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Meg Hillier MP
Chair of the Committee of Public Accounts
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By email

29 April 2020

Dear Chair

Northern Ireland Office Excess Vote 2018-19

Thank you for your letter of 16 April 2020 in relation to the Northern Ireland Office's Excess Vote in 2018-19. I welcome the opportunity to provide further detail on the reasons behind the excesses which led the Comptroller and Auditor General to qualify his regulatory opinion for the NIO's 2018-19 financial statements. I have sought to address each of your questions in detail below.

Context

By way of context, 2018-19 was a particularly challenging year for the Department, with a significant and intensified focus on the restoration of the Northern Ireland Executive and planning for the UK leaving the EU. At the same time, the Department continued to manage an already complex range of policy areas. This in no way excuses the excesses in my Department's expenditure, but sets it in the context of the complexity and ambiguity in which we were managing an increased level of issues and risk.

The external audit of the NIO 2018-19 final accounts (and those of all the NIO's NDPBs) was undertaken by Ernst & Young LLP (EY). The NAO appointed EY to provide external audit services for an initial three-year period commencing with the year ended 31 March 2019. This was therefore the first year that EY has acted as external auditors on the NIO accounts.

Qualifications

The Comptroller and Auditor General's certificate and report on the Northern Ireland Office (NIO) 2018-19 Accounts, covers two qualifications: authorised limits being exceeded by £0.231 million for the Resource Departmental Expenditure Limit (RDEL); and by £0.785 million for Annually Managed Resource Expenditure (AME). As you note in your letter, there are three separate issues that led to these qualifications:

> i) The Department reviewed its records of incurred but unbilled external legal costs as at 31 March 2019 and, as a result, recognised additional resource expenditure of £0.296 million during 2018-19. This resulted in a breach of RDEL.
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> ii) In the final months of 2018-19 the Department realised a liability to contribute to the compensation cost of a number of individuals in respect of unlawful stop and searches undertaken between September 2009 and May 2013. This resulted in the recognition of liabilities of £509,000 in the NIO accounts for which there was insufficient budgetary cover, resulting in a breach of AME.
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> iii) The Department incurred a constructive obligation in respect of restructuring costs of the Chief Electoral Officer for Northern Ireland and should have established a provision of £306,000 for these costs. This further contributed to the breach in AME.

Why the mistakes occurred:

RDEL Breach - external legal costs

The NIO has a small overall budget, around £25 million RDEL in 2018-19, which means that we have very limited ability to absorb unexpected costs arising towards the end of the year. The Department maintained a contingency of 2% of RDEL in 2018-19 which proved insufficient when a number of late costs emerged. The need to accrue for unbilled external legal costs resulted in the RDEL limit being breached.

The Crown Solicitor's Office (CSO) arranges legal support on behalf of the NIO in Belfast. It was previous practice for counsel to only invoice for work carried out once a case had concluded; in some cases this would take several years. Prior to the 2018-19 audit, I understand that the NIO had not accrued these costs as they were not considered to be material. This approach was not challenged by the NAO (which audited the accounts "in-house" prior to 2018-19). The cases themselves, including when they were likely to conclude, were tracked through the departmental Financial Risk Register, to ensure they were correctly budgeted for when the expenditure was likely to arise.

After the 2018-19 year end, the new auditors considered that the unbilled external legal costs had not been accrued and requested that the amount was estimated using an agreed methodology. This exercise suggested that the value as at 31 March 2019 was now material and should be included in the accounts. Estimates of the equivalent amounts for 31 March 2018 and 2017 were made and the 2018-19 accounts restated to show the revised position and the prior year's adjustments. For 2018-19, this resulted in the breach of the Department's RDEL.

The auditors took the view that the prior year adjustment for 2017-18, which amounted to £0.197m, was not material and that the total adjustment could be made in 2018-19 rather than restating the 2017-18 figures if the then Accounting Officer wished to do so. He consulted the NIO's Audit and Risk Committee and accepted its view that it would be more appropriate to make the prior year adjustment so that the primary financial statements showed the correct comparative year on year position.

I accept that the NIO should have accrued for external legal costs, not least as the work carried out by legal counsel had increased significantly in 2018/19 compared to previous years. Even if in previous years the NIO had determined and the NAO concurred that the amounts were not material, the Department should still have kept this position under review by collecting the necessary information and ascertained the year-end values. For 2018-19 however, the NIO did not have the information necessary to make an accurate estimate until after the year end, at which point it was not able to absorb the subsequent increase to RDEL.

AME breach - Stop and Search

The Police Service of Northern Ireland (PSNI) Legal Services had been dealing with claims brought against the Chief Constable in relation to the use of stop and search powers from September 2009 to May 2013 under the Justice and Security (NI) Act 2007. In January 2017 PSNI agreed to manage the claims, with the NIO making a contribution to costs in respect of this group litigation.

At a meeting on 28 February 2019 between the Crown Solicitor's Office, NIO and PSNI to determine an apportionment of damages and costs, it was agreed (subject to Ministerial approval) that NIO would accept liability for 80% of the costs, a payment of £509k.

The NIO had been aware of this potential financial liability for some time and it had been included in the Financial Risk Register. An early decision to create a provision for an estimated value of liability should have been taken, but was not. At the time, the NIO financial risk register was not designed in a way that would automatically indicate a need for a financial provision as set out in IAS 37. Nor did the Department at that time judge there was sufficient certainty of the cost to justify bidding to HM Treasury for additional AME provision in the supplementary estimates.

AME breach - the Electoral Office of Northern Ireland (EONI) Voluntary Exit Scheme (VES)

The Electoral Office for Northern Ireland (EONI) and the NIO published a joint consultation in October 2016 to consider the future delivery model for electoral services in Northern Ireland. This sought views on a range of measures to modernise and improve the provision of electoral services. Publication of the consultation response was delayed until June 2018 due to political uncertainty.

Following publication, the Chief Electoral Officer of EONI moved to implement digital registration and centralise the electoral services which had previously been delivered through seven local offices and the headquarters in Belfast. Five offices remained open to deal with forthcoming elections but the plan was to close these after the local elections in May 2019. Plans had been discussed with staff and unions during 2018-19, though official documentation regarding the VES was not issued to staff until April 2019.

The NIO was aware of the intention to offer a VES to a known number of staff from June 2018, and therefore that there would be an estimable financial liability, even though an accurate valuation of that liability was not reached until after 31 March 2019. The NIO had planned to fund the potential costs from within the 2018-19 budget, thereby forgoing the need for a provision. It was not until late in the year that it became certain the costs would fall in 2019/20, at which point it was too late to request the necessary AME at Supplementary Estimates.

Considering the level of uncertainty, I accept that NIO should have been more prudent and requested the necessary AME cover via the Supplementary Estimates.

Specific steps that have been taken to minimise the risk of such issues arising in future

Since taking over responsibility as Accounting Officer in February 2020, I have sought to understand what went wrong in the 2018-19 financial year and to ensure both that lessons have been learned since these breaches occurred, and that further steps have been since taken to minimise future risk.

Regarding accruals for external legal costs:

The NIO has accepted the need to do this in a more systematic and ongoing way. The Crown Solicitor attended the Audit and Risk Committee meeting in January 2020 and confirmed that all counsel instructed in NIO cases are now required to provide a figure for their outstanding fees as at 31 March 2020.

This exercise will be repeated annually to establish the figure for outstanding fees at year end for inclusion in the NIO accounts. Furthermore, counsel have been reminded by the Crown Solicitor of the requirement (stated in their terms and conditions of appointment to the Government Legal Service for Northern Ireland Civil Panels) to submit fee notes fourteen days following conclusion of a case and, in long running, cases bi-annually. This should ensure more accurate year-end figures are available and verifiable for accounting purposes.

Regarding the NIO Financial Risk Register:

EY and NAO recommended in the 2018-19 Audit Completion Report:

- *that the risk register is redesigned to ensure that it captures the information required for management to ascertain if a provision is required in line with IAS 37.*

- *that the register should be reviewed in conjunction with input from the finance team on a monthly basis to enable any changes to be actioned. This will also enable external legal costs to be captured fully and appropriately accrued.*

The NIO has accepted these recommendations. The risk register has been redesigned and guidance issued to staff on its use. Deputy Directors across the department now have responsibility to ensure that the register is immediately updated when circumstances of a current risk change or a new risk emerges.

The risk register is regularly reviewed by the Head of Finance and was discussed in detail with EY and NAO at the NIO ARC in January 2020. Discussion of the risk register will be a standing item for internal discussion between finance and NIO business areas in 2020/21. This enhanced communication across the department regarding financial risk should significantly improve the assurance that all potential costs are being accounted for correctly.

Maintaining NIO internal controls within the spending limits set by Parliament

I take my role as Accounting Officer at the NIO extremely seriously and I am fully aware of my personal responsibility for the regularity and propriety of expenditure, robust evaluation of different mechanisms for delivering policy objectives, value for money, the management of risk and accurate accounting for the use of resources.

I derive assurance for this from the NIO's governance structures and through close communication with the Audit and Risk Committee, the internal and external auditors, and the NIO finance team. Together, these ensure that the department's system of internal controls is robust, enabling me to monitor the use of resources and the delivery of agreed policies and objectives. Since I started in the role of Accounting Officer, the

NIO has reviewed its governance arrangements and established an Executive Committee (which I chair). This Committee is focussed on operational leadership, management and direction, ensuring the most effective prioritisation of resources to deliver our aims and objectives within the spending limits set by Parliament. It has a standing item to look at financial matters and has commissioned an internal audit review in 2020-21 to check that the improvements and changes put in place after the 2018-19 audit have been embedded across the entire department.

The NIO’s Audit and Risk Committee was fully involved in working through the impact and response to the breaches at the time of the 2018-19 audit, and has been instrumental in ensuring that recommendations arising from that audit have been addressed. I have discussed these matters extensively with the Chair of the Audit and Risk Committee since taking up my position. I am grateful for her work to help the NIO improve financial governance, ensuring that in future issues will be escalated quickly to enable a decisive response when required.

As you have noted, my predecessor indicated that he did not believe that the breaches that occurred in 2018-19 were indicative of significant weaknesses in internal controls at the NIO. I have now reviewed the events that led to the breaches, and have taken steps to ensure that the lessons identified by my predecessor after that audit have been both learned and embedded across the organisation. I am confident that the necessary steps have been taken to address the issues and minimise the risk of a recurrence.

I would, of course, be happy to provide you with any further detail you may require.

I am copying this letter to the Comptroller and Auditor General.

Yours sincerely,

Madeleine Alessandri
Permanent Secretary
Northern Ireland Office