National Audit Office

Report
by the Comptroller
and Auditor General

Nuclear Decommissioning Authority

Assurance of reported savings at Sellafield

HC 778 SESSION 2013-14 29 OCTOBER 2013

Summary

Background

1 Sellafield is the UK's largest and most hazardous nuclear site. The Nuclear Decommissioning Authority (the Authority) owns the site, its assets and liabilities, and leases the site to Sellafield Limited. Sellafield Limited holds the management and operations contract for the site and is the site licence company. In 2008, the Authority appointed Nuclear Management Partners Limited (NMP) as the 'parent body' of Sellafield Limited for an initial period of five years from 2009-10 to 2013-14, with options for extensions up to 17 years. As parent body, NMP owns Sellafield Limited for the duration of the parent body agreement and provides the senior management leadership to drive performance on the site.

2 Cost performance is an important part of overall site performance and is measured by site-wide savings figures. Savings at Sellafield are calculated by comparing actual spend in each year under NMP's management with baseline estimates of costs which would have been incurred under previous management to achieve the same outcomes. These baseline estimates are known as the contract baseline. One of the minimum performance standards for NMP was the achievement of at least 80 per cent of the site-wide savings potential for the initial period, which it had identified in its bid. The standard was revised in December 2012 to exclude legacy ponds and silos. Sellafield Limited is also eligible for efficiency fees. These are paid to NMP as dividends. The maximum efficiency fee available is calculated as 17.5 per cent of savings up to one-tenth of site funding for eligible activities, and 25 per cent of savings above that level.

3 The Committee of Public Accounts, in their report published in January 2013, *Nuclear Decommissioning Authority: Managing risk at Sellafield*[1] expressed concern that claimed savings figures are often overstated across government. They were particularly concerned that organisations can overstate their savings by moving costs from one part of their business to another. The Committee asked the National Audit Office to review the basis on which the Authority assesses savings at Sellafield and provide assurance to the Committee that the Authority has accurately measured and reported the level of savings achieved.

1 HC Committee of Public Accounts, *Nuclear Decommissioning Authority: Managing risk at Sellafield*, Twenty-third Report of Session 2012-13, HC 746, February 2013.

Scope of the report

4 We reviewed the Authority's systems for assuring the reported savings at Sellafield, and performed our own testing on items contributing to savings in 2012-13. The Authority has not yet completed its work to agree with Sellafield Limited the savings for 2012-13. This report is based on progress to date and includes the Authority's latest forecasts of savings for 2012-13 and 2013-14. We did not test the reliability of reported actual site-wide costs reimbursed by the Authority because assurance over those costs is gained through our certification of the Authority's accounts.

5 In this report:

- Part One describes the systems for measuring and reporting savings at Sellafield, including setting the baseline against which savings are judged. It presents latest forecasts of site-wide savings.
- Part Two describes and evaluates the Authority's assurance systems during the initial period to validate savings reported by Sellafield Limited.
- Part Three presents the results and conclusions from our own testing of reported savings for 2012-13.

Key findings

6 The original target for site-wide savings was £796 million over the initial period of the parent body agreement (from 2009 to 2014) at 2012 prices. This target is also one of the minimum performance standards for NMP, achievement of which would provide for automatic rollover of the contract into a second term. The target is calculated as 80 per cent of £1.4 billion of savings potential based on NMP's bid, adjusted to the same estimating basis as the baseline for savings. Forecast site-wide savings over the initial period fell from the £825 million forecast in October 2012 to £652 million forecast based on latest data. These forecast savings relate to impacts in the initial period and do not include the impacts of savings initiatives on costs in later years (paragraph 1.17).

7 On the most high-risk parts of the site – the legacy ponds and silos, the Authority is looking to incentivise progress on the ground rather than cost efficiency. Therefore, during 2012-13, it removed legacy ponds and silos from the efficiency fee mechanism. It is the Authority's view that legacy ponds and silos should also be removed from the minimum performance standard for savings from the date of agreement of the new mechanism, December 2012. Removing legacy ponds and silos from the minimum performance standard from December 2012 reduces target savings to £699 million at 2012 prices. The Authority's latest forecasts are for savings of £691 million against this target (paragraphs 1.18 to 1.19).

8 Moving from a whole-site approach creates new risks for the accuracy of reported savings against the minimum performance standard for the rest of the site. These risks can be mitigated by continuing to track the side-wide position and focused assurance work to confirm that costs are not shifted inappropriately to legacy ponds and silos from the rest of the site. The Authority understands the risk and intends to continue to monitor site-wide savings (paragraph 1.16).

9 The Authority tracks savings by comparing the cost of work carried out with the estimated cost of that work in the contract baseline, adjusted to remove savings not attributable to Sellafield Limited's actions. This system provides transparency over the baseline for measuring savings against. We reported previously that the contract baseline against which savings are currently measured underwent extensive assurance but uncertainty remains about delivery schedules and costs in the short and long term. The contract baseline is maintained through robust change control procedures (paragraphs 1.12 to 1.13 and 2.4 to 2.7).

10 The Authority's forecast of savings for 2012-13 are drawn from consistent and well-established systems and the Authority has undertaken appropriate assurance tests. It has also commissioned some further tests in the light of initial results. In addition to its general systems for measuring and reporting savings, the Authority requires Sellafield Limited to report progress on specific cost reduction initiatives. The project by project narratives associated with this reporting can help the Authority understand and, where necessary, challenge Sellafield Limited's attribution of the savings to practices, methods or initiatives it has introduced since appointment of NMP. It is, however, difficult to distinguish the contributions of such positive actions from the natural evolution of cost estimates when seeking to explain and attribute variances from that baseline (paragraphs 1.14 and 2.9 to 2.10).

11 Less reliance can be placed on savings reported in the previous years of the initial period when the baseline and/or the Authority's assurance were less well developed. The contract baseline was not established until October 2010 and was not applied to the first year of the initial period – 2009-10. The Authority's systems for assuring savings in 2010-11 and 2011-12 had weaknesses in the timing of scrutiny and/or the basis of sampling (paragraphs 1.10 and 2.15 to 2.16).

12 The Authority's current measurement, reporting and assurance systems for savings are very different from central government because they are based on its contractual framework for the site. In particular, site-wide measurement and reporting of savings mitigates the risks of efficiency savings being claimed by reallocating costs between cost categories. Costs moved from one unit to another will not improve site-wide performance (paragraphs 1.15 and 2.11 to 2.12).

Overall assurance conclusion

13 We judge that Authority's systems for recording, scrutinising and challenging claimed site-wide savings at Sellafield provide moderate assurance of reported overall savings. The Authority's testing and challenge of claimed savings was strongest in 2012-13, yielding credible explanations or appropriate adjustments, although this process is not yet complete. Weaknesses in the baseline, timing of scrutiny, or basis for sampling projects in earlier years means we can provide less assurance for savings reported for those years. As the Authority recognises, the exclusion of legacy ponds and silos from the minimum performance standards creates new risks to the accuracy of reported savings against that standard. These risks arise from the opportunity to allocate or charge a disproportionate share of costs to legacy ponds and silos, thus improving the apparent performance on the rest of the site. The Authority intends to mitigate this risk by continuing to monitor site-wide savings.

Recommendations

14 Irrespective of whether fees or other contractual provisions continue to be associated with savings the Authority should:

- continue to measure, scrutinise and report site-wide savings against a robust baseline, set the baseline for the next contract period, and agree a stretching savings target relative to that baseline, before the start of that period;
- exercise particular scrutiny and timely challenge of change requests which seek to add budget to the baseline (or remove scope without adjusting the baseline);
- proactively identify where external changes have reduced the need for spending and seek to agree baseline changes accordingly;
- make better use of reports on specific savings initiatives to provide assurance on the source of savings and learn lessons on which actions have proved most effective in improving efficiency;
- finalise and report on savings within four months of year end; and
- report estimated changes in whole-life costs alongside its reports of annual savings attributed to management action.