



National Audit Office

The budget for the London 2012 Olympic and Paralympic Games

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 612 Session 2006-2007 | 20 July 2007

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SUMMARY

1 This is the second in a series of National Audit Office reports on the preparations for hosting the London 2012 Olympic and Paralympic Games. It examines the development of the budget – costs, provisions and funding – for the venues and infrastructure required to host the Games and related costs such as security. The development of the budget has been led by the Department for Culture, Media and Sport (the Department), with input from the Olympic Delivery Authority and the Treasury. A summary of the development of the budget over time is at Appendix 1.

Overview

- 2** On 15 March 2007 the Secretary of State for Culture, Media and Sport (the Secretary of State) announced to Parliament the budget for the Games and infrastructure associated with the Olympic Park and other venues totalling £9.325 billion (**Figure 1**).¹
- 3** References to the ‘budget’ for the Games tend to focus on those costs that are to be publicly funded and therefore exclude the staging costs to be incurred by the

¹ Hansard, 15 March 2007, Columns 450-452.

Summary text continued

London Organising Committee of the Olympic Games and Paralympic Games (LOCOG), which is intended to be self-financing.² As required by the International Olympic Committee, however, the Government is the ultimate guarantor of funding for the Games, including LOCOG's staging costs.

4 At the time of London's bid to host the Games the estimated gross cost of the Games was £4 billion comprising £2.992 billion core Olympic costs plus £1.044 billion for infrastructure on the Olympic Park. These costs were to be met by a public sector funding package of £2.375 billion for the core Olympic costs, £1.044 billion Exchequer funding for the infrastructure, plus an anticipated £738 million from the private sector.

5 The £9.325 billion budget announced in March 2007, which the Department for Culture, Media and Sport has told us represents the upper limit on the funding available for the Games from the public sector, is some £5.289 billion higher than the cost estimate at the time of the bid in gross terms (**Figure 2 overleaf**). Within this overall increase, the cost estimates (before deduction of anticipated private sector funding) for those elements which the Department defines as the 'core' costs of the Olympics are £1.1 billion higher than the estimates at the time of the bid (see Figure 6 on page 16). However, these 'core' costs exclude programme contingency, tax, and policing and wider security.

1 The budget as announced for the Games on 15 March 2007

Costs and provisions ¹	£ million	Public funding available	£ million
Olympic Delivery Authority (ODA) Olympic costs			
Olympic Delivery Authority Core Olympic costs	3,081		
Infrastructure and regeneration costs associated with the Olympic Park and other venues	1,673	Exchequer	5,975
Contingency (excluding tax) ³	500	National Lottery	2,175
Total (net of tax)	5,254	Greater London Authority	925
Other (Non ODA) Olympic costs²	388	London Development Agency	250
Other provisions			
Policing and wider security	600		
Tax (on ODA costs)	836		
General programme contingency (including tax) ³	2,247		
Grand total	9,325		9,325

Source: Department for Culture, Media and Sport

NOTES

- 1 The costs are net of £165 million of private sector funding (further details are provided in Figure 7 on page 17).
- 2 Other (Non ODA) Olympic costs such as support for elite and community sport to be met from public funding.
- 3 The Department's intention was that there would be a contingency of £2.747 billion (as reflected in the Secretary of State's statement of 15 March 2007). This contingency was intended to cover potential financial pressures on the construction of venues and infrastructure, potential increases in the £600 million costs of policing and security and cost increases arising from factors such as unforeseen ground conditions, inflation beyond existing provision, or changes in legislation. The Department intended that an initial amount of £500 million of the contingency would be given to the Olympic Delivery Authority to enable it to manage early pressures.

2 The staging of the Games is intended to be self-financing with the exception of a fifty per cent contribution in 2012 towards the costs of the Paralympics (a provision of £66 million was made in the March budget to cover this obligation).

2 The difference between the estimates at the time of the bid and the March 2007 budget

	Estimate at the time of the bid (£ million)	March 2007 budget (£ million)	Difference (£ million)
Net cost of the Games to be met from public sector funding	3,298 ¹	9,325 ²	6,027
Expected private sector contribution ⁴	738 ¹	165 ²	(573)
Gross cost of the Games ⁴	4,036 ¹	9,325 ²	5,289
Public funding available	3,419 ³	9,325 ³	5,906

Source: National Audit Office drawing on information from the Department for Culture, Media and Sport

NOTES

1 See paragraph 34 on page 15.

2 The Department told us that, should the anticipated £165 million private sector funding not materialise, this would be met from within the contingency provision (which is included within the £9.325 billion) or from a reduction in costs. Therefore, the gross and net cost of the Games as stated here are the same, with the £9.325 billion representing the Department's upper limit on public funding for the Games.

3 See paragraph 37 on page 18.

4 The figure for gross cost of the Games includes the expected public sector contribution to the cost of the Olympic Village, but does not include the gross cost of the Village itself, which is expected to be largely funded by the private sector. Similarly, the figure for expected private sector contribution does not include the expected contribution to the cost of the Village.

6 This increase in cost estimates, along with a reduction in anticipated private sector funding, means that public sector funding for the Games has increased by £5.906 billion (Figure 2). The costs to be covered by this increase in funding include £1.173 billion of tax³ which will ultimately flow back to the Exchequer. On the basis that the Department has confirmed to us that the tax liabilities associated with the Games will be met entirely from Exchequer funding, this means that the net increase in public sector funding should be £4.733 billion. The funding increase of £5.906 billion includes contingency of £2.747 billion which the Department has made clear to us may not be used in full.

7 The main reasons for the difference between the cost estimates at the time of the bid and the budget announced in March 2007 are:

- A new provision of £2.747 billion for programme contingency (including £337 million of tax).
- A new provision of £836 million for tax, following the Treasury's confirmation that the Olympic Delivery Authority would be liable to VAT in the normal manner and unable to reclaim it (which, although a real cost to the Games, will flow back to the Exchequer).
- A new estimate of £600 million for policing and wider security (which remains subject to further oversight and scrutiny).
- An increase in the Olympic Delivery Authority's programme delivery budget from £16 million to £570 million (the original estimate of £16 million

at the time of the bid was based on the costs of a small Urban Development Corporation and did not include the costs of complex site logistics, or a delivery partner to undertake programme and project management which the Department and the Delivery Authority deem necessary for successful delivery of the venues and infrastructure).

- A decrease in anticipated private sector funding from £738 million to £165 million. This excludes, however, the significant increase in the estimated private sector contribution to the Olympic Village which is outside of the budget. It also excludes any receipts from future sales of land and property after the Games, out of which the Government has since estimated, in June 2007, that £675 million would be available for repayment to the National Lottery.

8 From the outset of any programme or project it is vital to use sound processes to establish a clear and accurate budget. The budget should not only set out the costs involved and the funding to meet these, but also the main benefits to be delivered, with a clear statement of any underlying judgements and assumptions. It enables stakeholders to plan and progress with confidence and certainty, and establishes a baseline against which to assess progress and performance. A programme of the scale, complexity and profile of the 2012 Games gives rise to a high level of inherent risk and uncertainty, and the need for significant judgements and assumptions about future costs and benefits. This increases the importance of adopting a rigorous and sound approach in establishing a budget for the Games.

3 £1.173 billion is the sum of £836 million and £337 million as set out in notes 5 and 6 to Figure 6 on page 16.

9 Against this background, our overall conclusion is that the budget announced by the Secretary of State in March 2007 represents a significant step forward in putting the Games on a sound financial footing and should help those involved in delivering the Olympic programme to move forward with greater confidence. The budget process followed since London was chosen to host the Games has been thorough, and the judgements and assumptions made by the Department and the Olympic Delivery Authority have been informed by detailed analysis and expert advice. Significant areas of uncertainty remain such as the finalisation of detailed design specifications, the legacy benefits to be delivered, how potential suppliers will respond to invitations to bid for work, and the impact of inflation in construction prices, as reflected in the high level of contingency that has been provided for. The Department and the Delivery Authority have continued to develop detailed project plans, budgets and cash flow analysis as a basis for cost control and financial management.

Main findings

10 Our main findings are as follows.

- The Department started work to develop cost and funding estimates for the Games in 2002, commissioning discrete pieces of work from Arup in 2002, from PricewaterhouseCoopers LLP in 2003 and 2004, and from Partnerships UK in 2004, prior to the submission in November 2004 of London's bid to host the Games. All made clear in their advice to the Department that significant uncertainties existed and that further work was required to develop robust budget figures, and this work was based on plans that have subsequently changed significantly. Although the Department anticipated that the public sector funding package that it had put in place would be sufficient, the Secretary of State for Culture, Media and Sport had also highlighted that there would be a need to take stock of the cost estimates should London's bid be successful.
- The budget announced in March 2007 was the result of a good deal of work during the course of an iterative process over some 17 months. Development of the budget was informed by advice from KPMG LLP and a number of other consultants with expertise in costing major projects. The cost estimates for the venues and infrastructure were built up using industry benchmarks and information from potential contractors and suppliers, and include allowances for uncertainty over design specifications which have not yet been finalised. The budget includes a number of new categories for costs and provisions which account for the bulk of the increase in costs from the time of the bid.
- The main areas of uncertainty that remain include the impact of construction price inflation, the response of contractors to the Olympic Delivery Authority's invitations to bid for work and the terms of contracts subsequently agreed, and the level of funding that can be secured from the private sector for building the Olympic Park.⁴ In view of the uncertainties and the tendency for the costs of major projects to be under-estimated, the budget for the Games now includes a programme contingency of £2.747 billion. The estimate of contingency was aggregated from broad assessments on each part of the programme, with reference to Treasury guidance and the experience of other Games. The Olympic Delivery Authority is to refine the estimate of contingency as individual projects go forward, by carrying out a more detailed assessment informed by quantitative risk analysis.
- The revised funding package announced by the Secretary of State in March 2007 is sufficient to cover the estimated costs of the Games and the contingency provision in full, so long as the assumptions on which it is based hold good. This is a most important proviso. Exchequer funding now accounts for £5.975 billion (nearly two thirds of the total), of which £5.570 billion is to be secured through forthcoming Spending Reviews. The National Lottery is expected to contribute £2.175 billion, the Greater London Authority £925 million and the London Development Agency £250 million.
- The expected funding from the National Lottery has increased by £675 million. This means that the total National Lottery contribution of £2.175 billion now includes over £1 billion which will be taken directly from the proceeds raised for the other non-Olympic good causes. The designated Olympic lottery games, expected to contribute some £750 million towards the total £2.175 billion lottery contribution, will also divert sales from mainstream lottery games. This is to be offset, as stated in the Secretary of State's budget announcement, by providing the other good causes with a share in the expected profits from the sale of land in the Olympic Park after 2012. As the ownership of the land rests with the London Development Agency, profits arising from land sales are not included in the Olympic Delivery Authority's budget. The profits will be shared with the Government, which in June 2007 expected to recoup for the lottery an estimated £675 million.

4 This does not include LOCOG's sponsorship income from the private sector to help meet the costs of staging the Games.

■ At the time of the announcement of the Games budget in March 2007 work to complete a cash flow forecast to show the timing and amount of expected future calls on funds had not been completed. While the Olympic Delivery Authority has an assessment of when spending will occur against the programme, following the Games budget announcement on 15 March the Department is developing a cash flow forecast to show the timing and amount of expected future calls on funds. Going forward it is likely that cash-flow requirements will vary year on year requiring effective and rapid decision making, and flexibility, on the part of funders. In turn funders will need regular, timely and accurate updated cash-flow forecasts from the Department and the Delivery Authority.

Recommendations

11 As we set out in our first report on the preparations for London 2012, the requirement for the budget to be clearly determined and effectively managed is one of the key areas of risk that need to be managed for successful delivery of the Games. The Department and the Olympic Delivery Authority are taking action in many areas and, now the top level budget has been finalised, their focus is on finalising the detailed plans needed to support the delivery of the Olympic programme, including a full detailed project plan over the whole life of the programme.

12 The box opposite sets out what we see at present as the key actions required to manage risk in relation to the budget for the Games. It is, however, important to recognise that the Games budget is just that – a budget not a target. Whilst effective risk management is essential, it is also important to seek opportunities where possible to manage within the available resources including the contingency if used, for example, by providing, where appropriate, suitable incentives for suppliers to come within the target cost for individual projects.

13 Within the actions required to manage risk, and acknowledging that the Department and the Delivery Authority have been doing further work in these areas, we have identified three aspects which require particular attention now.

■ **Producing a clear statement of the key deliverables that are expected in return for the public funding of £9 billion, making clear the time, cost and quality assumptions.** A statement of this kind would provide a basis for accountability to Parliament and the public by spelling out what is to be delivered, in terms of both the Olympic venues and infrastructure and the wider benefits. The outputs and outcomes should be specific and where possible quantified so it will be clear whether they have been achieved (for example, venue specifications and legacy benefits). And making clear the underlying assumptions means that any changes in cost or quality to achieve delivery should be transparent.

■ **Producing more robust estimates of contingency.** In line with Treasury guidance, provision has now been made for programme contingency which has increased the budget for the Games by £2.747 billion. The Olympic Delivery Authority now needs to take forward the work it has begun to refine the estimate of contingency so it better reflects the specific risks associated with particular elements of the programme. By more realistically reflecting the risk of additional costs, a risk based contingency should provide a better basis for effective cost control.

■ **Developing a cash flow analysis.** As well as the total amount of funding, the timing of funding is also vital so the Olympic Delivery Authority has money available and is not delayed in taking forward its delivery programme. Work is underway to develop a detailed project plan which will profile the Olympic Delivery Authority's expenditure (i.e. funding need) over the coming years. In the same way, the timing of the various sources of funding needs to be worked through and action taken in good time where the Olympic Delivery Authority's demand for funds is projected to exceed the supply. The Department is currently preparing a cash flow forecast, based on the Delivery Authority's draft detailed budget, to show the timing and amount of expected calls on funds.

The requirement for the budget to be clearly determined and effectively managed – action required to manage risk

Making clear what is to be delivered in return for the budget

- a Producing a clear statement of the key deliverables that are expected in return for the agreed funding package to provide a basis for assessing in due course whether they have been delivered (paragraph 82).
- b As part of this, finalising and making clear the legacy plans for the venues and facilities that will remain after the Games to address one of the remaining areas of cost uncertainty (paragraphs 51 and 83).

Establishing a detailed baseline for managing and controlling the budget

- c Finalising a detailed delivery plan showing when costs are expected to be incurred and the interdependencies between different elements of the Olympic programme.
- d Setting out the key assumptions that underpin the cost estimates and monitoring against these to provide early warning of potential budget implications if the assumptions prove not to be correct.
- e Being clear about the scope of the budget for the Games and where the boundaries lie between the Olympic Delivery Authority and LOCOG (in particular the boundary between venue construction and fit-out), and with other bodies, such as the Home Office, who will be spending money in support of the Games (paragraphs 55 and 56).
- f Capturing data on the costs of the Games consistently and in line with the definitions used in establishing the budget.
- g Communicating the detailed budget clearly to stakeholders and delivery partners so they share a common and clear understanding of the available budget and how it has been determined.

Managing the contingency effectively

- h Making the entire estimate of programme contingency more robust by underpinning the estimate with a systematic analysis of risk (paragraph 66).
- i Putting in place arrangements for managing the 'general programme contingency' of £2.247 billion (paragraph 67) and establishing clear criteria for its use.

Delivering the funding

- j Making clear how and when the £6 billion of Exchequer funding will be made available to the Olympic Delivery Authority (paragraphs 69 and 75).
- k Confirming how and when the £1.1 billion of funding to be provided from 2009 from general National Lottery proceeds will be made available to the Olympic Delivery Authority (paragraph 70).
- l Finalising a cash flow analysis for the Olympic Delivery Authority, being clear how the Authority's cash flow needs will be met and providing regular, timely and accurate updated forecasts to enable effective decision making on the part of funders (paragraphs 75 and 76).
- m Clarifying how requirements for funding and release of the contingency will be apportioned across the various funders. This will require clear and quick decision making and financial control (paragraph 77).

Exercising effective oversight of LOCOG

- n Exercising effective government oversight of LOCOG, including review of the assumptions underlying its separate budget for the staging of the Games, and monitoring against these, as LOCOG's financial position will determine directly the extent of any call on the Government's underwriting guarantee (paragraphs 57 and 58).



14 This is the second report by the National Audit Office on the preparations for hosting the Olympic and Paralympic Games in London in 2012. Delivering and funding the Olympic programme involves many bodies, and **Figure 3** sets out key facts about the governance and delivery structures for the Games.

15 Our first report on the preparations for the Games was published in February 2007⁵ and was an early look at the progress that had been made to put in place the necessary delivery and financial arrangements since London was chosen as the host city for 2012 in July 2005. The report set out the main areas of risk that need to be managed for the successful delivery of the Games (**Figure 4**). Our work on London 2012 is being informed by the experience of other host cities, and we have arranged with the Auditor General in China to learn lessons from the Beijing Games in 2008 that could usefully be applied to London.

16 Risk area 3 concerns the need for the budget for the Games to be clearly determined and effectively managed. Our first report on the preparations for the Games noted that we would be reviewing the work to establish the budget, with a view to reporting our findings when the budget had been finalised, and the Secretary of State for Culture, Media and Sport referred to this in her evidence to the Culture, Media and Sport Committee on 21 November 2006 and in her statement to Parliament on 15 March 2007 when she announced a revised budget for the Games. Following that announcement, we have completed our work to review the development of the budget. Our approach is described in Appendix 2. We were assisted in our work by HVR Consulting Services Limited.

17 This report is about the determination of the budget for the Games and the aim of our work was to assess whether the process underlying the development of the budget was sound. We shall report in the future on the management of the budget (the second part of risk area 3) and our future work will also focus on how well the money being spent on the Games is being used.

The categories of cost and funding associated with the Games

Costs

18 As explained in Figure 5 on page 12, there are potentially four categories of costs associated with the Games – **olympic costs, infrastructure and regeneration costs associated with the Olympic Park and other venues, staging costs and wider costs** – which are covered by different sources of funding. The main focus of this report is on the development of the budget for the Olympic Delivery Authority (which will incur most of the Olympic costs and all of the regeneration and infrastructure costs associated with the Olympic Park). Our first report on the Games⁶ included details of LOCOG's budget for staging the Games and consideration of the wider costs.

19 At the time of our first report, the Department had described the four categories of cost slightly differently, with spending on infrastructure projects in the Olympic Park split between 'Olympic' and 'non-Olympic' costs. (Some infrastructure costs were labelled as 'non-Olympic' because it was assumed that they would have been incurred as part of the planned regeneration of the Lower Lea Valley in East London but were being brought forward to facilitate delivery of the Games.) In announcing the new funding arrangements in March 2007, the Secretary of State described all spending on Olympic Park infrastructure as 'Olympic infrastructure and regeneration'.

⁵ Preparations for the London 2012 Olympic and Paralympic Games – Risk assessment and management (HC 252, Session 2006-07).

⁶ Preparations for the London 2012 Olympic and Paralympic Games – Risk assessment and management (HC 252, Session 2006-07).

3 Key facts about the governance and delivery structures for the Games

- There are **three principal Olympic Stakeholders** in the delivery of the Games – the Government, the Mayor of London and the British Olympic Association. A number of other bodies are also involved in delivering or funding the Games (for example, the Olympic Lottery Distributor).
- The **Olympics Minister (prior to July 2007 this post was held by the Secretary of State for Culture, Media and Sport)**. Olympic matters are overseen by a Ministerial Committee (MISC 25).
- The **Department for Culture, Media and Sport** is the lead government department for the Games. Within the Department, the **Government Olympic Executive** has been set up to manage the Government's interest in the Games and provide cross-government co-ordination.
- The **Olympic Delivery Authority** has been set up to prepare the Olympic Park site, build the new venues and provide for their legacy use, and deliver the Olympic Village, media facilities, infrastructure and transport projects. The Authority is a non-departmental public body, overseen by the Department for Culture, Media and Sport.
- The **London Organising Committee of the Olympic Games and Paralympic Games (LOCOG)** is responsible for the operational and staging aspects of the Games, and is the liaison point for the International Olympic Committee. LOCOG has been established as a private sector company limited by guarantee. It is accountable to the Department for Culture, Media and Sport, as well as its other key stakeholders, the British Olympic Association and the Greater London Authority, under the terms of a Joint Venture Agreement.
- The **Olympic Board** is responsible for co-ordinating the Olympic programme as a whole. The Board comprises the Olympics Minister, the Mayor of London, and the Chairs of the British Olympic Association and LOCOG. The Chair of the Olympic Delivery Authority attends Board meetings as a non-voting member. The Board is supported by the **Olympic Programme Support Unit**, which provides a programme office and secretariat function.

Source: National Audit Office

4 Main areas of risk that need to be managed for successful delivery of the Games as set out in the Comptroller and Auditor General's first report

- Delivering the Games against an immovable deadline.
- The need for strong governance and delivery structures given the multiplicity of organisations and groups involved in the Games.
- The requirement for the budget to be clearly determined and effectively managed.
- Applying effective procurement practices.
- Planning for a lasting legacy.
- The installation of effective progress monitoring and risk management arrangements.

Source: Comptroller and Auditor General's report 'Preparations for the London 2012 Olympic and Paralympic Games – Risk assessment and management' (HC 252, Session 2006-07)

Funding

20 The current 'public sector funding package', which funds core Olympic costs (see Appendix 3), comprises contributions from:

- the National Lottery, which includes the designated 'Olympic' lottery games, via the Olympic Lottery Distributor (although the Board of the Distributor can decide to fund any costs that it judges expedient and necessary to deliver the Games, whether specifically core Olympic costs incurred by the Olympic Delivery Authority or wider costs associated with the Games).
- the Greater London Authority and the London Development Agency (both of which are restricted to funding Olympic costs in London).

Exchequer funding has been used to meet 'Non-Olympic' infrastructure costs.

21 Under the new funding arrangements, announced by the Secretary of State in March 2007 (which will take effect from 1 April 2008), the Exchequer will also fund core Olympic costs. The release of Exchequer funds remains at the discretion of the relevant funding body. **Figure 5 overleaf** provides further details on the funding arrangements.

5 The costs associated with the Games

Cost category

Funding source

Olympic costs

a Olympic Delivery Authority Core Olympic costs

- Expenditure on building new venues and facilities, and on their legacy conversion.
- Expenditure on upgrading and enhancing existing facilities (for example, such as those at Weymouth and Eton Dorney).
- Expenditure on transport projects the Delivery Authority is contributing to.
- Expenditure on site security.
- Programme Management, including staff, accommodation, the contract with the delivery partner and on-site logistics.

b Other Olympic costs (Non ODA)

- The spending by the sports lottery distributors on support for community and elite sport.
- Public funding towards the running costs of the Paralympic Games.
- 'Look of London' costs (involving improvements to the streets in the vicinity of the Olympic Park).

Infrastructure and regeneration associated with the Olympic Park and other venues.

- Expenditure by the Olympic Delivery Authority on infrastructure in the Olympic Park, including preparing the ground to enable construction of the venues and creation of a park for legacy use.

Public funding from the:

- National Lottery, which includes the designated 'Olympic' lottery games¹
- Greater London Authority
- London Development Agency
- Exchequer

Some private funding

Government guarantees

Staging costs

- Expenditure by LOCOG on the operational and staging aspects of the Olympic and Paralympic Games.

- Funding to be raised by LOCOG, including income from the International Olympic Committee (for broadcasting rights etc.), ticket sales, sponsorship and official suppliers.

Wider costs

- Capital investment, for example to improve transport links in London.
- Expenditure by the London Development Agency to acquire the land for the Olympic Park.
- Services to support the delivery of the Games, such as security, policing London during the event and providing health services in the local area.
- Expenditure by the Department for Culture, Media and Sport, other government departments and other public bodies on staff dedicated to Olympic related work.

- The capital investment will be funded by contributions from the public and private sectors.
- Other expenditure is expected to be subject to the usual public spending and accountability arrangements.

Source: National Audit Office

NOTE

¹ National Lottery, which includes the designated 'Olympic' lottery games, funding distributed via the Olympic Lottery Distributor (OLD) can in practice be used to fund any specific element; the Board of the OLD has the discretion to fund any costs that it deems necessary or expedient and where a demonstrable need exists.

Guarantees

22 As required by the International Olympic Committee, the Government is the ultimate guarantor of funding for the Games. On behalf of the Government, the Chancellor of the Exchequer guaranteed that the Government will provide all the necessary financial support to ensure a successful Games. This includes acting as the ultimate guarantor of the construction costs of the infrastructure, venues and facilities necessary to hold the Games, and bearing the costs of providing security, medical and other government-related services for the Games.⁷ It also covers meeting any shortfall between LOCOG's costs and revenues.

23 Given the International Olympic Committee's requirement for the Government to guarantee the Games financially, in December 2003 the Department for Culture, Media and Sport reported to Parliament a contingent liability in the event of London winning the bid to host the Games.⁸

The basis for the budget at the time of London's bid to host the Games

24 This section of the report looks at the work that went on to develop cost and funding estimates ahead of London's bid to host the Games.

Early work before the decision to bid was made (early 2002 to May 2003)

25 The first work on costs was done in 2002 before the Government had decided whether it would support a London bid to host the Games. The Department, the Greater London Authority and the British Olympic Association jointly commissioned Arup to assess the costs and benefits of bidding for and staging the Games in London. Arup's work, carried out over 16 weeks, produced a high level cost-benefit analysis of a 'specimen' Games (excluding regeneration) for appraisal purposes, based on outline proposals for staging the Games in London which had been developed by the British Olympic Association. Although Arup was not asked to conduct a risk based probability assessment, their estimates contained some provision for risks associated with construction costs. In May 2002 Arup reported that, on the basis of the information available, the attributable

Olympic costs of the physical infrastructure and the costs of staging the 'specimen' Games would exceed the staging and land disposal revenues by £494 million⁹ at 2002 prices (which the Department considered was equivalent to a public subsidy of £1.1 billion at outturn prices).^{10, 11}

26 The Department, recognising the extent of uncertainty at this stage, subsequently commissioned PricewaterhouseCoopers LLP to produce a probability assessment of the impact of risk and uncertainty on the level of public subsidy required to host the Games. PricewaterhouseCoopers performed this work in January 2003. At this stage the precise location of the Olympic Park in London had not been finalised. PricewaterhouseCoopers concluded that there was an 80 per cent chance that the expected public subsidy for the Games would fall between £1.1 billion and £2.1 billion at cash outturn prices. Meanwhile, in late 2002 the Department began discussing options for funding the Games with other parts of government and the Mayor of London, informed by the earlier and ongoing work of consultants on the amount of funding likely to be required.

27 In January 2003 the Department stated in its evidence to the Culture, Media and Sport Select Committee that until it was able to achieve greater certainty it should allow for a higher potential public subsidy of around £2.5 billion and that there might always be exceptional circumstances which could make it even higher. This figure drew on the baseline work of Arup, the subsequent probability assessment of PricewaterhouseCoopers and high-level inter-departmental discussions. In May 2003 the Government announced it would support a London bid for the Games and agreed a memorandum of understanding with the Mayor of London which provided for a 'public sector funding package' of up to £2.375 billion to meet the costs of the Games (see Appendix 3).

Work to inform the bid for the Games (June 2003 to November 2004)

28 In May 2004 the Department commissioned PricewaterhouseCoopers LLP to produce a further report to identify and assess the potential gross costs and revenues related to the Games and the regeneration of the Stratford area of the Lower Lea Valley if London were to host the Games.¹² PricewaterhouseCoopers' work, carried out over

7 Letter from the Chancellor of the Exchequer to the President of the International Olympic Committee 10 November 2004.

8 Departmental Minute of 2 December 2003 Reporting Contingent Liabilities in the event of London winning the bid for the 2012 Olympic and Paralympic Games.

9 £494 million in net present value terms (discounted at 6 per cent per annum).

10 The Culture, Media and Sport Select Committee's report 'A London Olympic Bid for 2012', memorandum submitted by the Department for Culture, Media and Sport (Session 2002-2003, HC 268), January 2003.

11 Outturn prices take account of the effects of inflation to provide a more accurate estimate of what costs will be.

12 In looking at gross costs PricewaterhouseCoopers was not asked to consider whether any elements of these would have been incurred if the Games had not been held.

four weeks, was primarily based on estimates compiled by three key stakeholders – London 2012 Limited (the bid company), the London Development Agency and Transport for London. PricewaterhouseCoopers reported that the net costs associated with hosting the Games totalled some £4.5 billion in outturn prices (£6.2 billion gross, less an estimated £1.7 billion of LOCOG revenues). The costs were significantly higher than the estimates made in 2003 (see paragraph 24); in large part because of new assumptions about inflation, and the wider scope of the estimate (for example, the inclusion of associated infrastructure costs). After the report from PricewaterhouseCoopers the three stakeholders were asked by the department to look at their estimates with a view to identifying cost reductions and it was these revised estimates from which the bid was constructed (see paragraph 30).

29 PricewaterhouseCoopers also carried out a probability analysis and concluded that there was an 80 per cent chance that the final costs would be within plus or minus 10 per cent of its estimates. PricewaterhouseCoopers made clear, however, that great care needed to be taken in interpreting the estimates presented in its report, and that important risks and uncertainties existed which needed to be examined further. Among other things, PricewaterhouseCoopers highlighted that: there were some important but highly uncertain costs, notably those linked to security (the assessment of which was outside of PricewaterhouseCoopers' terms of reference); the estimates provided by the three stakeholders were based on different assumptions and had been subject to constant change throughout the period of the review; and the lack of a clearly defined legacy plan made it difficult to provide a comprehensive picture of the expected costs and benefits.

30 The Department also sought advice from Partnerships UK¹³ on the extent to which the costs of the Olympic facilities and infrastructure might be met by financing from the private sector. In June 2004 Partnerships UK advised that opportunities for private finance would be mostly limited to those elements of infrastructure that would continue to be used after the Games and could therefore support a Private Finance Initiative arrangement.¹⁴ Partnerships UK's preliminary view was there was potential to secure private

financing for the Games and it provided an indicative estimate of £1.336 billion (excluding any funding generated from the increase in land values as a result of the Games). Later in 2004, the Department, following discussion with relevant stakeholders about Partnerships UK's indicative estimate, reduced this estimate to £738 million.

The £738 million estimate of costs that might be met by financing from the private sector was the estimate in place when London's bid to host the Games was submitted in November 2004.

31 Partnerships UK had made clear, however, in 2004, that the information to support a robust analysis was not yet available, in particular there was, at that stage, no legacy plan which it considered would be the main driver for determining the extent of private sector funding. Partnerships UK concluded that further work was needed to develop the potential mechanisms for private financing and to work up a robust proposal for the purposes of supporting London's bid. Partnerships UK provided further advice in June 2005 and concluded that there was little prospect of securing significant private sector funding to deliver the Olympic Park, but that there remained the potential to secure private finance (for example, through a Private Finance Initiative type arrangement) to support the delivery of the venues and legacy.

The cost estimates at the time of the bid (November 2004)

32 Following the work by PricewaterhouseCoopers LLP on costs and the work by Partnerships UK on the potential for private finance, and the agreement of the public sector funding package, the Department continued to develop the cost estimates for the Games, in conjunction with other stakeholders, including the Treasury, the Greater London Authority, the London Development Agency and London 2012 Limited. The work focused on identifying cost savings, in particular on the infrastructure elements of the programme. Adjustments were made to the cost estimates, which fed into the London 2012 Candidate File which was presented to the International Olympic Committee in November 2004.

¹³ Partnerships UK is a joint venture between the government and private sectors, which provides advice on using partnerships between the public and private sectors to deliver infrastructure renewal and public services.

¹⁴ A Private Finance Initiative arrangement would involve a Unitary Charge payment (the sum paid to a contractor to cover the debt financing, maintenance and operating costs) as opposed to a net contribution from a private source.

33 The Candidate File set out planned capital investment in venues and facilities, Olympic Park infrastructure, and roads and railways, totalling \$15.8 billion (£9.9 billion)¹⁵, of which over two thirds (some \$11 billion (£6.9 billion)) related to transport improvements for which funding was already committed at the time of the bid. The Candidate File was approved by the members of MISC 25, the Ministerial Committee which oversees Olympic matters, and by the Mayor of London.

34 At the time of the bid, however, the net costs to be covered by the public sector funding package were £3.298 billion (£4.036 billion gross costs, including infrastructure costs of £1.044 billion, less the then £738 million anticipated private sector funding). Further details of the cost estimates at the time of the bid are set out in our first report on the preparations for the Games¹⁶ and are summarised at Appendix 3.

The budget for the Games

35 On 15 March 2007 the Secretary of State for Culture, Media and Sport announced to Parliament the budget for the Games and infrastructure associated with the Olympic Park and other venues. Her statement was the culmination of a process to review the costs and funding for the Games which began soon after London was chosen as the host city for 2012 on 6 July 2005.

Costs

36 The Secretary of State's announcement included costs and provisions for the Games and infrastructure associated with the Olympic Park and other venues (net of estimated private sector contributions of £165 million) totalling £9.325 billion (**Figure 6 overleaf**), providing a lifetime budget for the Olympic Delivery Authority of £5.254 billion (in 2006-07, its first year of operation, the Olympic Delivery Authority's spending totalled £210 million). The budget also includes new provisions for tax (which, although a real cost to the Games, will flow back to the Exchequer) and contingency. The budget announced in March 2007 is some £5.289 billion higher than the cost estimate at the time of the bid in gross terms. The cost estimates (that is, before deduction of anticipated private sector funding) for those elements which the Department defines as the 'core' costs of the Olympics are £1.115 billion higher than the estimates at the time of the bid. However, these 'core' costs exclude programme contingency, tax, and policing and wider security. The main reasons for differences between the budget and the cost estimate at the time of the bid are set out in **Figure 7 on page 17**.

¹⁵ As required by the International Olympic Committee, the estimates in the Candidate File were expressed in US dollars at 2004 prices. The costs were estimated in pounds sterling and converted into US dollars for the Candidate File, using an exchange rate of £1=\$1.6.

¹⁶ Comptroller and Auditor General's report *Preparations for the London 2012 Olympic and Paralympic Games – Risk assessment and management* (HC 252, Session 2006-07).

6 The budget for the Games as announced on 15 March 2007 – costs¹ and provisions

Costs and provisions	March 2007 budget	Change from the cost estimates at the time of the bid	
	£ million	£ million	
Olympic Delivery Authority Core Olympic costs			
Venues (including legacy conversion)	1,063	3	
Transport infrastructure and operating costs	794	94	
Additional inflation allowance, contribution to the Olympic Village and Insurance ²	386	386	
Programme Management	570	554	
Site security	268	78	
Sub-Total	3,081		1,115
Infrastructure and regeneration costs associated with the Olympic Park and other venues (to be incurred by the Olympic Delivery Authority).	1,673	(11)	(11)
Contingency (excluding tax) ³	500	500	500
Olympic Delivery Authority budget (net of tax and general programme contingency)		5,254	
Other Olympic (Non ODA) costs (to be met from public funding)			
Support for elite and community sport	290	(10)	
Paralympics ⁴	66	12	
'Look of London' costs	32	0	
Sub-Total	388		2
Other Provisions			
Tax (on ODA costs) ⁵	836	836	
General programme contingency (including tax) ⁶	2,247	2,247	
Sub-Total	3,083		3,083
Wider costs			
Policing and wider security	600	600	600
Total⁷	9,325		5,289

Source: National Audit Office analysis of Department for Culture, Media and Sport data

NOTES

1 Costs are net of estimated private sector contributions of £165 million.

2 The split between Exchequer and private sector funding for the Olympic Village has not been agreed by the respective parties and therefore remains commercially sensitive. Hence the figures for inflation allowance, the Village and insurance are aggregated. The gross cost of the Olympic Village is not included in this budget.

3 An initial assessment at the time of the budget announcement of £500 million to meet known financial pressures on the construction of the venues and infrastructure. The £500 million excludes £88 million VAT which is provided for in the figure for tax under 'Other Provisions' (see note 5 below).

4 The Government's share (50 per cent) of the marginal cost of staging the 2012 Paralympics. The remaining 50 per cent is met by the Organising Committee (LOCOG).

5 £836 million tax comprises:

- £736 million VAT comprising 17.5% of the £1.673 billion costs of infrastructure and regeneration (£293 million), 17.5% of £2.034 billion of core Olympic costs (£356 million) largely comprising the costs of venues, security, logistics and delivery partner, and 17.5% of the £500 million contingency element (£88 million); and
- A notional sum of £100 million covering both Corporation Tax (set against the potential sale by the Olympic Delivery Authority of certain major venues in the Olympic Park) and stamp duty on any Delivery Authority acquisitions of land.

6 The general programme contingency comprises:

- £1,910 million contingency to reflect the risk of additional costs arising from factors such as unforeseen ground conditions, inflation beyond existing provision and changes in legislation. And potential increases in the budgeted £600 million costs of policing and security; and
- £337 million VAT comprising 17.5% of £1.929 billion contingency (before £19 million was transferred to security and wider policing which is VAT exempt).

7 The total cost estimate for the Games does not include the gross cost of the Olympic Village, which is expected to be largely funded by the private sector (but it does include the expected public sector contribution towards the Village – see note 2 above).

7 Main reasons for the increase in costs from the time of the bid to the budget announced in March 2007

Olympic Delivery Authority programme management costs – increased from £16 million to £570 million

At the time of the bid, the Department based its estimate of the resources the then proposed delivery body (the Olympic Delivery Authority) would need on the model of an urban development corporation. The Olympic Delivery Authority is now expected to require a significantly higher level of resources and this, together with the need to secure the necessary expertise within the timescales of the programme, has resulted in higher programme management costs. The £570 million programme management costs (excluding VAT) comprise:

- £344 million Delivery Authority staff costs and Delivery Partner costs. The Delivery Partner (CLM) is engaged on a framework basis. Under this arrangement there is no commitment for ODA to use CLM and it may use other project managers or recruit directly. While they have agreed staffing requirements and base level costs to July 2008 there is no contractual commitment beyond this date. It is therefore uncertain what the division of costs between ODA and CLM will be over the duration of the programme. The average monthly number of full time equivalent staff employed by the Delivery Authority during the year to 31 March 2007 was 152.
- £132 million for IT, rent, other property, communications, and other overheads, plus a relatively small amount for planning development control covering the running of the Delivery Authority's planning authority function (including staff costs, local authority liaison and overheads).
- £94 million for on-site logistics (including, for example, materials management, temporary roads and health facilities for around some 9,000 construction workers).

Tax costs – new provision of £836 million

Comprising £736 million for VAT (including on the costs of venues and infrastructure, and on running costs) and a notional sum of £100 million for corporation tax (as the Olympic Delivery Authority may in due course make a profit on the sale of assets) and stamp duty land tax. At the time of the bid, the tax status of the proposed Olympic Delivery Authority was undecided and the cost estimates at the time of the bid therefore excluded provision for tax. The Treasury confirmed in March 2007 that the Olympic Delivery Authority would be liable to VAT in the normal manner and unable to reclaim it. While a cost to the Games, all tax paid by the Delivery Authority will be a future receipt to the Exchequer.

Contingency – new provision totalling £2.747 billion

The Department's intention was that there would be a contingency of £2.747 billion (as reflected in the Secretary of State's statement of 15 March 2007). This contingency was intended to cover potential financial pressures on the construction of venues and

infrastructure, potential increases in the £600 million costs of policing and security and cost increases arising from factors such as unforeseen ground conditions, inflation beyond existing provision, or changes in legislation covering, for example, environmental protection or health and safety. The Department intended that an initial amount of £500 million of the contingency would be given to the Olympic Delivery Authority to enable it to manage early pressures (£88 million of VAT on this is included within the £836 million provision for tax).

The use of contingency is subject to approval by the Funders' Committee. At its first meeting on 21 June 2007 the Committee agreed to the immediate release of £360 million of contingency to the Olympic Delivery Authority. Contingency is covered further in paragraphs 60 to 67.

Policing and wider security costs – new estimate of £600 million

For policing and wider security, reflecting the international and national security situation, including the terrorist attacks in London on 7 July 2005 (but excluding on-site security during construction of the venues and infrastructure which is the responsibility of the Olympic Delivery Authority, and in-venue security which is the responsibility of LOCOG). The Secretary of State, when announcing the budget, stated that the £600 million figure would be subject to continued oversight and scrutiny by the relevant Cabinet Committee, the Home Secretary and the Olympic Security Directorate.¹ At that time the work on security estimates remained ongoing. The Home Office, which is responsible for co-ordinating wider security planning, has also commissioned further work in this area and it and the other affected departments (including those with responsibility for the emergency services) are considering the funding implications.

Private sector funding – reduced from £738 million to £165 million (excluding the Olympic Village)

The Department asked Partnerships UK to update its earlier work on the potential for securing private funding for the Olympic Park and legacy (see paragraph 30 to 31) in the light of developments to the Olympic plans. In June 2005 Partnerships UK advised that, with the exception of the Olympic Village, there was little prospect of being able to use significant private sector funding to deliver the Olympic Park due to the tight timetable (Partnerships UK for example, advised that the establishment of a Private Public Partnership typically takes 30 months) and a lack of clearly identifiable revenue streams. In the light of this advice, the Department reduced the estimate of private funding that could be secured.

This estimate of private sector funding does not include the expected private sector contribution to the Olympic Village, which is expected to be largely funded by the private sector (see paragraph 53).

Source: National Audit Office, drawing on information from the Department for Culture, Media and Sport

NOTE

¹ The Olympic Security Directorate is a multi-agency group led by the Assistant Commissioner of the Metropolitan Police. It comprises members from regional police forces and the emergency services.

Public funding

37 The Secretary of State announced a funding package of £9.325 billion to cover the costs and provisions set out in Figure 5, an increase of £5.906 billion on the public funding of £3.419 billion¹⁷ previously committed. **(Figure 8)** The contributions from the National Lottery and the Greater London Authority have increased, but the bulk of the additional funding is to come from the Exchequer, in line with the Government's commitment to underwrite the cost of the Games. The costs to be covered by this increase in funding include £1.173 billion of tax¹⁸ which will ultimately flow back to the Exchequer. The Department has confirmed to us that the tax liabilities associated with the Games will be met entirely from Exchequer funding¹⁹, which means that ultimately the net increase in public sector funding is £4.733 billion. The funding increase of £5.906 billion includes contingency of £2.747 billion which the Department has made clear to us may not be used in full.

8 The budget for the Games at March 2007 – public funding available

Source	£ million	£ million	Change from the funding at the time of the bid £ million
Exchequer funding		5,975	4,931
National Lottery			
Proceeds from designated 'Olympic' lottery games	750		0
Spending by the sports lottery distributors	340 ¹		0
General lottery proceeds transferred from the National Lottery Distribution Fund to the Olympic Lottery Distribution Fund ²	1,085		675
Sub-Total		2,175	675
Greater London Authority			
Council tax precept	625		0
Additional contribution	300		300
Sub-Total		925	300
London Development Agency		250	0
Total		9,325	5,906

Source: Department for Culture, Media and Sport

NOTES

1 Of the £340 million from the sports lottery distributors, £50.5 million will go towards the costs of the Aquatic centre and velodrome. The remaining £289.5 million will be spent by the distributors on continuing support for elite athletes and coaches, facilities for elite and community use, and community programmes.

2 The National Lottery Distribution Fund holds the money raised for good causes by the mainstream (i.e. non-Olympic) lottery games. The Olympic Lottery Distribution Fund holds the money raised for the Games from both the designated Olympic lottery games and that transferred from the National Lottery Distribution Fund.

17 The Public Sector Funding Package of up to £2.375 billion plus £1.044 billion Exchequer funding for infrastructure on the Olympic Park site (see Appendix 3).

18 £1.173 billion is the sum of £836 million and £337 million as set out in notes 5 and 6 to Figure 6 on page 16.

19 This is consistent with the March 2007 budget statement by the Secretary of State in which she made clear that the tax treatment of the Olympic Delivery Authority would have no impact on other funders.

The basis for the revised cost estimates

38 This section of the report looks at the development of the budget for the Games after London was awarded the Games. The budget announced in March 2007 was the result of a good deal of work during the course of an iterative process over some 17 months. Compilation of the budget was led by the Department for Culture, Media and Sport, with input from the Olympic Delivery Authority and the Treasury, and informed by advice from KPMG LLP and a variety of other consultants with expertise in costing major projects.

Work to develop the underlying cost estimates (July 2005 to March 2007)

39 In 2003 the Department had expected that the public sector funding package would be sufficient²⁰, although the Secretary of State had earlier highlighted in a statement to Parliament (15 May 2003) that there would be a need to take stock of the estimates should London's bid be successful. Following the choice of London to host the Games, the Department initiated a review of the cost estimates.

40 In October 2005 the Department commissioned KPMG LLP to review cost estimates for the Games (excluding LOCOG's budget for staging the Games). These estimates included:

- On **venues**, Davis Langdon LLP's estimate of costs. Davis Langdon (project and cost management consultants) reviewed the earlier estimates that Franklin Sports Business (the sport and leisure arm of Franklin + Andrews, a firm of cost consultants and construction economists) had prepared for London 2012 Limited to support the bid submission, and to bring these estimates into line with the revised masterplan for the Olympic Park (see paragraph 39). Davis Langdon examined the baseline costs produced by Franklin Sports Business against the specifications for each venue set out in the Candidate File and, where data was available, against industry benchmarks, incorporating their own allowances for design contingency and legacy conversion costs.
- On **infrastructure** (such as site clearance, roads and bridges), Faithful and Gould's estimate of costs. Faithful and Gould (project and cost management consultants in the property, industry and transport sectors) had been commissioned by the London Development Agency, prior to the bid, to provide

a cost estimate for the work on the Olympic Park infrastructure. They were subsequently engaged by the 'Interim Olympic Delivery Authority'²¹ to update this work. They built up cost estimates on the basis of a schedule of requirements, drawing on industry benchmarks and information from potential contractors and suppliers; and updated the estimates to reflect the revised masterplan for the Olympic Park. The cost estimates included allowances for design and construction contingency and, due to the early stages of design development, Faithful and Gould estimated that their figures were accurate to within plus or minus 20 per cent.

- The Olympic Delivery Authority's estimated programme management costs, based on likely staff numbers and salaries, the rental agreement for office space, and assumptions about administration (including likely payments to the Delivery Partner), IT costs and other overheads.
- The Olympic Delivery Authority's estimated transport costs, based on work carried out by Transport for London in advance of the bid. These estimates form the basis for the contributions the Authority has agreed to make to schemes being led by Transport for London, the Department for Transport, the Docklands Light Railway and Network Rail.
- The estimate for the Olympic Delivery Authority's site security costs. The policing element was developed in conjunction with the Home Office and the Olympic Security Directorate based on work done at an early stage which was then incomplete; and the site security element using private security consultants Intelligent Risks Limited, who had provided specialist services in security to the Sydney Games.

Work to identify cost savings

41 During 2006 the Department and the Olympic Delivery Authority, advised by KPMG LLP (whose contract was extended in January 2006 to provide advice on potential cost saving strategies), sought to identify the scope for savings in different areas of the budget, with a view to achieving value for money and reducing the extent of the gap between the new cost estimates and the funding package in place at the time of the bid. Between January and July 2006 changes to the 'masterplan' (the design of the Olympic Park) reduced some construction costs, at the same time as optimising the layout and enhancing legacy benefits. Other ways of reducing costs

²⁰ Government's response to the Culture, Media and Sport Select Committee report *A London Olympic Bid for 2012* (Cm 5867, June 2003).

²¹ From the time of the successful bid (July 2005) until the establishment of the Olympic Delivery Authority (April 2006) the London Development Authority and Transport for London operated as an 'Interim Olympic Delivery Authority'.

were also considered, including changes to the design of the Olympic venues. A good deal of work was done to identify where savings might be made and in total some £600 million of offsetting savings were identified.

42 Over the entire period from the work to inform the decision whether to bid to stage the Games to the most recent work on the revised cost estimates, there has been considerable input from a range of consultants²² over and above the costs outlined in the budget. These consultants have been commissioned by a range of public bodies involved in developing the cost estimates (or in some cases commissioned on a sub-contractual basis by other consultants). However, five pieces of consultancy have been at the heart of the Department for Culture, Media and Sport's review of the Games costs, at a total cost to the Department of some £1.5 million (**Figure 9**).

The cost review by the Olympic Delivery Authority's Delivery Partner

43 Further work on the cost estimates was carried out by CLM²³, the Olympic Delivery Authority's Delivery Partner (appointed in September 2006), as part of their early work to review the programme. The contractual arrangements with CLM link an element of their profits

to the savings they can achieve against an agreed detailed baseline cost for the projects for which they are responsible (in broad terms, the venues and infrastructure on the Olympic Park). Therefore CLM, as a first step, carried out a review of the cost estimates for each of these projects. CLM factored into their cost estimates a programme risk provision (equivalent to programme contingency – see paragraph 62), calculated using probability based risk modelling.

44 The Olympic Delivery Authority commissioned KPMG LLP to assist in comparing the Authority's cost estimates with those of CLM (to provide independent assurance given the link between CLM potential contractual earnings and the costs of the programme). This work showed a broad alignment between CLM's estimates and the Olympic Delivery Authority's budget at an overall aggregate level (the difference was £4 million on the £3.7 billion of work CLM was potentially responsible for at the time, subject to contractual agreement which had yet to take place). There were, however, variations in the cost estimates for individual projects and going forward the Olympic Delivery Authority and CLM are to agree a final budget as part of the business case for each project.

9 The consultants engaged by the Department for Culture, Media and Sport to assist in development of the Games' cost estimates

Stage	Consultants	Commissioner	Period of engagement	Cost (inc VAT)
Prior to the decision to bid	Arup (paragraph 25)	Department for Culture, Media and Sport, Greater London Authority and British Olympic Association	January – May 2002	DCMS share £81,000
	PricewaterhouseCoopers LLP (paragraph 26)	Department for Culture, Media and Sport	December 2002 – January 2003 ¹	£31,000
Preparation of the Bid (and between submission of the bid and the outcome)	PricewaterhouseCoopers LLP (paragraphs 28-29)	Department for Culture, Media and Sport	May – June 2004	£182,000
	Partnerships UK (paragraph 30-31, Figure 7)	Department for Culture, Media and Sport	May – June 2004 (and subsequently in June 2005)	£33,000
Since London won the right to host the Games	KPMG LLP (paragraphs 40-41)	Department for Culture, Media and Sport	October 2005 – July 2006	£1,190,000

Source: Department for Culture, Media and Sport

NOTE

¹ The PricewaterhouseCoopers probability assessment (see paragraph 26) was part of this overall engagement and was itself carried out in January 2003.

²² Consultancy in this context is defined as project based (time limited) work where the contractor is providing advice to a client, but the client is accountable for delivery (as opposed to outsourcing where the contractor is accountable for delivery).

²³ CLM are a consortium comprising CH2M HILL, Laing O'Rourke and Mace.

Assumptions about inflation

45 A key assumption underlying the cost estimates is the allowance for price inflation, in particular construction price inflation, in the period up to 2012. Over recent years, construction price inflation has been higher than the retail price index not only because of increasing demand for construction work combined with shortages in supply capacity in key areas, but because of worldwide shortages of key products such as steel leading to steep increases in prices.

46 In 2006 the Office of Government Commerce published an assessment of the impact on UK construction industry capacity of expected public sector demand, including the 2012 Games, over the period 2005-2015.²⁴ An output of the OGC study was an econometric model to enable scenario modelling of future demand using output price inflation²⁵ as a proxy measure for the effect of UK public sector demand on construction industry's capacity. While not intended to represent a robust forecast of construction price inflation (as it did not take account of all the external factors that might apply) the results indicated a rate of construction price inflation of just under four per cent.

47 A number of construction consultancy firms routinely track trends in prices and produce forecasts of construction price inflation²⁶, and some have produced specific analysis of the impact of the Games itself on tender prices in London and the South East. Most forecasts indicate that there will be an increase in construction prices in the run up to the Games, with some predicting a rise of between five and six per cent a year.

48 The Olympic Delivery Authority is using an inflation rate of five per cent a year to calculate the overall cost estimates for the Games. The budget also includes a separate provision of £161 million to allow for additional inflation of one per cent for construction related spend only, to give an overall rate of six per cent a year. While this inflation assumption is consistent with the latest industry forecasts, and represents a sound basis for establishing the budget, construction price inflation is difficult to predict accurately and prices can be volatile. This is an area that will require close monitoring as the programme goes forward.

The completeness of the budget

49 The budget for the Games includes a number of new categories, including a contribution towards the Olympic Village, tax and programme contingency. The new elements account for the bulk of the increase in costs and provisions from the time of the bid to the position announced in March 2007 (see Figure 6). The budget also now includes provision for policing and wider security costs, although other 'wider costs' are not included (see Figure 5), such as the London Development Agency's budget for acquiring the land for the Olympic Park and the costs of departmental staff carrying out Olympic related work (including the costs of the Government Olympic Executive within the Department for Culture, Media and Sport).

The main areas of uncertainty that could affect the budget

50 Regardless of the robustness of the budget process, estimates are by their nature uncertain to some degree, and the revised funding package for the Games will only be sufficient if the assumptions underlying the cost estimates hold good. This section of the report considers what the main areas of uncertainty are in relation to the revised budget for the Games, in addition to the overarching uncertainty about construction price inflation (see paragraphs 45 to 48).

51 In some areas the cost estimates are uncertain because the requirements of the task in hand remain uncertain or because plans have not been fully worked through. For example:

- The budget includes groundwork, remediation and demolition work on the Olympic Park but the extent of the work that will be needed in practice to prepare the site for construction is as yet unclear. The Olympic Delivery Authority cannot determine the full extent of land contamination until it has vacant possession of (and therefore access to) the full site, which is scheduled for summer 2007.
- The delivery of the venues and infrastructure of the Games is subject to planning applications. This means that uncertainty remains over the timescale for obtaining planning approvals, along with the nature of any associated conditions and obligations that arise.

²⁴ 2005-2015 Construction Demand/Capacity Study (June 2006). The report is available on the Office of Government Commerce website.

²⁵ Output price inflation measures movements in prices of construction work being carried out. It makes no allowance for project-specific cost increases due to, for example, fixed delivery deadlines or expectations-led inflation.

²⁶ For example, Franklin + Andrews, Gardiner and Theobald, EC Harris, and Davis Langdon.

- The cost estimates for the Olympic venues were based on the schedules of requirements set out in the London 2012 Candidate File (specifying, for example, the number of seats and the balance between permanent and temporary facilities) but detailed designs are still being worked up with LOCOG.
- The legacy plans and designs for the venues have not yet been finalised and these will have an impact on construction and legacy conversion costs.
- The revised cost estimates, compiled by the Olympic Delivery Authority with the assistance of KPMG LLP, were based on a high level project plan itself derived from the earlier work of other consultants. The project plan has been subject to subsequent revision following the appointment of CLM and their work to develop a detailed project plan as the basis for programme management and control is ongoing.

52 As described above, the cost estimates for the Olympic venues and infrastructure were built up using anticipated construction costs. In practice, the actual cost (the price paid) will depend on the response of contractors to the Olympic Delivery Authority's invitations to bid for work and the terms of contracts subsequently agreed. The immovable deadline for the Games means the Authority may have to manage a greater level of risk of cost overruns than is normally the case on many infrastructure projects where typically there may be greater flexibility to trade between cost, time and quality. The commercial arrangements on each project agreed by the Authority with their suppliers will need to address these risks, for example, through effective incentive systems for performance to cost.

53 A key contract currently being negotiated concerns the construction of the Olympic Village, which forms part of the wider Stratford City Development in East London. The Village will provide more than 17,000 beds for athletes and team officials, and at the time of the bid was expected to be fully funded by a public-private partnership (with an estimated £650 million, at 2004 prices, to be met from private finance²⁷). The Village represents a significant part of the Games' planned legacy as it will provide much needed housing in this part of London. The Olympic Delivery Authority now expects to make a contribution to the cost of the Village to compensate the private developer for holding on to the accommodation prior to the Games rather than being able to release units on to the market on, or in advance of, completion. The overall deal will include profit sharing arrangements with the developer. The amount to be paid, however, will remain subject to

a high degree of uncertainty until a deal on the Village is agreed and under any profit sharing arrangement will be dependent on market conditions after the Games. This uncertainty has been reflected in calculating the provision for programme contingency (see paragraphs 60 to 67).

54 As well as the Olympic Village, some other costs have been included in the budget net of funding from the private sector, albeit at a much lower level than the private funding expected at the time of the bid. In the light of further advice, including from Partnerships UK, the estimates for private sector funding now total £165 million (see Figure 7). However, until this funding is secured it will remain uncertain and the cash flow position is complicated by the fact that any income from the disposal of assets will not be received until after 2012, while the construction costs will start to be incurred well in advance of the Games.

55 Another source of income which helps to offset the cost estimates is assumed contributions from LOCOG to the Olympic Delivery Authority for 'overlay' works. In general terms, the Olympic Delivery Authority is responsible for constructing the venues and LOCOG is responsible for temporary construction works required for the staging of the Games and venue fixtures and fittings ('overlay' works). In practice the boundary between the two and the split of costs will be agreed between the Olympic Delivery Authority and LOCOG on a venue by venue basis as the need arises. The cost estimates for the venues have been compiled on the basis that the Olympic Delivery Authority will carry out the fit-out work, for which it will be reimbursed by LOCOG. The budget for the Games therefore assumes contributions from LOCOG totalling some £390 million, although these estimates have not been updated from the time of the bid or reconciled to LOCOG's budget and are the subject of ongoing commercial negotiations.

56 It is ultimately for LOCOG to determine, on a venue by venue basis, whether they directly appoint contractors to carry out these works or use the Olympic Delivery Authority. In each case the choice will need to be determined on a best value basis. If LOCOG does use the Olympic Delivery Authority for all or part of this work then the actual contractual and cost sharing arrangements will be subject to negotiation between the two parties. If LOCOG does not use the Delivery Authority the net impact on the Authority's budget is zero, because the Authority's costs and LOCOG's contributions will fall by equivalent amounts.

²⁷ Source: London 2012 Candidate File. The Candidate File figure of US \$1.040 billion has been restated here using the exchange rate of £1 = \$1.6.

57 More generally, the costs LOCOG will incur in staging the Games are not part of the budget announced by the Secretary of State as LOCOG is intended to be self-financing with the exception of a 50 per cent contribution in 2012 towards the costs of the Paralympics (a provision of £66 million was made in the March budget to cover this obligation).²⁸ LOCOG’s budget was, therefore, excluded from the budget review process begun after London was awarded the Games. The Department recognises, however, that oversight of LOCOG, as contemplated in the Joint Venture Agreement through which it is accountable to the Department and its other stakeholders, will be crucial as the Government has underwritten the staging costs of the Games.

58 The London 2012 Candidate File set out a budget for LOCOG of £1.5 billion (at 2004 prices). The cost and revenue estimates had been built up drawing on expert advice from financial consultants, people involved in previous Games and specialists in particular fields, such as sponsorship and transport. Since London was awarded the Games, LOCOG has converted the budget to outturn prices (producing a cash budget of some £2 billion) and kept the cost and revenue estimates under review. In the event that there is a shortfall between LOCOG’s costs and revenues, however, the extent to which the Government’s guarantee is called upon will impact on the cost of the Games to the public sector and this will therefore remain an area of ongoing uncertainty.

59 Finally, although developed in consultation with the Home Office and the Olympic Security Directorate, the cost estimates for policing and wider security (£600 million) were based on a preliminary assessment of the costs involved and will require regular review right up to the Games. They will be directly affected by the prevailing national and international security situation and require the involvement of multiple departments, associated agencies and the emergency services. These costs will be subject to continued oversight and scrutiny by the relevant Cabinet Committee, the Home Secretary and the Olympic Security Directorate in the light of the developing security assessment.

The basis for the contingency provision

60 Treasury guidance recommends that the budgets for major projects should be adjusted to include a contingency to allow for the observed systematic tendency for the benefits of a project to be overestimated and the costs and duration to be underestimated. This is known as ‘optimism bias’. The contingency provision should realistically reflect the risk of additional costs but not be overly generous so as to undermine the need for costs to be kept under control. Treasury guidance sets out adjustment ranges for ‘optimism bias’ for different types of project, based on data from large public procurement projects in the past (**Figure 10**).

61 The cost estimates at the time of London’s bid for the Games included contingency provision at the level of **individual projects**. These ranged from 10 to 23.5 per cent, principally to allow for the risk of cost escalation because of design uncertainties.

62 At the time of the bid, no provision was made for contingency for the Olympic **programme as a whole**. During the course of the budget review process, however, the Department and the Olympic Delivery Authority concluded that it would be appropriate to increase the budget to include programme contingency because of the general risk of ‘optimism bias’ and more specifically because of the complexity, and scale of the Olympic programme, the interdependencies of different elements of the programme, and the immovable deadline for delivering the Games. These factors bring significant risks of cost pressures with, for example, additional resources needing to be brought in to bring projects back on schedule.

10 Recommended adjustment ranges for ‘optimism bias’

Project type	Recommended percentage adjustment to capital expenditure	
	Upper	Lower
Standard buildings	24	2
Non-standard buildings	51	4
Standard civil engineering	44	3
Non-standard civil engineering	66	6
Equipment/Development	200	10

Source: Supplementary Green Book Guidance, HM Treasury

²⁸ Under the Host City Contract, the State is required to fund 50 per cent of the marginal cost of the Paralympic Games, with the other 50 per cent funded by the Organising Committee (LOCOG).

63 In assessing the appropriate level of programme contingency, the Department drew on Treasury guidance and other relevant research. The Department also sought to draw on the experience of previous Games but found that, while in general terms it was clear that final costs tended to be significantly higher than estimates made at the time of the bid, it was difficult to draw meaningful comparisons about the extent of costs and overruns (for example, due to differences in the scope of the budget at different Games).

64 The budget announced by the Secretary of State in March 2007 includes programme contingency of £2.747 billion (which represents some 42 per cent of the total budget less contingency), in addition to the design contingency provision at the level of individual projects which is included in core costs (see paragraph 61). This is at the higher end of the range for non-standard civil engineering projects set out in Treasury guidance (see Figure 10). Public knowledge of the scale of the contingency provision, the fact that the Government has underwritten the Olympic programme, together with the high public profile of the Games and immovable deadline, may influence the pricing strategies of suppliers. This underlines the importance of the Olympic Delivery Authority achieving competition where possible and driving value for money in its negotiations with contractors.

65 The £2.747 billion contingency is intended to cover potential financial pressures on the construction of venues and infrastructure, potential increases in the £600 million costs of policing and security, and cost increases arising from factors such as unforeseen ground conditions, inflation beyond existing provision, or changes in legislation covering, for example, environmental protection or health and safety (see Figures 6 and 7). The Department, the Delivery Authority and HM Treasury, agreed at the time of the budget announcement in March 2007, that an initial amount of £500 million of the contingency would be given to the Olympic Delivery Authority to enable it to manage early pressures on the construction of the venues and infrastructure.

66 In June 2007, the Funders Committee²⁹ reviewed the amount of contingency to be released to the Olympic Delivery Authority, based on the latter's assessment that its immediate need for contingency was £360 million. The Committee agreed to release the £360 million, and that

they should meet again in due course to consider how much of the remaining contingency should be released to the Delivery Authority and how much to retain for strategic purposes. As a basis for this the Delivery Authority has been asked to provide the Committee with a report setting out estimates of contingency at project level based on a more detailed risk assessment. As part of the business case for each project, the Delivery Authority is identifying the risks to delivery; estimating the probability that each risk will materialise and the likely financial impact; and establishing the level of contingency required to be 80 per cent confident that the project will be delivered to time and within the budgeted cost including any allocated contingency.

67 The Department and other funders are currently considering how the contingency provision of £2.747 billion should be managed, and the decision making and control arrangements that should apply. The proposal is for the Olympic Delivery Authority's access to the contingency funds (aside from the element for policing and wider security) to remain at the discretion, in the first instance, of the Funders Committee. The precise arrangements for making calls on the contingency (for example, whether each call on the contingency will be spread evenly across all funding bodies) remain to be determined. Additionally, where the use of lottery monies is involved, it will also be for the Olympic Lottery Distributor to consider whether this is then offered to the Delivery Authority in response to a specific application.³⁰ Ultimately, the arrangements will need to combine the need for clear and quick decision making, which as we reported previously is a key challenge on the Olympic programme, with the need for effective budgetary control.

The revised funding package for the Games

68 The revised funding package announced by the Secretary of State (see Figure 8 on page 18) is sufficient to cover the estimated costs of the Games and the contingency provision in full. As highlighted previously, the funding package excludes the staging costs to be incurred by LOCOG, which is intended to be self-financing. Any shortfall in funding would ultimately be covered by the Government, which has underwritten the costs of the Games (see paragraph 22).

²⁹ Comprising the Olympics Minister, the Secretaries of State for Communities and Local Government, and Transport, the Chief Secretary to the Treasury, and chaired by the Lord Chancellor, Ministry of Justice (who also chairs the Ministerial Committee which oversees Olympic matters).

³⁰ The Distributor's Board has a statutory duty to conduct its own deliberations on applications for funds. Therefore, whilst the Funders Committee may decide to release contingency funding to the Olympic Delivery Authority, the Authority would then separately have to seek drawdown from the Olympic Lottery Distributor of any element of the contingency provision to be met from lottery funding.

Exchequer funding

69 The Exchequer funding of £5.975 billion accounts for nearly two thirds of the total revised funding package. £405 million of this has been secured and the remaining £5.570 billion is planned to be secured through forthcoming Spending Reviews, which will confirm spending allocations for individual departments. The ongoing 2007 Comprehensive Spending Review will cover departmental allocations from 2008-09 to 2010-11, and allocations from April 2011 onwards will be subject to future Spending Reviews. As well as providing funding itself, the Department for Culture, Media and Sport will co-ordinate further contributions from other Departments.

National Lottery funding

70 In total the National Lottery, which includes the designated 'Olympic' lottery games, is now to provide up to £2.175 billion (subject to Parliamentary approval) of funding for the Games (Figure 8), which the Department estimates as 20 per cent of the total lottery income expected to be raised from April 2005 to March 2013. The revised funding package for the Games announced by the Secretary of State in March 2007 increased the amount to be taken from 2009 from general lottery proceeds held in the National Lottery Distribution Fund³¹ from £410 million to £1.085 billion (Figure 8). Of this, £638 million will come from the Big Lottery Fund and a total of £447 million from the other lottery distributors in proportion to their shares of lottery income (see Appendix 4), with the exception of UK Sport whose income the Department has decided to protect in recognition of UK Sport's role in supporting elite athletes to achieve success in the Olympic and Paralympic Games. This change requires the approval of both Houses of Parliament and before proceeding with the change the Department is consulting with the lottery distributors and other stakeholders.

71 Under the Horserace Betting and Olympic Lottery Act 2004, the Secretary of State for Culture, Media and Sport can transfer monies from the National Lottery Distribution Fund to the Olympic Lottery Distribution Fund³², reducing the sums available for dispersal by the funders of non-Olympic good causes.³³ The Department expects that the first transfer to the Olympic Lottery Distribution Fund will be in February 2009, at which

point these monies will become available for the Olympic Lottery Distributor to make grant payments to the Olympic Delivery Authority at its discretion.

72 Although the new designated Olympic lottery games which have been introduced are expected to generate some new ticket sales, they will also divert sales from mainstream lottery games. Estimates compiled by Camelot (the current operator of the National Lottery) in 2005 were that some £575 million of the £750 million being sought through the Olympic lottery games may be diverted from the non-Olympic good causes³⁴, and this together with the £1.085 billion to be transferred from the National Lottery Distribution Fund, means that the estimated reduction in the money available to the non-Olympic good causes is some £1.660 billion (Figure 11 overleaf). Camelot aims to mitigate the effect of the designated Olympic lottery games on the returns to the other good causes by increasing ticket sales across the board. Camelot's licence to operate the lottery expires on 31 January 2009; whichever company wins the competition for the next licence will be incentivised to maximise returns to the good causes.

73 In recognition of the National Lottery's contribution to the Games, the Government and the Mayor of London have agreed to put in place arrangements for sharing the profits that are expected to be generated by the increase in land and property values in the Olympic Park as a result of the investment for the Games. The arrangements are set out in a revised memorandum of understanding between the Government and the Mayor of London which was deposited in the House of Commons on 27 June 2007.³⁵ The arrangements are not legally binding. They do include an estimate of the receipts from sales of land and property following the Games that the Government expects to be available for repayment to the Lottery (some £675 million). There is no guarantee, however, that this sum will be available. It requires the achievement of a significant profit on land and property sales post the games, although it is also possible that the profits will be higher than estimated; the precise value will be dependent on prevailing market values at that time. Any profits will also have to be first used to reimburse the estimated land purchase costs of the London Development Agency (which are not expected to exceed £650 million).

31 The National Lottery Distribution Fund holds the money raised for good causes by the mainstream (i.e. non-Olympic) lottery games.

32 The Olympic Lottery Distribution Fund holds the money raised for the Games from both the designated Olympic lottery games and that transferred from the National Lottery Distribution Fund.

33 The non-Olympic good causes are: the arts; sport; heritage; charities and voluntary groups; and health, education and environment projects.

34 Prior to the introduction of the designated Olympic lottery games, Camelot estimated that some £440 million of the £750 million to be raised might come from players switching from existing games. This 'cannibalisation' rate varies according to the assumptions underlying the calculation but, using the same set of assumptions, the latest estimates supplied by Camelot to the National Lottery Commission in 2005 are that some £575 million may be diverted.

35 Revised Memorandum of Understanding between the Government and the Mayor of London (27 June 2007).

11 The impact of lottery funding for the Games on other lottery good causes

	Contribution to the revised funding package for the Games	Reduction in the money available to the non-Olympic good causes	
	£ million	£ million	
Proceeds from designated 'Olympic' lottery games	750	575 (estimated)	See paragraph 70
Spending by the sports lottery distributors	340	n/a	Note
General lottery proceeds transferred from the National Lottery Distribution Fund to the Olympic Lottery Distribution Fund	1,085	1,085	See paragraph 68
Total	2,175	1,660	

Source: Department for Culture, Media and Sport and National Lottery Commission

NOTE

£50.5 million (from Sport England) to be spent by the Olympic Delivery Authority, towards the cost of the Aquatics Centre and Velopark, plus £289.5 million which the distributors will themselves spend on support for elite and community sport (see Figure 8).

Funding from the Greater London Authority

74 In addition to the contribution of £625 million from London council tax payers, the revised funding package (Figure 8) also includes £300 million which the Mayor of London is to make available over the lifetime of the Olympic programme. The revised memorandum of understanding between the Government and the Mayor of London states that the additional £300 million will not be found from either an increase in the Council Tax precept or an increase in fares.

The timing and arrangements for funding

75 The Department is responsible for securing a smooth flow of funds to the Olympic Delivery Authority and has formed a working group of officials from the bodies providing public funding for the Games to consider and manage cash flow issues. However, there remains uncertainty surrounding the timing of much of the funding. Since the budget announcement, the Olympic Delivery Authority has prepared a more detailed draft budget, and provided this to the Department for Culture, Media and Sport in early May. On this basis the Department is preparing a cash flow forecast to show the timing and amount of expected calls on funds. This will inform the settlement in the ongoing Comprehensive Spending Review and beyond. In the meantime, cash flow will need to be closely managed, for example, during the course of 2006-07 a potential cash flow issue emerged for the Olympic Delivery Authority (Figure 12).

12 Cash flow issue for the Olympic Delivery Authority

The Olympic Delivery Authority has identified a potential cash flow deficit for 2007-08 of some £84 million (first notified to the Department in November 2006), with a risk of running out of funds in January 2008.

The Department expects the potential deficit will be eliminated by use of a combination of:

- Bringing forward £28 million of lottery funding, out of the £750 million to be raised from games specifically designated to raise proceeds for the Olympics, from future years into 2007-08. There will be no overall extra cost to the Lottery as it is a timing change, with the overall amount to be raised from these designated games remaining unchanged at £750 million. The actual offer of these funds to the Olympic Delivery Authority will remain subject to decision by the Olympic Lottery Distributor's Board.
- Meeting the balance of £55 million by utilising unspent grant from 2006-07, and if necessary, using receipts from the already programmed sale of land owned by the Department for Culture, Media and Sport.

Source: National Audit Office, based on information from the Department for Culture, Media and Sport and the Olympic Delivery Authority

76 Effective management of the timing of funding is important so that the Olympic Delivery Authority has money available and is not delayed in taking forward its delivery programme because certainty of payment, alongside the adoption of fair payment practices, will help to encourage a high level of supply chain performance and ultimately the delivery of good value for money. The Authority was among the signatories to the '2012 Construction Commitments' designed to demonstrate and develop good practice in the UK construction industry.³⁶ The commitments set out good practice principles which include a commitment to ensure effective and equitable cash flow for all those involved.

77 Beyond timing issues, the detailed arrangements for making calls on available funding have yet to be determined and will potentially hinder clear and quick decision making if not resolved. For example, it is unclear, when the Olympic Delivery Authority requires funding, which funder will meet the requirement, or how it will be shared across each of the funders. It also remains the case that calls on funding will remain subject to decisions by the relevant funder, for example, the Olympic Lottery Distributor has a statutory duty to conduct its own deliberations on applications for funds.

Whether there is a clear baseline against which delivery can be monitored

78 A clear baseline budget can inform decision making, support effective financial management and control, provide a means for assessing performance, and promote accountability. The budget for the Games as announced by the Secretary of State is in effect an outline budget, providing a funding envelope and showing at a high level the main categories of expenditure and sources of income. Alongside the work to develop the detailed budget, the Department and the Delivery Authority are establishing the arrangements for monitoring spending against the budget.

79 The budget is underpinned by a detailed breakdown of the Olympic Delivery Authority's expenditure but, at the time of our examination, the work to draw together the lifetime budget into an agreed cash flow forecast, setting out the timing of income and expenditure in the period to March 2014 (as the basis for detailed monitoring) was not complete. The Olympic Delivery Authority has a business plan for 2007-08, and a lifetime corporate plan which was approved by the Olympic Board in July 2007.

80 The budget announced by the Secretary of State included a separate provision for taxation (see Figure 6), which will need to be attributed to other budget areas, such as venues and infrastructure, to provide a basis for monitoring and reporting on a full cost basis. Similarly, if and when the allowances for programme contingency and additional inflation start to be applied, the cost will need to move from the central provisions to the budget area in question.

81 A baseline budget should be underpinned by clear definitions to help ensure that costs are allocated consistently and financial information can be relied upon. The precise scope of the budget is also important, in this case the boundaries between the Olympic Delivery Authority, LOCOG and the other bodies incurring Olympic related costs, such as the Home Office and the London Development Agency. Without clear definitions and boundaries, budgetary control could be undermined. For example, spending may not be accurately recorded against the right part of the budget or overspending against one budget may be obscured by costs being allocated to a different budget.

82 The budget was finalised only shortly before the Secretary of State's announcement to Parliament, but the timescales meant that the formal drawing together of the budget, the key assumptions and judgements underpinning the cost estimates, and the key deliverables which the Olympic programme is expected to bring had not been completed. Since the announcement was made, work has been ongoing at the Department and the Delivery Authority to take these matters forward. A detailed 'Programme Baseline Report'³⁷ was submitted to the first full meeting of the Funders Committee in June 2007. Going forward, the Delivery Authority will supplement the detailed project plan with detailed annual business plans and budgets.

83 As we reported previously, a key element in London's bid to host the Games was the expected legacy benefits. Work is ongoing to develop legacy plans for the Olympic Park and venues that will remain after 2012, and government departments are also continuing to work up plans for delivering the wider economic, social, health and environmental benefits. Identifying, and where possible, quantifying the key legacy benefits that are expected will provide a baseline for assessing in due course whether they have been achieved and for informing an analysis of the overall costs and benefits of the Games.

³⁶ Paragraph 82 of the Comptroller and Auditor General's report, *Preparations for the London 2012 Olympic and Paralympic Games – Risk assessment and management* (HC 252), Session 2006-2007).

³⁷ The Programme Baseline Report, prepared by the Olympic Delivery Authority, details the Olympic Programme scope, budget and risks on a project by project basis based on information available to date.

APPENDIX ONE

A summary of the development of the budget for the Games

Early work before the decision to bid was made	May 2002	Arup (jointly commissioned by the Department, the Greater London Authority and the British Olympic Association) reports on the costs and benefits of bidding for and staging the Games.
	January 2003	PricewaterhouseCoopers (commissioned by the Department) produces a probability assessment of the risks and uncertainties involved in a bid to host the Games.
	May 2003	The Government announces its support for a London bid for the 2012 Games, and the Government and the Mayor of London agree a public sector funding package of £2.375 billion to meet the costs of the Games.
Work to inform the bid for the Games	June 2003	The Government provides reassurance to the Culture, Media and Sport Select Committee that the public sector funding package contains significant provision for risk and contingencies in case overruns, unforeseen costs or revenue shortfalls arise. The Secretary of State had highlighted in a statement to Parliament (15 May 2003) that there would be a need to take stock of the estimates should London's bid be successful.
	December 2003	Given the International Olympic Committee's requirement for the Government to guarantee the Games financially, in December 2003 the Department for Culture, Media and Sport reports to Parliament a contingent liability in the event of London winning the bid to host the Games.
	June 2004	Partnerships UK (commissioned by the Department) provide advice on the extent to which the costs of facilities and infrastructure for the Games might be met by financing from the private sector.
	July 2004	PricewaterhouseCoopers (commissioned by the Department) produces a further report to identify, collate and present on a consistent basis the potential gross costs and revenues related to the Games and the regeneration of the Stratford area of the Lower Lea Valley if London were to host the Games.
	Mid-2004	Faithful and Gould (commissioned by the London Development Agency) provide estimates of the costs of infrastructure on the Olympic Park.
	September 2004	Franklin Sports Business Ltd (commissioned by London 2012 Ltd) conclude their work on estimates for the costs of venues.
	November 2004	Submission of the London 2012 Candidate File to the International Olympic Committee.

NOTE

At the time the bid was submitted the estimated cost to the public sector of the Games was £3.3 billion. The £2.375 billion public sector funding package was intended to cover the £2.992 billion core Olympic costs, towards which £738 million of private sector funding was also expected. Additionally, there was £1.044 billion Exchequer funding towards the infrastructure on the site of the Olympic Park.

Work between submission of the bid and the award of the Games to London	February 2005	International Olympic Committee Evaluation Committee visits London.
	May 2005	Faithful and Gould provide updated estimates of their earlier estimates of the costs of infrastructure on the Olympic Park.
	June 2005	Partnerships UK provides further advice to the Department on the potential for private financing for the Games.
	July 2005	The International Olympic Committee awards the 2012 Olympic Games and Paralympic Games to London.
Work to develop revised cost estimates following London's success	September 2005	Interim Olympic Delivery Authority is established.
	October 2005 (to July 2006)	KPMG LLP is engaged by the Department to advise on the further development of cost estimates for the Games.
	March 2006	Royal Assent for the Olympic and Paralympic Act.
	April 2006	First meeting of the full Olympic Delivery Authority Board.
	September 2006	The Olympic Delivery Authority appoints CLM as its Delivery Partner to provide support in project managing the delivery of the Olympic venues and infrastructure. CLM starts its review of cost estimates for the venues and infrastructure on the Olympic Park.
	November 2006	The Secretary of State for Culture, Media and Sport announces that the estimated costs of the Olympic Park have increased by around £900 million and there are other areas of costs to be resolved, including security, contingency, and tax liability.
	March 2007	The Secretary of State for Culture, Media and Sport announces a budget for the Games and infrastructure associated with the Olympic Park and other venues totalling £9.325 billion.

APPENDIX TWO

Study approach

1 This report is about the development of the budget for the London 2012 Olympic and Paralympic Games. It is the second report by the National Audit Office on the preparations for hosting the Games. The main focus of our work for this report was on the process following the International Olympic Committee's award of the Games to London in July 2005, and we also considered the work that went on to develop cost and funding estimates ahead of London's bid to host the Games.

2 The main elements of our work were a review of key reports and other papers, and interviews with staff at the Department for Culture, Media and Sport, the Olympic Delivery Authority and other organisations involved in the setting of the budget. Our approach is described in more detail in the following paragraphs.

3 We commissioned HVR Consulting Services Limited to assist and advise on our work. HVR critically reviewed the process used to develop the budget for the Games against good practice. Their work included consideration of the costing boundary and assumptions, the cost estimating methodology, and the setting of contingency.

Review of key reports and other papers

4 We examined key reports and advice relating to the budget for the Games, including:

- *London Olympics 2012 – Costs and Benefits*, Arup (May 2002).
- *Olympics Bid London 2012 – Probability Assessment*, PricewaterhouseCoopers (January 2003).
- *Olympics and Lower Lea Valley Costing Validation Review*, PricewaterhouseCoopers (July 2004).

- Advice from Partnerships UK (June 2004 and June 2005).
 - *The Green Book, Appraisal and Evaluation in Central Government, and Supplementary Guidance*, HM Treasury.
 - The London 2012 Candidate File, Comprehensive Supporting Data, and associated guarantees submitted to the International Olympic Committee (November 2004).
 - Summary cash flows and other cost schedules developed by the Olympic Delivery Authority based on advice from KPMG LLP, including the underlying cost schedules developed by Davis Langdon and Faithful and Gould.
 - *Cost Review, London 2012 Programme*, CLM (March 2007).
- 5** We examined other papers prepared by the Department and the Olympic Delivery Authority, relating to the development of the budget in general and to specific issues, such as the scope for cost savings, taxation, contingency, and National Lottery funding.

6 We also examined reports by the Culture, Media and Sport Committee (*A London Olympic bid for all*, Third Report of Session 2002-03, HC 268; and *London 2012 Olympic Games and Paralympic Games: funding and legacy*, Second Report of Session 2006-07, HC 69), submissions made by the Department and others to inform the Committee's inquiries, and the Government's response to the Committee's reports.

Interviews

7 We carried out a series of interviews with staff in the Government Olympic Executive at the Department for Culture, Media and Sport, and with the Chief Executive and Finance Director at the Olympic Delivery Authority. We also interviewed the Finance Director of the London Organising Committee of the Olympic Games and Paralympic Games, who was also the Finance Director for London 2012 Limited (the bid company), and staff at the Treasury with responsibility for Olympic matters.

8 The interviews covered:

- the development of cost estimates prior to London's bid and since London was chosen to host the Games;
- the funding in place at the time of the bid and the revised funding package announced in March 2007;
- the contingency provision;
- key risks and uncertainties going forward;
- the Government guarantees provided to the International Olympic Committee.

9 We met representatives of KPMG LLP, PricewaterhouseCoopers LLP and Arup to discuss the work they carried out to inform the development of the budget for the Games. And we met staff from CLM, the Olympic Delivery Authority's Delivery Partner, to discuss their review of the cost estimates for work on the Olympic Park.

APPENDIX THREE

The funding and cost estimates at the time of London's bid to host the Games in November 2004

Public funding

1 In May 2003 the Government and the Mayor of London agreed a memorandum of understanding which provided for a 'public sector funding package' of up to £2.375 billion to meet the costs of the Olympic and Paralympic Games (see **Figure 13**).

2 In addition to the public sector funding package, the Department was also to co-ordinate Exchequer funding of £1.044 billion towards the costs of infrastructure on the site of the Olympic Park.

13 The public sector funding package for the Games (agreed in May 2003)

Source	£ million	£ million
National Lottery		
■ Proceeds from designated Olympic lottery games – from the Olympic Lottery Distribution Fund	750	
■ Spending by the sports lottery distributors	340	
■ General lottery proceeds – from the National Lottery Distribution Fund	410	
National Lottery total		1,500
Greater London Authority – council tax precept		625
London Development Agency		250
Total		2,375

Source: Department for Culture, Media and Sport

3 More information on the public funding at the time of the bid is provided in paragraphs 44 to 51 of the Comptroller and Auditor General's first report on the preparations for the London 2012 Games.³⁸

Cost estimates

4 At the time of the bid the net costs that were expected to be covered by the public sector funding package for the Games totalled £2.254 billion (£2.992 billion gross costs less £738 million expected private sector funding). **Figure 14** sets out the relevant costs extracted from the London 2012 Candidate File, which was submitted to the International Olympic Committee in November 2004. The cost estimates in the Candidate File were expressed in US dollars at 2004 prices. The table also sets out the equivalent cash outturn estimates at the time of the bid, taking into account assumptions about price inflation.

5 There were also infrastructure costs of £1.044 billion, for which the Government was to provide Exchequer funding. At the time of London's bid to host the Games the estimated gross cost of the Games was therefore £4.036 billion comprising £2.992 billion core Olympic costs plus £1.044 billion for associated infrastructure.

6 More information on the cost estimates at the time of the bid is provided in paragraphs 41 to 43 and in Figure 4 of the Comptroller and Auditor General's first report on the preparations for the London 2012 Games.

38 Preparations for the London 2012 Olympic and Paralympic Games – Risk assessment and management (HC 252, Session 2006-07).

14 Estimates at the time of the bid of the costs to be covered by the public sector funding package for the Games

	Candidate File estimates – 2004 prices in US\$	Candidate File estimates – 2004 prices in £ sterling ²	Outturn estimates at bid submission
	US \$ million	£ million	£ million
Venues	1,132 ³	708	971
Venues legacy conversion	n/a	n/a	89
Olympic infrastructure	800 ⁴	500	640
Transport infrastructure	600 ⁵	375	466
Transport operating costs	n/a	n/a	234
Support for elite and community sport	n/a	n/a	300
Paralympics	72 ⁶	45	54
Other	n/a	n/a	238 ⁷
Total	–	–	2,992
Less Expected private sector funding	–	–	(738)
Total to be met from the public sector funding package	–	–	2,254

Sources: London 2012 Candidate File; outturn estimates taken from paper prepared by the Department for Culture, Media and Sport in September 2004

NOTES

- 1 n/a – not applicable as International Olympic Committee instructions on completion of Candidate City File did not request this information.
- 2 The costs were estimated in £ sterling and converted into US dollars for the Candidate File, using an exchange rate of £1=\$1.6.
- 3 This figure includes the cost of sports venues (**\$917 million**) and the International Broadcast Centre/Main Press Centre (**\$215 million**) shown in the Candidate File. It does not include the cost of the Olympic Village (shown in the Candidate File as **\$1,040 million**) which was expected to make use of a planned \$1 billion public private partnership.
- 4 The cost of Olympic infrastructure is included within the **\$2,100 million** shown in the Candidate File for Olympic Park infrastructure. The total of \$2,100 million also includes \$1,300 million of investment in 'non-Olympic' infrastructure, which was to be covered by Exchequer funding.
- 5 \$600 million represents the amount the Olympic Delivery Authority was expected to spend on transport infrastructure and was included within the **\$11.5 billion** shown in the Candidate File for capital investment in roads and railways.
- 6 The \$72 million shown for the Paralympic Games represents half of the total marginal cost of the Paralympics (shown as \$144 million in the Candidate File). Under the Host City Contract, the state is required to fund 50 per cent of Paralympic costs, with the other 50 per cent to be funded by LOCOG.
- 7 Other costs include £190 million of security costs.
- 8 This Figure does not include the costs to be incurred by LOCOG in staging the Games. LOCOG's estimated costs were set out in Appendix 6 of the Comptroller and Auditor General's first report on the preparations for London 2012.

APPENDIX FOUR

The money to be transferred from the National Lottery Distribution Fund

1 The revised funding package for the Games, announced by the Secretary of State for Culture, Media and Sport on 15 March 2007, includes £1.085 billion (£410 million of which was included in the original public sector funding package) that will, subject to Parliamentary approval, be transferred from general lottery proceeds held in the National Lottery Distribution Fund from February 2009.

2 The impact of this transfer on the individual lottery distributors is set out in **Figure 15**. £638 million will come from the Big Lottery Fund and a total of £447 million from the other distributors in proportion to their shares of lottery income, with the exception of UK Sport whose income the Department has decided to protect in recognition of UK Sport's role in supporting elite athletes to achieve success in the Olympic and Paralympic Games.

15 The impact of transfers from the National Lottery Distribution Fund on individual lottery distributors

Lottery distributor	Reduction in available funds
	£ million
Big Lottery Fund	638.1
Heritage Lottery Fund	161.2
Arts Council England	112.5
Sport England	99.9
UK Film Council	21.8
Sport Scotland	13.1
Scottish Arts Council	12.5
Arts Council of Wales	8.1
Sports Council for Wales	7.3
Arts Council of Northern Ireland	4.5
Sports Council for Northern Ireland	4.1
Scottish Screen	1.8
UK Sport	0.0
Total	1,084.9

Source: Department for Culture, Media and Sport