

## VALUE FOR MONEY ACCOUNTABILITY IN THE UK GOVERNMENT: IS THERE A GAP?

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### ABSTRACT

*This paper argues that a significant gap exists in the accountability of the UK Government to the UK Parliament with respect to value for money wastage resulting from flawed government policies. The paper reviews existing mechanisms of accountability in the UK Parliament to demonstrate the existence of an accountability gap and then analyses examples of failed policies to demonstrate that these may create conditions encouraging value for money wastage. The paper concludes that there is a gap in value for money accountability and suggests appropriate changes to the existing accountability structures.*

### INTRODUCTION

The auditing and reporting activities of the United Kingdom's Comptroller and Auditor General (C&AG), the government's external auditor, play a critical role in ensuring that the UK national government is held accountable to Parliament for its expenditure of public monies. However the C&AG, operates under a statutorily imposed constraint on the scope of both his financial and value for money audit reporting. Under the National Audit Act 1983 the C&AG is explicitly barred from making any criticism of Government policy:

Subsection (1) above shall not be construed as entitling the Comptroller and Auditor General to question the merits of the policy objectives of any department, authority or body in respect of which an examination is carried out. (HMG, 1983, Sctn 6, Sub-Sctn 2)

From a political perspective this is an understandable restriction, what elected government would want its policies publicly criticised by a figure as respected and authoritative as the C&AG, the individual who is the head of the National Audit Office (NAO) and the signatory of all of its audit reports? However, this paper argues that the bar on criticising policy, hereinafter referred to as the "policy bar", has adverse effects on holding Government to account when it fails to achieve adequate value for money (VFM) from its expenditure of public money.

Value for money is a term commonly found in the not for profits sectors which provide a service but have no intention of generating a profit. VFM has been justifiably criticised for being a poorly defined construction e.g. Jacobs, (1998) and

Heald (2003). Traditionally VFM has been thought of as a combination of three different aspects of service delivery, these are economy, efficiency and effectiveness. Economy translates simply as paying the least amount for a given service, efficiency is the ratio of services delivered to resources consumed and effectiveness is concerned with the degree to which the service is fit for purpose. The NAO conducts what it describes as VFM audits but these appear to be principally concerned with the economy aspect. It is unclear why this is so but a plausible reason for this restriction is that the difficulties of measuring and quantifying service outcomes render efficiency and effectiveness metrics unreliable if not actually misleading. There is an additional argument that effectiveness, being concerned with fitness for purpose, has the potential to stray into the area of policy criticism which, because of the policy bar, is outside of the NAO's remit. A final reason is that the principal metric used by Parliament to assess the performance of the NAO is concerned with the level of savings that the NAO's recommendations generate for its clients. So, for the purposes of this paper, VFM has the rather simplistic definition of being concerned with spending the minimum amount of money to obtain a given level of a specified service, consequently VFM waste is the amount of money wasted when government spent more than it should on providing a particular service.

Holding to account, or accountability, is traditionally understood in terms of the relationship between principal and agent. The agent is responsible for fulfilling a task or duty on behalf of the principal and consequently is accountable to the principal. Typically the agent will present an account of his/her activities to the principal who may, take some form of action that involves a reward or a penalty and is usually intended to engineer behaviour by rewarding appropriate behaviour and to penalising inappropriate behaviour. This form of accountability is relatively simple and is based largely on prior agreement (a contract) between agent and principal. However, in recent years, accountability has come to be perceived more widely than the simple principal agency model and now involves a stakeholder approach where the individual or entity is more generally accountable to others who are affected by his/her actions and even inactions. The nature of the accountability relationship is not always evident in advance. While this parallels the development of legal doctrines such as the widening of the duty of care doctrine, contributory negligence etc., it does mean that accountability is becoming increasingly complex. For the academic, there is considerable difficulty in constructing a framework for such a dynamic subject. Sinclair (1995) reviews the literature on public sector accountability and suggests a broad framework of five types: political, managerial, public, professional and personal. Stone (1995) analyses a type of public sector accountability which he names as administrative accountability. This is broadly similar, although not identical, to Sinclair's "managerial" type, and Stone breaks this type down into five further sub-categories. These are: accountability as parliamentary control, the managerialist conception of accountability, accountability as judicial and quasi-judicial review, accountability as constituency relations, and finally market accountability. These frameworks and others that are found in the literature are useful from a taxonomic

perspective and are helpful in sub-dividing the disciplinary area but are of limited use in determining the construction and trajectory of the constantly evolving systems of accountability found in the public sector. More recently, Mulgan (2000) and Koppell (2005) have discussed both the extraordinary variety of meaning that is being attributed to accountability in the public sector and also the considerable practical difficulties of exercising accountability in the public sector.

The Civil Service, the executive wing of Government, is a hierarchical bureaucracy and the degree of initiative and discretion that may be exercised by individuals, who are not at the top of the hierarchy, is very limited. Consequently, low and even middle-ranking civil servants, cannot be held personally responsible for failings that result from the shortcomings of the overall system that they are a part of but have little influence over. The responsibility and accountability for system failure rests at the top of the hierarchy with those who have oversight of the system and the authority to change it. *The difficulty in traditional accountability terms is that senior civil servants are usually very capable individuals with a strong sense of public duty. Except in extreme circumstances, exercising accountability by penalising such people would likely be counter productive.* The NAO and the House of Commons Select Committee of Public Accounts (PAC), being parliamentary and not governmental bodies, have no direct role in the exercise of traditional accountability over government, for example, they cannot fire a civil servant. What the NAO and the PAC do is expose to parliamentary and public view both VFM waste and the processes that led to VFM waste. With that transparency established it becomes very difficult for Government to ignore what has happened and it must then decide what actions, if any, are appropriate. The action most commonly taken by government is not one of actively penalising the senior civil servants involved, but of accepting the recommendations about process change that have been made by the NAO and the PAC. The outcome of the form of accountability adopted by the NAO and the PAC, what this paper calls VFM accountability is, most typically, a change to flawed civil service processes that have contributed to waste of public money and a minor loss of face by the senior civil servants involved.

The motivation for this paper is the lack of literature directly identifying the accountability gap. While there is considerable discussion of issues surrounding ministerial accountability, the specific accountability gap outlined by this paper is not mentioned. For example Stone (1995) details some of these issues. He describes the developing controversy in the literature concerning the extent of ministerial accountability with some writers arguing for a situation where the minister is fully accountable for the activities of his/her civil servants by virtue of the his/her structural position as head of a civil service department. While others have noted the practical difficulties of this approach and argued that the minister cannot be held accountable for a department that he/she has little experience of and operational knowledge. He also describes the argument that civil servants have an accountability not only to their ministers but also to a wider group of stakeholders. This view is controversial, at least among civil servants and ministers. Since Stone wrote his paper the perspective that has arguably emerged

is that ministers are not held fully accountable for failings in their departments and that the responsibility that civil servants have to their ministers outweighs their responsibility to Parliament and to the public. This suggests a separation of political accountability from managerial and administrative accountability and arguably renders ministerial accountability less effective. Mulgan also touches on general issues, providing evidence for what is a growing accountability deficit in government (Mulgan 2006a). He also discusses the interesting issue that on some occasions could be construed as being a misuse or even an abuse of power. Because the public trust the civil service rather more than they trust government ministers, ministers take advantage of this by “seeking to attribute assessments of evidence to their officials” (Mulgan, 2006b).

The paper develops its argument by first demonstrating the existence of an accountability gap with regard to the VFM impact of flawed policy through a review of the current arrangements for ensuring governmental accountability to Parliament. For this gap to constitute a genuine issue, it must be linked to VFM wastage. The complexity of VFM wastage makes it difficult, if not impossible, to isolate specific causes of wastage so that a conclusion that a specific flawed policy directly causes wastage is unlikely. Accordingly, the paper argues that flawed policy, as distinct from flawed policy implementation, creates conditions that allow, and in some cases force, VFM wastage. This argument is developed by reviewing one particular policy in an area of high VFM wastage, the procurement of central government information technology (IT) services. The specific policy reviewed is the use of the Private Finance Initiative (PFI) as a mechanism for contracting and financing the procurement of IT services from the private sector (PFI for IT). This policy, now withdrawn following the recognition of its failure, is argued to have been deeply flawed and to have provided the conditions for significant VFM wastage. (Please note that the use by this paper of a highly specific PFI based policy as an example of poor policy making practice is not intended to be taken as a general indication of the quality of policy making in other areas of PFI.) The lack of an effective apparatus of accountability over the VFM effects of flawed policy and the possibility that flawed policy is at the very least a contributory factor to VFM waste strongly suggest that an effective accountability gap exists which is allowing public money to be wasted without providing the opportunity to hold policy makers to account. The principal evidence for this paper's arguments is derived from material contained in reports published by the NAO, from reports and the related transcripts of evidence sessions published by Parliamentary select committees, from Parliamentary debates and from Government reports and Government sponsored reports. The paper is reliant on the NAO reports. As it is up to the NAO to decide what is a VFM issue and how it should be investigated and reported, then there is an apparent opportunity for the NAO to create spurious VFM issues. However, there is a strong validation mechanism. The NAO's reports must be fully agreed by the department or agency that is the subject of the report. If agreement has not been reached before the report is published then the report must state this fact. In addition the PAC evidence hearings provide the opportunity for the relevant accounting officer (the

head of the department or agency) to give his or her perspective should there be a difference of opinion on what constitutes a VFM issue.

## UK GOVERNMENTAL ACCOUNTABILITY FOR VALUE FOR MONEY

In the UK, the elected Parliament represents the public and as such is constitutionally the sovereign body to which government is accountable. The machinery for exercising accountability comprises many individual and overlapping mechanisms. There are parliamentary debates and question times where individual members of both Houses of Parliament, may raise issues for government ministers to answer directly. Members may also put written questions to ministers which will be answered albeit through the filter of the civil service. In addition to these individual efforts by members, there is a system of Standing Committees that scrutinise and debate legislation and of Select Committees that oversee Government activity and policy.

In addition to this work undertaken by members of both the Lords and the Commons, there are Parliamentary offices that are also involved both indirectly and directly in accountability. The House of Commons Library and the Parliamentary Office of Science and Technology prepare briefings and papers relevant to members' needs, their accountability function is indirect but their work does help members in asking relevant questions of Government. However, there is one officer of Parliament with direct responsibility for ensuring governmental accountability, this is the Comptroller and Auditor General (C&AG), a post currently held by Sir John Bourn, a former senior civil servant with considerable expertise in the workings of the machinery of government. He is tasked with undertaking both financial and value for money audits of public expenditure by central government. While he consults with Parliament about the subjects of his value for money reports he has total discretion concerning the selection of those subjects and he undertakes some sixty such assignments annually. Sir John is head of the National Audit Office (NAO), a parliamentary body that exists purely to assist him in carrying out his duties as C&AG and so, in this paper, the NAO is synonymous with the C&AG. It is important to emphasise that the C&AG and the NAO report to Parliament and are entirely independent of Government.

The NAO has a procedural problem, it works for Parliament but having no authority with respect to Government its conclusions and recommendations may be ignored by Government. A way around this problem has been established by working closely with one specific select committee, the PAC. The PAC has a roving parliamentary remit to hold central government accountable for its expenditure of public monies. The PAC is quite unusual among select committees: by tradition it is chaired by a member of the opposition who has had experience as a Treasury minister, it also includes a Government minister (the Financial Secretary to the Treasury) as an ex-officio member and it has a scheduled annual debate on the floor of the House of Commons to air its concerns. It is the most productive of the select committees in that it generates some fifty reports annually,

it is influential and highly regarded, and its conclusions are frequently quoted in Parliament and by the national press. The advantage to the NAO of joining forces with the PAC is that the Government may not ignore a Select Committee and must formally respond to its concerns. Reporting to the Public Accounts Commission the C&AG has stated 'a PAC hearing adds a lot of muscle to what we are able to say' (Bourn, 2002, q. 2).

For the PAC the advantage is that the NAO, as the Government's auditor, has statutory access to government information (a level of access is not otherwise available to Parliament) and it has the resources of funding and personnel necessary to undertake its audit role. The NAO uncovers, investigates and reports on a large number of value for money failures, work that the PAC would otherwise have to undertake by itself which, because of its limited resources and the lack of direct access to government information it would find near impossible. Parliamentary committees have no statutory right of access to Government information. Government exercises discretion in what information it provides to select committees and it can and does deny the requests of select committees. For example, members of parliament and select committees have been trying and failing to obtain the reports of the internally conducted "gateway" reviews of the state of individual government IT projects (Todd, 2004, clm 1305). The government has to give reasonable grounds for refusing to supply information and the reason given for refusing access to gateway reviews is that the information is commercially sensitive. However Parliament's view is that this arrangement is sometimes being abused. The following Hansard excerpt is taken from a parliamentary debate dealing with work undertaken by the select committee of Works and Pensions into IT and related issues in the Department of Work and Pensions and it illustrates the problem:

**Rob Marris:** Hon. Members will know that I sat on the Work and Pensions Sub-Committee that produced the report. On commercial confidentiality, on which I am sure the hon. Gentleman will comment, does he share my memory of the flavour of the overall evidence, which was that the Government were more concerned with hiding behind commercial confidentiality than were the commercial suppliers?

**Sir Archy Kirkwood:** Absolutely. It was a revelation. I fully expected to run into a lot of hostility, suspicion and concern from the commercial sector, but that was far from being the case. Instead, it welcomed us with open arms. Subject to the terms applying fairly to everyone and the protection of the genuine tenders for contracts—obviously, we are grown up enough to understand that they have to be protected, otherwise that way madness lies—it egged us on. We should grasp that opportunity. The hon. Gentleman is right. The conclusion we are driven back to is that the Department is merely protecting its own situation by hiding behind a cloak of commercial sensitivity and confidentiality. It is not justified. (Marris and Kirkwood, 2004, clm. 1305)

Further evidence of a lack of government transparency appears in a note written by the Clerks of the Liaison Committee (2004) the select committee that liaises between select committees to aid their effectiveness. The note unfavourably compares the differences in the quality and quantity of evidence made available to

the Hutton Enquiry, a Government enquiry with no powers to compel either the production of evidence or the attendance of witnesses, and the evidence Government typically provides to a select committee inquiry. The Clerks state that a select committee would receive neither the “form of documentary evidence” given to the Hutton inquiry nor the “nature of the documentary evidence” given to the Hutton Enquiry and they also make the point that the government prefers not to provide select committees with documentary evidence at all.

The PAC undertakes further investigation of some fifty or so of the NAO's value for money reports by holding evidence sessions where civil servants and government contractors are effectively held to account. These further investigations are published as PAC reports to which the Government formally responds by means of Treasury minutes. A further indirect response from Government, affirming the significance of the PAC/NAO collaboration, also occurs through the medium of the “Dear Accounting Officer” (DAO) letters. These are instruction and guidance letters sent by Treasury to every accounting officer. A number of these letters contain specific reference to PAC and NAO report conclusions. This symbiotic collaboration between the NAO and the PAC has been very advantageous to both parties in carrying out their obligations.

The disadvantage to the PAC of the collaboration with the NAO is that the PAC is heavily dependent on the investigative work that the NAO does and also on the Government information that the NAO is able to pass on to them. Consequently, the PAC is indirectly constrained by the policy bar. However, this does not matter in practice because the PAC has another characteristic that is very unusual for a select committee and that is highly significant to this paper - the PAC is deliberately apolitical. While other Select Committees are keen to criticise policy and to publicly and robustly interview government ministers *in order to hold them to account*, the PAC desists. This behaviour ensures that *the committee is united in its recommendations and not split along party lines*. This is a significant consideration for the exercise of accountability because if the PAC were split then the Government would be able to ignore the PAC and thus also the NAO. However, the side - effect is a serious restriction in scope that effectively exempts ministers and policy makers from VFM accountability at least through the NAO/PAC. The following quote from the PAC chairman responding to a question during a recent PAC parliamentary debate illustrates the restriction:

On the key aspects, this is the only publicity – we are not supposed to mention this – directed at civil servants. None of our reports ever criticise the Labour Government or Labour Ministers. We never get involved in politics. It is important that civil servants know that this public spotlight is on them. That, as the hon. Gentleman says, is a spur to better performance. (Leigh, 2006, clm 1603)

If the NAO cannot call ministers to account and the PAC refuses to, how can they be held accountable for the value for money issues relating to policy? Other select committees do review and criticize policy, but they do not have the VFM remit that the PAC has, nor do they have access to the expertise and knowledge of the NAO to anything like the same degree. The C&AG is himself accountable to Parliament

through the Public Accounts Commission (as distinct from Public Accounts Committee). The Commission's 11<sup>th</sup> annual report (2002) affirmed the NAO's avoidance of policy issues and suggested some of the pressures that the NAO and the PAC are under and which provide other reasons for keeping them away from policy issues:

The Chairman asked how the C&AG decided priorities for VFM studies, and how far the number of such studies was contingent on the expected number of PAC meetings. The C&AG confirmed that the number of VFM studies conducted arose from the concept of aligning them with the number of PAC meetings. In the context of VFM studies the C&AG thought that the selection of subjects as far away from the policy nexus as possible, with an emphasis on management and implementation, had been instrumental in avoiding threats to the NAO's independence or clashes with other Select Committees. (Public Accounts Commission, 2002, Section 2)

There is a measure of accountability both through other parliamentary committees, and the activities of individual members of both houses, but these committees and individuals lack the direct access to pertinent information that the NAO has and they also lack the resources to undertake substantial investigative work by themselves. The Sharman Report (2001) recommended an increase in the role of the NAO, suggesting that it provide select committees other than the PAC with some limited assistance. However, Sharman also explicitly invoked the policy bar in relation to these services:

further use could be made of the work of the NAO, for example, by providing the C&AG with the resources to brief departmental select committees annually on key financial issues, without in any way undermining the key relationship between the NAO and PAC, or drawing the C&AG and his staff into questioning policy matters. (Sharman, 2001, p. 3)

The other select committees have not adopted the same self-imposed apolitical stance that the PAC takes and are perfectly free to consider the implications of policy and to hold government ministers accountable where appropriate. However, Sharman's emphasis on the policy bar makes it very unlikely that the NAO could be of substantive help to those select committees with an interest in promoting the accountability of policy makers because of the adverse VFM effects of their policies.

This, then, is the accountability gap with which this paper is concerned. The two parliamentary bodies principally responsible for supervising government expenditure restrict their activities to reviewing the implementation of government policy and they ignore the VFM implications of the underlying policy. The NAO operates under a statutory policy bar and the PAC operates under a policy bar brought about by political pragmatism. Neither undertakes any form of analysis of the value for money impact of the policies themselves. Individual members and the other select committees attempting VFM based analysis of policy are placed at a heavy disadvantage by the lack of government transparency and the imposition that the policy bar places on their potential use of the NAO. Lacking the information necessary to present an authoritative VFM based critique of policy, they can only criticise policy on estimated VFM figures or on political grounds



which the government can effectively ignore. Key to all of this is the policy bar and its effect of denying Parliament access to VFM relevant information. This is not to suggest that policy related value for money issues escape notice. Individual members and committees do argue that policies they perceive to be flawed cause monetary wastage, however the lack of relevant and authoritative information means that these criticisms are easily deflected.

By ignoring flawed policy the accountability system arguably becomes protective of policy makers and may exhibit an unfair bias against those civil servants involved in policy implementation. The NAO may not, and the PAC will not, hold ministers to account for VFM failures. While the NAO's practice is to treat the problems it uncovers as opportunities for learning, the PAC is arguably less forgiving and sometimes puts civil servants through a robust and public questioning of their behaviour and achievements. The civil service is itself part of Government and the responsibility of individual civil servants is to their minister and not to Parliament. As such civil servants are constrained in the evidence that they may give to a select committee and are not permitted to place the blame on poor policy formulation, even when it may be justified. A conceivable side effect of the avoidance of considering VFM related policy issues is that the PAC might place the blame for a VFM failure on the shoulders of a civil servant when it may perhaps more properly belong on the shoulders of the relevant minister.

## **GOVERNMENT IT PROCUREMENT AND THE PRIVATE FINANCE INITIATIVE**

In the last three decades the UK NAO has published numerous value for money audit reports criticising VFM failures in UK government information technology (IT) projects and procurements. These have ranged from VFM failures among relatively small projects such as "Trawlerman" (National Audit Office, 1999), to the much more substantial VFM failures of large-scale projects such as "Pathway", "NIRS2" and "Libra" (National Audit Office, 2000, 2001 and 2003). Among members of Parliament, government IT failures are gaining the reputation of being 'the area which wastes the most in the public sector' (Flight, 2004, clm. 249).

The image of poor performance in the procurement of government IT and in particular of the large-scale IT procurements, is upheld by a recent analysis of government IT procurement in seven developed countries that spend at least 1% of their GDP on IT: the USA, the UK, Canada, Australia, New Zealand, the Netherlands and Japan (Dunleavy, Margetts, Bastow and Tinkler, 2004). One of the study's principal conclusions was that the UK government demonstrated the poorest IT procurement performance of those seven countries.

Within this context of poorly performing IT procurement, one clear example of a flawed policy was the policy of funding large scale IT service procurements through the Public Finance Initiative (PFI). The use of PFI for IT has been a policy of the present government until the practice ceased following a Treasury review of PFI policy. The review document published Treasury's conclusion that the use of

PFI for IT contracts was inappropriate and that no new PFI-based IT contracts were to be entered into. Existing PFI-based IT contracts were to continue as before.

Overall, this research [undertaken by Treasury and Partnerships UK into the effectiveness of PFI] indicated that because of the significant differences between IT PFI and PFI in other sectors, and the attendant difficulty of ensuring an appropriate sharing of risk through PFI, IT PFI may not be able to consistently offer value for money benefits. In particular many aspects central to IT procurement do not fit well with the central requirements of PFI. (H.M. Treasury, 2003, p. 54)

The policy objectives given by Government for the use of PFI are twofold: a principal objective of ensuring value for money on transactions with the private sector and a subsidiary objective of ensuring value for money by transferring the construction and operating risks to the procurer wherever possible. In order to achieve the principal objective of ensuring VFM, the Government's approach is to use market competition. The process followed is that the Government invites tenders from interested parties and then after a period of negotiation and further bidding it selects the preferred bidder who usually ends up with the contract. By way of both a safeguard for itself and a price guide for bidders the Government calculates a value benchmark known as the Public Sector Comparator (PSC). The PSC is intended to be the risk adjusted projected cost of the public sector undertaking the supply of the required goods or services itself. Unfortunately the construction of the PSC for large-scale IT projects is an academic exercise as the Government no longer has the capability to construct its own large-scale IT.

What is now clear is that the use of PFI for large scale IT contracts created a market structure that was anti-competitive. Of the world's three major IT contractors, two, IBM and Computer Science Corporation, did not bid for UK Government IT contracts specifically because of PFI. Peter Gershon, the then head of the Office of Government Commerce, a Treasury Agency responsible for advising the public sector on best procurement practice said:

We have had a number of discussions with IBM and Computer Science about what they saw as the barriers to entry to the UK market. They were very open discussions. One of the things they did not like was PFI. They were just not willing to take that strain on their balance sheets. At a time when the UK private sector market was fairly buoyant, frankly they thought they could get a better return on their scarce resource by allocating them to the private sector market than the public sector market. (Gershon, 2004, Ev-7)

The third player, EDS, was prepared to tender for UK Government IT contracts and being the only available contractor that could handle the very large-scale contracts it consequently holds some 54% by value of UK Government IT contracts (Marris, 2004, Ev-19). The policy of using PFI for large-scale IT procurement bears direct responsibility for the failure of competitive tendering by reducing the number of contractors willing to bid. This bears out Dunleavy et al's (2004, p. 36) observation that 'it seems clear that government-IT industry relations have become dangerously unbalanced in at least one major country (the UK).'

The Treasury report bears out this analysis stating 'in the IT sector, structural characteristics have proven to be at odds with the principal benefits of PFI' (H.M.

Treasury, 2003, p. 8). Since the use of PFI was withdrawn for new IT contracts both CSC and IBM have tendered for UK Government IT projects (Gershon, 2004) thus creating a more competitive market.

Another problem that arose was the high incidence of supplier led renegotiation of IT contract terms *after* the contracts had been signed by both contracting parties. The Treasury review of PFI contained another significant observation about the efficacy of PFI as a basis for IT contracts:

the best performing [PFI funded IT] projects were those that renegotiated their contracts after signature to obtain greater ongoing flexibility and looser output specifications, moving away from the PFI model. (H.M. Treasury, 2003, p. 56)

Quite apart from this recognition by Treasury that PFI was not a suitable basis for IT contracts this statement was disingenuous as not only did the best performing projects renegotiate their contracts but so too did some of the worst performing projects e.g. the Libra contract (National Audit Office, 2003), neither does the statement point out that the renegotiated terms were invariably one sided, benefiting the contractor and not the Government. However, it does make the point that contract renegotiation was to be expected with PFI based IT contracts. This near-certainty of renegotiation may also solve the apparent conundrum as to why EDS was prepared to take a dominant role in a market place that its major competitors thought insufficiently profitable.

Thus the policy of using PFI for large-scale government IT contracts has resulted directly in the destruction of the competitive marketplace for those contracts, the emergence of a single dominant supplier and in those contracts being routinely renegotiated to the benefit of the supplier. None of this is any way commensurate with the principal aim of PFI; that of ensuring value for money. The policy of using PFI for IT contracts has been a clear failure in terms of meeting its principal objective.

The PSC value benchmark has been subjected to much criticism not least by Jeremy Colman (2002), then an Assistant Auditor General at the NAO and currently the Auditor General for Wales, who has criticised the PSC on the basis of unreliability, over-complexity, and that it measured cost and not value. This sort of criticism taken together with the high probability of contract renegotiation suggests that the PSC was inadequate for its role as a contract value benchmark. Although Colman's criticism was widely reported at the time it was made and has been quoted in parliamentary debate it appears to have been personal comment made at a meeting at which reporters were present and was not the formal position of the NAO which remained policy neutral. However it does make the point that senior officers in the NAO were aware that the problems of PFI were not simply those of poor policy implementation.

While it is evident that the conditions for achieving VFM have not been met it is impossible to reliably quantify any monetary wastage. The NAO does attempt to quantify the wastage by using a calculation based on the difference between the original agreed contract price (usually based on the PSC) and the final price paid adjusted for the cost of dealing with any contingencies that have arisen during the

project and for any changes to the specification of the system. However, the use of contract renegotiation by contractors suggests that a successful commercial strategy is to bid below cost, suggesting that the PSC is generally set too low, and then to renegotiate the price upwards once the contract has been awarded. This makes the initial agreed contract price meaningless as any sort of contract value benchmark and therefore unreliable in an attempt to calculate VFM wastage.

The effectiveness of the secondary policy objective of PFI, risk transfer, is highly questionable. The PSC benchmark includes a premium for the risk that is transferred to the contractor which, if it has been quantified correctly, would result in the negation of the value for money created by the risk transfer. The objective of risk transfer in PFI has been closely examined and found wanting by Froud (2003) who found that the term "risk" was used largely as a rhetorical device. Froud demonstrated not only that the anticipated risk transfer to the supplier usually fails in practice, but that in some circumstances the use of PFI will increase the total risk, a conclusion validated by the specific terms of many of the contract renegotiations seen in the PFI based IT contracts. Some attempts at risk transfer have also been wholly inappropriate. The Work and Pensions Select Committee, in its investigation of the IT systems development problems at the Child Support Agency, had this to say about the risk transfer involved:

The Department appears to have been determined under the old Public Finance Initiative (PFI) rules to shift the risk of development of the new system away from itself entirely onto the shoulders of the contractor. Priority appears to have been given to avoiding culpability instead of establishing an effective partnership to achieve the extent of change needed to turn a decentralised, paper-based business model into a centralised system, working in an entirely new screen-based environment with all communications based on phones, not paper. (Work and Pensions Select Committee, 2004, pp. 16, para. 42)

The committee was not undertaking a VFM investigation and came to no VFM relevant conclusions but it is reasonable to suggest that this inappropriate form of risk transfer could result in the increased costs with a resultant decrease in overall VFM.

Ensuring value for money and appropriate risk transfer are the two principal policy objectives of PFI, policy objectives that were unachievable in PFI for IT. However, precisely because they are policy objectives the NAO is barred from questioning their merits. The result is that the NAO may not produce a generalised strategic critique of the policy, no matter how valuable that may be, but is forced to base its recommendations on specific examples of poor practice from specific projects, e.g., the recommendation in the report on the Libra project (National Audit Office, 2003) that a lack of bidders for the contract should be regarded as a warning sign, or the recommendation on the report on the NIRS 2 Contract Extension that departments should develop strategies to manage risks effectively (National Audit Office, 2001). The NAO could not even consider a discussion that these problems were generic as a consequence of poor policy but was restricted to treating them as if each was an isolated occurrence resulting from poor policy implementation. So, could the policy flaws in PFI for IT have been

foreseen? Yes, they could have been but not by the presently existing system for exercising accountability over government.

The failure of PFI for IT was entirely predictable on the basis of microeconomic analysis using incomplete contract theory (Hart, 1988). PFI is effectively a fixed price contracting mechanism. Fixed price contracting encourages, and in highly competitive conditions may force the economically rational contractor to follow particular adaptive profit maximising behaviours i.e., adverse selection and moral hazard, that are detrimental to the procurer. The standard mechanism for dealing with these behaviours is to ensure that the contract is as complete as is possible by catering for all feasible contingencies. The direct consequence of a fixed price and a rigorously defined contract is high transactions costs at the pre-contractual stage and the encouragement of an adversarial approach by both parties post-contractually. While this appears to work reasonably effectively for some public sector contracts, e.g. the building of schools, it is not universally appropriate and is entirely at odds with the requirement of governmental large-scale IT procurement. The existence of adverse selection and moral hazard is made evident in PFI for IT by the frequency of contract renegotiation and by the manner in which the renegotiated contract terms invariably favour the contractor. There are a number of factors that influence the success of IT procurement but among the most significant is the creation of an unambiguous, detailed and mutually agreed specification for the proposed system. This specification underlies the functional requirements stipulated in the contract. This depends on close co-operation and good communication between the parties, unlikely with an adversarial contracting relationship, and it is further dependent upon having a stable set of requirements for the proposed system and sufficient time to undertake the necessary detailed planning. Government usually requires its large-scale IT systems for the administration of novel legislation; as such the requirements of the legislation form the basis for the system specification which in turn forms the basis of the contract. Unfortunately the process that generates legislation ensures that the proposed legislation is fluid until it is passed by Parliament and even then it is subject to further revision by statutory instrument. Additionally, the requirement to produce the IT system as soon after legislative enactment as possible creates considerable time pressures which impact on the time available for planning as well as for development, creating further problems for the specification as well as for the build. Accordingly, the detailed specification for the required IT may not effectively exist when the contract is signed and the contract is therefore necessarily substantially incomplete. It is difficult to imagine a better example of an incomplete contract scenario than a large-scale government IT project for administering novel legislation. Making a success of an incomplete contract requires a high degree of flexibility from both contracting parties. However, the manner in which PFI contracts are framed allows for very little flexibility making PFI and IT development essentially incompatible. The IT suppliers are well aware of this problem, the managing director of EDS's UK public sector division has said:

With experience and maturity in the business, you begin to have rules of thumb...I have a rule that says that the words 'fixed price' and 'applications development' should never appear in the same sentence. (Whittaker, 2004, Ev-75)

Even before running into the problems of market structure and the failure of risk transfer that were discussed earlier, the evident incompatibility between fixed price contracting and the incomplete nature of IT contracts should have signalled that PFI for IT was more than merely a flawed policy. It was a policy oxymoron that could not work. The policy driven attempt to apply a fixed price mechanism such as PFI to a substantially incomplete government IT contract demonstrates either an unrealistic adherence to particular political goals or a failure to understand the dynamics of contracting and the particular requirements of IT development. This policy was a recipe for VFM disaster that should have been abundantly obvious to the professional economists and policy advisers in the Treasury and the Cabinet Office. That this policy was allowed to come into effect and to continue for the five or so years that it did, demonstrates the absolute need for parliamentary oversight of the value for money aspects of policy.

PFI for IT is not an isolated example of a flawed policy with VFM implications in the area of IT procurement. The Thatcher Government's policy of improving the cost efficiency of public services by opening up public service provision to the private sector was another. The underlying idea was that if the public sector could not match the cost-efficiency of the private sector in public service supply, then the private sector should be made the supplier. This hit particularly hard in government IT departments. Following what was known as "market testing" – comparing the cost of public sector provision of public services to the tenders of private sector suppliers invited to bid for the provision of the same services – a number of private sector suppliers took over service provision from the public sector. The result in public sector IT was the outsourcing of complete IT divisions from some government departments to the point where in-house development became impossible. The further, perverse, result was that the government departments who outsourced their IT divisions now had to procure IT services from the private sector, but having outsourced, not only their IT capability, but their IT knowledge, they were neither able to properly evaluate bids from commercial suppliers nor monitor the performance of procurement contracts. Through outsourcing its IT functions Government effectively became a naïve client (Lapsley, Brown and Jackson, 2001) for IT services, and at the mercy of the private sector suppliers.

Unlike PFI for IT, no direct admissions of policy failure have been made for outsourcing. However, there have been changes in policy directed at correcting the naïve client position. The Department of Work and Pensions, one of the departments most afflicted by IT procurement failures is currently rebuilding its in-house IT expertise. Mr Charles Law, a senior civil servant, and a member of the Department of Work and Pensions Group Executive Committee, in giving evidence before a sub-committee of the Work and Pensions Select Committee stated:

The other key lesson is the point about having in-house expertise. The Department outsourced its information technology agency several years ago and that left a vacuum of knowledge about IT that is gradually being clawed back. (Work and Pensions Subcommittee, 2004, q390)

A second and more general sign of the policy reversal has been the recent formation of a new professional cadre in government, the Government IT Profession, and an accompanying newly-formed fast-stream recruitment route into the civil service specifically for IT and project management specialists. Could the problems associated with the policy have been foreseen? The answer is once again yes, analysis of the policy using information asymmetry theory (Akerloff, 1970) would have demonstrated the considerable potential for adverse selection and moral hazard. Information Asymmetry theory is closely related to Agency theory and provides an explanation for a class of economic transaction failures where one party to the transaction has privileged access to relevant information that the other party lacks. In such a case the existence of economic rationality will ensure that the party with exclusive access to the private information will make use of it to their own advantage and to the detriment of the other party. This type of outcome is known as either adverse selection, where there was a pre-contractual intention to benefit from the private information or moral hazard which is effectively post-contractual opportunism. (These outcomes are also seen with incomplete contracts because by virtue of being incomplete an incomplete contract embodies an inherent information asymmetry). As an economically efficient transaction is one in which neither party to the transaction is made worse off, a transaction that results in one party being made worse off is therefore economically inefficient. The presence of an information asymmetry, compounded by the adaptive behaviour created by economic rationality, result in economically inefficient transactions. This condition may lead ultimately to the wholesale failure of a market as the transaction price is not being set by the market based solely on the interaction between supply and demand but is being substantively influenced by the existence of the asymmetric information. An information asymmetry-based analysis would have shown that an unfavourable information asymmetry was being created as government progressively outsourced its IT capabilities and was consequently losing both technical IT knowledge and knowledge of the commercial IT market. In addition, the organisations which were taking over the government work were profit - motivated private sector contractors and should be expected to be economically rational. The two requirements for information asymmetry-based economic inefficiency were therefore present. Following outsourcing, the signs of adverse selection and moral hazard also became evident, the suggestion of low balling during initial tendering, the aforementioned contract renegotiations and the regular failure of suppliers to deliver a product to specification. All of these signals taken together are strongly suggestive of a major information asymmetry issue and alarm bells should have been ringing. This time the Government response was not so swift as it was for PFI for IT, it took not five years, but ten, to recognise and to start dealing with the problem (the announcement of the outsourcing of the Department of Social Security's,

predecessor to the Department of Work and Pensions, Information Technology Services Agency was made in 1994). This again demonstrates the need for parliamentary oversight of the VFM implications of policy.

## DISCUSSION

For the UK Government, policy is something of a sacred cow, its sanctity is not to be questioned. Government prefers to show unanimity in support of its policies so the policy analyses carried out within Government are not made available to Parliament and civil servants are obligated not to reveal the policy advice that they give to ministers. Even the Sharman Report (2003), the Treasury sponsored major review of Audit and Accountability of Central Government, unquestioningly accepted the policy bar. It is perhaps an indication of just how deeply embedded the doctrine of the policy bar has become, that Sharman did not even consider it to be an issue.

Unfortunately, VFM oriented policy analysis appears to be off the governmental accountability radar. When the existence of flawed policies and their potential for monetary wastage is considered alongside an accountability mechanism that allows ministers to avoid being made accountable for the monetary wastage caused by their flawed policies, then there is clearly an issue in need of resolution. This situation echoes the concerns of Mulgan about an increasing accountability deficit and the possible misuse of the Civil Service and provides a compelling argument for Parliament to undertake a deeper and more informed analysis that explicitly questions the impact of policy on the achievement of value for money. It is important to emphasise that such an analysis need not be a mechanism for criticising the political objectives of policy, but is suggested as a strategic level analysis of the VFM implications of policy. Despite this caveat there is likely to be strong opposition to this idea both from senior civil servants who do not wish to see their policy advice exposed, and from Government Ministers who do not want their policies forensically dissected or to be held accountable for VFM related policy flaws. It would be a politically brave move for a Government to embrace this level of accountability but the long-term result would likely include both improved value for money and improved policy making.

There then arises the question as to how to deal with this issue. An obvious solution to this issue would be to improve governmental transparency, select committees and members of Parliament should not be unreasonably denied information relating to governmental accountability. There is a precedent for increased government transparency. The Hutton Inquiry, convened in 2003, and referred to earlier in this paper was a Government inquiry into the circumstances of Dr David Kelly's death. The inquiry had no formal authority to compel the Government to provide either documentary evidence or access to witnesses. However, the strength of public opinion about the case ensured the compliance of the Government with the requirements of the inquiry. Despite having markedly less authority than a select committee, the inquiry was able to obtain access to considerable quantities of detailed and relevant documentary information and was



also able to take evidence from any civil servant that it wished to as well as from any minister. Even the Prime Minister gave evidence to the inquiry. This contrasts with the Government's treatment of select committees which are rarely given any documentary evidence by Government and on occasion have even been refused access to specific civil servants (the Clerks of the Liaison Committee, 2004). The Hutton Inquiry demonstrated that Government can be made more transparent. Whether the political will exists to move to greater transparency is another matter, but Government should not be in a position to restrict the flow of information about its own performance. Other measures could involve refining the existing policy bar so that while the C&AG remains barred from criticising policy objectives on political grounds, he would be allowed to criticise them solely on VFM grounds. Again there is a precedent. The Cabinet Office has recently (2005) revised its guidance for departments giving evidence to select committees. This guidance contains a statement concerning the *constraints on civil servants when giving evidence to select committees about policy*:

Any comment by officials on government policies and actions should always be consistent with the principle of civil service political impartiality. Officials should as far as possible avoid being drawn into discussion of the merits of alternative policies where this is politically contentious. (Cabinet Office, 2005).

This is effectively a statement of the policy bar as it affects civil servants giving evidence, but unlike the statutory policy bar acting on the C&AG it does permit civil servants to provide an opinion on policy as long as it is impartial and apolitical. It does seem unreasonable that the policy bar on the C&AG is more restrictive than that on the civil service and the above wording could form the basis for a suitable redefinition of the C&AG's policy bar. This however would mean extending the role of the NAO and could conceivably compromise the NAO's independence and authority in its traditional role as auditor and it might therefore be more appropriate to create a new parliamentary office of VFM policy analysis to undertake the role. The fruitful experience of the NAO/PAC collaboration suggests that a mutually supportive arrangement with a select committee would be advisable, but probably not with the PAC as this would change the way the committee functions and would also impact on its collaboration with the NAO. It might therefore be necessary to constitute an entirely new select committee. It matters little who undertakes the task, as long as it is undertaken and providing it does not undermine other existing mechanisms of accountability.

This paper has limitations; the theory underlying governmental accountability is not well developed making it difficult to develop a theoretically sound analysis of the issue. The paper is also entirely dependent on publicly available information and as such focuses on the formal systems of accountability. Consequently evidence relating to the informal forms of accountability that may be operating is not available to this style of research. For example, it is perfectly conceivable that the C&AG, as an ex-senior civil servant, would have close contacts at high level in the civil service and could use them as an informal channel to

communicate any concerns that he had about policy issues. Such an arrangement is entirely speculative but also plausible. Research into the existence and impact of informal systems of accountability would be a very useful addition to this area of study as would work that further clarifies the very complex theoretical issues of accountability in the public sector.

## CONCLUSION

This paper advances the thesis that the restriction in scope imposed on the NAO's VFM audits by the statutory ban on questioning the merits of policy objectives, has resulted in an undermining of Government's accountability to Parliament through the creation and maintenance of an accountability gap.

The collaboration of the NAO and the PAC forms the principal means of Parliament's exercise of VFM accountability over Government. Despite having this significant role, neither of the two bodies will engage in any criticism of government policy. The NAO is statutorily banned from doing so and the PAC's apolitical stance, together with its dependence on the NAO as a source of primary information, forms an equally effective barrier. Consequently neither the NAO nor the PAC holds politicians to account for VFM wastage resulting from flawed policies. Other select committees and individual members of Parliament also experience difficulty in obtaining the information that would enable them to hold ministers to account for the VFM effects of flawed policies. This combination of circumstances results in a lack of systematic accountability being exercised over ministers who promulgate flawed policies that waste public monies. The evidence, as rehearsed in this paper, supports the thesis that a demonstrable accountability gap in relation to the value for money waste due to flawed policy does appear to exist in the UK.

Because of the difficulty of determining specific causality in a complex phenomenon such as VFM wastage, it is impossible to state that specific flawed policies *cause* VFM wastage. However, the argument that a flawed policy may create conditions that actively contribute to VFM wastage is demonstrated by the PFI for IT policy with its incidence of one-sided contract renegotiations and by its damaging impact on market structure, and also by the IT outsourcing policy which resulted in Government turning itself into a naïve buyer in the highly sophisticated information systems market.

Because an accountability gap with respect to the VFM effects of flawed policy is demonstrated to exist and because flawed policies are shown to create conditions encouraging to VFM wastage this paper can reasonably conclude that Government's accountability to Parliament for VFM wastage is, at the very least, partially undermined by the present limitations of the accountability system. Clearly this is a situation that, in a democratic country, begs to be remedied.

If ignored, the continued existence of the gap will allow the obvious consequences of continuing promulgation of flawed policies and the accompanying VFM waste. However, another problem is made evident by the existence of this particular accountability gap. By ignoring the effects of flawed

policy on VFM, the current system for holding government to account appears to work on the assumption that all VFM issues result from poor policy implementation. Accordingly, there is a danger that the PAC, and other select committees, may unfairly place blame on the civil servants who have the responsibility for implementing a flawed policy, rather than those who were responsible for defining that policy in the first place.

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