



PERMANENT SECRETARY

D/PUS/11/7/1(60)

19 February 2018

Meg Hillier
Chair of the Public Accounts Committee
Sent electronically

Dear Chair,

CONTINGENT LIABILITIES

Further to my letter of 22nd January which confirmed the legal position on the DE&S contracts and responded to other points raised at the oral evidence session, you wrote again on 29th January requesting consideration of how the Department might more rigorously assess the levels of liability in cases where they are categorised as unquantifiable.

As previously noted by the National Audit Office [NAO Report: Evaluating the government balance sheet: provisions, contingent liabilities and guarantees (HC 462 session 2016-17 30 June 2016)], provisions and contingent liabilities are inherently difficult to measure because the size, probability or timing of any future payments is uncertain. Whilst I recognise and agree with the need for rigorous risk assessment to understand the potential liabilities against individual contracts, and to provide HM Treasury and Parliament with an estimate of potential costs wherever possible, this assessment also needs to be balanced and realistic.

Where the Department identifies a present obligation which we know will require a future payment - nuclear decommissioning costs for example - we recognise this as a provision. In cases where there is a possible obligation that may not occur but would result in a requirement for a future payment if it did – such as environmental clean-up costs following a nuclear incident - we recognise this as a contingent liability. In all cases where the Department permits suppliers to limit their contractual obligations there is a value for money assessment made on who is best placed to hold a risk, government or the supplier. Only where there is a value for money case will the Department agree to holding the risk and in these cases too we recognise a contingent liability.

We endeavour to place a value against all such liabilities where it is possible to obtain a reliable estimate of potential costs, should certain circumstances materialise. Only in cases where it is not possible to obtain a reliable estimate, due to the nature, scope, range and

scale of possible scenarios that might occur, are contingent liabilities treated as unquantifiable. The majority of cases where it has not been possible to quantify the risk are for those contingent liabilities where there is only a remote possibility of occurrence.

Going forwards, we will ensure that the rationale for contingent liabilities is more clearly justified through the approvals process. We are already working more closely with HM Treasury to better articulate the maximum exposure and potential examples of the scenarios that could lead to unquantifiable contingent liabilities. In assessing the potential of a contingent liability occurring we have recently engaged Government Actuaries Department to help measure the likelihood of the risks crystallising.

The Department will write to the Committee in March on the outcome of the wider review on Contingent Liabilities. It is possible that further instances may arise from this.

I am copying this letter to the Comptroller and Auditor General and to the Chair of the House of Commons Defence Committee.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Stephen L', is positioned above the printed name.

STEPHEN LOVEGROVE