National Audit Office

SHORT GUIDE

Reorganising arm's length bodies

Good practice principles for implementation

Introduction

The National Audit Office exists to provide independent opinion and evidence to assist Parliament in holding the Government to account. We can only do this effectively if we retain our ability to comment objectively and independently on what government does, and we cannot therefore act as an adviser on specific decisions the Government takes. We can, however, reasonably and helpfully point out what we understand to be principles of good practice in particular areas, and that is what this Short Guide, one of a series, aims to achieve. Drawing on our financial audit and value for money work, we have identified a number of areas where government is currently facing particular challenges. One challenge is to implement effectively decisions to close or merge a number of arm's length bodies. This paper highlights key issues for public bodies to consider in facing this challenge.

Summary

Government has announced its intention to close or take out of public ownership 192 arm's length bodies and to merge a further 118. The process of reorganising arm's length bodies can reduce costs, but it can also lead to a higher risk of impropriety, a loss of control over public expenditure and poor value for money. These risks are different to those that organisations are used to managing as part of 'business as usual', and may require a different response. Equally, it is important not to lose sight of 'business as usual' risks. Our past work has highlighted a number of challenges including identifying in advance the benefits reorganisation is intended to bring, monitoring the costs and benefits of reorganisation, ensuring adequate governance arrangements are in place, and, ensuring that there is enough robust information to produce auditable accounts for both the merged or abolished 'legacy' bodies, and any newly created 'successor' bodies. The NAO is therefore well-placed to set out principles of good practice for the effective reorganisation of arm's length public bodies, in order to assist public bodies in ensuring that the closure or merger process obtains good value for money. Publications which provide further guidance and useful examples are listed at the back of this guide.

Reorganising arm's length bodies

Government has established a target of delivering £600m of savings in 2010-11 through cutting the cost of arm's length bodies. Government has announced its intention to close or take out of public ownership 192 arm's length bodies and to merge a further 118 over the next few years. The closure or merger of these bodies can present an opportunity for savings, but for these savings to be realised the closure or merger must be managed effectively. This requires appropriate processes to be in place, including **governance arrangements, risk management, people and information management, and communication strategies**. These need to be established in advance of the closure or merger and regularly updated as closure or merger proceeds. The transition project will present additional risks to value for money, and some of these can be managed by early consideration of **how to monitor the costs and benefits of reorganisation, and putting in place appropriate project management arrangements**. Finally, there are specific risks around the creation of a new body or winding up an old body. These include **managing contractual liabilities** and **ensuring parliamentary approval for expenditure.**

The National Audit Office has scrutinised the merger and closure of arm's length bodies and machinery of government changes. This guide starts from the point at which the decision has been made to carry out a closure or merger, and sets out principles for a controlled change that protects value for money. It gives particular considerations to the governance arrangements necessary to secure a sufficiently robust control environment around expenditure as the closure or merger process is implemented.

There are a number of different ways a government department can close or merge arm's length bodies. Activities can be abolished altogether, reassigned to one or more other arm's length bodies, or absorbed into a department. Arm's length bodies can take a variety of legal forms, with differing statutory footing and relationships with the department. While this guide is intended to set out helpful principles for consideration, organisations involved in a reorganisation will have to consider how to apply these principles to their particular circumstances.

To achieve cost-effective reorganisation of arm's length bodies, public sector bodies should consider the following four areas:

- Managing ongoing processes
- Managing the transition project
- Winding up the legacy body
- Setting up the new body

Managing ongoing processes

Accountability and Governance Arrangements

Parliamentary authority is required for expenditure on reorganising arm's length bodies, and the bodies involved will need to ensure that the ambit of their Vote includes this expenditure. There should be clarity about who is the Accounting Officer for the funds disbursed. Where functions are being transferred, the transfer of the budget together with the accountability for that budget must be formally agreed between the two Accounting Officers. Governance can be strengthened by increasing the involvement of the Audit Committee.

Responsibility for production of a final set of accounts for the merged or closed body should also be clearly assigned, and it is for individual organisations to decide what arrangements to make. Issues for consideration may include

- ensuring that there are sufficient finance staff to complete the process
- ensuring provision is made for any costs incurred after the year end on the preparation of the accounts
- ensuring that there is an Accounting Officer who can sign off the final accounts. Where the accounts cannot be signed on the final day of the legacy body's activity, responsibility for the accounts may transfer to the departmental Accounting Officer when an organisation closes, or to the new body's Accounting Officer where functions are transferred. Where the Accounting Officer has changed, the new Accounting Officer should obtain assurances on the operation of controls from the departing Accounting Officer.

Any change in Accounting Officer and the assurances obtained should be documented in the Statement on Internal Control. The Audit Committee should also be retained until the organisation winds down, to review the Accounts and make recommendations to the Accounting Officer. Where the accounts are not finalised before the organisation closes, arrangements should be made to present the accounts to the Audit Committee that will be advising the Accounting Officer who signs the accounts.

Risk assessment and management

During a closure or merger, organisations will be confronted by both 'business as usual' risks, and risks arising from the closure or merger process. Both of these need to be managed, and it will be important to ensure that management focus on one, does not result in ineffective control of the other. Arm's length bodies and their sponsor department must consider which risks are likely to increase (or reduce) as a result of the merger of closure process, and develop appropriate cost-effective plans to mitigate them. Examples of risks arising from closure or mergers can include the loss of information as staff leave, loss of assets and lack of clarity about duties as staff numbers reduce. As with business as usual risks, there should be clear ownership of the risks associated with the closure or merger. Knowledge of risks should be transferred along with activities as they move to another body. New risks will emerge as the organisation winds down and arrangements for managing them will need to be updated accordingly.

Managing Information

Organisations undergoing closure or merger will in most cases continue to be subject to **data protection** and **freedom of information** legislation, and **records management** requirements. It may be helpful to start by carrying out an audit of the information held by the legacy body or bodies, and considering what information is necessary for carrying out particular functions. Information may need to be destroyed, archived or transferred to other bodies. Organisations may need to update their information management strategy to ensure that at all points in the merger process it is clear who owns information, and who is responsible for any ongoing data protection or freedom of information enquiries. It is essential that organisations keep track of sensitive data to meet their data protection obligations. It may be helpful to speak to the National Archives early on, to understand which records should be archived. Where information is destroyed the Information Owner must ensure that it is destroyed securely, where appropriate.

It will also be important to ensure that the merger of information systems does not prevent the finance department and auditors being able to identify information relevant to the accounts of the body that has been merged. Financial records should be stored in line with record keeping requirements.

Managing people

Staff in the bodies involved will play a key role in the success or otherwise of the closure or merger. Timely and effective communication and engagement with staff is crucial. Effective engagement with staff may include:

- Explaining how changes will affect staff and the principles the organisation will use when dealing with staff;
- Keeping staff informed about the timetable for closure or merger, and any changes to it, as they emerge;
- Minimising uncertainty about redundancy or transfers to other organisations by providing information on the terms and timing of any redundancy as early as possible;
- Negotiating with the Trade Unions to agree any early exit schemes, or subsequent pay harmonisation in case of a merger;
- Ensuring that staff have a consistent message to give to external stakeholders about the closure or merger process;
- Providing appraisals and performance reviews to secure operational delivery; and
- Providing career advice and other support, and providing opportunity for staff to improve their skills through the closedown and merger process.

In addition to budgeting for early retirement and redundancy costs, organisations should take into account the costs of properly supporting staff and obtaining the right legal advice. Where staff are transferred, Cabinet Office guidance recommends that organisations should act as though staff are entitled to Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) protection.

Severance payments made to staff should be within the relevant conditions of service or approved severance scheme. These costs and ongoing liabilities must be accurately recorded in the accounts of the arm's length body or department as appropriate. Severance costs of senior management should be fully disclosed in the Remuneration Report.

In exceptional cases, where payments are over and above the relevant conditions of service or approved severance scheme, departmental and Treasury approval should be obtained prior to any agreement being made. They should also be disclosed in the losses and special payments note. Further information is available in Managing Public Money.

It is important to balance the need to have sufficient staff to complete the process, against the need to minimise close down costs from redundancy and early retirement. It is also important to be aware of the value for money and propriety risks of re-employing staff once they have taken early retirement or redundancy.

Liaising with external stakeholders

The closure or merger process will affect external stakeholders as well as staff. Where functions are being transferred to another organisation, it will be important to minimise service disruption. Stakeholders will need clarity on the timescale for the closure or merger, and who their primary contact point will be under the new arrangements. Where the closure or merger process will lead to the termination of contracts, it will be important to try and give as much notice as possible. To improve communication with the stakeholders, the website should be kept up to date, and on closure of the organisation it may be appropriate to keep the website available for a period of time.

Internal Audit

For bodies being abolished, internal audit plans should be revisited to ensure that work is focused on the key risks associated with abolition, and to verify that appropriate internal controls are in place right up to the time of closure.

For bodies being merged, the internal auditors of each organisation need to coordinate work programmes to ensure that the bigger picture issues affecting the merger are addressed and do not fall between the two sets of auditors.

For newly merged organisations, internal audit arrangements need to be reviewed. The merging organisations may have existing contracts with internal audit providers, and it may be necessary to have a joint arrangement for the first year of operations until a formal tender process can be undertaken for the new organisation.

Engaging with your external auditors

Early engagement with your external auditors to agree accounting policies and timetable will help to manage the final accounts production and certification. Consideration needs to be given to availability of information for audit, continuity of accounting systems and the availability of key staff to answer questions. The NAO can provide examples of accounts of organisations that have closed or merged.

Key accounting policies to consider are:

- Whether merger accounting applies, and whether the accounts should be prepared on a going-concern basis;
- Valuation or impairment of non current assets;
- Identifying provision for losses;
- Residual liabilities resulting from contract commitments; and
- Losses and special payments.

Managing the transition project

Managing costs and benefits of reorganisation

There are a number of steps that organisations involved in merger or abolition of arm's length bodies can take to improve the chances of being able to demonstrate cost reductions. These include determining in advance the financial and other benefits expected from the merger or closure, and establishing metrics and reporting arrangements for monitoring whether these are realised. The NAO's 2009-10 report on Reorganising Central Government found that central government bodies are weak at identifying and systematically securing the benefits they hope to gain from reorganisation.

In addition to costs incurred by the exchequer, closure or merger of arm's length bodies may impose costs on other stakeholders, for example through reduced service levels. Any impact on stakeholders, particularly customers, should be considered and managed.

Ensuring appropriate skills and knowledge are in place to deliver the project

Closure or merger requires different skills to 'business as usual', and arm's length bodies should consider whether they need to bring in additional expertise, either for guidance on specific issues or to ensure that the focus on managing business as usual risks isn't excessively diluted. This expertise may take the form of advice from the Cabinet Office or other departments. Organisations may find it helpful to identify another government body at a similar stage of closure or merger with whom to discuss challenges they face and emerging risks. In some circumstances, it may be necessary to bring in external expertise, for example from other public bodies that have been through a closure or merger. Where no appropriate public sector support is available, arm's length bodies should explore whether there is a central Government contract in place which can provide the necessary skills, and if not whether there are other bodies requiring the same skills with whom to co-procure.

Transition project team

The Accounting Officer will be responsible for ensuring an effective and efficient closure process while carrying out the organisation's statutory functions as business as usual. In order to do this, it may be useful to have a separate project management team, with a Senior Responsible Officer, a Programme Board and clear line of reporting to the Management Board to manage the transition process. The project management team should engage with the sponsoring department to identify what functions and the related staff, assets and liabilities are affected and to produce a project plan, including a timetable with clear milestones and related costs.

Transition budget

A separate budget to cover the costs of merger or closure should be agreed with the sponsor department and kept separate from the costs of business as usual activities. Responsibility for managing and monitoring this budget should be clearly allocated. The responsible officer should ensure that expenditure charged to the budget in the close down period is regular (authorised by Parliament) and meets the requirements for the proper use of public funds, with appropriate Departmental and Treasury authority obtained.

Liaising with the successor organisation

Good working relationships with successor bodies is essential for smooth transition of functions, and senior mangers should agree in principle how they will work together and how the functions will transfer. A memorandum of understanding could be used to set this out. Operational staff should also work together and it could be the role of the project team to identify cross functional teams. Financial teams from the legacy organisation should agree with the successor organisation what financial information will be required to produce the first set of accounts. This is particularly important if the successor organisation applies merger accounting and transition occurs mid year.

Winding up the old body

Managing contractual liabilities

Arm's length bodies are likely to have a number of ongoing contracts, including accommodation, facilities services, and equipment hire. Arm's length bodies should identify all existing ongoing contracts. They should consider which of them need to be varied or terminated during the closure or merger process. It may be better value for money to transfer contracts due for renewal before the date of closure onto a rolling month by month basis where possible, to retain access to the necessary resources but avoid paying for services or equipment after they cease to be needed.

Leases may be in place beyond the organisation's abolition date and there may be financial penalties associated with early termination. However these may be reduced if sufficient notice is given. Consideration should also be given to whether it is possible to transfer leases to another organisation.

Arm's length bodies should seek to renegotiate contracts that are due to terminate after the likely date of closure or merger. Where these are part of a wider government contract, it may be helpful to work with the Office of Government Commerce and the Efficiency and Reform Group in renegotiating the contracts, and to identify whether there are other government bodies who could take the contracts over.

When an arm's length body is abolished, the sponsor department should establish that adequate provision exists to meet residual pension liabilities for board members and staff. The source of finance should be carefully considered with the Treasury Spending Team. Further Guidance can be found in Non-Departmental Public Bodies Pension and Compensation Guidance Notes, issued by the Treasury.

Collection of Debts

Where debtors are aware that an organisation is closing there is a risk that they will not pay amounts due. Arm's length bodies should not lose sight of this, and should ensure that they collect as much of the outstanding debt as possible. Any residual debts should be passed over to the sponsor department or successor organisation.

Disposing of assets

Arm's length bodies will have a variety of assets. Some of these may be transferred to the department, or other body in the case of a merger. Others may need to be sold. Arm's length bodies should protect the interests of the tax payer in disposing of assets and avoid a 'fire sale'. It is important to ensure that there is accurate information that identifies all assets held, and their current market value. For land and buildings it may be necessary to obtain valuations. It will also be important to develop a disposal strategy, and to ensure that there is the necessary legal authority to dispose of the assets and that the disposal in properly recorded in the accounts. Some assets, in particular IT systems or paper files, may need to be cleaned before being disposed of, or destroyed altogether to ensure data security.

Creating a successor body

Ensuring parliamentary approval for expenditure

As part of his audit opinion, the Comptroller and Auditor General (C&AG), must confirm that expenditures incurred by public bodies are 'regular', meaning that they were authorised by Parliament. The C&AG has qualified his opinions on accounts for a number of new bodies because they have started work before they had any parliamentary authority to do so. It is important for the Accounting Officer of the new body to ensure he or she has parliamentary authority to spend public funds before the new organisation begins work.

Establishing Prior Year Comparators (PYCs)

The accounts of the successor bodies should include PYCs for the costs of activities that had previously been carried out, by any other body. This should include all material balances for the successor organisation's activities, whoever undertook them prior to its creation. Where there are entirely new activities, the notes on the accounts should explain that PYCs are not fully comparable.

Re-employment of staff made redundant by legacy bodies

The Public Accounts Committee has severely criticised new organisations that have re-employed staff who have received redundancy payments from legacy bodies, and the Comptroller and Auditor General qualified his opinion on the 2008-09 accounts of the Equalities and Human Rights Commissions partly because they had reemployed staff. Unless there is an extremely strong case to demonstrate value for money, this should be avoided.

Further guidance and examples

There are a number of publications that can provide further guidance and assistance. These include:

A Short Guide to Structured Cost Reduction (NAO 2010)
www.nao.org.uk/publications/1011/structured_cost_reduction.aspx

Reorganising central government (NAO, 2010)
www.nao.org.uk/publications/0910/reorganising_government.aspx

The creation of Ofcom: wider lessons for public sector mergers of regulatory agencies (NAO, 2006)
www.nao.org.uk/publications/0506/the_creation_of_ofcom_wider_l.aspx

Managing Public Money (HM Treasury, 2009)
www.hm-treasury.gov.uk/psr_mpm_index.htm

Non Departmental Public Bodies Pension and Compensation Guidance Notes (HM Treasury, 2003)
www.hm-treasury.gov.uk/d/ndpb_pensions.pdf

Where to find out more

The National Audit Office website is

www.nao.org.uk

If you would like to know more about the NAO's work and how we can help public bodies to improve performance, please contact your NAO client lead in the first instance or contact us via our general enquiries desk on:

020 7798 7264
enquiries@nao.gsi.gov.uk

Alternatively you can contact Marcial Boo, our Director of Strategy, Knowledge and Communications, who can then put you in touch with the most appropriate person within the NAO.

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Further reading

Further guidance, tools, technical information and good practice can be found on our website:

www.nao.org.uk/guidance_and_good_practice.aspx

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