National Audit Office

Departmental Overview

The performance of HM Treasury 2013-14

AUGUST 2014

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO, which employs some 820 employees. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £1.1 billion in 2013.

Contents

Introduction
Aim and scope of this briefing 4

Part One
About HM Treasury 5

Part Two
Developments in this Parliament 16

Part Three
Recent NAO findings on HM Treasury 29

Appendix One
HM Treasury's sponsored bodies at 31 March 2014 45

Appendix Two
Results of the Civil Service People Survey 2013 46

Appendix Three
Publications by the NAO on HM Treasury since April 2013 48

Appendix Four
Cross-government reports of relevance to HM Treasury 49

Introduction

Aim and scope of this briefing

1 The primary purpose of this report is to provide the Treasury Select Committee with a summary of Her Majesty's Treasury's (HM Treasury's) activity and performance since September 2013, based primarily on published sources, including HM Treasury's own accounts and the work of the National Audit Office (NAO).

2 Part One focuses on HM Treasury's activity over the past year. Part Two examines developments in this Parliament. Part Three concentrates on NAO analyses of activity over the last year.

3 The content of the report has been shared with HM Treasury to ensure that the evidence presented is factually accurate.

Part One

About HM Treasury

HM Treasury's responsibilities

1.1 HM Treasury is the United Kingdom's economics and finance ministry, setting the direction of the UK's economic and fiscal policy and working to achieve strong and sustainable economic growth.

1.2 HM Treasury's Annual Report for 2013-14 sets out that HM Treasury is responsible for:

- reducing the structural deficit in a fair and responsible way;
- securing a growing economy that is more resilient, and more balanced between public and private sectors;
- continuing the reform of the regulatory framework for the financial sector to avoid future financial crises; and
- building a great Treasury that operates as a high performing organisation in collaboration with its strategic partners.

The first 3 of these responsibilities are the Coalition priorities, which have remained consistent since they were first announced in 2010.

1.3 As the economics and finance ministry, HM Treasury has a range of additional complementary activities, meaning it is also responsible for:

- public spending, including departmental spending, public sector pay and pensions, annually managed expenditure (AME) and welfare policy, and capital investment;
- financial services policy, including banking and financial services regulation, financial stability, and ensuring competitiveness in the City of London;
- strategic oversight of the UK tax system including direct, indirect, business, property, personal and corporation taxes;
- the delivery of infrastructure projects across the public sector and facilitating private sector investment into UK infrastructure; and
- ensuring the economy is growing sustainably.

How HM Treasury is organised

1.4 The Chancellor of the Exchequer has overall responsibility for HM Treasury and chairs the HM Treasury Board. The Chancellor is supported by a further 5 Ministers. The Board, whose members include ministers, also has executives and non-executives, who support and challenge the ministerial team and the senior officials who run HM Treasury. The Board also considers long-term strategy and monitors HM Treasury's performance and risk management, and its progress against priorities. The Board is scheduled to meet quarterly, but only met twice in 2013-14.

1.5 Below the HM Treasury Board there is a HM Treasury Board (Sub-Committee) which meets 4 times a year, 6 weeks either side of scheduled HM Treasury Board meetings. This is attended by the non-executive board members and the members of the Executive Management Board (EMB). The EMB itself, along with 3 risk groups (Economic, Fiscal and Operational) and the Audit Committee further supports the HM Treasury Board in its management of HM Treasury.

1.6 The aims and priorities set out by HM Treasury ministers are delivered by civil servants (**Figure 1**). The most senior is the Permanent Secretary, Sir Nick Macpherson. The Permanent Secretary is also the Principal Accounting Officer for the HM Treasury Group and so has personal responsibility for the proper presentation of HM Treasury's annual report and accounts. He also has overall responsibility for the delivery of the aims and priorities of ministers and the decisions and actions taken by HM Treasury officials.

1.7 The Permanent Secretary is currently principally supported in carrying out his duties by 2 Second Permanent Secretaries. Sharon White takes the lead on HM Treasury's finance ministry role, and John Kingman on HM Treasury's economic role. There are 5 director generals acting as senior advisers to the Chancellor on 5 specific policy areas: public spending; financial services; economics; tax and welfare; and international and EU.

1.8 HM Treasury is divided into 14 director-led groups (**Figure 2** on page 8). Each director has responsibility delegated to them from HM Treasury's EMB for the delivery of policy and management of risk within their group. They are also responsible for ensuring any policy or operational risks in their groups are shared across the Department to help actively manage the cross-cutting risks facing HM Treasury.

1.9 The HM Treasury Group consists of the wider family of partner organisations, companies and accounts overseen by the Permanent Secretary. At the end of the 2013-14 financial year there were 11 members of the HM Treasury Group (as shown in Appendix One). Many of the bodies were brought into the Group as a result of the 'Clear Line of Sight'[1] project in 2011-12, however the 2013-14 accounts were the first Group accounts which consolidated UK Asset Resolution Ltd (UKAR).[2]

1 Also known as the "Alignment Project". A government-driven project to simplify central government financial reporting to Parliament by reporting in a more consistent way, in line with the fiscal rules. Also refer to: http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/psr_clear_line_of_sight_intro.htm, accessed 20 August 2014.

2 UKAR is the holding company for the nationalised NRAM and Bradford & Bingley banks. See paragraph 2.9 for more information.

Figure 1
How HM Treasury is organised (as at 31 March 2014)

Permanent Secretary	Nick Macpherson							
Second Permanent Secretary	Sharon White				John Kingman			
Director General / **Director**	James Bowler	Dave Ramsden	Alison Cottrell	Vacant[1]	Indra Morris	Mark Bowman	Charles Roxburgh	Kirstin Baker
Area of responsibility	Strategy, Planning and Budget	Chief Economic Advisor	Corporate Services	Public Spending	Tax and Welfare	International and EU	Financial Services	Group Finance

Note

1 Following the Review of Financial Management in Government, Julian Kelly was appointed as the new Director General of Public Spending and Finance on 13 May 2014.

Source: HM Treasury, Annual Report and Accounts 2013-14

Figure 2

HM Treasury director-led groups at 31 March 2014

Nick Macpherson	Ministerial and communications
Dave Ramsden	Economics
Mike Williams	Business and international tax
Lowri Khan	Financial stability
Beth Russell	Personal tax, welfare and pensions
Alison Cottrell **Vacant**	Financial services
Peter Curwen, Director (Europe) **Shona Riach, Director (International Finance)**	International and EU
James Bowler	Strategy, planning and budget
Kirstin Baker (Group Finance Director) **Alison Cottrell, Director (Corporate Services)**	Corporate centre
Jeremy Pocklington, Director (Enterprise and Growth) **Geoffrey Spence, Chief Executive (Infrastructure UK)**	Enterprise and growth
James Richardson	Fiscal
Stephen Parker	Treasury legal advisors
Julian Kelly	Public spending
Tamara Finkelstein **Lindsey Fussell**	Public services

Source: National Audit Office analysis of HM Treasury Annual Report and Accounts 2013-14

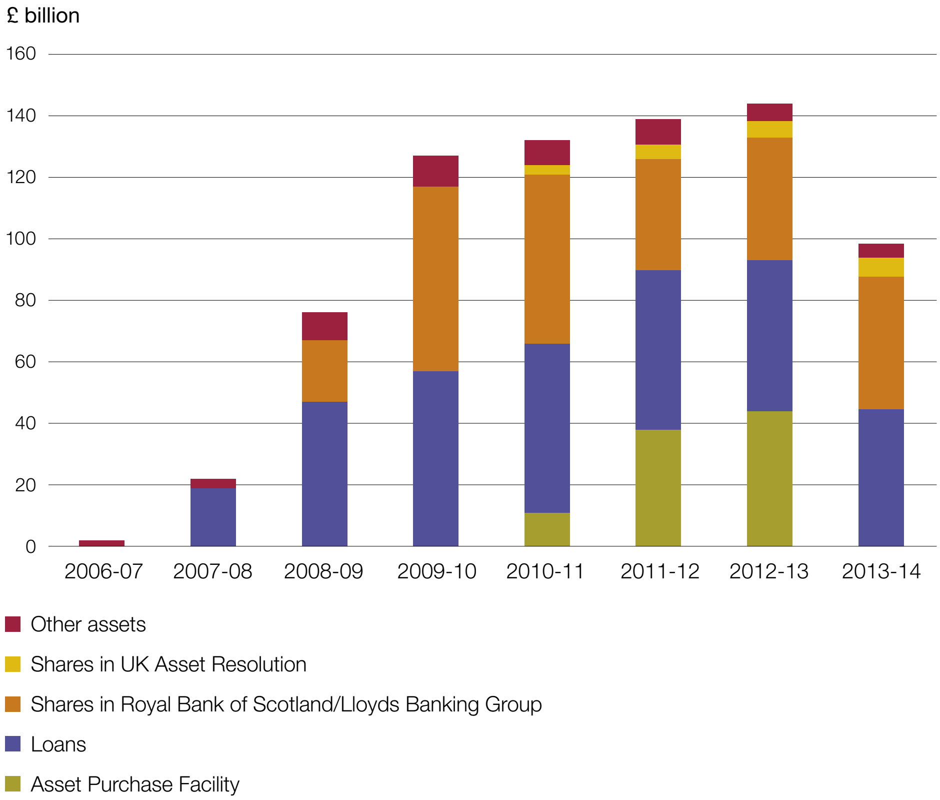
Where HM Treasury spends its money

1.10 Since 2007, HM Treasury's interventions to maintain financial stability and support wider economic growth have dominated its financial statements.

1.11 The Statement of Financial Position at 31 March 2014 contains total assets of £98 billion. Whilst the value of assets held by HM Treasury remains significantly larger than would be expected of a department with operational activities of its scale, 2013-14 was the first year since the financial crisis in which the Statement of Financial Position has decreased in size rather than continued to grow (**Figure 3**). This is largely due to a significant decrease in the value of the Asset Purchase Facility asset from £44.3 billion to £0.2 billion. Further information on this scheme and the valuation of the asset is provided in paragraphs 2.15 to 2.18 of this report.

Figure 3

HM Treasury core gross assets



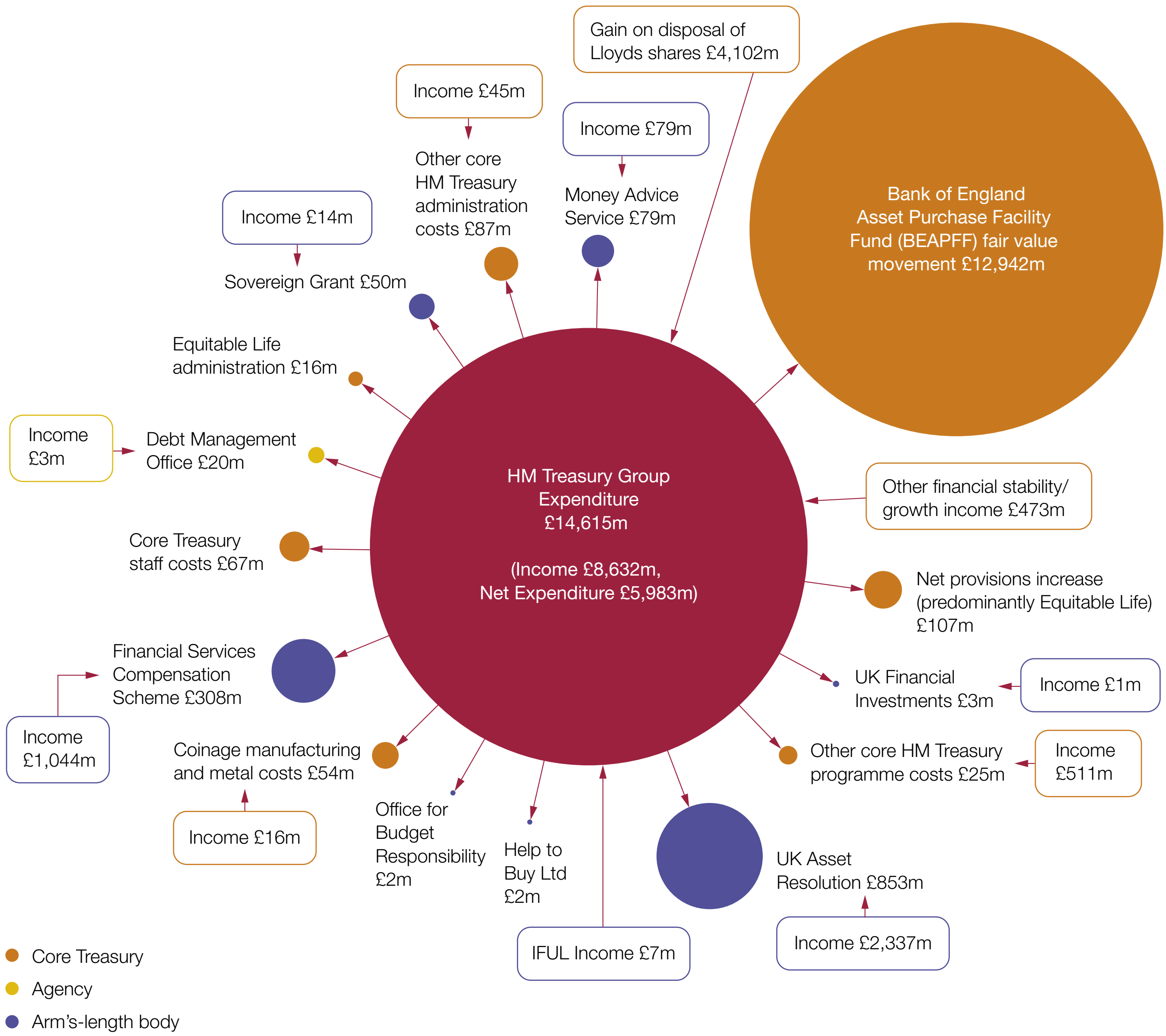
Note

1 Figures represent gross assets of core HM Treasury.

Source: National Audit Office analysis of HM Treasury Annual Report and Accounts

1.12 HM Treasury's sale of 9.8 billion of the 27.6 billion shares it held in Lloyds Banking Group during 2013-14 has had little impact on the value of the share asset included in its Statement of Financial Position (£13.3 billion at 31 March 2014 compared with £13.4 billion at 31 March 2013). Although the sale resulted in a 36% decrease in the share holding, this is almost wholly offset by a 53% increase in share price from 48.69p at 31 March 2013 to 74.65p at 31 March 2014. For 2013-14, HM Treasury Group outturn was net expenditure of £5,983 million (**Figure 4** overleaf). The most significant items of income and expenditure in the accounts are derived from the financial interventions, for example, gains on disposal of shares of £4.1 billion and a non-cash reduction in the valuation of the Asset Purchase Facility asset of £13.0 billion.

Figure 4
HM Treasury Group income and expenditure in 2013-14



Notes

1 This analysis excludes capital expenditure.

2 The above figures exclude transactions between entities within the HM Treasury Group.

3 Further detail on the bodies within the HM Treasury Group can be seen in Appendix One.

Source: National Audit Office analysis of HM Treasury Annual Report and Accounts

1.13 The income and expenditure associated with running the administrative functions of core HM Treasury and its agencies are less significant to the accounts than those related to financial interventions. Income not related to interventions ("non-intervention income") totalled £574 million, and expenditure not related to interventions ("non-intervention expenditure") equalled £445 million (**Figure 5** overleaf).

1.14 The most significant categories of expenditure (other than non-cash costs) are purchase of goods and services of £93 million and staff costs of £77 million. Of the £574 million non-intervention income, the largest item is fine income receivable from the Financial Conduct Authority. This mainly related to fines imposed on some banks in relation to the attempted manipulation of London Inter-Bank Offered Rate (LIBOR).

Staff attitudes

1.15 The government has conducted its Civil Service People Survey annually for the past 5 years. The most recent survey was carried out during October 2013. Continuing our practice in past briefings, we summarise here the views of HM Treasury's staff on a number of key issues, and compare them to benchmarks for the civil service as a whole. Detailed results for all departments are reproduced at Appendix Two.

1.16 HM Treasury continues to be at or above benchmarks for all of the themes covered by the Civil Service People Survey, with the exception of pay and benefits, which remains significantly lower than the civil service benchmark (**Figure 6** on page 14). Since the 2012 survey HM Treasury has improved upon all of the themes included in the survey.[3]

1.17 In our reports[4] we have noted the high staff turnover rates in HM Treasury. In HM Treasury Group, turnover was 25%, 22% and 23% in 2011-12, 2012-13 and 2013-14 respectively.[5] HM Treasury believes that turnover contributes to maintaining a variety of skills and expertise as needed. However, we have reported our concerns about the risk of losing expertise and experience, which may adversely affect service quality and efficiency.[6]

1.18 In terms of the themes management are most able to influence which are 'leadership and managing change' and 'organisational objectives and purpose', HM Treasury is significantly above the civil service benchmark on both a theme and individual question level. The shape of **Figure 7** on page 15 suggests that HM Treasury mirrors the rest of the civil service in its relative strengths and weaknesses in these areas.

3 As part of HM Treasury's response to its performance against the civil service benchmark for pay and benefits, the D2 and E2 grades were introduced during 2013 to encourage staff retention and progression.

4 Comptroller and Auditor General reports: *Managing budgeting in government*, Session 2012-13, HC 597, National Audit Office, October 2012, para 2.29; *Certificate and Report of the Comptroller and Auditor General on HM Treasury's Annual Report and Accounts 2012-13*, Session 2013-14, HC 34, National Audit Office, July 2013, paras 7.78–7.81.

5 HM Treasury, *Annual Report and Accounts 2013-14,* Session 2013-14, HC 20, July 2014; HM Treasury, *Annual Report and Accounts 2012-13*, Session 2012-13, HC 34, July 2013. Turnover data are not reported for the core department as a single entity.

6 Comptroller and Auditor General, *The centre of government*, Session 2014-15, HC 171, National Audit Office, June 2014.

Figure 5
Core HM Treasury and Agencies income and expenditure 2013-14

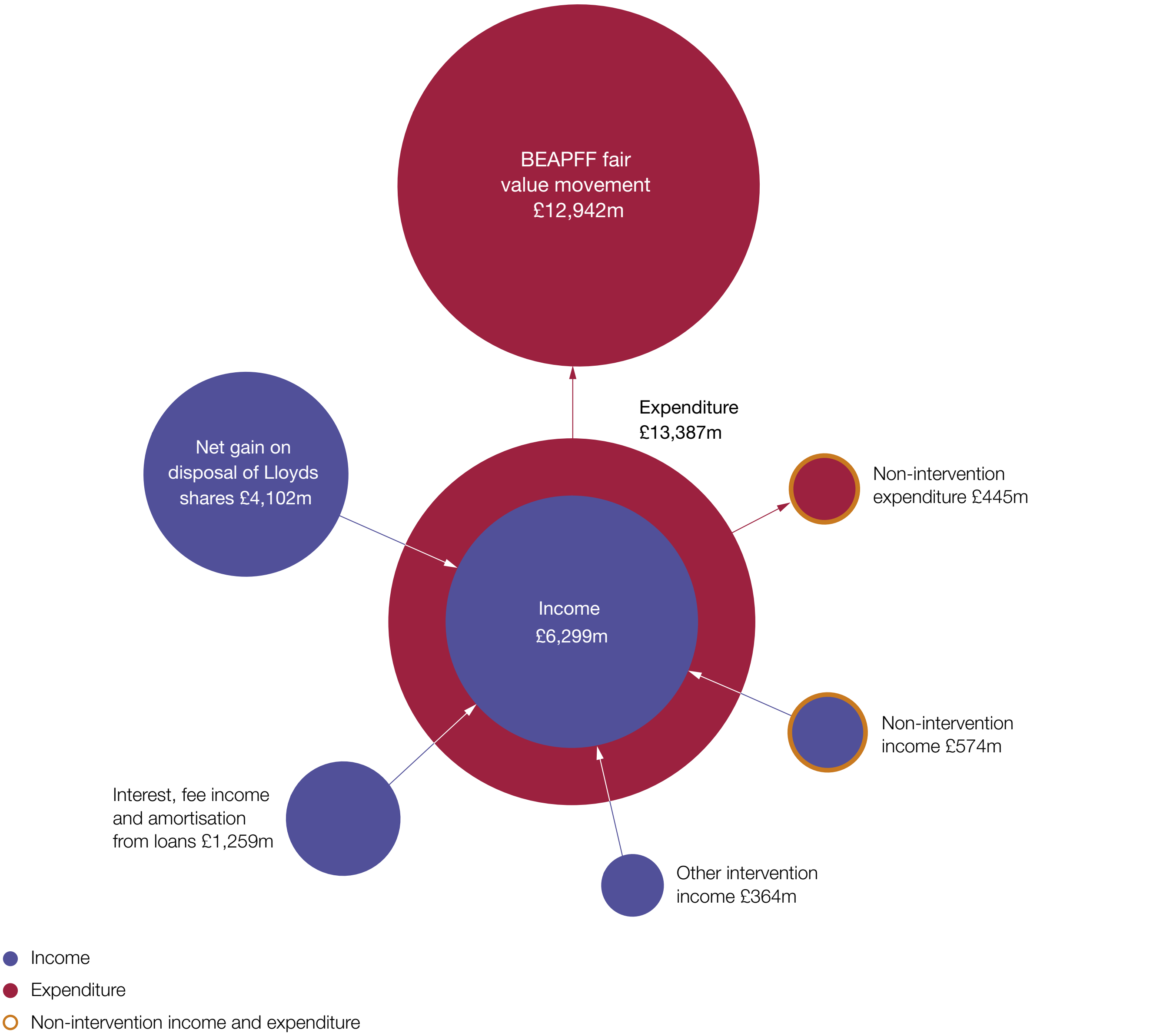
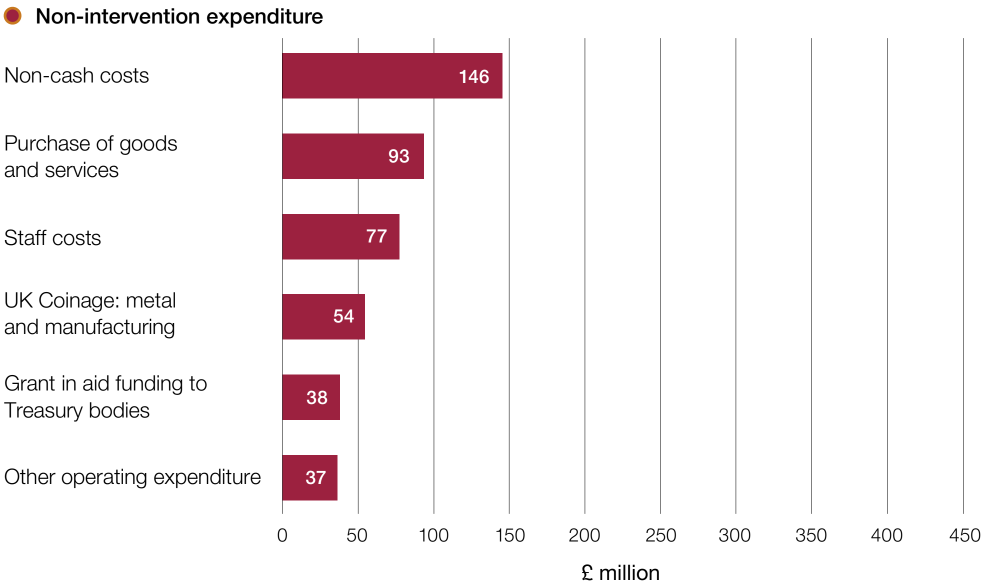
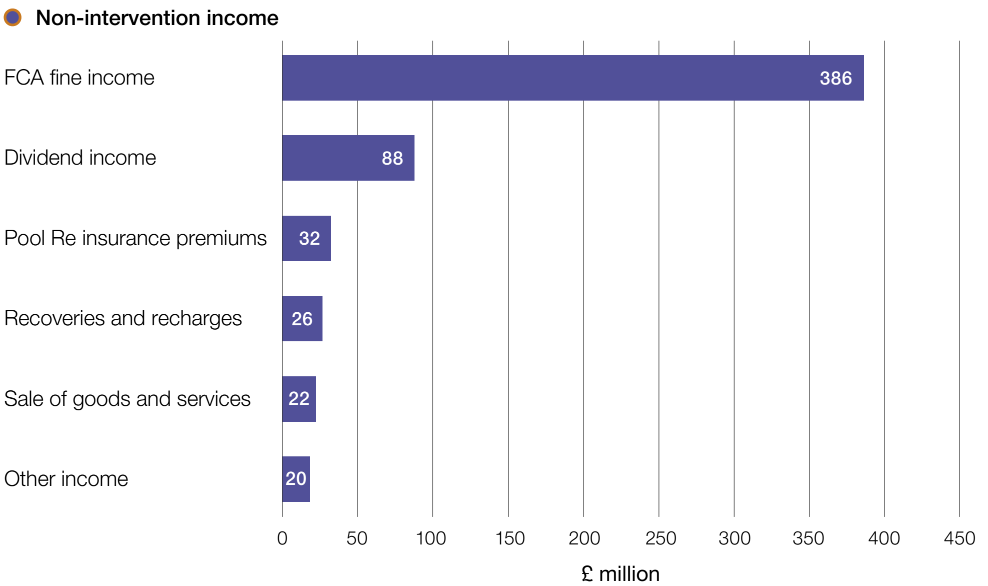


Figure 5 *continued*

Core HM Treasury and Agencies income and expenditure 2013-14



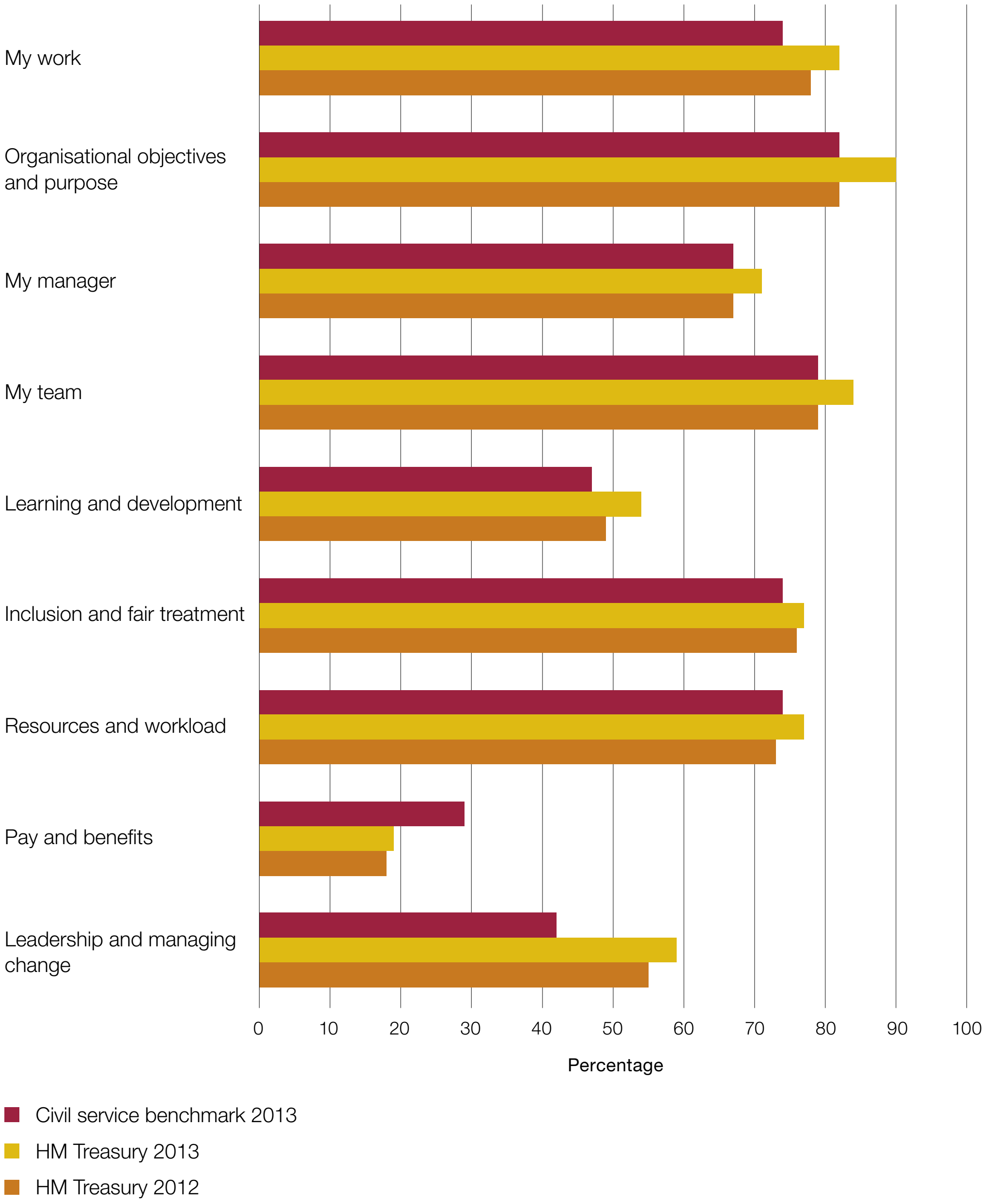


Note

1 Other intervention income consists of fees for guarantees (£124 million) and RBS contingent capital fees (£240 million).

Source: National Audit Office analysis of HM Treasury 2013-14 accounts

Figure 6
HM Treasury's staff attitudes by Civil Service People Survey theme



Notes

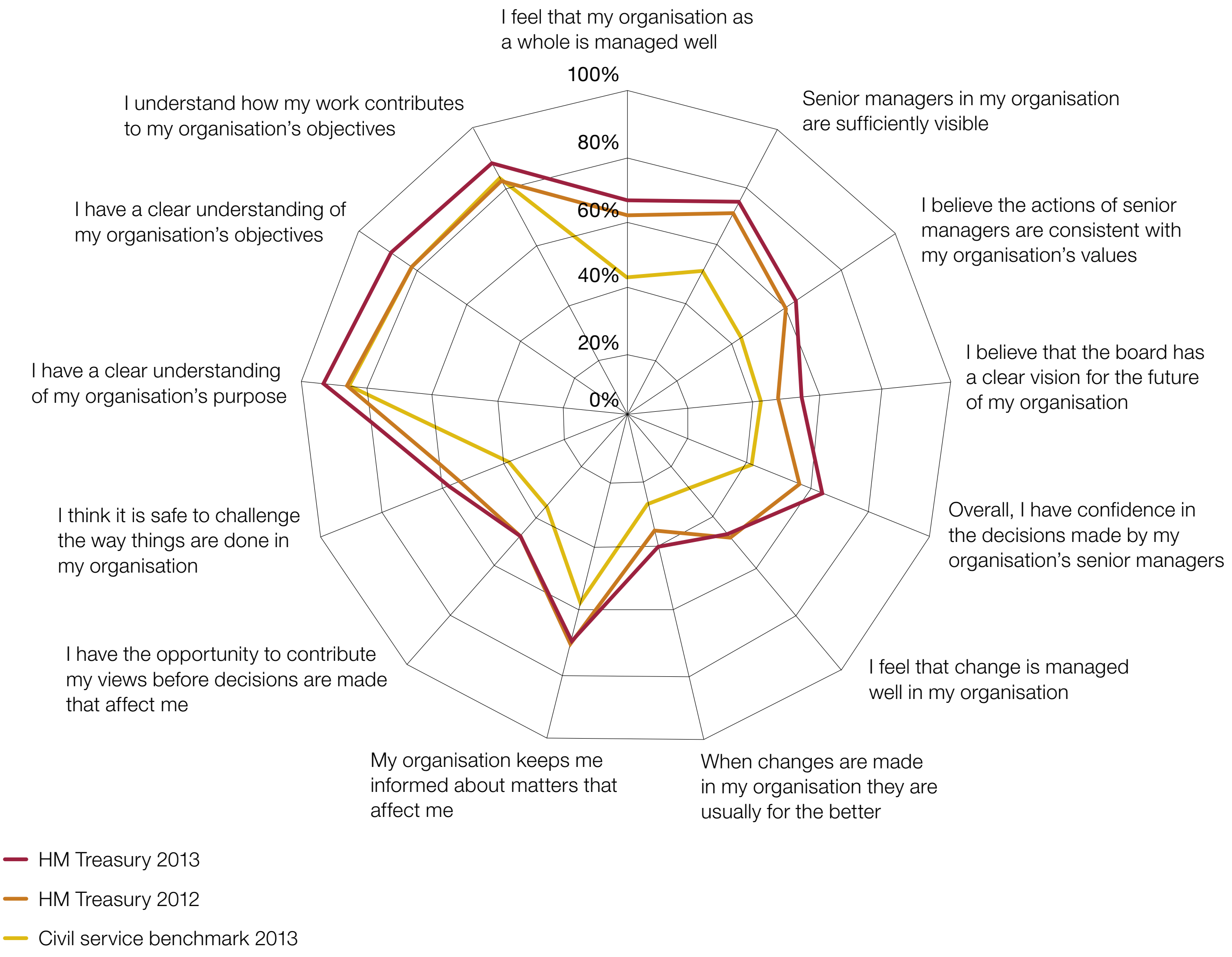
1 Percentage positive measures the proportion of respondents who selected either 'agree' or 'strongly agree' for a question.

2 The 2013 benchmark is the median per cent positive across all organisations that participated in the 2013 Civil Service People Survey.

Source: National Audit Office analysis of the Civil Service People Survey

Figure 7

Detailed breakdown of HM Treasury's staff attitudes to 'leadership and managing change' and 'organisational objectives and purpose' themes



Notes

1 Percentage positive measures the proportion of respondents who selected either 'agree' or 'strongly agree' for a question.

2 The 2013 benchmark is the median per cent positive across all organisations that participated in the 2013 Civil Service People Survey.

Source: National Audit Office analysis of the Civil Service People Survey

Part Two

Developments in this Parliament

Policy and delivery and impact on finances: major developments since 2010

2.1 HM Treasury has undertaken many interventions since the financial crisis of 2007. Initially the focus was on short-term stability measures; however, as the economy has stabilised the focus has moved towards longer-term stability and economic growth (**Figure 8**). As the focus has shifted, a number of the earlier stability interventions have been completed.

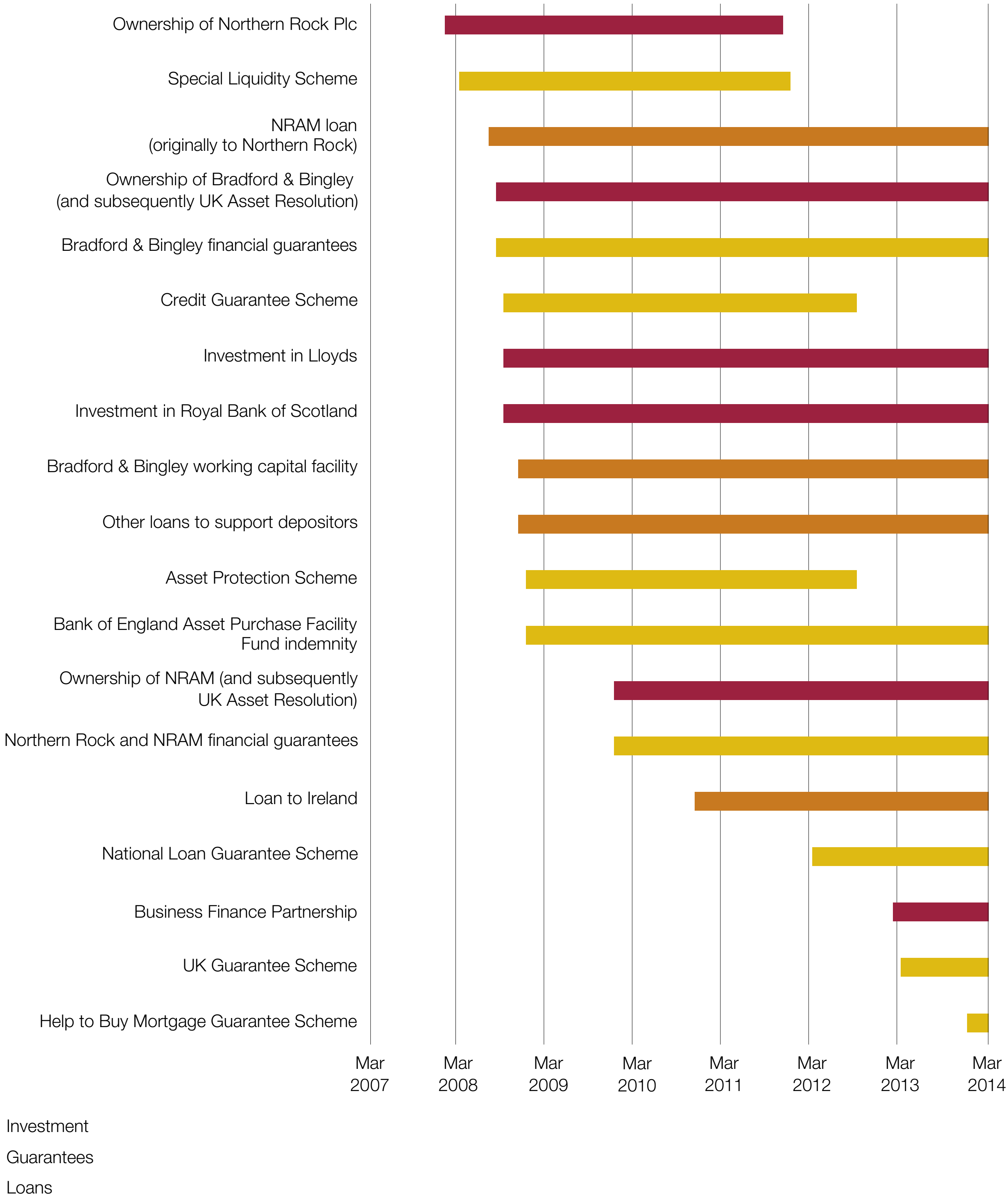
2.2 Financial stability and economic growth has been a key focus for HM Treasury since 2010 and has dominated its financial statements. However, HM Treasury has also continued to undertake activities in relation to its wider responsibilities. This includes introducing a revised financial regulatory system and administering the compensation scheme for Equitable Life policy holders.

Financial stability interventions

2.3 In 2007, financial markets entered a sustained period of instability, causing difficulties for banks across the world, precipitating a global credit crisis and a widespread economic downturn. Between 2007 and 2010, HM Treasury, like many other finance ministries around the world, took actions to:

- protect depositors in banks suffering insolvency or a severe decline in market confidence;
- maintain liquidity to allow banks to pay claims and outstanding borrowings as they fell due;
- ensure that systemically important banks would have sufficient capital to cushion them from losses caused by a potential further deterioration in the financial markets; and
- encourage banks to lend to creditworthy borrowers.

Figure 8
A timeline of HM Treasury's stability and growth interventions following the 2007 financial crisis



Source: National Audit Office analysis

2.4 These interventions were made in the form of:

- Cash – direct cash support such as loans made to a range of financial institutions and the purchase of shares in 2 large banks, Royal Bank of Scotland (RBS) and Lloyds Banking Group (Lloyds), are recognised as assets in the Statement of Financial Position.
- Guarantees – guarantees do not involve direct cash support but expose HM Treasury to potential liabilities if the guarantees are called.

2.5 At its peak, the value of HM Treasury's support exceeded £1,100 billion. At 31 March 2014, this had fallen to approximately £123 billion.

2.6 Whilst a number of the financial stability interventions have now been completed, HM Treasury still holds the loans made to Northern Rock (Asset Management) plc (now known as NRAM plc) and Bradford & Bingley[7] as well as shares in both Lloyds and RBS.

Loans

2.7 NRAM and Bradford & Bingley are the 2 remaining financial institutions that continue to benefit from significant support in the form of loans from HM Treasury. HM Treasury's Statement of Financial Position at 31 March 2014 includes loans to these 2 institutions of £14.9 billion and £7.3 billion respectively.[8] HM Treasury also has outstanding loans relating to a range of other financial institutions, which are supported by the Financial Services Compensation Scheme's (FSCS) powers to impose levies on the wider banking industry.

2.8 The total value of loans outstanding is recorded as an asset in HM Treasury's accounts. At the 31 March 2014 this totalled £44.5 billion, a reduction of £4.5 billion compared to the prior year.

Investment in UKAR

2.9 UKAR is the holding company for the nationalised NRAM and Bradford & Bingley banks. UKAR's financial statements have been fully consolidated into HM Treasury's group accounts for the first time in 2013-14. The group accounts now recognise the substantial assets and liabilities of Bradford & Bingley and NRAM.

Investments in RBS and Lloyds

2.10 HM Treasury injected capital of £66.3 billion in the form of shares in RBS and Lloyds during the financial crisis to ensure that they would have sufficient capital to continue trading. In addition to purchasing ordinary shares in both banks, HM Treasury subscribed to 51 billion non-voting B shares in RBS[9] and received one enhanced Dividend Access Share (DAS) as part of the arrangements for RBS's participation in the Asset Protection Scheme (see paragraph 2.30).

7 Northern Rock was split into 2 businesses in 2009: Northern Rock plc, a deposit-taking and mortgage-providing bank that could be returned to private sector ownership; and NRAM plc, to retain in public ownership the majority of the outstanding mortgages that would be wound down.
8 The Bradford & Bingley balance includes both the Working Capital Facility and the statutory debt. It does not include loans from the FSCS to Bradford & Bingley to cover deposit balances up to £35,000.
9 The B shares are convertible to ordinary shares at a ratio of 10:1.

2.11 The government is committed to returning the banks to private ownership and the first disposals of Lloyds shares were made during 2013-14 in 2 separate sales processes in September 2013 and March 2014.[10] It is widely considered that the first stage required in disposing of RBS shares will be to extinguish the DAS. In April 2014 RBS announced that it had reached agreement with HM Treasury and the European Commission for the future retirement of the DAS for some £1.5 billion. This was approved by its independent shareholders on 25 June 2014.

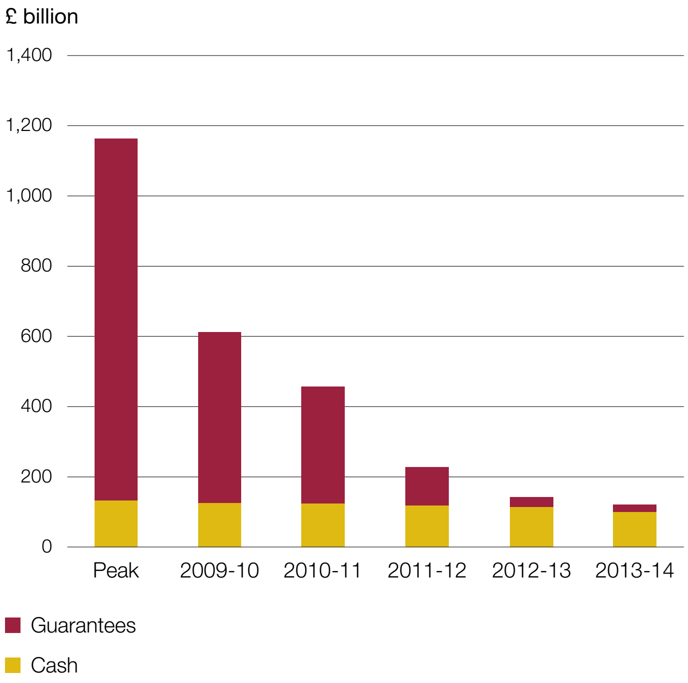
Financial implications

2.12 The balances associated with these support mechanisms (**Figure 9**) have steadily decreased as loans are repaid, shares are sold and guarantees are extinguished.

2.13 This pattern is expected to continue in the coming years as the banks are returned to private ownership and loans are repaid.

Figure 9

Financial stability support to banks



Notes

1 Cash support refers to the cash investment in shares and loans to banks.

2 Investment in shares includes losses on the basis of sales proceeds received to date.

3 Guarantees represent contingent liabilities and financial commitments to banks.

Source: National Audit Office analysis

10 Comptroller and Auditor General, *The first sale of shares in Lloyds Banking Group*, Session 2013-14, HC 883, National Audit Office, December 2013, and Comptroller and Auditor General, *HM Treasury Annual Report and Accounts 2013-14*, Session 2014-15, HC 20, HM Treasury, July 2014, Chapter 8.

Wider economic support

2.14 Since early 2009, HM Treasury has introduced a number of initiatives to support and strengthen the wider economy following the financial crisis and these are now the major driver of HM Treasury's Statement of Financial Position. An overview of the major schemes is provided in the following paragraphs.

Asset Purchase Facility

2.15 In early 2009, the Bank of England (the Bank) initiated a programme of asset purchases (often referred to as quantitative easing) in order to boost spending and help to achieve the 2% inflation target. The programme is run through the Bank of England Asset Purchase Facility Fund Limited (BEAPFF), a wholly owned subsidiary of the Bank. Under the programme, the Bank made a loan to BEAPFF, backed by a claim on the Bank's balance sheet. BEAPFF used this loan to purchase assets held by investors, mainly gilts, and effectively injected money directly into the economy. The loan from the Bank is a liability of the BEAPFF.

2.16 HM Treasury has provided an indemnity to BEAPFF under which it covers any losses incurred as a result of the programme, and will receive any profit made through selling the assets back to the market or holding them to maturity.

2.17 HM Treasury's exposure to any gains (or losses) is recorded as an asset (or liability) in its accounts. The value of HM Treasury's asset (£0.2 billion) is equal to the difference between the value of the assets (£375.5 billion) and liabilities (£375.3 billion) of BEAPFF. At 31 March 2014, the programme had made cumulative profits of £42.6 billion. These profits were mainly made through coupons (interest) received and the increased market value of the assets held.

2.18 During 2012-13, HM Treasury and the Bank agreed to a revised indemnity to require excess cash to be transferred between BEAPFF and HM Treasury. This enabled more efficient cash management across government. By 31 March 2013, £11.3 billion had been transferred and a further £31.1 billion was transferred during 2013-14. This has reduced the balance of cumulative profits held by BEAPFF, leading to a significant reduction in the value of the asset recorded in HM Treasury's accounts.

Help to Buy Mortgage Guarantee Scheme

2.19 The Help to Buy Mortgage Guarantee Scheme aims to increase the availability of mortgages on new or existing properties for those with small deposits. It targets those who could afford interest repayments on a mortgage, but are unable to save the large deposits required by lenders.

2.20 The Scheme, which launched in January 2014 and will run until December 2016, allows lenders to purchase a guarantee where a borrower has a deposit of between 5% and 20%.[11] The guarantee lasts for 7 years and will cover the loss suffered by the lender, net of recoveries, minus the first 5%, in exchange for a fee. HM Treasury's maximum exposure will be limited to £12 billion on mortgage lending of up to £130 billion over the 3 years of the scheme. The estimated contingent liability at 31 March 2014 was £94.6 million and is expected to increase over the next year as further guarantees are issued.

UK Guarantee Scheme

2.21 The UK Guarantee Scheme (UKGS) aims to prevent infrastructure projects[12] being delayed or cancelled by difficulties in obtaining debt financing due to adverse credit conditions. The Scheme aims to meet its objective by utilising the government's credit rating to provide protection against default for the lenders to the projects in the form of a sovereign backed guarantee. This means that lenders are able to provide debt with confidence that HM Treasury will compensate them in full for the guaranteed debt if the project company is unable to finance the interest and principal.

2.22 A total of two guarantees were issued under the Scheme in 2013-14. HM Treasury's Statement of Financial Position includes a liability for each guarantee equal to the value of the fees payable for the guarantee. At 31 March 2014 these liabilities totalled £7.1 million. The Statement of Financial Position also includes an asset of £6.8 million. This represents future fees payable by Scheme participants to HM Treasury. HM Treasury's maximum exposure to losses has been calculated as £83.8 million. This is based on the amount of debt guaranteed and is disclosed in HM Treasury's accounts as a contingent liability. This amount is not included in the Statement of Financial Position at 31 March 2014 as HM Treasury assessed that it was not probable that it would be required to pay out under the guarantees.

2.23 In addition to the 2 financial guarantees, HM Treasury has provided a loan commitment under the Scheme of £750 million to the Greater London Authority in relation to the Northern Line extension to Battersea, and a commitment to provide a financial guarantee of £257.2 million for the Mersey Gateway Bridge.[13] So far, no claims in relation to the guarantees have been received.

2.24 The UKGS is set to continue in 2014-15 and since the financial year-end a fifth guarantee has been issued. Around 40 projects have been declared as pre-qualified for the UKGS – and therefore HM Treasury's exposure is likely to increase substantially in future years.[14] The most significant project that is under consideration is the Hinkley Point C nuclear power station.

11 The Mortgage Guarantee Scheme was announced at the same time as the Help to Buy Equity Loan Scheme, which is run by the Department for Communities and Local Government, in the 2013 Budget. Comptroller and Auditor General, *The Help to Buy equity loan scheme*, Session 2014-15, HC 1099, National Audit Office, March 2014.

12 Infrastructure projects include water, electricity, gas, telecommunications, sewerage or other services; railway facilities (including rolling stock), roads or other transport facilities; health or educational facilities; court or prison facilities; and housing.

13 The guarantee for the Mersey Gateway Bridge was signed on 30 March 2014; however, the guaranteed debt was not issued until 2 April 2014.

14 Available at: www.gov.uk/government/publications/uk-guarantees-scheme-prequalified-projects/uk-guarantees-scheme-table-of-prequalified-projects, accessed 20 August 2014.

Financial implications of these schemes

2.25 Under the majority of the economic growth schemes, HM Treasury has provided guarantees or indemnities rather than direct cash support. This means that the support schemes' impact on the Statement of Financial Position is limited at present, but the maximum liability to which HM Treasury is exposed is increasing (**Figure 10**) and will, over the coming years, become the dominant feature in HM Treasury's financial statements. Due to their nature, the likelihood of guarantees being called upon is closely linked to the macroeconomic position of the UK. If the UK economy declines, HM Treasury's exposure to financial losses is likely to increase.

2.26 It is important that HM Treasury's approach to financial management is able to address the financial risks that these items represent, particularly as the investments in banks, UKAR's mortgage book, the UK Guarantee Scheme, and the Help to Buy Mortgage Guarantee Scheme are long term in nature and will be in place for many years to come.

Completed financial stability interventions

2.27 Since 2011 there have been 4 interventions which have been completed as the economy has recovered and HM Treasury's focus has moved away from measures for financial stability and towards economic growth.

Special Liquidity Scheme

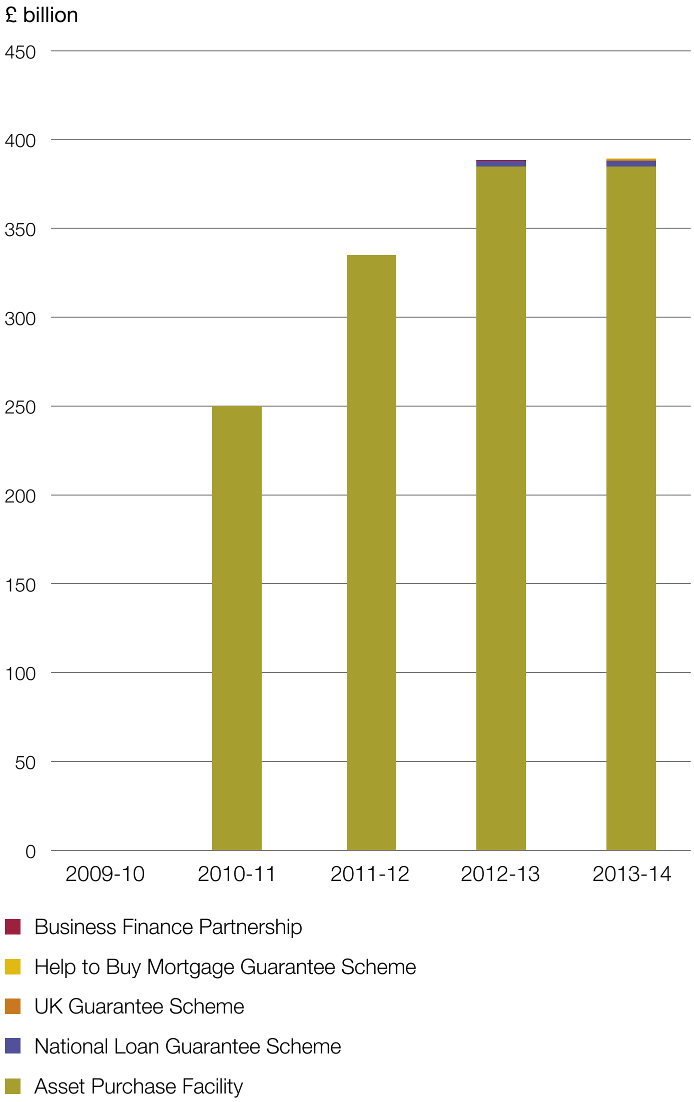
2.28 The Special Liquidity Scheme (SLS) was introduced in April 2008 to increase the liquidity of the UK banking sector and reduce the impact of disorderly failure of a bank. It was a Bank of England scheme, guaranteed by HM Treasury, in which participating banks and building societies swapped illiquid assets for highly liquid Treasury bills. At the Scheme's peak the taxpayer was exposed to a maximum of £185 billion of risk, against which a significant amount of collateral was held. In the event, no pay-out was made under the scheme. This scheme ended during 2011-12 and was the first of the major schemes to be withdrawn.

Northern Rock

2.29 In 2008, in order to protect its depositors and facilitate an orderly wind-down of its obligations, the shares of Northern Rock plc were transferred into Temporary Public Ownership and included within HM Treasury's accounts. In January 2010, the business was restructured to create 2 new companies: Northern Rock plc and NRAM plc. In late 2011, the government announced the sale of Northern Rock plc to Virgin Money. This was completed on 1 January 2012 with proceeds of £747 million in cash going to the government, with a further £73 million of cash proceeds paid in July 2012. NRAM plc remains in public ownership and is managed by UKAR. It is therefore consolidated into the HM Treasury Group Accounts from 2013-14.

Figure 10

Maximum exposure due to economic support schemes



Notes

1 Figures represent maximum exposure through contingent liabilities for Help to Buy Mortgage Guarantee Scheme, UK Guarantee Scheme, National Loan Guarantee Scheme and Asset Purchase Facility.

2 UK Guarantee Scheme also includes commitments to provide loans.

3 Business Finance Partnership represents investment made and excludes future commitments to invest.

Source: National Audit Office analysis

Asset Protection Scheme

2.30 The Asset Protection Scheme was set up in 2009 to protect banks against exceptional losses on loans, mortgages and other financial assets. RBS was the only bank to place assets into the Scheme. The terms of the Scheme were set so that RBS bore the first £60 billion of losses and 10% of any remaining losses. The actual losses on the covered assets totalled £33 billion as at 31 March 2012; the scheme was wound up in October 2012 without any payment made by HM Treasury.

Credit Guarantee Scheme

2.31 The Credit Guarantee Scheme was a scheme in which the taxpayer guaranteed debt issued by UK banks and building societies. The aim of the scheme was to help restore investor confidence in bank wholesale funding by guaranteeing certain unsecured debts in return for a fee. Government exposure under the Scheme peaked at just under £140 billion. The scheme was wound down as banks repaid their debts to private sector holders. The Credit Guarantee Scheme was closed during Autumn 2012 without any payment made by HM Treasury.

Non-intervention activity

2.32 In addition to the work to maintain financial stability and promote economic growth, HM Treasury has continued to undertake activities in relation to its wider responsibilities such as financial services regulation and public spending.

Financial regulation

2.33 Following the financial crisis, the government decided to reform the regulatory system. The Financial Services Act 2012 created the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) to replace the Financial Services Authority (FSA) from April 2013.[15] The PRA undertakes prudential regulation of all banks, building societies, insurers and credit unions, and major investment firms. The FCA is responsible for conduct regulation, as well as prudential regulation of firms not covered by the PRA.

2.34 The Financial Services (Banking Reform) Act 2013, which received Royal Assent in December 2013, represents the final step in the government's plan to improve stability across the entire financial system. The Act implements key recommendations of the Independent Commission on Banking (ICB), including the ring-fencing of important everyday banking activities from volatile investment bank activities, and the introduction of depositor preference and bail-in.

2.35 The Act also contains a suite of tough new measures to overhaul the standards of conduct in the UK's banking industry, including a new senior managers regime and a new criminal offence of reckless misconduct in the management of a bank – both key recommendations of the Parliamentary Commission on Banking Standards.

15 As well as establishing the regulators, the Financial Services Act 2012 amended existing legislation including the Financial Services and Markets Act 2000 (FSMA), the Bank of England Act 1998 and the Banking Act 2009.

2.36 As a result of these changes to the regulatory system, HM Treasury now has an additional income stream from the enforcement fines issued by the FCA and PRA, net of the enforcement expenditure of these bodies. In 2013-14, £386 million was received by HM Treasury from FCA enforcement fines, mainly in relation to the attempted manipulation of the London Inter-Bank Offered Rate (LIBOR).

Equitable Life Payment Scheme

2.37 The purpose of the Equitable Life Payment Scheme is to make payments to policyholders who suffered financial losses as a result of government maladministration which occurred in the regulation of Equitable Life. As part of the 2010 Spending Review, the government announced that in the region of £1.5 billion would be made available for an Equitable Life Payments Scheme, £1 billion of which will be paid out upfront over the first 3 years of the Spending Review period.

2.38 By 31 March 2014, the Scheme had made payments totalling £901 million to 860,972 policyholders, with payments of £324.0 million made during 2013-14. At 31 March 2014, HM Treasury holds a provision of £609 million, being the anticipated future liabilities of the scheme. It has also recognised a payable of £66.3 million, representing future payments to policyholders which have been confirmed.

2.39 In October 2013 the government announced that the Scheme would stay open until mid 2015, although after this date annuitants will continue to be paid for the duration of their annuity.

2.40 The poor quality of some of the data held by Equitable Life, for example out-of-date or incomplete address details, has made tracing policyholders more difficult than anticipated. At 22 July 2014, HM Treasury reported that there were approximately 160,000 policy holders who were due a payment but where the scheme had not yet been able to trace or validate their address.

Review of financial management in government

2.41 HM Treasury published a review of financial management in government in December 2013,[16] which considered how to strengthen the government finance function and made a number of recommendations.

2.42 One of the review's recommendations was that the roles of the Head of the Government Finance Profession and the Head of Public Spending in HM Treasury should be combined. Julian Kelly was appointed in May 2014 as Director General of Public Spending and Finance in HM Treasury.

2.43 The review also recommended that internal audit shared services be consolidated over the medium term, providing a single, integrated internal audit function for government. The first step in achieving this will be to move the existing cross-departmental internal audit service (XDIAS), which provides an internal audit service to 8 departments, to be an independent agency of HM Treasury. This is currently planned for 2015.

16 HM Treasury, *Review of financial management in government*, December 2013.

Impact of Spending Reviews

2.44 During this Parliament, HM Treasury has led the Spending Review 2010 and Spending Round 2013 with an aim of reducing the deficit through lower public spending while reforming public services to ensure that reduced spending does not result in a reduction in the quality and quantity of these services.

2.45 Like all government departments, HM Treasury has been subject to spending reductions. The 2010 Spending Review required a 33% reduction in the HM Treasury Group net resource budget. The Autumn Statement 2012 announced a further reduction in departmental plans of 1% in 2013-14 and 2% in 2014-15, and Budget 2013 introduced a further 1% reduction in plans for 2015-16.

2.46 In line with the 2010 Spending Review, HM Treasury has been seeking to reduce its headcount and staff costs. It aims to reduce its headcount (excluding Infrastructure UK staff) by 25% over the 4 years to 2014-15 from 1400FTE to 1000FTE (Full Time Equivalents). At 31 March 2014, HM Treasury reported it had met its headcount target.

Whole of Government Accounts

2.47 HM Treasury produces Whole of Government Accounts (WGA). WGA consolidates the audited accounts of around 4,000 organisations across the public sector in order to produce a comprehensive, accounts-based picture of the financial position of the UK public sector. The first WGA, for the year ended 31 March 2010, was published in November 2011. WGA is considered in more detail in Part Three.

Independent assessments of HM Treasury's performance

2.48 In Part Three of this report, we look at the National Audit Office's (NAO) assessment of the Department's performance in 2013-14. Alongside our work and that of the Treasury Select Committee, however, a number of other bodies regularly produce independent analyses of how HM Treasury is doing and of the challenges it faces. In this section, we look at some of the most notable of these reports published in the last year.

Parliamentry and Health Service Ombudsman review

2.49 The Parliamentary and Health Service Ombudsman (PHSO) can investigate complaints against the administrative actions of a wide range of government departments and other public bodies, or the actions of organisations acting on their behalf.

2.50 In May 2014 the PHSO published The Parliamentary Ombudsman's review of government complaint handling, 2013.[17] This review confirms during 2013 there were 37 (2012: 34) HM Treasury-related enquiries; of these, 3 complaints were accepted for investigation, and one was not upheld. At the end of the 2013 calendar year, 2 complaints remained under scrutiny.

17 Available at: www.ombudsman.org.uk/improving-public-service/annual-government-performance-information, accessed 20 August 2014.

Board effectiveness review

2.51 The role of the Board in the work of HM Treasury and its effectiveness was reviewed this year by Dr Tracey Long, a non-executive from the Department for Culture, Media & Sport and founder of the evaluation specialist Boardroom Review.

2.52 One of the key findings was a need for better coordination between the horizon-scanning of the HM Treasury Board Sub-committee and the work of the Audit Committee, with greater membership cross-over. To strengthen the link between both committees, the incoming Audit Committee chair will be asked to consider increasing the number of non-executive board members on the Audit Committee and the make-up and remit of the Audit Committee itself. Richard Meddings, the former finance director of Standard Chartered, has joined the Board and will take the post of Audit Committee chair from September 2014. A further appointment to the Board[18] will be made during 2014-15.

Financial management review

2.53 The Government Finance Profession's report, *Putting finance at the heart of decision-making*, recommended that all government departments assess the maturity of their financial management periodically. To encourage consistency of approach it was agreed that the Chartered Institute of Public Finance and Accountancy (CIPFA) model should be adopted across Whitehall departments. Unlike other departments which employed CIPFA to undertake the review using the CIPFA model, HM Treasury undertook a self-assessment of its financial management against the CIPFA model.

Major developments for the year ahead

Asset sales

2.54 UKAR's key purpose is to facilitate the orderly management of the closed mortgage books of both Bradford & Bingley and NRAM to maximise value for taxpayers. In line with this strategy, in June 2014 it appointed Credit Suisse to commence a marketing process for a potential sale of a portfolio of performing residential mortgages from the legacy books of those two banks. It has stated that the transaction would only be completed if the sale price achieved represents value to the taxpayer.

2.55 In June 2014 the Department for Transport transferred its 40% stake in Eurostar International Ltd to HM Treasury in advance of the government's intended sale of its stake in the company.

2.56 As noted elsewhere within this report, the Government is committed to returning Lloyds and RBS to private ownership. The retirement of the RBS DAS was approved by its independent shareholders on 25 June 2014. The first instalment payment of £320 million is due to be paid in summer 2014.

18 This is likely to be a non-executive board member.

Other key developments

2.57 PF2 is HM Treasury's new mechanism for obtaining private finance for public projects, replacing PFI contracts. PF2 is designed to be faster, more flexible and more transparent than PFI contracts. HM Treasury, through the Infrastructure UK PF2 Equity Unit, will hold and manage the government's minority equity investment in PF2 projects. Contracts for the first PF2 projects, which are in the education and health sectors, are expected to be agreed during 2014-15.

2.58 In October 2013, as part of his speech to the World Islamic Economic Forum, the Prime Minister announced that the government wanted the UK to become the first non-Muslim country to issue an Islamic bond. On 25 June 2014 HM Treasury announced the issue of £200 million of sovereign Sukuk, the Islamic equivalent of a bond. The issuance was 11.5 times oversubscribed and the profit rate was set in line with the yield on gilts of similar maturity. The Sukuk were issued by HM Treasury UK Sovereign Sukuk plc (a special purpose vehicle wholly owned by the Treasury Solicitor as a nominee for HM Treasury).

2.59 In line with the government's Next Generation Shared Services strategy, HM Treasury is due to transfer back-office functions to Independent Shared Service Centre One (ISSC1), outsourced to Arvato Ltd, in 2015. This was originally planned for November 2014 but has been delayed.

2.60 The Chancellor announced a range of pension reforms as part of the 2014 Budget in March 2014. These will come into effect from April 2015. The reforms will allow greater flexibility in how pensions are accessed and pension providers will be required to ensure everyone has access to free and impartial guidance. HM Treasury is the lead department on these reforms, working closely with HM Revenue & Customs and the Department for Work & Pensions.

Part Three

Recent NAO findings on HM Treasury

Our audit of HM Treasury's accounts

3.1 The National Audit Office's (NAO) financial audits of government departments and associated bodies are primarily conducted to allow the Comptroller and Auditor General (C&AG) to form an opinion of the truth and fairness of the public accounts. In the course of these audits, the NAO learns a great deal about government bodies' financial management and sometimes this leads to further targeted pieces of work which examine particular issues. In this section, we look at the outcome of our most recent financial audit on HM Treasury and its bodies.

3.2 The C&AG gave an unqualified opinion on HM Treasury's 2013-14 financial statements on 14 July 2014.

3.3 Alongside the financial statements, the C&AG published his fourth report[19] on HM Treasury's Annual Report and Accounts. The purpose of the report is to provide an overview of the context in which the audit of HM Treasury's 2013-14 financial statements was conducted, and details of the assessment of audit risk arising from HM Treasury's major financial stability and wider economic support schemes.

3.4 The C&AG has also audited the accounts of other bodies in the HM Treasury Group, namely the Debt Management Office; Office for Budgetary Responsibility; Money Advice Service; Financial Services Compensation Scheme; UK Financial Investments Ltd; Infrastructure Finance Unit Ltd; and the Sovereign Grant. The financial statements of these bodies all received, or are expected to receive, unqualified audit opinions.

3.5 The C&AG also audits the central funds, which HM Treasury is responsible for but which are not consolidated into HM Treasury's accounts. The financial statements of the Debt Management Account, National Loans Fund, Exchange Equalisation Account, Contingencies Fund, Consolidated Fund and balances held by the Commissioners for the Reduction of the National Debt all received unqualified audit opinions.

19 Comptroller and Auditor General, *HM Treasury Annual Report and Accounts 2013-14*, Session 2014-15, HC 20, HM Treasury, July 2014, Chapter 8.

3.6 Additionally, the C&AG audits the Whole of Government Accounts (WGA), which are produced by HM Treasury. Since the 2009-10 WGA was first published, HM Treasury has made continuous improvements to its processes for compiling these accounts, to data quality and to its commentary published alongside the accounts. As a result, HM Treasury has produced the 2012-13 WGA more quickly, meeting a major milestone in its aim of delivering the WGA 2014-15 within 9 months of the year end.

3.7 The C&AG's audit opinion on the 2012-13 WGA is similar to that for 2011-12 and previous years as significant issues remain with the quality and consistency of the data included in the WGA. However, HM Treasury has made significant progress in reducing the elimination error over the last 3 years and has put plans in place to address the issues that have led the C&AG to qualify his audit opinion.[20]

3.8 WGA is one part of a wider set of processes which HM Treasury uses to manage significant risks to public finances. As HM Treasury now has more WGA trend data, it is starting to highlight some of the longer-term risks on the balance sheet and is beginning to use this information to help inform government's spending plans.

Our audits of HM Treasury's effectiveness and value for money

3.9 The NAO's work to test the effectiveness and value for money of government spending in 2013-14 included a number of projects which focused on HM Treasury. The principal findings of these, and in some cases the actions that have been taken since, are summarised below.

The centre of government

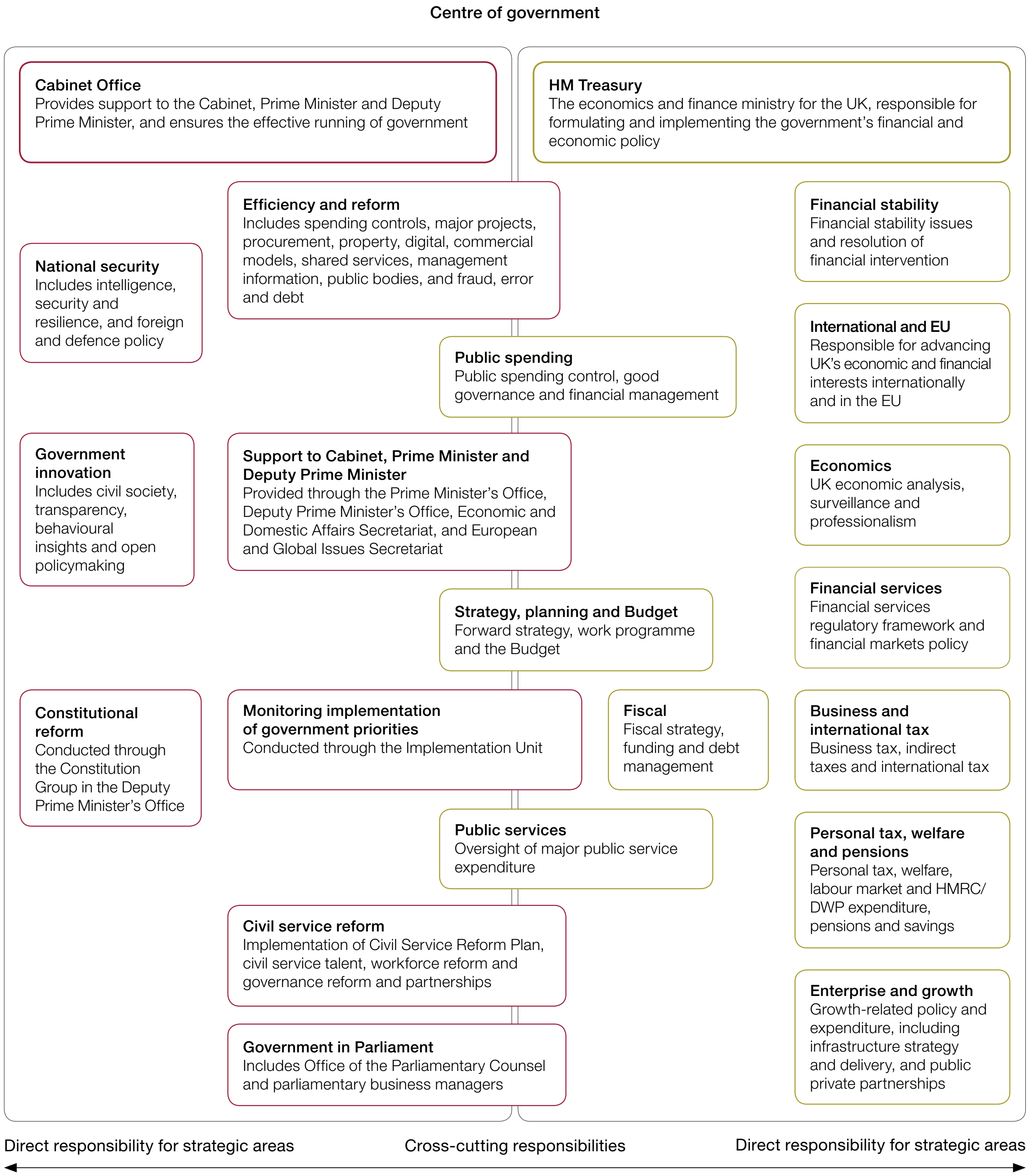
3.10 The centre of government has responsibility for coordinating and overseeing the work of government, enabling it to achieve its strategic aims and ensuring there is a central view of the effective operation of government as a whole. Most of these strategic functions are performed by the Cabinet Office and HM Treasury (**Figure 11**).

3.11 This report[21] examined the role of the centre of government, including changes to the centre in recent years. Whilst not intended to be a comprehensive examination of the roles and functions of the Cabinet Office and HM Treasury, nor a conclusion on the value for money of the centre of government, it drew together insights from previous reports and those of the Committee of Public Accounts on these issues.

3.12 In recent years, the centre has recognised that there are other areas of government activity where introducing central strategic leadership could achieve greater benefits for government as a whole.

20 Comptroller and Auditor General, *Whole of Government Accounts 2012-13*, Session 2014-15, HC 93, HM Treasury, June 2014, Chapter 8.
21 Comptroller and Auditor General, *The centre of government,* Session 2014-15, HC 171, National Audit Office, June 2014.

Figure 11
Cabinet Office and HM Treasury: main responsibilities



Source: National Audit Office, based on Cabinet Office and HM Treasury organisation charts

3.13 In our reports on centre of government issues, we have been generally positive about the rationale for central initiatives. We have also recognised where these initiatives have had an impact, and can draw out some shared characteristics.

3.14 More emphasis could be given to long-term planning. Centrally applied preventive controls are generally effective, but they can also be rather blunt instruments, and cumbersome to operate. Although they may never disappear altogether, they can be substantially replaced by the more positive approach of detailed business planning over more than one accounting period, supported by budgetary control and strong accountability. Progress in this direction would support the more coherent management of longer-term projects and programmes, which form such a large part of the business of government.

3.15 Where the centre of government builds pools of deep and scarce expertise, however, it is important that these contribute to the decision-making processes of departments at the right time, and preventive controls can assist in ensuring that this happens.

3.16 Our perception is that there remain significant tensions within central government over the appropriate role of the centre, and that of individual departments. We see this as unhelpful to the effective management of government's projects and programmes.

The first sale of shares in Lloyds Banking Group

3.17 In September 2013 the government sold just over 15% of the taxpayers' shares in Lloyds to institutional investors for £3.2 billion. While UK Financial Investments Ltd devised and executed the strategy for selling the shares, the decision on the final form and timing of the sale rested with the Chancellor of the Exchequer.

3.18 This report[22] examined the value for money of the Lloyds share sale, particularly whether:

- the most appropriate sale method was chosen;
- the sale was timed and structured appropriately;
- the price obtained was reasonable; and
- whether there was a gain or shortfall for the taxpayer.

22 Comptroller and Auditor General, *The first sale of shares in Lloyds Banking Group*, Session 2013-14, HC 883, National Audit Office, December 2013.

3.19 The first sale represented value for money. UK Financial Investments Ltd conducted a thorough review of its options, choosing a sale process that maintained flexibility on timing and allowed the transaction to be completed quickly once a decision to sell had been made. The sale took place when the shares were trading close to a 12-month high and at the upper end of estimates for the fair value of Lloyds' business. Furthermore, the shares were sold at a relatively low discount to the market price compared with discounts seen in similar sales, and the after-market in the shares has remained steady. The shortfall of at least £230 million should be seen as part of the cost of securing the benefits of financial stability during the financial crisis, rather than any reflection on the sale process, which UK Financial Investments Ltd managed very effectively.

3.20 Subsequent to this report, a second sale of Lloyds shares took place in March 2014, reducing the taxpayer's holding in Lloyds Banking Group to below 25%. The second sale was conducted using the same process as the first, but was the largest sale of its type on record (outside of the US). The second sale was completed at a higher discount to the market price of the shares than the first sale, although the discount was below the average seen in comparable transactions (**Figure 12**).

3.21 In planning and executing the second sale, UK Financial Investments Ltd took action to implement a recommendation from the NAO that would help in the pricing and allocation of shares for the second and future sales.

3.22 In the second sale, the gain amounted to £180 million. The combined gains of £300 million do not, however, take account of the cost of funding the purchases of the shares. If this cost of financing is taken into account the second sale resulted in a shortfall of £300 million. The second sale was examined further in the C&AG's report on HM Treasury's Annual Report and Accounts 2013-14.[23]

Figure 12

Comparison of the two sales with other comparable sales

	First sale (September 2013)	Second sale (March 2014)	Averages for comparable sales[1]
Sale proceeds (£bn)	3.2	4.2	1.9
Discount to market price of shares ahead of the sale (%)	3.1	4.6	5.3
Proportion of total issued share capital sold (%)	6.0	7.8	10.8
Shares sold as a multiple of average daily trading volume	x18	x29	x26

Note

1 Largest 20 comparable share sales in European markets since 2003.

Source: JP Morgan analyses for first and second sales

23 Comptroller and Auditor General, *HM Treasury Annual Report and Accounts 2013-14*, Session 2014-15, HC 20, HM Treasury, July 2014, Chapter 8.

Regulating Financial Services

3.23 This report[24] examined the progress made by the Financial Conduct Authority and the Prudential Regulation Authority in developing and implementing their regulatory approaches to date.

3.24 There are numerous areas where the regulators' work overlaps, and they are legally required by the legislation to coordinate their activities effectively. The FCA is operationally independent of government but accountable to HM Treasury. The PRA is a legal subsidiary of the Bank of England, and is also accountable to HM Treasury (**Figure 13**).

3.25 These are still early days for the new regulators. The new regulators come at a higher cost that is borne directly by regulated firms, and ultimately by customers of the financial services industry. Building on their work to date, they will need to clearly link resource allocation to regulatory effectiveness, and demonstrate how they will address the problem of attracting and retaining the right staff to make the more proactive approaches to regulating financial services work.

HM Treasury in a cross-government context

3.26 In addition to our work on individual departments, the NAO increasingly looks at performance across government, in order to understand how different departments measure up on important issues. Of the cross-government reports we have published in the last year, many have included substantial coverage of HM Treasury.

3.27 HM Treasury interacts with other government departments in many ways in its capacity as the centre of government. Key central activities include coordinating or overseeing policies and spending proposals, providing guidance to all departments, and collating departmental data to monitor cross-government issues.

3.28 HM Treasury is responsible for the overall budgetary and spending framework within which departments receive, and account for, the funds needed for their operations. It gives guidance on financial management issues, such as preparing budgets and financial reporting, so departments work to consistent and common standards. HM Treasury has spending teams for each department which scrutinise budget and spending proposals, including ensuring departmental business cases represent good value for money and are affordable as part of the approval process. Departments provide spending forecast and outturn data to HM Treasury through the OSCAR system (online system for central accounting and reporting), and must seek HM Treasury approval for spending above departmental delegated limits, as well as novel and contentious spending.[25]

24 Comptroller and Auditor General, *Regulating financial services*, Session 2013-14, HC 1072, National Audit Office, March 2014.

25 HM Treasury, *Managing public money*, July 2013, para 2.3.4. *Managing public money* states that explicit HM Treasury consent is required for spending commitments which involve: "transactions which set precedents, are novel, contentious or could cause repercussions elsewhere in the public sector". Examples given include ex-gratia payments to compensate for official errors, special severance payments to terminate contractual commitments, and unusual schemes or policies using novel techniques.

Figure 13
Accountability in the financial services regulatory framework

Parliament

Sets legislative framework, holds government to account for the regulatory framework. Regulatory bodies are accountable to Parliament for the performance of their functions

Bank of England

Protecting and enhancing the stability of the financial system of the United Kingdom

Appoints members of the PRA Board

Financial Policy Committee

Identifies and monitors systemic risks and takes actions to remove or reduce them (including through directions and recommendations to the PRA and FCA)

HM Treasury

Responsible for the regulatory framework and for all decisions involving public funds

Has the power under the 2012 Act to arrange independent inquiries of both the PRA and the FCA. Reports are to be published

Can appoint an independent person to review the economy, efficiency and effectiveness of the regulators

Can direct the regulators to carry out an investigation into regulatory failure. Reports are to be published

Regulators are required to report annually to HM Treasury and the report is laid before Parliament

Receives the certified accounts of both regulators from the Comptroller and Auditor General and lays the accounts before Parliament

Prudential Regulation Authority

Responsible for the safety and soundness of firms

Subsidiary of the Bank of England

Board appointed by the Bank of England, and approved by HM Treasury

Budget approved by the Bank of England

Operationally independent for the purposes of carrying out its regulatory functions

Has potential to veto decisions of the FCA

Accountable to Parliament

Financial Conduct Authority

Responsible for protecting consumers, promoting competition and enhancing confidence in financial services and markets

Board appointed by HM Treasury

Accountable to Parliament

Source: National Audit Office analysis

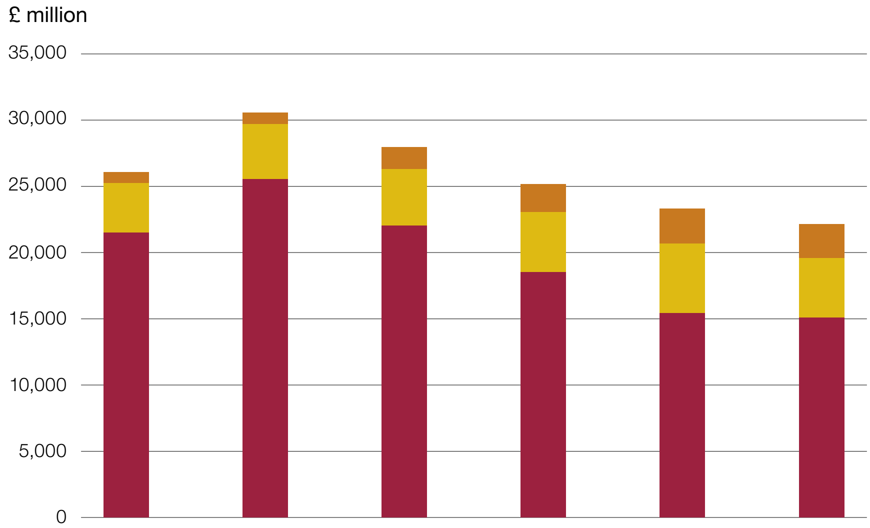
Managing debt owed to central government

3.29 Individuals and businesses owe debt to government for overdue tax liabilities, benefit or tax credit overpayments, and for other reasons including outstanding fines and court confiscation orders. As shown in the C&AG's report on *Managing debt owed to central government*,[26] there is no official figure for the total owed to central government that is overdue. However, our data suggested that debt identified by government was at least £22 billion at March 2013, against total collected revenue of more than £600 billion (**Figure 14**).

3.30 We found there was no integrated approach for managing debt across government. The Cabinet Office has raised awareness of the issue across government and HM Treasury has agreed new financial incentives for departments, but the centre of government has not yet fully got to grips with debt management, and the Cabinet Office and HM Treasury need to work together better.

Figure 14
Government debt balances from 2007-08 to 2012-13

Progression of government debt figure over last six years



	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Rest of government	825	870	1,625	2,072	2,626	2,553
Department for Work & Pensions	3,693	4,121	4,256	4,508	5,240	4,504
HM Revenue & Customs	21,549	25,578	22,494	19,331	15,445	15,114

Notes

1 This chart is based on 2013 consolidated data returns submitted to the Cabinet Office. Where debt balances were incomplete or missing entirely, we used alternative sources, including 2013 debt-type survey, 2012-13 financial statements, and departmental debt management information. Debt balances 2007-08 to 2010-11 taken from 2011 Debt Survey returns.

2 Confiscation orders have been included in the 'rest of government' debt balance from 2009-10.

Source: National Audit Office analysis of financial accounts, management accounts and Cabinet Office data

26 Comptroller and Auditor General, *Managing debt owed to central government*, Session 2013-14, HC 967, National Audit Office, February 2014.

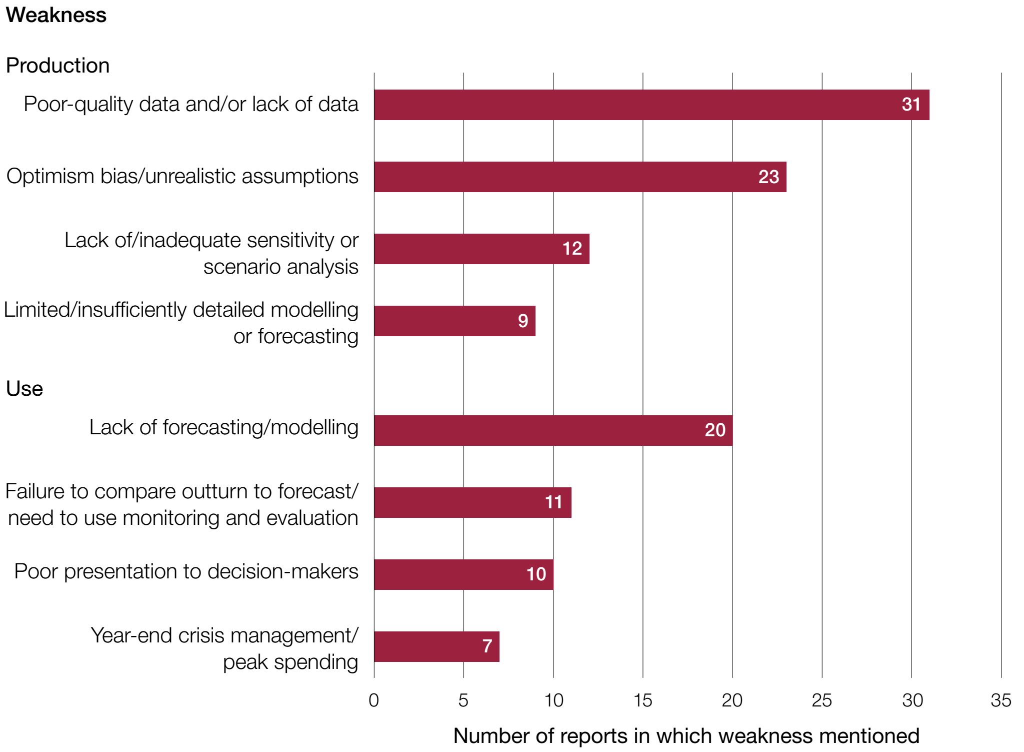
Forecasting in government to achieve value for money

3.31 Poor forecasting by government departments is an entrenched problem, leading to poor value for money and increased costs for the taxpayer as outlined in the C&AG's report on *Forecasting in government to achieve value for money*.[27]

3.32 This report found that government departments do not take forecasting sufficiently seriously, with the process often hampered by poor quality data and unrealistic assumptions driven by policy agendas. Poor forecasting can result in ill-informed decisions, cost overruns, delay and fewer benefits than predicted (**Figure 15**).

3.33 HM Treasury's efforts to improve forecasting through incentives in the budgetary system are unlikely to prove effective given the pressure in the spending control framework to avoid overspending and deliver small underspends. Improvements to transparency and scrutiny are needed to enable HM Treasury and Parliament to more effectively assess the quality of departments' financial management and the value delivered.

Figure 15
Key weaknesses identified in recent NAO reports



Source: National Audit Office

27 Comptroller and Auditor General, *Forecasting in government to achieve value for money*, Session 2013-14, HC 969, National Audit Office, January 2014.

Evaluation in government

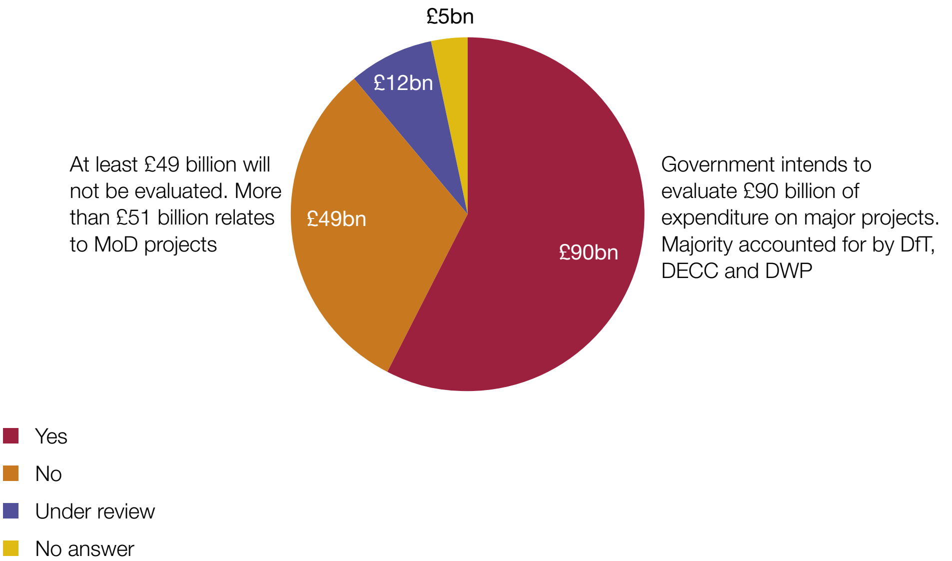
3.34 An informed government collects high-quality information on context, expenditure, activities and results, and analyses this to expose issues or opportunities. It presents informed options to internal decision-makers, as well as candid assessments of plans and performance externally. Without this information, the government is not well placed to respond to funding cuts and longer-term challenges of providing sustainable, high-quality services and supporting economic growth.

3.35 This report[28] found that the government spends significant resources on evaluating the impact and cost-effectiveness of its spending programmes and other activities. Coverage of evaluation evidence is incomplete, and the rationale for what the government evaluates is unclear (**Figure 16**). Evaluations are often not robust enough to reliably identify the impact, and the government fails to effectively use the learning from these evaluations to improve impact and cost-effectiveness.

3.36 We believe a key factor is the lack of incentives for departments to generate and use evaluation evidence, with few adverse consequences for failing to do so. HM Treasury should ask departments to provide evaluation evidence in the context of strategic resourcing decisions such as spending reviews, and also incentivise its use in business-as-usual decision-making in government.

Figure 16

Government intentions to evaluate major project spend (£ billion)



Note

1 Based on analysis using major project spend for each department.

Source: National Audit Office analysis of chief analyst survey and quarterly data summaries

28 Comptroller and Auditor General, *Evaluation in government*, National Audit Office, December 2013. Available at: www.nao.org.uk/report/evaluation-government/

The privatisation of Royal Mail

3.37 Although this report was focused on the role of the Department for Business, Innovation & Skills and is not a cross-government report, some of its messages may be relevant to future sales of shares in Lloyds Banking Group and the Royal Bank of Scotland, and therefore to HM Treasury.

3.38 In October 2013 the Shareholder Executive, part of the Department for Business, Innovation & Skills, sold 60% of the government's shares in Royal Mail plc to private investors for 330p each, generating proceeds of £1,980 million. Following this transaction Royal Mail shares have been admitted to the main London Stock Exchange index (FTSE 100). On the first day of conditional trading Royal Mail's shares closed at 455p (38% higher than the sale price) and in the following 5 months have traded in the range of 455p to 615p.

3.39 This report[29] concluded that although the primary objective of delivering a sale of shares within this Parliament was achieved, it could have achieved better value for the taxpayer (**Figure 17** overleaf).

Gift Aid and reliefs on donations[30]

3.40 Gift Aid provides an important source of income for many charities and reflects Parliament's intention that the income of charities should not be taxed where it is used for charitable purposes.

3.41 HM Treasury is responsible for strategic oversight of the tax system. HM Treasury and HM Revenue & Customs (HMRC) work together in a policy partnership on the development of tax policy, including the design of tax reliefs.

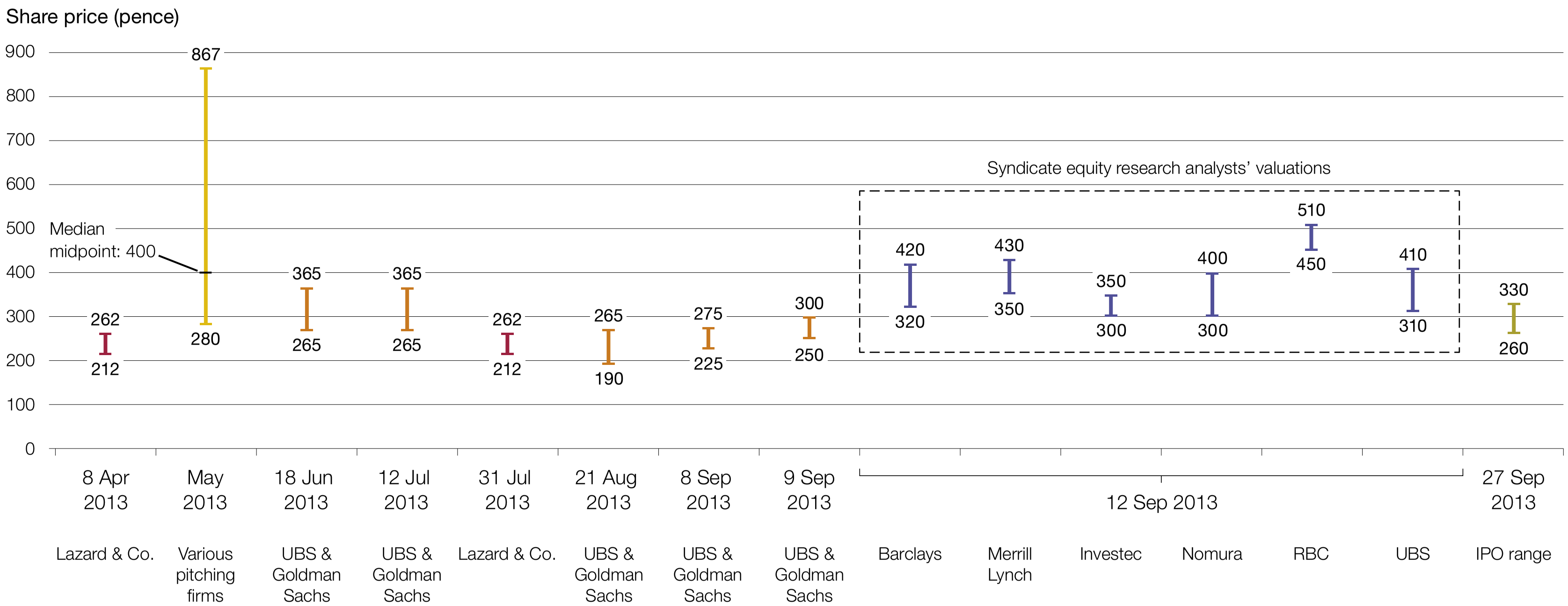
3.42 HMRC and HM Treasury do not know if Gift Aid and other tax reliefs on donations provide as much value for the charitable sector as they could. There is insufficient evidence that government actively encourages take-up of these reliefs so that those charities which are entitled to them receive the intended benefits. The effectiveness of changes made in 2000 to increase charitable giving is not proven.

29 Comptroller and Auditor General, *The privatisation of Royal Mail*, Session 2013-14, HC 1182, National Audit Office, April 2014.

30 Comptroller and Auditor General, *Gift aid and reliefs on donations*, Session 2013-14, HC 733, National Audit Office, November 2013.

Figure 17

Equity valuation ranges prepared by the independent corporate finance adviser, pitching firms, global coordinators and syndicate equity research analysts



Notes

1 The equity valuations have been derived using a variety of different methods and assumptions.

2 Equity valuations for 100% of Royal Mail's shares have been converted into a price per share by dividing by 1 billion shares. For example, an equity value of £3.3 billion equates to a share price of 330p.

3 The equity valuation ranges presented by the independent corporate finance adviser are stated after a 10% indicative IPO discount, the ranges presented by the global coordinators are stated after a 5–10% IPO discount and no discount has been applied to the equity valuation ranges presented by the syndicate equity research analysts.

4 The prospectus price range (260p to 330p) is equivalent to a dividend yield of 6.1 to 7.7%, an EV/EBITDA multiple of 4.2 to 5.0 and a price to earnings ratio of 8 to 10 (based on estimated results for 2014).

5 No valuation range was published by the Goldman Sachs equity research analyst.

Source: National Audit Office analysis of valuations by various parties

3.43 As the auditors of central government, we would reasonably expect to see evidence of an effective system of controls to design, manage and evaluate the use of a tax expenditure which is rigorous and proportionate, and would share many of the features that we would expect for a spending programme. HMRC and HM Treasury should collect better evidence on the impact of reliefs on donor behaviour, working with the charitable sector and academics to obtain this.

Tax reliefs[31]

3.44 As reported in the C&AG's report on Gift Aid and reliefs on donations, tax reliefs are a longstanding element of fiscal policy, and are growing in number, with more than 1,000 reliefs in the UK tax system. HM Treasury and HMRC (the exchequer departments) share oversight of tax reliefs and there is no single accounting officer responsible for their effectiveness. HMRC works with HM Treasury to develop, design and deliver tax policy. HM Treasury is responsible for strategic tax policy design and HMRC for delivering and maintaining policy and the administration of the tax system.

3.45 The value of reliefs in relation to tax revenue and public spending has increased in recent years. Since 2010-11, while public spending has fallen sharply, the value of reliefs has continued to rise (**Figure 18** overleaf).

3.46 There is no documented framework specifically governing the introduction or modification of tax reliefs. In 2010 HM Treasury increased the policy cycle for creating new reliefs from 7 to 18 months. This was to allow more time to consult on the objectives of a proposed measure, to appraise the options and to draft legislation. HM Treasury also committed to developing a framework for the introduction of new reliefs, recognising that it should consider new reliefs carefully, and that these should only be introduced when there is a strong and proven case. At the time of the report, it had yet to develop such a framework. Since 2011, the scope of tax impact notes has narrowed and an options appraisal is no longer required.

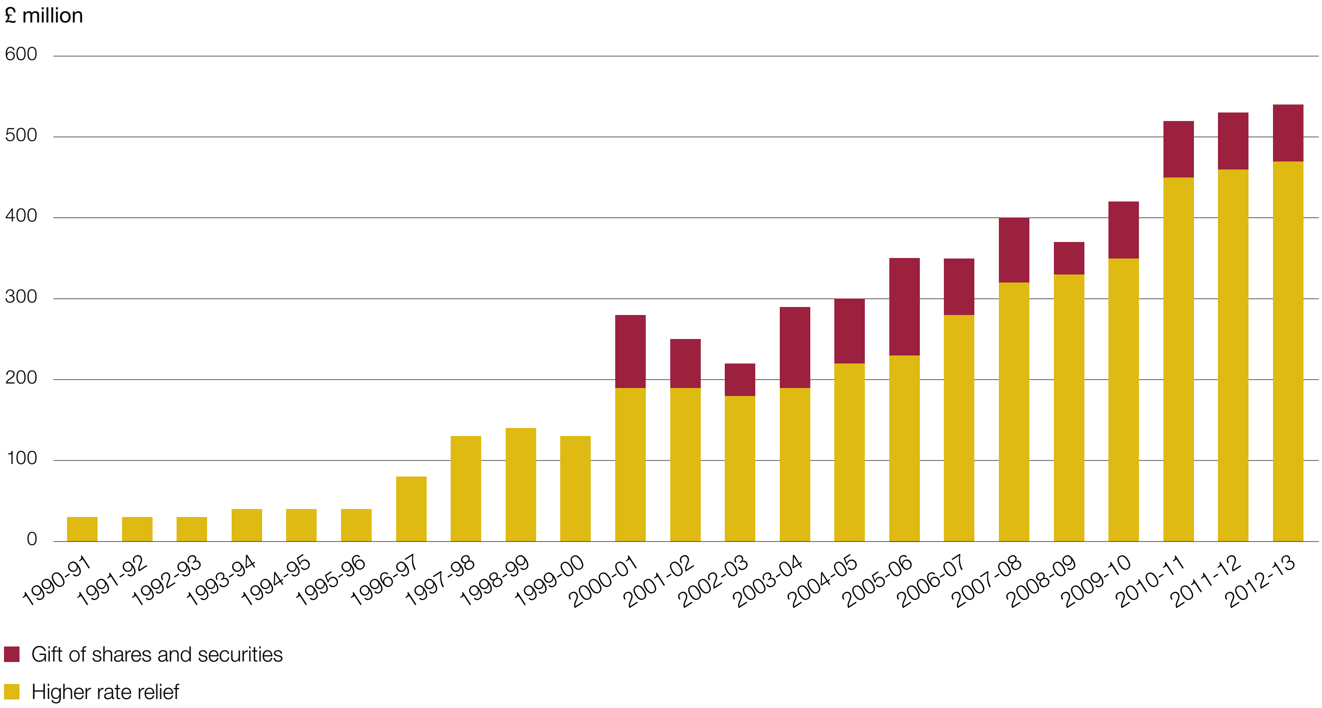
3.47 HM Treasury depends on HMRC's feedback on the use of specific reliefs. Evaluation is important to understand the extent to which a tax relief is misused, its behavioural consequences and, in the case of tax expenditure, whether it is meeting its social or economic objectives. HMRC does not evaluate tax reliefs systematically, and has commissioned few evaluations of their impact.

31 Comptroller and Auditor General, *Tax reliefs*, Session 2013-14, HC 1256, National Audit Office, March 2014.

Figure 18

Tax reliefs to individuals

The value of tax reliefs provided to individuals on their donations and gifts has steadily increased



Note

1 Figures are adjusted for inflation to 2012-13.

Source: National Audit Office analysis of HM Revenue & Customs *UK Charity Tax Relief Statistics* available at: www.hmrc.gov.uk/statistics/charity.htm, accessed 23 October 2013

NAO work in progress

3.48 Work currently being undertaken by the NAO relating to HM Treasury that will be published in the next year includes the following reports:

- **Guarantees for infrastructure** (autumn of 2014) will examine the impact of guarantees on infrastructure projects including how HM Treasury manages taxpayers' exposure to risk.
- **Choice of finance** (December 2014) will outline the factors government considers when deciding to use public or private financing for capital investment projects. The study will focus on HM Treasury but will also be informed by a number of departmental case studies.
- **Financial institutions in government** (December 2014) will take the form of a landscape review and will set out the financial institutions the government has created, describe the scope of their activity and assess any exposure to risk they may represent to taxpayers.
- **Hinkley Point C** (we will report to Parliament at an appropriate point in the conclusion of the deal) will cover the Department of Energy and Climate Change's commercial approach to securing the deal with EDF Group and the proposed terms of the contract, to report to Parliament on value for money and the resulting risks which the Department must manage. We will also identify lessons learned to inform decisions on future 'contracts for difference'. This report will be of interest to the Treasury Select Committee, should Hinkley Point C be approved for the UK Guarantee Scheme.

3.49 In addition to the above, in his report on the HM Treasury 2013-14 Accounts, the C&AG stated that he planned to report to Parliament on the value for money of HM Treasury's Help to Buy Mortgage Guarantee Scheme in 2015.

Appendix One

HM Treasury sponsored bodies at 31 March 2014

Core Department

HM Treasury, Office of Tax Simplification and Infrastructure UK
Nick Macpherson
Permanent Secretary and Principal Accounting Officer

Executive agency

UK Debt Management Office
Robert Stheeman
Chief Executive

Non-departmental public bodies

Office for Budget Responsibility
Robert Chote
Chairman

Royal Mint Advisory Committee on the Design of Coins, Medals, Seals and Decorations
Adam Lawrence
Chief Executive

Levy-funded bodies

Money Advice Service
Caroline Rookes
Chief Executive

Financial Services Compensation Scheme
Mark Neale
Chief Executive

Managed by the Royal Household

Sovereign Grant
Keeper of the Privy Purse and Treasurer's Office
Sir Alan Reid GCVO

Treasury-owned companies

UK Financial Investments Ltd
James Leigh-Pemberton
Executive Chairman

UK Asset Resolution Ltd
Managed by UK Financial Investments Ltd on HM Treasury's behalf

Help to Buy (HMT) Ltd

Infrastructure Finance Unit Ltd

Note

1 HM Treasury Group does not include the central funds which collectively form the Exchequer pyramid, namely the Debt Management Account, National Loans Fund, Exchange Equalisation Account, Contingencies Fund, Consolidated Fund and balances held by the Commissioners for the Reduction of the National Debt. In addition, the Debt Management Office also has a non-departmental public body, the Public Works Loans Board, which is not consolidated into the Debt Management Office or the wider HM Treasury Group. As an executive agency of the Chancellor of the Exchequer, rather than HM Treasury, National Savings and Investments (NS&I) is also outside of the HM Treasury Group.

Source: HM Treasury, Annual Report and Accounts 2013-14

Appendix Two

Results of the Civil Service People Survey 2013

Survey question (% strongly agree or disagree)	HM Treasury	Civil Service benchmark
Leadership and managing change		
I feel that my department as a whole is managed well	**67**	43
Senior managers in my department are sufficiently visible	**75**	51
I believe the actions of senior managers are consistent with my department's values	**63**	43
I believe that the board has a clear vision for the future of my department	**54**	42
Overall, I have confidence in the decisions made by my department's senior managers	**64**	41
I feel that change is managed well in my department	**47**	29
When changes are made in my department they are usually for the better	**40**	27
My department keeps me informed about matters that affect me	**70**	58
I have the opportunity to contribute my views before decisions are made that affect me	**48**	36
I think it is safe to challenge the way things are done in my department	**58**	38
Organisational objectives and purpose		
I have a clear understanding of my department's purpose	**93**	85
I have a clear understanding of my department's objectives	**88**	80
I understand how my work contributes to my department's objectives	**88**	83

Notes

1 These are summary results of the Civil Service People Survey 2013. Not all question scores have been included.

2 The score for a question is the percentage of respondents who strongly agree or agree to that question.

Source: *Civil Service People Survey 2013*, available at: www.civilservice.gov.uk/about/improving/employee-engagement-in-the-civil-service/people-survey-2013, accessed 28 August 2014

Department for Business, Innovation & Skills (excluding agencies)	Cabinet Office (excluding agencies)	Department for Communities and Local Government (excluding agencies)	Department for Culture, Media & Sport (excluding agencies)	Ministry of Defence (excluding agencies)	Department for Education	Department of Energy & Climate Change	Department for Environment, Food & Rural Affairs (excluding agencies)	Foreign & Commonwealth Office (excluding agencies)	Department of Health (excluding agencies)	HM Revenue & Customs	Home Office (excluding agencies)	Department for International Development (excluding agencies)	Ministry of Justice (excluding agencies)	Department for Transport (excluding agencies)	Department for Work & Pensions (excluding agencies)
45	39	43	28	24	32	42	35	57	41	26	37	64	48	41	40
55	53	53	42	32	41	63	49	60	57	38	47	69	55	57	39
44	43	42	37	29	35	50	41	57	46	32	41	62	49	45	39
48	28	39	23	27	29	24	28	53	32	28	32	55	39	34	40
42	41	39	30	22	30	44	34	51	43	23	35	57	43	37	33
29	28	29	20	14	21	28	23	40	26	20	22	43	32	25	34
24	25	20	16	11	16	27	16	35	18	17	19	34	27	21	30
65	59	60	51	45	53	69	58	62	56	45	57	69	59	60	58
38	34	41	30	23	29	42	31	44	37	25	34	48	37	33	35
40	42	39	32	33	31	48	38	46	36	33	37	44	39	40	42
85	73	75	70	82	83	89	77	84	77	80	84	94	82	80	85
79	63	72	62	74	77	86	74	81	73	77	81	92	77	75	83
84	73	78	74	79	81	87	79	84	78	80	82	91	80	79	84

Appendix Three

Publications by the NAO on HM Treasury since April 2013

Publication date	Report title	HC number	Parliamentary session
17 July 2014	Report of the Comptroller and Auditor General: HM Treasury Annual Report and Accounts 2013-14	HC 20	2014-15
19 June 2014	Centre of Government	HC 171	2014-15
10 June 2014	Report of the Comptroller and Auditor General: Whole of Government Accounts 2012-13	HC 93	2014-15
10 April 2014	Review of the VfM assessment process for PFI	www.nao.org.uk/wp-content/uploads/2014/01/Review-of-VFM-assessment-process-for-PFI1.pdf	
25 February 2014	Regulating financial services	HC 1072	2013-14
18 December 2013	The first sale of shares in Lloyds Banking Group	HC 883	2013-14
29 November 2013	Savings from operational PFI contracts	www.nao.org.uk/wp-content/uploads/2013/11/Savings-from-operational-PFI-contracts_final.pdf	
1 November 2013	Improving access to finance for small and medium-sized enterprises	HC 734	2013-14
9 August 2013	2012-13 review of the data systems for HM Treasury	www.nao.org.uk/wp-content/uploads/2013/07/009877-011_HMT_Data-summary-sheet.pdf	
17 July 2013	Report of the Comptroller and Auditor General: Whole of Government Accounts 2011-12	HC 531	2013-14
16 July 2013	Report of the Comptroller and Auditor General: HM Treasury Annual Report and Accounts 2012-13	HC 34	2013-14
12 July 2013	Government interventions to support retirement incomes	HC 536	2013-14
24 April 2013	Administering the Equitable Life Payment Scheme	HC 1043	2012-13

Appendix Four

Cross-government reports of relevance to HM Treasury

Publication date	Report title	HC number	Parliamentary session
3 July 2014	Government grant services	HC 472	2014-15
1 April 2014	The privatisation of Royal Mail	HC 1182	2013-14
28 March 2014	Tax reliefs	HC 1256	2013-14
6 March 2014	The Help to Buy equity loan scheme	HC 1099	2013-14
14 February 2014	Managing debt owed to central government	HC 967	2013-14
31 January 2014	Forecasting in government to achieve value for money	HC 969	2013-14
December 2013	Evaluation in government	www.nao.org.uk/wp-content/uploads/2013/12/10331-001-Evaluation-in-government_NEW.pdf	
21 November 2013	Gift Aid and reliefs on donations	HC 733	2013-14
8 October 2013	Confidentiality clauses and special severance payments – follow up	HC 684	2013-14
21 June 2013	Confidentiality clauses and special severance payments	HC 130	2013-14
13 June 2013	Financial Management in Government	HC 131	2013-14

Where to find out more

The National Audit Office website is
www.nao.org.uk

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