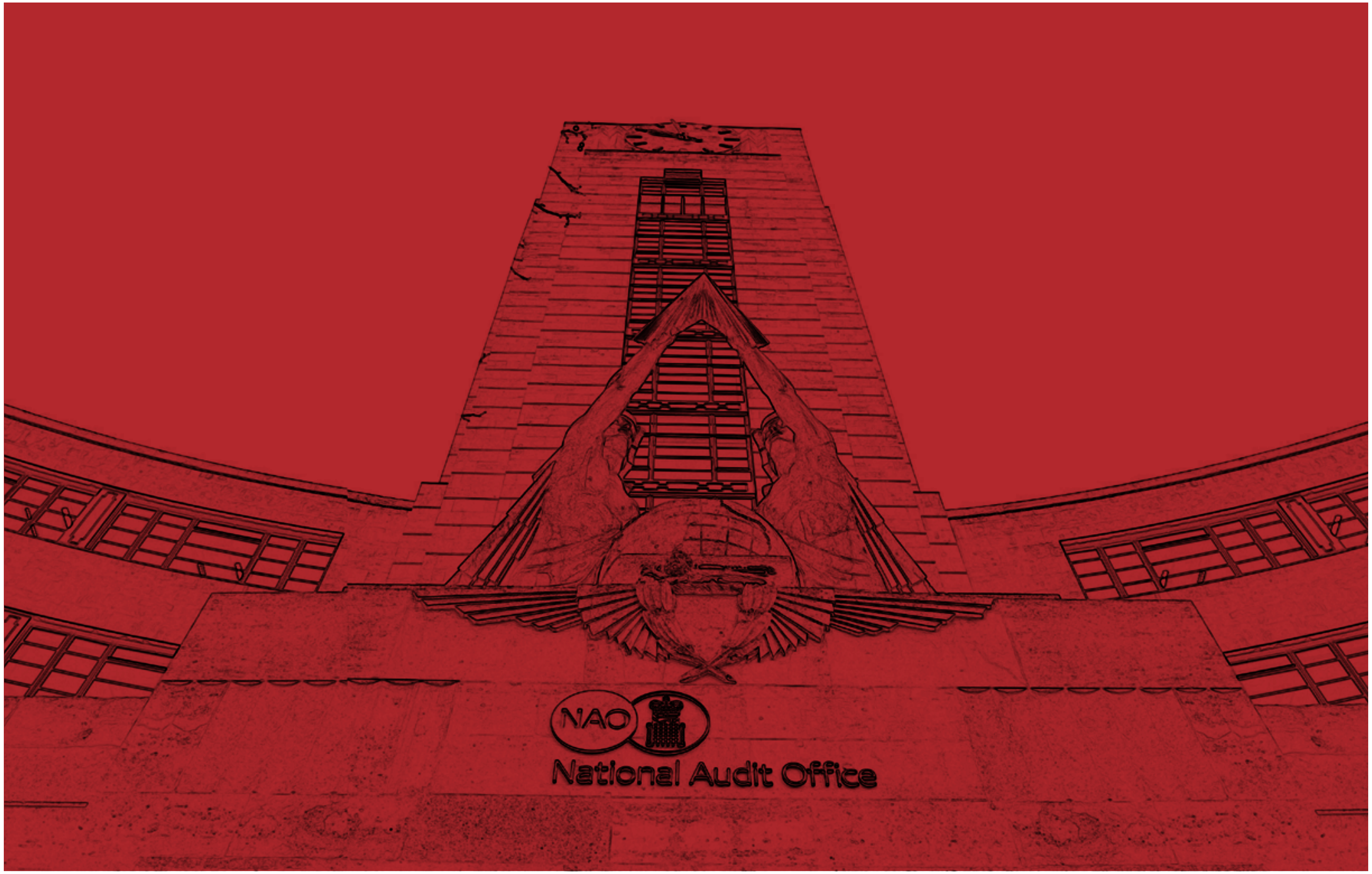
Departmental Overview 2015-16

# HM Treasury

October 2016

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# Executive summary

This Departmental Overview looks at HM Treasury (the Department) and summarises its performance during the year ended March 2016, together with our recent reports on it. The content of the report has been shared with the Department to ensure that the evidence presented is factually accurate.

Part One sets out some **facts about the Department and how it has performed against its responsibilities**.

- In 2015-16, HM Treasury made significant reductions to its asset portfolio, including the sale of £13 billion of UK Asset Resolution (UKAR) financial assets to Cerberus and £9.2 billion of Lloyds Banking Group and RBS shares.
- On 4 May 2016 the UKAR Group announced that it had signed a contract to transfer its mortgaging servicing operations to Computershare, along with some 1,700 UKAR employees.
- The overall reduction in net operating expenditure for the HM Treasury Group (£297 million in 2015-16 down from £976 million in 2014-15) is primarily due to accounting adjustments rather than actual financial gains. The 'savings' made this year are therefore not likely to be repeated and are largely outside of HM Treasury's control.

Part Two sets out our **findings from our work on the Department**.

- Our report on the sale of Eurostar concluded that the government achieved its policy objective of maximising the proceeds from the sale of its stake in Eurostar and the redemption of the preference share. The report also noted that total taxpayer investment in Eurostar, prior to its incorporation, was significantly greater than the proceeds generated from the sale.
- Our report on the £13 billion sale of former Northern Rock assets concluded that it was an extremely large and complex transaction that was professionally executed within a tight timeframe, although there are some lessons to be taken from the process. Overall, in the context of the overall objective of swiftly reducing the balance sheet, the sale achieved value for money.
- Our report on the Spending Review 2015 found that HM Treasury had made some positive changes to the spending review process since 2010, but the process itself, while acting as a strong spending control, did not work to maximise value for money.
- Our reports on evaluating the government balance sheet found that HM Treasury's main financial risks are related to its assets and liabilities rather than its expenditure. The government's total risk exposure from provisions, contingent and remote liabilities at 31 March 2015 was £317 billion.

Part Three sets out key **developments for the year ahead**.

- As part of its role to manage the government balance sheet, HM Treasury needs to continue to focus on addressing the long-term nature of its assets and liabilities.

# About the Department

## Significant changes to the HM Treasury Group

Creation of UK Government Investments Limited (UKGI) on 11 September 2015 – a private limited company which is wholly owned by HM Treasury.

UKGI is the government's centre of expertise in corporate finance and corporate governance, overseeing all significant corporate asset sales by the UK government and advising on all major UK government financial interventions into corporate structures.

On 1 April 2016 HM Treasury's entire shareholding in UK Financial Investments Limited (UKFI) was transferred to UKGI. UKFI is now a wholly owned subsidiary of UKGI, with responsibility for managing the UK government's investments in Lloyds Banking Group, RBS and UKAR. Together both companies make up the UKGI Group.

Appendix One lists the bodies that make up the HM Treasury Group.

Substantial reductions to the HM Treasury asset portfolio including the sale of £13 billion of UKAR financial assets to Cerberus and £9.5 billion of Lloyds Banking Group and RBS shares.

In December 2015 the UK became a member of the Asian Infrastructure Investment Bank (AIIB), an international development bank founded to support financing for infrastructure projects across Asia. The UK's capital contribution will eventually total approximately £2.0 billion, comprising 20% of 'paid-in' capital contribution, which is payable in five annual payments, and 80% of 'callable capital', which the AIIB would be able to call on in the unlikely event that the bank was not able to meet its obligations. In January 2016, HM Treasury, on behalf of the UK government, made the first of these payments with an initial investment of £85 million (US$ 122 million) of paid-in capital.

On 4 May 2016 the UKAR Group announced that it had signed a contract to transfer the UKAR Group's mortgage servicing operations to Computershare, along with some 1,700 UKAR employees.

July 2016 saw the appointment of a new ministerial team, including The Rt. Hon. Philip Hammond MP as Chancellor of the Exchequer.

In July 2016 Tom Scholar was appointed Permanent Secretary and Principal Accounting Officer.

# Departmental spending

a Royal Household
Costs £40m

b Other core HM Treasury capital
Costs £30m

c Debt Management Office
Costs £20m, Income £3m

d Eurostar
Income £16m

e Government Internal Audit Agency
Costs £13m, Income £13m

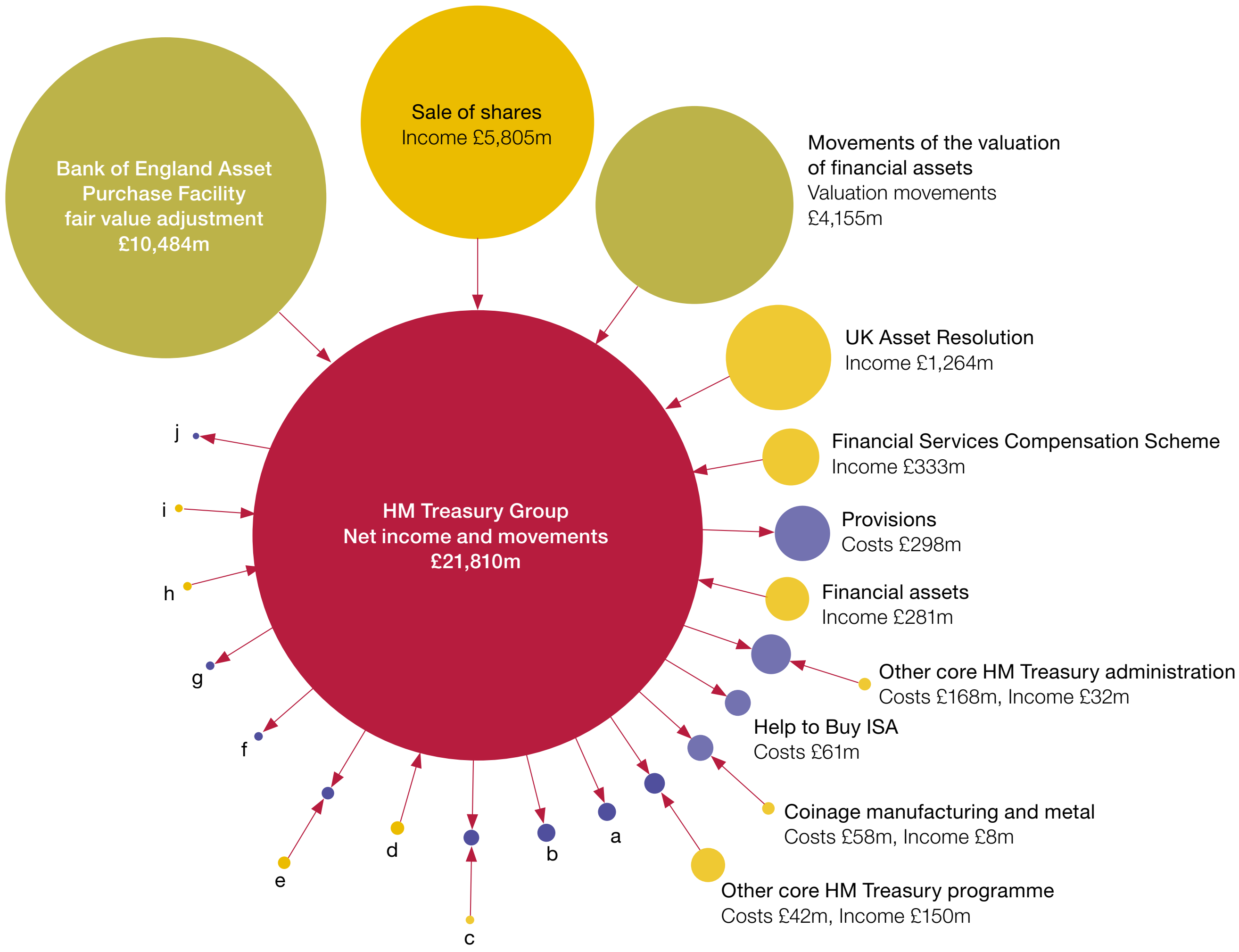
f Administration of Equitable Life
Costs £4m

g UK Financial Investments
Costs £4m

h Infrastructure Finance Unit Limited
Income £4m

i Money Advice Service
Income £3m

j Office for Budget Responsibility
Costs £2m




- HM Treasury Group
- Income
- Costs/expenditure
- Valuation movements

Source: National Audit Office analysis of HM Treasury Annual Report and Accounts 2015-16

# 2015-16 Spending Review settlement

The 2015-16 Spending Review outlines that HM Treasury should achieve a 24% real-terms reduction in DEL expenditure (that is, the expenditure that is within HM Treasury's control rather than being demand-driven), excluding depreciation, by 2020-21.

These reductions need to be achieved alongside continued management of the process to reduce the deficit and support the economic recovery, including through the sale of the financial sector assets acquired in 2008-09.

While HM Treasury's 2015-16 accounts show that DEL expenditure has remained fairly constant at £141 million compared with £142 million in 2014-15, that year included a one-off income classification of £16 million from the sale of Eurostar. Without this, HM Treasury would have reported a net increase in DEL expenditure for 2015-16, consistent with the increasing core HM Treasury staff numbers as shown in Appendix Three.

HM Treasury's 2015-16 accounts show staff numbers increasing from 4,315 to 4,515 in the year to 31 March 2016 (Appendix Three). Part of this increase was due to the establishment of the GIAA (Government Internal Audit Agency (153 full-time equivalent staff)), with the majority of staff transferring from other government departments.

Some 47% (2,127) of HM Treasury Group staff work for UKAR; however, on 4 May 2016 a contract was signed to transfer the UKAR Group's mortgage servicing operations and associated servicing assets (circa £43 million) to Computershare for a seven-year period. As part of this contract, around 1,700 UKAR employees will transfer to Computershare, significantly reducing staffing numbers within the HM Treasury Group.

The overall reduction in net operating expenditure for the HM Treasury Group (£297 million in 2015-16 down from £976 million in 2014-15) is primarily due to accounting adjustments rather than actual financial gains (the main adjustment was the reversal of an historic provision relating to customer compensation claims against UKAR, which was no longer required following a favourable court judgment). The 'savings' made this year are therefore not likely to be repeated and are largely outside of the HM Treasury's control.

The fact that the UK is due to leave the European Union is also likely to have a significant administrative toll on HM Treasury. Whether it can keep spending down despite additional staffing burdens will be a key challenge over the next few years.

# Findings from our audit of the 2015-16 Annual Report and Accounts

HM Treasury has overseen a series of significant asset sales during 2015-16.

HM Treasury delivered asset sales across government worth approximately £25 billion (**Figure 1**) including:

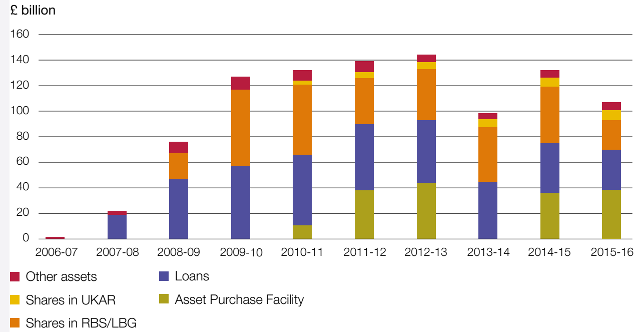
- the sale of £7.1 billion of Lloyds Banking Group shares, raising proceeds of £7.4 billion (reducing the government's shareholding to 9%, or £4.4 billion of shares at 31 March 2016);
- the sale of £2.1 billion of RBS shares in August 2015 (reducing the shareholding to below 75%: £18.8 billion at 31 March 2016, allowing the conversion of RBS 'B' shares back to ordinary shares);
- the sale of £2.1 billion of RBS shares in August 2015, reducing the shareholding to below 75% (a total value of £18.8 billion at 31 March 2016);
- UKAR's sale of a £13 billion asset portfolio (£12 billion of mortgages from the Granite securitisation structure in December 2015 with a further £1 billion of non-Granite assets in May 2016), along with the associated debt securities, resulting in net proceeds of £5 billion; and
- the sale of Eurostar in May 2015, which generated cash proceeds of £757 million and an accounting gain of £432 million.

These asset sales form part of the government's plans to sell an unprecedented range of financial assets over the remainder of this Parliament, reducing public sector net debt, which stands at approximately £1.6 trillion at the end of April 2016 – equivalent to 83% of GDP. Including those above, the Office for Budget Responsibility (OBR) forecasts that these sales will generate proceeds of around £106 billion for the government.

On 6 June 2016, UKAR completed the transfer of the group's mortgage servicing operations to Computershare. This transaction takes place ahead of further possible UKAR asset sales, primarily in relation to the Bradford & Bingley mortgage book, sufficient to repay UKAR's £15.7 billion debt to the Financial Services Compensation Scheme (FSCS).

Zoom In+

**Figure 1**
HM Treasury core and agencies – Gross assets




Source: HM Treasury Annual Report and Accounts

# Findings from our audit of the 2015-16 Annual Report and Accounts *continued*

## Provisions and contingent liabilities

### Provisions

HM Treasury accounts include a number of provisions (**Figure 2**). In addition to the Help to Buy ISA provision (details of which are set out on the next page), HM Treasury provides for the Equitable Life Payments Scheme (£522 million as at 31 March 2016) and recognises a provision of £327 million for a claim made against oil and gas decommissioning deeds guaranteed by HM Treasury. There are currently 72 of these guarantees in force, so future claims against these guarantees are possible.

UKAR has recognised provisions totalling £166 million (31 March 2015: £388 million) in respect of expected customer compensation claims, primarily relating to payment protection insurance and Consumer Credit Act (CCA) non-compliance. This reduced provision reflects an in-year write-back of £268 million following a Court of Appeal ruling in UKAR's favour in relation to potential customer remediation under the CCA.

### Contingent liabilities

HM Treasury disclosed several contingent liabilities within the 2015-16 Annual Report and Accounts. These include contingent liabilities in respect of Pool Re and Pool Re (Nuclear) Ltd – mutual reinsurance companies providing terrorism cover for damage to industrial and commercial property or nuclear facilities and consequential business interruption in Great Britain. Pool Re and Pool Re (Nuclear) had total reserves of £6.0 billion and £29 million respectively at 31 March 2015 and in the event of losses exceeding their available resources, HM Treasury will fund the difference, which will be repaid over time.

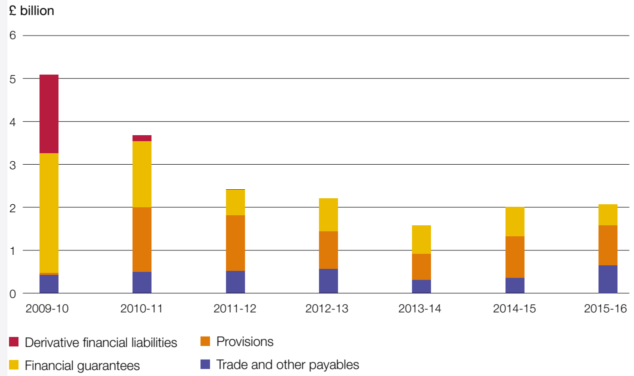
### Financial reporting

The HM Treasury Annual Report and Accounts 2015-16 received a clear audit opinion.

There were no qualifications on 2015-16 accounts within the departmental boundary.

Zoom In+

**Figure 2**
HM Treasury core and agencies – Gross liabilities




Source: HM Treasury Annual Report and Accounts

# Findings from our audit of the 2015-16 Annual Report and Accounts *continued*

## Wider economic support and guarantees

Following the stabilisation of the financial sector, HM Treasury has focused on schemes to support the wider economy. Under the majority of these schemes HM Treasury has provided guarantees or indemnities rather than direct cash support.

In December 2015, HM Treasury launched the Help to Buy ISA scheme as part of a series of economic growth schemes. To date, £63 million has been provided in relation to Help to Buy ISA, with 415,000 eligible ISA accounts opened in the period to March 2016.

The HM Treasury accounts also contain a financial guarantee liability of £84 million (2014-15: £53 million) in relation to the Help to Buy mortgage guarantee scheme, as well as a contingent liability of £1.1 billion (2014-15: £0.6 billion) to reflect the maximum potential liabilities under this scheme. The first claim under the scheme was paid in April 2016.

During 2015-16, HM Treasury issued two new guarantees under the UK Guarantee Scheme (UKGS), which helps businesses to access cheaper finance for infrastructure projects:

- £39 million for a new student village and the refurbishment of existing university facilities at the University of Gloucestershire; and
- £86 million for Countesswells, the construction of a new community including homes and other facilities in Aberdeen.

No claims have been received in relation to these two new guarantees to date.

These additional guarantees mean that as at 31 March 2016 guarantees were now provided in respect of eight projects, totalling an estimated £1.0 billion (2014-15: £0.9 billion) of outstanding principal and one year of unpaid interest of £24 million (2014-15: £23 million), as the maximum potential liabilities.

### Bank of England Asset Purchase Facility Fund Ltd (BEAPFF) derivative

The BEAPFF derivative represents HM Treasury's support for the Bank of England's quantitative easing programme. The derivative asset increased by a net £2.0 billion in 2015-16 to £38.4 billion. HM Treasury indemnifies the Bank for any losses in the operation of the programme, and in return is entitled to any profits made. In the Statement of Comprehensive Net Expenditure, positive market movements of £10.5 billion are shown in Revaluation of assets and liabilities. This is offset by cash receipts of £8.5 billion, resulting in the net movement of £2.0 billion. At 31 March 2016 the BEAPFF held £406.7 billion of gilts at market value (2014-15: £407.1 billion).

# Sale of Eurostar

In March 2015, HM Treasury sold the UK government's entire financial interest in Eurostar (40% stake and preference share), generating proceeds of £757 million.

The NAO report concluded that the government achieved its policy objective of maximising the proceeds from the sale of its stake in Eurostar and the redemption of the preference share.

Once the decision was made to sell, the government and its advisers prepared well. Changes to the shareholder agreement made the investment attractive to a wide range of investors, such as pension funds. There were a number of risks to value for money associated with this deal that the deal team managed successfully, including: the tight timetable, the need to attract high-quality bids at a time that Eurostar was embarking on investment in new and unproven trains, and the corresponding uncertainty about the increase in future profits.

The sale price of £585.1 million for the 40% stake in Eurostar was more than 90% above the mid-point valuations of £305 million prepared by the government and its financial adviser. To a large extent the gap demonstrated a successful sale, but the NAO concluded that credible valuations above £500 million could have been supported through altering two of the key input assumptions.

The report also noted that that total taxpayer investment in Eurostar, prior to its incorporation, was significantly greater than the proceeds generated from the sale.

The report included a number of recommendations for future asset sales including: giving due prominence in sale business cases to the relationship between the timing of the sale and the marketability to investors; ensuring deal teams contain the right balance of internal and external staff; applying a range of valuation methods; and using independent valuation experts who have no prior knowledge of existing valuations.

# Sale of former Northern Rock assets

UKAR sold more than £13.3 billion of assets resulting in a significant reduction of government balance sheet debt in 2015-16.

The report concluded that UKAR and UKFI carried out a complex transaction professionally within a tight timeframe during benign market conditions.

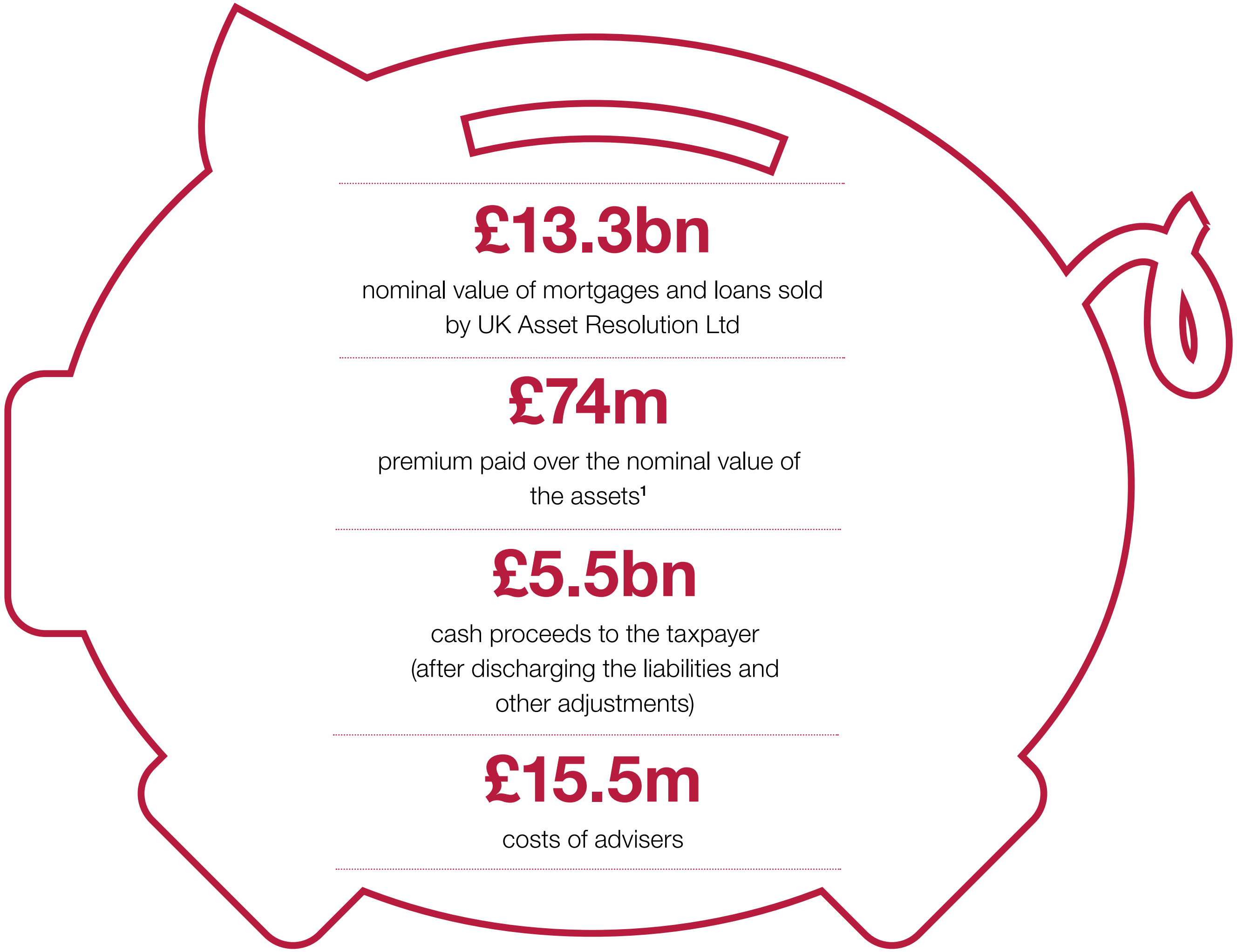
UKAR acted opportunistically in responding to a market enquiry for the Granite portfolio – a larger asset pool than UKAR had ever previously considered selling.

The sales process was well run and competitive, taking 18 months from appointment of advisers to final close in May 2016.

Once UKAR had decided on the structure of the sale, the sales process achieved competitive tension. This resulted in a price above the par value of the assets and the government's valuation.

Overall, in the context of swiftly reducing the balance sheet, by selling £13 billion of assets in a single transaction, the sale achieved value for money.

However, UKAR's limited competitive tendering in the procurement process for its financial adviser did not follow best practice, with the adviser's scope and fee being increased during the process.




1 This represented a £280 million premium to the carrying value of the assets.

# Spending Review

Our report on the Spending Review 2015 found that HM Treasury had made some positive changes to the spending review process since 2010, but the process itself, while acting as a strong spending control, did not work to maximise value for money.

This report was published alongside a report on Single Departmental Plans (further details of which are set out on the next page), and together they suggested that government lacked a coherent, enduring framework for planning and management.

HM Treasury considers the spending review process is effective in prioritising resources and delivering value for money. It does not agree with a number of the NAO's key findings including in relation to joint working across departments, consulting with experts and longer-term thinking.

The Spending Review is the process by which HM Treasury and departments agree multi-year budgets. It involves bilateral negotiations between individual departments and HM Treasury, based on spending forecasts produced by departments, taking into account HM Treasury expectations of spending and departmental objectives.

Since their introduction in 1998, spending reviews have become increasingly important. The period which they cover has extended, allowing departments more certainty over their funding and allowing them to improve their medium-term planning and budgeting. Although annual Budgets may make minor changes, actual spending closely follows the patterns set out in spending reviews.

Recent spending reviews have focused on reducing overall spending as well as how funds are allocated.

**Taken together with our report on Government's management of performance – progress with single departmental plans we concluded that, while the Spending Review does reach its goal of setting clear limits on departmental spending, the current process prevents HM Treasury from maximising value for money by tackling difficult and entrenched issues.**

**Some of the key reasons for this are:**

- the bilateral approach means that policy areas which span multiple departments may not be appropriately dealt with and HM Treasury could expand its role in facilitating good practice;
- the process focuses on spending allocations and their consequences in the spending review period, so the attention paid to long-term impacts is necessarily reduced; and
- the spending review process is complex and time-constrained, which may make it difficult to make best use of experts or engage with departments in the time formally allocated to the Spending Review.

We consider that the current, process-led approach will not enable government to deliver the objectives and achieve the transformation it aspires to. Without making a shift to the overarching integrated framework for strategic business planning and management that government needs, government cannot hope to optimise value for taxpayers' money or deliver continuous performance improvement.

# Single Departmental Plans

**Key findings from our NAO report on Single Departmental Plans**

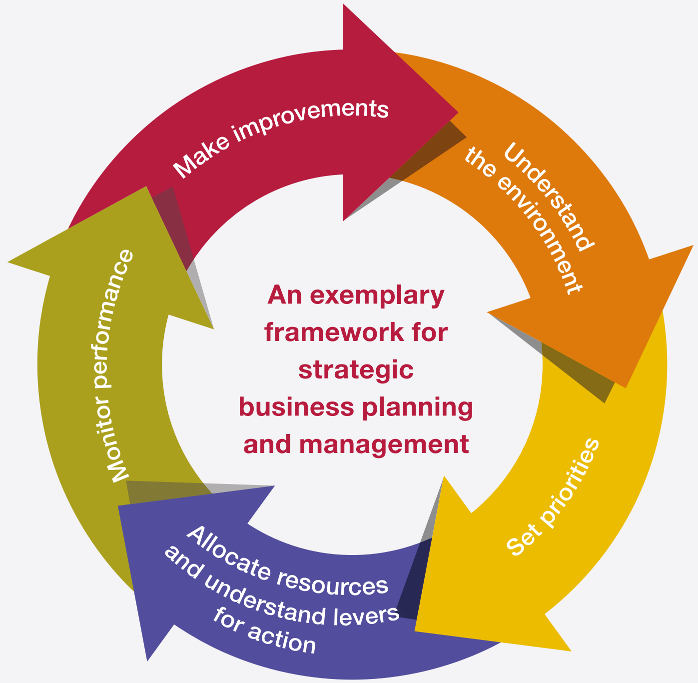
Despite improvements in the planning and managing of public sector activity, we do not consider that there exists a coherent, enduring framework for planning and management that government needs.

Such a framework (see right), which should operate in a cyclical way with continuous feedback and adjustment, would allow any new government to know what the baselines of performance and spending are, to redefine objectives and reallocate resources according to its priorities, and quickly start to monitor progress, adjusting performance indicators or targets where necessary.

Making the shift to a new approach will not be easy. The challenge for the UK cannot be underestimated, given the scale and complexity of government and the additional requirements of exit from the European Union. In our view, however, this makes achieving that shift all the more urgent.

A fundamental part of such a framework is how government allocates its resources, and this is primarily carried out through spending reviews.

We remain concerned that, while the Single Departmental Plan initiative builds on learning from previous performance systems, it does not provide the degree of Parliamentary accountability that was promised, nor represent good practice in transparency.




This framework is based on the standard management cycle, which we have used in previous reports as a framework for reviewing specific projects and programmes. We have enhanced the framework to reflect the more strategic viewpoint of these reports, as well as our previous work on accountability and the centre of government.

Source: National Audit Office analysis

# The role of the Whole of Government Accounts in aiding HM Treasury's financial management

## Whole of Government Accounts

*"HM Treasury's Whole of Government Accounts (WGA) are a key mechanism for improving the understanding of its management of the public sector, and there is no more complete record of what the government spends, receives, owns and owes. The WGA could, however, be a more powerful tool for understanding the public finances.*

*Better analysis by HM Treasury of the nature of the assets across the government's portfolio, the extent and sources of liabilities and the financial risks it is exposed to, will help Parliament and the public to understand better the full range of the government's financial commitments and its approach to managing them… It provides a unique perspective because of its reach and approach to measuring the government's financial performance and position."*

Amyas Morse, Comptroller and Auditor General, 27 May 2016

This set of accounts shows that in 2014-15, the WGA net expenditure (the shortfall between income and expenditure) increased by £6.3 billion, to £152.0 billion. This is owing to an £8.4 billion increase in the estimated costs of provisions, which mainly relates to an increase in the liabilities for nuclear and oil and gas field decommissioning; a £7.5 billion increase in net interest on pension scheme liabilities; and the impact of the triple lock policy on state pensions of £3.6 billion. While net expenditure has increased, total revenue has continued to grow from taxes and other sources (an increase of 1.0% in the year to £659.3 billion) as the economic recovery continued.

The government's net liabilities (the shortfall between assets and liabilities) increased to £2,103.2 billion from £1,840.6 billion, which is mainly due to increases in pension liabilities of £190.2 billion and government borrowing of £78.4 billion.

## Office for Budget Responsibility and HM Treasury accounts

The Whole of Government accounts are a key source of data that the OBR uses in preparing its reports on the management of public finances. The reports produced by the OBR provide independent and authoritative analysis of the UK's public finances, acting as one of a number of official independent fiscal watchdogs around the world *(Source: OBR website).*

The timeliness of the information in the Whole-of-Government accounts is such that published information is always at least one year out of date, and so there is a disconnect between the information presented in the WGA when compared to the analysis produced by the OBR and the commentary on the wider financial position of government included in the Annual Report and Accounts of HM Treasury.

# Government balance sheet – Assets

The first in a series of reports on the government balance sheet, our report: The government balance sheet: financial assets and investments highlights key issues surrounding asset sales which government is likely to face over the next and current Parliament.

The government's most significant financial assets relate to: the portfolio of businesses managed by the Shareholder Executive (which include student loans, debt securities and equity investments); and the assets that are a legacy of the financial crisis.

As at 31 March 2015 legacy assets comprised government's investments in the Royal Bank of Scotland Group plc (RBS) and Lloyds Banking Group plc (Lloyds); as well as its ownership of the former Northern Rock and Bradford & Bingley mortgage books; and the Bank of England's quantitative easing programme.

On 5 May 2016 the government sold NRAM to Cerberus. Government's policy is to sell assets unless there is a particular policy or strategic reason to keep them. The last two spending reviews have asked departments to set out their asset disposal plans for the rest of the Parliament, thus we can expect government asset sales to be a key concern over the next few parliaments.

The OBR forecasts that asset sales will generate proceeds of around £106 billion for the government during the remainder of this Parliament. The most significant sales will be the government's remaining shares in Lloyds and its holding in RBS; part of the student loan book; and sales of mortgages held by UKAR relating to the nationalised former Northern Rock and Bradford & Bingley businesses.

The March 2016 Budget outlined a further planned reduction in HM Treasury investments in RBS and Lloyds Banking Group. However, between 31 March 2016 and 27 June 2016, these shares experienced a fair value reduction of £5.2 billion. It is hard to see any further reduction in the government's holding in these financial institutions until share prices have significantly recovered.

## Government balance sheet projections to March 2020

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**Lloyds Banking Group**

Expected cash flows as of March 2016:[1] **£11.0bn**

Description: **Trading plan and retail offer**

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**Student Loans**

Expected cash flows as of March 2016:[1] **£9.6bn**

Description: **Sale of loan portfolio**

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**Student Loans**

Expected cash flows as of March 2016:[1] **£12.7bn**

Description: **Interest and repayments**

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**UKAR**

Expected cash flows as of March 2016:[1] **£48.8bn**

Description: **Interest and repayments and sale of mortgage portfolio**

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**RBS**

Expected cash flows as of March 2016:[1] **£23.6bn**

Description: **Sale of stake**

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Total **£105.7bn**

*1 OBR projections include RBS and Lloyds shares sold during 2015-16*

# Government balance sheet – Liabilities

Our report on The government balance sheet: provisions, contingent liabilities and guarantees reveals that HM Treasury's main financial risks are related to its assets and liabilities rather than its expenditure.

The WGA show that the government's total risk exposure from provisions, contingent and remote liabilities at 31 March 2015 was £317 billion (**Figure 3**).

The most significant long-term financial risk is that significant liabilities, with a large combined value, crystallise at the same time.

The likelihood of multiple liabilities becoming due at the same time is increased as a number could be triggered by a single event. A significant shock to the economy such as a recession could result in multiple liabilities crystallising at once, particularly where HM Treasury has made guarantees under the UK Guarantee Scheme (UKGS).

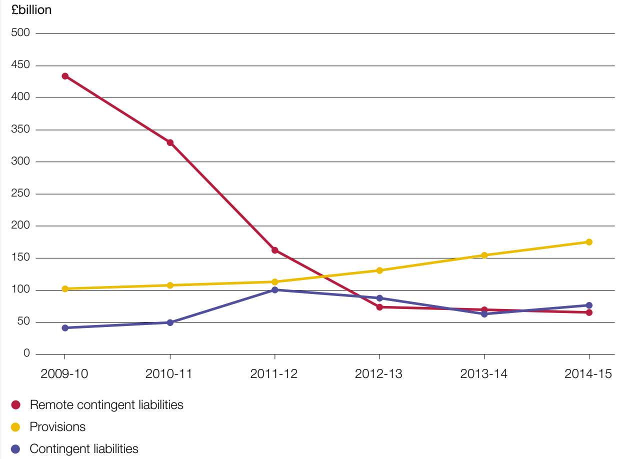
Since the WGA was first published in 2009-10, provisions have increased by more than two-thirds to £175 billion in the latest WGA accounts (2014-15). Similarly, contingent liabilities in 2014-15 were £76 billion and 85% higher than in 2009-10.

The 2014-15 WGA also discloses several unquantifiable contingent liabilities in the note to the accounts. Recent measures to strengthen the financial sector and resolve the problem of 'too big to fail' have reduced risk to the government; however, future financial crises could nonetheless pose risks.

Provisions and contingent liabilities have been on an upwards trend in recent years. If this trend were to continue, provisions alone could reach around £300 billion by 2020. Around two-thirds of provisions are expected to settle after five years or more. This means that although public sector bodies may be able to afford to pay provisions and known liabilities that crystallise in the short term, they could face greater pressures on their cash flow in the future.

Zoom In+

**Figure 3**
Movement in provisions and contingent liabilities since 2009-10




Source: National Audit Office

# Government balance sheet – Liabilities *continued*

Our report on The government balance sheet: provisions, contingent liabilities and guarantees also demonstrates that the value of provisions and contingent liabilities within government are highly volatile due to their long-term nature.

There has been a £368 billion decrease in remote contingent liabilities and guarantees since 2009-10 following the reduction in direct government support to the banking sector after the financial crisis.

However, changes to the discount rates used to value provisions in today's prices can have a significant impact on the values reported in the accounts and, therefore, the visibility and understanding of potential cash outflows in the future. The introduction of a negative long-term discount rate from 2015-16 increased the value of existing provisions that are reported in the accounts further. For example, the nuclear decommissioning liability more than doubled during 2015-16 to £160.7 billion* (2014-15: £69.9 billion), primarily due to the impact of negative long-term discount rates.

Source: ** Nuclear Decommissioning Authority, Annual Report and Accounts 2015-16*

The nuclear decommissioning provision is particularly difficult to estimate because of the long timescales involved, the technical difficulty of managing the nuclear legacy and the likelihood that future technological advances could have a major impact on costs and timescales.

For example, the provision increased by just less than half between 2009-10 and 2014-15 as more information emerged about the likely future costs associated with the Sellafield site. The Nuclear Decommissioning Authority (NDA) recognises that the undiscounted costs could range between £95 billion and £218 billion (paragraphs 2.1 to 2.7).

# Government balance sheet – Pensions

Our third report on The government balance sheet: evaluating the government balance sheet: pensions highlighted the increasing burden public sector pension liabilities have on public sector net debt.

In the report on pensions, we note that at £1,493 billion the public sector pension liability is the single, largest liability on the government's balance sheet.

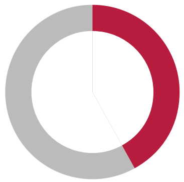
There is a limit to the level of pensions the government can finance annually as a proportion of gross domestic product (GDP) without having to reduce spending in other areas or increase income through higher taxes or further borrowing.

Around 8% of GDP is projected to be spent by the government on state and unfunded public sector pensions net of member contributions to unfunded schemes in 50 years' time.

The report found that the government's reforms have helped to reduce pension costs but overall its balance sheet liability has continued to rise in recent years (mainly due to adjusting the discount factor used to express future expenditure in current terms).

The government's exposure to risk in relation to pensions is significant and challenging due to the varied nature of pension arrangements over which the government has different degrees of influence and control, and the significant impact of the country's economic performance on affordability.

There has been a **32%** increase in net public sector pension liability since 2009-10 from £1,132 billion to £1,493 billion in 2014-15.



As of 2014-15 public sector pension schemes make up **42%** of the whole of government's liabilities (£3,559 billion).

Total net public sector pension liability was **81%** of GDP at 2014-15. In contrast, public sector payments in 2014-15, net of member contributions, was 1.6% of GDP.

# Long-term financial management

## The importance of long-term financial management

As previously reported to the Select Committee in the Short Guide to HM Treasury 2015, HM Treasury had to make significant financial interventions at a substantial cost to the taxpayer in response to the financial crisis of 2008. Many of these interventions resulted in long-term assets and liabilities, which in some cases (such as infrastructure guarantees), will require management for some 40 years.

### Future financial management

As part of its wider role to manage the government balance sheet, HM Treasury needs to continue to focus on addressing the long-term nature of its assets and liabilities.

- Financial guarantees issued by HM Treasury (including those for major infrastructure projects) are set to rise over the course of this Parliament.
- Financial risk is heavily concentrated on the performance of the wider UK economy. HM Treasury is exposed to credit risk on its loans and financial guarantees and an economic shock could result in debt holders defaulting, increasing the risk that loans will not be recovered and that guarantees issued by HM Treasury will crystallise.
- HM Treasury's investments and the BEAPFF derivative (see page 8) are susceptible to economic shock due to their exposure to market risk.

In addition, HM Treasury's Budget-setting responsibilities as a finance ministry will have a significant impact on public sector pensions liabilities – the most significant of government's liabilities, which continue to grow year-on-year.

# HM Treasury bodies

**Core HM Treasury and agencies**

HM Treasury

UK Debt Management Office (DMO)

Government Internal Audit Agency (GIAA)

Office of Tax Simplification

Office of Financial Sanctions Implementation

**HM Treasury Group**

Office for Budget Responsibility (OBR)

Financial Services Compensation Scheme (FSCS)

The Money Advice Service (MAS)

UK Financial Investments Ltd (UKFI)

UK Government Investments Ltd (& UKGI Financing plc)

UK Asset Resolution Ltd (UKAR)

HM Treasury UK Sovereign Sukuk plc

Help to Buy (HMT) Ltd

Infrastructure Finance Unit Ltd

IUK Investments Holdings Ltd

Royal Household Sovereign Grant

Royal Mint Advisory Committee

**Other accounts prepared by HM Treasury**

Whole of Government Accounts (WGA)

Central funds

National Loans Fund (NLF)

Consolidated Fund

Contingencies Fund

Exchange Equalisation Account

**Other HM Treasury-related bodies**

Bank of England

Bank of England Asset Purchase Facility Fund Ltd (BEAPFF)

Prudential Regulation Authority (PRA)

Financial Conduct Authority (FCA)

Financial Ombudsman Service (FOS)

Payment Systems Regulator (PSR)

Royal Mint Ltd

National Savings and Investments (NS&I)

The Crown Estate

Local Partnerships LLP

Royal Bank of Scotland Group plc

Lloyds Banking Group plc

# Relevant National Audit Office publications in 2015-16


A Short Guide to HM Treasury
National Audit Office, July 2015

**Recent work: Whole of Government Accounts and HM Treasury**

Report of the Comptroller and Auditor General: Whole of Government Accounts 2014-15 (May 2016)

Evaluating the government balance sheet: financial assets and investments (June 2016)

Evaluating the government balance sheet: provisions, contingent liabilities and guarantees (June 2016)

Evaluating the government balance sheet: pensions (June 2016)

**Recent work: Long-term financial management**

Spending Review 2015 (July 2016)

Government's management of its performance: progress with single departmental plans (July 2016)

The £13 billion sale of former Northern Rock assets (July 2016)

English devolution deals (April 2016)

Managing the welfare cap (April 2016)

The sale of Eurostar (November 2015)

Financial institutions landscape (September 2015)

**Our work in progress and planned work**

Our programme of work in the HM Treasury space is under consideration following the outcome of the referendum on membership of the European Union.

The NAO's website contains a summary of work in progress along with scheduled publication dates.

# Staff attitudes and engagement

The government has conducted its Civil Service People Survey annually for the past six years. The most recent survey results were published in November 2015.

HM Treasury staff showed greater satisfaction than the civil service average in all areas except for pay and benefits.

The results suggest increased satisfaction among HM Treasury staff in all nine areas compared with 2014.

The main measure from the People Survey is the employee engagement index, which measures staff members' emotional response to working for their organisation.

The engagement index for HM Treasury's arm's-length bodies is higher than the civil service average but below that of HM Treasury itself.

The GIAA was established in 2015 so has no data for 2014.

**Attitudes of staff in 2015 compared with 2014 – HM Treasury**

Key
- Results in 2015
- Increase since 2014
- Decrease since 2014
- No change

| | Results in 2015 | Change since 2014 | Civil service average |
|---|---|---|---|
| My work | 84% | +1 | 74% |
| Organisational objectives and purpose | 89% | +1 | 83% |
| My manager | 76% | +3 | 68% |
| My team | 87% | +2 | 80% |
| Learning and development | 60% | +5 | 49% |
| Inclusion and fair treatment | 83% | +1 | 74% |
| Resources and workload | 77% | +2 | 73% |
| Pay and benefits | 22% | +2 | 30% |
| Leadership and managing change | 64% | +4 | 43% |

**Engagement index 2015**


Sources: Civil Service People Survey 2015 and 2014

# Core staff breakdown

## Staff breakdown (FTE) 2015-16

**2,127 (47%)**
UKAR

**153 (3%)**
MAS

**1,300 (29%)**
Core HM Treasury

**118 (3%)**
DMO

**437 (10%)**
Royal Household

**19 (0.5%)**
OBR

**193 (4%)**
FSCS

**15 (0.5%)**
UKFI

**153 (3%)**
GIAA

**4,515** HM Treasury total average staff

## Core staff numbers (FTE) 2009–2016

| | |
|---|---|
| **1,243** | 2009 |
| **1,350** | 2010 |
| **1,249** | 2011 |
| **1,178** | 2012 |
| **1,133** | 2013 |
| **1,091** | 2014 |
| **1,140** | 2015 |
| **1,297** | 2016 |

Calculated on a year ending 31 March