taxpayers’ interests, has proper oversight of the re-capitalised banks and it fulfils and discharges its responsibilities that we are giving to it.

Q475 Mr Brady: How would you judge whether UKFI has succeeded or failed?

Ian Pearson: We will clearly want to look to develop performance measures but, as I say, we are very much in early days with regards to the establishment of UKFI. As you will be aware, it was only set up either late last month or early this month in terms of the announcement. It is a little bit too premature for us to give a full detailed explanation of exactly how it is going to operate and what its performance regime is going to be. That is evolving. Clearly there is a lot of interest here and we will want to be as open and transparent as we can sensibly be in this matter. I am sure it is something that the Committee will want to return to at a later date.

Q476 Mr Brady: Without excessive detail, and I understand it is a very new institution, what would be success for UKFI?

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Ian Pearson: Clearly we want to make sure the actions that we took and the announcements that the Chancellor made to the House on 8 and 13 October are actually seen through, that we proceed on an orderly basis, that we make sure that, through UKFI, we ensure that the conditionality that we are imposing on the banks as part of the recapitalisation process is being fully followed through which is what you would expect us to do. We need to plan as well an exit strategy as part of the normal work of what UKFI will do. These things will emerge over the coming weeks and we will want to report fully to the House and be subject to full scrutiny in the normal way.

Q477 Mr Brady: When would we reasonably expect to have a clearer idea on all of that, how many weeks?

Ian Pearson: I do not think it is possible to give a timescale. Things are rapidly evolving but all I can say is we have no secrets here. We want to be open and transparent in the way we deal with things. There are clearly issues of commercial confidentiality which you will expect but the normal way in which we want to do these things would be to be as open and transparent as possible about what is going on.

Q478 Mr Brady: So a full report by Easter?

Ian Pearson: I certainly can undertake to the Committee that we will get back to you and we will let you know more detail about UKFI and how it will operate in the future and when it will report. The sensible way to proceed is to let UKFI get on with its work. It is clearly an important point in time. It is a very new institution and the key thing here is to say let it operate, let it do its business and let us make sure we have full parliamentary scrutiny, to the extent that is reasonable, given the boundaries of commercial responsibility, and we will endeavour to do that.¹

Q479 Chairman: Which of you is responsible for IFRS balance sheets being adopted across Whitehall?

Angela Eagle: I am.

Q480 Chairman: Louise Tulett, your finance director, told us that only half of Government departments met the deadline of 30 September. Why are they ignoring you?

Angela Eagle: The current position is that three departments are yet to submit their restated balance sheets to the National Audit Office as part of this system. One of them, which is the Cabinet Office, is expected to complete that action by the end of next month. There are two remaining departments and it is no real surprise that they are the most complex ones, the MOD and Health Department. We are obviously working with them to see how quickly they can get through what for them are a very complex series of calculations. We are confident that

they will be prepared for full introduction but clearly they have got the most difficult task ahead of them. We are supporting them and they are actively engaged in trying to complete it.

Q481 Chairman: What sanction do you have?

Angela Eagle: At this stage this is a trigger point of a process where we hope by the end of financial year 2009–10 to be able to completely make the shift to the new accounting system. We do not particularly want to get into sanctions at the moment. We want to assist departments in the shift from the current method of accounting to the new one which requires a great deal of work in some departments. We are being supportive and helpful but insistent, I suppose, would be my response to that. At this stage it is more important that we support this shift rather than resort too quickly to sanctions.

Q482 Chairman: Does this mean we will have further slippage in the target of moving to hold other government accounts?

Angela Eagle: We certainly hope not. We are still aiming and reasonably confident that we can do this by 2009–10.

Q483 Chairman: Who is responsible for HMRC?

Mr Timms: I am.

Q484 Chairman: Their Annual Report lists 17 areas in which improvements to internal controls are still ongoing, yet your own resource accounts, at page 27, say no internal control issues in the Treasury Group were identified. Can you explain the difference between those two? Who is right?

Mr Timms: The explanation is that HMRC for these purposes is not part of the Treasury Group referred to in your second remark.

Q485 Chairman: I thought HMRC was part of the Treasury Group.

Mr Timms: In the context that the phrase is used that you just read out, it is not.

Q486 Chairman: That sentence, in fact, just refers to the Treasury.

Mr Timms: Yes.

Chairman: It will be corrected next year I hope.

Q487 Mr Breed: Can we turn to the PSA targets which I suspect you probably thought we were going to approach. In June 2008 the Treasury and HMRC between them had met or were “on course” to meet only 13 of the 20 PSA targets. Could we ask what went wrong in that sense? Perhaps even more so, bearing in mind the Treasury’s performance is very similar to the Government’s performance as a whole, that slippage is being reported in 40% of the targets, are actually PSAs working in any meaningful sense?

Mr Timms: Are we talking about the new PSAs for the current spending review period or is your question about performance on the PSAs in the previous spending review?

¹ See letter from the Chancellor of the Exchequer to John McFall MP, Chairman of the Treasury Committee, dated 3 November, Ev 111.

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Q488 Mr Breed: In the Annual Report of 2007–08, so it is last year.

Mr Timms: We are looking back over the past performance. What I would argue is that the PSAs, and there were three PSAs in particular that we were responsible for, were extremely valuable and indeed effective in directing the efforts of HMRC. They were not all met but I do not think that in itself is a surprise. We can go through the individual points in the targets, if you like, but I do think the system worked well in directing effort and raising performance. Of course there were some lessons learnt for drawing up the new set of PSAs across government. We have a smaller number of PSAs now than we had before. I do think that the system in place for the 2004 spending review was effective across government and effective for HMRC.

Q489 Chairman: Were the lessons learnt that perhaps the previous targets were too challenging so, therefore, you have reduced the hurdles so you can meet a few more?

Mr Timms: No, not at all. There were, as I have said, many elements in the old PSAs that were achieved and the fact they were highlighted in the PSAs in that way increased the focus on delivering them and raised the level of performance. The key lesson that was drawn, and this is a point about the system across government rather than specifically as it affected HMRC, was that it was better to have a smaller number of genuinely cross-government performance targets. In the new system, with the 30 or so PSAs, most of them have more than one department involved in their delivery whereas in the older system it was more segmented by department. The new system has a smaller number of genuinely cross-government targets and I think that probably is a better way of drawing the system up. There is no doubt in my mind that the previous system did contribute very significantly to raising performance across government and in HMRC.

Q490 Mr Breed: The PSAs are working but not quite as well as you would have hoped and next year we can look towards a substantial improvement in meeting the targets?

Mr Timms: We have certainly learnt lessons and will continue to do so. I cannot tell you that every single element of the new framework will be certainly delivered. These are stretching targets, and they should be, because we want to aim high on performance. We have certainly learnt lessons and we will be working very hard to deliver all of the new targets.

Q491 Mr Breed: Can we turn to the unemployment figures which, of course, are higher now than they have been for a very long time. In fact, the number of unemployed people is higher than at any time since 1997. You will know that the Committee has been particularly focused over the last year or so on child poverty. Can you tell us what you are doing there to minimise the effect of this rising unemployment on child poverty?

Mr Timms: You will know that we have made very good progress in reducing child poverty since 1997. There has been a reduction of 600,000 so far and the headline numbers started at 3.4 million. Measures that were announced in this year's budget will lead to a further significant reduction in the number of children growing up below the poverty line.

Q492 Mr Breed: Even taking into account the new unemployment situation?

Mr Timms: Yes. We estimate that the measures in the Budget this year will reduce by half a million the number of children below the poverty line.

Q493 Mr Breed: But you were using unemployment statistics which clearly are nothing like what we have now.

Mr Timms: The measures in the Budget will have the effect of reducing by half a million the number that otherwise there would have been. I must say it is not completely clear. The number of children growing up below the 60% median income line, it is not completely clear how they will be affected by what is happening at the moment. It depends in which parts of the workforce unemployment rises in and so on. We are confident that the announcements we made in the Budget will reduce by half a million compared to what the figure otherwise would have been.

Q494 Mr Breed: You are not taking any additional pre-emptive action in the light of the current economic situation or employment figures?

Mr Timms: There were, as you will know, some changes in the PBR which will be helpful: the bringing forward of the uprating of child benefit, the bringing forward of the uprating of the child tax credit, both of those will certainly help.

Q495 Mr Breed: Can we just go to regional inequality which has been a problem for a very long time and is likely to be exacerbated on the impact of the recession. What additional things might you bring in to try and address what was, and is, and has been, a problem of regional inequality for some time but is likely, I suspect, to be made even worse in the next year or so?

Mr Timms: What we have done, as you know, is announced a major stimulus to the whole economy in the PBR this week worth about 1% of GDP and we believe that will be a very effective measure in rebuilding momentum in the economy across the country. Alongside that, one of the responses that the Government has made to the current challenges is the establishment of the National Economic Council and that is being replicated now by regional councils involving regional ministers and others and the regional development agencies for example. I think that will be a very effective way of concentrating minds in the regions on what needs to be done, and can be done regionally, to tackle the particular challenges which, as you rightly say, vary across the country.

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Q496 Mr Breed: I suspect presiding over the demise of the South East economy to bring it down to the average of the rest is not what we were thinking about, more like bringing up other regional economies to try and tackle what are likely to be quite substantial difficulties in many areas particularly those that are involved in manufacturing and such.

Mr Timms: Yes. We want to raise it across the country.

Q497 Mr Breed: Last year the Financial Secretary told us that she would commission some work on the impact of rapid food inflation on the wellbeing of low income families. Can we know what the result of that work was and when it is going to be published?

Mr Timms: I am not quite sure where that research has got to but I can write to you.

Q498 Mr Breed: Can you write to the Committee and let us know?

Mr Timms: Yes.²

Q499 Mr Love: Can I come back to this issue of PSA targets and the unprecedented situation we are now going through? That is the mantra of government, and I have to support it, that this is a whole new ball game we are in. In that whole new ball game do we need to revise and re-look at our PSA targets? Are you, in fact, doing that as we speak?

Mr Timms: No, I think the framework that we put in place at the time of the Comprehensive Spending Review is right. There certainly is not any general review of the PSAs under way and I do not think it would be right to do so. If we look at the PSAs which HMRC is contributing to, deliver the conditions for business success in the UK, reduce the harm caused by drugs and alcohol and so on, I think those targets, as they have been expressed, remain right for Britain over the three year period we are looking at.

Ian Pearson: Essentially PSAs look to the longer term, and the longer term objectives that we have set I believe very strongly are absolutely right. There is a big difference between that and, because of the unprecedented changes that we have seen in recent months, some of the short-term things that we need to do. It is quite important that as we go through this difficult economic period at the moment and have to respond to very short-term issues that we do not lose sight of the longer term challenges that face the UK economy and I think the PSA framework that we have got as a Government really sets out those longer terms issues that we need to continue to address.

Q500 Mr Love: I certainly accept that. However, as a minister who will no doubt be better aware than I am, there are certain PSA targets which are much more firmly in the public mind than others. The ones you quoted from HMRC I do not expect the ordinary person in the street would be able to quote them but quite a lot of people can quote the halving of child poverty by 2010 and its eradication by 2020.

While I accept the figures that you have given, and they were given at the time of the Budget, that we would reduce it by half a million as result of the measures taken in the Budget, we are still a long way from reducing it by half likely in 2010. How confident are you that in the changed economic circumstances it will be possible for us to even approach that target?

Mr Timms: It is certainly true that there is more to be done to achieve the 2010 target. As you know, and the Chancellor mentioned this in the Pre-Budget Report speech, we are committed to introducing legislation for the 2020 target and we will be consulting on the form of that legislation and the content of it over the coming months. As I said earlier, I do not think it is completely clear what, as yet, the effects of the changes in the economy are going to be on the proportion of children growing up below 60% of median income. We may see an impact on median income because of what is happening in the economy at the moment. At this stage it is a little too early to say precisely what the effects on the child poverty statistics measured in terms of relative income are going to be.

Q501 Mr Love: This is a rather unfair question because it is a London member asking another London member but in terms of regional inequality the actual target we are setting ourselves is about growth rates going forward and the differential in growth rates for different regions. Whether or not London and the South East have much greater impact in terms of the current recession we are going through, it is still very likely that they will grow at a faster rate than other regions of the country. We have had little real impact in the level of growth of different regions. I know it is unequal and an unreasonable question but how do we improve the growth rates in some of our lower growing regions in the country?

Mr Timms: As you know, we have had an ambitious, and I would argue, effective programme of regional development ever since we set up the RDAs a decade or so ago. We have seen very substantial benefits to regional economies from the measures we have put in place. Just on the point of London, I would just make the point that the growth of the London economy has, as you have indicated, been very healthy but London employment, and the employment rate amongst Londoners, has not moved very much. There is more work there still to be done but the framework of the regional policy that we have put in place has been a sound one and an effective one.

Angela Eagle: I wanted to point out how we are taking that forwards with some of the changes with multi-area agreements, with sub-regional developments, our working with local authorities, asking them to take a duty of taking care of economic development in their areas more explicitly on the institutional side. On the other side, the Government is working to try to assist and encourage greater levels of entrepreneurship in regions. Some of the measures we took in the Budget last year, for example particularly focusing on

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female entrepreneurship, if we could have women creating businesses at the same percentage as they do in America we would have nearly a million more small and medium-sized enterprises. There are a range of interventions that the Government is making explicitly with developing the focus on economic development at both regional and local level that we hope will produce a positive result.

Q502 Mr Love: Ian, you can respond but I will add something to it. A couple of years ago we lost European structural funding which had quite a heavy impact in some of the regions. Is there a need for the Government, because of the shift to the East effectively when all the new countries came in, to look at that again?

Ian Pearson: We still do have European structural funding. There is European regional development funding available in the regions. It is right, as you say, to point out that with the accession countries a lot of the structural funds that have been allocated by the European Union have gone in that direction but there is still a programme, during this current financial perspective to 2013, from the European Union. I do not want to stray too far from the brief of the Committee this morning but in terms of direct response, if you look at Regional Development Agencies and the regional level of government I want to offer a couple of reflections. The RDAs are doing a good job. Ten years into existence they have found their feet. There were issues early on with RDAs but now they are making an effective contribution at a regional level. A lot of them, like my own West Midlands region, have set targets about closing the output gap with the rest of the UK, in particular the South East as you mentioned. It is important to recognise that a lot of what we do as a Government is to pass legislation and to have budgets that get implemented at a regional and sub-regional level. I do not think the level of scrutiny, particularly in terms of performance management, at a regional level has been strong ever when it comes to government. It is one of the reasons I think regional ministers and regional select committees are an important innovation. I find it very surprising that some people do not really accept that. It is at a regional and sub-regional level that a lot of this money that comes from government does get spent and it should be accountable. I would hope that Select Committees like this would want to strongly support regional ministers and regional Select Committees as a way of ensuring that taxpayers' money is being spent in the best possible way.

Mr Love: I will say Amen to that!

Q503 Chairman: Mr Timms, the Revenue and Customs Annual Report disclosed that they had lost a quantity of Class A drugs held at their own lock-up. Have you found them yet?

Mr Timms: Not that I know of.

Q504 Chairman: Can you tell us how much went missing? This is the loss at Coventry.

Mr Timms: I do not think that is a figure I have in front of me.

Q505 Chairman: It is an entire paragraph in the Report so it sounds like it was a substantial amount of Class A drugs. Are you not aware of that?

Mr Timms: I am aware of the paragraph in the Report but I am not aware of the quantity or the value. I am sure that is something we can provide you with.

Q506 Chairman: This was last Christmas. What have you done since then to ensure that when HMRC seize drugs they remain secure?

Mr Timms: HMRC will certainly have been seeking to learn the lessons from that episode. I do not have in front of me the specific measures that they have taken in response to that but I agree with you that it is a serious loss, it should not have happened and steps I know will have been taken to make sure it does not happen again.

Q507 Chairman: You understand why we are asking you. You are the minister responsible for HMRC and it seemed quite a serious matter that drugs go missing in its own lock-ups.

Mr Timms: I agree with you.

Q508 Chairman: Perhaps you could let us have a note as to what has been done to improve security there.

Mr Timms: I would be happy to do so.³

Q509 Nick Ainger: We were told when we interviewed HMRC officials that in terms of the head count reduction in HMRC they were 3,000 ahead of target. You referred, in your opening remarks, to the unprecedented situation that we face globally and the downturn and its severity and so on. Are you going to review the head count reduction, as an employer of a substantial number of people, bearing in mind the unprecedented situation that we face?

Mr Timms: If you mean are we going to back off the head count reduction or indeed the efficiency measures more generally, the answer to that is no. It is very important that we maximise efficiency across Government, including in HMRC. Indeed, of course, as you will have heard the Chancellor say earlier this week, across Government we want to look for additional efficiency savings to those that have already been announced and committed to by the end of the current spending review period. We have not worked out what that is going to mean for individual departments but I certainly do not think there will be the opportunity, and neither should there be, to reduce the commitment to improving efficiency in HMRC.

Q510 Nick Ainger: Nicholas Macpherson told us that the Treasury was operating at its limits and that is before there is the next tranche of job losses. Are you satisfied that, in fact, the Treasury can maintain its efficiency with these additional job losses?

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Mr Timms: Yes, I believe it can. It is certainly a very substantial managerial challenge to undertake the level of efficiency reduction that is required while maintaining standards. Actually there are examples where through genuinely transforming the organisation, whether it is in HMRC or other parts of Government, it is possible both to achieve these efficiency goals, very demanding as they are, whilst also improving performance and raising the levels of performance. It is a very demanding challenge but I am confident that it will be achieved. There are certainly examples in HMRC where it is already, and examples elsewhere in Government as well, and I am confident we are going to be able to achieve that.

Q511 Nick Ainger: In the 2004 Spending Review Final Report on the efficiency programme published this month, in relation to relocations under the Lyons Efficiency Programme, the Chancellor's department delivered only 2,987 relocations against their target of 5,050. These are relocations out of London into the regions of Britain. Your head count reduction programme and the HMRC tax office closure programme will actually reduce even further the number of jobs in the regions of Britain. How are you going to meet that target?

Mr Timms: First of all, the target that was set in Spending Review 2004 for HMRC, including the Valuation Office Agency, was 1,950. The relocation savings actually achieved was 2,492, so HMRC exceeded the Lyons relocation target set for it in the 2004 Spending Review. The target for 2010 is 5,050 and that will be achieved as well.

Q512 Nick Ainger: Looking at the figures in the report, page 11, it does say reported relocations by June 2008 just under 3,000. The target is a further 2,050 ahead of that. You have until the end of 2009 to achieve that so that is a very substantial number of relocations to be achieved in 13 months.

Mr Timms: I am confident that it will be achieved. As I have said, in terms of the target set for March 2008 HMRC substantially overachieved by a margin of 28% and I am confident that the 2010 target will be achieved as well.

Q513 Nick Ainger: Can we turn to staff morale because it is linked with these job losses particularly in HMRC. The staff survey shows that 70% of staff are dissatisfied with HMRC. What are you going to do to improve that performance?

Mr Timms: That is a very fair point. There are odd pieces of data in the survey that I could point to which give a slightly rosier picture than the figure you have given but your characterisation of the overall picture on morale is a fair one. In my view one of the major difficulties that staff have to contend with has been the uncertainty over the workplace re-organisation. As you know, HMRC is committed to concluding the exercise by the end of this year or making the announcements about the final configuration of the HMRC estate by the end of this year. I think when there is certainty everywhere then that will be a very important

milestone to pass from which it will be possible to rebuild staff morale. Other changes have happened as well. There is a new chief executive, a new chairman in place, and I think the organisation is now in a position to move forward. I am confident that one of the effects of that will be to improve morale but there is no getting away from the fact that at the moment the picture is a rather unhappy one as you rightly pointed out.

Q514 Nick Ainger: Have you recently met with the trade unions, PCS in particular who represent the vast majority of staff in HMRC?

Mr Timms: No, I have not.

Q515 Nick Ainger: Do you think it would be a good idea to start with that?

Mr Timms: There are very regular discussions between PCS and the executives of HMRC. I have only been in this role for a few weeks and I have not yet had that opportunity but I think it is extremely important that HMRC continues to work very closely with its trade unions and I am certain that under its new leadership, as with its old, it will do so.

Q516 Nick Ainger: In terms of the overall efficiency of HMRC, is not one of the problems that you face in the future not only tackling this morale problem, which obviously affects people's performance and maybe sickness levels and all that sort of the thing, but also the fact it would appear that many of the staff in the small tax offices are the most experienced staff that you have and they are going to be going. The quality of your overall workforce is actually reducing at a time when you want to see it radically improving. Is that not a structural problem that you have?

Mr Timms: It is certainly true we have a large number of highly experienced and indeed expert staff in HMRC. Once the final decisions on the HMRC estate are announced then HMRC will work with all of the staff in the offices which are going to close to try and find alternative locations to which they are happy to move. There will be support for additional transport costs, and so on, and there will be a very careful interview with every single member of staff affected. I hope the consequence of that will be that the expert staff you are referring to will continue to work in the organisation. No doubt some will choose that they do not wish to and that will need to be addressed by HMRC. As you are relating to our earlier conversation, there is a continuing need to reduce overall numbers further and I think that is something we are going to be able to manage successfully. I am very optimistic that staff morale will improve quite sharply once there is certainty about the future of this configuration.

Q517 Mr Brady: Are there any management or technical implications that arise for HMRC from the temporary VAT reduction?

Mr Timms: There certainly have been some very short-term implications in that some hundreds of staff have been trained up to respond to questions from businesses in this period between the

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announcement and the implementation of the VAT fall next week and some of those staff will continue to be working on those phone lines after implementation of the reduction on Monday. In terms of a larger scale impact, no, I do not anticipate a substantial effect.

Q518 Jim Cousins: We have just nationalised a good chunk of the commanding heights of the economy, and the commanding heights of the economy have responded to this by blowing a polite raspberry and putting up “business as usual” signs. Do you think the Treasury has the firepower in terms of numbers, expertise and experience to actually shift that?

Mr Timms: This may be something that Ian will want to comment on but I just make the point that, as you know, we have committed to regular reporting on the extent to which banks are meeting the commitment that they have signed up to: to maintain lending to households and small businesses. Alongside that we have made a number of announcements in the PBR this week specifically around supporting people looking to buy homes and small businesses.

Ian Pearson: What I want to say in response to you is we are very aware as a Government of the concerns that are out there and that are very clearly expressed by industry about some of the lending practices of the banks at the moment and that is why we have had numerous meetings. The Chancellor and Peter Mandelson have been involved in talking to the banks about their lending practices for the future. I think it is fair to say when it comes to the banking recapitalisation issues this is a process that is still going on. There has been clear conditionality attached to those banks which are taking advantage of the recapitalisation scheme that we have introduced as a Government and we do expect banks to continue to make available competitively priced lending both to the mortgage market and to small businesses. You will be aware of the announcements we made in the PBR, which we are not discussing this morning, which take our policy further in this area. We will continue to want to hold bank’s feet to the fire to make sure they do the right thing by small businesses and by people who want mortgages for the future.

Q519 Jim Cousins: Talking about holding people’s feet to the fire is a very dramatic phrase. Personally speaking I am very New Labour so the last thing I would want to see are bodies swinging from lamp posts or feet being held to the fire, although in some respects the medieval Catholic Church is an inspiration! That is a very dramatic phrase but the reality stands in great contrast to that. The reality is nothing has changed and the drama of your language I am afraid does not mitigate the fact that nothing has changed. The conditionality has not been worked to. You have conceded yourself this morning that the performance indicators have not yet been worked out. Nothing has changed and the drama of the language only emphasises that point.

Ian Pearson: I do not accept that nothing has changed. When you see some of the recent announcements only this week about RBS and how they are acting with regard to their small business clients, I think that shows things have changed. Also let me be very clear I do not think it is acceptable for bank chief executives to be saying one thing to Peter Mandelson, Alastair Darling and indeed the Prime Minister and then the lending practices down the line at regional and local level show no recognition of what those chief executives are saying to us. We cannot, as a Government, accept a situation where we are being told one thing and something completely different is happening. I think some of this is a communication issue within the banking system at the moment. We do need to make sure that we have responsive responsible bank lending and that is a key issue for us. We will continue to want to hold the banks accountable particularly those that, as I say, have taken advantage of the recapitalisation scheme to make sure that they continue to lend to small businesses at what is a very difficult time.

Q520 Jim Cousins: If we are optimistic enough to assume you are right in thinking that what we are dealing with is a communication problem inside the banks, something we need to think about, it is very important that the Treasury, and it can only be the Treasury and not HMRC, has the knowledge of what is going on on the ground. Do you have the firepower both in terms of numbers, experience and expertise to make sure that is the case?

Ian Pearson: It is not just the Treasury. Government as a whole, through BERR as a Department, gets regular feedback from industry about lending practices, about credit lines, about what is going on in the real economy and that all gets fed into Government at different levels. I am confident that we have a good understanding of what is going on out there in terms of lending practices and that is why we are very much challenging the banks to say that we understand that risks have changed and we do not want to do anything that is going to stop you operating in a normal commercial way but also, clearly, we do not want banks to overreact to market conditions and take blanket decisions which do not take account of individual company positions. We want to ensure that banks continue to make available competitively priced lending to viable businesses and it has to be the issue for us for the future to make sure that happens. There is a lot of noise in the system at the moment as you would expect in the sort of economic situation we are in. There is a clear responsibility on us as a Government to hold bank’s feet to the fire and say we want you to be acting reasonably in these difficult economic circumstances and we are going to want to continue to do that.

Q521 Jim Cousins: You can assure the Committee that you think you have the administrative firepower to make sure that happens?

Ian Pearson: I can certainly say to you that we understand what is going on. We have the resources within our officials and the market intelligence that

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is out there to be able to be quite clear as to the situation in the economy at the moment, and to be in a position to have a serious dialogue with the banks about their lending practices at the moment. That is what we have been doing and it is what we will continue to do.

Mr Timms: I would add that I know the Permanent Secretary has told the Committee that the Treasury does have the resources to address exactly the challenges you have been discussing.

Q522 Jim Cousins: Can I ask the Financial Secretary, following up the questions that were asked earlier, does the increased efficiency savings target point to an increase in the head count reduction to be achieved by HMRC and to an increase in the closure of tax offices?

Mr Timms: Your question is about the additional efficiency savings announced this week. We have not yet worked through what the overall additional 5 billion figure, on top of the 30 to which we have already committed, is going to mean for individual departments. I would say that at this stage I would not envisage additional office closures. The exercise we have been working on, and the rationalisation of the estate, has always had quite a long-term focus. It has been designed to provide an estate configuration which meets HMRC's long-term business needs. My initial reaction to your question would be I would not expect there to be any additional closures beyond those that would have been announced by the end of the year.

Q523 Jim Cousins: And head count reductions?

Mr Timms: That is possible. I do not think that can be ruled out at this stage but we have not yet done the work to assess what are the implications for Government departments.

Q524 Jim Cousins: We both acknowledge that HMRC is an organisation which functions on many tens of thousands of workers earning way less than the national average earnings, two thirds of whom are women. If their morale is to be raised and their performance is to be improved, and the Government is going to be depend on both of those things, they must be able to look to a future that contains more for them than the threat of the sack and the squeeze on their real take-home pay.

Mr Timms: Yes, they must. That is the reason why, in my view, it is very important that the estate configuration announcements are made by the end of the year so everybody knows where is the office they are going to be working and that will be a very important step in raising morale. The HMRC workforce does a great job. We have been able to make the workforce head count reductions so far without any compulsory redundancies. We will do everything we can to ensure that continues to be the case in the period ahead including if there are going to be additional efficiency requirements placed on the organisation. As I said earlier in answering Mr Ainger, we are going to see morale considerably improving over the next few years.

Angela Eagle: Can I say on the extra 5 billion that the operational efficiency programme has four strands and it has been identifying things like the fact that there is a 50% difference in the price per kilowatt of energy that different Government departments actually purchase. It is about things like the potential for savings of collaborative procurement. There is not going to be an extra head count requirement put in but it is about things like that, better use of shared services, collaborative procurement, driving the prices of the services and suppliers' prices down by aggregating procurement so you can get value from having bigger spending power. It is that kind of thing, and there is no head count reduction attached to it, that is going to be expected.

Chairman: We will return to some of those particular issues during our sessions on the Pre-Budget Report later on.

Q525 Mr Todd: It is a bit alarming that that initiative is starting now.

Angela Eagle: It is not. It has actually come from some of the work that has been done over time which has demonstrated by increasing the capacity for collaborative procurement, by doing a lot of work to make more transparent costs that had been hidden in the past, that these things have come to light. If you like, it is a deepening of the entire efficiency programme which comes about because of the cumulative effect of efficiency programmes over the last few years.

Q526 Mr Todd: I think co-purchasing was part of this programme at its commencement, so discovery of large variances in energy costs, perhaps surprising it has happened so late.

Angela Eagle: It does demonstrate that there is scope for further efficiency savings without affecting the service delivered.

Q527 Mr Todd: I take that reassuring message but stand by the criticism. I think, Stephen, you probably caught the hospital pass of tax credit administration, am I right?

Mr Timms: You are correct.

Q528 Mr Todd: A large number of customers were being handled manually because of failures within the IT system of HMRC. What is the current position on that number? We were told around 25,000 about 19 months ago.

Mr Timms: I do not think that figure is one I have in front of me. As you know, we have established the tax credit transformation programme to improve the services that families receive and that has introduced a number of new services. Certainly it is my impression in my surgery, and no doubt other members of the Committee will have experienced the same, that there has been a very considerable improvement in recent months in the service that is provided to tax credit customers.

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Q529 Mr Todd: Not, I have to say, in the volume of queries that MPs tend to get. The quality of response may be better.

Mr Timms: I am glad that quality of response is improving. Certainly the number of overpayments and the level of overpayments is very significantly down as a result of the changes we have made.

Q530 Mr Todd: Will you give us a note on the numbers that are currently manually being handled as opposed to being handled within the system?

Mr Timms: I can certainly do that.⁴

Q531 Mr Todd: Where are you with the IT supplier for this particular system? Do they have some responsibility for continuing problems or was this system handed over to HMRC and it is now yours to resolve and your liability?

Mr Timms: The original supplier is no longer involved. There is a new supplier and the new supplier is providing a good service.

Q532 Mr Todd: The original supplier, if they bore any blame for poor design and that is quite a significant qualification, is out of this frame.

Mr Timms: Yes.

Q533 Mr Todd: The change in COP26, which this Committee has spent quite a lot of time querying in the past, has received a broad welcome and certainly has had a welcome in my office.

Mr Timms: And in mine.

Q534 Mr Todd: However, there remain some areas of difficulty, one of which is over the recording of phone calls where I think it has been disclosed that on some occasions phone call records have not been complete. I have to say that has certainly occurred in my office. How confident are HMRC of the solidity of their evidence of communication? You will know that COP26 is very specifically tied now to communication by the customer to HMRC so the validity of that communication is absolutely critical. What degree of confidence do you have? I must admit that mine has been shaken by a couple of local cases.

Mr Timms: I think there are good grounds for confidence. We replaced, from the end of January, the reasonable belief test in COP26 on recovering overpayments. The new test is a good deal clearer, setting out HMRC's responsibilities and the customer's responsibilities for checking factual information and that has been very helpful in making it much clearer.

Q535 Mr Todd: There is a critical requirement to inform HMRC within 30 days and if one is not entirely sure of the robustness of the telephone recording system—and I have to say it is certainly not true they can always get through—then that difficulty of demonstrating that communication is problematic.

Mr Timms: I agree. The confidence over that is very important. This is not a concern that has been raised with me previously but I will certainly have a look at where we have got to.

Q536 Mr Todd: To give an example, I very unusually had the entire file of a client sent to me which, because they were extraordinarily assiduous, they had kept their communication with HMRC and it was quite clear that not all of the communications had been recorded within the HMRC file. I must admit that was alarming, as was a catalogue from a customer's telephone calls which showed large apparent hanging-on periods which could not be properly explained. 11 minutes apparently hanging on without a call being connected, which the customer recalled as a conversation, indicates that this system is far from flawless. I would welcome your personal attention to that.

Mr Timms: If you still have the file, I would be happy to do so.

Q537 Mr Todd: If you have a very, very large envelope on that particular one I am sure we can provide you with it. What do you expect the impact to be from the change to COP26 on the write-off of overpayments? Presumably this is going to produce logically an increase in write-offs if there is a softening of the policy.

Mr Timms: Overpayments are, as you know, very substantially down. I think the most recent figure I have is for 2006–07. They are now less than half the level they were in 2003–04 and the trajectory is very encouraging. Clearly there is still an issue here and I do not want to give the impression to the Committee that I think the problem has been entirely resolved. There is more we need to do but things are certainly moving in the right direction.

Q538 Mr Todd: That is the overpayments but the write-off, in other words where the implications of the new policy indicate that HMRC must bite the bullet on the loss, what is your estimate of the write-off that we can expect as a result of the new policy?

Mr Timms: I do not have in front of me an estimate for that. I think the Committee would agree that the change in policy has been absolutely right and very helpful.

Q539 Mr Todd: It has a financial consequence which we should be aware of. Could you write to us with an estimate of the implications of that based on the experience to date?

Mr Timms: I will be happy to provide whatever information is available.⁵

Q540 Mr Todd: Finally, there were issues raised when Kitty Ussher was before us in May concerning the linkage between child tax credit payments where that is delayed and the implications for supplementary payments for Child

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Trust Funds. Kitty agreed the substance of the argument and went away to consider what could be done. Have you an update on that?

Mr Timms: Yes. I know that Kitty wrote to the Chairman on the 17 July explaining she would be introducing new regulations to change the rules so that children otherwise eligible for the additional payment under the Child Trust Fund do not miss out because a tax credit claim is not made within three months. Those new rules will extend the eligibility window from three months to a minimum of 12 and regulations to achieve that will be laid shortly.

Q541 Mr Todd: Those are not currently in place.

Mr Timms: That is correct.

Q542 Mr Todd: Therefore the circumstance this Committee identified remains true, that some may lose the benefit. The examples given, mental illness, postnatal depression, which might lead to a delay in a claim having a further additional financial consequence, remain true.

Mr Timms: But the regulations that are to be laid will deal with that and put that right. Once the outstanding payments are made, along with further payments which will be made in lieu of missed investment growth, no family will have suffered a financial loss. The regulations have not been laid yet but they soon will be.

Q543 Mr Todd: There is no intent to backdate the implication of this regulation?

Mr Timms: What I am able to reassure the Committee of is that no child or family will have suffered a financial loss once all the regulations have been put in place. The rule change will come into effect for children who become eligible for a Child Trust Fund account from the 2008–09 tax year onwards.

Q544 Mr Todd: You would agree that this regulation ought to be placed quite urgently.

Mr Timms: Yes.

Q545 Mr Todd: It is slightly alarming that a good case was presented to this Committee for change and a welcome announcement of intent quite rapidly followed but the action has not followed as a consequence.

Mr Timms: It very shortly will do.

Q546 Mr Todd: The other point raised at that time was the flagging of some of this critical information on the website so people clearly understood how important rapid communication was in some of these instances, not that it would necessarily help some of the customers I just mentioned but nevertheless the clarity of communication is vital. Has that been rectified? I think the example that may have been raised by Mr Ainger who took part in this exchange was that you went to page 8 of the information pack before you encountered the critical piece of information as to how rapidly you should do something.

Mr Timms: I am not sure what changes have been made to the website. I entirely agree that the website should be clear on this and I will check what changes have been made.

Q547 Mr Todd: Can you make sure that is done?

Mr Timms: Yes.

Chairman: We do need to speed this up. We examined all this in May so it is a little disappointing to hear nothing much has changed.

Q548 Mr Todd: To be fair, it was accepted.

Mr Timms: Kitty Ussher wrote to John at the end of July.

Chairman: This is November.

Mr Todd: Writing a letter does not change the law or necessarily implement the website change.

Q549 Chairman: Can you give us an assurance you will personally have a look at this and chase that up?

Mr Timms: Yes.

Chairman: We will turn to the Valuation Office Agency and the issue of ports rating. We are obviously grateful for the letter you sent on 24 November and the speed at which you got that reply to us. I have to say we have discussed it collectively and we remain disappointed but Nick Ainger will start with some questions on that.

Q550 Mr Ainger: Stephen, when you came before us with John Healey we asked for a breakdown of all the changes in the ports. When are we going to get that information?

Mr Timms: This is the figures for pre-review of rateable value?

Q551 Nick Ainger: It is the changes because, if you recall, the problem was we were told by the Valuation Office that overall there had only been a 10% increase.

Mr Timms: That is correct.

Q552 Nick Ainger: And we had been given information which indicated that there were some huge rises and therefore we asked for a full breakdown.

Mr Timms: I have the full breakdown in front of me and it says on it “sent to Committee on 5 November” so I would have hoped that would have reached the Committee by now.

Q553 Nick Ainger: Everyone in the room is shaking their heads.

Mr Timms: I can only apologise. It certainly was sent and I have a copy here so we can leave that here.⁶

Q554 Nick Ainger: I am sure we will now get it. Since our exchanges on 29 October we have received a lot more information from individual companies. Can I just take you through some of them so you clearly understand the extent of the

⁶ Following the hearing the Committee Secretariat was able to confirm receipt of the note on 5 November.

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problem. I have a letter here from Stena Line that operate out of Fishguard, Holyhead, Fleetwood, and they used to operate out of Harwich. In Fishguard, where they are not only a port user they are the port operator as well, the change has been 227%, which is an increase per annum of £400,000. In Holyhead the percentage increase is 242%, an increase of £1.1 million. In Fleetwood, where they are just a user, their increase is 430%. In Harwich they used to have a berth which they closed in January 2007 and they have been given a bill by the Valuation Office back-dated to April 2005 for £1.8 million for a berth that they have not used since January 2007. What Stena Line say is that this is going to have a significant impact on their business and on their investment plans and there could even be redundancies as a result of it, so that is Stena Line, a major company. We then move on to some smaller operators in Liverpool. I have here a letter from Mr Kirk of Stanton Grove Ltd who tells us that his company faces a back-dated bill of £1.5 million with the increase on-going of some £568,000. He only makes annual profits of £250,000 and does not know how on earth he can afford not only the back-dating but the actual increase that he faces. Finally I have a letter here from Mr Dixon, the Managing Director of Freshney Cargo Services in Grimsby and they are facing a back-dated bill of £3 million and a £750,000 annual increase. Your letter suggests that we can address this problem by giving these companies eight years to pay back the back-dated element, but it is clear from those figures that they will not even be able to afford the actual annual increase never mind about the back-dated increase. Your letter also refers to a fast-track appeals system but as you intend to legislate in order to provide them with this eight-year period, could that legislation not actually look again at this back-dating issue and whether it should actually be applied, bearing in mind that not one of these companies was consulted, despite what the Valuation Office has said? Stena Line make it absolutely clear that they had no consultation whatsoever both as a port user and a port owner. Do you not think that you should look at this again? While you have moved substantially, and I accept that, I do not think it has gone far enough, and I think the Committee would agree with that.

Mr Timms: Let me just comment on some of the figures. I have figures in front of me for a couple of the ports that you mention—and again I apologise that the Committee has not seen that yet—and for Fleetwood before the review the port rateable value was £310,000, the non-port was £324,000, so a total rateable value of £634,000. Post the review the figures are for the port £245,000 and non-port £325,000 so a total of £570,688, which is a reduction in that particular case of the overall rateable value, so I am a little puzzled. I suppose in that case Stena is not the port operator, it is simply the tenant.

Q555 Nick Ainger: No, it is not the port operator, it is a port user there. Their figures show a 430% increase.

Mr Timms: Yes. On the question of notification, as you know from our previous exchange, the Valuation Office Agency did write to all the port operators affected as soon as the appeal from Southampton was withdrawn, which was in the early part of 2006. There was some discussion at the Committee last time I appeared with John Healey about letters to port occupiers in Hull and, in that particular case, because the Valuation Office Agency did have some information about the occupiers in Hull, 72 letters were issued between November 2006 and February 2007. What has happened is that it has become clear through this series of events that some occupiers who previously were not being charged rates actually should have been charged those rates for a very long time. That has now been put right. I think the change that has been announced in the PBR is a very significant one. It will allow people to stage payments over eight years instead of having to pay in the current financial year, which would otherwise have been the case, but I do not think I can hold out to the Committee the prospect of negating what clearly is a liability which does need to be paid and indeed should have been raised in previous years as well. My colleague, Jim Fitzpatrick, the Ports Minister, will, as our letter to the Committee said, continue to speak to the port operators because of course in many cases their rateable value has reduced as a result of the changes as the counterpart of the operators' rateable value being raised, and there may be some help that some of the port operators therefore can provide. I think I would need to point out to the Committee that the rates liability does need to be met.

Q556 Nick Ainger: Again, we have had correspondence from individual companies who had always understood that the rent that they were paying to the port owner did cover an element for rates. They have told us that the port owners are refusing to offer them any compensation for the rates that have been already paid and they do not seem to be negotiating any significant reduction for future payments either, so they are being hit with a double-whammy. They are being hit by the fact they believe that they have already paid a substantial contribution towards their rates between 2005 to date to the port owners and then they are being hit by the Valuation Office saying that they have got to pay their full rates with effect from April 2005. Talks can go on but at the end of the day they want a clear decision in relation to this back-dating element, and if there is no way that the port owners can be made to compensate in some way, then the only way is to look to the Valuation Office for some form of compensation because at the end of the day—and I will quote you again what Stena Line said: “The Valuation Office did not consult with Stena Line either before the new valuation list came into force or before any of the subsequent actions to alter the list.” It goes on to say: “This contrasts with the situation in Scotland where a consultation exercise did take place with port operators and we do not appear to

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have a problem in Scotland.” Thus it is clear that there is a lot of evidence that port operators are being asked to pay twice, that they are being faced with very high increases, and that they were not properly consulted at all, and it came as a bombshell to them when they were informed of the new valuations. I think we need to make some progress.

Mr Timms: I think we have made some progress in the announcements in the PBR. On this point of the port operators’ rateable values, those have reduced from £127 million for England and £8.6 million for Wales to £84 million for England and £7.8 million for Wales, so there has been a significant reduction in the port operators’ rateable values. In the case of Hull the figure has gone from £9 million for the port operator before the review down to £3.1 million now. I appreciate the position is going to vary considerably between occupiers, but I would hope that the arrangements would have been set out in a licence agreement between the port operators and their occupiers and that on the basis of those agreements the occupiers may perhaps be able to press their landlords for some adjustments. I hear very clearly what you have said about what is actually happening on the ground and I will draw that to the attention of Jim Fitzpatrick for his discussions with the port operators (which are continuing) but I do not think there is very much more that I can offer or that the Valuation Office Agency is likely to be able to offer beyond the very important step that the Chancellor announced this week.

Q557 Nick Ainger: But you accept that there is an issue of natural justice here as well if the port occupiers/the port users, who are the people that actually generate the wealth in those ports, they are the ones that employ people and do the business there and so on, are faced with these huge rises and their landlords, certainly in certain circumstances, do not appear to be prepared to pass on their reductions to their tenants. As you intend to legislate so that the eight-year period can be addressed without interest being applied, can we not address also the issue of the refusal of individual ports to pass on to their tenants the savings that the Valuation Office has given to them?

Mr Timms: You are suggesting that we should legislate some new obligation on the port operators?

Q558 Nick Ainger: Indeed.

Mr Timms: I do not think the legislative opportunity that allows us to stage these payments over eight years would allow us to make the change that you have suggested. I am perfectly happy to have a look at that, but I would not want to encourage the Committee to think that that is something that could readily be done. I do agree that the port operators do have some responsibility here, and I think all that we can really do is press upon them the importance of them fulfilling those obligations because it is not in their interests that their tenants should needlessly be put out of

business, which in some cases may be the consequence. However, I would not want to encourage unduly the Committee to think that there is something in legislation that we could quickly do.

Q559 Nick Ainger: Can you look at that?

Mr Timms: I am very happy to have a look at it.⁷

Chairman: Does any other colleague want to ask about ports? Right, let us turn to the Debt Management Office. Sir Peter Viggers?

Q560 Sir Peter Viggers: As we leave ports I think we all recognise, Ministers, that you have not come here this morning authorised to say that there will be a change in this situation, but we as a Committee tasked to scrutinise the Treasury’s functions feel strongly that something should be done. I move on to the Debt Management Office. The Debt Management Office employed about 80 people before the present dramatic expansion in borrowing. There is some discussion about DMO being given further resources. Can you comment on that please?

Ian Pearson: Firstly, I would want to say that the DMO people are doing a terrific job at the moment. They are certainly working hard under the current circumstances and, as you will be aware from when Nick Macpherson came and spoke to the Committee, Nick assured you that he is in regular meetings with the Head of the Debt Management Office and if they needed further resources those resources would be made available, and that remains the position.

Q561 Sir Peter Viggers: An auction of gilts in July 2008 was only 1.1 times oversubscribed, which was a pretty poor result really. How confident are you that the DMO will be able to fund the enormous amount that you are calling upon it to try to obtain?

Ian Pearson: Government assets are in strong demand both globally and in the United Kingdom and they do represent the preferred risk-free asset for major international investors and we have no reason to believe that that is not going to continue to be the case. When you look at the wider environment at the moment with falling interest rates and falling inflation as well, I think there is going to be a continuing strong demand for gilts in the future. You rightly highlight one of the auctions where there was not as high coverage as normal with regard to gilts, but if you actually look at the coverage rates so far this year they are slightly up on last year despite the fact that we have had bigger issuance as well, so I remain very confident that there is every reason why international and institutional investors will want to invest in UK gilts in the future.

Q562 Sir Peter Viggers: But sterling has fallen considerably and the market which values creditability through credit default swaps values the

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United Kingdom less well than some UK companies. It costs more to insure the Government's creditability than some UK companies.

Ian Pearson: I think there is a bit of rubbish being spoken by your leader of the Opposition on CDS and UK gilts. The simple fact of the matter is that CDS spreads, when it comes to sovereign debts, is pretty much an illiquid market at the moment. The fact is we have had two issues that have not been covered within the last 10 years when it comes to UK gilts. They do remain highly popular and I have got every confidence in the officials in the Debt Management Office to be able to continue to raise the funds that will be required in the future.

Q563 Sir Peter Viggers: Giving evidence to us the Debt Management Office said: "If there is an uncovered auction we have processes in place to deal with that." What are the processes?

Ian Pearson: A lot of processes relate to the fact that these issues will be taken up rather than through auction by other arrangements in the relatively unlikely event that a gilt auction is not fully covered. As I say, we have no reason to expect that future auctions will not be fully covered. We can never guarantee when we are talking about the sort of sums that we are here that there will not be a case in the future where there are problems with a particular auction, but I think there is every reason for the Committee to be confident that we have a very effective gilt-raising operation in the United Kingdom.

Q564 Sir Peter Viggers: But the amount of prospective borrowing since the Budget has almost trebled. Do you expect the price of gilts to increase and have you factored a higher price into your calculations?

Ian Pearson: I do not want to speculate on details of prices. Those will be determined in the normal way as part of the issuance process. In terms of the fact that we are going to need to raise more money through gilts, that is absolutely right. In actual fact, about two-thirds of the extra money that we need to raise currently is as a result of the bank recapitalisation programme and Bradford & Bingley and what we are doing with regards to the Financial Services Compensation Scheme to compensate people who have retail deposits in the Icelandic banks. That has required a significant additional level of activity on the part of the Debt Management Office. They have already significantly upped the amount of issuances so far this year. They have got a pretty significant forward programme for the rest of this current financial year, but, again, I have got every confidence in their ability to do that job and to raise the funds that we require.

Q565 Sir Peter Viggers: Some commentators have said that it is rather surprising that long-dated gilts are not offered more than they currently are. Can you comment on that?

Ian Pearson: We do offer long-dated gilts and obviously there is always an issue about the balance between short, medium and long term in terms of the offerings that we make. Certainly there is a significant market appetite at the moment for short-term gilts. We have also got a short-term requirement in the sense that some of the things that we want to do to raise funds have their timescale over the next two or three years, and we think it right that we should be matching the market appetite with our own requirements as a government for short-term finance, so I think the overall balance at the moment in terms of what we are proposing to do is the right one. We continue as a matter of course to consult and work closely with the markets about our forward programme so there should be no alarms and surprises when it comes to future issuances as well.

Q566 Sir Peter Viggers: You were planning to increase VAT by 1% and your tax ready reckoner helpfully points out that this would have raised £5,000 million in 2011–12. How are you going to fill the black hole if you are not going to do that?

Mr Timms: There is not a black hole. I think you will have gathered from the coverage since yesterday that we looked at a series of options in the lead-up to the Pre-Budget Report, as everybody would expect. There was an exercise looking at that particular option and that was rejected. In its place the fair way forward was determined to be the one that was announced by the Chancellor yesterday. The revenue that would have been raised by that measure is instead being raised by the announcement that the Chancellor made in the PBR.

Chairman: The final area we want to look at this morning is the Government Actuary's Department. Nick Ainger?

Q567 Nick Ainger: Ian, could I ask you about the Mineworkers' Pension Scheme. We asked the Government Actuary when he was here these same questions. There was an article by John Ralfe in the *FT* in July in which he claimed that there was a major problem arising in the future because of the way that the surpluses were being calculated by the Government Actuary. Mr Ralfe said in his article that these surpluses were fictitious and he went on to say that: "This is because the method of actuarial valuation, set down by the Government Actuary, understates liabilities by discounting at the expected return on assets, including 70% equities, not the index-linked gilt rate which would better reflect the fact that pensions are inflation linked and government guaranteed." He went on to say: "On an index-linked gilt basis, there was a £0.9 billion deficit at market values at the 2005–06 valuations, not the reported £1.9 billion surplus. In 2002–02 the deficit would have been a whopping £5.3 billion at market values, rather than the reported £0.7 billion deficit." To be fair to the Government Actuary, he had only recently taken up his post and really was not in a position to give us any detailed response, but if Mr Ralfe is right

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that we should be calculating the surpluses using the gilt rate, are we not building up a major problem in this pension fund because it is guaranteed by the taxpayer that in the future, if Mr Ralfe is right, then the taxpayer is going to have to be pumping money into the pension fund rather than taking, as it does at the moment, 50% of the surpluses?

Ian Pearson: I am not aware of the particular article, but from what you are saying there it strikes me that there is clearly an issue about how you undertake valuations of pension funds and whether you base the valuation on the assets receiving the return that index-linked gilts would do or whether they receive some other sorts of returns that relate to the fact that they might have equity as part of their portfolio. I think the best thing that I can say in response to you is let me take the issue away and

either the Government Actuary or I will write to the Committee and directly address the questions that you have raised.⁸

Q568 Chairman: Anybody else? I think that you owe us a series of notes as a result of this morning because we have covered quite a range of topics. We will continue to press on the issue of ports re-evaluation. I hope you will continue to work with the Ports Minister on how the port operators might be persuaded to pass back some of the very considerable savings that they have made. I hope you will keep us updated on that work as it proceeds.

Mr Timms: We are happy to do so.

Chairman: In the meantime I thank all three of you for your attendance this morning.

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Written evidence

Memorandum from the Public and Commercial Services Union (PCS)

1. The Public and Commercial Services Union (PCS) is the largest civil service trade union, with over 300,000 members working in over 200 civil service departments, non-departmental public bodies and related areas. This includes over 70,000 members employed by HM Revenue and Customs (HMRC).

2. Since the creation of HMRC, the Department has pursued a programme of job cuts and office closures and plan to close over 200 offices and cut 25,000 jobs by 2011. PCS believe that these cuts are undermining the Department's ability to assess, enforce and collect relevant taxes and monies.

3. HMRC have stated that since the merger of the former Inland Revenue and Customs and Excise departments that the new department has more accommodation than it needs and therefore needs to make savings by rationalising its estate and employees. To this end it has introduced a programme called "Workforce Change" (WFC).

4. PCS supports any estate rationalisation that is both cost efficient and does not have a detrimental impact on staff and the service they provide. However, we are concerned that too many of the current restructuring of estate and services are being determined by arbitrary job cuts and office closure targets.

5. PCS are concerned that in many parts of the UK tax debts are no longer being pursued because of lack of resources due to staff leaving the debt management business not being replaced. The current debt balance, the amount of tax and duties assessed as being due to the Exchequer but has yet to be collected, stands at over £21.5 billion and is projected to rise significantly because of the economic crisis.

6. The processing business operation within HMRC is responsible for capturing Self Assessment tax returns for eight million people and dealing with the tax affairs of a further 15 million under PAYE. Although it categorises its work under 27 priority headings in most offices only the six or seven highest priority items are dealt with because of the lack of resources. This means that many individual taxpayers possibly have the wrong PAYE code and they could be underpaying or overpaying their income tax.

7. Processing work is routinely sent around the country in an attempt to get it dealt with. PCS believe it to be ironic that the most difficult work often ends up in the smaller offices that are threatened with closure, because that is where many of the most experienced staff are based.

8. In the tax compliance section, which includes the work done by tax inspectors, VAT officers and employer compliance staff, over 7,000 jobs have gone in the last three years and a further 2,000 are expected to go by 2011. The average tax yield for each member of compliance staff is £640,000 after employment costs each year. PCS believes it would therefore make more sense to increase resources and jobs in tackling uncollected tax and tax evasion.

9. HMRC claims it is reallocating compliance staff to areas where they are able to collect a greater amount of tax. However, we are concerned that the centralisation of compliance offices is effectively removing staff out of local communities. It is reducing local knowledge and significantly reducing the Department's ability to identify risk.

10. PCS are concerned that HMRC's move away from face to face engagement to less rigorous interventions by mail or telephone are lacking in credibility. Therefore, less honest individuals, businesses and agents may believe that they will not be called to account. All too often our members tell us that businesses and individuals responsible for millions of pounds in fraud are able to get away with it as the Department do not have the resources to effectively deal with them.

11. HMRC claims that substantial estates cost savings will result from its WFC. We have challenged this assumption in some locations such as where there never was a doubling up of Inland Revenue and Customs & Excise premises in the first place. In others the department is still contractually committed to paying maintenance and running costs of buildings, even if vacant. In many locations costs associated with moving staff will outweigh any projected savings. Although HMRC initially publicised potential savings they have now decided that any information regarding costs is commercially sensitive and will no longer disclose it, and indeed view the disclosure of such as a disciplinary offence.

12. PCS also have concerns about the effect the closure of local offices will have on customer service. HMRC claims that customer service will not be affected as Revenue Enquiry Centres will remain in the towns where they plan to close offices. This will however be with minimal staffing cover and it will therefore not be possible to maintain the current levels of service. Enquiry centre staff currently rely upon their backroom colleagues to provide immediate advice and cover for absences. Both these facilities will disappear, resulting in delays in answering customers' queries and restrictions in the availability of the service.

13. HMRC is already piloting enquiry centres with reduced opening hours each day or fewer open days per week. HMRC's declaration that it will not completely remove itself from any location where there is already an HMRC enquiry centre has been used as a means of dismissing fears expressed by constituents to their MPs, implying that the retention of "a presence" equates to maintaining the level of service to the public. We believe this is misleading.

14. Customers will end up facing a longer journey to their nearest office for advice or having to write or contact one of the HMRC telephone contact centres which are often too busy to answer calls. A high proportion of more vulnerable members of society, such as pensioners, migrant workers and people who rely on the tax credit system, or live in rural areas, will experience extreme difficulty in obtaining the tax based help that is necessary to be able to comply with complex and confusing legislation.

15. PCS believe that any savings being made through the WFC job cuts will be short lived and will have a detrimental impact on the tax yield and the service provided to the taxpayer. We believe that increasing resources in tackling uncollected tax and tax evasion, in addition to closing loopholes, will ensure the billions of pounds of revenue currently being lost could be ploughed into public services and help stimulate the economy.

October 2008

Letter from Simon Leafe, Managing Director, Leafe and Hawkes Ltd, to John McFall MP

We understand that you will be chairing a meeting of the Treasury Select Committee on 15 October when the issue of the non-domestic rating of U.K. Ports will be discussed. As a company whose future could be seriously adversely affected by this, we would like to comment on some of the issues.

The profile of our Company is typical of many in the shipping and freight forwarding industry: we are a family business, established almost 40 years ago, currently providing direct employment for 10 people and a living for 10 families.

Please be in no doubt that small companies such as ours will be forced out of business if they are faced with enforcement for these huge back-dated rating demands. In most cases, this will mean that ultimately the rates bills are not paid at all, leaving The Treasury in a worse overall position than they were before this new policy was introduced. The Treasury will lose out further as the bankrupted companies will no longer be paying any corporation tax nor making national insurance contributions. Former employees of those businesses will not be paying any personal income tax, having lost their livelihoods. They will in fact be costing the Government money as they claim unemployment benefits.

Businesses such as ours arrange the efficient handling of imports and exports through the ports which are the lifeblood of our Country's economy. We wonder how the Country's economy can properly function if these companies no longer exist and this expertise is lost. It surely cannot be Government policy to destroy such an important industry, at the same time risking the direct loss of thousands of jobs in the Humber area alone. However, this will be the result if you allow this policy to continue.

We liken this situation to a scenario where the Government decides to increase the rate of VAT from 17.5% to 35% and to then back-date this for three years. Clearly retailers and other businesses could not realistically go back to their customers to recover the extra costs and neither can we. There would quite correctly be outrage from Tesco, Sainsburys and others if such a thing was allowed to happen, so you and your colleagues on The Treasury Committee will understand how we feel about being put in this impossible situation.

We are not aware of any consultation having been held in England with our industry prior to the introduction of this significantly revised Government policy and wonder why this was not carried out? We would urge you to use your powers to instruct the V.O.A. to abort this exercise, to remove the threat of back-dating of these huge rates increases, and to work with our industry toward s the orderly introduction of a new rating regime in 2010.

6 October 2008

Letter from A J Dixon, Managing Director, Freshney Cargo Services Ltd, to John McFall MP

RE: TREASURY SELECT COMMITTEE MEETING 15 OCTOBER 2008 RE PORT RATES

I have been informed that you are collating details regarding the subject of ports rating to be held on 15 October 2008.

This is a matter which has caused us a great deal of anxiety for some time as the new and backdated rating issue would have a real and significant impact on the viability of our Company and its employees.

We have operated within the Ports of Grimsby and Immingham for over 18 years and pay a substantial amount of money as part of a commercial agreement to the owners of the Port, Associated British Ports "ABP". ABP have always paid business rates on their ports and properties on what is known as the "Port Cumulo basis" prior to and throughout this period, calculated as a percentage of Port operatives/tenants payments to them.

The only business rates which we have had throughout this term are only in relation to buildings which we own ourselves i.e offices and smaller buildings which total around £48k p.a. Our business and subsequent charges to our clients was founded/developed and has operated on this basis for the last 18 years.

The port business is extremely price sensitive, such that we struggle to achieve even inflationary rises from our Clients for fear of business moving away to other Ports vying for diminishing tonnages as manufacturing in the UK falls.

Basically anything that increases our operating cost such as Fuel/Electricity costs which we have been suffering with of late are unfortunately having to be absorbed.

I am writing to you because of a significant and potentially “Catastrophic” new threat to our business. The new Port rating system which has landed completely “unannounced” threatens our very livelihood particularly in times of recession.

The first notification we received from the VOA was only November last year (2007) to say that they are revaluating Ports which:

1. MAY give rise to a new liability.
2. Could be backdated to April 2005.

Additionally we have only just received valuation notices which alter our rates from PAYABLE £48,142 p.a.(104,000 RV) to over £834k (£1875,500 RV) ie £786k increase p.a.(over 1700%).

Also we face backdated bills going back to 2005 of over £2.4 million.

The new rates calculation which is used in arriving at a figure which covers the backdated and future demand represents an unjustified increase of over 1700%. This figure has been calculated in a haphazard and unjustified way by the Valuation Office Agency (“VOA”). We would have extreme difficulties recovering such increases from our clients and even if it were possible any increase of this magnitude would severely damage manufacturing which is already struggling in the UK.

We have built a substantial stevedoring and transport business over the last 18 years in Grimsby and Immingham and currently handle around 700,000 tonnes of cargo p.a. which is now under threat.

Employing the services of over 100 people and a similar number of sub-contractors and suppliers this makes some 200 “families” reliant on our company continuing in business.

We trust that following the hearing at the Treasury Select Committee on 15 October 2008 that a meeting can be arranged with the VOA to bring this deeply unsettling nightmare to a close. We need to concentrate on protecting jobs in these troubled economic times rather than risk destroying them by driving companies into bankruptcy as a result of these ludicrous back dated rates demands and would appreciate any assistance you can bring to bring this ludicrous matter to a close.

This is not just about Grimsby and Immingham but being rolled out to 55 ports in the UK. Demands of this nature would be catastrophic and cause huge job losses in the Shipping Industry upon which as an Island we are heavily dependant and cannot stress enough the magnitude and urgency of the situation.

7 October 2008

Letter from Mr David Rumsey, Finance Director, Clarkson Port Services, to John McFall MP

As you will be aware, the business rates levied on businesses in the ports of England and Wales are currently being revised by the VOA.

We use warehouse facilities in the Port of Ipswich. Our business exports grain and imports animal feedstuffs for third party customers. In line with the rest of this industry, we operate on very thin profit margins. For many years we have paid our business rates via the local port’s “cumulo rates” assessment. Last year, we were contacted by the VOA saying that this arrangement would cease, but it is only in the last week that we have received our rateable values—a whole year later. This places our business rates liability at c£100,000pa. We have a number of complaints about the way this re-rating exercise has been conducted and its fairness.

Whilst we have received our rateable values, our major competitor in the port of Ipswich has not even been valued by the VOA. We are told by the VOA this is due to a breakdown in communication within their organisation. Thus, whilst we are about to be charged, our competitors have nothing to pay.

Port owners remain assessed, effectively, on their old income based assessment basis. Our rateable values exceed £200,000 and yet Ipswich Port’s assessment is just over £500,000 despite them having considerably greater warehouse capacity than us, maintenance buildings, offices, 1.5 km of quays and a great deal of open storage land that is in profitable use. Were Ipswich port to take back our facilities, which they could do at will, it is clear to us that they would pay a very much smaller rates bill than we are being asked to. We find this iniquitous and anti-competitive occasioned by local Government taxation policy.

Frankly, to add insult to injury, we are being told that the rates change will be backdated to 5 April 2005. We neither knew of the existence of this planned change by the VOA, nor until recently the monetary effect; and the delays are entirely of the VOAs making. We have spoken to our local rates collecting authority and they tell us that they are forced to change their billing software as they “have never had to backdate this far”. The charge for each year going backwards is greater than the profit we made in each fiscal year. The proposed rates charge amounts to an increase in our overheads of c35% per annum. Any business takes time to adjust to such a rise—time we have not been given because of the decisions of arms of Government.

We do not argue with the right to amend the rules in this regard. However, we would respectfully ask that the changes be delayed until 2010 when the whole procedure can be properly completed, when businesses have had the chance to adjust to their new cost base and so that the thinking behind the differential taxing of ports and their users can be thought through.

8 October 2008

Letter from Mr Nicholas Orbell, General Manager, Real Estate Development, Hutchinson Ports UK Ltd, to John McFall MP

VOA / PORT RATING—HARWICH INTERNATIONAL PORT & PORT OF FELIXSTOWE

Hutchinson Ports UK Ltd is the owner and operator of the above two ports. We understand that the Treasury Select Committee is to consider shortly with the VOA the issue of the rating of ports in respect of the 2005 Rating List.

Both of these ports were subject to significant increases in rateable value in 2005; at Felixstowe an increase of 212% to £14.167 million and at Harwich 275% to £4.14 million. In both instances, the move by the VOA has resulted in significant adverse impact on the business in terms of its planning and third party customer relationships, as explained below.

HARWICH INTERNATIONAL PORT

1. This port was subject to a 2005 List assessment that was appealed in early 2006. This port was not subject to prior negotiation or discussion, evidenced by the following email communication from the VOA officer in May 2004, which accompanied the publication of the 2005 List valuation.

“In the time available this is clearly an adopted figure...In the event of an appeal all these allowances and adopted figures will be disregarded. We will do an entirely fresh valuation, look at all the assets and management accounts and get our own expert opinion.”

In effect, the VOA contrived financial figures for the port to arrive at a valuation without proper analysis and foundation, and in the clear expectation that the entire valuation will be reconsidered; however it has taken until October 2008 in the case of Harwich International Port to begin to have a meaningful dialogue with the VOA. This is an unacceptable situation where the impact on the cash flow of a business is a liability that increases from £0.8 million in 2005 to £1.5 million in 2008.

2. The rateable hereditament was physically reassessed by the VOA in 2007 and 2008, two years after the introduction of the 2005 List. As a consequence, the port’s assessment was split on 28 September 2008, valuing one berth as a separate assessment. This change to the List occurred three days prior to the date of the Harwich Port’s rating tribunal appeal hearing for the 05 List (thereby negating the appeal). Whilst Harwich was made aware some weeks ahead that this was likely to occur, the VOA did not offer any meaningful opportunity for prior discussion on the principle of the split, nor to date has provided any explanation of its revised rateable values.

3. The 2005 List valuation has resulted in a new assessment (Rateable Value £1.25 million) on a port customer, Stena Line. This is a significant rate liability, levied on Stena without prior notification, and backdated to 2005. This follows the examples seen at other ports (Hull, Immingham, Liverpool).

4. The contractual situation between Harwich International Port and Stena Line was put into place in the 1990’s. The same circumstances of occupation existed at the time of the 2000 Rating List, consequently any likelihood of separate assessment was both unprecedented and unforeseen until very recently. The sudden timing of the new List entries has prevented Harwich having a proper dialogue with its customer, Stena. Moreover, this separate assessment results in unforeseen and fundamental commercial difficulties in respect of the contractual relationship and payment structure that will have to be resolved at a cost of both time and money.

PORT OF FELIXSTOWE

1. This port was identified by the VOA in 2003 as one of five “sample” ports for close scrutiny ahead of the formulation of the 2005 List. Intensive discussions commenced with the VOA in 2003, with the objective of agreeing appropriate methodology to provide a “conventional valuation” to determine the rateable value. The exercise was not concluded satisfactorily, and in 2008, five years on, we are in no measurable way closer to a resolution on the 2005 List.

Significantly, the outcome of a formal rating appeal by Southampton Container Terminal, which is regarded as important precedent, that was heard in January 2008 has yet to be pronounced. Ten months delay to produce a local tribunal determination is extremely unsatisfactory, given the extent of other ports’ assessments that are awaiting this outcome. Further delay is anticipated if the initial decision is referred to the Lands Tribunal.

TREASURY SELECT COMMITTEE—PORT RATING

2. With the lapse of time, and the reduction in “transitional relief” available to the ratepayer, the consequence of this delay has been significant additional cost to the Port of Felixstowe business, with the annual rates cost increasing from £3.7 million in 2005 to £6.5 million in 2008.

In conclusion, whilst my company recognizes that it is the VOA’s responsibility to maintain the rating List, it is our view that the VOA has failed in the duty it owes, set out in the VOA’s own Ratepayers Charter, reproduced below, in not applying correct and timely valuation expertise;

“Our aims are to:

- provide a fair, prompt and helpful service to our customers;
- be impartial in our assessment of value;
- provide an efficient and value for money service; and
- secure a sound and fair tax base.

Our commitment to you:

We believe that meeting your needs is important. We will do this by:

- giving you the best possible service;
- providing helpful and impartial advice;
- helping you to understand your rights and obligations;
- treating everyone fairly by valuing all properties accurately and impartially; and
- keeping information about your property confidential except when it is required for a Valuation Tribunal hearing.”

The VOA has failed to communicate with occupiers on significant new rate assessments, proceeded over the past three years in an unacceptable manner, and fundamentally changed past precedent. This has resulted in direct and unforeseen adverse commercial impacts on businesses. Furthermore, it must be recognized that the ultimate cost, particularly given the significance of this industry to the UK economy, is the affect on investment decisions and jobs arising from the unprecedented approach and rating liability the VOA has placed on affected ports’ businesses.

We ask that the Select Committee takes these points into consideration, and provides clear and appropriate direction to the VOA to resolve the unacceptable circumstances that now prevail in the industry.

14 October 2008

**Letter from Mr Karl Howarth, Chief Financial Officer, P&O Ferries Holdings Limited,
to John McFall MP**

**REVALUATION OF RATES AT PORTS / SELECT COMMITTEE MEETING
WEDNESDAY 15 OCTOBER**

The route network of P&O Ferries includes services from the port of Hull where we face a demand for rates under the new assessments being applied to Statutory Ports by the Valuation Office.

The repercussions of the new assessments and the way they are being backdated are such that the local authority concerned, Hull City Council, is currently stalling the collection of business rates from companies trading from the port. There can be little doubt that the new rates will force small companies out of business in the short term and that over the longer term the unexpected scale of the new rates demands will adversely affect future investment by companies that remain.

Hull City Council cannot decline to collect rates indefinitely and the difficulty facing P&O Ferries at Hull is a rates demand for the current financial year of £2.4 million, plus a backdated demand of £5 million.

The extra burden we face under the new assessment seriously calls into question the commercial viability of future investment in our services from Hull, where we provide employment for 408 people ashore and 818 people afloat.

As you are aware the charges levied by ABP in Hull on our Company incorporate an amount to cover the business rates for our premises. We do not have a problem of paying our fair proportion of business rates. However the changes to the rates and the resulting backdated demands have been applied without any consideration of commercial reality.

- Since April 2005 we have been carrying passengers and freight at prices that were incorrect as they did not include these additional rates charges which we were never advised of. Clearly we are unable to go back to all the passengers and freight companies we have transported since April 2005 to collect supplements from them to cover the cost of these additional business rates.
- We have paid and continue our business rates as part of the charges levied by ABP as Port Operator. They in turn paid them to the relevant collecting agency as part of the Cumulo. We are now required to pay additional business rates so effectively we are being charged twice.

With regard to the way this has been handled by the Valuation Office we draw your attention to the following points:

- The VOA may have had discussions with the Port Operators but there is no evidence of any systematic attempt by the VOA to contact the tenants that would be affected by the ending of the cumulo. The Port Authorities stood to gain financially from this change and not unreasonably from their perspective, support the change. The VOA did not advise the tenants back in 2004 that they would be hit by very substantial rates bills.
- As late as March 2008 we received a letter from the VOA (Copy attached) advising that there could be an impact on the business rates paid by the tenant. You will note in the last sentence of paragraph 5 the VOA state that the Port Operator may have already alerted us to this. The VOA clearly accept that this may well be the first notification we have had about the change to business rates in ports.
- In the current climate companies will find it very difficult to borrow to pay these backdated rates. Even where they can borrow, these will be at a substantially higher interest charge than has been the case in recent years.

The situation at Hull is just a precursor to what is happening at other ports in England and Wales where rates are being reassessed. For P&O Ferries, this raises pressing concerns about the consequences for our operations from Liverpool and elsewhere.

I trust this assists your understanding of the seriousness of this issue as it currently stands and that you will support our call for the implementation of the new system to be put on hold whilst a practicable way forward is pursued which could be brought in from 2010 in a fair and timely manner.

14 October 2008

Memorandum from the CBI

We have concerns relating to the business rates for ports which fall into two categories:

- 1) The time taken to decide appeals submitted by port operators against their 2005 valuations.
- 2) The process for drawing up and backdating the rates bills for port occupiers.

Some suggested questions which the Committee may wish to ask the VOA:

- 1) Why has it taken so long to determine the appeals for port operators given that they were submitted by 2006 at the latest? When appeal dates have been given why has the VOA not been ready to proceed?
- 2) Prior to 2005 port operators were assessed for all business rates liable on property within the port. Operators would then claim back the rates from individual operators through their rental payments. As of 2005 the system was changed to assess port occupiers' property directly. Given that this was changed in 2005, why were the valuations for port occupiers not completed before this date?

- 3) The report of a meeting of the Tenth Standing Committee on Delegated Legislation at 1630 on Thursday 16 March 2000 shows that the meeting considered the draft Docks and Harbours (Rateable Values) (England) Order 2000. Beverley Hughes (as the then Parliamentary Under-Secretary for State for the Environment, Transport and the Regions) explains that the government was working towards ending prescribed assessment in time for the next valuation, ie to come into effect on 1 April the 2005. Paragraphs 6 and 7 of the report record Beverley Hughes as saying:

“Since the spring of last year (ie spring 1999) the Department, assisted by the Valuation Office Agency, has been engaged in detailed discussions with the industries concerned regarding their rateable values, or formulae for reaching their rateable values. For the 2000 valuation, the Valuation Office Agency has made good estimates of the rateable value of these industries using conventional rating methods...The team has worked closely with the industries for several years, and they have considered the valuations together line by line.”

If the Valuation Office Agency had, by 16 March 2000, “made good estimates of the rateable value” of the docks and harbours in England and Wales using conventional rating methods then why has it taken eight years to produce rates bills? Why did the VOA not use them as the basis for the 1 April 2005 lists?

<http://www.publications.parliament.uk/pa/cm199900/cmstand/deleg10/st000316/00316s01.htm>

- 4) In the same report, in para 12, the then minister states that “The exact figures for each port have not been calculated, but we estimate that the effect on the overall rateable value for large docks and harbours is neutral.” Figures we have received from businesses suggest that at Hull the aggregate rateable value has increased by about 78% (from £9 million to 16 million), at Goole the increase is about 300% from £1 million to just over £3 million whilst Ipswich is approximately 50% from £600,000 to about £1.3 million. There is nothing to suggest that the overall effect is neutral. What is the explanation for this dramatic increase in the rates bills?
- 5) Given that the valuations were not prepared in a more timely way, would it not have been possible for the VOA to have undertaken the assessments between 2005 and 2010 and applied the new system from 2010 rather than starting in between valuations and back-dating the bills? If rates were to be charged in this way the VOA should have prepared the bills by the start of the 2005 list.

16 October 2008

Supplementary memorandum from the Debt Management Office

FACTUAL ERRORS ON THE DMO WEBSITE IN 2008: A NOTE BY THE DMO

1. At the Treasury Sub- Committee hearing on 15 September, the issue of the number of factual errors on the DMO website was mentioned. This note provides further detail on these errors.
2. A total of six factual errors were discovered and corrected in the year to-date; these are:
 - a. April: an incorrect total was published for the number of bilateral Treasury bills¹ issued in March 2008. This data was published automatically on to a website report following which a discrepancy was noted between the actual issuance and the numbers inputted into the DMO’s Debt Portfolio System (DPS) data base from which the website report picked up the data. The website report was disabled and the data reconciled before re-publication.
 - b. May: a similar error was noted in the website for bilateral Treasury bills issued in April 2008. Corrective action was again taken and internal procedures changed to ensure that relevant data inputs into DPS were verified before the website report was updated.
 - c. June: incorrect end-May 2008 totals for government holdings of gilts were published. Data published was that for end May 2007 as a result of human error.
 - d. 10 July: incorrect PWLB fixed loan lending rates were published due to the incorrect end of day yield curve data being fed into PWLB’s Informix database and subsequently published on the website. This arose from problems experienced with the generation of end-of day yield curve data for 9 July. Published yields were some 3bps higher than they should have been, but no lending was carried out at these rates. Internal procedures have been changed to reduce the chance of this occurring again.

¹ Bilateral Treasury bills are those issued on request from cash management counterparties— as opposed to those issued at weekly tenders.

- e. September: an out of date footnote was noted on the page describing the methodology used to calculate Treasury bill prices.
- f. October: as part of the disclosures on the use of the DMO's special repo facility an incorrect amount of 4% Treasury Stock 2009 was published due to human error.

5 November 2008

Supplementary memorandum from the Valuation Office Agency

Q 56: *How much additional revenue will be gained by altering these [port] ratings?*

The net overall movement in rateable value for the aggregate assessments for the 51 ports in England and Wales that have been reviewed is, in round terms, an increase of £16.5 million. This is an update to the figure quoted to the Committee on 15 October.

At a current (2008–09) rate in the pound of 46.2 pence, and ignoring any reliefs that might be available, this would equate to an increase in yield annually of just under £8 million.

This net movement in rateable value is derived from the latest totals, which are as follows. The aggregate rateable values for assessments in these ports before the review initiated in May 2006 totalled £195 million in England (and £32 million in Wales)—and after the review £211 million in England (and £32.5 million in Wales). These figures could change further in the future, depending on the outcome of discussions or formal appeals by the ratepayers. It was not made clear to the Committee, but should have been, that the estimated totals quoted at the hearing on 15 October related to England.

Within these headline amounts, the individual impact on port operators and port occupiers can vary markedly—with some assessments going up, some going down, some remaining broadly the same.

Q 108 and 109: *How many of your council tax valuations have actually moved homes to lower bands...since 1997?*

The following amendments to the council tax valuation lists have been made in each financial year since 1997 involving movement of a property to a lower band:

<i>Year to</i>	<i>England</i>	<i>Wales</i>	<i>Total</i>
31 March 1998	91,040	5,605	96,645
31 March 1999	70,767	4,718	75,485
31 March 2000	61,078	4,622	65,700
31 March 2001	45,613	4,571	50,184
31 March 2002	33,074	3,139	36,213
31 March 2003	35,802	2,408	38,210
31 March 2004	40,022	2,150	42,172
31 March 2005	33,400	1,837	35,237
31 March 2006	32,163	21,176	53,339
31 March 2007	40,104	14,249	54,353
31 March 2008	61,718	7,973	69,691

In the same period the total number of banding entries in the council tax lists grew as follows:

1 April 1997 22,094,245 (England 20,708,408: Wales 1,255,524)

1 April 2008 24,070,903 (England 22,506,502: Wales 1,351,686)

During the period concerned—and in accordance with statute—a full Revaluation took place in Wales, with new council tax bandings taking effect from 1 April 2005.

29 October 2008

Supplementary memorandum from HM Treasury

EXECUTIVE SUMMARY

1. This memorandum responds to the Treasury Sub-committee's requests at the hearing on 22 October 2008 to provide supplementary written evidence for its review of HM Treasury's Administration and Expenditure in 2007–08.

BANKING

European state Aid Inquiry into Northern Rock

2. The committee were interested to know the time frame within which the Commission's State Aid investigation into Northern Rock would be completed. The investigation must be completed within 18 months from notification, which the Treasury lodged on 18 March 2008. The Treasury currently has no estimate for the completion of this inquiry.

Northern Rock Bonuses

3. The committee asked about the announcement of bonus payments to staff of Northern Rock.

4. The Treasury as shareholder is in regular dialogue with Northern Rock, including about remuneration. However general staff bonuses are a matter for the Northern Rock board. Our shareholder framework agreement with Northern Rock does require shareholder approval of the incentivisation arrangements for Executive Directors: these arrangements will be made with reference to the company's upcoming revised business plan.

Public Assurances given by Sir Victor Blank

5. The committee requested detail on the public assurances given by Victor Blank and others with regard to employment safeguards, particularly in the regions. Lloyds TSB said in their announcement of the original merger that "The management focus is to keep jobs in Scotland". That announcement is available on the website of the London Stock Exchange².

Agreements with the Nationalised Banks

6. In response to the request for these agreements to be placed in both Libraries of the House, the Treasury can confirm that hard copies of the agreements with RBS, Lloyds TSB and HBOS were placed in these libraries on 13 October; in addition an electronic copy was placed in the Commons library on 27 October.

BARNETT FORMULA

7. The committee requested an update on the progress of the review into the Barnett Formula. The Government has no current plans for reviewing the Barnett formula, however the Committee may wish to be aware of the following independent reviews:

- In Scotland, the Calman Commission is reviewing the devolution settlement and as part of this it is reviewing whether there is scope for improving financial accountability.
- In Wales the Holtham Commission is reviewing Welsh funding arrangements.
- In addition the House of Lords is planning a review of the Barnett formula.

8. The Government has announced that it intends to publish a factual paper on the Barnett formula to inform the debate. We will send a copy to the Committee when it is published.

CHILD POVERTY

9. The committee requested further clarification on the performance, and measurement, of the 2004 Spending Review Public Service Agreement (PSA) target to halve the number of children in relative poverty by 2010–11, on the way to the eradication of child poverty by 2020. HM Treasury can confirm that, as reported in the 2007 Annual Report, 1.7 million children have been lifted out of Absolute Poverty.

² www.londonstockexchange.com/LSECWS/IFSPages/MarketNewsPopup.aspx?id=1961683&source=RNS

Measurement

10. Following extensive consultation, the Government adopted three measures for child poverty: absolute low income, material deprivation and relative low income. The Government monitors child poverty against all three measures with a target attached to the relative low income measure. Reaching the target set in PSA 7 requires the halving of child poverty on the relative measure.

- The relative low income measure the number of children living in households with an income that is 60% below the median income of people in the UK before housing costs.
- Absolute low income measures whether the poorest families are seeing their income rise in real terms. The level is fixed as equal to the relative low income threshold for the baseline year of 1998–99 expressed in today's prices.
- Combined indicator measures poverty by looking at the number of children living in households that are both materially deprived (as assessed by a survey) and have income below 70% of the contemporary median income.

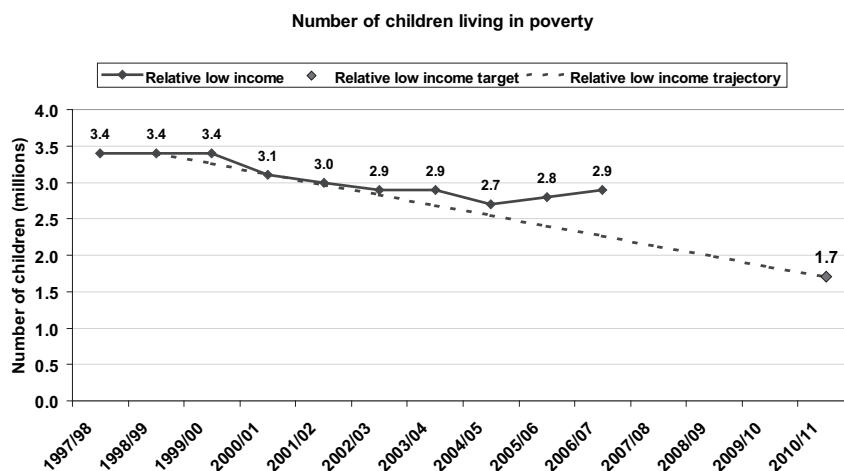
11. The statistics are gathered by the Department for Work and Pensions as part of their annual Households Below Average Income (HBAI) analysis. The latest results are for 2006–07 and were published in June 2008. They are published under National Statistics rules and can be found on the internet <http://www.dwp.gov.uk/asd/hbai.asp>.

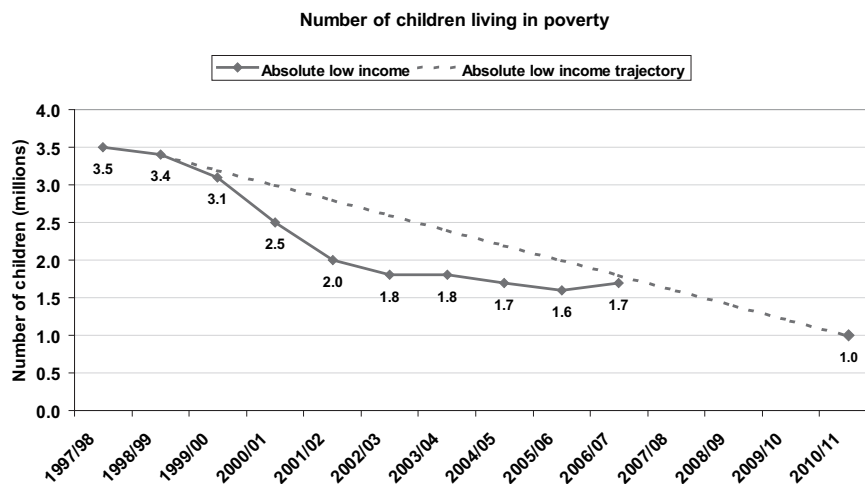
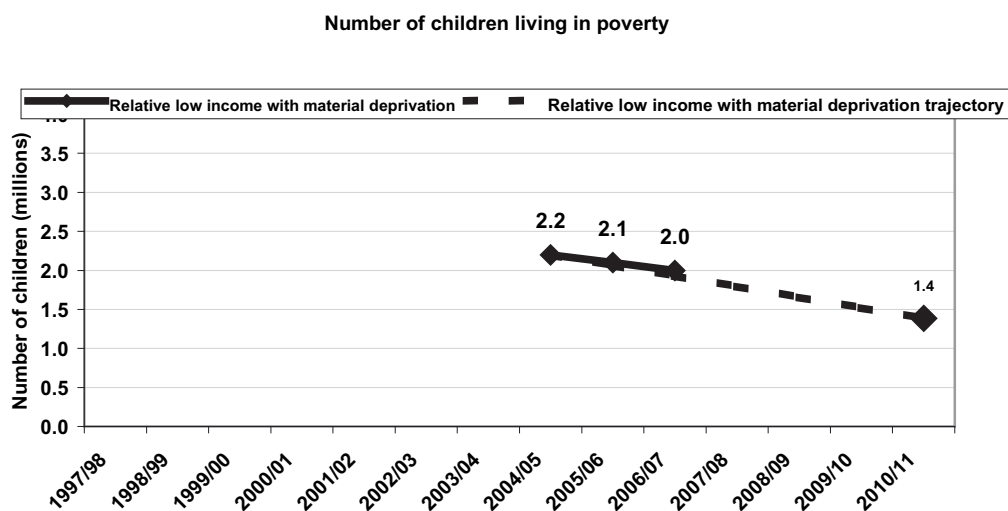
Results

12. There were 3.4 million children in relative poverty in 1998–99. As a result of the Government's policies and investment around 600,000 children have been lifted out of relative poverty between 1998–99 and 2006–07. Measures from the last three fiscal events are expected to lift a further 500,000 children out of relative poverty. The target is 1.7 million or less children in relative poverty.

13. There were 3.4 million children in absolute poverty 1998–99. As a result of the Government's policies and investment around 1.7 million children have been lifted out of absolute poverty between 1998–99 and 2006–07.

Relative Indicator



Absolute Indicator*Combined Indicator*

14. In 2004–05 (the first year that this was measured) there were 2.2 million children who were defined as poor using the combined indicator. As a result of the Government's policies and investment, the number of children in material deprivation has fallen to 2.0 million in 2006–07.

DEADLINE FOR DRY RUN IFRS BALANCE SHEETS

15. The Committee requested further information about the progress on the dry run of IFRS Balance sheets. Only nine departments are yet to submit restated balance sheets to the National Audit Office as part of the IFRS Trigger Point 1 process. Of these, four departments submitted restated balance sheets by 31 October 2008. Of the remaining five departments, three are expected to complete the required action during November 2008. The last two departments (Department of Health and the Ministry of Defence) face particular complexities in the restatement exercise. As a result, they will complete the process to an agreed later timetable. The Treasury continues to work closely with all departments to ensure that they remain on track to complete the move to IFRS based financial reporting from financial year 2009–10.

CLARIFICATION OF THE VFM AND CSR DOCUMENTS

16. The committee requested clarification of the statements included in the HM Treasury Group Value for Money (VfM) Delivery Agreement 2007, page 11, and the Comprehensive Spending Review 2007, chapter three, paragraph 3.31.

17. Paragraph 3.1 of the 2007 HM Treasury Group VfM Delivery Agreement advises that VfM savings made by HM Treasury will be calculated as the difference between Treasury Group's actual expenditure (excluding non-recurrent restructuring costs) and its counterfactual, being the baseline costs adjusted for inflation. The Treasury's approach to VfM is consistent with the statement in the 2007CSR at Chapter 3, paragraph 3.31. as this also refers to savings as "net of implementation costs".

HM TREASURY'S DEPARTMENTAL STRATEGIC OBJECTIVES

18. Finally, the committee requested information regarding the publication of the Treasury Group's Departmental Strategic Objectives (DSOs) for the 2007CSR period. The Treasury Group's DSOs are as set out in the document "HM Treasury Group Departmental Strategic Objectives—2008-2011"³, published December 2007. This document describes the DSOs, the related outcomes, and the indicators by which performance against these outcomes will be measured. The first public report of performance will be in the Treasury Group's Autumn Performance Report (APR), which, in line with central guidance, is due to be published before the Christmas recess. Also in line with that guidance, and to adhere to the Treasury's commitment to sustainable development, the report will be published as a purely electronic document. The Treasury will, however, ensure that hard copies of the report are placed in the library of the House for the committee's ease of reference.

6 November 2008

Supplementary memorandum from HM Revenue and Customs

1. Q386: *Mr Mudie asked for a note concerning the departure of the former CFO, Stuart Cruickshank*

Mr Cruickshank (SC) left HMRC on 31 March 2008, having been appointed to the role of CFO on 18 December 2006, under a three year contract.

He was paid £88,125 for loss of office and at that time the Department also met: legal fees of £1,457, for advice on the early termination of his contract; outplacement fees of £11,750, for employment advice. These two amounts were grossed up for tax purposes and shown in the 2007–08 accounts as benefits in kind of £22,000. This means the total expenditure is £110,125 not £88,000 as implied in the response to Q404.

In late 2007 SC indicated to us that he felt his role in HMRC was not meeting his longer term career aspirations. We felt it vital that HMRC had certainty around its leadership and believed firmly that we needed a Chief Finance Officer who was absolutely committed to HMRC, not one who was planning another career.

SC had not indicated clearly when he wanted to go and so we decided to enter into a negotiated arrangement with him. Our aim was to ensure continuity at the top during that particularly troubled time and this would involve SC leaving at a time and manner of our choosing. This arrangement enabled us to quickly recruit and appoint a temporary CFO, Philip Moore (PM), who joined the Department on 21 January 2008 and so was able to benefit from a short handover period with SC. During PM's period with HMRC he provided the stable financial leadership platform we needed, preparing the way for the appointment of a permanent CFO. The recruitment process is now in train.

2. Q 411–413: *Mr. Mudie asked for a note about the bonus schemes for Executive Committee members and other members of the Department*

Senior Civil Service Bonuses

Senior Civil Service bonus arrangements are governed by Senior Salaries Review Body (SSRB) recommendations and the subsequent Cabinet Office advice which is received on an annual basis. The Cabinet Office (CO) advice provides guidance on the amounts available to fund non-consolidated bonuses and the constraints within which HMRC must work. On receipt of the CO advice a summary of the key points is issued to all Senior Civil Service (SCS) members.

The bonuses paid to Executive Committee (EXCOM) members in 2007 were based on the SSRB recommendations, from which the following is an extract:

"The SSRB broadly supports the longer term SCS reward strategy as set out in the Government's evidence, and especially the emphasis on bonus as the primary reward for delivery of in-year priority business objectives. It endorses the Government's decision to increase the non-consolidated bonus pot and recommends it increases from 6.5% to 7.6% of the SCS pay bill in 2007. Payment of all bonuses will be delayed until 1 November 2007."

³ www.hm-treasury.gov.uk/strategic_objectives.htm

The above arrangements did not apply to Steve Lamey and Deepak Singh as they were on a fixed term contract and outside the normal SCS pay round. The amount they received was that due under the terms of their contract.

The bonuses received by Excom members were determined by Paul Gray and Kate Owen, Non—Executive Director.

Non Senior Civil Service Bonuses

For staff outside the SCS, the HMRC 2005/06—2007/08 three year pay settlement made provision for bonuses to be paid as follows:

- Top performers
Staff received a bonus of 2.6% of base salary, payable on 1 June 2007.
- Good performers
A bonus was payable to staff on the pay band range maximum, as they had received a lower consolidated pay award. The bonus of 1.27% of base salary, was payable on 1 June 2007, though the bonus was abated by an amount depending on how much consolidated pay award was paid. In real terms the non-consolidated bonus was approximately 1% of base salary.
- The bonuses totalled £16.8 million and were paid to 55,693 of staff, averaging at £302.

3. Q430–431: *Jim Cousins: “It is the Revenue & Customs resource account, page 39. The figure of net operating costs is note 3,13, the last line of that top table, and it has gone up by £192 million..... You will see immediately the contrast between quite large scale staff cuts, 3,000 ahead of programme, and still a net increase in operating costs, and the implication there of additional pressure on staff.”*

The net increase in spend of £192 million is distorted by the increase of over £500 million in the value of Child Benefit payments made during the year. The Operating Cost Statement shows that our payments for Stakeholder Pensions, Incentive Payments, legal and investigation, and enforcement costs reduced by £117 million. Most importantly, in the context of our day to day running costs, staff reductions and other efficiencies have led to a reduction in expenditure of over £190 million.

4. Q440: *Jim Cousins: “In the first year of the Transformation Programme on tax offices, there is an additional spend of £209 million to cut tax offices and additional benefits of nil.”*

The purpose of the Workforce Change Programme is to fit HMRC’s staff resources and estate to future business needs, achieving significant benefits for HMRC within the wider Departmental Transformation Programme (DTP). Office closures are a consequence of the Workforce Change programme, but not its objective, and the benefits of the programme are recorded against other change programmes within the DTP.

In its report on HM Revenue & Customs’ transformation programme (HC 930), the National Audit Office (NAO) sets out the Department’s main change programmes as at March 2008 (Figure 1, page 9), along with planned expenditure and expected costs in the years 2006 to 2011. As the NAO explains, the DTP is a large portfolio of change programmes spanning the Department. At the time of the NAO report, HMRC planned to spend £2.7 billion on these programmes from 2006–07 to 2010–11. It aims to achieve benefits valued at £11.5 billion by 2011, an overall benefit-to-cost ratio of 4.3-to-1, estimated to increase to 10.5-to-1 by 2016. As at March 2008, the Department had achieved an estimated £254 million in savings from reductions in staff and in non-staff savings.

As a portfolio of programmes, the benefits delivered by individual programmes are in many cases dependent on changes being delivered elsewhere within the change portfolio. Likewise, to avoid the double-counting of benefits between programmes within the portfolio, in the assessment published by the NAO, where benefits are being achieved by the contribution of more than one change programme, they are only counted once.

Within this portfolio, the Workforce Change Programme is ensuring that the right number of staff with the right skills are in the right locations, and thereby enabling a reduction of the Department’s estate. A budget of £209 million over the three years 2008–09 to 2010–11 has been allocated to this programme to spend on the staff redeployment and exit schemes to support this departmental restructuring. Many of the other projects and programmes depend on Workforce Change delivering these changes, and among the main DTP programmes these include:

- Pacesetter—which is streamlining processes by increasing management capability and implementing Lean techniques to deliver continuous improvement, increasing productivity by between 40% and 70%.
- Compliance and Enforcement—which is targeting responses to different customer groups and introducing new risk assessment and profiling tools and techniques, to enable reductions in the tax gap while operating more efficiently with a reduced number of staff.

- Debt Management and Banking—which is facilitating flexible methods of payment and streamlining processes.
- Estates Consolidation—which is rationalising and making better use of HMRC's existing estate, identifying the office locations required to meet customers' needs, including the retention of face to face services in all current localities.

Although no benefits are directly attributable to Workforce Change in the model used by NAO, taken together these programmes provide a significant level of benefits to the Department and Government. As at 30 September 2008, this includes over 5,000 full-time equivalent staff savings in the three years to 2010–11 worth £155 million, and £145 million non-paybill running cost savings.

5. Q445: *Mr. Ainger: "On 30 September I had a meeting with one of your officials over the Workforce Change programme. I asked him the question "Can you provide me with any statistical evidence to show that large processing plants are more efficient than small processing plants?"*

HMRC has a large back office processing business. It handles annually, for example, 18 million items of PAYE/SA correspondence from customers, 9.5 million SA Tax Returns and 45 million PAYE records for employments and pensions handled by 18,800 staff dispersed over 253 offices with over 14,000 staff in 45 large offices of 100 or more. Its current organisation is a mix of small town offices (typically with less than 30 staff) and larger sites (with up to 1,000 or more staff) created to respond to earlier customer needs.

HMRC is in the process of reducing its headcount by 25,000 and making estate savings of £100 million per year to help meet the CSR07 5% year on year efficiency savings required by Government.

Why HMRC needs large processing sites

- Larger sites run at a lower cost per person per year than smaller sites—£1,950 as opposed to £5,700, representing a potential saving of up to £3,750 per person per year, around £5 million per year in total.
- Larger sites enable HMRC to manage its processing business more efficiently and more cost effectively. Across large sites more effective middle and senior manager/staff ratios are being achieved. Compared to the ratio of 1:17 typical in smaller sites, a ratio of 1:25 is achievable in larger sites which is equivalent to an estimated £8 million saving per year.
- Large sites have enabled new ways of working (such as Lean) to be introduced within HMRC, which has created additional capacity in PAYE/SA offices equivalent to 2,944 Full Time Equivalents (FTE) between April 2006 and March 2008. This has enabled PAYE/SA processing to realise performance and efficiency savings equivalent to cumulative annual paybill savings of £56 million as at March 2008. This is not possible across a network of small sites. Savings released can be reinvested in larger sites.
- Staffing capacity created has, for example, enabled three large sites in the North of England and Scotland to absorb 700 FTE units of work from the South—a significant contribution to HMRC's Lyons target. Small sites do not have the capacity to absorb this level of work.
- Larger sites enable HMRC to have the workforce and process flexibility it needs to respond to peaks of work and event driven customer demands—for example two large processing offices are now able to deal over a four month period with 2.5 million employee benefit annual returns. Small sites don't have the staff numbers to respond to customer demand in this way. In order to provide this flexibility the optimum number of teams per office is between eight and nine for each process worked in the office, each team comprising 8–11 people.
- Larger sites enable HMRC to cope with very high volumes of processing transactions that small sites can't cope with—18 million pieces of PAYE/SA correspondence per year; 9.5 million SA returns per year. 70% of this work is carried out in large sites.
- Operating across a dispersed network of small sites is administratively inefficient and means HMRC's processing business is carrying unnecessary cost. For example around 20% of the 18 million pieces of correspondence dealt with every year are internally generated. Moving from around 253 sites to 47 larger sites will significantly reduce this traffic and its associated cost.
- Large numbers of small sites increases IT service costs and increases data security risks. HMRC can make better use of IT equipment through twilight shifts in larger sites.

Comparison of large and small processing sites

- Direct comparison between large and small sites is statistically difficult because larger sites tend to handle more complex cases—taxpayers with multiple source income, a higher proportion of SA returns that require related PAYE work and pensioner cases.
- There is an experience dividend currently in small sites that is unsustainable. There are around 3,600 staff in small offices who typically have been doing processing work for many years and so have relatively high capability levels. The demographics for HMRC as a whole show that around 42% of staff in these small offices are over 50 and their expertise will be lost as they retire over the next ten years or so. The performance of those sites will consequently weaken.
- Maintaining a small office network results in a large opportunity cost in terms of overall back office efficiency and effectiveness. To date processing staff numbers have reduced by 8,000 predominantly in large offices undermining their capacity to maximise performance. Looking ahead HMRC faces a strategic choice—to either continue to lose staff from its large offices, further undermining their ability to maximise performance and improve customer service, or to take people from its higher cost smaller offices and invest the cost savings in enhancing performance and service.
- HMRC's processing business is part way through a journey to transform its business and improve its customer service. And while therefore a steady state mature business model comparison between large and small sites is not yet possible there are concrete indications that performance in large sites is better and improving:
 - On a like for like comparison, Employer Maintenance productivity gains of 30% and Customer Correspondence of 11% are being achieved where large numbers of teams are co-located.
 - The larger sites process around 13 million pieces of correspondence per year—around 50,000 pieces per day. Correspondence on hand overall has reduced from 1.2 million to 650,000 items in the last year and older correspondence on hand has been virtually eliminated.

6. Q448: *Mr Love: "Some concern has been expressed by a number of people in articles that we have received about the relationship between you and your PFI provider. Does that contribute in any way to the lack of being able to report accidents? Are you in discussions with them about improving the situation?"*

HMRC's relationship with Mapeley (the PFI provider for a large percentage of HMRC's accommodation) has no bearing on the reporting system. HMRC's system for reporting and recording incidents is the same across the department, irrespective of whether the incident occurs on PFI or non-PFI estate.

The new reporting system follows the Health and Safety Executive's "Investigating accidents and incidents" guidance and provides for the reporting and recording of accidents, injuries, ill health and incidents of violence" Guidance provided to staff states that building related incidents should be reported to both the service provider and internal HMRC Estates representatives for remedial and/or follow up action as appropriate.

Mapeley must action any accident/incident reports provided by HMRC within one business day. They are also required to immediately inform HMRC of any incidents, accidents and dangerous occurrences and provide a report to HMRC including details of any remedial action undertaken within one business day.

7. Q449: *Mr Love: "Does your contract allow you to be more demanding? Can Mapeley, in effect, refuse under the contract? There is some evidence to suggest that they only do health and safety works when the Health and Safety Executive appear on the doorstep."*

Mapeley cannot refuse to carry out works they are obliged to do under the terms of the STEPS contract. Under Clause 9.4 Mapeley have to provide accommodation and facilities management services in a manner that:

- Is in accordance with good industry practice.
- Is not likely to be injurious to health or cause damage to property.
- Complies with all applicable UK or European law and all Statutory Requirements.

In general terms, to assure the compliance of HMRC's estate, the contract provides for the completion of planned preventive maintenance tasks, (including statutory maintenance). As well as general contract management, HMRC Estates can at any time audit the compliance and/or performance of Mapeley. Mapeley have acknowledged a previously low level of compliance against contract service levels and a number of in-depth technical audits were carried out in June this year. Following on from this recent joint and concerted effort by both Mapeley and HMRC, action plans have subsequently been agreed and are being taken forward. Mapeley currently report a significant improvement in performance to approximately 97% against contract service levels. This reporting will be subject to ongoing audit activity by HMRC Estates. Any outstanding or failed tasks are resolved in a timely manner, reducing risk to HMRC employees.

With regard to being more demanding in terms of managing the contract, there is a range of contract remedies, ranging in efficacy, which can apply in the event that the service provider's performance does not meet the contract standard. Where a breach of contract obligations creates an immediate and serious threat to the health and safety of staff or users of the buildings, HMRC can ultimately step-in and undertake the required works at Mapeley's cost.

8. Q456: *Sir Peter Viggers: "There has been a 37% jump in applications to tax tribunals. Can you explain that?"*

It seems that Sir Peter Viggers based his question on an article in the *Guardian* dated 25 August 2008, which cites, in particular, a rise in referrals to the Tribunals from 3146 in 2006 to 4311 in 2007.

We have looked again at the statistics produced by the Administrative Justice and Tribunals Council (the ultimate source of the *Guardian* figures). The figures quoted by the *Guardian* relate to the Special Commissioners of Income Tax and the VAT and Duties Tribunal. The figures do not include referrals to the General Commissioners of Income Tax, who are responsible for hearing the vast majority of appeals against HMRC decisions in the field of direct taxes. The figures for the General Commissioners show a decrease in referrals between 2006 and 2007.

Turning to the figures for the Special Commissioners and VAT Tribunals, indirect taxes account for the bulk of referrals. The *Guardian*'s emphasis on the change between 2006 and 2007 suggests a worrying rate of increase. In fact, the numbers of referrals fluctuate. The AJTC figures for referrals to the VAT and Duties Tribunals were higher in 2004–05 than they were in either 2005–06 or 2006–07.

So the picture is somewhat more complex than is implied by a straightforward comparison of referrals to the specialist Tribunals in 2006 and 2007.

The single most significant contributory factor to the fluctuations in indirect tax referrals is the strong priority given by HMRC to tackling Missing Trade Intra Community (MTIC) VAT fraud and the associated large number of cases subject to "extended verification".

A less tangible change that we have detected is a tendency for taxpayers to seek more formal resolution of disputes with HMRC than in the past. This is not necessarily a bad thing, as clarification of the law can have benefits for both HMRC and the taxpayer. HMRC's "Litigation and Settlement Strategy", launched in June 2007, makes it clear that we will seek non-confrontational resolution of disputes where possible. But it also means that we will seek full value from settlement, or take the matter to litigation if necessary, in cases where we think our arguments are strong.

In summary, there have been fluctuations over the last few years in the number of cases moving towards formal resolution by the Tribunals (and in some cases by the Courts). We will keep the figures closely under review, particularly in the context of the new tribunal reforms (including the creation of a tax chamber) which will impact on tax appeals and the way tax disputes generally are resolved.

9. Q 459–460: *Ms. Keeble. "On the Tax Credits, you have introduced a new Code of practice. Can you say what the result of that has been, both in terms of fairness or perceived fairness and also in terms of further payments and write-offs?"*

We believe that the new test has been very well received in terms of fairness. Since the end of January 2008, when we started the new Code of Practice 26, to the end of October 2008, we reviewed around 109,700 disputed overpayments and wrote off 8,600 as official error—around 8%. In practice we write off the vast majority of cases of official error under the new responsibilities test. For example in October 2008 we wrote off 96% of all official error cases.

10. *Ms. Keeble submitted the following further question in writing following the hearing. "Do tax credits count as public funds? If yes, what actions are taken by HMRC to ensure that this is known by other departments, such as the Home Office?"*

Apart from specified circumstances (for example where only one member of a couple making a joint tax credit claim is subject to immigration control) persons subject to immigration control are not entitled to tax credits. All those admitted to the UK for a temporary purpose are required to maintain themselves without recourse to public funds.

For these purposes tax credits are counted as "public funds". The Home Office and the Borders Agency are aware of this. There is a description on their website at <http://ukba.homeoffice.gov.uk/ukresidency/rightsandresponsibilities/publicfunds/> and a further description of what this means can be found in the Home Office leaflet No recourse to public funds.

25 November 2008

**Letter from the Financial Secretary to the Treasury and the Minister for Local Government to the
Chairman of the Sub-Committee**

Thank you for your letter of 16 October. We are aware of the Treasury Sub-Committee's concerns about the impact of recent changes to the rateable value of ports, and we think that we can best address these concerns through a written response. In this memorandum, we would like to set out some of the background to the recent changes, and explain the work that we have put in train to investigate how we can mitigate the impact on port occupiers.

There are 55 major statutory ports in England and Wales, in each case run by a designated port operator who has responsibility for business rates, except where any part falls to be separately rated—this will depend on the facts of the case, but the key issue is whether the occupier of that part is in “paramount” control. So, for example, a berth or storage land used by a number of companies would be regarded as in the rateable occupation of the designated port operator. But where a company has exclusive use, under a licence or other agreement with the designated operator, a separate assessment is appropriate. This is a principle that applies right across rating and is not limited to ports.

For many years each port was largely assessed as a single entity, with the value calculated using a standard formula. The law changed with effect from April 2005 to bring ports into line with the more conventional valuation techniques which have also replaced prescribed valuation for other statutory undertakings, including gas, water supply and railways. Thus for the 2005 rating lists, the rateable values for ports were derived from analyses of receipts and expenditure. This change did not affect the principle determining whether the operator or occupier was liable to rates.

In the course of the Valuation Office Agency's (VOA's) work to keep rating lists up to date, it had cause to look more closely at the Port of Southampton in mid-2004, and concluded that there were more parts requiring separate assessment than previously identified. This was contested by the other parties involved, and so needed to be further tested. After extensive legal and valuation argument the matter of separate assessment was finally agreed in accordance with the Valuation Office Agency's view just prior to a hearing by an independent valuation tribunal in April 2006.

As it was clear that similar circumstances might exist elsewhere, the VOA initiated a wider investigation into the issue by writing to the operators of all the main statutory ports in May 2006. This proved more complex and lengthy than the Agency expected, but it has now reviewed the position in all 55 ports, focusing on getting the right allocation of rateable value between port operator and port occupiers. The process is complete in 51 ports, with four ports still under enquiry.

At your hearing on 15 October, the VOA accepted that the communications around the change to rateable values should have been more broadly-based, and we strongly agree. It is a cause of great regret to us that some port occupiers were not made aware of the full implications of the changes until this year, and we have expressed our disappointment about this to the VOA. In response, the VOA has given us assurances that it will strengthen its communications effort in any future valuation exercise of this kind. We have asked the VOA to prepare an action plan—for our approval—to bring about this strengthening.

It is important to point out that the national aggregate rateable value for assessments relating to these ports has only increased by a relatively moderate amount: of the order of £20 million rateable value. However, in many instances the balance of liability for business rates between port operators and port occupiers has altered—in some cases quite markedly—towards the latter. Designated port operators may in these cases be eligible for substantial rebates of business rates from their local Billing Authority, while some businesses will be liable for business rates for the first time.

Port occupiers have told us that, where the designated port operator was regarded as liable to pay the business rates, the contractual arrangements between the port operator and port occupiers typically contained explicit or implicit fee elements to cover the business rates incurred by the port operator. Jim Fitzpatrick, Parliamentary UnderSecretary of State at the Department for Transport, has met with the major port operators today to discuss whether, and if so how, in such instances, port operators can help mitigate the impact of the change in rating liabilities on their tenants.

The Government is also exploring policy options for mitigating the impact of changes in cases such as this. As VOA officials rightly pointed out in their evidence to you, the statutory framework gives them no discretion to remove a liability to taxation, and we do not believe it would be in line with the principles of taxation or in the interests of fair competition for such a liability to be waived. However, we have instructed officials to urgently investigate options for reducing the financial impact on businesses facing significant backdated liabilities.

We would be happy to write again to the Committee to report progress on that work.

27 October 2008

Letter from Mr Nicholas Orbell, General Manager, Real Estate Development, Hutchinson Ports UK Ltd, to John McFall MP

We have followed with interest the session on Wednesday 14th October and the evidence presented by the Valuation Office Agency. There are several points that emerged that we would like to highlight and clarify ahead of furtherance as this is evidently an issue that the Committee will progress, for which we are grateful.

Adopting the numbering used in the (unedited) transcript version.

Q56—Additional Revenue & Q95 to 99- RV increases

The VOA referred to an aggregate of the ports' rateable values of £181 million, which increased to around £200 million.

We believe that the figure of £181 million is the initial 2005 Rating List aggregate for Ports, which subsequently has been increased by around £19 million through the identification and separation of port users (as seen at Hull and Harwich).

Of greater significance has been the substantial increase within the ports' industry in the change from the 2000 Rating List (the valuations being quinquennial) to the 2005 List in its initial compilation, and it is this measure of change (in excess of 200% for Felixstowe and Harwich) that is of concern to the ports as much as the later increase arising from new rating occupiers being identified.

Q66—Overall impact

Following from the above point, it is correct that many ports have benefited from "transitional relief" in the actual annual rates payable, this being the statutory mechanism to effectively smooth rate adjustments during each quinquennial period.

Work undertaken by the UK Major Ports Group in 2004 assessed the overall impact for Ports in the region of 150%. This must be compared to an ODPM estimated increase in the commercial property Rateable Value base as a whole (including offices, shops, warehouses etc) in England of 17.9% in 2005.

It should also be noted that in January 2004 discussion within the UK Major Ports Group members had identified at that time a significant increase in rateable values, estimated then to be around 200%. This was prior to the VOA's investigation into detailed occupations. It is not unreasonable to deduce that, at that time, the VOA was aware of the potential impact of its proposed actions.

This imbalance was highlighted in the Ports' consultation response to Government on the proposed transitional relief.

To put the overall impact into some perspective, however, the Felixstowe annual rates bill has increased as follows:

Change in annual amount actually payable (April–March)

- £3.06 million (April 2004, prior to 05 List introduction)
- £3.63 million (April 2005) to
- £6.55 million (April 2008).

From 2005, this represents an increase in annual billings of £2.92 million / 50% in just three years. It is projected to increase further to £6.5 million in April 2009.

Similarly, at Harwich International Port:

Change in annual amount actually payable (April–March)

- £0.686 million (April 2004, prior to 05 List introduction)
- £0.825 million (April 2005)
- £1.56 million (prior to assessment split Sept 08)

From 2005, this is an increase of 95% although it should be noted that the recent subsequent split and readjustment has reduced the port's billing to 25% increase and a rise in rateable value of 43%. As a consequence of the split, however a customer has suffered a backdated charge of £1.5 million.

Further, changes introduced by Government in transitional relief in 2005 are of further adverse financial impact to many ports compared to the transitional benefits allowed pre 2005.

Q68 to 71—*Occupiers*

There is, in our view, a fundamental point behind the treatment by the VOA of individual occupiers. Mr Hudson refers to ports as “a peculiarly complicated sector”, but, arguably, this is attributable to the VOA’s change in approach towards the sector since 2005 and polarized view of rating law.

Mr Hudson correctly explained that, prior to 2005, the rateable value for ports was calculated on a formula basis. Nevertheless, neither the statutory principles of rating relating to the definition of “occupation”, nor the accessibility for the VOA to inspect ports has changed in respect of work on the 2005 List.

The Docks and Harbours Rating Statutory Instrument (SI2000/951) that set out the formulaic approach to the 2000 List enshrined this approach in defining the “port” for rating purposes as a hereditament (rateable property) consisting exclusively of operational land “which is for the purposes of the carrying on of the [port] undertaking”.⁴

Since 2005, the VOA has taken the previously un-precedented step of fundamentally changing its view of port customers and users that occupy, *prima facie*, areas solely for their own particular operation, within the area of the port undertaking. For example, at Harwich, the recent separate assessment of one ship berth is attributable to the berth being of a specialist design and only capable of use by a particular fast ferry. This, in the VOAs view, justifies it being classified as a separate rateable entity. In reality, however, the berth cannot operate without the benefit and infrastructure provided by Harwich Port, within which it is located and to which the berth is attached.

Historically, ships and operators have, by their nature, tended to occupy relatively defined areas albeit within the confines of “the port”. Rating case law extending into the 19th Century has examined the point, and generally accepted that ports operate on a common user basis, although there are recognized exceptions where particular leases may give rise to the need to separately assess.

The situation that we now see at Harwich, particularly in relation to customer’s use of particular berths, totally contradicts much of this previously accepted precedent. Moreover, the new precedent is being applied contrarily, as the ports industry sees no difference in the treatment of ships berths to aeroplane passenger embarkation gates at airports, which are often within the exclusive control and use by one airline. The VOA is not, so far as we are aware, seeking to apply this methodology and approach to rating of airports.

Q91 to 93—*Port inspections*

As anecdotal evidence, the port provided the VOA with a schedule of all occupations in December 2004. Three years later, the VO first inspected Harwich Port for the purposes of verifying any separate occupiers on 4 January 2008. The alteration to the assessment was made on 26 September 2008 (being 3.5 years after April 2005).

The inspection of Port of Felixstowe first occurred on 27 May 2007, two years into the current List period. (In this case, the port believes that no VOA readjustment is expected as no separate occupations were identified.)

Q 101—*Ministerial knowledge*

As an industry body, the UK Major Ports Group wrote to David Jamieson MP, Minister for Shipping at the DfT in early 2004 drawing this issue to this attention and highlighting likely consequences (copy attached). Further concerns were raised in the UKMPG’s response to the Ports Policy Review in 2006, and at a meeting with DfT in December 2006.

We hope these points are of benefit, and would like to thank the Committee for its focus on this matter.

As a final observation, the removal of the Industrial Buildings Allowance, brought in through the Finance Act 2008, has similarly occurred without consultation. The ports’ industry is a significant investor in infrastructure, and a major beneficiary of the Allowance. Its removal has had a direct financial impact in the current financial year; for Hutchison Ports amounting to a cost of £21.5 million. The impact of this change in combination with the rating issue, is placing further and significant financial burdens on the industry. To effect this second tax change without consultation is yet further evidence of inconsiderate and misapplied taxation policy by Government.

Ultimately, this will become manifest through reduced investment, and creates an uncompetitive arena for the UK industry to operate at European level.

28 October 2008

⁴ The Docks and Harbours (Rateable Values) (England) Order 2000 No 951 Clause 3 (4) and (5)

Letter from Simon Leafe, Leafe and Hawkes Ltd, to Nick Ainger MP

NON-DOMESTIC RATING OF ENGLISH AND WELSH PORTS

We were able to watch via the internet the Treasury Select Committee's Meeting on 15 October with the Officials from the Valuation Office Agency and we were extremely encouraged by the questions asked of the VOA. These clearly demonstrated that the members of the Committee have a very good understanding of the serious problems we are currently facing as a result of the VOA's activities; rather better than that of the VOA themselves, who admitted that they had made no overall assessment of the impact on the ports industry, despite having been working on this for more than five years.

We were surprised to hear the apparently misleading reply given by the Shipping Minister Jim Fitzpatrick when answering questions in the House of Commons earlier this week. He stated "...I can say there have been assessments made of the financial impact on ports and the businesses within the ports in respect of the increase in revenue that will be afforded as a result of the examination by the VOA in respect of rates for businesses within ports..." I wonder from where he got this information and by whom these assessments have been carried out, as clearly the VOA themselves are not aware of these?

During his evidence, Mr Tretton acknowledged that even when they had visited a port, due to the complex nature of the ports, it was often difficult for them to understand what was going on. The VOA's misunderstanding of how our ports work has led them to incorrectly describe many facilities as "warehouses" which are in fact transit sheds. A warehouse generally has four walls, can be secured and is used for medium to long term storage, generating income accordingly. A transit shed is often open on one or more sides and is used to handle import and export cargoes quickly and efficiently as a part of the loading or discharging operation, and does not generate any storage income. Indeed any period storage of cargo in these transit sheds could lead to a grid locking of the facilities.

This fundamental misunderstanding has meant that the rateable values they have put on some facilities in ports are much too high. Andrew Hudson stated that it is "our job to get the rateable values right". In our opinion they have failed to do this and the unreasonably high values they have used will lead to thousands of companies lodging formal appeals. If in the meantime we are all forced to pay the back-dated and inflated rating bills we have received, many small companies may not be around to witness the outcome of their appeals. In this respect, I refer you to the example of Fortress, a timber-handling business based on Tilbury Docks, which went in to voluntary liquidation on September 19 after receiving a £2.4 million rates demand from Thurrock Council.

The VOA has admitted they made a serious error in corresponding with only the statutory port operators. Many of the problems we now face are as a result of the VOA's failure to engage with and to investigate our industry correctly. During his evidence, Mr Hudson invited any company to "come and talk to them". When we received a letter in March of this year from the VOA, we asked them why we were being assessed for business rates at all. They replied that they were basing the assessment on information provided by ABP (the statutory port authority). After a brief exchange of e-mails in which we pointed out to them that the grounds on which they had earlier suggested we were responsible for the business rates on the property were incorrect, they simply stopped corresponding with us.

To compound these errors, and having examined the rating lists for our area on the VOA's website, it appears that, using the principles employed by the VOA to issue individual assessments, there are properties which should have been the subject of individual assessments but which have been left out.

Mr Hudson stated that it was their job "... to provide a fair and consistent basis for the bills..." but then went on to tell the Committee that "some assessments are backdated some aren't". How can this be fair and consistent?

I would like to hear the VOA's explanation as to why, when they knew already in 2000 that they had to carry out the revaluation by 1 April 2005, they did not begin it until 2006 and still have not finished it? If this had been completed before 2005, then there would have been no backdating, and it is their failure to carry out their statutory duty which has caused this current crisis.

These appeals and the likely destruction of many viable businesses providing much needed employment could be avoided if the Secretary of State used his powers to instruct the VOA to remove the threat of back-dating these huge increases and to work with our industry towards an orderly introduction of a new rating regime in 2010. Suspending the introduction of the revaluation until 2010 would enable the VOA to properly complete the revaluations before the new rating lists are issued as well as lifting the threat to port businesses.

28 October 2008

Letter from Ken Kirk, Stanton Grove Limited, to John McFall MP

I am the Managing Director of a small Forest Products Terminal Operations business with facilities in Liverpool, Newcastle and Tilbury, with nearly 100 employees we have been established 30 years, we have weathered recession, competition, currency fluctuations, changing demand patterns and changing technologies. We now face being wiped out as a business, not as a result of the turn down in the global economy but entirely as a result of the VOA's inept introduction of the new rating list for Ports. My business was entirely based inside the major Ports and was rated within the cumulo system that was being used until 5 September this year when I was advised by the VOA that I would face a backdated rates bill to 2005 of £1.5 million pounds and £500,000 per annum going forward at the Port of Liverpool.

The VOA made no prior contact with our business informing us of the method of rating, the potential of back dating and what the likely level of rating would be. The consequences are quite simple as are the maths we handle 250,000t of business through the port at an average of £8.00 a tonne, to survive going forward we must increase our prices by an average of £2.00 per tonne 25%, this will mean that we will no longer be competitive and the business will fail. It does not deal with the threatened back dating which will lead to our business immediately failing, the loss of 30 direct jobs in Liverpool and the related consequences for rail transport, haulage companies, plant and equipment suppliers and we are one of 60 companies in the Port now facing this. The uncertainty means that we cannot plan our futures and that our businesses seem almost certain to fail unless there is immediate Government intervention. (I was interested to see the number of MP's who had time to discuss Jonathan Ross, when around them one of the Port industry is left on the brink of disaster due to Government policy.)

The situation is made doubly insulting to our industry when in meeting with the valuation officer in Liverpool yesterday it emerged that our Landlord Peel Ports had met with the Valuation Office as part of the Major Ports Group and they have negotiated a get out clause for themselves where they can declare land as operational and be rated under a system of revenue similar to the old cumulo system. This means that they can compete directly with me in the same facility with out the penalty of rates at the level I am faced with. This is an obscene and ridiculous situation, which could be avoided firstly by an immediate delay in the introduction of the system until proper and full consultation has taken place with ALL the Port operations companies and the VOA has a proper understanding of the relationship between the Port users, Landlords and customers to ensure that a fair system is introduced across the country and that all port users are fully aware of the implications.

Additionally when I observed the recent committee meeting where the Valuation Office was questioned by the committee I was surprised to here the valuation office state that there was only a marginal increase in the business rates. This was misleading at best and an outright lie at worst! The 10% increase is based on a notional figure in 2005 which was not charged ie for the Port of Liverpool:

Notional Rates 2005 £16.5 million

Actual Rates for 2008 £16.8 million

However the actual rates charged in 2005 were significantly less than £16.5 million as they were charged under the old cumulo system.

I would ask that you give this your immediate and urgent attention.

29 October 2008

**Letter from the Financial Secretary to the Treasury and the Minister for Local Government to the
Chairman of the Sub-Committee**

During the course of our Oral Evidence to the Sub-Committee on Wednesday last week we undertook to provide more information, which we trust, will assist with your inquiry.

The material falls into four discrete areas, which we append as annexes, covering the following topics:

Annex A: Consultations regarding the treatment of ports for the purpose of the 2005 Revaluation

Annex B: Port by port breakdown of the rateable value changes consequent on the Valuation Office Agency's review initiated in May 2006

Annex C: Comparisons between England and Wales, and Scotland

Annex D: The powers to prescribe rateable values

However, before getting into the detail we believe there is some merit in re-clarifying the context within which the changes in ports are taking place, and the fact that we are dealing with two separate issues, both linked to the way port property is rated, but nonetheless separate.

The first, and perhaps simpler, is the move from prescribed (by the Secretary of State) rating for the Statutory Port Operators. And the second is the review of ports carried out by the Valuation Office Agency (VOA) following their discovery in Southampton that significant elements of property within the port boundaries were not properly captured in the rating system.

The ending of prescribed rating came into effect from 1 April 2005. This change covered the operational land and buildings occupied by the statutory Port Operators only. The process of moving to conventional rating methods was started in 2002. Valuations on the new basis were prepared in consultation with the statutory ports during 2003 and draft list valuations were published in October 2004 along with all other valuations ahead of the 2005 rating lists.

The second issue is perhaps somewhat more complicated and sits at the heart of the matter for the port occupiers. What became clear in the case of Southampton was that a significant amount of property within the port boundary was not listed correctly (ie separately) on the local rating list—it should have been, but wasn't. Once this discovery was made, the VOA was under a statutory obligation to put matters right. A legal challenge was made to the approach towards separate assessment in Southampton (in July 2004), which was clearly highly relevant to other ports, if the VOA's view was proven to be correct. After extensive argument, the challenge was withdrawn in April 2006. Only then, with the correctness of the VOA approach confirmed, was a wider review initiated, with a letter to Port Operators in May 2006, to ensure fairness and consistency across ports throughout England and Wales.

In summary, the removal of prescribed rating and the work now nearing completion to correct inaccuracies in the list are two separate issues, and the return to prescription, which has been put to us by the port occupiers, would only alter the rating treatment for Statutory Port Operators and could not in law change the position for those properties that are now, correctly, identified separately.

We will write further to the Committee to report progress on the work we have initiated to investigate options for reducing the impact on businesses facing significant backdated liabilities.

5 November 2008

Annex A

CONSULTATION

Since 1 April 2005, large statutory ports have been subject to two separate changes in the manner in which they are rated:

- (i) the ending of prescribed assessment. From 1 April 2005, the statutory ports (ie the operational land and buildings occupied by the statutory port operators) were removed from prescribed assessment under paragraph 3 of Schedule 6 to the 1988 Act. Instead, their rateable values were assessed by the Valuation Office Agency using conventional rules (in paragraph 2 of Schedule 6 to the 1988 Act); and
- (ii) the review of other businesses within the ports which should have been separately assessed and not included with the assessment of the statutory port operator. The review of other businesses at the port is based upon established rating principles (that where a company has exclusive use, under a licence or other agreement with the designated operator, a separate assessment is appropriate) and is unconnected to the powers covering prescribed rateable values.

CONSULTATION ON THE REMOVAL OF PRESCRIBED RATING FOR STATUTORY DOCKS AND HARBOURS

Consultation on the removal of the power to prescribe rating (leading to the valuation process described at (i) above) was undertaken in:

- “Modernising Local Government Finance: A Green Paper” published by Department for the Environment Transport and the Regions in September 2000 as follows:
Paragraph 5.39—Most ratepayers have their rateable values assessed by the Valuation Office Agency of the Inland Revenue using conventional methods. However, certain industries—in the transport and utility sectors—have their rateable values prescribed by the Secretary of State. We intend to end prescribed assessment by the time of the next revaluation. Considerable progress has already been made toward using conventional methods to assess the valuations that were prescribed for the last revaluation.
- “Strong Local Leadership—Quality Public Service” a White Paper published by the Office of the Deputy Prime Minister in December 2001 as follows:
Paragraph 7.14—As we said in Modernising Local Government Finance: A Green Paper, we will end prescribed assessment at the time of the next revaluation. This means that those industries that currently have their rateable values prescribed by the Secretary of State will have them assessed by the VOA like other ratepayers. They will also acquire the same right as other ratepayers to challenge their valuation.
- The Consultation Paper published by the Office of the Deputy Prime Minister in June 2002 alongside the Draft Local Government Bill and scrutinised by the House of Commons Transport, Local Government and the Regions Committee. The draft Bill included provision at clause 75 for removal of the power. The drafting of the power at section 69 of the 2003 Act is unchanged from that included in the draft Bill.

The resulting valuation process was started by the Valuation Office Agency later in 2002. Valuations were prepared in consultation with the statutory ports during 2003 and draft valuations were shared with them in 2004. The conventional draft rating list valuations were published on time in October 2004.

CONSULTATION ON THE REVIEW OF OTHER BUSINESSES WITHIN THE PORT

The review of other businesses within the ports (at (ii) above) was started in May 2006 once the legal principles had been clarified and, to date, reviews on 51 of the 55 ports have been completed. It is this review which has resulted in some businesses facing rates bills with liability from 1 April 2005.

The Valuation Office Agency has a duty to maintain correct rating lists and where inaccuracies are identified in the list they have a duty to correct them. They do not, and are not required to, undertake impact assessments or formal consultations as part of their statutory functions. Therefore, no formal consultation was undertaken prior to the review of other businesses at ports. However, the Valuation Office Agency did contact the statutory ports in May 2006 to inform them of the review and sought later in 2006 to contact other businesses at the ports. The Valuation Office Agency accept that more efforts should have been made to contact all the businesses at the ports to inform them of this review although until the review was substantially advanced the identity of many of the occupiers was not known.

Annex B

PORT BY PORT BREAKDOWN OF THE RATEABLE VALUE CHANGES

55 major ports have been covered by the review undertaken by the Valuation Office Agency. For clarification, all of these are statutory, with the exception of three container terminals at Southampton, Tilbury and Thamesport. In 51 cases the reviews are complete, though in one of these—concerning Humber Sea Terminal—the formal service of notices to effect the changes the VOA believes necessary have been deferred pending conclusion of discussions between the valuation officer and the occupiers' agents. In the remaining four the reviews are due to be completed by 28 November.

COMPLETED REVIEWS

For the 50 ports where the reviews are complete and formal notices served to effect the change, the position in England (41 ports) and Wales (9 ports) is as follows:

Overall there are two major aggregate changes in the rateable values of ports and businesses within ports.

In regard to the Port Operators the Review of Ports shows that their aggregate rateable values have reduced from £127,428,000 for England and £8,572,500 for Wales, to £83,674,500 for England and £7,835,000 for Wales. The Port Operators business rates liability has been effectively reduced. There are however significant variations port to port, as the committee will see from the figures we set out.

The other major aggregate change is that the number of business properties separately rated has increased by 569 properties in England and 81 in Wales respectively. This, alongside increasing the rateable values of existing separately assessed properties, has caused the non port rateable values to increase from £69,876,784 in England and £22,372,059 in Wales to £124,937,278 in England and £24,132,200 in Wales respectively.

It is this increase in non port properties and the rateable values that has caused the increase in the business rates liabilities faced by business within ports.

Overall the increase in the total ports rateable values (port operators and businesses within ports) has increased by £11,302,554, from £197,304,784 to £208,607,338 in England, and £1,022,110, from £30,945,090 to £31,967,200 in Wales. The VOA has undertaken a fully updated reconciliation of all figures to be able to give the very latest information as at close on 31 October 2008.

The rateable values of properties are not the amount of liability that a business will face as they only form part of the business rates calculation. The actual bills are a function of the rateable values and the multiplier, currently 46.2p.

Changes to Ports—England.

Port	Pre Review (1 April 2005)				Post Review (1 April 2005)				Cumulative Change	
	Port RV (URT)	Non Port RV	Total RV	No of Hereditaments	Port RV (URT)	Non Port RV	Total RV	No of Hereditaments	RV (+/-)	No of Hereditaments (+/-)
BARROW	£580,000	£641,005	£1,221,005	56	£575,000	£643,555	£1,218,555	57	-£2,450	1
BLYTH	£130,000	£329,102	£459,102	39	£100,000	£386,062	£486,062	52	£26,960	13
BOSTON	£125,000	£233,755	£358,755	7	£125,000	£333,625	£458,625	20	£98,870	13
BRISTOL	£5,250,000	£15,791,740	£21,041,740	109	£2,635,000	£15,816,760	£18,451,760	114	-£2,589,980	5
DOVER	£2,670,000	£1,314,515	£3,984,515	53	£2,670,000	£2,104,316	£4,774,316	118	£789,801	65
FALMOUTH	£130,000	£569,375	£699,375	21	£130,000	£586,825	£716,825	22	£17,450	1
FELIXSTOWE	£14,187,000	£3,804,585	£17,991,585	164	£14,187,000	£4,077,885	£18,264,885	172	£273,300	8
FLEETWOOD	£310,000	£324,080	£634,080	40	£245,000	£325,680	£570,680	41	-£63,400	1
FOLKESTONE	£110,000	£23,675	£133,675	6	£25,000	£111,625	£136,625	11	£2,950	5
GARSTON	£90,000	£163,000	£253,000	12	£82,500	£978,050	£1,060,550	20	£807,550	8
GOOLE	£940,000	£77,891	£1,017,891	6	£205,000	£2,960,095	£3,165,095	32	£2,147,204	26
GREAT YARMOUTH	£400,000	£345,485	£745,485	28	£400,000	£425,985	£825,985	32	£80,500	4
GRIMSBY	£1,350,000	£3,884,531	£5,234,531	256	£500,000	£6,064,881	£6,564,881	271	£1,330,350	15
HARWICH DOCK	£125,000	£0	£125,000	1	£150,000	£4,425	£154,425	3	£29,425	2
HARWICH INTERNATIONAL	£4,140,000	£1,052,150	£5,192,150	20	£2,125,000	£2,317,975	£4,442,975	24	-£749,175	4
HEYSHAM	£1,050,000	£6,400	£1,056,400	2	£1,050,000	£687,340	£1,737,340	13	£680,940	11
HULL	£9,000,000	£2,944,075	£11,944,075	75	£3,100,000	£14,264,685	£17,364,685	114	£5,420,610	39
HUMBER SEA TERMINAL	Subject to discussion with agent									
IMMINGHAM	£17,930,000	£2,653,050	£20,583,050	40	£11,000,000	£11,534,115	£22,534,115	75	£1,951,065	35
IPSWICH	£580,000	£1,207,640	£1,787,640	64	£512,500	£1,743,980	£2,256,480	74	£468,840	10
KING'S LYNN	£185,000	£575,750	£760,750	15	£175,000	£686,000	£861,000	24	£100,250	9
LIVERPOOL	£16,500,000	£3,697,650	£20,197,650	43	£6,800,000	£16,969,760	£23,769,760	127	£3,572,110	84
LOWESTOFT	£150,000	£853,250	£1,003,250	30	£150,000	£926,510	£1,076,510	36	£73,260	6
MANCHESTER SHIP CANAL	£1,400,000	£0	£1,400,000	1	£1,400,000	£0	£1,400,000	1	£0	0
NEWHAVEN	£75,000	£0	£75,000	1	£75,000	£0	£75,000	1	£0	0
PLYMOUTH CATTEDOWN	£91,000	£184,000	£275,000	2	£91,000	£184,000	£275,000	2	£0	0
PLYMOUTH MILLBAY										
POOLE										
PORT OF LONDON	£200,000	£0	£200,000	1	£200,000	£0	£200,000	1	£0	0
PORTSMOUTH	£5,400,000	£1,828,965	£7,228,965	60	£5,400,000	£1,839,575	£7,239,575	65	£10,610	5
RAMSGATE										
SCT	£9,650,000	£0	£9,650,000	1	£9,500,000	£69,700	£9,569,700	10	-£80,300	9
SEAHAM	£200,000	£122,500	£322,500	3	£165,000	£132,819	£297,819	10	-£24,681	7
SHARPNESS	£170,000	£0	£170,000	1	£170,000	£109,750	£279,750	5	£109,750	4
SHEERNESS	£9,070,000	£1,397,690	£10,467,690	44	£2,125,000	£4,431,570	£6,552,130	98	-£3,915,560	54

Port	Pre Review (1 April 2005)				Post Review (1 April 2005)				Cumulative Change	
	Port RV (URT)	Non Port RV	Total RV	No of Hereditaments	Port RV (URT)	Non Port RV	Total RV	No of Hereditaments	RV (+/-)	No of Hereditaments (+/-)
SHOREHAM	£100,000	£888,975	£988,975	17	£100,000	£931,725	£1,031,725	21	£42,750	4
SOUTHAMPTON	£9,400,000	£11,865,270	£21,265,270	113	£7,500,000	£13,723,675	£21,223,675	134	-£41,595	21
SUNDERLAND	£95,000	£1,093,650	£1,188,650	15	£95,000	£1,165,150	£1,260,150	30	£71,500	15
TCS	£3,400,000	£0	£3,400,000	1	£3,400,000	£35,300	£3,435,300	4	£35,300	3
TEESPORT	£5,500,000	£3,259,050	£8,759,050	57	£1,000,000	£3,595,785	£4,595,785	72	-£4,163,265	15
TEIGNMOUTH	£550,000	£0	£550,000	1	£490,000	£153,000	£643,000	2	£93,000	1
THAMESPORT	£2,475,000	£393,500	£2,868,500	5	£2,240,000	£648,475	£2,888,475	17	£19,975	12
TILBURY	£2,725,000	£5,149,825	£7,874,825	95	£2,100,000	£10,416,975	£12,516,975	131	£4,642,150	36
TYNE	£900,000	£3,031,300	£3,931,300	49	£616,500	£3,375,840	£3,992,340	63	£61,040	14
WORKINGTON	£95,000	£169,355	£264,355	4	£65,000	£173,805	£238,805	8	-£25,550	4
Totals (excl Ramsgate, Poole, Humber Sea Terminal & Plymouth Millbay)	£127,428,000	£69,876,784	£197,304,784	1,558	£83,674,500	£124,937,278	£208,607,338	2,127	£11,302,554	569

Changes to Ports—Wales

Port	Pre Review (1 April 2005)				Post Review (1 April 2005)				Cumulative Change	
	Port RV (URT)	Non Port RV	Total RV	No of Hereditaments	Port RV (URT)	Non Port RV	Total RV	No of Hereditaments	RV (+/-)	No of Hereditaments (+/-)
BARRY	£135,000	£1,597,015	£1,732,015	92	£122,500	£1,715,415	£1,837,915	97	£105,900	5
CARDIFF	£325,000	£1,527,850	£1,852,850	34	£300,000	£2,261,950	£2,561,950	64	£709,100	30
FISHGUARD	£1,600,000	£72,900	£1,672,900	9	£1,000,000	£94,900	£1,094,900	12	-£578,000	3
HOLYHEAD	£4,000,000	£45,115	£4,045,115	16	£4,000,000	£146,585	£4,146,585	27	£101,470	11
MILFORD DOCK COMPANY	£115,000	£440,510	£555,510	61	£115,000	£473,135	£588,135	65	£32,625	4
MILFORD HAVEN PORT AUTHORITY										
MOSTYN	£87,500	£437,500	£525,000	3	£87,500	£442,050	£529,550	4	£4,550	1
NEWPORT	£1,850,000	£1,449,775	£3,299,775	25	£1,750,000	£1,593,090	£3,343,090	37	£43,315	12
PORT TALBOT	£150,000	£16,543,350	£16,693,350	23	£150,000	£16,602,400	£16,752,400	29	£59,050	6
SWANSEA	£310,000	£258,575	£568,575	14	£310,000	£802,675	£1,112,675	23	£544,100	9
Totals (excl Milford Haven)	£8,572,500	£22,372,590	£30,945,090	277	£7,835,000	£24,132,200	£31,967,200	358	£1,022,110	81

RIGHTS OF RATEPAYERS TO CHALLENGE OR APPEAL AGAINST AN ASSESSMENT

If a business considers its rateable value is wrong, it can make a proposal to alter it, if any of the following applies:

- The rateable value shown in the rating list (either following a revaluation or when the property is first valued) is wrong.
- A valuation officer's change to the rateable value is wrong.
- A decision by a valuation tribunal (VT), lands tribunal or higher court has affected the valuation.
- The property should be considered for rating as more than one property, or several properties should be considered as one property.
- There is another sort of error in the list entry, for example the address is wrong or the date of an alteration is wrong.

A business can also make a proposal if there has been a material change of circumstances which has affected the value of your property. Material changes of circumstances include:

- a physical change to the building (for example, if part of it is demolished or destroyed);
- a physical change in the local area (for example, if there have been major road works or flooding in the area);
- a change in the use of the building; and
- a change in the use of a neighbouring property.

It costs nothing to make a proposal and if a business decides to, it can make a proposal by asking the local valuation officer for a form or one can be obtained from the VOA's website at www.voa.gov.uk.

Most cases are settled by agreement between ratepayers and their local valuation office. Where it is not possible to resolve any challenge by agreement the dispute will proceed to be heard by an independent valuation tribunal.

Annex C

DIFFERENCE BETWEEN THE ENGLISH/WELSH AND SCOTTISH APPROACH TO PORTS RATINGS

There are three large statutory ports in Scotland compared to 52 in England and Wales.

The Scottish Assessors (the Scottish equivalent of valuation officers) are responsible for the rating of non-domestic properties in Scotland.

Up until the 2005 list certain ports in England, Wales and Scotland were assessed according to prescribed formulas. Across England, Wales and Scotland no formulas were prescribed for the 2005 list, with the effect being that the prescribed formula method for rating utilities, including ports, was replaced by rating by conventional methods.

Subsequently the Valuation Office Agency (VOA) rated ports and properties in England and Wales within ports for the 2005 list based upon information supplied by the ports operators. Properties within ports identified as separately occupied have always been separately assessed; they continued to be so treated for the 2005 List.

The Scottish Assessors undertook the same process in Scotland. They undertook no special exercise at this point and they relied upon their own records and what was notified to them by the port operators.

Following the VOA's review of Southampton they entered into dialogue with the Scottish Assessors regarding the number of separate assessments in their ports. They said that they were satisfied that they had correctly identified all separate occupations and did not need to further review the position.

TRANSITIONAL RELIEF

Both England and Scotland have transitional relief schemes to limit the increase in rates bill following a five year revaluation.

The summary of response to a consultation document issued by the then Scottish Executive in December 2002 made reference to a "robust self-financing transitional scheme" for ending prescription.

In the event, when it came to Revaluation in 2005, the utilities which came out of prescription on 1 April 2005 were subject to the standard transitional relief scheme, available to all ratepayers in Scotland, which limited increases to 12.5% in real terms (and decreases to 10%). The Transitional Relief scheme was limited to three years. There was therefore no special transitional scheme for ports and harbours in Scotland.

There is also a transitional relief scheme in England for the 2005 rating lists, which limits the increases in bills of business from increases in rateable value as a result of the statutory five yearly revaluations of properties for rates. All ratepayers in England, including those in ports and harbours may receive transitional relief if they meet the qualifying criteria.

The scheme is aimed at changes in actual bills as a result of revaluation rather than rateable values as the multiplier also reduced at the 2005 revaluation from 45.6p in 2004–05 to 41.5p in 2005–06. To meet the criteria for transitional relief, any increase in bills resulting from revaluation, above a set percentage set out in the tables below, was capped at that percentage.

<i>Year</i>	<i>Max Increase: Small Properties (under £15,000 Rateable Value or £21,000 in London)</i>	<i>Max Increase: Large Properties</i>
2005–06	5%	12.5%
2006–07	7.5%	17.5%
2007–08	10%	20%
2008–09	15%	25%
2009–10	no limit	no limit

Special rules apply for properties which first came on to the rating list on 1 April 2005 as a consequence of either (i) an existing property being split (as is the case with the property in ports) or (ii) two or more existing properties being merged. Where this split or merger should have occurred before 1 April 2005 (again as is the case with property in ports) then the new properties are allocated a certified rateable value for 31 March 2005 (see regulation 17 of the Non-Domestic Rating (Chargeable Amounts) (England) Regulations 2004).

However, the purpose of these provisions is not to provide relief against increases, which may arise from the property being split or merged and backdated. The purpose of the certified value is to ascertain whether, had the property actually been shown on the rating list for 31 March 2005, it would have seen a significant change in rates bills as a result of the 2005 revaluation. If, had it been rated prior to 1 April 2005, the increase in the rates bill would have been above the percentages set out above then the property qualifies for transitional relief but only upon the increase between the notional bill for 2004/05 (based on the certified value) and the actual bill for 2005–06.

Annex D

THE POWERS TO PRESCRIBE RATEABLE VALUES (PARAGRAPH 3, SCHEDULE 6 TO THE LOCAL GOVERNMENT ACT 1988 (“THE 1988 ACT”))

It has been suggested that the problems said to be caused by the backdated rates liability now being faced by certain port occupiers could be overcome if the Secretary of State exercised her power to prescribe rules for determining the rateable value of those occupiers’ properties. This power is in paragraph 3 of Schedule 6 to the Local Government Finance Act 1988. Currently, no such rules are prescribed and the properties are subject to assessment on the same basis as all other non-domestic properties; that is on the basis of their market rent, in accordance with paragraph 2 of Schedule 6.

PRESCRIPTION OF RATEABLE VALUES

The power in paragraph 3 of Schedule 6 was used to prescribe rules for the valuation of docks and harbours for the purposes of the 2000 rating list in the Docks and Harbours (Rateable Values) (England) Order 2000 (SI 2000/948). This order does not have any effect in relation to entries on 2005 rating lists.

The power was revoked by section 69 of the Local Government Act 2003. However, section 69 has never been brought into force and paragraph 3 of Schedule 6 remains extant.

As discussed in Annex B, since 2005, ports have been subject to 2 separate changes in the manner in which they are rated:

- (i) the ending of prescribed assessment. From 1 April 2005, the statutory ports (ie the operational land occupied by the statutory port operators) were removed from prescribed assessment under paragraph 3 of Schedule 6 to the 1988 Act. Instead, their rateable values were assessed by the Valuation Office Agency using conventional rules (in paragraph 2 of Schedule 6 to the 1988 Act). The conventional valuation process was started in 2002, was developed in close consultation with the statutory ports and included the consultation on valuations with each statutory port in 2004. All the new draft rating list conventional valuations were in place and published on 1 October 2004, and
- (ii) the ports review of other business within the ports which should have been separately assessed. This was started in 2006 following clarification of the legal basis for separate assessment. The review of other businesses at the port is based upon established rating principles (that where a company has exclusive use, under a licence or other agreement with the designated operator, a separate assessment is appropriate) and is unconnected to the powers in paragraph 3 to Schedule 6 to the 1988 Act.

If the Government had decided to retain the prescribed formula for docks and harbours for the 2005 list (and therefore not proceeded with the valuations at (i) above), the current review of businesses within ports (at (ii) above) would still have had to have been undertaken. Indeed, had the Valuation Office Agency been aware of the inaccuracies prior to 2005 then the review would have taken place while the prescribed assessments of the statutory port operators (paragraph 3 to schedule 6 of the 1988 Act) was still in place.

Therefore, reintroducing prescribed assessment of the statutory ports would reverse the conventional valuations (as described at (i) above) but have no effect on the review of other businesses at ports (at (ii) above).

Since 2005, no rateable values in England have been established based on rules prescribed under paragraph 3 of Schedule 6 to the Local Government Finance Act 1988. All properties are conventionally assessed.

BACKGROUND TO THE BACKDATING OF THE NEW ASSESSMENTS

In relation to the businesses within ports, backdated liability has arisen because of the operation of regulation 14 of the Non-Domestic Rating (Alteration of Lists and Appeals) (England) Regulations 2005 (SI 2005/659). Pursuant to this regulation, the effective date of revisions to the rating list was established as 1st April 2005, giving rise to backdated rates bills. Regulation 14 is a general provision, which operates in respect of all changes to the 2005 rating list. Therefore, any split or merger discovered by the Valuation Officer which should have occurred before 1 April 2005 will be backdated to 1 April 2005.

COULD PARAGRAPH 3 OF SCHEDULE 6 BE USED TO PRESCRIBE RULES IN RELATION TO THE BUSINESSES WITHIN PORTS?

The Secretary of State still has the power to prescribe rules for ascertaining rateable values. In theory, she could use those powers to prescribe rateable values for the individual businesses at ports. However, it is very difficult to see how exercising such powers would assist businesses at ports. This is because:

- (i) the businesses within ports would still be rated separately from the port as they should be and, in some instances, were prior to 1 April 2005,
- (ii) the businesses within ports would still be faced with three years' backdated liability payable immediately on top of the liability for this year and the liability which will shortly fall due for next year,
- (iii) the power in paragraph 3 of Schedule 6 is not itself retrospective. So we cannot prescribe a formula which is to apply for the purposes of ascertaining rateable values for a day before the order prescribing the formula was made, and
- (iv) in order to deliver some benefit to the businesses, we would need to prescribe a formula which generated results below the market rental value. However, there are no other properties valued other than on the basis of market rent and there is no clear rationale for special treatment. In particular, there is no basis on which a low rateable value could be established. If the valuation methodology was challenged by any other ratepayer whose property is valued conventionally, it would be difficult to defend in rationality and reasonableness terms.

Finally, we would also anticipate that the exercise of the rules in such a manner would constitute state aid. The four tests for state aid contrary to European law are:

- the aid is provided by the State or through State resources;
- the aid favours certain undertakings or the production of certain goods;
- the aid distorts competition; and
- the aid affects trade between Member States.

It is very likely that special valuation arrangements which reduce the rateable value of the port occupiers' properties to less than the market rental value will be in contravention of all of these tests. The state would be foregoing tax revenue; the port operators would be directly favoured in comparison to their competitors occupying hereditaments outside of ports; this favouring would be capable of distorting competition, particularly between the port occupiers and other occupiers facing backdated liability; and the aid would at least potentially be capable of affecting trade between member states. This is particularly true as ports are, by their nature, involved in trade between states.

Letter from the Financial Secretary to the Treasury and the Minister for Local Government to the Chairman of the Sub-Committee

In our memorandum to you of 5 November we undertook to update the Committee on progress with the work we had initiated on options for reducing the impact on businesses facing significant backdated business rates liabilities and particularly those based in the major ports.

Since we wrote our officials have been working hard to finalise a way forward that will reduce the cashflow impact on existing businesses when significant backdated business rates bills are issued in relation to properties new to the current (2005) rating list.

As you will know, the Chancellor has today announced at the Pre-Budget Report that the Government will legislate to give businesses more time to pay in certain circumstances. Businesses facing such bills in those circumstances will not be required to pay their liability for previous years within the financial year, as at present, and will instead be able to do so in equal interest-free instalments over eight years.

Although representing only a small proportion of the total number of changes which are made to rating lists each year to keep them up to date, this provision could nevertheless benefit ratepayers on up to 1,500 properties a year across England, including qualifying occupiers of ports. Further details of the new regulations, including the conditions under which it is proposed a payment schedule will be offered, will be published by CLG shortly.

In addition to this, we can confirm that the Valuation Office Agency has put in place special fast track arrangements for ratepayers affected by the review of ports who wish to question or challenge their new rating assessments. This will ensure a fast response and early resolution to any inquiries or appeals. Contact details and other information about the fast-track system will be included in letters the VOA is sending tomorrow to every ports occupier.

The VOA's special arrangements mean that cases involving backdated rate liabilities in ports will be given priority attention at all stages by the Agency, which will:

- Review all initial enquiries and respond within five working days, unless a site visit is requested or required in which case it may take up to 10 working days.
- Give an initial response to points raised in any proposal within 10 working days and aim to confirm a final decision shortly after that; in any event a decision will be issued within two months in all but the most complex cases.
- Refer appeals to the independent valuation tribunal (VT), where agreement can't be reached and a ratepayer wants to pursue the case, requesting that the tribunal list the appeal for hearing as soon as possible.

In all cases, the VOA will look to ratepayers and their advisers to assist by ensuring full disclosure from the outset of facts or matters they wish taken into account, avoiding delay through the need for further VOA enquiry. The VOA will also continue to give early attention to other priority cases, in line with its existing published service standards.

Some firms have expressed a concern about the impact of backdated rates on their balance sheet and their ability to continue trading, even if there is no pressing need to meet the debt. Spreading payments cannot entirely remove the balance sheet risk and, as with any other business, the prime test that directors will have to look at in deciding whether their business can continue to trade is whether they have a reasonable expectation of covering the debt in the future. This measure will help businesses in two ways—first, the ability to spread payments will help cashflow pressures and provide a greater level of reasonable expectation of meeting the bill on the new payment terms. Secondly, because the spread business rates payments would be interest free, this saves them interest costs compared with alternatives such as borrowing to pay the bill.

Finally, the Ports Minister Jim Fitzpatrick will continue to engage with port operators to discuss these arrangements and the valuation changes within ports.

24 November 2008

Letter from Ken Kirk, Stanton Grove Limited, to John McFall MP

I note with some sadness and much disappointment that the Chancellor, Treasury and the various departments concerned have failed to grasp the seriousness of the issue regarding non domestic rates and port operators in Liverpool and Hull. The idea that eight years to pay the back dating is of some assistance is quite bizarre!

My company faces a back dated bill of £1.5 million, with £568,000 ongoing pa, this means that over eight years we would pay in excess of £700,000 per annum on annual profits of £250,000 in a good year, it does not take a mathematical genius, to see that this will effectively put us out of business in Liverpool with the loss of 50 jobs and the subsequent effect on our suppliers and customers.

In addition we face the situation that we have already contributed to the payment of rates in 2005, 2006, 2007 and 2008 through our rental to the landlord so now have the pleasure of being asked to pay again as we are forced into insolvency! I know that we are a small casualty in the scheme of things, the difference being that this is nothing to do with recession but is entirely the result of Government policy and Government failure to understand the nature or structure of the businesses that are being affected by this change to the rating structure.

25 November 2008

Estimates Memorandum submitted by HM Treasury: Winter Supplementary 2008–09

This memorandum provides details of changes sought in the Treasury's Winter Supplementary Estimate for 2008–09 published in "Central Government Supply Estimates 2008–09: Winter Supplementary Estimates" HC1163. Further details of the work of the Treasury and its finances can be found in the "HM Treasury Annual Report and Accounts 2007–08" CM 7048. Supply Estimates and the Treasury's Departmental Report are available from <http://www.hm-treasury.gov.uk/>

2. The purpose of this memorandum is to provide the select committee with an explanation of how the resources and cash sought in the Winter Supplementary Estimate will be applied to achieve departmental objectives and Public Service Agreement (PSA) targets. This includes information on comparisons with the resources provided in earlier years in Estimates and departmental budgets.

SUMMARY OF THE CHANGE SOUGHT IN THE ESTIMATE

3. The Estimate seeks an increase of £7,748,000 in resources and an increase of £23,413,267,000 in the net cash requirement. The increase in capital AME is £27,207,455,000. The increase in resources is the net effect of transfers to and from other Government departments and the draw down of a proportion of our administration Departmental Unallocated Provision (DUP). The increase in the net cash requirement comprises the near cash consequences of the net resource increase plus capital payments in connection with the refinancing of loans and the provision of working capital to financial institutions.

DETAILED EXPLANATION OF THE CHANGES BEING SOUGHT

Request for Resources 1: Raising the rate of sustainable growth and achieving rising prosperity and a better quality of life, with economic and employment opportunities for all.

4. The increase in resources is the net effect of the following:

Inter-departmental transfers

i) a transfer to the Cabinet Office of £103,000 comprising an outward machinery of government transfer of £273,000 following the transfer of responsibility of the Statistical Reform Team, £80,000 outwards transfer as a contribution to the Government Secure Zone and an inwards transfer of £250,000 as a contribution towards the consultancy costs incurred by the Prime Minister's Delivery Unit;

ii) a transfer to the ONS/Statistics Board of £100,000 programme costs as a contribution towards the costs of a project to improve the quality of migration statistics;

iii) a transfer to the Office of Government Commerce (RfR 3) of £45,000 near cash administration costs towards the costs of the Centre of Expertise in Sustainable Procurement; and

iv) a transfer from HM Revenue and Customs of £21,000 near cash administration costs towards the cost of a post in the Budget, Tax and Welfare Directorate.

Movements between RfRs

5. There is a neutral change following a transfer of gross provision of £1,200,000 with matching income to RfR 3 that was erroneously included in RfR 1 at the time of the Main Estimate.

Departmental Unallocated Provision

6. There is a draw down of administration DUP of £5,305,000 to fund a variety of projects mainly from agreed Strategic Pot bids including:

- (i) £1,111,000 for a new function to respond to the need for better performance data via the development of a data warehouse to track key centre of government priorities and the new PSA framework;
- (ii) £967,000 for work on the instability in the financial markets;

- (iii) £568,000 for the establishment of the Asset Freezing Unit;
- (iv) £250,000 to enhance flexible working practices including improvements to IT equipment and updated software;
- (v) £240,000 in connection with the UK Presidency of the G20 Finance Ministers and Central Bank Governors in 2009;
- (vi) £200,000 in support of the health and wellbeing of staff, including the introduction of an Annual Health Screening programme; and
- (vii) £187,000 to support the delivery of HMT Group Procurement Transformation.

Capital AME

7. The increase in capital AME of £27,207,455,000 is required for the following:

Northern Rock

(i) A reduction of £518,545,000 in the amount included in the Treasury's Supply Estimates for the novation of the Bank of England's loan facilities to Northern Rock. The original Supply provision was based on a forecast of the amount of loan outstanding at the point of novation. The revised amount included in the Winter Supplementary is the actual total outstanding at the point of novation.

Bradford & Bingley (B&B)

(ii) The Chancellor's written ministerial statement of 13 October 2008 on the use of the Contingencies Fund explained that, under the Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008 No. 254, the Financial Services Compensation Scheme (FSCS) had made a payment to Abbey National plc in respect of the transfer of B&B's retail deposits. The FSCS payment was financed by a short-term loan from the Bank of England and that this would be replaced by a loan from the Government. This Winter Supplementary Estimate includes provision for the payment of £14,325,000,000 to refinance the loan.

(iii) In addition, the Bank of England has made available a working capital loan facility to Bradford & Bingley and £5,735,000,000 is included in this Supplementary Estimate to cover the refinancing of this facility.

Kaupthing Singer & Friedlander (KSF) and Heritable

(iv) The Chancellor's written ministerial statement of 13 October 2008 on the use of the Contingencies Fund explained that, under the Transfer of Rights and Liabilities to ING Order 2008 No 2666, the FSCS made a payment to ING Direct to enable retail deposits in KSF and Heritable to be transferred to ING Direct. The FSCS payment was financed by a short-term loan from the Bank of England, which would be replaced by a loan from Government after a short period of time. This Winter Supplementary Estimate includes £3,066,000,000 to enable the loan to be replaced.

Icesave UK

(v) A Treasury Minute dated 6 November 2008 entitled "Financial support for depositors in Icelandic banks" notified Parliament of guarantees given in respect of Icelandic banks. A guarantee was made on 4 November 2008 by HM Treasury in respect of a loan facility between the Bank of England and the FSCS. The loan was made to enable the FSCS to pay out to eligible UK retail depositors in Icesave, the internet savings product made available by the UK branch of Landsbanki. This Winter Supplementary Estimate includes £3,800,000,000 to enable the Bank's loan to be replaced with direct Government financing.

(vi) The Chancellor's written ministerial statement of 6 November 2008 entitled "Financial support for depositors in Icelandic banks" explained that the Government was making an advance to the FSCS to enable the FSCS to pay out that part of a depositors rights arising from deposits over the FSCS depositor compensation limit. This advance amounted to £800,000,000 and is included in this Winter Supplementary Estimate.

The refinancing of the Bank of England loan facilities is necessary in order to comply with restrictions in the Treaty Establishing the European Community on central bank financing of government undertakings.

Request for Resources 3: Obtaining the best value for money from Government's commercial relationships on a sustainable basis.

8. The increase in resources of £2,670,000 is the net effect of the following:

Inter-departmental transfers

9. Contributions from a number of departments towards the costs of the Centre of Excellence in Sustainable Procurement comprising near cash administration costs of £800,000 and near cash programme costs of £745,000. The Centre of Excellence in Sustainable Procurement was created within OGC in response to the Sustainable Development Commission's 6th Annual Sustainable Development in Government (SDiG) Report.

Departmental Unallocated Provision

10. An increase of £1,125,000 to fund a range of activities relating to the delivery of "Transforming Government Procurement". The activities form part of OGC's work on delivering projects to time quality and cost, getting the best from the Government Estate, and improving central Government capability in procurement, project management and estates.

Neutral changes

11. An increase in gross provision of £737,000 non cash programme spending for cost of capital charge in respect of the investment in OGC.buyingsolutions offset by a matching increase in dividend income.

12. An increase in gross spending of £3,900,000 near cash administration costs offset by a matching increase in income from Gateway Reviews and sale of products. The increase in spending relates to the set of activities which is being funded from Departmental Unallocated Provision (paragraph 10).

Movements between RfRs

13. There is a neutral change following a transfer of gross provision of £1,200,000 with matching income from RfR 1 that was erroneously included in RfR 1 at the time of the Main Estimate.

IMPACT ON THE DEPARTMENT'S PUBLIC SERVICE AGREEMENTS

14. The increase in capital AME of £27,207,455,000 is to support stability in the financial services sector and is in line with treasury DSO outcome DSO 2(e): "Supporting fair, stable and efficient financial markets" and with PSA 6: Deliver conditions for business success in the UK".

DEPARTMENTAL EXPENDITURE LIMIT

15. The Resource DEL is increasing by £1,318,000 comprising the machinery of government and inter-departmental transfers covered in the explanation of the changes for RfRs 1 and 2 set out above. There are no changes to the Capital DEL. The following table shows a comparison between DEL plans between 2004-05 and 2007-08 (after changes made via Supplementary Estimates) and the outturns for those years, and the DEL for 2008-09.

<i>Comparison of expenditure against Departmental Expenditure Limits</i>					<i>£m</i>
<i>Year</i>	<i>Voted</i>	<i>Non-voted</i>	<i>Total DEL</i>	<i>Outturn</i>	<i>Variance</i>
<i>Resource</i>					
2004-05	217	31	247	192	- 55
2005-06	227	29	256	215	- 41
2006-07	225	21	246	206	- 40
2007-08	212	20	232	201	- 31
2008-09	195	27	222		
<i>Of which near cash</i>	<i>183</i>	<i>38</i>	<i>221</i>		
<i>Capital</i>					
2004-05	8	—	8	- 28	- 36
2005-06	5	—	5	- 9	- 14
2006-07	7	—	7	- 1	- 8
2007-08	7	—	7	- 1	- 8
2008-09	5	2	7		

DEPARTMENTAL UNALLOCATED PROVISION (DUP)

16. A total of £6,430,000 has been drawn down from the DUP comprising £5,305,000 for RfR 1 and £1,125,000 for RfR 3.

END YEAR FLEXIBILITY

17. No EYF will be drawn down in the Winter Supplementary. The following table shows the EYF entitlements for 2008–09.

<i>Administration</i>	<i>Other resources</i>	<i>Total resource EYF</i>	<i>Of which near cash</i>	<i>Capital</i>	<i>£m Total EYF</i>
70	132	202	202	73	275

ADMINISTRATION BUDGET

18. The Administration Budget is increasing by £1,223,000. This is the net effect of the increases set out in the explanations for RfRs 1 and 3 plus a reclassification of £470,000 programme spending to administration costs following the completion of work on the establishment of the UK Statistics Board. The following table shows a comparison between administration budget plans between 2004–05 and 2007–08 (after changes made via Supplementary Estimates) and the outturns for those years, and the budget for 2008–09.

<i>Comparison of Administration costs against limit</i>					<i>£m</i>
<i>Year</i>	<i>Voted</i>	<i>Non-voted</i>	<i>Total</i>	<i>Outturn</i>	<i>Variance</i>
2004–05	164	0	164	149	15
2005–06	167	0	167	161	8
2006–07	167	1	168	160	8
2007–08	171	0	171	160	11
2008–09	165	4	169		

CONTINGENT LIABILITIES

19. The following changes have been made to the list of contingent liabilities:

Northern Rock (NR)

(i) The indemnity that HM Treasury gave to the Bank of England in respect of additional facilities made available to NR has been removed following the refinancing of the Bank of England loan by HM Treasury.

(ii) The Chancellor's written statement of 31 March 2008 entitled NR announced that the Treasury had agreed a back up liquidity facility to ensure that NR met the Financial Services Authority's requirements until sufficient alternative liquidity arrangements are in place. The contingent liability is unquantifiable.

Bradford & Bingley (B&B)

(iii) The Treasury has put in place guarantee arrangements for six months to safeguard certain wholesale borrowings and deposits with Bradford & Bingley (29 September 2008 letters to Chair of PAC and TSC). The contingent liability is unquantifiable.

Icelandic Banks

(iv) HM Treasury has guaranteed a loan by the Bank of England to the Financial Services Compensation Scheme to provide compensation to retail deposits held in non-Edge accounts in Kaupthing Ltd that were not transferred to ING Direct. The total facility made available by the Bank of England to the Financial Services Compensation Scheme is up to £1 billion. The facility has not been drawn upon to date and continues to remain a contingent liability of up to £1 billion.

(v) HM Treasury has guaranteed certain retail deposits of Heritable Bank plc not covered either by the Financial Services Compensation Scheme or the transfer of retail deposits to ING Direct. The contingent liability is up to £2.5 million.

(vi) HM Treasury has guaranteed a short-term working capital loan by the Bank of England to Kaupthing Singer & Friedlander Ltd of up to £50 million to enable an orderly wind up of the company. (Treasury Minute dated 21 October 2008). The contingent liability is £50 million.

(vii) HM Treasury has guaranteed a short-term working capital loan by the Bank of England to the UK branch of Icelandic bank Landsbanki. (Treasury Minute dated 21 October 2008). The contingent liability is £100 million.

The Banking Industry

(viii) HM Treasury has made available guarantees to back banks' new short and medium term debt. They will be made available for terms of up to 36 months to help refinance maturing wholesale funding obligations as they fall due. (Treasury Minute 8 October 2008). The contingent liability is £250 billion.

(ix) HM Treasury has indemnified a scheme to allow banks to swap temporarily their high quality mortgage-backed and other securities for Treasury Bills. Under the terms of the indemnity no amounts would become payable by HM Treasury before 2012 and they would only arise if the capital losses exceed any surplus accruing to the Bank of England over the duration of the scheme. The contingent liability is unquantifiable.

(x) HM Treasury committed to provide capital to certain banks through the Government's Bank Recapitalisation Fund. In addition to the £37 billion which has already been committed and which was included in the Treasury's Out of turn Supplementary Estimate, the Government has committed to make capital available to smaller institutions, should they need it. (Treasury statements dated 8 and 13 October 2008). The contingent liability is up to £13 billion.

25 November 2008

Estimates Memorandum submitted by HMRC: Winter Supplementary 2008–09

INTRODUCTION

The HMRC winter Supplementary Estimate for 2008–09 seeks the necessary resources and cash to support the functions of the Department.

The purpose of this memorandum is to provide the Select Committee with an explanation of how the resources and cash sought in the winter Supplementary Estimate will be applied to achieve Departmental Strategic Objectives (DSO's) targets. This includes information on comparisons with the resources provided in earlier years in Estimates and departmental budgets. Details of changes in resources relative to original plans set out in the last Spending Review are provided.

During this winter round, the increases in provision sought in this Supplementary Estimate relate primarily to:

- £62,500,000 near cash Resource draw down on the Modernisation fund (Resource DEL)
- £27,500,000 Capital draw down of the Modernisation fund (Capital DEL)

An explanation of key terms used in the memorandum is provided as an annex.

SUMMARY OF THE MAIN SPENDING CONTROL FIGURES CONTAINED IN THE ESTIMATE VOTED PROVISION

The Supplementary Estimate provides a 2.6% increase in voted resource:

— Increase in the Net Resource Requirement (NRR) of	£107,500,000
RfR1	£107,499,000
RfR2	£1,000
— Increase in the Net Cash Requirement (NCR) of	£134,999,000

BUDGETARY DATA

The changes to key budgetary figures are:

Resource Departmental Expenditure Limit increased by **£63,838,000**

The increase in resource DEL is mainly attributed to the draw down of Modernisation Funds.

Capital Departmental Expenditure Limit increases by **£27,500,000**

This increase is due to the draw down of the Modernisation Fund.

DETAILED EXPLANATION OF CHANGES IN PROVISION SOUGHT IN THE SUPPLEMENTARY ESTIMATE, AND IMPLICATIONS FOR BUDGETS

<i>Amount</i>	<i>Description</i>
	Movements in provision related to DEL
	Transfer from Central Funds: draw down of Modernisation Fund
£62,500,000	<p>Draw down of resources from the ring-fenced modernisation fund of £62,500,000 to support costs for various programmes supporting the modernisation of the department. The following programmes are the primary spends</p> <p>Workforce Change Estates Consolidation Government Banking Modernising PAYE Processes for the Customer (MPPC) Carter programme</p> <p>More details follow:</p> <p>A large part of this funding will be used for Workforce Change a programme that helps HMRC:</p> <ul style="list-style-type: none"> — put staffing and location strategies into practice as far as possible, and resolve competing demands wherever necessary; — spot and manage opportunities to exchange staff or space; — communicate successfully with their staff, unions and external HMRC stakeholders on Workforce Change issues; and — understand related HR policies and how to apply them. <p>Estates Consolidation The programme scope is to deliver a flexible and affordable network of offices and ancillary properties, strategically located to meet customer service and operational requirements. It will make efficient use of the HMRC estate and will work closely with WFC to match operational requirements.</p> <p>Government banking Programme (GBP) The aim of the GBP is to implement the recommendations of the Chancellor's Departments' Banking Review which were approved by Treasury Ministers in 2004.</p> <p>Modernising PAYE Processes for the Customer (MPPC) MPPC will be moving PAYE processing onto one national IT platform, the "PAYE Service", which will significantly improve customer service and the Department's efficiency. We will no longer be using COP IT system for PAYE work. Instead, the PAYE Service will replace the 12 separate geographical databases that we use at the moment. PAYE staff will have access to customers' pay, tax, National Insurance and pension information in one place. This means staff will be able to answer queries more efficiently.</p> <p>The PAYE Service will help us to make sure customers pay the right amount of tax sooner and enable us to answer questions faster and more accurately. We will also be able to resolve more enquiries ourselves, reducing the need to go back to employers or employees with more queries.</p> <p>Carter Programme Based on Lord Carter's recommendations for the aim to have universal electronic delivery of business tax and individual tax returns for IT literate groups covering SA, PAYE, VAT and CT.</p>
	Draw down of Modernisation Fund
£27,500,000	<p>Draw down of capital from the ring-fenced modernisation fund of £27,500,000 to support costs for various programmes supporting the modernisation and transformation of the department. The programmes listed above will also include a capital element. (RfR1: subhead A7)</p>

<i>Amount</i>	<i>Description</i>
Transfer from Cabinet Office	
£1,520,000	Transfer in from Cabinet Office in respect of funding of Parliamentary Counsel Office. (RfR1: subhead A1)
Transfer to Home Office	
(£77,000)	Transfer to Home Office in respect of transfer of five Information Officers for the UK Border Agency. (RfR1: subhead A1)
Transfer to HM Treasury	
(£66,000)	Transfer to HM Treasury of £45,000 in relation to the contribution towards the Centre of Expertise in Sustainable Procurement and, £21,000 in relation to the transfer of one policy post. (RfR1: subhead A1)
Transfer to Cabinet Office	
(£40,000)	Transfer to Cabinet Office to cover a share of Metropolitan Police monitoring station costs associated with the Government Secure Zone works in Whitehall. (RfR1: subhead A1)
VOA token vote	
£1,000	An additional £1,000 has been added to allow parliament to vote the movement to Appropriation in Aid and expenditure in RfR2 mentioned below.
£91,338,000	Total change in provisions related to DEL

Movements in provisions of neutral budgets

Take up of Department Unallocated Provision

£43,662,000

Draw down of non-voted DUP of £43,662,000 taken up as voted administration near cash costs to facilitate improvements to key operational activities. This will be spent on the Data Security Programme (DSP) which is continuing to put in place a regime that ensures that we restore and then maintain public confidence, by being better at handling customer's data and sensitive documents. We are taking forward data security in HMRC, communicating the vision and the standards of security we expect to achieve and how we plan to implement the changes needed. We are drawing up a blueprint that illustrates how our department will look and feel as a result of our data security strategy and building a roadmap showing how we get there, establishing a performance measurement framework for assessing our success, as well as a statement of roles and responsibilities that affect everyone within HMRC.

Many things have been done already or are in train but data security is a key part of our transformation programme as we seek to modernise our operations and the IT that supports them, and deliver greater value to the tax payer. DSP has been working with Departmental Transformation teams and others to ensure data security was incorporated into the HMRC Strategic Framework and Target Operating Models agreed by HMRC Executive Committee in March 2008. The key to success will be our ability to raise information awareness leading to long-term behavioural change.

(RfR1: subhead A1).

£43,662,000 Total change from the take up of DUP

Changes in operating appropriations-in-aid (fully offset by changes in spending)

£67,930,000

To increase the levels of near-cash administration costs and income by £67,930,000, primarily in relation to employer compliance schemes and additional OGD receipts. With respect to penalties incurred by employers for late filing of end of year returns, improvements in the identification of collectible debt balances and the recording of penalty income on an accrued basis have led to increases in reported income for 2008–09. These improvements have coincided with an increase in the actual volumes of penalties incurred by employers, the combined effect being an increase of £48 million in forecast income. This is matched by administrative costs in terms of staff activity and overhead costs.

(RfR1: subhead A1 A5).

<i>Amount</i>	<i>Description</i>
£2,020,000	The increase to the VOA's receipts and expenditure relate to additional income expected from The Rent Service (TRS) / DWP to fund the costs of preparation for the transfer of functions from TRS to the VOA with effect from 1 April 2009 and because income from their Commercial Services business is now forecast to be higher than originally planned.
	(RfR2: subhead A1 A5)
£69,950,000	Total change in operating appropriations-in-aid
Transfer of Capital from RFR1 to RfR2	
£4,000,000	The additional capital is required by the VOA to fund investment in transformation projects to improve customer service and make efficiencies over the remainder of this CSR period and beyond.
	(RfR1 & 2: subhead A7)
Changes to net cash requirements	
£134,999,000	The changes above reflect the increase to the net cash requirement.
£134,999,000	Total change to net cash requirement

IMPACT ON DEPARTMENTAL STRATEGIC OBJECTIVES

Objective I: *Improve the extent to which individuals and businesses pay the amount of tax due and receive the credits and payments to which they are entitled*

A proportion of £27,500,000 Capital drawdown of Modernisation Fund

Draw down of Capital from ring-fenced modernisation fund to support our transformational programmes and projects.

A proportion of £62,500,000 Resource drawdown of Modernisation Fund

Draw down of Capital from the ring-fenced modernisation fund to support costs for transformational programmes and projects.

Objective II: *Improve customers' experience of HMRC and improve the UK business environment*

A proportion of £27,500,000 Capital drawdown of Modernisation Fund

As detailed in objective 1.

A proportion of £62,500,000 Resource drawdown of Modernisation Fund

As detailed in objective 1.

DEPARTMENTAL EXPENDITURE LIMIT

This Supplementary Estimate will result in an overall increase in Capital DEL of £27,500,000, and an overall increase in Resource DEL of £63,838,000. The revised total DEL will increase by £91,338,000. Details of DEL in Estimates are:

<i>£ '000s</i>	<i>Voted</i>	<i>Non-voted</i>	<i>TOTAL</i>
Resource DEL			
Main Estimate	3,975,044	391,401	4,366,445
Winter Supplementary Estimate	4,082,544	347,739	4,430,283
Capital DEL			
Main Estimate	257,366	3,648	261,014
Winter Supplementary Estimate	284,866	3,648	288,514
Revised Total DEL*	4,188,410	351,387	4,539,797

*Depreciation, which forms part of RDEL, is excluded from total DEL since CDEL includes capital spending and to include depreciation of those assets would lead to double counting.

The table below compares outturn for 2005–06, 2006–07 and 2007–08 with planned DEL.

<i>Year</i>	<i>Voted</i>	<i>Non-voted</i>	<i>TOTAL</i>	<i>Outturn £ '000s</i>	<i>Variance</i>
Resource					
2005–06	4,236,827	349,051	4,585,878	4,392,771	– 4.20% *
2006–07	4,271,163	347,939	4,619,102	4,574,712	– 0.96% **
2007–08	4,164,498	372,813	4,537,311	4,410,929	– 2.78% ***
2008–09	4,082,544	347,739	4,430,283		
2009–10	3,868,779	389,724	4,258,503		
2010–11	3,765,429	388,074	4,153,503		
Capital					
2005–06	374,269	2,977	376,635	377,889	+ 0.33% *
2006–07	338,331	0	338,331	305,613	– 9.67% **
2007–08	288,230	3,739	291,969	260,427	– 10.80% ***
2008–09	284,866	3,648	288,514		
2009–10	250,955	3,559	254,514		
2010–11	244,642	3,472	248,114		

The Resource DEL outturn for 2007–08 of £4,410,929 represents an underspend of £126,382 compared to final provision of £4,537,311k (equivalent to 2.78% of Resource DEL). The main underspends relate to Departmental Transformation Programme and general administrative underspends including payroll.

The Capital DEL Outturn for 2007–08 of £260,427k compares against a final provision of £291,969k. The main underspends primarily relate to Information Technology.

* Removes baseline transfer and costs associated with a machinery of government change to SOCA in 2006–07. The outturn figure has been taken from the HMRC Spring Report.

** Figures are those published in the Public Expenditure Outturn White Paper published in July 2007 (CM7156).

*** Figures are those published in the Public Expenditure Outturn White Paper published in July 2008 (CM7419).

DEL END-YEAR FLEXIBILITY

The 2008–09 EYF stock for HMRC was reported in the Public Expenditure Outturn White Paper 2007–08 (PEOWP) (Cm 7419). The breakdown below shows changes since the 2006–07 PEOWP (CM7156).

<i>£'000</i>	<i>Admin Resource</i>	<i>Other Resource</i>	<i>Total</i>	<i>of which: Near-cash</i>	<i>Non-cash</i>	<i>Capital</i>
PEOWP (July 2007)	61,825	63,106	124,931	155,790	– 30,859	33,257
Take-up in Winter Supplementary Estimate	–	1,400	1,400	1,400	–	–
Balance of EYF After Spring Supplementary Adjustments To PEOWP	61,825	61,706	123,531	154,390	– 30,859	33,257
July 2007	–	–	–	–	–	–
PEOWP July 2008	1,500	– 1,500	–	– 30,859	30,859	2,295
PEOWP July 2008	63,325	60,206	123,531	123,531		35,552
2007–08 Underspend	144,432	– 18,050	126,382	62,289		31,202
Reductions For virement Out of Admin budgets	– 18,050	18,050	–	–	–	–
Reductions for Reserve claims	– 30,000	–	– 30,000	– 30,000	–	–
Other Adjustments	299	–	299	299	–	–
2008–09 Entitlement	160,006	60,206	220,212	156,119		66,754

ADMINISTRATION BUDGET

The administration budget is £4,329,802,000. A comparison with earlier years (outturn) and plans is set out below.

<i>Administration budget (previous years)</i>		
<i>Year</i>	<i>Plans</i>	<i>Outturn</i>
2005–06 *	4,447,899	4,246,352
2006–07 **	4,523,493	4,496,817
2007–08 ***	4,441,607	4,297,275

During 2005–06 an underspend was generated mainly as a result of the de-scoping and deferral of some projects following a review of our change portfolio.

For 2006–07 there was a small voted underspend. An excess level of receipts was added to this, which led to a surplus of £26,676k for EYF purposes.

The 2007–08 underspend of £144,332k mainly relates to Departmental Transformation Project and general administrative underspends including paybill.

* Removes baseline transfer and costs associated with a machinery of government change to SOCA in 2006–07. The outturn figure has been taken from the HMRC Spring Report

** Figures are those published in the Public Expenditure Outturn White Paper published in July 2007 (CM7156)

*** Figures are those published in the Public Expenditure Outturn White Paper published in July 2008 (CM7419)

The changes to the current year's Administration Budget are:

<i>Changes to administration budget in 2008–09</i>	
1 April 2008 at Main Estimate	4,265,924
Change announced in winter supplementary	63,878
Revised Administration Budget	4,329,802

<i>Administration budget (Remaining CSR years)</i>	
<i>Year</i>	<i>Plans</i>
2009–10	4,159,826
2010–11	4,056,226

MACHINERY OF GOVERNMENT CHANGES

There are no changes resulting from Machinery of Government.

<i>Description</i>	<i>RfR and section</i>	<i>Date of transfer</i>	<i>Amount £000</i>	<i>Transferring Dept</i>	<i>Receiving Dept</i>

APPROVAL OF MEMORANDUM

This memorandum has been prepared with reference to guidance in the Estimates Manual provided by HM Treasury and that found on the House of Commons, Scrutiny Unit website. The information in this memorandum has been approved by the interim Principal Accounting Officer of HMRC David Hartnett.

GLOSSARY OF KEY TERMS

Appropriations-in-aid—income received by a department which it is authorised to retain (rather than surrender to the Consolidated Fund) to finance related expenditure. Such income is voted by Parliament in Estimates and accounted for in departmental resource accounts.

Administration Budget—a Treasury control on the resources consumed directly by departments in providing those services which are not directly associated with frontline service delivery. Includes such things as: civil service pay, resource expenditure on accommodation, utilities and services. The Administration Budget is part of Resource DEL.

Annually Managed Expenditure (AME)—a Treasury budgetary control for spending that is generally difficult to control, large as a proportion of the department's budget, and volatile in nature.

Departmental Expenditure Limit (DEL)—a Treasury budgetary control for spending that is within the department's direct control and which can therefore be planned over an extended (Spending Review) period (such as the costs of its own administration, payments to third parties, etc).

Departmental Unallocated provision (DUP)—a part, usually between 1% and 1.5% of a department's total DEL that is not allocated to particular spending, but held back by the department to meet unforeseen pressures.

End Year Flexibility (EYF)—a mechanism whereby departments are allowed to carry forward unspent DEL provision into later years.

Estimates—a statement of how much money government needs in the coming financial year, and for what purposes, by which Parliamentary authority is sought for the planned level of expenditure and receipts in a department.

Estimates Memorandum—an explanation to the relevant departments select committee setting out the links to other spending controls and the contents of a department's Estimate.

Near-cash—resource expenditure that has a related cash implication, even though the timing of the cash payment may be slightly different. For example, expenditure on gas or electricity supply is incurred as the fuel is used, though the cash payment might be made in arrears on a quarterly basis.

Non-cash—costs where there are no cash transactions but which are included in the body's accounts (or taken into account in charging for a service to establish the true cost of all resources used).

Request for Resources (RfR)—a function based description of the organisational level of the department. These can vary between one or more RfR and should be objective- based, referring to the purpose for which the functions being carried out by the department are intended to meet.

Letter from LD Stracey, Director and Company Secretary, Stena Line, to John McFall MP

Stena Line is one of the world's largest ferry operations and its business consists of 18 strategically located ferry operators of which eight operate from the UK across both the North Sea and Irish Sea. Stena Line employs around 1,700 people in the UK including approximately 1,000 British officers and crew.

As Chairman of the Treasury Select Committee that has recently heard from the Valuation Office on the subject of business rates at ports, I would like to bring to your attention the impact of the changes in business rates on Stena Line.

Stena Line operates as both Port Authority and as Ferry Operator at Holyhead and Fishguard in Wales as well as Ferry Operator at Fleetwood and Harwich. The company is already under severe financial pressures due to large increases in fuel costs and the significant increases in Business Rates as a result of the 2005 Revaluation has added to these pressures.

Fishguard: Even taking into account a recent reduction in the rating assessment, liability has still increased by 27%.

Holyhead: Liability has increased by 242%. Various third party contractors at the port are also being charged backdated rates to 1 April 2005 some of whom may not be able to afford the charge.

Fleetwood: This assessment initially decreased between the 2000 and the 2005 valuation lists but has recently been hit by an increase of over 430% in the assessment made by the Valuation Officer.

Harwich: Stena Line operated a dedicated fast ferry service from this port but terminated the service on the 8 January 2007 as it was no longer viable, primarily due to the large increase in fuel costs. In September 2008 the Valuation Office brought into assessment the berth from 1 April 2005 with the result that Stena Line faces a backdated rates bill amounting to £1.8 million. This bill relates to the period up to 31 March 2009, even though we no longer occupy the berth.

A number of issues arise from these matters:

1. The significant increased financial burden imposed by the Rates could eventually lead to reduced investment and redundancies. Given the importance of the ports and our ferry operations to the local economies this could have an adverse affect.
2. Welsh Ports do not benefit from the transitional arrangements which are available to its competitors in England. Holyhead and Fishguard have had to face the full force of the increases (approx £1.1 million and £0.4 million pa respectively) from the 1st April 2005.
3. In respect of Harwich, Stena Line is faced with a substantial backdated rates demand which we could not have known about or budgeted—this is grossly unfair as it is difficult for any business to budget for such eventualities. It is also worth mentioning that Stena Line is the only ferry operator at Harwich that has been assessed for rates, hardly a level playing field.
4. The Valuation Office did not consult with Stena Line either before the new Valuation List came into force or before any of the subsequent actions to alter the List. This contrasts with the situation in Scotland where a consultation exercise did take place with Port Operators.

We need help to deal with this added burden which is being imposed upon us at a time when there is a downturn in the economic climate. Action is needed to prevent any further backdating of bills and also to implement a period of consultation to deal with the current problem and also to provide a smooth transition into the next Rating Revaluation in 2010.

7 November 2008

Supplementary memorandum from HM Treasury

Q497 (Mr Breed): Last year the Financial Secretary told us that she would commission some work on the impact of rapid food inflation on the wellbeing of low income families. Can we know what the result of that work was and when it is going to be published?

The Treasury published “Global commodities: a long term vision for stable, secure and sustainable global markets” in June 2008. A copy of this report is enclosed, and can be found at <http://www.hm-treasury.gov.uk/d/globalcommodities.pdf>.

The Government acknowledges the impact that high food price inflation can have on family finances. In response, we have put in place a series of reforms to tackle poverty and disadvantage faced by vulnerable groups. On 13 May 2008, the Chancellor announced further support for low and middle-income families for 2008–09. For the current tax year, income tax personal allowances will be increased by £600 for all tax payers under 65. Around 22 million basic-rate taxpayers will benefit from this change.

This year, adults aged 60 and over will benefit from an additional payment of £50, and those aged over 80 from an additional payment of £100 to be paid alongside the winter fuel payment. In addition, extra help for the vulnerable this winter will be provided by an increase in cold weather payments, which will triple from £8.50 to £25 for this winter.

Q503–507 (Chairman): What is the quantity and value of drugs that went missing at Coventry? What have HMRC done since to ensure that seized drugs are securely stored?

As the Committee is aware from the discussion at last year’s hearings, four packages were reported missing on 4 December 2007. These packages contained a total of 1.5kg of cocaine with an approximate street value, at the time of the loss, of £60,560.

HMRC has since taken steps to ensure the security of seized goods. On 1 April 2008, a Single Point of Contact (SPOC) for security was appointed. The SPOC has responsibility for security issues within the former HMRC Detection directorate, and is now taking this role forward in the UK Border Agency. In addition to this, the Detection National Operations group has upgraded the Enforcement Management Assurance Framework from amber to amber/red. This means secure premises are thoroughly inspected more often—the frequency of lock up assurance checks has been raised from quarterly to monthly. It is not possible to further specify additional measures taken to boost security, as to do so may compromise security at the Coventry Hub.

Q528–Q530 (Mr Todd): The number of Tax Credit cases being handled manually

Out of the six million households in receipt of tax credits, around 19,100 were being dealt with manually at the end of October 2008. HMRC is aiming to reduce the number of cases dealt with manually.

Q538–Q539 (Mr Todd): *The financial implications of the new write off policy in Code of Practice 26*

Over the period April 2008 to October 2008 HMRC wrote off £10 million after customers disputed their overpayment under the new Code of Practice 26. What happens if we have paid you too much tax credit? It is too early to say whether this level will be sustained over time. Most of this may well have been written off under the previous code of practice and there will be other factors influencing the level of write off such as the amounts being disputed. HMRC will continue to monitor the level of write off going forward.

Q540/549 (Mr. Todd): *Supplementary payments for Child Trust funds and the link between Child Tax Credits*

The regulations amending the additional payment eligibility rules will be made shortly. The regulations, once made, will have effect for children who became eligible for the Child Trust Fund (CTF) on or after 6 April 2008. As the effect of the regulations will look back in this way, there is no question of children missing out because the regulations have not yet been laid.

Because some parents will still have CTF vouchers that fall under the old and the new rules the CTF website has been changed to include an explanation of how to decide which set of rules applies. After April 2009, when there are no vouchers left to which the current rules apply, HMRC will update the website to remove references to the old rules.

Q557 (Nick Ainger): *As you intend to legislate so that the eight-year period can be addressed without interest being applied, can we not address also the issue of the refusal of individual ports to pass on to their tenants the savings that the Valuation Office has given to them?*

We understand the Committee's concerns on this aspect of the ports issue. However, any rebates port operators receive would be legally theirs and it is not clear that the Government could direct that those monies be applied in whole or in part to any third party without potentially breaching Article 1 of the First Protocol to the European Convention of Human Rights (right to protection of property).

The Committee is aware that the exact details of proposed legislation to implement the new generous payment schedule for businesses facing backdated rates bills are still being considered. We will write again once these details are finalised.

Q567 (Nick Ainger): *The Mineworkers' Pension Scheme*

Mr Ainger asked about the 2005 actuarial valuation of the Mineworkers' Pension Scheme (MPS). Specifically he referred to John Ralfe's assertion, in the Financial Times, that "the method of actuarial valuation set down by the Government Actuary, understates liabilities by discounting at the 'expected return on assets', including 70% equities, not the index-linked gilt rate, which would better reflect the fact that pensions are inflation linked and Government guaranteed". Mr Ainger also referred to the statement "on an index-linked gilt basis, there was a £0.9 billion deficit at the 2005–06 valuations, not the reported £1.9 billion surplus. In 2002–03 the deficit would have been a whopping £5.3 billion at market values rather than the reported £0.7 billion deficit". This letter can be looked at in the context of both the MPS and its sister scheme the British Coal Staff Superannuation Scheme (BCSSS).

There is no single right set of valuation assumptions; the legal framework, the purpose of the valuation and the objectives of the parties should drive the assumptions to use. This becomes clear if you consider the range of different surpluses/deficits that are reported under any single traditional private sector scheme for purposes of funding, accounting, winding up, transfers etc. All use different assumptions and all give different answers. As a consequence, the comments in the article that "(variation in surpluses and deficits) has virtually disappeared in private sector schemes" are not correct for funding purposes.

In terms of legal framework, this scheme is a statutory public service pension scheme which operates in many respects quite differently to private sector pension schemes. Therefore, private sector ways of looking at these issues are not appropriate in this case. The main differences are that:

- (i) the Government gives a guarantee to fund any ultimate deficits in the longer term;
- (ii) surpluses arising under the MPS can translate into bonuses for members and returns to Government under a prescribed 50/50 formula;
- (iii) there are checks and balances built into the scheme such as the subfund structures, investment reserves, standstill and crystallisation arrangements, etc, which stabilise the financial position; and
- (iv) the actuarial valuations are prepared jointly for the trustees and Government (rather than solely for the trustees).

Against this background the primary purpose of the valuation (of the MPS) is to get a snapshot of the current financial position of the scheme in order to permit determination of the level of bonus pension augmentations, and payments to and from Government.

With such a purpose it is critical to understand the objectives which the trustees and Government jointly agreed to in 1994 when the scheme was consolidated into its current structure. In essence, the principal objective in 1994 was to set an investment strategy to maximise surpluses and minimise deficits. In the face of these two objectives, from 1994 the coal schemes embarked upon a long-term equity investment strategy combined with what at the time was the standard, near universal, actuarial valuation methodology which looked at long-term expectations of asset values, rather than “present-day” positions, in determining surpluses and deficits.

Two further objectives were also effectively put in place:

- an actuarial valuation approach designed to minimise inter-generational unfairness for members and taxpayers which would otherwise arise through, for example, a prudent approach; and
- a bonus approach aiming for reasonable stability over the years, consistent with the checks and balances mentioned above.

These objectives have not changed to date.

New valuations for the MPS, and the BCSSS which operates in a similar way, are currently in train. As part of this process and now that the scheme is 15 years’ old, the relevant parties ie the new Government Actuary (who took up his appointment on 1 May 2008), the Trustees and Government are all working together to re-test their views and decisions on purpose and objectives in advance of determining assumptions for the next valuation. The valuation results will then deliver an up-to-date snapshot of potential future contributions or surplus returns.

If the Committee requires any further information at this stage in relation to the scheme, both the Economic Secretary to the Treasury and the Government Actuary would be very happy to oblige.

19 December 2008

Letter from the Chancellor of the Exchequer to John McFall MP, Chairman of the Treasury Committee

1. I am writing to update you on the financial stability measures that I announced to the House on 8 and 13 October.

2. As you know, following detailed discussions with the major UK banks and the largest building society, I announced the initial implementation of these measures, including that the Government would be underwriting capital investments for RBS and, upon successful merger, HBOS and Lloyds TSB, totalling £37 billion. All three institutions subscribing to the Government’s bank recapitalisation fund will be seeking shareholder approval for raising their capital levels before the end of the year. The Government will then take shareholdings in these banks on the terms agreed on 13 October, subject to claw back by existing shareholders or take up by new shareholders of the ordinary shares and, in the case of HBOS and Lloyds TSB, to the merger going ahead. If for any reason the merger between HBOS and Lloyds TSB does not go ahead, the FSA would need to re-assess both banks to determine the extent to which each would need to recapitalise.

3. As I said on 13 October, the Government’s investments will be managed on a commercial basis by an arm’s-length company, “UK Financial Investments Limited” (UKFI), wholly owned by the Government. Its overarching objective will be to protect and create value for the taxpayer as shareholder with due regard to the maintenance of financial stability and to act in a way that promotes competition. This includes:

- maximising sustainable value for the taxpayer, taking account of risk;
- maintaining financial stability by having due regard to the impact of its value realisation decisions; and
- promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.

4. UKFI will manage the Government’s shareholdings in financial institutions subscribing to the bank recapitalisation fund announced on 8 October. Consistent with the agreements reached with the companies, UKFI will work with the Boards to strengthen their membership through the appointment of suitably qualified, independent non-executives. Final decisions will be taken by the relevant company Boards. In addition, the Government wholly owns Northern Rock plc and Bradford & Bingley plc and, in due course, the Government intends UKFI will also manage these investments on its behalf. All these companies will continue to have their own independent Boards and management teams, determining their own strategies.

5. UKFI will work to ensure management incentivisation based on long-term value maximisation, which attracts and retains high quality management and which minimises the potential for rewarding failure. UKFI will also oversee the conditions attached to subscribing to the Government's recapitalisation fund, including maintaining, over the next three years, the availability and active marketing of competitively-priced lending to home owners and small businesses at 2007 levels.

6. The Government will not be a permanent investor in UK financial institutions and will over time seek to dispose of the investments in an orderly way, through sale, redemption, buy-back or other means, in accordance with the UKFI's objectives.

7. The governance of UKFI will be consistent with the Government's intention to manage its investments on a commercial and arm's-length basis and not intervene in day-to-day management decisions. There will be seven members of the Board, comprising a private sector Chair, three further non-executive private sector members and a Chief Executive. Two senior Government officials will sit on the Board: one from HM Treasury and one from the Shareholder Executive.

8. In order to ensure that the Company can be operational in good time to manage investments made by the recapitalisation fund, we have informed the Commissioner for Public Appointments that we believe it is in the national economic interest for the appointment of the Chair and Chief Executive to be accelerated. I am pleased that Sir Philip Hampton has agreed to become the UKFI's first Chair, and that John Kingman has been appointed as UKFI's Chief Executive. Both will be taking up their positions shortly. The remaining private sector board members will be recruited expeditiously. These roles will be filled by individuals of relevant commercial skill and experience to enable UKFI to best meet the objectives set out above.

9. The Board will be accountable to the Government and, through me, to Parliament for the delivery of its objectives. Annual reports on UKFI's performance will be laid before Parliament and the Chair and Chief Executive will be available to scrutiny by the relevant Parliamentary committees. In due course, the Government will publish a full framework agreement setting out the details of the UKFI's relationship with the Government. We have remained in close contact with the European Commission regarding the implementation of the bank recapitalisation fund, which authorised the fund under the state aid rules on 14 October.

10. On 13 October, alongside my own announcement, the Debt Management Office published the arrangements for operating the credit guarantee scheme, which has now been operating as intended for two weeks. The scheme's objective is to restore confidence in the inter-bank money market by providing credit guarantees to banks to refinance their maturing unsecured debt as it falls due. The guarantees are priced to reward taxpayers for the risk they take on and, by controlling the total size of the scheme and the term of guaranteed debt, taxpayer exposure to banking sector risk is limited. The contingent liabilities taken on through the scheme will be reported to Parliament through the usual Winter and Summer Supplementary Estimates process.

11. In addition to the recapitalisation fund and the credit guarantee scheme, as the Prime Minister and I have said, it is important that all lenders do everything they can to support homeowners and small business during this period of financial market turbulence. Last week, the Secretary of State for Business and I met a range of banks to discuss the steps they can and should take to help borrowers struggling with mortgage payments, and to strengthen their arrangements for supporting small business. We will continue discussions with the industry on these issues and will shortly publish proposals for monitoring information on lending to homeowners and small businesses.

12. Finally, the UK continues to lead international efforts to bring stability to the financial system. Many other countries have now adopted similar measures to those that the Government announced on 8 October and in the next two weeks the Prime Minister, other Ministers and I will discuss measures to ensure financial stability in both the short and long term with our European and global counterparts, including at ECOFIN in Brussels tomorrow; an extraordinary Informal European Council, again in Brussels, on 7 November; a G20 Finance Ministers' meeting in Brazil on 8-9 November; and an extraordinary G20 Heads and Finance Ministers' Summit in the USA on 15 November.

3 November 2008

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