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Mr Mike Hedges AM
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Pages	**1** of **3**

Dear Mr Hedges

STUDENT LOAN BUDGETING ARRANGEMENTS

I am responding to the query that you raised at the Public Accounts Committee on 15 July 2014, and subsequently by email, in response to the Auditor General's suggestion that the Committee could explore issues relating to the student loan book when scrutinising the Welsh Government's 2013-14 consolidated accounts. During the Committee meeting, you questioned some of the comments I made about the way in which costs associated with student loans are met. You referred then in general terms to the loan book and the debt associated with it. However, I note that your email referred specifically to your belief that, in respect of the potential effect on the Welsh budget of the loan book, it would not cause any change in the AME (Annually Managed Expenditure) because it was effectively covered by the Treasury.

It was the distinction between the AME and Departmental Expenditure Limit (DEL) budgeting arrangements that I was seeking to highlight in my comments to the Committee on 15 July. I confirmed then your understanding that, in principle at least, the issuing of student loans is underwritten by the Treasury as AME. The Welsh Government is able to draw down additional AME funds from HM Treasury if required. Unspent funding, due to lower-than-expected demand, has to be returned to HM Treasury.

From its main DEL budget the Welsh Government has to account for an annual adjustment based on the estimated level of future loan policy write-offs, for example because of death, students' earnings not reaching the repayment threshold or loans not being fully repaid by the end of the repayment period. This adjustment also takes into account the interest subsidy on student loans – the difference between the market rate and the interest actually charged to students. We referred to that charge in our November 2013 *Higher Education Finances* report as the 'loan policy write-off' charge, although it is referred to in the Welsh Government's budget as the Resource Accounting and Budgeting (RAB) charge.

Paragraphs 2.7 to 2.16 in our report related to the Welsh Government's arrangements for monitoring forecast student finance income and expenditure and the associated risks. Paragraph 2.9 in our report noted that it is important that the Welsh Government has at its disposal in sufficient time the information needed to accurately estimate the amount of AME cover required to make student loan payments. Our report noted that there had been some difficulties in that regard in late 2012-13. On that occasion, the Welsh Government was able to negotiate a change to cover a prospective budget shortfall late in the budgetary process. In reporting on this issue, the Welsh Government's internal auditors noted that that option was unlikely to be available in future and could result in serious consequences for Welsh Government budgets.

We noted in our report that changes to the way in which the student loan book is valued and RAB charges calculated – the adoption of a new model developed by the UK Government – were likely to necessitate a one off 'stock-charge' to the value of what had been estimated to be around £326 million. The Welsh Government had also estimated that the move to the new model could see RAB charges increase by around five per cent. Our report summarised briefly the consideration that the Welsh Government had given to other options for its future modelling of the loan book. In considering other options, which would themselves have been likely to result in an additional stock-charge, the Welsh Government had been mindful that the Treasury may have been less likely to cover that charge if the Welsh Government had not adopted the model in use elsewhere in the UK. Even when deciding, in September 2013, to adopt the UK-wide model, Treasury cover was not guaranteed. However, the Welsh Government considered it likely given that the Treasury had covered the equivalent charge when the same model was adopted in Scotland and Northern Ireland.

In February 2014, the Welsh Government laid its 2nd Supplementary Budget Motion for 2013-14. The explanatory note accompanying the budget motion pointed to various changes to the budget arising from the need to reflect the stock-charge and changes to the RAB charge rate. The supplementary budget pointed to the transfer in of £326,450k of non-fiscal resource from the Treasury to cover the stock-charge and an increase in the RAB charge rate. However, the Welsh Government's consolidated accounts for 2013-14, laid on 30 July 2014, note the following with regard to the additional non-cash cover from the Treasury:

> *Governance statement (page 24)*: "During the finalisation of the figures for the 2013-14 financial year, it was reported that some data inputting errors had occurred. This resulted in a shortfall of £25.6m in non-cash provision because the error was identified too late to bid for additional non-cash cover from Treasury. This has resulted in a breach of the Department for Education and Skills Ambit Resource Limit by £10.1m. This was an isolated administrative failure which does not give rise to any concerns about the underlying affordability of the student finance model. An investigation has been commissioned to ensure controls are strengthened to avoid a similar occurrence in future years."

> *Note 11 on financial assets (page 49)*: "The statistical model used has changed in the year resulting in a large one off adjustment to the value of the loans. This adjustment represents extra provision needed as over the past few years interest rate and earnings forecasts have been lower than expected. In addition, during the last quarter of 2013-14 an error was identified that created an additional write off of loans in year which resulted in a £25.6m over spend in non-cash within DfES. The error occurred post the supplementary budget and, therefore, although there were underspends elsewhere within Welsh Government, a transfer was not actioned and hence DfES exceeded its departmental ambit by £10.1m. A lessons learned exercise has been undertaken to prevent a similar error occurring in future."

The Welsh Government noted in its governance statement that a further new model for the valuation of student loans is being worked on. The Welsh Government indicates that any new model will need to be fully tested and adapted for Welsh policies, such as the partial cancellation of maintenance loans, before any move to it this year. The change to the new model could result in further stock-charges and changes to the RAB charge for which, again, the Welsh Government may need to seek cover from the Treasury. In January 2014, the Treasury updated Chapter 8 of its 'Consolidated Budgeting Guidance from 2013-14'. The revised Chapter 8 reflects changes in the budgeting treatment of student loans. The Committee might wish to explore with Welsh Government officials the possible implications of these changes.

I hope that this letter helps to clarify why, in the Auditor General's previous letter, he noted that there were issues relating to the loan book that the Committee could explore with the Welsh Government as part of an evidence session on the consolidated accounts. The Welsh Government's Department for Education and Skills has recognised that if forecasts for the student loan book are not accurate, this presents an on-going risk to the Department's budget which could limit the Department's ability to afford a higher demand on student finance or to fund other priorities.

I apologise if my response, in the short discussion during the meeting on the 15 July, was insufficiently clear. Because you raised this issue as part of the Committee's evidence session on 15 July, I am copying this letter to the Chair of the Committee and to the clerking team so that it can be used to inform any background briefing for the planned evidence session on the consolidated accounts.

Yours sincerely

Matthew Mortlock
Director Performance Audit

cc. Darren Millar (Chair of the Public Accounts Committee)
Michael Kay (Clerk to the Public Accounts Committee)