National Audit Office

BRIEFING FOR THE
HOUSE OF COMMONS
TREASURY SELECT
COMMITTEE

NOVEMBER 2009

Performance of HM Treasury 2008-09

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NOVEMBER 2009

This briefing has been prepared for the Treasury Select Committee to provide an overview of the work and performance of HM Treasury in the financial year 2008-09 and subsequent months.

Contents

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Summary

Aim and scope of this briefing

1 This briefing has been prepared for the Treasury Select Committee (the Committee) to provide an overview of the work and performance of HM Treasury in the financial year 2008-09 and subsequent months. The briefing takes as its basis the Department's *Annual Report and Accounts 2008-09* (HC 611), drawing upon the work of the National Audit Office (NAO) together with relevant material from other external and internal reviews of departmental performance.

2 The briefing has been shared with the Treasury to ensure that the evidence presented is factually accurate, but the commentary and views expressed are the sole responsibility of the NAO.

The Department's role

3 The Treasury is the United Kingdom's economics and finance ministry, responsible for formulating and implementing the UK Government's financial and economic policy. There are a number of Departments, Agencies, Offices and Non-Departmental Public Bodies that fall under the responsibility of Treasury Ministers (see **Figure 1**). For full details of the division of Ministerial responsibilities within the Treasury, please see pages 21 to 23 of the *Annual Report and Accounts*.

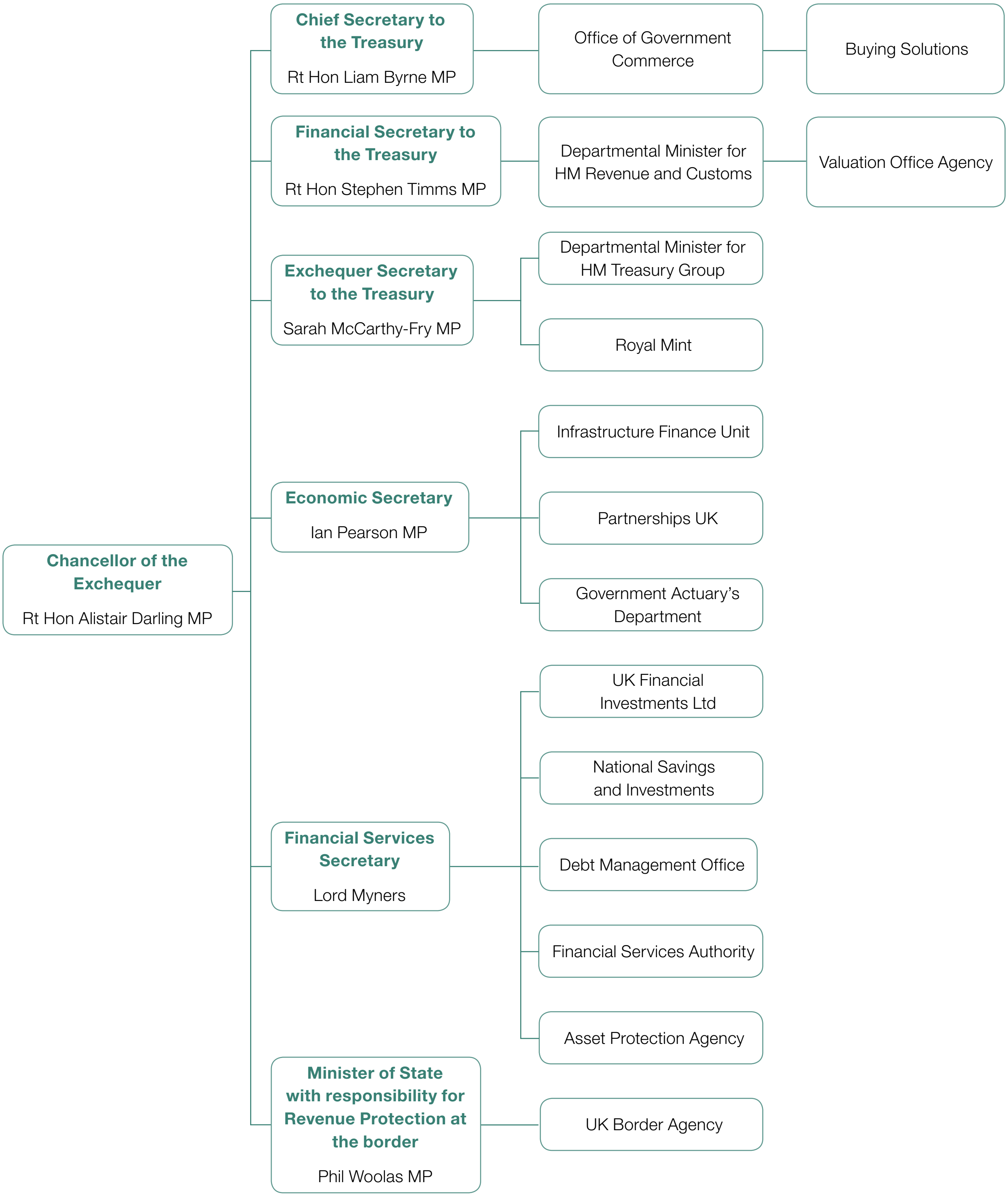
4 The Treasury Group consists of HM Treasury (Core Treasury), the UK Debt Management Office (DMO) and the Office of Government Commerce (OGC). The Treasury Group published its Annual Report and Accounts 2008-09 in July 2009, and this included the consolidated Resource Accounts for the Treasury Group.

5 The "Core" Treasury is responsible for formulating and implementing the UK Government's financial and economic policy. The Permanent Secretary and Principal Accounting Officer is Sir Nick Macpherson, who is supported by the Board.

6 The DMO is an executive agency of the Treasury which specialises in the delivery of treasury management services and related policy advice. The DMO's Chief Executive, Robert Stheeman, is an Additional Accounting Officer for the Treasury Group.

7 The OGC is an office of the Treasury responsible for driving value for money improvements in public procurement and estates management in central government. Nigel Smith is the OGC's Chief Executive and is also an Additional Accounting Officer for the Treasury Group.

Figure 1
Ministerial responsibilities



Source: HM Treasury Annual Report and Accounts 2008-09

8 In addition, there are several arm's length bodies, entities which are linked to the Treasury, but which operate under distinct framework agreements and legislation that dictate the involvement of Treasury at a corporate governance level. As at 31 March 2009, these were the Bank of England, the Royal Mint, Buying Solutions, Partnerships UK, Pool Re and Pool Re (Nuclear), Northern Rock, Bradford & Bingley, Deposits Management (Heritable) Limited, and UK Financial Investments Limited (UKFI).

9 Since April 2009, the Treasury has created an additional arm's length body, the Infrastructure Finance Unit Limited, and has announced the establishment of the Asset Protection Agency as an executive agency of the Treasury with Stephan Wilcke as Chief Executive.

10 Further information on the arm's length bodies acquired or created since September 2008 is provided in **Figure 2**.

Figure 2
Arm's length bodies acquired or created since September 2008

Acquired or created in 2008-09

Bradford & Bingley plc – On 29 September 2008, Bradford & Bingley was transferred into temporary public ownership under the Banking (Special Provisions) Act 2008. Immediately after this transfer, the bank's UK retail deposit business along with its branch network and Isle of Man operations were transferred to Abbey National plc. The remaining assets and liabilities of Bradford & Bingley remain in public ownership, and will be wound down over a period of time.

Deposits Management (Heritable) Limited – On 8 October 2008, the Treasury set up Deposits Management (Heritable) Limited to facilitate the restructuring of Heritable Bank plc. The entity has net assets of nil as the cash it holds, being the consideration paid by ING Direct for Heritable's UK deposit business, is payable to the administrators of Heritable plc. The company does not perform any function on behalf of the Treasury, but rather is a shell company.

UK Financial Investments Limited – On 3 November 2008, the Government created UKFI to manage the investments it has acquired in UK financial institutions, in the interests of wider financial stability. UKFI currently manages the Government's interests in the Royal Bank of Scotland, Lloyds Banking Group and Bradford & Bingley.

Acquired or created in 2009-10

Infrastructure Finance Unit Limited (IFUL) – On 3 March 2009, the Chief Secretary to the Treasury announced that the Government would lend to PFI projects to ensure vital PFI infrastructure projects go forward as planned despite the current financial market conditions. As a result of this announcement, the Treasury established Infrastructure Finance Unit Limited. IFUL completed its first loan facility on 8 April 2009, providing a £120 million loan for the Greater Manchester Waste Disposal Authority's PFI project.

Asset Protection Agency – On 19 January 2009, the Government announced its intention to offer an Asset Protection Scheme. Under this Scheme, the Treasury will provide banks with protection against future credit losses on certain assets in exchange for a fee. A "first" loss remains with the bank but the Government's protection will cover 90 per cent of credit losses above this amount, with the participating bank retaining the residual exposure. The Asset Protection Agency will operate the Scheme.

Source: National Audit Office

Key Events

11 Since October 2008, the Government has made a series of interventions to ensure the stability of the UK's financial system and restore the flow of credit in the economy. These include:

- capital injections of some £36,926 million to purchase shares in the Royal Bank of Scotland and Lloyds Banking Group;
- provision of some £28,365 million to provide compensation to the UK depositors of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Icesave, London Scottish Bank, and Dunfermline Building Society (either directly or by providing funding to match deposits transferred to third parties such as Abbey National plc);
- several schemes to aid the flow of credit in the economy, including the Credit Guarantee Scheme and the Asset Backed Securities Guarantee Scheme (there has not yet been any take-up of this scheme); and
- provision of indemnities to the Bank of England over operations it has implemented to restore financial stability in UK markets, such as the Asset Purchase Facility Fund.

The Treasury has also continued to provide support to the two financial institutions it holds in temporary public ownership, Northern Rock and Bradford & Bingley. Further details of the support given to these institutions is provided in Part 1: Financial Review.

12 In addition, the Banking Act 2009 obtained Royal Assent on 12 February 2009. The Act is similar to the Banking (Special Provisions) Act 2008, which was repealed under the 2009 Act and was used to provide financial support to several financial institutions during 2007-08 and 2008-09. Among other things, the 2009 Act allows the use of the Consolidated Fund Standing Service, which enables the Treasury to obtain funding outside the normal supply process (i.e. non-voted expenditure) to provide financial assistance to financial institutions. The Act states that the Service should only be used in cases where the need for funds is so urgent that the normal supply process cannot be applied and requires that such drawings are authorised by the Comptroller and Auditor General (C&AG).

13 There was one use of this new arrangement during 2008-09. On 30 March 2009, the Treasury drew some £1,555 million using the Standing Service to fund the transfer of certain elements of Dunfermline Building Society's business, including all retail and wholesale deposits, to Nationwide. It was deemed that the need for expenditure was too urgent to permit arrangements for the provision of money by Parliament and therefore the use of the Standing Service was authorised by the C&AG.

Key Issues

14 **Financial Stability** – The Treasury's key role during 2008-09 has been to respond to the instability in the financial markets, and this has had an impact on both the operations of the Treasury and its financial statements for that year. Measures taken include the acquisition of shares in a number of financial institutions, provision of loans to fund compensation payments to depositors of financial institutions declared in default, and provision of guarantees and indemnities to third parties. As a result, net operating cost has increased by some £42,022 million and net assets have increased by some £42,531 million (see Part 1: Financial Review).

15 **Excess Vote** – In 2008-09, the Treasury incurred some £23,816 million more resources than Parliament had authorised in the Supply Estimate. This represents an "excess" for which further Parliamentary authority is required. The C&AG therefore qualified his opinion on the Treasury's 2008-09 Resource Accounts. Further information is provided in Part 1: Financial Review.

16 **Public sector implementation of International Financial Reporting Standards (IFRS)** – Budget 2008 announced that the implementation of International Financial Reporting Standards (IFRS) would be delayed until 2009-10 to ensure a smooth transition. All government departments, except those granted specific dispensation by the Treasury, were required to restate 1 April 2008 balances from UK GAAP to IFRS and present this restatement to auditors by 30 September 2008. Around 50 per cent of the 47 Resource Accounts required to produce a restated balance sheet did so by the 30 September deadline, with a number of further returns submitted during the following months. An unqualified audit opinion was provided on 23 of the 47 Resource Accounts subject to the requirements. For the remaining 24, either evidence to support the restated balance sheet was substantially incomplete, or material disagreements arising from the IFRS restatement remained unresolved. In his General Report for 2008, the C&AG concluded that whilst many departments had a significant amount of work to do to ensure that their accounts could be prepared on an IFRS basis, the work completed by departments represented significant progress, and provided a good basis for the move to formal statutory IFRS based accounts to be achieved in time for the resource accounts for 2009-10.

17 As part of the next stage in the implementation of IFRS, the Treasury required all government departments to restate their 2008-09 accounts on an IFRS basis (including the opening balance sheet) and submit them for audit by 10 September 2009. These IFRS "shadow accounts" will then be subject to NAO audit by 31 December 2009.

18 **Whole of Government Accounts (WGA)** – The 2008 Budget also announced the Government's intention that Whole of Government Accounts (WGA) would be published for the first time for the 2009-10 financial year. The NAO is currently reviewing the data for 2008-09, but its review of the 2007-08 dry-run WGA reported issues relating to the interpretation of the boundary for consolidation of bodies in WGA, different accounting policies and treatments across the government sectors, weaknesses in the quality of data submitted from bodies consolidated in WGA, omission of key disclosures in WGA, unexplained discrepancies and misstatements relating to movements on reserves and intra-group transaction streams and balances, and significant qualifications and uncertainties in the statutory accounts of consolidated bodies.

19 The Treasury is aware of these matters and it has strengthened its WGA team to progress these matters ahead of the 2009-10 preparation of the WGA. To address the issues of data quality and completeness, it has adopted a more proactive approach to engagement with the public sector community. These issues will need to be resolved if the Treasury are to achieve the objective of preparing 2009-10 WGA which present a true and fair view and conform to generally accepted accounting practice (International Financial Reporting Standards from 2009-10).

20 **Follow-up of the Capability Review** – in December 2008, the Treasury underwent a follow-up to its original Capability Review. This found that some progress had been made against the four areas of action highlighted in the original review, although further improvements could still be made (see Part 2: Treasury's Capability).

21 **Public Service Agreements (PSAs) and Departmental Strategic Objectives (DSOs)** – The Treasury is the lead department on one PSA target, *PSA 9: Ending child poverty*, against which it has rated its overall performance in 2008-09 as "No progress".

22 The Treasury also has two Departmental Strategic Objectives (DSOs): *DSO 1 Maintaining sound public finances, and DSO 2 Ensuring high and sustainable levels of economic growth, well-being and prosperity for all*. Each DSO is split into a number of key outcomes of which there are 14 in total. The Treasury's own assessment of its performance, based on published performance indicators that are linked to these outcomes, has concluded that overall performance on both DSOs is in the category "some progress" meaning that 50 per cent or less of indicators have improved. Further details of performance against both DSOs and PSA 9 are provided in Part 3: Performance against PSAs and DSOs targets.

Part One

Financial Review

1.1 The Treasury's Consolidated Resource Accounts report annually the Department's financial performance and year-end position. The Accounts, including the Statement of Parliamentary Supply which is the primary accountability statement, are subject to external audit by the C&AG.

1.2 The C&AG qualified his audit opinion on the Treasury's Resource Accounts for the year ended 31 March 2009, because the Department had incurred expenditure of some £23,816 million more than Parliament had authorised leading it to incur an Excess Vote (**pages 171 to 174**, HM Treasury Annual Report and Accounts 2008-09).

1.3 This overspend arose because of the need to provide for expected estimated net losses arising from the operation of the Asset Protection Scheme, under which the Treasury provides banks with protection against future credit losses on certain assets in exchange for a fee. The Treasury knew from the outset that the Scheme would result in a significant loss, but could not estimate the amount until the Royal Bank of Scotland and Lloyds Banking Group had confirmed their intention to participate in March 2009. It was therefore too late at this stage for the Treasury to seek extra resources from Parliament to meet these losses, which it recorded as a provision against expenditure.

Analysis of expenditure by programme

1.4 The Treasury Group has three distinct programmes of expenditure, represented by the three Requests for Resource (RfR) detailed in its Main Supply Estimate:

- **Request for Resource 1: "Raising the rate of sustainable growth and achieving rising prosperity and a better quality of life, with economic and employment opportunities for all."** The programme's objectives are delivered by the "Core" Treasury and the DMO. In 2008-09 net outturn under this programme was £44,808 million (2007-08 £231 million).

- **Request for Resource 2: "Cost effective management of the supply of coins and actions to protect the integrity of coinage."** This programme's expenditure is linked to the Service Level Agreement with the Royal Mint for the procurement of UK circulating coin. In 2008-09 net outturn under this programme was £42 million (2007-08 £44 million).

- **Request for Resource 3: "Obtaining the best value for money for Government's commercial relationships on a sustainable basis."** This programme is delivered through the Office of Government Commerce. In 2008-09 net outturn under this programme was £24 million (2007-08 £33 million).

1.5 The Treasury's net total outturn for 2008-09 was £44,874 million, a substantial increase on the £307 million incurred in 2007-08. As noted above, the majority of this increase has occurred on RfR 1.

1.6 The increase in net outturn on RfR 1 is largely attributable to measures arising from the Government's response to the global economic crisis. In particular, non-cash costs relating to the expected net losses on the Asset Protection Scheme, and impairment of shareholdings in UK financial institutions and of certain loans to financial institutions in administration (see below for further details).

1.7 Net outturn on RfR 2 has varied very little year on year. The slight decrease in outturn is mainly attributable to a fall in the cost of capital charge, as a result of the change made to the methodology to calculate this figure so that it more accurately reflects working capital performance.

1.8 The £9 million decrease in RfR 3 outturn is largely as a result of £10.3 million exceptional, one-off staff exit costs incurred during 2007-08. These arose primarily as a result of the restructuring of OGC following the "Transforming Government Procurement" programme, and so equivalent costs were not incurred in 2008-09.

1.9 For 2009-10, the Treasury has made some changes to the coverage of the three Requests for Resources. RfR 1 will now include spending on core Treasury, Debt Management Office, Office of Government Commerce, the cost of Group shared services, and the cost of capital charges on the Treasury's investment in the Bank of England. RfR 2 will continue to cover the costs associated with UK coins and RfR 3 will now cover spending by UK Financial Investments Limited (UKFI) and Infrastructure Finance Unit Limited (IFUL), assistance to financial institutions and the cost of capital charges on financial investments and loans.

Financial performance and position 2008-09

1.10 Net operating costs have increased by some £42,022 million (**Figure 3**), a substantial increase in costs from 2007-08 (£179 million). The majority of this increase is in programme costs and, as outlined above, has arisen as a result of the financial stability measures put in place during 2008-09.

1.11 The substantial £43,940 million increase in exceptional programme costs is in relation to the following items:

- creation of a £25,000 million provision for the expected estimated net loss on the Asset Protection Scheme. The provision value is based on the terms of the pre-accession agreements with the Royal Bank of Scotland and Lloyds Banking Group, signed in February and March 2009, respectively, and the initial due diligence work performed at that time (see section on financial stability below for further details);
- £17,308 million impairment of the shareholdings in the Royal Bank of Scotland and Lloyds Banking Group as a result of the decline in the market price of those shares since they were purchased; and
- £1,618 million impairment of certain statutory debts to reflect their expected recoverability rates.

1.12 Non-exceptional programme costs have increased by some £725 million, largely due to an increased cost of capital charge. This rise occurred because of the substantial increase in the Department's net assets arising as a result of the support provided to various financial institutions. Further details on these assets are provided below.

Figure 3
Operating Cost Statement

	2008-09 (£000s)	2007-08 (£000s)	Variance (£000s)
Staff Costs	90,894	94,003	(3,109)
Other Administration Costs	121,796	102,592	19,204
Exceptional Administration Items	–	3,757	(3,757)
Administration Income	(59,063)	(36,750)	(22,313)
Programme Costs	873,823	149,160	724,663
Exceptional Programme Costs	43,934,882	(4,657)	43,939,539
Programme Income	(2,773,204)	(140,852)	(2,632,352)
Expenditure Outside of Supply	11,305	11,358	(53)
Net Operating Costs	**42,200,433**	**178,611**	**42,021,822**

Source: HM Treasury Annual Report and Accounts 2008-09

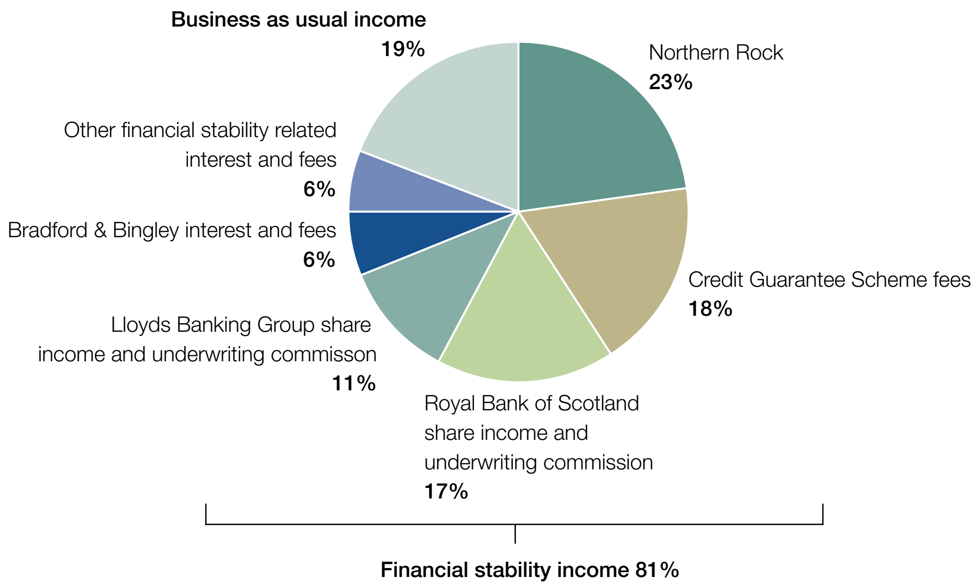
1.13 Programme income, the majority of which is surrendered to the Consolidated Fund when received, has increased by some £2,632 million to £2,773 million. Some 81 per cent of the income recognised in 2008-09 was in relation to the dividends, commitment fees, interest and guarantees fees falling due to the Treasury in relation to the financial stability measures (**Figure 4**).

1.14 In addition, what might be considered to be 'business as usual' programme income increased significantly due to an increase in the dividend receivable from the Bank of England. The Treasury receives an annual dividend equivalent to 50 per cent of the Bank's post-tax profit. As a result of the high level of fees receivable by the Bank in respect of schemes such as the Special Liquidity Scheme, post-tax profit increased more than 400 per cent to some £833 million in the year ended 28 February 2009 and, therefore, the dividend receivable by the Treasury increased in line with this.

1.15 Administration income has increased by some £22 million, a 61 per cent increase on the 2007-08 position. This is largely due to recharges made to certain financial institutions benefiting from the support provided by the Government, to recover consultancy and legal costs incurred by the Treasury in relation to the various financial stability measures.

Figure 4

Split of programme income (£2,773 million)



Source: National Audit Office

1.16 Net assets have increased by £42,531 million on the 2007-08 position to some £44,778 million (**Figure 5**). Again, this is largely as a result of financial stability measures, in particular: the acquisition of ordinary and preference shares in the Royal Bank of Scotland and Lloyds Banking Group (£19,716 million after impairment); provision of loan facilities to the Financial Services Compensation Scheme (£20,978 million); and provision of statutory debt and working capital facilities to financial institutions in administration (£11,504 million after impairment). In addition, there was a £1,028 million increase in the valuation of the Treasury's investment in the Bank of England, reflecting the substantial increase in the Bank's own net assets.

1.17 This increase in the Treasury's assets has been partly offset by a £4,220 million decrease in the value of the Northern Rock loan as a result of in-year repayments; and a £6,076 million increase in provisions (being the creation of a £25,000 million provision for expected estimated net losses on the Asset Protection Scheme offset by the utilisation of the £19,300 million provision made in 2007-08 for the novation of the Northern Rock loan from the Bank of England).

Financial Stability

1.18 Over the past financial year, the Treasury's operations, and its Accounts, have been dominated by the response to the worsening global economic crisis that began in 2007. Many of the key events occurred in the second half of the 2008-09 financial year (see timeline at Appendix One) and, as a result, the Treasury was required to increase its net cash requirement from £14,221 million in the Main Estimate (published in April 2008) to £89,236 million in the revised Spring Supplementary Estimate (published in February 2009). A summary of the amounts authorised by Parliament for the Treasury during 2008-09 is provided in **Figure 6**.

Figure 5
HM Treasury Balance Sheet

	2008-09 (£000s)	2007-08 (£000s)	Variance (£000s)
Fixed Assets	104,902	116,701	(11,799)
Financial Assets	71,155,349	21,622,309	49,533,040
Debtors	4,725,408	110,086	4,615,322
Stock	5,883	8,045	(2,162)
Cash	4,975	3,504	1,471
Creditors	(2,133,196)	(295,987)	(1,837,209)
Financial liabilities	(3,691,538)	–	(3,691,538)
Provisions	(25,393,801)	(19,318,062)	(6,075,739)
Net Assets	**44,777,982**	**2,246,596**	**42,531,386**
Taxpayers Equity	**44,777,982**	**2,246,596**	**42,531,386**

Source: HM Treasury Annual Report and Accounts 2008-09

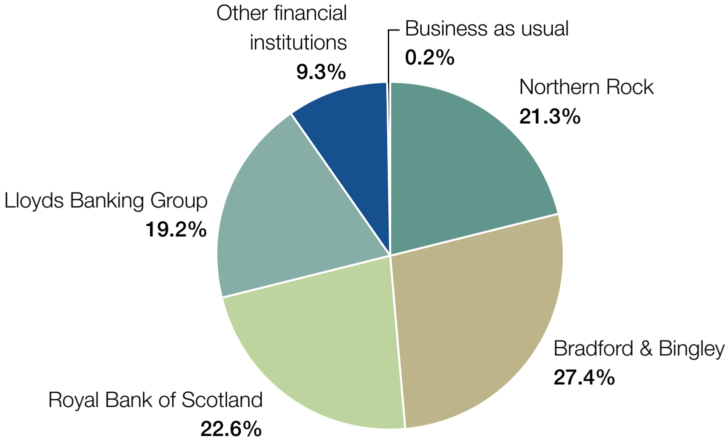
1.19 The final outturn on the net cash requirement for 2008-09 was some £88,310 million, of which 99.8 per cent related to financial stability measures. **Figure 7** provides an overview of the split of the 2008-09 net cash requirement between the various financial institutions that received support during 2008-09. It should be noted that this does not include support provided in the form of guarantees and indemnities, as no cash was required for these items in 2008-09.

Figure 6
Amounts authorised by Parliament for HM Treasury 2008-09

2008-09 Estimates	**Net Resources (£m)**	**Net Cash (£m)**
Main Estimates April 2008 (HC 479)	315	14,221
Summer Supplementary Estimates June 2008 (HC 621)	–	5,300
Out-of-turn Supplementary Estimates October 2008 (HC 1061)	–	42,200
Winter Supplementary Estimates November 2008 (HC 1163)	8	23,413
Revised Spring Supplementary Estimates February 2009 (HC 265)	20,745	4,102
Total	**21,068**	**89,236**

Source: HM Treasury Estimates 2008-09

Figure 7
Split of Net Cash Requirement by Institution



Source: National Audit Office

1.20 As a result of the various financial stability measures, the 2008-09 Resource Accounts feature:

- **Investments** in a number of financial institutions including Northern Rock, Bradford & Bingley, Royal Bank of Scotland, Lloyds Banking Group, and several arm's length bodies.
- A number of **guarantees and indemnities** offered to third parties including the Bank of England and the depositors of various financial institutions declared in default.
- **Loans** to the Financial Services Compensation Scheme (FSCS) and **receivables** due from the wind-up of the various financial institutions placed in administration where action has been taken to protect depositors' interests.
- **Derivative financial instruments** arising from hedging arrangements put in place to reduce the Treasury's exposure to foreign currency fluctuations on fees it receives for the Credit Guarantee Scheme, and from commitments to purchase further banking shares during the post balance sheet period.
- **Provisions** for the estimated net loss on the Asset Protection Scheme and the potentially unrecoverable elements of statutory debt payments yet to be made for commitments in excess of Financial Services Compensation Scheme (FSCS) limits.

1.21 The majority of these entries, excluding provisions, are included in Note 13 to the Accounts. Further details of each category are provided below and a summary of the basis of valuation for each asset is provided at **Figure 8** and each liability is provided at **Figure 9**.

1.22 In addition, a number of events occurred during the period between the financial year-end (31 March 2009) and the date the accounts were certified (17 July 2009), the post balance sheet period, which were reflected in the Accounts (Appendix One). In the majority of cases, these events are considered to be 'non-adjusting' and are simply disclosed within Note 42 to the Accounts. There were, however, some events which occurred during the post balance sheet period which required adjustments to be made to the figures included within the 2008-09 Resource Accounts. These included notification that an additional payment of some £428 million (split between the FSCS and the Treasury) was due to Abbey National plc in respect of the deposits transferred from Bradford & Bingley; further information on the split of funding between the FSCS and the Treasury on compensation paid to depositors of London Scottish Bank; and the completion of the redemption of preference shares held in the Royal Bank of Scotland and Lloyds Banking Group and related purchases of further ordinary shares in these institutions.

Figure 8
Financial assets

	Balance Sheet value at 31 March 2009 £'000	Valuation method
Available for sale assets:		
Bank of England	3,321,000	Net asset value based on published accounts
Partnerships UK Shares	7,865	Net asset value based on published accounts
Royal Mint	5,500	Public dividend stock held at cost
Buying Solutions Public Dividend Capital	350	Public dividend stock held at cost
Shares in Northern Rock and Bradford & Bingley	–	At cost (pending independent valuations)
Ordinary shares in Royal Bank of Scotland	5,599,180	Market value
Preference shares in Royal Bank of Scotland	5,052,647	Fair value based on discounted future cashflows
Ordinary shares in Lloyds Banking Group	5,019,496	Market value
Preference shares in Lloyds Banking Group	4,044,484	Fair value based on discounted future cashflows
UK Financial Investments Limited	–	Held at cost (value of less than £100)
Deposits Management (Heritable) Limited	–	Held at cost (value of less than £100)
Loans and receivables:		
Partnerships UK loan stock	15,594	Held at cost as a proxy for amortised cost
Northern Rock Loan	14,561,479	At cost as a proxy for amortised cost
Bradford & Bingley Working Capital Facility	6,000,000	At cost as a proxy for amortised cost
Statutory Debts	5,503,514	Discounted cost as a proxy for amortised cost
Loans to the Financial Services Compensation Scheme	20,978,433	At cost as a proxy for amortised cost
Derivative financial instruments:		
Ordinary share forward contract	1,018,341	Fair value based on discounted future gain
Forward currency contracts	27,466	Fair value based on market value
Total financial assets	**71,155,349**	

Source: HM Treasury Annual Report and Accounts 2008-09

Figure 9
Financial liabilities

	Balance Sheet value at 31 March 2009 £'000	Valuation method
Financial guarantees:		
Credit Guarantee Scheme	2,261,443	Fair value based on discounted fees receivable
Other	963,293	Fair value based on discounted fees receivable
Derivative financial liabilities:		
Ordinary share forward contract	427,607	Fair value based on discounted future loss
Forward currency contracts	39,195	Fair value based on market value
Total financial liabilities	**3,691,538**	

Source: HM Treasury Annual Report and Accounts 2008-09

Investments in financial institutions

1.23 During 2008-09, the Treasury purchased shares in several financial institutions and set up two arm's length bodies, UKFI and Deposits Management (Heritable) Limited to assist with the management of those interests. The following interests are included in Note 13 to the Accounts:

- **Bradford & Bingley (Note 30 to the Accounts)** – the equity investment in Bradford & Bingley was acquired on 29 September 2008 at zero cost. The Treasury, therefore, recognised the investment as zero in the Balance Sheet in line with the treatment of the equity investment in Northern Rock. In accordance with the Bradford & Bingley Compensation Scheme Order 2008 (18 December 2008) on 24 June 2009, and following a competitive process, the Treasury appointed Peter Clokey as independent valuer to assess any compensation that may be payable to those affected by the transfer of Bradford & Bingley to the Treasury, this being noted as a contingent liability in the Resource Accounts (Figure 12 on page 21). In July 2009, UKFI announced that it has taken a formal responsibility for the Government's investment in Bradford and Bingley.

- **Ordinary shares in the Royal Bank of Scotland and Lloyds Banking Group (Notes 31 and 32)** – the Treasury acquired ordinary shares in the Royal Bank of Scotland, Lloyds TSB and Halifax Bank of Scotland (HBOS) on 1 December 2008, 13 January 2009 and 15 January 2009, respectively, at a total cost of some £27,926 million. Following these purchases, on 19 January 2009, Lloyds TSB and Halifax Bank of Scotland merged to become Lloyds Banking Group, and the Government's shares in the two institutions were converted accordingly.

All of the shares were purchased at above market price on the date of purchase and the market price continued to fall to the balance sheet date (**Figure 10**). This resulted in a book loss of some £17,308 million being recorded in the 2008-09 Operating Cost Statement. This loss will not be realised until the shares are sold and then only if the shares are sold at below the value at which the purchases were made.

Figure 10
Ordinary share purchases

	Number of shares (million)	Purchase price (£)	Market price on date of purchase (£)	Market price 31 March 2009 (£)
Royal Bank of Scotland Group	22,854	0.66	0.55	0.25
Lloyds Banking Group[1]	7,100	1.83	1.25	0.71

Source: National Audit Office

NOTE

1 'Purchase price' and 'Market price on date of purchase' represent the average position on the shares purchased in Lloyds TSB and Halifax Bank of Scotland, which were converted to shares in Lloyds Banking Group on 19 January 2009.

UKFI manages the shareholdings in the Royal Bank of Scotland and Lloyds Banking Group on behalf of the Treasury. Its objectives are to sell the investments in a way and at a time that will protect and create value for the taxpayer as shareholder, whilst also ensuring due regard for financial stability and acting in a way that promotes competition.

- **Preference shares in the Royal Bank of Scotland and Lloyds Banking Group (Notes 31 and 32)** – in addition to the ordinary share holdings outlined above, on 1 December 2008 and 15 January 2009 the Treasury acquired some £9,000 million preference shares in the Royal Bank of Scotland and Lloyds Banking Group (at the time of purchase Lloyds TSB and HBOS). These shares have been revalued upwards to reflect the premium and future dividends due to Treasury on their redemption, which was agreed with the Royal Bank of Scotland on 19 January 2009, and Lloyds Banking Group on 7 March 2009. The £5,000 million preference shares held in the Royal Bank of Scotland were fully redeemed on 15 April 2009, whilst some £3,475 million of the preference shares in Lloyds Banking Group were redeemed on 8 June 2009 with the remaining shares (some £525 million) redeemed on 11 June. These events are fully disclosed within the post balance sheet events note (Note 42) to the Accounts.
- **Deposits Management (Heritable) Limited and UK Financial Investments Limited** – the equity investments in Deposits Management (Heritable) Ltd and UKFI Ltd were acquired on 8 October 2008 and 3 November 2008, respectively, each at a nominal cost of less than £100. The Treasury, therefore, recognised these investments as zero in the Balance Sheet as the value is trifling.

Guarantees and indemnities

1.24 The Treasury issued a number of guarantees and indemnities in relation to the various financial stability measures. The implementation for the first time of the accounting standards covering the reporting of financial instruments meant that any guarantees which were deemed to meet the definition of a financial guarantee per these standards had to be recognised in the Treasury's Balance Sheet.

1.25 A financial guarantee is defined as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of an agreed contract. The definition of a financial guarantee is only met if the contract requires, as a precondition for payment, that the holder of the contract has incurred a loss on the failure of a debtor to make payments when due.

1.26 Those guarantees which were deemed to meet the definition of a financial guarantee in accordance with the financial reporting standards (guarantees issued under the Credit Guarantee Scheme and the guarantees provided over certain deposits held by Northern Rock and Bradford & Bingley) have been included as liabilities in the Balance Sheet at 31 March 2009. These guarantees have been valued at fair value based on the fees receivable over the lifetime of the guarantee, discounted to reflect the time value of money. The liabilities included on the Balance Sheet therefore do not reflect the Treasury's potential total exposure on these measures which amounts to some £287,700 million (**Figure 11**).

1.27 All other guarantees and indemnities issued by the Treasury did not meet the definition of a financial guarantee. In accordance with accounting standards, the Treasury recognised these commitments as contingent liabilities, except in cases where it was deemed that the call on the indemnity was probable rather than just possible. The only such case in 2008-09 was the indemnity provided to the Bank of England over losses incurred in respect of the Asset Purchase Facility, part of the Quantitative Easing programme. A loss will be deemed to arise if the administrative expenses of running the Fund plus the fair value movements on the assets purchased exceed the interest and similar income received on those assets. In return, the Treasury is entitled to any surplus arising. Indications at the balance sheet date were that the Bank will call on the indemnity at the end of the Scheme. The Treasury, therefore, included a provision of some £85 million in the 2008-09 Accounts for the expected call on this indemnity as at 31 March 2009.

1.28 HM Treasury's financial stability contingent liabilities as at 31 March 2009 are listed in **Figure 12**. Of those that the Treasury can quantify, the maximum financial impact could potentially amount to some £833,300 million.

Figure 11
Financial Guarantees

	Balance sheet value at 31 March 2009 (£m)	Maximum potential liability (£m)
Credit Guarantee Scheme	2,261	250,000
Northern Rock retail and wholesale deposits	346	20,700
Bradford & Bingley retail deposits	618	17,000
Total	**3,225**	**287,700**

Source: HM Treasury Annual Report and Accounts 2008-09

Figure 12
HM Treasury's financial stability contingent liabilities as at 31 March 2009

Contingent liability disclosed	Maximum Potential Financial Impact for the Treasury
Northern Rock	
The 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
The 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 in pursuit of their duties.	Unquantified
The Treasury, under the terms of the loan agreements with Northern Rock, has also guaranteed a back-up liquidity facility, secured against the assets of the company to meet the FSA's requirements.	£3,800 million
Bradford & Bingley	
The Treasury has confirmed to the FSA that it will take appropriate steps, if necessary, to ensure that Bradford & Bingley will continue to operate above the minimum regulatory capital requirements.	Unquantified
The Treasury has guaranteed indemnities provided by Bradford & Bingley for the directors appointed post public ownership against liabilities and losses in the course of their actions whilst the company is in public ownership.	Unquantified
The Treasury has committed, in Budget 2009, to provide further working capital support to Bradford & Bingley in 2009-10.	£5,500 million
Dunfermline	
Following intervention under the Banking Act Special Resolution Regime, Dunfermline's social housing was placed into a bridge bank, owned and controlled by the Bank of England. The Treasury provided a guarantee to the Bank of England to underwrite any losses incurred through not being able to recover all the funds advanced in the form of loans and equity to the bridge bank and a guarantee in respect of losses sustained in connection with the bridge bank.	£190 million
The Bank of England has provided a short-term working capital facility to help Dunfermline with an orderly wind-down of its business, and to avoid a fire sale of its assets that could otherwise result in a lower value for the business being realised. The Treasury has provided a guarantee to the Bank of England to underwrite any losses the Bank of England will incur in managing this working capital facility.	£10 million
Royal Bank of Scotland	
As a condition of entry into the Asset Protection Scheme, the Government agreed to provide additional capital to the Royal Bank of Scotland. This took the form of £13,000 million in exchange for B shares and a further £6,000 million at the Royal Bank of Scotland's option in 2010-11.	£19,000 million

Figure 12

HM Treasury's financial stability contingent liabilities as at 31 March 2009 *continued*

Contingent liability disclosed	Maximum Potential Financial Impact for the Treasury
Heritable	
The Treasury has guaranteed indemnities provided by Deposits Management (Heritable) Limited for the appointed directors against liabilities and losses in the course of their actions.	Unquantified
Special Liquidity Scheme	
The Treasury has indemnified the Special Liquidity Scheme. Payment under the Scheme will only arise if capital losses exceed any surplus accruing to the Bank of England over the duration of the scheme.	£185,000 million
Recapitalisation Fund	
Through the Recapitalisation Fund, the Treasury committed to provide capital to eligible banks to a maximum of £50,000 million. Of this, £37,000 million has already been advanced.	£13,000 million available to be advanced
Bank of England Asset Purchase Facility	
The Treasury has indemnified the Bank of England and the fund specially created by the Bank to implement the facility from any losses arising out of, or in connection with, the facility.	£150,000 million
Asset Protection Scheme	
To provide certainty and confidence to banks in their lending, the Government announced its intention to offer capital and asset protection on those assets most affected by the current economic conditions.	£457,000 million
Compensation Schemes	
Under the Banking (Special Provisions) Act 2008, compensation schemes have been established by the Northern Rock plc Compensation Scheme Order 2008 and the Bradford & Bingley plc Compensation Scheme Order 2008. Under the schemes, the Treasury is liable to pay any amount of compensation considered to be payable by the independent valuers to persons who held shares in Northern Rock and Bradford & Bingley immediately before they were transferred to the Treasury, and also to other parties affected by the provisions of the Transfer Orders.	Unquantified (as any amounts due to shareholders would be a matter for the valuers)

Source: HM Treasury Annual Report and Accounts 2008-09

Loans and receivables

1.29 In August 2008, the £18,781 million loan to **Northern Rock** was novated from the Bank of England to the Treasury. The novation occurred in three parts with the final payment made in October 2008. By 31 March 2009, Northern Rock had repaid some £4,220 million of this loan balance. Some £3,198 million, equivalent to 76 per cent of this, was repaid by 31 December 2008 as a result of the success of the company's active redemption policy, and the greater than expected growth in retail deposit balances held. This growth in retail deposits arose as consumer confidence in other high street banks began to decline and therefore more individuals viewed Northern Rock as a 'safe' bank.

1.30 In January 2009, Northern Rock announced that the rate of repayment of the government loan would slow going forward, as the company reduced the rate of redemptions from the mortgage book, in order to support government policy to increase mortgage lending capacity in the market. The Treasury then announced in February that, as part of a planned restructuring of the company, the Government intended to increase the loan to Northern Rock and extend the repayment schedule. Further details will be published once Northern Rock's revised business plan has been agreed, but new injections of equity and loans are likely to be of the order of £15,000 million during 2009-10 (**Note 23** to the Accounts).

1.31 The Treasury also provided a Working Capital Facility of up to £6,000 million to **Bradford & Bingley**. This facility was fully drawn at 31 March 2009, and has since been extended to a maximum of some £11,500 million. The £5,500 million increase was included in the Department's Main Estimate for 2009-10 (published June 2009) and is disclosed as a capital commitment within the 2008-09 Accounts (Note 23 to the Accounts). In addition to the interest payable on the amount of facility drawn down (some £32 million in 2008-09), Bradford & Bingley pays a commitment fee of 0.5 per cent on the amount of the facility made available but not yet drawn down (some £0.5 million in 2008-09). Further to this, any interest accruing on the Bank of England account these funds are held in is also payable to the Treasury (some £0.7 million in 2008-09).

1.32 During 2008-09, the Treasury has provided several loan facilities totalling some £20,978 million to the **Financial Services Compensation Scheme** (FSCS). The Scheme is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation to those customers if a firm is unable, or likely to be unable, to pay claims against it. Since 1 October 2007, the Scheme has offered 100 per cent protection of the first £35,000 held by each depositor in an insitution declared in default. On 7 October 2008, this limit was raised to the first £50,000.

1.33 The FSCS does not maintain a standing fund to meet claims when needed. Rather, it raises levies from the industry each year to enable it to meet its anticipated obligations in respect of compensation costs in the following 12 months and to meet management expenses in the current financial year. Due to the level of financial institutions being declared in default by the Financial Services Authority during 2008-09, the FSCS was unable to fund the compensation due to depositors directly and, therefore, these funds were provided by the Treasury in the form of loan facilities to the FSCS.

1.34 The FSCS will repay all loan facilities in full, firstly using funds recovered from the wind-down of institutions placed in administration, and then using funds raised through levies on the industry. The FSCS pays interest on the amounts drawn down to fund compensation payments made (some £147 million in 2008-09) as well as commitment fees on the amounts made available by the Treasury but not drawn (some £0.2 million in 2008-09). These payments will be met using funds raised through the annual industry levies.

1.35 The Treasury has also provided funds of some £5,503 million to third parties, such as Abbey National plc (who took on Bradford & Bingley deposits) and the FSCS to match liabilities arising on deposits exceeding the FSCS compensation limit. By providing these funds, the Treasury has legally taken on the depositors' right to make a recovery claim against the banks in question during the administration process. These amounts have, therefore, been included within the draft Accounts as **statutory debt** and have been impaired to reflect the latest information about their recoverability through the administration process. As the balances are non-interest bearing, this impairment includes an element of discounting to reflect the time value of money.

Derivative financial instruments

1.36 The guarantees under the **Credit Guarantee Scheme** can be issued in several different currencies including Sterling, Euros, Yen, US Dollars, Australian Dollars and Swiss Francs. The rules of the Scheme require that all fees are paid in the currency in which the guarantee has been issued, resulting in the Treasury receiving a significant amount of foreign currency income during 2008-09.

1.37 In order to protect itself against the risk of fluctuations in foreign currency exchange rates, the Treasury entered into forward currency contracts with the Bank of England. These contracts are effectively an agreement with the Bank that it will purchase the foreign currency from the Treasury on a specific date and at a pre-arranged rate thus enabling the Treasury to hedge its risk. In accordance with the financial instrument reporting standards, the Treasury included these forward contracts as financial derivatives within its Balance Sheet. Where the pound has strengthened from the rate on the day the contract was entered into, a derivative asset is recognised, whereas in cases where the pound has weakened, a derivative liability is recognised (**Note 13** to the Accounts).

1.38 In addition to forward currency contracts, the agreements to underwrite the open and placing offers launched by the Royal Bank of Scotland and Lloyds Banking Group to fund the redemption of the preference shares held by the Government were deemed to meet the definition of forward contracts. As both share purchases occurred during the post balance sheet period, the valuation of the contracts was based on the difference between the price paid for the shares (31.75 pence and 38.43 pence) and the market price of those shares on the dates of purchase (29.2 pence and 61.1 pence, respectively). Since the Royal Bank of Scotland shares were purchased at above market price, the Treasury recognised a derivative financial liability of some £428 million. In contrast, Lloyds Banking Group shares were purchased at below market price and, therefore, the Treasury recognised a derivative financial asset of some £1,018 million (see **Note 13**).

Provisions

1.39 Provisions totalling some £25,379 million were recognised at 31 March 2009 in respect of financial stability and related actions by the Bank of England. The most significant of these was the £25,000 million provided for the expected estimated net loss on the **Asset Protection Scheme**, under which the Treasury provides banks with protection against future credit losses on certain assets in exchange for a fee (further details on the Scheme operation are provided in **Note 31.2** to the Accounts).

1.40 As at 31 March 2009, both the Royal Bank of Scotland and Lloyds Banking Group had announced that they planned to participate in the Scheme, and had signed pre-accession agreements. Whilst the Treasury had no legal obligation to continue with the Scheme at the balance sheet date, as negotiations with the banks were ongoing and State Aid approval was still pending, it had taken actions which created an expectation that the Scheme would be implemented. In accordance with Accounting Standards, the Treasury concluded that, at the balance sheet date, it had a "present obligation" and therefore recognised a provision for the net loss it anticipated it would incur as a result of the Scheme.

1.41 The £25,000 million provided in the Accounts is based on the draft Scheme terms and reflected the base-case estimate of the net potential losses of the scheme per initial due diligence work undertaken in spring 2009, and which was extant at the time the annual Accounts were signed. It is likely that the factors on which the Treasury rely for the assessment will evolve over the life of the Scheme, and as a result the estimate could be subject to substantial revision (up or down) in future years.

1.42 The Treasury also provided some £295 million for the potentially unrecoverable element of statutory debt payments yet to be made for commitments in excess of the FSCS limits (see section above); and £85 million for the anticipated call on the indemnity provided to the Bank of England against any losses it incurs as a result of the Asset Purchase Facility.

NAO Value for Money work

1.43 A summary of our recent Treasury related value for money reports is provided at Appendix Two. The NAO is also planning to publish a value for money report in late 2009 that provides a high level overview of the key measures implemented to maintain financial stability in the UK including the context to the measures, the developments to date, and establishing criteria for judging success.

Report on the nationalisation of Northern Rock

1.44 The NAO report on the nationalisation of Northern Rock was published in March 2009. The report concluded that the nationalisation of Northern Rock in early 2008 offered the best prospect of protecting the taxpayers' interests, and that it was based on a sufficiently robust analysis of the options available. However, the Treasury was stretched to deal with a crisis of this nature and there were lessons to be learned.

1.45 At the time of the initial run on deposits at Northern Rock, the Treasury put in place guarantee arrangements for retail depositors and wholesale creditors. The immediate risk of instability in the financial system was stemmed. But the Treasury could have been more engaged with the actions being taken in the early stages by Northern Rock. As a condition of public support, mortgage lending was reduced, but the company still went on writing high-risk loans up to 125 per cent of a property's value. Mortgages of this type have a higher than average default rate.

1.46 When considering Northern Rock's first business plan in public ownership, the Treasury could, however, have done more to test the company's initial business plan, and to challenge with greater rigour its forecast of trading conditions.

Progress on savings targets

Spending Review 2004 efficiency targets

1.47 The Treasury's efficiency targets were set as part of the public sector wide change programme and have their origin in the 2004 Gershon Independent Review of efficiency, which was a key part of the 2004 Spending Review. The Treasury was initially set an efficiency target of £17.7 million of sustainable annual savings by 2008, but this target was subsequently raised to £18.7 million of sustainable annual savings. In December 2008, the Treasury reported final savings of £29.9 million, £27.3 million of which were cash releasing (**Figure 13**).

Comprehensive Spending Review 2007 value for money savings

1.48 The 2007 Comprehensive Spending Review (CSR) set new savings targets for all government departments. The Treasury's initial target was to make a further £30 million of cash releasing value for money savings by 2010-11. Budget 2009 then announced that additional savings had been found to increase the CSR value for money target by £5 million to £35 million by 2010-11. The Treasury considers that delivering these savings will mean the Group must become more efficient in the way it delivers, focused on priority areas with the right systems in place to support and enable staff to deliver its objectives. Detail of how the Treasury intends to deliver the savings is provided in **Figure 14**.

1.49 Outturn figures for 2008-09 had not been finalised at the time of publication of the *2008-09 Annual Report and Accounts*, but Treasury considered in its 2008 Autumn Performance Report that it was on course to at least meet the interim target for 2008-09 of some £12 million.

Figure 13
Performance against Spending Review 2004 efficiency targets

	2007-08 target savings (£m)	Final savings (£m)	Of which cashable (£m)
Core Treasury	10.9	21.3	21.3
OGC	3.5	3.5	2.0
OGC Buying Solutions	1.8	2.2	1.1
DMO	1.0	1.0	1.0
Group Shared Services	1.5	1.9	1.9
Total	**18.7**	**29.9**	**27.3**

Source: HM Treasury Autumn Performance Report 2008

Figure 14
Intended delivery of £35 million value for money savings

Core Treasury – Core Treasury intends to deliver its value for money savings by rationalising its organisational structure to exploit synergies across business areas. The restructuring provides the opportunity to ensure that the core Treasury's workforce becomes more highly skilled and more flexible, resulting in annual net-cash releasing savings by 2010-11 of £15.3 million.

Group Shared Services (GSS) – the programme will build on the progress made since the establishment of shared services in June 2006, including better use of the Group's estate and further refinement of the Group's HR, Finance and Information Services functions work. This aims to produce annual net cash releasing savings of £12.8 million by 2010-11.

Office of Government Commerce (OGC) – savings against baseline are being sought through a combination of reducing spend on its core work, including consultancy; lower staff costs in areas where functions are being merged; and a simplified top management structure. This will lead to annual net cash releasing savings of £5.9 million by 2010-11.

UK Debt Management Office (DMO) – the DMO aims to deliver its value for money savings by investing in enhanced technology, raising its skills profile, and achieving better value from its estate by accommodating increasing staffing levels within the same floor area. This will produce annual net cash releasing savings of £0.7 million by 2010-11.

Programme expenditure – this will be managed down across the Group to achieve annual net cash releasing savings of £0.3 million by 2010-11.

Source: HM Treasury Value for money delivery agreement – revised July 2009

Part Two

The Treasury's capability

Follow-up of the 2007 Capability Review

2.1 In autumn 2007, the Treasury underwent a Capability Review as part of a government-wide initiative led by the Cabinet Office. The aim of the Review was to assess the Department's ability to meet current and future challenges, and identify key areas where the Department needs to improve. The review team identified four areas on which the department should focus its attention:

- Work more effectively to change the culture of behaviours and diversity of the Department, and secure skills needed to meet future challenges.
- Engage and communicate more effectively with stakeholders and other government departments to build a common purpose.
- Clarify the Department's role at the centre of government to improve performance management and support delivery across the Civil Service.
- Focus on the role of the leadership in driving change with pace in a new operational framework.

2.2 The Department's progress in these four areas was assessed in December 2008. The findings of this review, summarised in **Figure 15**, were broadly positive and suggested that the Treasury is making strong progress, although there are still areas where further improvement could be made. The Treasury underwent its two year re-review in October. Findings will be published in December 2009.

HM Treasury staff survey 2008

2.3 A survey of HM Treasury's staff was completed in December 2008 by Towers Perrin-ISR. The response rate was over 80 per cent, and the results showed a marked improvement on the previous year's survey (**page 92**, *Annual Report and Accounts*).

Figure 15
Results of HM Treasury's Capability Review: One Year Update

Area for action identified by original Capability Review	Progress to date	Areas for further improvement
Work more effectively to change the culture, behaviours and diversity of the Department, and secure the skills needed to meet future challenges	• Three new non-executive directors have added value to the Treasury Board. • The Treasury has continued to reform the performance appraisal process. • The Treasury has now completed a staff skills audit. • Positive feedback has been received on the Treasury's new induction process.	• The Treasury needs to help staff to achieve a proper work-life balance. • The Treasury needs to demonstrate the relevance of the '2011 Vision' to its workforce.
Engage and communicate more effectively with stakeholders and other government departments to build a common purpose	• The Treasury has undertaken extensive consultation to establish best practice in stakeholder management. • Work is under way to develop a new strategic approach to this area. • The Treasury is improving knowledge management in its interactions with stakeholders	• The Treasury needs to maintain momentum in its reforms to ensure openness in dealings with other Departments.
Clarify the Department's role at the centre of government to improve performance management and support delivery across the Civil Service	• A joint Treasury/Cabinet Office team has been established to look at performance management across government. • Staff report closer working between the Prime Minister's Delivery Unit and spending teams.	• The Treasury needs to ensure that other bodies understand the overall picture and how different initiatives are linked.
Focus on the role of the leadership in driving change with pace in a new operational framework	• Change towards the '2011 Vision' has continued, despite huge pressure on the Treasury. • The Permanent Secretary has been a role model for departmental change. • Better management information on delivery against targets is available. • New IT has strengthened supporting business systems.	• The Senior Civil Service needs to play a more active role in promoting change. • Staff need to be more fully engaged in the change process.

Source: Cabinet Office – Capability Reviews: One Year Update

2.4 To place the staff survey results in wider context, the results of the Department's staff survey were compared against several external benchmarks of employee opinion in the UK. This exercise identified the following:

- On nine categories (out of twelve) the Treasury scores significantly better than the Towers Perrin-ISR **UK Public Sector Norm**.
- When compared to the Towers Perrin-ISR **UK National Norm,** the Treasury exceeds the norm on five categories.
- Compared to the Towers Perrin-ISR UK **High Performing Norm**, the Treasury is now above norm on three categories.
- Three categories – Talent Management, Performance Management & Reward, and Change – are consistently low scoring Categories against all three benchmarks.

NAO assessment of HM Treasury's capacity in relation to Northern Rock

2.5 The NAO's report on the nationalisation of Northern Rock (HC 298) specifically considered the Treasury's capacity to respond to and manage events. The review identified that the action needed to resolve Northern Rock's difficulties stretched the capacity of the Treasury to handle the complex issues involved. The Public Accounts Committee also observed that very few people within the Treasury had the relevant skills to deal with the crisis at Northern Rock, necessitating extensive use of external advisers.

2.6 The NAO's key findings in relation to capacity and the related recommendations are documented in **Figure 16**.

Figure 16

Key findings on Treasury's capacity taken from the NAO study on the nationalisation of Northern Rock

NAO finding	NAO recommendation
The Treasury had been aware of potential shortcomings in the arrangements for dealing with a financial institution in difficulty prior to the crisis at Northern Rock (as a result of the scenario tests conducted by the Tripartite Authorities), but had not judged this to be a priority in a benign economic environment, compared with other financial crisis response planning.	When reviewing the lessons to be learned from future scenario tests, the Tripartite Authorities, having identified lessons learned and agreed an action plan with target dates, should take forward the necessary work with vigour. The Tripartite Authorities should review progress against these targets at suitable intervals.
Once the scale of the crisis was recognised, the appointment of the second Permanent Secretary to lead the Treasury team was crucial to providing clear leadership at an official level.	In future crisis situations, the appointed officials, as in this case, should have sufficient seniority to marshal the necessary resources, make clear the Treasury's position to third parties, and act as a focus for overseeing the response at an official level. The Treasury should also examine the training and development it provides to its officials to handle crisis situations, for example, drawing on other parts of the public sector, for instance civil and military contingency planning, where preparation for handling a crisis is a key part of staff development.
Following the initial guarantee arrangements for depositors, the Treasury brought together a team drawn from across the Department, but struggled to maintain continuity in its staffing. The availability of people with relevant skills and experience was severely stretched, and the Treasury was therefore reliant on key officials and its advisors for the expertise it needed.	Although the Treasury challenged the underlying assumptions used by external advisers, it should be in a position to validate analyses prepared for it, particularly in fast moving situations where crucial decisions have to be taken quickly. To this end, it should draw where appropriate on expertise from within the Treasury or from expertise available elsewhere in the public sector, such as Partnerships UK.
There were weaknesses in the management of electronic records.	The Treasury should put in place adequate arrangements for filing, storing and accessing the electronic and paper records generated. The Treasury should consider whether its working processes and IT infrastructure is capable of supporting the demands of such a project and take action to address any shortcomings.

Source: The nationalisation of Northern Rock, Report by the Comptroller and Auditor General (HC 298)

Part Three

Performance against PSA and DSO targets

Public Service Agreement 9: Ending child poverty

3.1 The Comprehensive Spending Review 2007 set the Government performance framework for 2008-11, and reduced the total number of PSAs across Government from over 100 to 30. This enabled the Government to focus on its highest priority, cross-cutting outcomes for some £589 billion of annual expenditure. The Treasury contributes to six cross-government PSAs and is the lead department for one, PSA 9: Ending child poverty.

3.2 Details of the PSAs that Treasury contributes to can be seen in the *Annual Report and Accounts* on **page 27**. The analysis below focuses solely on PSA 9 for which the Treasury is the lead department.

3.3 PSA 9 has targets in two stages to halve the number of children living in poverty by 2010-11 and eradicate child poverty by 2020. Child poverty is assessed by three separate indicators: the number of children in absolute low income households (indicator 1); the number of children in relative low income households (indicator 2); and the number of children in relative low income households and material deprivation (indicator 3). The Treasury works with the Department for Work and Pensions and the Department for Children, Schools and Families in meeting this target.

3.4 **Chapter 3** of the *Annual Report and Accounts* (**pages 77 to 80**) concludes that no progress had been made towards meeting this target during 2007-08, the most recent financial year for which data is available. There has been no change on indicators 1 and 2, whilst indicator 3 has increased back to the baseline level of 2.2 million. It is expected that this increase is as a result of the high prices, particularly on fuel, during the period to which the data relates. The report notes that whilst progress is slow, with current economic conditions making progress more difficult, measures announced in and since Budget 2007 will lift around a further 500,000 children out of relative poverty, the impact of which is yet to feed through in the child poverty statistics.

Departmental Strategic Objectives (DSOs):

3.5 The Comprehensive Spending Review 2007 framework required departments to develop a set of Departmental Strategic Objectives (DSOs) for the period 2008-11. DSOs set specific objectives for individual departments to progress and the key performance indicators that they will be assessed against.

3.6 The Treasury has been set two DSOs: Maintaining sound public finances and Ensuring high levels of sustainable economic growth, well-being and prosperity for all. Each of these DSOs comprises a series of measurable outcomes, which are detailed in full in the *Annual Report and Accounts* on **page 26**. An overview of the Department's progress against its current DSOs is provided in **Figure 17** overleaf and a more detailed analysis can be found in the *Annual Report and Accounts*, **Chapters 1 and 2**.

Legacy Targets

3.7 In addition to DSOs and Cross Government PSAs set in the Comprehensive Spending Review in 2007, the Treasury is also responsible for meeting ongoing targets from earlier reviews. These legacy targets are addressed with in the *Annual Report and Accounts* Annex A. A summary of the Treasury's performance against legacy targets is provided in **Figure 18** on page 35.

NAO review of data systems for PSAs

3.8 The Treasury has responsibility for the performance management framework including the 30 PSAs and underpinning indicators. It is responsible for working with departments to ensure that data systems are adequate for the task of monitoring and measuring performance against the PSAs.

3.9 During 2008-09, the NAO reviewed the data systems in place for measuring PSAs at eight departments and identified a number of weaknesses. The review noted that a number of improvements had been made to increase the rigour and transparency of progress reporting, with 89 per cent of systems at least broadly appropriate for measuring progress against their PSA indicator and a qualitative improvement in the clarity and presentation of PSA monitoring information.

3.10 Nevertheless, the review also highlighted scope for further improvement identifying that 34 per cent of the data systems used had weaknesses and 11 per cent were unfit for purpose. Many of the weaknesses identified stemmed from a lack of formal consideration by departments of the quality of data needed for effective PSA monitoring, and an associated lack of formal risk assessment. While the Treasury issued good, comprehensive guidance on the development of indicators, departments did not consistently apply it, and the Treasury did not enforce its application. As a result, lessons learned over the past decade have not been fully integrated into the system.

Figure 17
Assessment of progress against DSOs

	DSO Outcome	Assessment
	DSO 1: Maintaining sound public finances	
a	Meeting the fiscal rules	
b	Ensuring that the tax yield is sustainable and risks managed	
c	Managing public spending	
d i)	Professionalising and modernising the finance function in government	
d ii)	Professionalising and modernising the procurement function in government	
e	Managing government cash, debt and reserves efficiently and effectively	
	DSO 2: Ensuring high and sustainable levels of economic growth, well-being and prosperity for all	
a	Supporting low inflation	Met – Ongoing
b	Promoting the efficiency and fairness of the tax system	
c	Improving the incentives and means to work; supporting children and pensioners; and helping people plan and save for the future	
d	Improving the quality and value for money of public services	
e	Supporting fair, stable and efficient financial markets	
f	Raising productivity with sustainable improvements in the economic performance of all English regions, including narrowing the gap in growth rates between the best and worst regions	
g	Protecting the environment in an economically efficient and sustainable way	
h	Pursuing increased productivity and efficiency in the EU, international financial stability and increased global prosperity	

No progress
Strong progress
Some progress
Not yet assessed

Source: HM Treasury Annual Report and Accounts 2008-09

Figure 18
Summary of performance against legacy targets

	PSA Target	Assessment[1]
PSA 5	As part of the wider objective of full employment in every region, over three years to spring 2008, and taking account of the economic cycle, demonstrate progress on achieving the employment rate. (Joint target with the Department for Work and Pensions).	On Course
PSA 7	Halve the number of children in low-income households between 1998-99 and 2010-11, on the way to eradicating child poverty by 2020 (Joint target with the Department for Work and Pensions).	Slippage
PSA 8 ii) a	Promote increased global prosperity and social justice by ensuring that 90 per cent of all eligible Heavily Indebted Poor Countries (HIPC) committed to poverty reduction that have reached a Decision Point by end 2005, receive irrevocable debt relief by end 2008.	Not Met
PSA 8 iii)	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.	Slippage
PSA 9 i)	Improve public services by working with departments to help them meet their PSA targets, consistently with fiscal rules (Joint target with the Cabinet Office).	Slippage

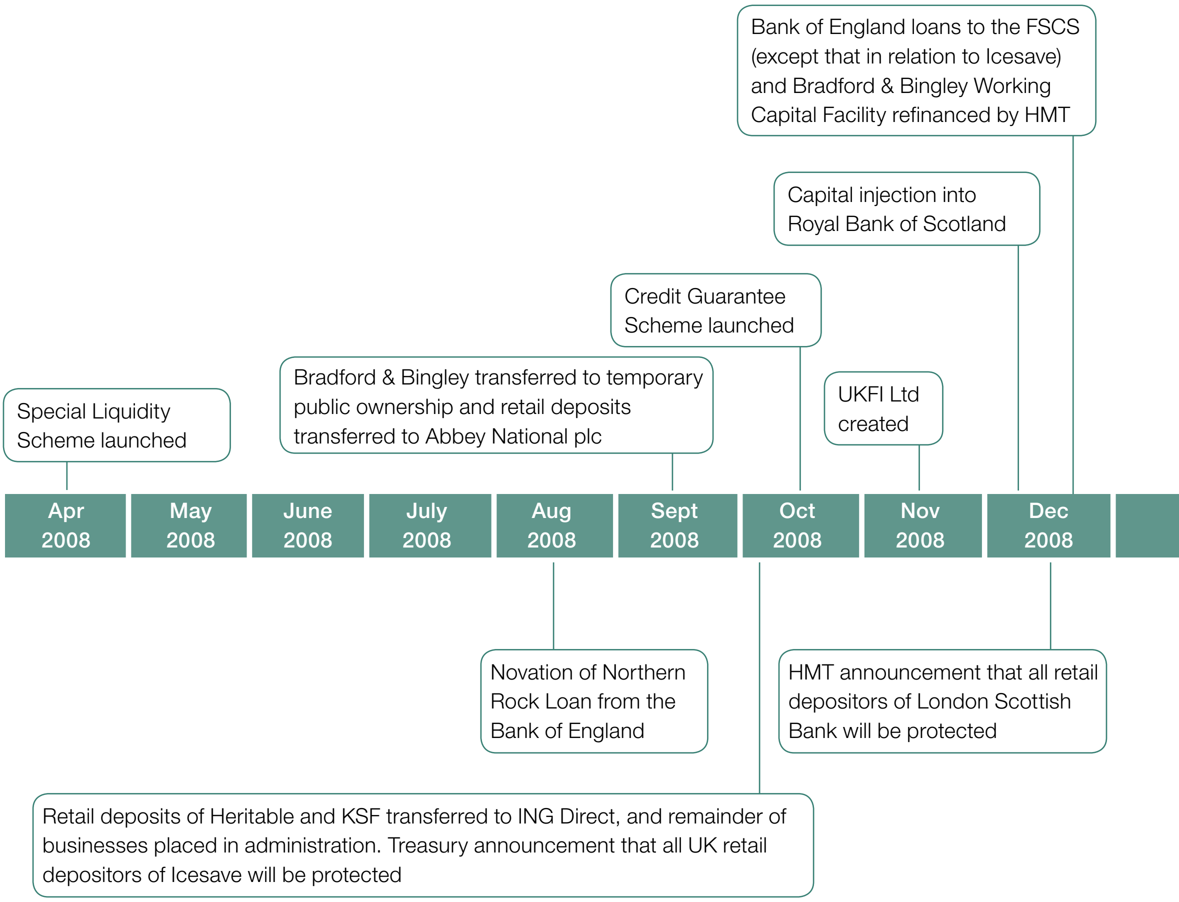
Source: HM Treasury Annual Report and Accounts 2008-09

NOTE

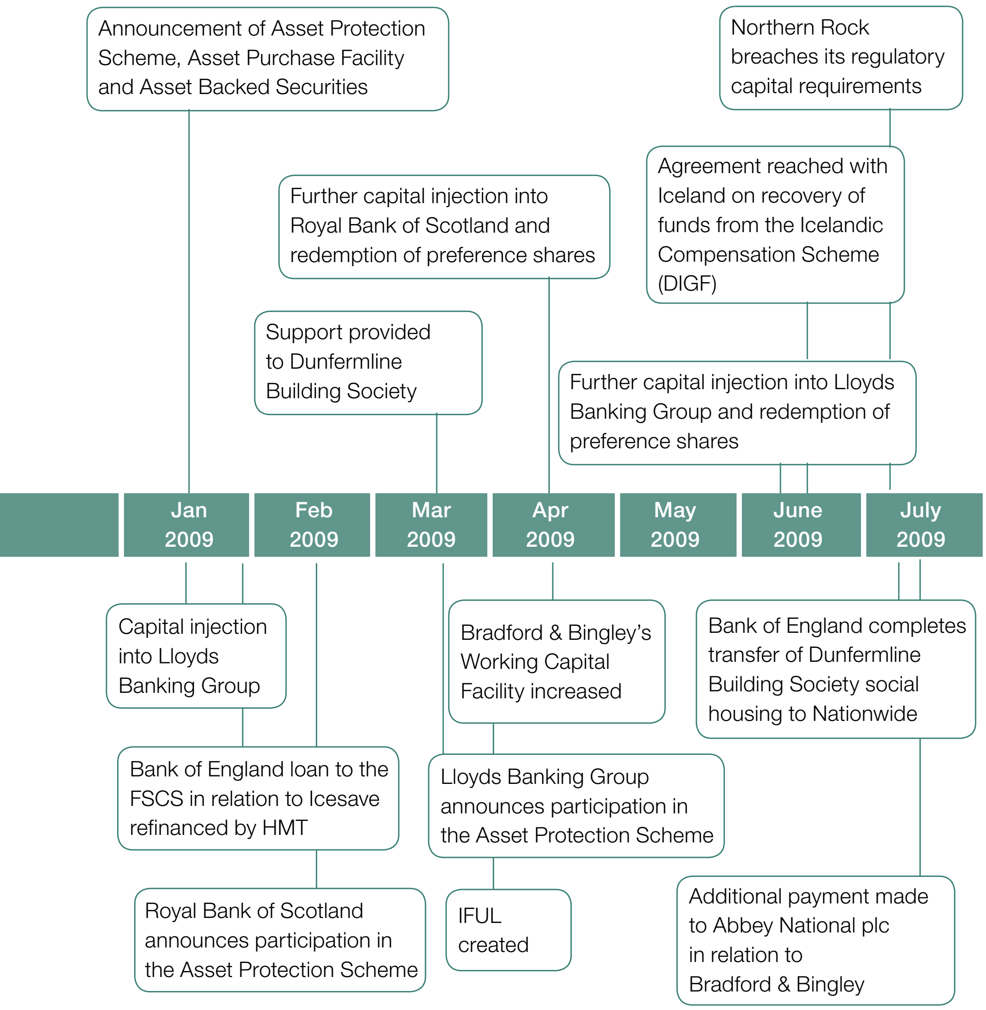
1 All assessments are interim with the exception of PSA 8 ii)a, which has received a final assessment.

Appendix One

Financial Stability Timeline



Source: National Audit Office


Announcement of Asset Protection Scheme, Asset Purchase Facility and Asset Backed Securities
Northern Rock breaches its regulatory capital requirements
Further capital injection into Royal Bank of Scotland and redemption of preference shares
Agreement reached with Iceland on recovery of funds from the Icelandic Compensation Scheme (DIGF)
Support provided to Dunfermline Building Society
Further capital injection into Lloyds Banking Group and redemption of preference shares
Jan 2009
Feb 2009
Mar 2009
Apr 2009
May 2009
June 2009
July 2009
Capital injection into Lloyds Banking Group
Bradford & Bingley's Working Capital Facility increased
Bank of England completes transfer of Dunfermline Building Society social housing to Nationwide
Bank of England loan to the FSCS in relation to Icesave refinanced by HMT
Lloyds Banking Group announces participation in the Asset Protection Scheme
Royal Bank of Scotland announces participation in the Asset Protection Scheme
IFUL created
Additional payment made to Abbey National plc in relation to Bradford & Bingley

Appendix Two

Recent NAO Value for Money Reports

Title	HC Number	Date	Key findings
Audit of the assumptions for the 2008 Pre-Budget Report	HC 1150	24 November 2008	The Treasury's conclusion that the last economic cycle ended in the second half of 2006 is consistent with the evidence available. There is naturally a degree of uncertainty in calculating economic cycles, but the methodology used is reasonable. The Treasury seeks to predict future changes in revenue from the oil industry by forecasting movements in the price of oil. It is using the best available methods to forecast this, but needs to keep monitoring the accuracy of forecasts to ensure that it is sufficiently cautious.
Central government's management of service contracts	HC 65	19 December 2008	Central government could make large savings by better managing its contracts for services such as IT, security, catering and cleaning. Better contract management could potentially generate estimated savings of between £160 million and £290 million a year, across total annual expenditure on service contracts of around £12,000 million. In addition, nearly all the organisations surveyed for the report thought that better contract management could improve the quality and/or quantity of the services provided by suppliers. The Office of Government Commerce can do more to support central government organisations to improve contract management.

Title	HC Number	Date	Key findings
Assessment of the Capability Review programme	HC 123	5 February 2009	The Cabinet Office's Capability Review programme aims to assess and improve government departments' ability to deliver their objectives. The programme has led to evidence of greater capability in departments. But departments have yet to show that the programme has had an impact on outcomes in delivering public services. Action to tackle weaknesses in capability is now a prominent feature of board business and every department has a board member leading its review response. However, there is some uncertainty in departments about whether, or how, the programme will continue, risking a loss of momentum.
HM Treasury: The nationalisation of Northern Rock	HC 298	20 March 2009	The nationalisation of Northern Rock in early 2008 offered the best prospect of protecting the taxpayers' interests, and was based on a sufficiently robust analysis of the options available. However, the Treasury was stretched to deal with a crisis of this nature and there were lessons to be learned. Further detail on the findings of this report is provided in **Part 1: Financial Review**.
Audit of the assumptions for Budget 2009	HC 408	22 April 2009	The Treasury has made reasonable adjustments to its economic growth estimates, in light of recent economic difficulties. Its new estimates include a necessary element of caution. New methodologies for projecting future interest are also reasonable in light of current circumstances. This will need to be regularly reviewed to ensure that the most appropriate measures are used.