



House of Commons
Liaison Committee

**Parliament and
Government Finance:
Recreating Financial
Scrutiny: Government
and National Audit
Office Responses to
the Committee's
Second Report of
Session 2007–08**

**Third Special Report of Session
2007–08**

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The Liaison Committee

The Liaison Committee is appointed to consider general matters relating to the work of select committees; to advise the House of Commons Commission on select committees; to choose select committee reports for debate in the House and to hear evidence from the Prime Minister on matters of public policy.

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Powers

The powers of the Committee are set out in House of Commons SO No 145. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at www.parliament.uk/parliamentary_committees/liaison_committee.cfm.

Committee staff

The current staff of the Committee are Helen Irwin (Clerk), Robert Wilson (Second Clerk), Kevin Candy (Committee Assistant) and Catherine Close (Secretary).

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Third Special Report

The Liaison Committee published its Second Report of Session 2007–08, *Parliament and Government Finance: Recreating Financial Scrutiny*, on 21 April 2008, as House of Commons Paper HC 426. The Government's response was received in June 2008, and is appended below. We are also publishing in Appendix 2 the response from Comptroller and Auditor General, National Audit Office, received on 27 June 2008.

Appendix 1 Government response

Introduction

1. The current problem is not the House's powers but the willingness and (even more) the ability of the House and its Members to scrutinise financial matters in the degree of detail required to hold the Government to account. (Paragraph 8)

2. We define the purpose of financial scrutiny as follows:

- **to make the Government's financial decisions transparent, including the relationship between its stated priorities and its funding decisions;**
- **to engage bodies and individuals outside Parliament and give them the opportunity to comment;**
- **to have the opportunity to influence the Government's financial decisions;**
- **to hold the Government, individual Departments and other public bodies to account for their financial decisions and financial management; and thereby**
- **to contribute to an improvement in the quality of Departments' financial decisions and management and improved value for money in public services. (Paragraph 9)**

3. Financial scrutiny is not a narrow exercise of poring over figures on a balance sheet but is about ensuring the effective management of finite resources to achieve purposes such as better hospitals or better-equipped troops. Better financial scrutiny would have advantages for the Government as well as for the public and for Parliament. (Paragraph 10)

The Government fully endorses the importance of financial scrutiny by the House and recognises the value of such scrutiny to Government, Parliament and the public.

The Government has in recent years implemented a number of significant changes in the way in which financial information is reported, with the aim of making the public expenditure system more transparent. These changes have included:

- the publication of three year spending plans, following each Spending Review, linked to the achievement of clear objectives set out in Public Service Agreements;

- the implementation of Resource Accounting and Budgeting (RAB), which brought the highest standards of the private sector into financial reporting by the public sector and created new value for money incentives for departments. The implementation of International Financial Reporting Standards (IFRS) in 2009–10 will build on this;
- significant improvements in the closing of departmental resource accounts, so that resource accounts are available much earlier in the year. This is enabling an increasing number of departments to publish combined Departmental Reports and Resource Accounts before the summer recess, providing more coherent information about the department's spending, akin to the annual report and accounts produced by private sector companies.
- Building on these improvements, the Government has further committed, in the "Governance of Britain" Green Paper (Cm 7170 of July 2007), to simplifying its reporting to Parliament by ensuring that it reports in a more consistent fashion, in line with the fiscal rules, at all stages from plans through to outturn. The Alignment Project has been set up to achieve this and the Government welcomes Parliament's involvement in, and support for, the project.

4. Knowledge of the Department's finances should underlie and inform much of a departmental select committee's activity, including examination of policy and administration, and knowledge of the Government's finances should similarly underlie and inform much of the House's own work. (Paragraph 11)

5. The reason why we question the ability at present of Members to hold the Government to account for its financial decisions is that, as just indicated, several of the fundamental requirements for doing so are missing. These missing requirements are:

- **a financial system which is coherently organised and comprehensible;**
- **provision to Parliament of information suited to the purpose set out in paragraph 9 above; and**
- **the opportunity to debate on the floor of the House specific items of expenditure or the objectives of expenditure and if necessary to vote on them. (Paragraph 13)**

The Government agrees that understanding of government finance should underpin the work of Select Committees and of the House itself. As outlined in the response to recommendations 1–3, the Government has committed to simplifying financial reporting to Parliament through the Alignment Project.

The Government also agrees that proper accountability of the Government for financial decisions depends on the financial system itself, the information provided to Parliament and (as the Committee discusses later in the Report) the mechanisms within the House for scrutiny and debate. As the Committee has noted, financial scrutiny cannot and should not be regarded as separate from scrutiny of policy, but it is nevertheless important that the underlying financial system and documentation provide Parliament with the detailed information it needs.

Building on previous improvements, the Alignment Project will aim to modernise the public spending system to make it more accountable and transparent, enabling the

Government to improve the way it manages the public finances in support of the fiscal rules and allowing Parliament to scrutinise public spending more effectively. Specifically, it will aim to:

- **bring into line three different expenditure frameworks** (Parliamentary Estimates, departmental budgets and departmental resource accounts) to make the financial system more coherent and comprehensible;
- **simplify the financial reports presented to Parliament**, significantly reducing the number of publication events from the current 12;
- **bring the highest standards from the private sector into public finances.** Building on the introduction of Resource Accounting and Budgeting (RAB) and the forthcoming implementation of IFRS, the new framework will incentivise departments to maximise the benefits of their capital assets and provide commercial-style information about Government spending.

The Government will continue to involve Parliament fully in the Alignment Project as it progresses.

History of financial scrutiny

6. There was no golden age in which the House rigorously scrutinised every line of the Government’s Estimates and accounts and routinely rejected or reduced requests for funding. (Paragraph 26)

7. Neither scrutiny on the floor of the House independently of select committees nor scrutiny by select committees without any link to proceedings on the floor is likely to be as effective as combining detailed work by select committees with debate on matters of particular interest on the floor, for example through select committees choosing financial matters for debate. (Paragraph 26)

The Government agrees with the Committee’s broad historical analysis and with its conclusion on the role of committees. Control over expenditure is not in practice often about rejecting—or even dividing on—individual spending proposals but about ensuring the House’s overall scrutiny of Government is properly informed, while recognising the importance of the House’s fundamental powers. This is best delivered in cooperation with select committee activity and debate, as now.

The Government’s financial system

8. The overall shape of the Government’s finances and changes in it are matters which could and should be presented comprehensibly, like the overall finances of any other organisation. (Paragraph 32)

The Government agrees with this recommendation. As outlined in the response to earlier recommendations, the Government has already made significant improvements in this area, including through the publication by some departments of combined Departmental Reports and Departmental Resource Accounts. The Government will build on these improvements through the Alignment Project, which will aim to simplify and streamline

the financial reports presented to Parliament, reducing them in number and making them more coherent and easier to understand. The Project will also examine the terminology used, with a view to making it more comprehensible and in line with that used in the private sector, where it is appropriate to do so.

9. We regard removing complexity from the Government's financial system as fundamental to improving financial scrutiny, as well as to improving financial management in Departments. The Alignment Project offers the possibility of achieving this. In revising the basis of Parliament's financial control and the system of reporting to Parliament, it is potentially a historic development in the long story of Parliament's scrutiny of government finances. (Paragraph 38)

10. We emphasise the magnitude of the prize which is potentially available: a comprehensible and coherent system of planning, authorising and reporting government expenditure, making it possible for the House and select committees to scrutinise the Government's finances far more effectively. We commend the Alignment Project to the House. (Paragraph 40)

The Government agrees that the Alignment Project represents a major opportunity to secure the significant prize of simplifying and modernising the public expenditure system. Given the importance of the changes proposed, the Government intends to adopt a measured approach to implementing the new system, and will fully consult all those affected. For these reasons, the new framework is likely to be implemented from either April 2010 or April 2011. Parliament will be fully consulted on all proposed changes.

Financial reporting

11. We recommend that each Department publish an annual statement in plain English about its internal financial planning processes and control mechanisms. (Paragraph 52)

The Government supports the intention behind this recommendation and is reviewing the content of the existing Statement on Internal Control (SIC) to consider how to ensure that it presents information about financial planning and control in an easily understood way. The Government intends to avoid requiring an additional statement, since this might have the unintended consequence of increasing complexity. The strength of the SIC is that it covers those aspects of control which the organisation considers to be of greatest significance. For this reason, organisations need to think hard about their risks and controls. This is preferable to requiring them to use a centrally determined checklist and report on each item, irrespective of its importance.

12. We recommend that the management letters provided to Departments by the National Audit Office identifying areas of significant weakness in financial control be published by Departments. (Paragraph 52)

The Government will discuss this recommendation with the National Audit Office. However, publication of management letters could potentially reduce the frankness of their content, and might thus limit their effectiveness, which would appear to run counter to the intention behind the recommendation.

13. We believe that Departments should move towards a system where data in their electronic management accounting and information systems are accessible to Members and Members are able to interrogate that data. (Paragraph 53)

Electronic management accounting and information systems are still in their infancy, and the merits and practicalities of this recommendation would need to be carefully considered, including in the light of international experience. Such an innovation would clearly not be possible in the short term, and is unlikely to be desirable in the long term, not least because of the significant IT costs and security issues involved. Parliament already has access to specific data through select committees' discussions with their departments and through Parliamentary Questions.

14. We recommend that provisions similar to those relating to the NAO be made in PFI contracts to enable the Government to pass information to select committees. It is inherent in the House's right to control expenditure that the House and select committees should have access to sufficient information about PFI contracts to make possible an assessment of whether they offer value for money, of the extent to which public bodies are locked into long-term commitments and of the extent to which risk is transferred to the private sector or retained within the public sector. (Paragraph 56)

The Government will make every effort to provide any information requested by parliamentary committees in their investigations of PFI contracts. In common with other areas of Government, decisions on the arrangements for handling information relating to PFI contracts are taken on a case-by-case basis to reflect its sensitivity and the potential commercial impacts of its release to different audiences.

15. We invite the Treasury to enter into dialogue with us about how our proposals concerning financial reporting should be implemented, and suggest that testing them first on a single Department or several Departments may be the best way forward. (Paragraph 61)

As set out in response to the Committee's earlier recommendations, much work has already been going on in this area, such as the move to combining departmental resource accounts with departmental annual reports. The Alignment Project will continue, and enhance, this process. The Government welcomes a continued dialogue with the Committee on financial reporting in the context of the Alignment Project, and agrees that testing such changes with a few lead departments may often be the best approach.

Making financial scrutiny worthwhile

16. In future Spending Reviews the Treasury and other Departments should publish information about the framework within which the negotiations are taking place, and this should include the draft Public Service Agreements and Departmental Strategic Objectives setting out what the spending is intended to achieve. We note the Treasury Committee's recommendation, made before the results of the CSR were published and not accepted by the Government, that each Department should inform the relevant select committee about "the Government's emerging views on those past objectives which have been achieved and those supporting programmes from which spending is potentially available for reallocation", and we endorse it. (Paragraph 66)

The Government will consider how best to consult with and communicate information about processes to stakeholders in future Spending Reviews. In announcing the start of the 2007 CSR process, the Government publicly set out the scope and themes of the review and explained how it would proceed. In addition, departments' bi-annual reports provide a regular update on their emerging priorities and performance in the current CSR period. Information about the achievement of PSAs and DSOs is also included in Departmental Reports and Autumn Performance Reports, and Schedule 5 of resource accounts indicates how resources are allocated to departments' objectives.

17. It is absurd that the outcome of the Comprehensive Spending Review was discussed for only an hour and a half in the Chamber, and makes a mockery of the House's right to scrutinise government expenditure. We recommend that the results of Spending Reviews be the subject of a day's debate on the floor of the House some weeks following the initial announcement, and that the timing be such that select committees can report on the outcome in order to inform that debate. (Paragraph 66)

18. Following the completion of Spending Reviews, select committees should consider examining how the Department is allocating its spending total across its various programmes. This will depend on Departments making the necessary information available earlier, well before the start in April of the Spending review period, instead of committees having to wait for the next Departmental Annual Report in May. (Paragraph 66)

The Government welcomes parliamentary scrutiny and debate over the outcome of the Spending Review. The timing of discussions on the allocations of individual Departments and the information made available by Departments is a matter for individual Departments and select committees to agree.

19. We welcome the fact that the NAO is increasingly assisting select committees other than the PAC, and we are keen to see this work develop further. (Paragraph 71)

The Government welcomes the work to support the role of select committees.

20. We suggest that the opportunities for debating Departments' future plans, including spending plans and Estimates, be considered by the Modernisation Committee together, with the aim of devising a coherent set of opportunities for debate. (Paragraph 79)

21. We consider it essential that the House take back the right to debate and vote on individual government programmes or items of expenditure. (Paragraph 80)

22. We recommend that it should be permissible to put forward "opinion of the House" motions proposing increases in future expenditure or transfers in the future between budgets, in addition to motions proposing reductions in expenditure. (Paragraph 82)

The Government sets overall totals for spending at the Budget and Pre-Budget Report, taking into account all relevant fiscal and economic information, to provide resources for public services while ensuring the sustainability of the public finances and maintaining economic stability. At Spending Reviews, the Government sets spending plans which

allocate available resources between Departments taking into account all relevant information on public service priorities and needs. Ultimately it is important that the House takes clear decisions with precise legal effect in granting expenditure authority, and motions of the kinds suggested by the Committee would not have such effect.

In respect of increased debate on expenditure, the outcome of the Alignment Project may well involve changes to current Supply procedure, and therefore provide a suitable opportunity for Parliament to consider changes to its own processes for financial scrutiny. This could be undertaken by the Modernisation or Procedure Committees, together with any review of the effectiveness of the proposed arrangements for promoting debates on departmental objectives.

23. We recommend that the Government provide an explanatory memorandum for each Estimates Day debate explaining how the figures in the Estimate relate to the subject under discussion. (Paragraph 83)

Departments already provide ‘Estimates Memoranda’ to their select committee alongside each Estimate presented to Parliament. Such memoranda contain a great deal of information about the spending plans in the Estimate and how these relate to departmental budgets and objectives. Nevertheless, for those cases where the Estimates Memorandum does not already provide the information requested, the Government is willing to consider including in the guidance manual on Supply Estimates (that sets out the policy and the process for departments) a formal requirement to provide this information through a separate explanatory memorandum.

24. For far too long the House has shirked the task of providing itself with the means to carry out financial scrutiny effectively, and it is time that the House was more assertive in this area. (Paragraph 89)

The Government recognises financial scrutiny as a prime function of the House of Commons. It welcomes the opportunity to discuss with the Committee and the House ways in which existing procedures can be used to best effect or can be improved.

Appendix 2: National Audit Office Response

Letter to the Chairman of the Liaison Committee from the Comptroller and Auditor General, 27 June 2008

I thought it might be helpful, following the publication of the Liaison Committee's report, Parliament and Government Finance: Recreating Financial Scrutiny, to set out our position on those conclusions and recommendations that relate to the National Audit Office.

The Alignment Project

The Treasury's Alignment Project seeks to secure consistency between spending plans, estimates and accounts. We agree with the Committee's assessment of the potential significance of the project in improving both financial scrutiny and financial management in departments. We support the aims of the project and are, as the Committee has noted, represented on the project's Steering Committee.

NAO support to select committees other than PAC

We welcome the Committee's support for the assistance we provide to select committees other than PAC and, like the Committee, we are also keen to see this work develop further.

In our memorandum to the Liaison Committee, published with its report on the work of committees in 2007,¹ we set out details of NAO support during the year. The support took a number of forms ranging from the provision of formal evidence for committees, including evidence-gathering and research in response to a committee's requests, to informal oral and written briefings and the secondment of staff with particular expertise in the area covered by a committee. In 2007 the NAO provided support of this kind to 11 Commons select committees.

As part of our programme of work aimed at strengthening financial scrutiny, the NAO produced formal briefings for three committees on the performance of their respective departments in 2006–07. Designed to assist the committees in the examination of their department's expenditure and administration, the briefings were based on material in Departmental Annual Reports and, where appropriate, on issues that had arisen from the NAO's mainstream value for money and wider work, for example on regulation and performance system validation, and the action departments had taken in response. Following positive feedback from the committees concerned, the NAO has allocated further resources to this area to increase the number of performance briefings it produces for departmental select committees in future years.

¹ Liaison Committee, Third Report of Session 2007–08, *The work of committees in 2007*, HC 427

Publication of NAO Management Letters

The report recommends that departments publish the NAO's management letters, which convey detailed audit findings to those responsible for managing expenditure in Departments. We will discuss this recommendation with the Treasury. We consider that publication would tend to reduce the frankness of the letters, however, while doing little to promote public understanding since their content is at a detailed and technical level.

Training for Members

The Committee notes that one way of increasing Members' capacity for financial scrutiny would be to make more training available for them, and notes that the NAO could provide training for more specialised areas such as the Private Finance Initiative. We would be happy to assist in this respect.

Yours sincerely

Tim Burr