

# Managing National Lottery Distribution Fund balances



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL  
HC 875 Session 2003-2004: 21 July 2004

# executive summary

- 1 Since its launch nearly ten years ago in November 1994, the National Lottery has raised over £15 billion for six good causes - the arts; sport; national heritage; charities and voluntary organisations; projects to mark the Year 2000 and the beginning of the Third Millennium; and health, education and the environment. Proceeds from lottery ticket sales are paid into the National Lottery Distribution Fund, which is maintained under the control and management of the Secretary of State for Culture, Media and Sport. The funds remain in the Distribution Fund until they are required by the 15 lottery distributors to make payments to the good causes or to meet their own costs. But while money is in the Distribution Fund it is not delivering the intended benefits in the community.



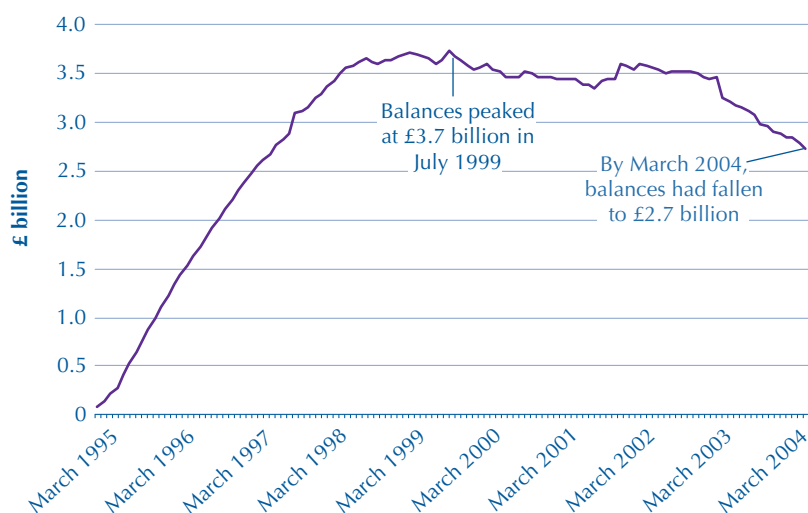
- 2 The Decision Document on National Lottery Funding, published by the Department for Culture, Media and Sport (the Department) in July 2003, highlighted "widespread concern" about how much lottery money was yet to be distributed and announced that, following discussions with the Department, the National Audit Office was to carry out an examination of balance management. This report therefore considers the management of National Lottery Distribution Fund balances and whether there are ways in which the balances could be reduced, within the existing framework of good causes set out in lottery legislation. Specifically we examined:
  - how the balances built up and what has been done to reduce them;
  - whether there is scope for the distributors to take action to reduce their balances further;
  - what uncertainties and risks the distributors face in managing their balances.

The methods we used are described in the Appendix.

## A brief overview

- 3 The balances in the National Lottery Distribution Fund peaked at £3.7 billion in July 1999 and by 31 March 2004 had fallen to £2.7 billion (**Figure 1**). Within this total, the balances held by individual distributors ranged from just over £2 million to nearly £943 million (**Figure 2**). The Heritage Lottery Fund and the New Opportunities Fund together held 61 per cent of the total balances: the nine distributors with the smallest balances held less than 10 per cent of the total.

## 1 Balances held in the National Lottery Distribution Fund since the start of the National Lottery



Source: Hansard, 26 March 2003 (for data to February 2003); Department for Culture, Media and Sport (for data after February 2003)

## 2 Distributors' National Lottery Distribution Fund balances at 31 March 2004

Distributor	National Lottery Distribution Fund balances at 31 March 2004 (£ million)	Percentage of the total National Lottery Distribution Fund balances at 31 March 2004
Heritage Lottery Fund	942.6	34.4
New Opportunities Fund	737.2	26.9
Arts Council England	224.1	8.2
Community Fund	213.3	7.8
Sport England	201.6	7.4
Millennium Commission	155.7	5.7
Sport Scotland	65.0	2.4
UK Film Council	44.3	1.6
Scottish Arts Council	42.0	1.5
Arts Council of Northern Ireland	35.6	1.3
Arts Council of Wales	24.0	0.9
Sports Council for Northern Ireland	23.5	0.9
Sports Council for Wales	21.5	0.8
UK Sport	3.8	0.1
Scottish Screen	2.2	0.1
<b>Total</b>	<b>2,736.3<sup>1</sup></b>	<b>100.0</b>

### NOTE

<sup>1</sup> This figure does not cast correctly due to rounding.

Source: data from the Department for Culture, Media and Sport

- 4 There is scope for the National Lottery Distribution Fund balances to be reduced further, in particular by distributors making more commitments to pay grants to deserving projects. But significant reductions in balances could take time. There can be considerable time lags between distributors making commitments to pay grants and the grants actually being paid. This is especially the case with high value grants as these are often for large projects which can take a long time to complete and involve the payment of grant over a number of years. There is though scope to speed up payments, which can also help to reduce balances.
- 5 However, distributors face uncertainties about future lottery distribution arrangements, income levels and expenditure (**Figure 3**). These uncertainties are important because each distributor must keep sufficient money in the National Lottery Distribution Fund to be able to meet its commitments and manage its business, and is not underwritten by other distributors or the Department.

### 3 Examples of the uncertainties that distributors face

- How much income will the National Lottery raise?
- What share of lottery proceeds will we receive after 2009?
- When will the projects we have funded draw down their grants?
- What if we don't have enough money to honour the grant commitments we have made?

*Source: National Audit Office*



## Our key findings

- 6 The balances in the National Lottery Distribution Fund peaked in 1999 and have fallen since then, but targets have not been met.**
- The balances in the National Lottery Distribution Fund increased steadily from the start of the National Lottery and peaked in 1999.
  - In 2002 the Secretary of State for Culture, Media and Sport announced a target for the balances in the National Lottery Distribution Fund to halve by 2004: since then balances have fallen by about a quarter. The progress made by individual distributors has varied: the balances of some have fallen significantly but others have increased.
- 7 There is scope to reduce the balances in the National Lottery Distribution Fund further.**
- There is scope for distributors to reduce balances by making more grant commitments.
    - Distributors' current levels of commitment vary considerably, with eight having commitments that exceed their National Lottery Distribution Fund balances. Distributors also have varying approaches to the maximum amount they are prepared to commit, and according to these policies at March 2004 distributors had scope to make additional commitments totalling nearly £450 million.
    - All distributors confirmed that they could attract sufficient, suitable applications to be able to make more commitments, without compromising value for money. And eight distributors, including those with the largest balances, consider that increasing commitments is a realistic way of reducing National Lottery Distribution Fund balances.
    - Increasing commitments could have a significant impact on National Lottery Distribution Fund balances, although it would take time for the impact to be felt.
  - There is some but more limited scope for distributors to reduce balances by increasing their speed of spending.
    - There is scope for distributors to influence the time projects take to complete and draw down their funding.
    - Speeding up projects could have some impact on National Lottery Distribution Fund balances, but the impact would be less than from increasing commitments. And eleven distributors do not consider that speeding up projects is a realistic way of reducing National Lottery Distribution Fund balances.
- 8 Distributors face a range of uncertainties and risks in managing their National Lottery Distribution Fund balances.**
- There is uncertainty about lottery distribution arrangements in the future and the lottery income that distributors will receive.
    - The current licence to operate the National Lottery runs until 31 January 2009 and the share of lottery proceeds that the good causes receive could change after that.
    - There is no guarantee about the amount of money that will be raised from lottery ticket sales and the impact of the proposed Olympic lottery games on the existing good causes is uncertain.
    - Investment income is uncertain and the Department proposes to change the way in which it is allocated to distributors to ensure there is no incentive to maintain high balances.
  - There is uncertainty about distributors' future expenditure and they lack confidence in the forecasts of expenditure that projects provide. Most distributors could estimate more accurately the amount of money they need to draw down from the National Lottery Distribution Fund, which would have financial benefits.
  - Distributors could find themselves in difficulty if income was significantly less and/or expenditure significantly more than expected. They could have insufficient funds to meet the grant commitments they have made or they might not be regarded as a 'going concern'.







## Our recommendations

The decisions about grant making that impact on the balances in the National Lottery Distribution Fund are the responsibility of individual distributors. Those distributors with the largest balances, particularly the Heritage Lottery Fund and the New Opportunities Fund, can make the biggest contribution to reducing the overall balances. However, the Department too has a role, especially in relation to the New Opportunities Fund where it decides the grant programmes to be run and the funding to be committed to them.

If distributors and the Department are to manage effectively the opportunities and risks in seeking to reduce balances, there are a number of areas that require attention.

### AREAS FOR ATTENTION

### RECOMMENDATIONS

#### Forecasting income

The uncertainty about lottery distribution arrangements beyond the end of the current licence in 2009 will start to affect distributors' grant making from 2005-06 as they reduce commitments to be sure of having sufficient funds available to meet them.

The sooner the Department can provide more clarity about future distribution arrangements, the more confident distributors will be in continuing to make further commitments.

In the more immediate future, distributors need reliable and regular information about the income that is expected to be raised from the sale of lottery tickets in the years to 2009.

- 1 The Department should set a clear timetable for making decisions about, for example, the proportion of lottery proceeds that will be allocated to the good causes, and the share of the proceeds that each good cause and distributor will receive.
- 2 The Department should seek to enhance distributors' confidence in the projections of future lottery income by:
  - producing the projections on time each quarter;
  - providing further information about the basis of the projections and the underlying assumptions;
  - reviewing periodically how accurate the projections have been and reporting the results to distributors.

## AREAS FOR ATTENTION

## RECOMMENDATIONS

## Managing expenditure

There are ways in which distributors can influence the time taken to complete projects and therefore their own speed of spending. In August 2003 the Department circulated good practice examples drawn from larger distributors on this area (see Figure 20 on page 25).

Distributors are dependent on projects' forecasts of expenditure to inform their own drawdown of money from the National Lottery Distribution Fund and to help calculate the amount of money that they have available to make new commitments. But at present they lack confidence in these forecasts.

Distributors draw down money from the National Lottery Distribution Fund to pay grants or meet their own expenses. Some distributors are better than others at predicting their cash requirements. If distributors draw down more money than they need, the money remains in their own bank accounts and is likely to earn a lower rate of interest than in the Distribution Fund.

- 3 Distributors should adhere to the good practice guidance on the earlier payment of grants and the Department should monitor the extent to which distributors are doing so.

- 4 Distributors should work with projects to achieve forecasts of expenditure that they have confidence in.

This could involve distributors:

- making clear to projects the criteria they will use to assess whether forecasts are reliable and realistic, the importance of such forecasts for projects themselves, and the impact of poor forecasting on distributors' capacity to fund other deserving projects;
- working with projects to ensure they have the capacity to provide such forecasts;
- considering ways of providing projects with positive financial incentives to draw down funding in line with their forecasts. An example of how such an incentive can work in certain circumstances is shown in Figure 25 on page 31.

- 5 A project's consistent failure to provide reliable and realistic forecasts or draw down funding in line with them may indicate wider problems with the project. In such cases, distributors should be prepared to reduce or withdraw funding.

Mindful of the community benefits that lottery funding can bring, distributors would have to weigh up the risks of continuing to fund a project that is struggling with the risks of a project being left unfinished. Distributors would also need to consider the materiality of a project's grant and the wider implications for their grant programmes.

- 6 Distributors should not draw down from the National Lottery Distribution Fund more money than they need. Drawdown should be based on the grants they expect to pay in the coming period and estimated administration costs.



## AREAS FOR ATTENTION

## RECOMMENDATIONS

## Focusing on funding capacity

A distributor's capacity to make new commitments (its 'funding capacity') is determined by:

- the balances it currently holds in the National Lottery Distribution Fund;
- **plus** its likely future income;
- **less** its likely future expenditure, stemming from existing commitments.

To manage their grant making, make informed decisions about making further commitments, and set targets for their National Lottery Distribution Fund balances, distributors need to know their funding capacity at any given time. They also need to be able to project the likely impact that their grant making decisions will have on their National Lottery Distribution Fund balances.

Distributors should be aiming to achieve a broadly stable position with annual income and expenditure more or less equal and minimum working balances in the National Lottery Distribution Fund.

Although addressing these areas for attention will enable distributors to manage more effectively the opportunities and risks in seeking to reduce balances, there will be residual uncertainties surrounding their future income and expenditure. This may lead distributors to maintain higher balances in the National Lottery Distribution Fund than would otherwise be necessary.

- 7 With a view to reducing their National Lottery Distribution Fund balances, distributors should identify whether they have the funding capacity to make more commitments without compromising value for money.

We have developed a model (see the Appendix) to help distributors assess their capacity to fund additional commitments. We have discussed the model with the Department and the Heritage Lottery Fund and have agreed that we will share it with other distributors. Accordingly, we are now preparing a user-friendly format for distribution.

- 8 In the short term, to provide a clear focus on tackling the accumulated balances currently held in the National Lottery Distribution Fund, distributors should set interim targets for bringing down their balances.

- 9 In the long term, distributors should hold no more money in the National Lottery Distribution Fund than is necessary to cover any short term differences between their income and expenditure.

- 10 Given the residual uncertainties, the Department should assess how a mechanism could be established within the National Lottery Distribution Fund to accommodate unexpected variations in individual distributors' income and expenditure.