

House of Commons
Committee of Public Accounts

**NIRS 2: CONTRACT
EXTENSION**

Thirty-eighth Report of Session
2001–02

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EXTENSION**

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*Report, together with
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Minutes of Evidence and an Appendix*

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Committee of Public Accounts

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Footnotes

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THIRTY-EIGHTH REPORT

The Committee of Public Accounts has agreed to the following Report:

NIRS 2: CONTRACT EXTENSION

INTRODUCTION AND LIST OF CONCLUSIONS AND RECOMMENDATIONS

1. NIRS 2—the National Insurance Recording System—is a large and complex computer system which supports the administration of the national insurance scheme. It holds details of some 65 million individual national insurance contribution records. This information is fundamental to the accurate calculation of contributory social security benefits, such as retirement pension and underpins payments to pension schemes in respect of contributors with contracted out personal pensions. In 2000–2001, the Inland Revenue collected over £50 billion in national insurance contributions and the Department of Social Security (now the Department for Work and Pensions) paid out £46 billion in contributory benefits, based on records held on the system.¹

2. NIRS 2 was developed by Accenture (then Andersen Consulting) in 1995. The contract covered the replacement of NIRS 1, transfer of data, development of the system to implement legislative changes arising from the Pensions Act 1995, and the operation of the new system until 2004. The original contract was valued at £45 million for operational services with provision for software enhancements increasing that amount to £76 million. We examined the difficulties that were experienced in delivering NIRS 2 on three occasions between 1998 and 2000.²

3. In 1998 the Government proposed significant changes to pensions and national insurance legislation, for example to introduce stakeholder pensions and pension sharing on divorce. The Inland Revenue, who had taken over responsibility for NIRS 2 in April 1999 with the transfer of the Contributions Agency, negotiated an extension to the contract to cover the work needed to support these legislative changes. The estimated value of the extension is between £70 million and £144 million, depending on the amount of work ordered over the remaining life of the contract.³

4. On the basis of a Report by the Comptroller and Auditor General⁴ we looked at the need for the new work, the reasons why the Inland Revenue chose to extend the contract with Accenture rather than conduct a fresh competition, and Accenture's performance so far.

5. In the light of this examination, the Committee draws three overall conclusions.

- The original contract for NIRS 2 showed the impact of setting too tight a deadline in statute for implementation of the Pensions Act 1995. The Department of Social Security repeated this mistake by not properly assessing the aggregate impact on NIRS 2 of the later proposed changes to pensions and national insurance legislation, or the risks and extra costs involved. Our Report on *Ensuring Policies Deliver Value for Money* has already emphasised the need for policies to be implemented

¹ C&AG's Report, paras 1, 1.2

² Committee of Public Accounts: 46th Report, *The Contract to Develop and Update the Replacement National Insurance Recording System* (HC 472, Session 1997–98); 22nd Report, *Delays to the new National Insurance Recording System* (HC 182, Session 1998–99); 31st Report, *National Insurance Fund 1998–99 and Wider Issues of Fraud and Error in Benefits Paid by the Department of Social Security* (HC 350, Session 1999–2000).

³ C&AG's Report, para 2

⁴ C&AG's Report, *NIRS 2: Contract Extension* (HC 355, Session 2001–02)

with sufficient flexibility and for the risks faced to be identified, assessed and regularly monitored.⁵

- In non-competitive situations, Departments need to have in place rigorous methodologies for assessing the reasonableness of the prices on offer, and arrangements to avoid contractors earning excessive profits. In the case of the NIRS 2 extension, the Inland Revenue's benchmarking arrangements suggested that Accenture's proposals offered value for money. The Inland Revenue are sharing the benefits of improved productivity, and "super profits", but Accenture have outperformed their target productivity levels by a wide margin. On the basis of experience so far, the prices agreed appear to be very generous for a non-competitive contract, where, in practice, the Inland Revenue had little option but to use Accenture because of the high break costs of the original contract.
- The Inland Revenue face a fresh challenge in 2004, when their contracts with Accenture and with EDS (their strategic supplier of other information technology systems) come up for renewal. Although they are taking steps to generate competition, the barriers may be too great, especially in terms of learning and set up costs for these large and complex systems in a deal likely to be worth over £4 billion. The methodologies they use to estimate and benchmark proposals will need to be rigorous.

6. Our more specific conclusions and recommendations are as follows.

- (i) The major welfare reforms planned by the new Government after May 1997 led to significant changes to NIRS 2, well beyond those that could reasonably have been foreseen when the initial contract was placed in 1995. While the Department of Social Security considered the technical feasibility and costs of each change, they did not assess whether the changes could be delivered within the existing contract. Failure to do so restricted the Inland Revenue's options when it became clear that significant additional work was required, because implementation dates were already set in legislation. The Inland Revenue should explore with the Office of Government Commerce how to build additional flexibility into future contracts, for example by inviting the bidders to propose a separate pricing structure for major enhancements as part of the initial tendering process.
- (ii) The Inland Revenue took advantage of the contract extension to introduce incentives for delivery and productivity, and to address many of the weaknesses the Committee of Public Accounts identified in its earlier reports on NIRS 2 and other IT projects that encountered difficulties. For example, there is now a clear framework for acceptance testing.
- (iii) The Inland Revenue negotiated arrangements for sharing the benefits of any productivity improvements achieved by Accenture, and to share any "super profits" above agreed margins. The productivity actually achieved by Accenture on the first two developments (3.4 compared with 7.5 days per function point) and the fact that Accenture appear to have made "super profits" in year two of the contract, do raise serious questions about how rigorous the original estimates and benchmarking were. The Inland Revenue should consider the scope to renegotiate the target productivity rate for the rest of the contract in line with performance to date.

⁵ Committee of Public Accounts: 49th Report, *Ensuring that Policies Deliver Value for Money* (HC 541, Session 2001-02)

- (iv) Both parties attributed improvements in performance under the contract to stronger and more robust partnership arrangements. In our Reports on *Improving Construction Performance* and *Non-Competitive Procurement in the Ministry of Defence*⁶ we highlighted the potential benefits of partnering, including incentivisation of performance; transparency; minimising the risk of disputes; replicating lessons learned on earlier projects and a sensible allocation of risks.

THE NEED FOR AN EXTENSION TO THE CONTRACT

7. The original contract for NIRS 2 made provision for routine enhancements and a ceiling on additional development work. The ceiling was expressed as 2000 function points per annum, at a fixed price per point agreed in May 1997, 2 years after the original contract was placed. However, between May 1997 and April 1999 the Government announced a number of significant legislative changes which affected the areas of national insurance and pensions dealt with by NIRS 2 (Figure 1). These changes far exceeded the provisions in the original contract.⁷

Figure 1: Main legislative changes affecting the National Insurance Recording System			
Development	Proposed	Enacted	Implementation date
Restructuring of National Insurance contribution thresholds and limits	November 1997	Social Security Act 1998	Phased from April 1999
Enabling SERPS pensions to be shared on divorce	June 1998	Welfare Reform and Pensions Act 1999	December 2000
Revised rules for calculating Incapacity Benefit	October 1998	Social Security Act 1998 Misc Amendments (Regs) 1999	April 2000
Reform of bereavement benefits	October 1998	Welfare Reform and Pensions Act 1999	April 2001
Introduction of stakeholder pensions	December 1998	Welfare Reform and Pensions Act 1999	Available April 2001. Employers must offer by October 2001
Introduction of State Second Pension	December 1998	Child Support, Pensions and Social Security Act 2000	April 2002 (earliest)

Source: National Audit Office summary of relevant Government announcements

⁶ Committee of Public Accounts: 2nd Report, *Improving Construction Performance* (HC 337, Session 2001–02); 29th Report, *Non-Competitive Procurement in the Ministry of Defence* (HC 370, Session 2001–02)

⁷ C&AG's Report, paras 2.2–2.5; Qs 150–157

8. The Inland Revenue consider that the ceiling on enhancements in the original contract negotiated by the Department of Social Security was adequate, based on all reasonably foreseeable assumptions. Those concerned could not have foreseen the extent to which, following the general election in 1997, there would be significant changes in legislative requirements. Even had they been foreseen, in their view it was not appropriate for an Accounting Officer to take into account the possibility of a change of government in planning the system.⁸

9. After the General Election, the proposed legislative changes were announced over a period of a year, from November 1997 to December 1998. The Department of Social Security assessed the technical feasibility and costs of each of these policy changes, but told the National Audit Office that they were not in a position to establish fully the aggregate effect of the changes on NIRS 2. Their ability to assess the overall capacity for NIRS 2 to accommodate the package of changes within the proposed legislative timetable was limited by uncertainties about the initial stabilisation of the system. As the original system had not been fully delivered, it was more difficult to assess the extent to which it would need to be modified. Thus it was not apparent to the Department of Social Security that the required developments might, in aggregate, exceed the annual enhancement limit included in the NIRS 2 contract, or more fundamentally, whether the system had the technical capacity to absorb the level of change required.⁹

10. The Inland Revenue confirmed that as far as they were concerned they would normally try to establish the full implications, costs and lead times for implementation taking into account issues that cut across departmental boundaries. The circumstances would determine the degree of flexibility they might need to build in to allow for possible changes, but it would be bad value for money to provide unlimited flexibility to allow for the possibility that at some point in the future the policy might change.¹⁰

11. When they took over responsibility for NIRS 2, in April 1999, the Inland Revenue formed a joint design team to assess the options with staff from the Department of Social Security and with technical support from Electronic Data Systems (EDS), their strategic information technology partners, and Accenture. The team considered the scope of the legislative commitments, the feasibility of delivering them through NIRS 2 or alternative means, and the risks and dependencies involved, in order to derive an estimate of the scale and optimum timing of future developments. In October 1999, they concluded that new development work would require between 5,860 and 7,240 function points to be delivered between October 2000 and April 2002. As this exceeded the limit in the original contract of 2,000 function points a year, the Inland Revenue examined ways of meeting the commitments arising from the legislative changes.¹¹

THE DECISION TO EXTEND THE CONTRACT WITH ACCENTURE

12. In examining the contract extension, we looked at the options available, the rigour of the evaluation of Accentures' proposals and other changes to the contract.

(a) The options available

13. The alternatives to using NIRS 2 to support the new legislative requirements included clerical solutions and using other information technology systems (Figure 2). Most of these were rejected because they were not technically feasible or were likely to involve greater

⁸ Qs 3, 72–75, 96–99, 158–161, 191–196

⁹ C&AG's Report, paras 2.8–2.9; Qs 3, 97–99, 159

¹⁰ Qs 3–6, 46–48, 50, 57–58, 162–163

¹¹ C&AG's Report, paras 2.11–2.12; Qs 88–92, 110

risk or cost than enhancing NIRS 2. The Inland Revenue concluded that NIRS 2 was the most practicable option for some 80 per cent of the work required.¹²

Figure 2: Alternative options considered for delivering key legislative changes			
Development	Solution	Alternatives considered	Rationale
Restructuring of National Insurance contribution thresholds and limits	Full implementation on NIRS	Clerical Defer changes	Affects core NIRS functions. Clerical option not viable as 48 million records affected. Deferral difficult as employers had started amending rates and thresholds on payroll systems.
Enabling SERPS pensions to be shared on divorce	Implementation on Benefits Agency system with some modification to NIRS	Defer scheme Clerical Full implementation on NIRS	Could be implemented using Pension Valuation on Divorce System at similar cost.
Revised rules for calculating Incapacity Benefit	Full implementation on NIRS	Alternative IT Clerical Deferral	Change manageable on NIRS. Alternative IT system likely to be more expensive. Clerical option available as fall-back. Deferral would jeopardise £25 million of savings.
Reform of bereavement benefits	Full implementation on NIRS	Clerical Deferral	No alternative to NIRS which delivered predecessor benefit. Deferral would risk legal claims from bereaved claimants under Human Rights Act.
Introduction of stakeholder pensions	Partial implementation on NIRS, plus new EDS system	Full implementation on NIRS Deferral	Registration of schemes and scheme members could be delivered by EDS on separate system at similar cost, reducing risk to NIRS.
Introduction of State Second Pension	Full implementation on NIRS	Alternative IT Deferral	Timetable not yet fixed so could be implemented on NIRS at lower risk.
The joint design team considered other developments, which mainly involved changes to the processing of annual returns from employers, and determined that they could be implemented without amending NIRS.			

¹² C&AG's Report, paras 9, 3.2

14. In order to implement the new pensions arrangements, the Inland Revenue therefore identified three main contractual options for commissioning the new NIRS 2 development work. These were to negotiate a contract extension; ask Accenture to provide the additional resources required at Department of Social Security framework rates, under the original contract terms; or exercise the break clause in the original contract and hold a new competition for the continuing operation and development of the system. They saw these as real choices and rejected the view that in practice Accenture were in a monopoly position.¹³

(b) The evaluation of Accenture's proposals

15. The Inland Revenue took four key factors into account in deciding whether or not they should go ahead with Accenture:

- Value for money;
- Whether the technical platform of NIRS 2 was robust, and would take the changes envisaged;
- Whether Accenture were capable of delivering the changes at the pace the Inland Revenue wanted them;
- The opportunity to revise some of the management controls in the contract, in areas commented upon by the Committee of Public Accounts in earlier reports, such as testing and acceptance criteria.¹⁴

16. On **value for money**, the Inland Revenue commissioned PA Consulting to develop a financial model to compare the cost of Accenture's proposals with that of using alternative suppliers. The work showed that Accenture's unit costs compared closely with the comparators. Accenture's staff charges were higher, but they agreed to a productivity target of 7.5 staff days a function point compared with rates of 8–10 staff days achieved on the base system, and an estimate of 11.5 staff days for any new supplier. Accenture's view was that their higher staff charges reflected the fact that they recruited and retained the best people, invested in their training and therefore delivered higher productivity. Their familiarity with the system was also a major factor in the higher productivity they were able to offer.¹⁵

17. Based on unit costs, Accenture's proposal compared closely with alternative benchmarks for suppliers. For example Accenture's proposal was costed at £100 million for 8000 function points compared with £105 million from EDS. However, breaking the NIRS 2 contract with Accenture and using alternative suppliers would have incurred additional costs estimated at £44 million. The results therefore supported the option to extend the contract with Accenture.¹⁶

18. As regards **the stability of NIRS 2 to take the changes, and Accenture's ability to deliver software of the required quality**, the earlier problems with NIRS 2 had been cleared up at the point that the Inland Revenue signed the extension. All its major elements were fully operational and it was performing in excess of requirements. There were, however, a number of lower priority areas that remained outstanding, for example automatic

¹³ C&AG's Report, paras 10, 3.3; Qs 2, 15–16, 93–94, 175–176

¹⁴ C&AG's Report, para 3.14; Qs 85–87, 94–95, 120, 174

¹⁵ C&AG's Report, paras 12, 3.5–3.8; Qs 1, 14, 17–22, 62–71, 121–126, 127–142, 225–226; Ev 23

¹⁶ C&AG's Report, paras 12, 3.5–3.6; Qs 1, 7–9, 14, 25–27, 71, 113, 169–173

printing of labels. The Inland Revenue had also received assurance about Accenture's commercial stability, and legal, commercial and security issues.¹⁷

19. As regards **delivery of the government's welfare reforms**, moving away from Accenture would have put delivery of them at risk, not least because a fresh competition could have taken in the order of 18 months.¹⁸

20. In addition to these factors, the Inland Revenue took the opportunity to introduce changes to the way development work is managed and paid for:

- There are stage payments for development work, whereas under the original contract development costs were rolled up into operational charges for the system as a whole.
- Productivity targets are agreed for each project under the extension, and the cost of variations shared between the parties. In addition, there is a "super profits" clause, which provides that if overall profits are higher than a target margin, the difference is shared between Accenture and the Inland Revenue 50:50. There is an open book accounting arrangement, which allows the Department's internal audit to check costs.
- There are improved processes for dispute resolution and for dealing with difficult issues.¹⁹

21. At the same time, Accenture became liable for penalties for non-delivery and failure to meet service targets. These include liquidated damages if they do not deliver on time representing a fixed amount for a period of up to three months, equivalent to 1.5 per cent of the project manpower cost up to a ceiling of 150 per cent of those costs.²⁰

22. The new arrangements correspond closely to the latest best practice guidance from the Treasury Taskforce and the recommendations of the McCartney Report, which was issued following the Committee of Public Accounts' report on Improving the Delivery of Government IT Projects.²¹ The risks of new developments not being delivered to cost and time are shared between the Inland Revenue and Accenture, recognising the Department's view that they have an essential role to play in effective software development.²² The Inland Revenue have also responded to the difficulties encountered in the original contract for NIRS 2 and to our conclusions and recommendations (Figure 3).

23. After taking these factors into account, as well as the latest Treasury guidance the Inland Revenue concluded that Accenture's proposals were the best option.²³

¹⁷ C&AG's Report, paras 13, 3.10–3.16; Qs 7, 13, 91, 94, 103–109, 111–113, 117, 164–166, 171

¹⁸ Qs 85–86, 95, 174

¹⁹ C&AG's Report, para 3.22; Qs 29–34, 80–83, 197, 203–204, 208; Ev 23

²⁰ C&AG's Report, para 3.22 and Figure 9; Qs 35–38, 76–79, 198, 204–205; Ev 23

²¹ C&AG's Report, para 3.22; 1st Report from the Committee of Public Accounts, *Improving the Delivery of Government IT Projects* (HC 65, Session 1999–2000); *Successful IT: Modernising Government in Action*, Cabinet Office Central IT Unit, 2000; Q188

²² C&AG's Report, para 3.22 and Figure 9; Qs 39–45, 187–188

²³ C&AG's Report, paras 13, 3.10–3.16

Figure 3: Action addressing points raised by the Committee of Public Accounts on the original contract for NIRS 2	
<p>Timetable for delivery</p> <p>In view of the risks of attempting to deliver the system to a tight timetable, there was a need for a fall-back position, and the Contributions Agency should have taken a hard look at alternatives (46th Report, Session 1997–98, conclusion (xi)).</p>	<p>Mechanisms have been introduced to manage the risks of delays in delivering software developments. Development work is managed as a series of projects leading to a single 6-monthly release. If the Inland Revenue order work to a timetable not accepted by the contractor, a grace period can be negotiated which can protect the contractor from unfair penalties.</p>
<p>Definition of responsibilities</p> <p>Where risks are transferred it is necessary to define responsibilities clearly (22nd Report, Session 1998–99, paragraph 8).</p>	<p>The contract addendum sets out each party's objectives and responsibilities. The business structure for managing the development work was endorsed by an independent adviser.</p>
<p>Acceptance testing</p> <p>Post-acceptance difficulties cast doubt on the quality and rigour of the Contributions Agency's acceptance testing; sufficient time needed to be built into the implementation plan to conduct rigorous testing (22nd Report, Session 1998–99, conclusions (viii) and (ix)).</p>	<p>The contract addendum sets out a clear framework for acceptance testing. Joint testing arrangements require the parties to agree definitions of acceptance as well as avoiding duplication of work.</p>
<p>Shared understanding of delivery</p> <p>The Contributions Agency and the contractor had not developed a shared understanding of what was meant by delivery of the system (22nd Report, Session 1998–99, conclusion (xi)).</p>	<p>As noted above, there is now agreement on what constitutes acceptance, and there are also joint project management arrangements.</p>
<p>Balance of benefits and risks on IPRs</p> <p>The Inland Revenue should look again at the balance of benefits and risks underpinning decisions on ownership of intellectual property rights in major government systems (31st Report, Session 1999–2000, conclusion (iii)).</p>	<p>The Inland Revenue did not seek to obtain explicit IPRs to the software to be developed under the extension, since it is inextricably linked to the main system software. However, the transfer payment to Accenture (£14 million) for rights to use NIRS 2 after the contract expires in 2004 remain unchanged, so the Inland Revenue gain the rights to use the new software and no extra cost.</p>

24. In 2004, the Inland Revenue's contracts with Accenture and EDS come up for renewal. Asked whether true competition was likely or whether Accenture would have competitive advantage because the entry costs would be high, the Inland Revenue accepted that there would be transition costs, but that these would not be the same as breaking the contract with Accenture in mid-stream. They had already taken steps to ensure that there was competition for the contract, which could be worth as much as £4 billion.²⁴

ACCENTURE'S PERFORMANCE SO FAR

25. The Comptroller and Auditor General reported that the contract managers at the Inland Revenue and Accenture both considered that the relationship between the parties had improved since the introduction and operation of the new arrangements. The Inland Revenue and Accenture agreed that much stronger and more robust partnership arrangements had contributed to the improved relationship. The first two software releases under the contract extension, which included changes required for pensions sharing on divorce, bereavement, incapacity and the restructuring of national insurance contributions, had been completed on schedule. The quality of software had improved significantly, compared with the earliest releases.²⁵

26. The Inland Revenue had also benefited from cost and productivity improvements under the new profit and productivity sharing arrangements. For the last three releases up to October 2001, actual productivity (3.4 days per function point) had been significantly less than the 7.5 days agreed in the contract extension. This had resulted in a total saving to the Inland Revenue of £9.6 million.²⁶

27. The average margin made by Accenture for the year ending 31 August 2000 at 26 per cent was below the average gross target margin of 30 per cent. However, their provisional margin in 2000–01 of 54 per cent had exceeded the trigger (35 per cent) by a large margin and assuming the provisional figures are ratified will result in a rebate to the Inland Revenue of £3.6 million. There have been no penalties under the contract extension so far.²⁷

²⁴ Qs 10, 178–180

²⁵ C&AG's Report, paras 3.29–3.30; Qs 51–52

²⁶ Qs 29–35; Ev 23

²⁷ C&AG's Report, para 3.22 and Figure 9; Qs 81–83, 202; Ev 23

MINUTES OF PROCEEDINGS OF
THE COMMITTEE OF PUBLIC ACCOUNTS

SESSION 2001–02

MONDAY 3 DECEMBER 2001

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Mr George Osborne
Mr Ian Davidson	Mr David Rendel
Mr Barry Gardiner	Mr Gerry Steinberg
Mr Nick Gibb	Jon Trickett
Mr Brian Jenkins	Mr Alan Williams

Sir John Bourn, KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Glenn Hull, Second Treasury Officer of Accounts, was further examined.

The Comptroller and Auditor General's Report on NIRS 2: Contract Extension (HC 355) was considered.

Sir Nicholas Montagu, KCB, Chairman, Inland Revenue, was further examined; Mr John Yard, CBE, Director, Business Services, Inland Revenue; Ms Lis Astall, Partner, Accenture, was examined; and Mr Sandy Gordon, Project Manager, National Audit Office, was examined (HC 423-i).

Resolved, That copies of the uncorrected typescript of evidence taken on 3 December on the National Insurance Recording System (NIRS) 2: Contract Extension, be placed in the House of Commons Library for the use of Members and in the Record Office, House of Lords, for public inspection.—(*Mr David Rendel*).

* * * * *

[Adjourned until Wednesday 5 December at Four o'clock.

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WEDNESDAY 12 JUNE 2002

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Mr George Osborne
Geraint Davies	Mr David Rendel
Mr George Howarth	Mr Alan Williams
Mr Brian Jenkins	

Sir John Bourn, KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Rob Molan, Second Treasury Officer of Accounts, was further examined.

* * * * *

Draft Report (NIRS 2: Contract Extension), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 5 read and agreed to.

Paragraph 6 postponed.

Paragraphs 7 to 27 read and agreed to.

Postponed paragraph 6 read and agreed to.

Resolved, That the Report be the Thirty-eighth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

* * * * *

[Adjourned until Monday 17 June at Four o'clock.]