



National Audit Office

**REPORT BY THE  
COMPTROLLER AND  
AUDITOR GENERAL**

**HC 653  
SESSION 2010–2011  
DECEMBER 2010**

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**HM Treasury**

Examination of the forecasts prepared  
by the Office for Budget Responsibility  
for 29 November 2010

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The National Audit Office scrutinises public spending on behalf of Parliament. The Comptroller and Auditor General, Amyas Morse, is an Officer of the House of Commons. He is the head of the National Audit Office which employs some 900 staff. He and the National Audit Office are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources. Our work leads to savings and other efficiency gains worth many millions of pounds: £890 million in 2009-10.



National Audit Office

**HM Treasury**

# Examination of the forecasts prepared by the Office for Budget Responsibility for 29 November 2010

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**Report by the Comptroller and Auditor General**

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Amyas Morse  
Comptroller and  
Auditor General

National Audit Office

2 December 2010

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This report can be found on the National Audit Office website at [www.nao.org.uk/OBR-Forecast-2010](http://www.nao.org.uk/OBR-Forecast-2010)

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## Statement of responsibilities

**1** The Chancellor launched the interim Office for Budget Responsibility (OBR) on 17 May 2010. The main duty of the OBR is to examine and report on the sustainability of the public finances. The interim OBR undertook its first set of forecasts for the June Budget. The terms of reference for the OBR have since been revised and are attached at Appendix 1. These terms of reference task the OBR with producing an updated fiscal and economic forecast before the end of the year. This was published on 29 November<sup>1</sup> and sets out the forecasts for the economy and public finances, and gives an updated assessment of long term fiscal sustainability.

**2** Under sections 156 and 157 of the Finance Act 1998 the Comptroller and Auditor General (C&AG) has a duty to examine and report on conventions and assumptions underlying the fiscal projections that are submitted to him by the Treasury for examination. The Government's Budget Responsibility and National Audit Bill is currently being debated by Parliament. The Bill is designed to establish the OBR on a statutory basis and repeal sections 156 and 157 of Finance Act 1998.

**3** Until there is statutory basis for the new arrangements, the C&AG's duties under the 1998 Finance Act remain. The Chancellor has requested that the C&AG undertake an examination with following scope:

- To consider whether key economic and fiscal assumptions underpinning the Office for Budget Responsibility's forecasts were independently arrived at.

**4** This report considers the OBR's forecasts published on 29 November 2010. The scope is the same as our previous examination looking at the forecasts that the interim OBR undertook for the Budget on 22 June 2010.<sup>2</sup> The remit of these assessments differs from requests by previous Chancellors which asked the C&AG to examine the reasonableness and caution underpinning projections of the public finances. The remit of this work does not include any review of the forecast itself or of specific underpinning assumptions.

<sup>1</sup> OBR Economic and Fiscal Outlook, November 2010, Cm 7979.

<sup>2</sup> Comptroller and Auditor General, Examination of the forecasts prepared by the interim Office for Budget Responsibility for the emergency Budget 2010, HC 142, Session 2010-11, June 2010.

## Criteria for this examination

5 This examination requires a clear understanding of the nature of independent judgements as they relate to economic and fiscal assumptions. We have used the same criteria for assessing whether the key economic and fiscal assumptions were independently arrived at as the C&AG's previous examination. The criteria are set out in **Figure 1**.<sup>3</sup>

6 In practice, these criteria can only be assessed using qualitative evidence and subjective judgements on the persuasiveness of evidence. Given the difficulties of proving the absence of factors which may inhibit the ability to arrive at forecasts independently, the key judgement is whether the evidence *reasonably* suggests that the criteria have been met.

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### Figure 1 Criteria for this examination

#### Whether key economic and fiscal assumptions underpinning the Office for Budget Responsibility's forecasts were independently arrived at

- The Budget Responsibility Committee had full discretion over the scope and nature of its judgments on the forecasts.
- The Budget Responsibility Committee and Secretariat had control over sufficient resources to consider the evidence and form a robust judgment.
- The Budget Responsibility Committee and Secretariat had unrestricted access to the necessary data and analysis.
- The Office for Budget Responsibility effectively scrutinised, questioned and challenged the information and advice it received.
- The Budget Responsibility Committee formed its judgments independently of any views of officials, or Ministers.
- The Budget Responsibility Committee had autonomy over the content of its published reports and the means of dissemination.

Source: National Audit Office

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3 These criteria have been derived from a range of sources, as explained in the June 2010 report.

## Background

**7** The interim OBR published its first forecast on 14 June 2010,<sup>4</sup> followed by another forecast on 22 June to reflect the measures announced in the June Budget.<sup>5</sup> In the previous examination, we came to the conclusion that the key economic and fiscal assumptions underpinning these forecasts had been independently arrived at.<sup>6</sup>

**8** Since that assessment, the Treasury has published revised terms of reference for the OBR (attached at Appendix 1). These required the OBR to produce an updated forecast by the end of the calendar year. The updated forecast was published on 29 November.<sup>7</sup> This sets out forecasts for the period up to 2015-16, assesses whether the government is on course to meet its medium-term fiscal objectives, and offers observations on the long-term sustainability of the public finances.

**9** The OBR consists of the Budget Responsibility Committee (the Committee) comprising three members and a secretariat. Robert Chote has been appointed as the new chair of the Committee and head of the OBR, through open competition and subsequent approval by the Treasury Select Committee.<sup>8</sup> The remaining two Committee members were also appointed through open competition and approved by the Treasury Select Committee.<sup>9</sup> The Committee is responsible for the OBR's forecasts and analysis.

**10** A secretariat of 13 staff support and advise the Committee. The Treasury has transferred the staff to the new body and made them directly accountable to the head of the OBR. Whereas previously the OBR relied on Treasury staff to conduct its economic forecasts this is now done in-house. The OBR also now coordinate, scrutinise and compile the fiscal forecast in-house. The OBR is expected to relocate from HM Treasury to separate premises by the end of 2010.

**11** The bill to put the OBR on a statutory footing is progressing through Parliament.

<sup>4</sup> [http://budgetresponsibility.independent.gov.uk/d/pre\\_budget\\_forecast\\_140610.pdf](http://budgetresponsibility.independent.gov.uk/d/pre_budget_forecast_140610.pdf)

<sup>5</sup> [http://budgetresponsibility.independent.gov.uk/d/junebudget\\_annexc.pdf](http://budgetresponsibility.independent.gov.uk/d/junebudget_annexc.pdf)

<sup>6</sup> Comptroller and Auditor General, Examination of the forecasts prepared by the interim Office for Budget Responsibility for the Emergency Budget 2010, HC 142, Session 2010-11, June 2010.

<sup>7</sup> OBR Economic and Fiscal Outlook, November 2010, Cm 7979.

<sup>8</sup> HC Treasury Select Committee, *Appointment of Robert Chote as Chair of the Office for Budget Responsibility*, 3rd Report of Session 2010-11, HC 476, September 2010.

<sup>9</sup> HC Treasury Select Committee, *Appointments to the Budget Responsibility Committee*, 5th Report of Session 2010-11, HC 545-II, October 2010.



## Summary of work performed

**12** In forming a judgement against the criteria, in principle there are four main types of evidence to consider:

- the institutional arrangements and processes governing the OBR forecasts;
- the views of key stakeholders;
- any positive evidence of challenge or scrutiny by the OBR; and
- the absence or existence of any evidence suggesting undue external interference over the forecast.

**13** Correspondingly, we collected evidence between 8 November and 2 December from the following:

- A written representation from Robert Chote, Chair of the Committee.
- Interviews with key individuals:
  - The three members of the Committee.
  - Members of the secretariat of the OBR.
  - Senior Treasury officials interacting with the OBR.
- Attending an internal challenge meeting between the OBR and government officials forecasting specific elements of taxation and expenditure.
- The revised terms of reference for the OBR and official statements on the finances of the OBR.
- A selection of briefing documents and correspondence between the Committee, the OBR secretariat and HM Treasury.
- Informal consultation with external non-government commentators to understand their views on the OBR's independence:
  - Jill Matheson, National Statistician and Chief Executive of the UK Statistics Authority.
  - Professor Tim Besley, of the London School of Economics.
  - Sir Alan Budd, former head of the interim OBR.
  - Carl Emmerson, acting director of the Institute for Fiscal Studies.
  - Professor Simon Wren-Lewis, of Oxford University.
- The OBR's Economic and Fiscal Outlook document, published 29 November 2010.
- The list of substantive contacts between the OBR and ministers, their special advisers and their private office staff during the forecasting process, as published on the OBR's website on 2 December.

## Findings

### Criterion: discretion over scope and judgements

**14** The terms of reference for the OBR state that as part of its remit it “will make independent assessments of the economy, public finances and fiscal sustainability”. They also state that “the Budget Responsibility Committee has direct control over the forecasts and will make all the judgements and assumptions underpinning the forecasts and analysis”.

**15** The Committee was briefed and advised by the OBR secretariat on the key assumptions for the economic forecast, and by Government officials who undertake detailed fiscal forecasting. The Committee retained discretion over whether or not to accept this advice. The Foreword to the OBR’s forecast document states that “the forecasts presented in this document represent the collective view of the three independent members of the OBR’s Budget Responsibility Committee. We take full responsibility for the judgements that underpin them and for the conclusions we have reached.”

**16** In preparing its economic and fiscal forecasts, the Committee’s assumption on the output gap is particularly important. The output gap attempts to measure how much spare capacity there is in the economy and is a key judgement that can affect the forecasts of several key variables including inflation and economic growth. The output gap is also critical to the Committee’s judgement as to whether the government’s policies are sufficient to meet its fiscal mandate. To inform their judgement, the OBR secretariat produced detailed analysis of the output gap for discussion with the Committee. In addition the Committee considered different methods for calculating the output gap including the views of HM Treasury economists. As a result of the review the Committee chose to keep the methodology that the previous Committee had used for its June forecasts, which differs from the approach previously used by the Treasury (the OBR will be reviewing this output gap methodology and historic Treasury estimates of the output gap in future work). The Committee’s discussion and judgement concerning the output gap is presented in the published forecast (of 29 November) and is consistent with the documentary evidence supplied to us.

**17** The terms of reference also state that “the Office for Budget Responsibility will not comment on the merits of individual policies, or examine alternative policy scenarios”. Some external commentators have suggested that this might reduce its ability and scope to assess fiscal risks and establish its independence. However, we do not believe this to be the case, for the following reasons. However, we do not believe this to be the case, for the reasons outlined in paragraph 18.

**18** Regarding the merits of individual policies, it is worth noting that other independent organisations, such as the National Audit Office, are not allowed to comment on the merits of government policy. The key question for this assessment is whether the interpretation of the terms of reference could reduce the ability of the Committee to have full discretion over the scope and nature of its judgments on the forecasts. In assessing this question we identified a number of considerations:

- Firstly, the members of the Committee and the Treasury officials interviewed were clear that the OBR is free to assess any *economic* scenarios that it chooses. This is confirmed by the discussion and analysis of two alternative economic scenarios in the OBR's forecast document (a "delayed rebalancing scenario" and a "persistent weak demand scenario").
- Secondly, Treasury officials explained that the prohibition on examining "alternative policy scenarios" relates to the OBR examining alternative "macro" policy scenarios such as a slower or a faster pace of fiscal consolidation, relative to announced government policy. The Committee and OBR secretariat shared this interpretation of the remit. The chair of the OBR confirmed his view as previously stated in a letter to the Treasury Select Committee, that he wanted Parliament to provide a steer on whether the OBR should analyse alternative policy paths.<sup>10</sup> Pending that decision, the Committee did not feel that the inability to assess alternative (macro) policy scenarios impinged on their ability to decide on the key economic and fiscal assumptions underpinning its forecasts.
- Thirdly, the Committee explained that for Government policies that are still to be implemented they considered the costings, and methodology underlying them. The Government provided the OBR with revised costings where the fiscal impact of these policies could be quantified with reasonable accuracy. The Committee certified these costings based on a judgment of whether they agreed:
  - that all measures that could be reasonably quantified had been included; and
  - with the underlying methodology of the costing.
- For example, they did not include the Universal Credit in their forecasts as the details of the policy are not certain enough. In contrast, the policy details on tuition fees were sufficiently detailed to warrant inclusion of this measure in their forecast.

**19** Based on the evidence provided to us and the scenarios presented in the economic forecast, we are content that the current scope of the OBR does not negatively impact on its ability to arrive independently at the key economic and fiscal assumptions and that there is positive evidence of OBR having full discretion over its scope and forecast judgements.

<sup>10</sup> [http://budgetresponsibility.independent.gov.uk/d/letter\\_rchote\\_to\\_atyrie.pdf](http://budgetresponsibility.independent.gov.uk/d/letter_rchote_to_atyrie.pdf)

### **Criterion: control over sufficient resources**

**20** In regard to resources, the OBR's terms of reference state that the Treasury will undertake two specific tasks:

- transfer the staff at the "heart of forecasting to the Office for Budget Responsibility"; and
- "provide the Office for Budget Responsibility with appropriate resources to fulfill the terms of reference".

**21** Twelve Treasury forecasting staff were transferred to the OBR by October 2010 and are answerable to the head of the organisation. This has given the OBR the capacity to undertake economic forecasting in-house, to coordinate the fiscal analysis undertaken by experts in various Departments, and to undertake the forecasting for total receipts and spending. The OBR needs to rely on staff resources across a number of government departments to undertake detailed fiscal forecasting and analysis.

**22** On 25 October, the Permanent Secretary of the Treasury, Sir Nicholas Macpherson, wrote to the head of the OBR to confirm that it will receive £1.75 million per annum between 2011-12 and 2014-15. While the Committee commented that the secretariat was fully stretched in producing the forecasts, it confirmed that it has been provided with sufficient resources to undertake this forecast.

**23** **The views of the Committee, and the quality and quantity of the analysis undertaken and published in the forecast, led us to conclude that the OBR has control over sufficient resources to fulfil its remit.**

### **Criterion: unrestricted access to data and analysis**

**24** The OBR's terms of reference state that the Treasury and all other relevant parts of Government will provide any data and analysis requested by the OBR.

**25** The Committee confirmed that it had the information required in sufficient time, that its requests for further data and analysis were met by Government analysts and that the data was of the expected quality. The papers and challenge meeting relating to the fiscal forecast seen by us are consistent with the Committee having access to the necessary government data and analysis, as is the extensive analysis of the fiscal outlook in the OBR's published document. In addition, the Committee and OBR secretariat confirmed that they sought advice from external organisations and were free to do so.

**26** **We conclude that the OBR had unrestricted access to the necessary data and analysis.**

### Criterion: scrutiny and challenge

**27** The Committee held over 40 challenge meetings to discuss key economic assumptions with Treasury officials, and the fiscal projections prepared by officials from the Department of Work and Pensions and HM Revenues and Customs. The meetings provided the Committee with an opportunity to discuss the key determinants, results and judgements of the main individual forecast variables with the appropriate departmental officials.

**28** Although effective scrutiny could of course result in consensus, disagreement provides positive evidence of scrutiny. We therefore sought evidence of assumptions on which, as a result of scrutiny and challenge, the Committee adopted a different position from the advice provided by departmental officials. The Committee provided us with several specific examples supported by documentary evidence where it had challenged the fiscal assumptions and analysis presented to it by officials and this evidence is consistent with the content of the published forecast.

**29** **We conclude that the evidence presented to us and the published forecast clearly show that the Committee effectively scrutinised, questioned and challenged the information and advice it had received.**

### Criterion: independent judgement

**30** It is, of course, very difficult to prove the absence of political influence. Views on this are likely to be more influenced by the OBR's judgements and behaviours over a period of time than by statements. But for this examination there are two key questions relevant to this criterion: first, the independence of the OBR staff who have transferred from the Treasury, and second the independence of the Committee from political interference.

**31** In relation to the first question, until the OBR is established on an independent statutory basis, the OBR staff remain members of the Treasury. However, all those interviewed by us were of the view that these arrangements do not hinder the independence of the secretariat. The Committee and senior Treasury officials argued that it would be clear to everyone that the OBR's forecasts and judgements were the responsibility of the Committee, and that the career prospects of secretariat members would depend primarily on the quality of their analysis. Whether this turns out to be the case will become clearer over time. But nothing has come to our attention that makes us concerned that the members of the OBR secretariat will feel constrained in offering their best professional advice to the Committee.

**32** With regards to the second question, the terms of reference indicate that the OBR may choose to consult the Chancellor in preparing its documents but is not obliged to do so. However, there is an understanding between OBR and HM Treasury that the OBR will share the details of the forecast with the Chancellor so that he can prepare a policy response if he deems it necessary. The head of the OBR stated that he met twice with the Chancellor before the publication of the forecast. The first meeting discussed OBR resources and the process around the Chancellor's statement to Parliament concerning the OBR's latest forecast. The second meeting, where all three members of the Committee met with the Chancellor on 18 November, presented the main elements of the OBR's forecast. The chair of the OBR explained to us that he had decided on the timing of the second meeting with the Chancellor. He wanted to balance two factors: firstly, the need to inform the Chancellor in sufficient time for the Treasury to prepare additional policy measures or announcements in response to the OBR's forecast (if the Chancellor deemed that necessary); and secondly, the need to present to the Chancellor a near-final version of the forecast and judgment on the fiscal mandate. Treasury officials said that they would have preferred earlier access to the Committee's judgements, to increase the time to plan for a policy response if the Chancellor wanted to do so, but that the decision over timing had been determined by the OBR for this forecast.

**33** To increase transparency, the OBR has compiled and published a communication log which lists all the interactions with the Chancellor, other Treasury Ministers and their Special Advisors.<sup>11</sup> The log confirms that members of the BRC met twice with the Chancellor.

**34** Finally, in the Foreword to the forecast report, the Committee state explicitly that following its meeting with the Chancellor and his officials on 18 November "no substantive changes were made to its forecast". The Committee also state that "we have come under no pressure from Ministers, advisers or officials to change any of our conclusions".

**35** As we noted above, it is very difficult to prove the absence of political influence. Evidence on the OBR's independence will emerge over time, and we welcome the steps by the OBR to improve transparency by publishing a list of all substantive contacts with Ministers and their advisers. **From the work we have performed, we are satisfied that there is no evidence of political influence on the assumptions and judgements of the Committee which would lead us to conclude that they were not independently arrived at.** We note that this independence will be more strongly entrenched as the OBR is established on a statutory basis and its staff are no longer formally employed by the Treasury.

<sup>11</sup> [http://budgetresponsibility.independent.gov.uk/d/obr\\_contact\\_log\\_4oct\\_29nov\\_2010.pdf](http://budgetresponsibility.independent.gov.uk/d/obr_contact_log_4oct_29nov_2010.pdf)

### **Criterion: autonomy over content and dissemination of published reports**

**36** The terms of reference state that the OBR has discretion over what material is published in fulfilling its remit, and this is also stated in the OBR's release policy.<sup>12</sup> In line with this release policy, Treasury officials and Ministers were unable to view the OBR's report until 24 working hours before release, which is confirmed by the Communications log.<sup>13</sup>

**37** The Committee confirmed to us that the OBR now has its own press officer, whereas it relied on Treasury resources for its previous forecasts in June. The Committee stated that it has been free to promote its report as it sees fit, which is consistent with the media presence of the Committee following the publication of its report.

**38** The OBR has also published additional information about the forecasts on its website that has not been published before, including quarterly employment forecasts and additional information regarding the projected path for the Consumer Price Index measure of inflation.

**39** **We conclude on this basis that the Committee exercised sufficient autonomy over the content and dissemination of its published report.**

## **Conclusion**

**40** In our opinion, based on the criteria in Figure 1, the key economic and fiscal assumptions underpinning the Office for Budget Responsibility's forecasts have been independently arrived at.

<sup>12</sup> [http://budgetresponsibility.independent.gov.uk/d/release\\_policy.pdf](http://budgetresponsibility.independent.gov.uk/d/release_policy.pdf)

<sup>13</sup> [http://budgetresponsibility.independent.gov.uk/d/obr\\_contact\\_log\\_4oct\\_29nov\\_2010.pdf](http://budgetresponsibility.independent.gov.uk/d/obr_contact_log_4oct_29nov_2010.pdf)

## Appendices

### **Revised Terms of Reference for OBR**

The Government will introduce legislation this autumn to establish the Office for Budget Responsibility on a statutory footing as part of its reforms to the UK fiscal framework.

In advance of the legislation coming into force, the OBR will operate to these Terms of Reference. Final operating arrangements will be published once legislation has been put in place.

### **Remit**

The OBR will make independent assessments of the economy, public finances and fiscal sustainability.

The OBR will act objectively, transparently and impartially.

The OBR will examine the impact of decisions made by the Government on the sustainability of the public finances. The OBR should not comment on the merits of individual policies, or examine alternative policy scenarios.

### **Economic and fiscal forecasts**

The Spending Review will allocate spending between departmental expenditure and annually managed expenditure within the envelope set at the June Budget. As part of the Spending Review, and consistent with the approach taken in the June Budget, the OBR will provide independent scrutiny of the Government's estimated costing of annually managed expenditure (AME) policies.

The OBR will produce an updated official economic and fiscal forecast before the end of this year (the "autumn forecast").

The OBR will produce the official economic and fiscal forecast for Budget 2011. This forecast will incorporate the impact of the Government's policy measures. The Government is responsible for the analysis of the direct impact of policy on the public finances; the OBR will provide independent scrutiny of these costings and determine any resultant impact on the economic forecast.



## **Fiscal mandate**

The OBR will not comment on the design of the fiscal mandate. The Chancellor is responsible for fiscal policy and setting the fiscal mandate.

Alongside its autumn forecast, the OBR will make an updated judgement on whether policy announced to that date remains consistent with a greater than 50 per cent chance of achieving the fiscal mandate.

Alongside its Budget forecast, the OBR will make a formal judgement on whether the fiscal policy set at that Budget is consistent with a greater than 50 per cent chance of achieving the fiscal mandate.

## **Fiscal sustainability**

The OBR will produce further analysis on long-term sustainability.

## **Ex-post fiscal assessment**

The OBR will produce an analysis of past forecasting performance.

## **Other analysis**

The OBR is responsible for determining its work programme, subject to its remit set out in these Terms of Reference.

The Chancellor may request the OBR, as an executive body, to provide reports on areas of interest to the Government. The OBR may choose whether or not to produce these reports, subject to its remit and available resources. Requests of this nature and resulting reports will be published.

## **Independence and relationship with HM Treasury and Parliament**

### **Decision-making**

The Chair of the OBR is responsible for leading the OBR, and will oversee its day-to-day operations.

The Chair leads the BRC.

The BRC has direct control over the forecast and will make all the judgements and assumptions underpinning the OBR's forecasts and analysis.

### Access to resources

The Treasury and all other relevant parts of Government will provide the OBR with any data and analysis requested by the OBR and deemed reasonable and necessary to fulfil the roles set out in these Terms of Reference.

The OBR should observe the standard confidentiality rules in relation to policy information and data provided.

Steps have already been taken to enhance the technical independence of the OBR by transferring those staff working at the heart of the forecasting process to the OBR. These staff will report to the Chair of the OBR.

The Treasury will provide the OBR with appropriate resources to fulfil these Terms of Reference, in particular, to allow the OBR to draw on expertise outside Government to support its remit.

There will be a separate disclosure relating to the costs of the OBR in the notes to the Treasury's Resource Accounts for the financial year 2010-11.

Resources provided to the OBR by the Treasury will be clearly set out in the Treasury's accounts at the end of the year, which will be laid before Parliament.

### Publications

The OBR has discretion over what material is published in fulfilling its remit set out in these Terms of Reference.

The Chancellor will commission the OBR to produce the official forecast and updates to it.

In all other cases, the OBR shall follow a transparent, regular and predictable process in its publication of reports, with release dates set out well in advance.

Where the OBR publishes other analysis or supplementary information in response to requests, it will do so on a monthly basis. The OBR will set out further details of its release policy.

The OBR may choose to consult the Chancellor in preparing documents, but is not obliged to do so.

### Accountability to Parliament

Until the legislation is passed, the Treasury and OBR will operate as far as possible as if it were in place. That is, the OBR will be accountable to Parliament for the delivery of the tasks set out in this Terms of Reference. Members of the BRC will be available to give evidence to relevant Parliamentary committees.

In advance of Royal Assent, the Treasury looks to the OBR to account to Parliament in the first instance for ensuring the office is properly and efficiently run.

All information published by the OBR will be made available to Parliament.



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