# GOVERNMENT ACCOUNTING

## *A guide to central government financial planning, control and reporting*

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## FOREWORD

This series of monographs is published by the Research Committee of The Institute of Chartered Accountants of Scotland which is responsible for identifying topics. The series is addressed to all groups with an interest in accounting and financial management and individual monographs are written in such a way as to be understandable to readers who are not already familiar with the existing extensive literature on the subject.

This particular monograph is a guide to central government financial planning, control and reporting. It provides an important insight into an area which impacts on all our lives but about which most of us have little knowledge. It will be of use to, among others, civil servants and MPs, whose working lives bring them into contact with the system of central government accountability. It will also be valuable to accountants and others working in the private sector who will be helped to understand how and why public sector mechanisms of accountability differ from those with which they are familiar. Students and, of course, members of the public will also find this monograph helpful.

The Committee commends this monograph for study in the interest of better understanding: the opinions expressed by the author are, of course, his own.

The Institute of Chartered
Accountants of Scotland

Jack Shaw
Convener, Research Committee

*Acknowledgements and inspiration*

Following two years which I spent working at HM Treasury as an accounting adviser, Professor Jack Shaw asked whether I would be prepared to undertake the task of writing a monograph on government accounting for the Research Committee of the Institute. I was attracted by the idea of setting down what I had learnt of the subject at the Treasury but little realised at the start how much more there was both to learn and to do! That I have completed the task (which, thankfully, was left largely to me to define) is due to the encouragement and assistance of many colleagues at the Treasury and in Scotland. Particular thanks are due to Sir Anthony Wilson for help at the beginning and Ken Bradley for much assistance at the end of the Project. Clifford Judd CB reviewed the original text and redrafted to help to focus the subject matter and Peter McMonnies CA edited and improved the content to make it more comprehensible. I owe them both a considerable debt for their time and trouble. Members of various Treasury divisions particularly David Deaton who kindly read the draft and brought the text up to date, Alastair Macaskill CA helped with the initial drafting and Professor Irvine Lapsley reviewed the proof and made helpful suggestions to improve the contents and clarity of presentation. Last and most important of all my secretary Liz Hume spent months typing and editing the drafts of text and diagrams tirelessly. To all of these and many others go my grateful thanks and credit for their ideas; after all their efforts, any remaining errors can only be mine.

CGA Fletcher
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## GLOSSARY AND ABBREVIATIONS

The following terms and expressions used in this monograph may have meanings that are not immediately clear. Accordingly they are explained here. The explanations are as brief as possible and are not "official" definitions; they are intended to help the reader understand the terms in the context in which they are being used.

*Accounting Officer:* normally, but not always, the permanent secretary of a government department who is responsible to the Minister for the financial transactions of that department (see Chapter 7).

*Appropriation Accounts:* accounts prepared for each Parliamentary Vote (see below) for the previous financial year ending 31 March

*Autumn Statement:* a financial planning document, covering planned government expenditure, published each November (See Chapter 6).

*Charges:* Charges made to and paid for by consumers of certain goods and services provided by public sector bodies (See Chapter 3).

*Comptroller and Auditor General:* an Officer of the House of Commons, who reports to the Public Accounts Committee (see below). He has dual responsibilities of first, through the National Audit Office, auditing certain government documents and carrying out certain reviews of economy efficiency and effectiveness and second, authorising daily requisitions for funds (see Chapter 7).

*Consolidated Fund:* the Fund into which most central government revenue is paid and from which most expenditure is made (see Chapter 8).

*Consolidated Fund Extra Receipts:* amounts which are paid into the Consolidated Fund other than the normal central government receipts (see Chapter 8).

*Estimates:* documents detailing central government's plans for expenditure and acting as requests presented to Parliament for the necessary Voted funds. When approved by Parliament they become Votes (see Chapter 7).

*External Financing Limits:* the cash limits imposed by the government on the external financing of nationalised industries.

*Financial Statement and Budget Report:* a central government financial document published on Budget Day that relates expenditure to prospective income, gives a summary of tax rates and reports on economic prospects (see Chapter 6).

*Funds* (with a capital "F"): government resources with specified sources of income utilised for specific purposes. They include: the Consolidated Fund (see above), the National Loans Fund, the Contingencies Fund, the Redundancy Fund, the National Insurance Fund and the Forestry Fund (see Chapter 8).

*General Government Expenditure:* broadly, the expenditure (and estimated capital consumption) of central and local government excluding transfers between them (see Chapter 5).

*Grants:* Payments made to individuals or bodies, with no resultant goods or services being received directly in return.

*Gross Domestic Product:* the value of goods and services produced by residents of the United Kingdom. See Chapter 5 for a discussion of the relationship between public expenditure and GDP.

*National accounts:* generally, accounts covering collectively the economic activity of the public and private sectors in the UK, but, specifically, the contents of the Blue Book (see Chapter 2 and Appendix 2). They are built up in accordance with certain national and international conventions so that they form a historical picture of economic activity in the UK economy.

*Negative expenditure:* receipts which are related to certain public sector expenditure and are thus deducted from the reported total of that expenditure rather than being shown as income in the national accounts.

*Non-departmental public bodies:* certain public sector bodies, other than public corporations (including nationalised industries), local authorities and government departments. They are normally required to account for their activities in a form "directed" by their sponsoring Minister.

*Public Accounts Committee:* a Committee set up by Standing Order of the House of Commons. It considers the reports of the Comptroller and Auditor General (see above) on accounts etc (see Chapter 7).

*Public corporations:* publicly owned trading bodies, which include nationalised industries (see Chapter 3).

*Public Expenditure Planning Total*: an aggregate expenditure figure reported in the Autumn Statement (see above) which identifies the elements of public expenditure used by government for control and monitoring purposes. It can be reconciled to General Government Expenditure (see above and see Chapter 5).

*Public Expenditure White Paper:* a central government financial planning document published in January each year until 1990, it outlines planned public sector spending by department (see Chapter 6). It will be replaced from 1991 onwards by departmental reports and a statistical supplement (see Chapter 9).

*Public Sector Borrowing Requirement:* the excess of general government expenditure plus public corporations' (see above) net market and overseas borrowing over general government receipts, spelled out in the Financial Statement and Budget Report (see above).

*Public Sector Debt Repayment:* the converse of the Public Sector Borrowing Requirement.

*Supply Expenditure:* expenditure by central government financed by monies voted by Parliament in the annual Supply Estimates (see "Estimates" above).

*Trading Funds:* bodies such as the Crown Suppliers, HM Stationery Office and the Royal Mint, as set up under the Trading Funds Act 1973, which are formally government departments (or part of them); and the Atomic Energy Authority, which was established under its own Act of Parliament. They are treated like public corporations for planning, control and statistical purposes and are intended in essence to be self-financing once set up.

*Votes:* individual Estimates (see above) which have been approved by Parliament (see Chapter 7).

## GLOSSARY AND ABBREVIATIONS

The following are the meanings of abbreviations used in this monograph:

| | |
|---|---|
| APEX | Analysis of Public Expenditure |
| BBC | British Broadcasting Corporation |
| C & AG | Comptroller and Auditor General |
| CFERs | Consolidated Fund Extra Receipts |
| CGE | Central government expenditure |
| COI | Central Office of Information |
| CSO | Central Statistical Office |
| E & AD | Exchequer and Audit Departments |
| EC | European Community |
| FMI | Financial Management Initiative |
| FSBR | Financial Statement and Budget Report |
| GDP | Gross Domestic Product |
| GGE | General Government Expenditure |
| HM | Her Majesty's |
| HMG | Her Majesty's Government |
| HMSO | Her Majesty's Stationery Office |
| HMT | Her Majesty's Treasury |
| IMF | International Monetary Fund |
| LGE | Local government expenditure |
| MP | Member of Parliament |
| MTFS | Medium Term Financial Strategy |
| NAO | National Audit Office |
| NATO | North Atlantic Treaty Organisation |
| NDPB | Non-departmental public body |
| NHS | National Health Service |
| NLF | National Loans Fund |
| PAC | Public Accounts Committee (of the House of Commons) |
| PEPT | Public Expenditure Planning Total |
| PES | Public Expenditure Survey |
| PEWP | Public Expenditure White Paper |
| PGO | Paymaster General's Office |
| PSBR | Public Sector Borrowing Requirement |
| PSDR | Public Sector Debt Repayment |
| TCSC | Treasury and Civil Service Committee (of the House of Commons) |
| VAT | Value Added Tax |
| VFM | Value for money |

# *CHAPTER I*

## INTRODUCTION

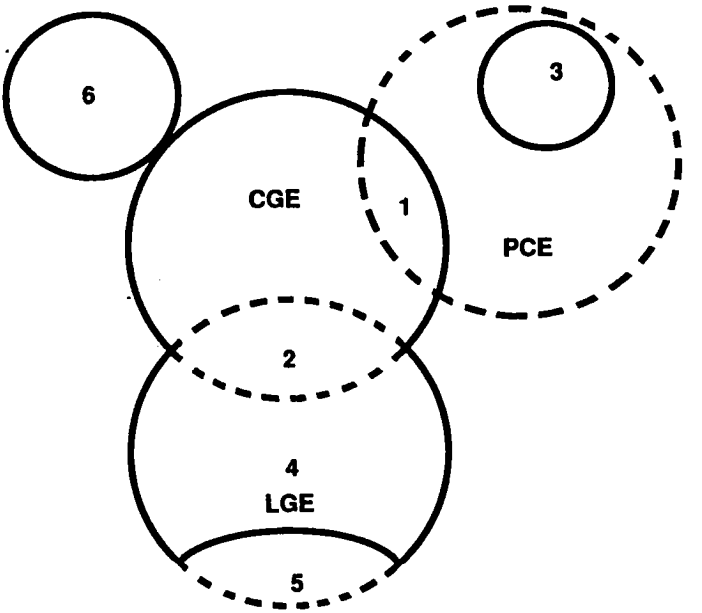
This book is designed to explain the bones of public sector and central government accounting - what is accounted for and in which documents "it" can be found. The emphasis is on central government cash flows and reports rather than on local authority, non-departmental public body (NDPB) or public corporation accounts. However, the way in which the latter fit into the broad picture is explained.

Coverage of public sector accounts

The next thing is to describe what "it" is. There are three essential points to grasp at the outset of a discussion of public sector accounts: the coverage of accounts, the components of public expenditure and the cash basis of accounting. First, in the private sector, it is normal to account for the transactions of individual businesses, charities and the like in a form which leads to a "bottom line" showing the historical result: the year's profit or loss together with the balance sheet of assets and liabilities. A funds statement shows changes in assets and liabilities and the structure of changes in the entity's finances. Combinations of entities are accounted for in consolidated accounts prepared, for companies, under more or less harmonised accounting conventions. Summarised statements of that nature would not, on the other hand, easily and fully explain government spending, which has a very complex structure dealt with in many different types of entity. There are also many levels of aggregation or consolidation with which financial documents in the public sector have to cope in order to meet the requirements of informing Parliament and public, of administration, of control and of the planning process. It is thus important to be clear about the coverage of public sector financial documents, ie which entities are included and on what basis.

Public expenditure

The question of coverage leads on to the second essential, one might say quintessential, concept of "public expenditure". In principle, public expenditure represents the call on public funds by general government services of all kinds. The main elements of public expenditure as reported by the public expenditure planning documents currently include all spending of central government, most local authority spending and certain spending of public corporations. This is shown diagrammatically in Figure 1.1 and is represented by the elements within continuous boundaries.



Expenditure included in the central government expenditure (CGE) circle comprises:

- Expenditure, net of certain receipts, voted by Parliament annually from the Consolidated Fund (normally called Supply Expenditure) which is the main part of central government expenditure (the Consolidated and other Funds are explained in some detail in Chapter 8); and

- Expenditure, net of certain receipts (including net lending), of central government from the Consolidated and other Funds as authorised by legislation other than by means of annual Votes (of which a significant example is expenditure from the National Insurance Fund).

The other main elements are local government expenditure (LGE) (excluding what is financed from local government's own resources) and elements of public corporations' expenditure (PCE).

Central government expenditure is the main part of public expenditure. In order to arrive at a consolidated total, central government transfers of cash to other parts of the public sector are netted out and only the eventual expenditure by recipients is included.

The numbers in the segments of figure 1.1 represent:

1. Transfers to certain public corporations, eg loans and grants

2. Net transfers of grants and loans to local authorities from central government

3. External finance (ie borrowing) of most public corporations so far as it is not provided by central government

4. Expenditure of local authorities not funded by central government (mainly authority to obtain external loans and credit)

5. Expenditure of local authorities from their own resources, including rents, Community Charge proceeds and capital receipts.

The expenditure represented by the number 6 comprises debt interest and certain other adjustments. The Public Expenditure Planning Total reported to Parliament in the public expenditure plans (in the Autumn Statement), which is an intermediate target set by government for planning and control purposes, excludes these elements; interest is not plannable or controllable in the same sense as other expenditure. Government expenditure reported in the national accounts is defined more comprehensively and includes debt interest. In reading documents which mention public expenditure, it is very important to be clear about which aggregate of expenditure is referred to.

The cash basis (or otherwise)

The third essential point to grasp is that most published financial reports dealing with the details of public finances, for example, the accounts of expenditure of government departments (called Appropriation Accounts), are prepared on a cash basis corresponding to the basis on which Parliament makes money available. In the early twelfth century, Henry I set up the Royal Exchequer and an attempt was made to control Royal Expenditure and Income (ie central government spending) on an annual cash basis. Central government accounts of departmental expenditure, and public expenditure generally, have been on an annual cash basis in the UK ever since, in common with those of most other countries.

However, in the case of some individual entities in the public sector, which are comparable with commercial or charitable organisations, financial documents may be prepared on a basis which takes account of certain accruals; for example, they include income not yet received in cash and expenditure not yet paid for. The accounts of the National Health Service are prepared on this basis. Some government departments (eg all trading funds) which supply goods and services on repayment, and many "non-departmental public bodies", are required to prepare accounts on a full accruals basis, including both the income and expenditure accruals mentioned above and fixed assets and depreciation. Statutory corporations, such as public corporations and nationalised industries, similarly account in this way. Such bodies' accounts are normally required by the

governing statutes to conform in all material respects to commercial accounting principles.

Finally there are the "national accounts" of all sectors in the economy including the accounts of government. These are reported in cash flow terms but also include estimates of accruals and capital consumption (ie depreciation). Although they do not include full balance sheets, certain balance sheet information is provided in table S7 of "Financial Statistics", published by the Central Statistical Office (CSO).

Purposes of public sector accounts

Leading on from these essential features of what are broadly known as government accounts, it is equally important to grasp the variety of purpose for which financial documents are prepared; their character differs depending on the entity reporting and the purpose of the report. Examples include:

- Appropriation Accounts, the formal audited accounts of spending by central government departments against the relevant appropriations made by Parliament. These accounts report to Parliament on the stewardship by the "Accounting Officer" (normally the head of department) of the money entrusted to him - often at a very detailed level for control purposes. These accounts compare expenditure with the Estimates, which are published up to 18 months earlier and which form the basis of Parliamentary appropriations, ie the detailed authority for such spending.

- Formal audited accounts of government Funds, reporting to Parliament on transactions in the Funds and balances remaining. These statements include details of both receipts and payments and, like the Appropriation Accounts, are the formal rendering of account for his stewardship by the Accounting Officer entrusted with controlling each Fund.

- More highly aggregated government statements of prospects, such as the public expenditure planning documents presented by Treasury Ministers,

which have a growing role to explain government intentions and inform the public and Parliament about financial plans. While these also report on past trends so as to put the new plans in context they are not strictly "accounts". These documents are not formally required by statute but are now regularly provided to Parliament as essential background to its discussion and control of financial matters.

- Central government department or agency reports, which (where appropriate) combine formal accounting and descriptive matter concerning the year's operations in a similar fashion to a private sector company. Some departments' reports include specific performance measures (both financial and physical) to complement the descriptive matter and provide a means of judging the quality and results of expenditure which are not susceptible to financial or commercial measurement.

One point to note about this list is the mixture of reports of historical financial outturn and reports of planned spending. In the private sector, company accounts are attested statements of past results. The Companies Act has (since 1981) required prospective statements to be given in the directors' report, but these are not required to be quantified. In government, on the other hand, much of the most publicised financial information is published in the form of expenditure plans. The planning documents (the main focus being the Autumn Statement) do include historical information but the primary purpose of this is to demonstrate the trend leading to the plan period. The format and analysis of historical data are therefore amended to bring them into line with the basis on which the plans have been prepared. Comparisons with published private sector accounts have to take account of the fact that in the public sector both outturns and plans are published whereas the private sector only reports history.

Central government accounting

The main feature of central government accounting at an aggregate level is its concentration on the absolute cash level of public receipts and payments. In the high level summary planning documents the "total" of planned public

expenditure (as conventionally defined and described above) is related to past actual levels of spending, Gross Domestic Product, public sector borrowing and taxation, and to performance indicators. By contrast, private sector accounts tend to focus on the difference between matched aggregates of income and expenditure, ie the profit, as defined in terms of accounting standards and practice, which provides its own measurement of performance. In view of the weight attached to "total" expenditure it is important to understand that certain public sector transactions are classified as "negative" expenditure rather than as "revenue" (ie income) and the reported total expenditure, which is the focus of attention, is shown net of negative expenditure. Negative expenditure includes items such as charges for services provided by government, eg prescription charges, which would be treated as income in a commercial environment. Thus public expenditure represents the net call on general public funds raised mainly through tax revenue and borrowing, and does not include expenditure financed by income specifically raised for the purpose.

In the UK, Parliamentary authorisation for most central government spending is annual - the nation's financial year being to 31 March. So is authorisation for rates of tax (not, notice, the total amount of taxation to be raised thereby), but borrowing authority is unlimited. If authority for spending and setting tax rates is annual, and Parliament controls both, any borrowing necessary to finance spending is a residual amount. Fiscal policy can however also be used as an instrument of economic policy to influence the path taken by the economy as a whole, and not only to service the government's own cash needs. However, governments only actually require revenue *per se* in order to finance spending or loan repayments; they do not set out to make a profit. Furthermore, "excessive" public expenditure is seen to be inflationary. There is thus a heavy emphasis in Parliament on the control of spending so as to minimise revenue requirements to achieve given objectives. This control is exercised in three stages: first, debating overall public expenditure and financing plans, then specifically authorising central government's planned spending and taxation rates, and finally holding Accounting Officers accountable for actual spending. Most government financial documents concern analyses of spending; less emphasis is placed on authorising

and reporting total revenue and borrowing. By contrast, West Germany, for example, requires its Parliament to authorise total expenditure, total revenue and total borrowing. Germans might consider the UK Parliament's control of public finances less complete.

Other matters

In outline, Chapter 2 discusses further the types of financial document which are used in the public sector to explain, monitor and control public finances. The emphasis is on those which are published. In view of the need to understand the coverage, this chapter also explains the broad levels of aggregation of the various types of document and where they link together. The documents themselves are dealt with in more detail in later chapters. Chapter 3 explains some of the main differences between the public and private sectors, and how this impacts on the ways in which the information is presented.

It is very difficult to understand the diversity of government documents without setting their development in a historical context, since they were each developed to meet a particular set of needs seen at that time. It is also essential to understand how public expenditure is defined. These topics are covered in Chapters 4 and 5.

Chapter 6 deals with the content of the planning documents (which cover spending by the whole of the public sector). Chapter 7 covers the formal Supply Estimates and Appropriation Accounts (which are concerned with Parliamentary authorisation and accounting for central government spending). Chapter 8 explains the authorisation procedures whereby central government develops and Parliament considers expenditure plans as a whole. It also deals with the cash flows in central government, and the government Funds through which these flows take place. Finally, Chapter 9 seeks to look ahead to financial reporting to Parliament as it might develop from 1991 onwards.

This brief introduction serves to outline the matters discussed in this book. The hope is that you will emerge at the other end enlightened!

# *CHAPTER 2*

## PUBLIC SECTOR FINANCIAL DOCUMENTS: WHAT IS PRODUCED AND HOW IT LINKS TOGETHER

### Types of Financial Documents In the Public Sector

As well as central government's own cash flows, the planning of income and expenditure has to allow for certain aspects of the plans of local government and public corporations if it is to deal comprehensively with the public sector. The extent to which any aspect is included depends on what is being reported or controlled and may vary as governments change or their philosophy evolves.

The main types of financial documents prepared in the public sector to present plans and report activities are outlined below.

i) Central government documents

The main central government summary financial planning documents are: the Autumn Statement, supplemented by the Public Expenditure White Paper, now being phased out and replaced by the Statistical Supplement and the Estimates, all of which contain both planning and accounting information dealing solely with expenditure; the Financial Statement and Budget Report (FSBR), which relates expenditure to prospective income. These documents are published and laid before Parliament; they have developed as documents presenting the government's intentions to Parliament as the basis for its control. The planning documents contain aggregated historical information designed to show trends by way of background. However, functionally, they are forward looking documents containing statements of policy intention, prospective revenue and expenditure, and the aims and objectives of the spending programmes described. These plans are prepared by departments and are co-ordinated for presentation to Parliament by the Treasury, on the basis of Ministers' collective decisions on the level of public expenditure for which they will seek Parliamentary authority.

The form of these documents is not prescribed by Parliament, but no spending or taxation can take place without statutory authority and Parliament has to be persuaded to give such authority. Their style and content is influenced by the comments of parliamentary committees, usually the Treasury and Civil Service Committee and the Public Accounts Committee. Changes have recently been announced to the ways in which expenditure plans are to be published. These changes are more fully covered in Chapters 6 and 9.

The historical information contained in plans is not separately audited, but it is of course based in part on the same information as the formal audited documents which report outturn to Parliament. By contrast, Appropriation and Fund accounts of outturn are prepared by the Accounting Officer of the department or Fund and are required by statute to be audited, normally by the Comptroller and Auditor General and his department, the National Audit Office.

The planning and summary outturn statements of cash flow are compiled from the Treasury database using APEX (the Analysis of Public Expenditure compiled by the Paymaster General's Office, which acts as the departmental "banker"), and individual departments themselves as its main sources. Income and expenditure statements on a full accruals basis (ie using accounting policies such as one would expect to find in commercial accounts) are not compiled for central government as a whole. Certain estimates of capital consumption (depreciation) and other accruals adjustments are however made in the national accounts and corresponding accruals adjustments are made in certain tables in the planning documents where consistency with the national accounts is required. Central government accounts do not include balance sheets showing all assets and liabilities of central government. It has proved difficult to decide on an appropriate valuation basis for many such assets and the uses to which such a balance sheet could be put have not been thought to justify the cost of

preparing it. The concept of "UK Limited" is thus not recognised in these documents.

Management accounts are used ever more extensively in central government. Internal management accounts have been in use in one form or another for many years. They have been progressively developed and their more extensive use was given a significant boost in the Financial Management Initiative (FMI) announced in 1982. This initiative (discussed further in Chapter 4) was designed to promote, in each government department, systems for devolving management and giving managers at lower levels in departments clear objectives, and responsibilities for managing the resources necessary to achieve them. The FMI intended that managers should be held accountable for their performance. In this context, assets are increasingly being valued and recorded in the accounts employing, for assets in use, open market value for existing use or depreciated replacement cost and, for surplus assets, alternative use valuations. Internal budgets and management accounts, increasingly based on the full accruals concept, form an important part of the information necessary for such management systems. Their purpose is mainly internal to the departments concerned and the documents are unpublished and so are not discussed further here. However, it may be that management systems and performance measurements will in future increasingly drive the development of external reporting in government rather than, as in the past, parliamentary cash control requirements.

ii) National accounts: The Blue Book and Financial Statistics

The national accounts are not strictly accounts but rather estimates. They give entirely retrospective data and cover central and local government aggregates (and the combination of central and local government, ie general government), public corporations and the private sector and so build up a picture of the UK economy as a whole. They are produced as a series of internally consistent building blocks and are compiled by the Central Statistical Office (CSO), an independent government department reporting and accountable to the Chancellor and ultimately the Prime Minister.

The information on the economy is compiled from a large variety of sources, some on the basis of statistical estimation techniques. The information thus assembled is not really comparable to, say, the consolidated accounts of a major group of companies, which are compiled on the basis of a summarisation of information from individually attested schedules conforming to uniform group accounting policies and company law. The national accounts contain an enormous amount of data, covering ten or more years in each table, designed to show trends in resource use and funding over time. The central government expenditure tables in the national accounts are largely based on central government cash returns compiled by the PGO, based on APEX. Income is based on the Inland Revenue and Customs & Excise department returns. The main objectives of the national accounts and the companion volumes of Financial Statistics are to enable economic analysis and forecasting to be carried out. They also show a great deal of outturn information in a form comparable to the aggregate plan data contained in the planning documents. The methods and classifications used are based on international statistical conventions, and are thus intended to be consistent over time. The UK methods and classifications are described in detail in "Source and Methods" published by CSO periodically.

However, some of the conventions used in national accounts are not suitable for government control purposes. The Public Expenditure Planning Total (PEPT) figures are therefore prepared using different methods of presentation in certain respects. As explained in Chapter 5 on public expenditure, there are some adjustments necessary in reconciling the government expenditure control total (PEPT, as shown in the Autumn Statement) to the equivalent national accounts figures.

In the process of compiling information for the national accounts, the CSO analyses and discusses with their sources the information given to them, and thus acts as scrutineer of its classification and treatment. Two important summaries of Government transactions are shown in tables 7.1 and 9.1 of

the National Accounts Blue Book. The contents of table 7.1 of the Blue Book and the sources of this information are given in Appendix 1 by way of illustration. Tables which are derived from national accounts data on a basis comparable to the PEPT shown in the planning documents are given in quarterly issues of the monthly publication "Financial Statistics" at Table 2.4 and annually, in the Autumn, a Treasury analysis of public expenditure is published in Financial Statistics Table S12 alongside the national accounts measure.

iii) Local government reports

Local authorities each produce annual accounts (and may produce other explanatory material) explaining their spending and financial position. The individual local authorities also send returns of information to central government departments to allow compilation of the aggregate general government statistics.

The financial accounts of local authorities are made available to ratepayers and are audited in England by the Audit Commission, either itself or through external auditors appointed by the Commission. In Scotland the Accounts Commission and its nominees perform this function. However, the form of accounts and accounting policies used are subject to some variety and, by contrast with companies governed by the Companies Act and accounting standards, the code of accounting standards for local authorities is not so comprehensive or well developed; many problems still remain to be satisfactorily resolved. For example, as with central government, asset valuation and recognition policies are a difficult area. There is, however, an accounting code of practice which was published in England and Wales for the first time in March 1988. A revised version is now being drafted which also extends the Code's coverage to Scotland. These and other initiatives will help to standardise the development of local authority accounting practice which is proceeding continuously.

iv) Public corporations and other public sector bodies

Money may be voted from the Consolidated Fund or (for certain specified bodies and purposes) lent from the National Loans Fund to public corporations, trading departments, subsidiary agencies of government, or other authorised bodies in central government. The departments responsible for any of these bodies are required to lay annual audited accounts in Parliament to demonstrate how they have used the funds made available to them. Normally all bodies which are answerable directly to a Minister will also be required to submit their accounts to him to be laid in Parliament. Most of these bodies are set up either under specific statutes or by Ministers acting under discretionary powers. In setting them up, there will normally be a provision which enables the Minister (or the Secretary of State) of their sponsor department to require them to prepare their accounts in compliance with a "direction" as to their "form". Treasury approval or consent for the direction is normally required. Accounts directions thus apply to bodies such as nationalised industries, trading departments and most NDPBs. Accounts directions usually require that commercial accounting principles and Companies Act formats and rules are adopted (with specified exceptions or additional information as appropriate). Most of the larger government sponsored bodies are of such a kind that they account on a full accruals basis and present an income and expenditure account and balance sheet providing, as with companies, the conventional true and fair view of their net revenue and state of affairs. A few small bodies, and those with no significant assets or liabilities, may instead produce statements of cash received and expended only, together with a "statement of balances" showing any cash or debtor movements.

The remainder of this book deals mainly with the first category of accounts, ie the financial documents containing plans and outturns prepared by central Government for Parliament.

## PUBLIC SECTOR FINANCIAL DOCUMENTS: WHAT IS PRODUCED AND HOW IT LINKS TOGETHER

The table at Appendix 2 summarises the purposes and nature of the main government financial documents. These are divided, by purpose, into four main phases: macro-economic financial strategy, planning, in-year monitoring and control, and accountability. The first two phases, which are a continuous process (economic forecasting and planning, and public revenue and expenditure planning) look forward for three years ahead.

### Coverage

As explained in Chapter 1, one difficulty which confuses the picture is coverage; the aggregated planning documents describe public expenditure and income relating to central government (including national insurance funds), local authorities, and certain aspects of public corporations' capital finance, after eliminating transfers between these sectors. However, the individual formal outturn documents cover only the budgets and subsequent transactions of the particular department, fund, body or institution concerned, and show transfers of cash to or from other parts of the public sector as income, expenditure or loan etc as the case may be. The interaction of different layers of government, the historical origins and purposes of the various forms of account, and the many facets of public sector operations and controls over them which the financial documents are designed to demonstrate (necessarily in a variety of ways), result in a complicated and non-homogeneous package of accounts and other documents in the public sector. The history of the various documents, which is described later (Chapter 4), shows that the accounting system was not designed at one time or as a whole but has grown as needs have arisen. The structure of the documents reflects the complex constitutional structure of planning, funding and accounting for public expenditure. This complexity is to some extent inevitable given the number of organisations which make up the public sector, and is compounded by the different views which may be taken by successive governments about what is or is not to be controlled by central government and the Treasury.

## PUBLIC SECTOR FINANCIAL DOCUMENTS: WHAT IS PRODUCED AND HOW IT LINKS TOGETHER

Figure 2.1 below describes the broad structure of the documents produced and their coverage in approximate terms. This diagram shows documents at three levels of aggregation. On the top row are documents combining all elements of public income and expenditure. The second row covers purely central government matters and finally the third row represents the accounts of the various public sector entities which are funded wholly or in part through central government; although they may submit accounts for parliament or local authority scrutiny, accounts of the last group are not considered further here. Many private sector entities also, of course, receive public funds from government as grants or investments. Likewise their accounts are not considered here.

The central government accounts in the first two rows of documents in Figure 2.1 are framed so as to show how tax revenues and other general public income and borrowing is spent, rather than to show how the total of money handled by departments, whether from charges or general public funds (tax revenue, proceeds from assets sales, loans etc), has been disposed of. However the accounts of individual public sector trading activities (where published) show a more commercial picture, ie how government loans and grants together with sales revenue etc are spent in each entity to provide the goods and services concerned.

# PUBLIC SECTOR FINANCIAL DOCUMENTS: WHAT IS PRODUCED AND HOW IT LINKS TOGETHER

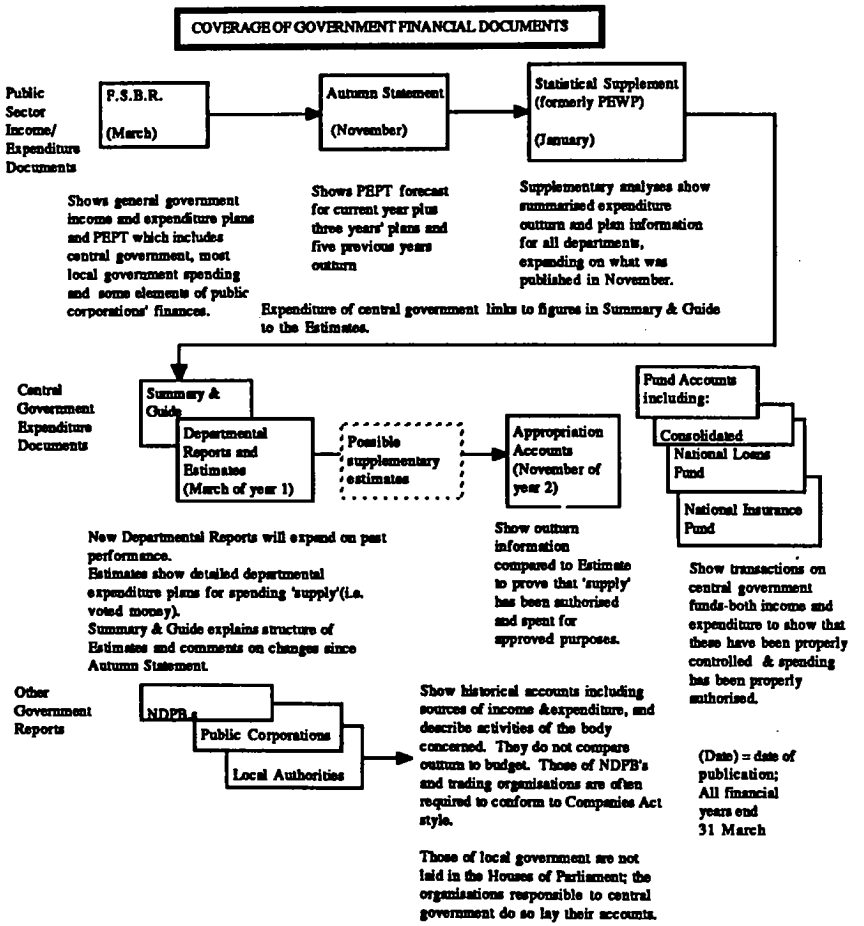



Figure 2.1

# *CHAPTER 3*

## WHAT GOVERNMENT IS AND WHY IT IS DIFFERENT

Given the absence of commercial criteria for judging departments' accounts it is not enough simply to report to Parliament the quantity of spending; spending alone gives no indication of its quality or what has been achieved. The term "accounts", in the sense of documents which are part of the process of accountability - ie accounting for the actions of the government (or "administration") to Parliament and the public - is therefore used broadly in this book to include documents giving any financial information, both plans and actual outturns, together with related explanations and indicators of performance. Published government accounts and other financial documents in this sense are not the same as private sector or commercial accounts, such as company reports. They are different in form and coverage and, even for accounts of outturn compared with plans, their purposes may be different. There are differences between private and public sector financial reports, most of which are a result of the public sector environment or of the history of their development. This chapter describes some of these differences under the broad headings of:

- The nature of government and the public sector;
- The nature of the political process;
- The relationships between providers and consumers of output and resources;
- The nature of capital assets.

### THE NATURE OF GOVERNMENT AND THE PUBLIC SECTOR

#### What is Government trying to account for?

Government operations cover a very wide field, whereas those of most private sector organisations are very narrowly focussed. Most private sector organisations are vertically structured entities, with legal ownership links; and

groups usually have some form of holding company or entity at the top of the corporate pyramid, whose shares are often held or traded by the public. Government is not similarly owned. Some additional features of the government's situation which have an impact on the way it accounts are: the nature of the services provided; the nature of its income and resources; its economic policy role; its size; and the nature of its organisation. These are described below and are followed by an indication of how government accounts are prepared to reflect the circumstances of the public sector.

The nature of the services provided

Public services divide into those for which direct charges are made and those which are financed by general taxation. The latter predominate.

a) *Directly charged services and nationalised industries*

The public sector provides some services which are paid for by the consumer. Many of these operations are organised in a way similar to those of trading operations in the private sector. Examples include those formally set up as departments financed by trading funds (eg Royal Mint and HMSO). There are also the nationalised industries (eg British Coal or the Post Office) which are merely government owned not government run, ie they do not actually provide "government services". Such operations are not very different from private sector operations and, although ultimately under government control, are separated in various ways and in different degrees from day to day government involvement. While in public ownership, these bodies will be under a form of control which, for instance, depends on their demand for public resources (eg through being loss makers or requiring borrowings to meet capital investment) or on the extent to which they are monopolies (eg electricity supply). Even where a particular form of financial control is applied, such as an "External Financing Limit" (see below), there may be different degrees of administrative or monitoring controls to which any particular body is subjected by its sponsoring department, depending on its circumstances and the political ideology prevailing. Industries in the

private sector may of course also be subject to controls over price levels or how they run their operations in the interests of consumers, safety or the environment. Particular examples are the regulated monopolies which have been "privatised". As with government owned entities, such private companies may be required to produce specific forms of account as a condition of their licence to operate.

Certain services provided by government departments are charged for directly, to cover their "full" cost (or to make a substantial contribution to it) but are not set up formally as separate trading entities. Such activities include health services charged to the public, drugs, or the sale of research work. The public may also purchase, and thus contribute to the cost of, necessary services made available for incidental use by the public (eg weather forecasts, maps or rescue services, all primarily required for defence purposes). In all cases there is a policy option whether or not to charge and how much to charge for the service given.

b) *Services not charged for specifically*

For the main bulk of general government activity in providing services few or no direct and specific charges are made, eg most health, school education, defence, police and the law. For these services, performance cannot be measured by commercial indicators such as profit - a point to which we shall return later. Another aspect of services provided "free" to the consumer is that there is an almost infinite demand for most of them (a logical inference from economic theory) but the supply has to be rationed since resources are not infinite. Central government revenue support grants are one mechanism to achieve this. The measurement of the ration and its effectiveness can be endlessly debated, and is difficult to pin down in financial terms; non-financial indicators have to be provided in accounts to complement financial ones so as to measure success in providing such services not only economically but also efficiently and effectively. Attempts are, of course, made to control the ration at an individual level - for instance

the concept of community charges which are designed to make those who benefit from local services pay a proportion of the cost.

Public sector income and resources

Public sector resources are very diverse. They come mainly from taxation and borrowing but also from public companies and corporations which pay dividends and interest on investments held by the public sector, the sale of assets (ranging from whole enterprises and shares in companies to land, books and trees), the sale of services, and the sale of rights or privileges, such as licences for firearms, cars and drivers, passports and company registrations. However there are two main features which are reflected in the accounts. First, most government income does not arise through the sale of goods or services at market prices in the open market, but comes from levies such as taxes, which are approved by Parliament. Second, the income of public sector corporations owned by government, such as nationalised industries or trading funds, arising from the sale of goods and services by those industries, is not regarded as government income and is thus not consolidated in government accounts; such turnover is dealt with in the accounts of the entity concerned.

Economic policy

A major activity of government in recent times (particularly since the time of JM Keynes) has been the attempt to direct the economy with a view both to maximising its potential for creating wealth and to countering the effects of economic cycles, thus providing better services and greater wealth in the community. Government policy and actions can take many forms and some of these generate flows of cash through central or local government. Such flows have to be planned and accounted for. These include:

expenditure — purchases of goods and services by the public sector. The actual level of expenditure has, of course, a major impact on the economy

| | |
|---|---|
| taxation | what the community pays annually to general government funds out of its income or wealth and how this tax is structured |
| direct charges | what the community pays specifically for particular services provided |
| redistribution | through receipt of taxation, levies or national insurance contributions on the one hand, and through payment of money (eg for social or regional programmes) on the other, resources are transferred from one section of the community to another |
| borrowing | loans received or repaid by the public sector, in the UK or abroad. |

Economic aggregates and indicators, such as totals for money supply, credit and interest and exchange rates, are used extensively in formulating economic policy. However, the significance of taxation, borrowing, redistribution and spending for government financial documents lies in the fact that these activities generate flows of resources which are recorded in the government's accounts. The sale of gilts in the market, for example, which absorbs savings and reduces money supply, results in government obligations increasing, and payments into the National Loans Fund (NLF). Borrowing, as we have already seen, also funds any deficit of government expenditure over income.

Government is, of course, constrained in what it can spend to achieve policy objectives while still remaining solvent in the very long run. However in the short or medium term, rising deficits shown in its accounts do not necessarily have the same implications as they would in a private company. Economic strength (ie taxable capacity) of a nation is not necessarily reflected in, for example, a strong government budget surplus, public sector debt repayments or a large asset base. It is future taxable capacity taken together with their own resources which gives governments the ability to run a budget deficit for a long

period. It is this point which can give rise to confusion in calls for government balance sheets; even if prepared they would not tell a complete story about future resourcing. However, they might show how, as a matter of accountability, the government had used the resources it inherited and whether it had reduced or increased the liabilities or burdens to be met by future generations.

Size of government

The size of the public sector is the main reason for its impact on the economy. Government operations generate "public expenditure" (as defined) amounting to about 40% of Gross Domestic Product. This very large proportion demonstrates the significance of the size of UK public spending by comparison to that of even the largest multinational companies. This size, of itself, carries with it a responsibility on the government of the day to be accountable for its actions to the community; its decisions affect the lives of all citizens, and have an economic significance which is greater than the actions of other individual entities. Government's accounts in the widest sense are important to the process of assessing its activity and are vital to ensure its accountability to Parliament and the public.

Organisation of governmental activities

An important feature of government and the public sector generally which makes it more difficult to account for than commercial entities is not only the diversity and size of its activities but the diversity of organisational structures in the public sector. Central government's activities are carried on through a large number of types of organisation, which account for their expenditure generally on a strictly annual basis because most government bodies and departments (unlike public corporations) are not permitted to hold reserves of accumulated surpluses or unutilised spending authority.

Examples of central governmental bodies include:

*Non-trading organisations*

- departments with few or no resources except funds voted by Parliament;

- departments which do not trade, but receive some funds from the beneficiaries (through sales, charges etc) in return for providing specific services, which funds are then "appropriated in aid" of departmental expenditure;

- other central government bodies, such as commissions, councils, agencies, funds, companies limited by guarantee, boards, and services (many of which are called "non-departmental public bodies" or NDPBs) for which their sponsoring departments may obtain voted funds or subsidies from Parliament. These bodies devote such funds to particular authorised purposes and are then accountable to the Minister and through him to Parliament for such spending and activities.

*Trading organisations*

- Trading departments and other bodies, such as the Forestry Commission or the Ordnance Survey, which may receive subsidies, loans or grants of money, as well as trading receipts. These bodies are generally not allowed to hold reserves of surplus or of profit. They are thus accountable for any voted funds on a strict annual basis and are not allowed to hold over surplus spending authority from one year to the next.

- Trading funds. There are four trading funds and these are able to function like public corporations, holding reserves. They are thus not strictly accountable to spend a budgeted amount on an annual basis. Of the four trading funds, three are formally government departments (or parts of them). These are Her Majesty's Stationery Office (HMSO), the Crown Suppliers and the Royal Mint. The establishment of these trading funds was enabled by the 1973

Government Trading Funds Act. The fourth (the Atomic Energy Authority) works like a nationalised industry and was established under its own Act of Parliament. There is no essential difference between the operations of trading funds and those of other commercial organisations.

Their history is that they have evolved from certain departments' trading activities which have been hived off into separate entities. They are self funded, having in effect bought their initial assets by having them appropriated to the Fund, NLF loans and/or public dividend capital being provided to capitalise the Funds initially. They sell their services to government and the private sector for a commercial price. However their turnover often has a high government or public sector content. Trading funds are treated as public corporations for statistical and planning purposes since they operate mainly on internal resources (ie trading receipts) alone.

There are certain characteristics which distinguish all these governmental organisations from each other, but particular activities could usually have been set up from a commercial point of view in one of several different forms. The form chosen reflects Parliament's perception of the needs for control at the time the bodies were set up.

Other public sector entities have also to be considered:

*The impact of local authorities*

The concept of "public expenditure" currently in use in the UK includes most expenditure by local authorities, and the structure of their expenditure is very like that of central government; it is organised through a number of similar types of body, all broadly falling into two groups: local authorities themselves and their dependent non-trading bodies, and local authority trading bodies such as theatres and ports. There are also some public corporations whose parent body is a local authority, not a central government department.

*Public corporations including nationalised industries*

The third element of the public sector is the public corporations sector. Public corporations are in essence wholly owned trading public companies. The most important practical difference between them and other forms of public sector trading body (other than trading funds) is their ability to hold reserves. They operate under explicit financial objectives such as to break even, or to make a target return on capital.

Nationalised industries generally have a formal limit placed on their external financing (called an External Financing Limit or EFL) and this distinguishes them from other public corporations. Some nationalised industries were originally formed after the second world war as a result of a number of existing commercial organisations being collected together under one management. Examples have included British Coal, British Rail, and the steel and shipbuilding industries. Others, such as the Post Office, Water and Electricity Supply have largely been public services or utilities since their origin. The nationalised industries were set up by special Acts of Parliament, which gave the bodies concerned particular rights and duties. There is, of course, no intrinsic reason why these industries have to be owned by government. Indeed, in many other countries (and in nineteenth century Britain) utilities were often set up through private sector initiatives. Recently some former nationalised industries have been returned to the private sector.

Forms of account of NDPBs, nationalised industries and trading funds

A list of "Public Bodies" is published each year by the Cabinet Office, and this forms a useful guide to the bodies involved. Many of these organisations account individually for their activities on commercial lines (even if they are not "trading" bodies) taking as their model the normal form of company accounts, which are required to show a true and fair view of the balance sheet, income and funds statements. The majority require an audit report of their accounts. Where appropriate each body is directed by its sponsoring department to produce accounts in commercial Companies Act form under an "accounts direction". This

direction should ensure that sufficient disclosure is made for proper accountability, normally specifying Companies Act disclosure as a minimum. Directions also ensure that appropriate principles (usually taking accounting standards as a starting point) are applied in presenting the accounts. Guidance to NDPB's, departments and other government bodies is included in a manual published by the Treasury entitled "Government Accounting" which promulgates the rules and conventions for government accounting generally. More detailed guidance on the preparation of trading accounts by public bodies is published by HM Treasury, most recently in "Trading Accounts: A Guide for Government Departments and Non-Departmental Public Bodies" (HMSO 1989).

Funding and accounts of departments of government

The central departments of government are quite different in form from trading organisations and NDPBs. Their expenditure is directly authorised by Parliament on the basis of Estimates, which are mainly published in the Spring and approved in the Summer when they become Votes appropriated to specific purposes. These Votes permit departments to request funds from the Consolidated Fund and may also allow them to retain and use, on an annual basis, specific amounts received from other sources (authorised as "appropriations in aid"). These appropriations are usually the proceeds of charges for sales of goods and services and, sometimes, sales of assets. Appropriation Accounts are produced in the Autumn for each Vote showing what was actually spent and received compared with what was authorised.

Departments' Estimates and Appropriation Accounts are formal documents. The first is the basis for granting supply by Parliament, in the annual Appropriation Acts, and the second demonstrates the correct use of that supply; they do not have a commercial parallel. They have their own style developed over the last 150 years and more, now set out in "Government Accounting", and are in effect statements of receipts and payments. The central characteristic of Votes and Appropriation Accounts is that they are used respectively to authorise and to account for funds which are provided from the Consolidated Fund on an annual

basis for specific purposes - to pay for departmental programmes and running costs.

Certain public bodies, such as public corporations and local authorities, receive funds within their External Financing Limits on loan from the National Loans Fund rather than payments voted from the Consolidated Fund. Such borrowings must be agreed by their sponsor department through the mechanism of the Public Expenditure Survey. The authority to borrow from the NLF similarly derives, *via* legislation, from Parliament but such authority tends to be given in tranches without specific time limits. NLF procedures are generally less stringent than the procedures required for payments from the Consolidated Fund because borrowing from the NLF is expected to be repaid.

Funding and accounts of Executive Agencies

In early 1988, the government decided to implement the main recommendations of a report by the Efficiency Unit entitled "Improving management and government, the next steps". The intention was that "to the greatest extent practicable, the executive functions of government, as distinct from policy advice, would be carried out by clearly designated units, referred to as Agencies". Agencies will normally be departments (or parts of them) and in many cases will be financed by a Vote. The purpose of the change is that it will lead to "improved performance and closer identification by staff with their own operational unit and its objectives". Before setting up Agencies, alternative options may be considered including contracting out work or setting up the service concerned wholly in the private sector. In setting it up, the role of the Agency as manager of a service, in contrast to the policy role of the responsible Minister and supporting officials, will be clarified. In addition, the Agencies' main objectives and type of performance targets, powers and accountability of the chief executive and, finally, the Agencies' regime for financial and personnel management will be set down. This process will be summarised in a framework document - one of the first of these was prepared for Her Majesty's Stationery Office in December 1988.

The financing and accountability of Executive Agencies is described in a command paper "The Financing and Accountability of Next Steps Agencies (CM 194)". In addition to the framework document, it is intended to produce commercial style accounts prepared on an accruals basis and including balance sheets for each supply-financed Agency to supplement the Estimates and Appropriation Accounts prepared for each Vote as a whole. The Treasury will have powers to direct the form of such accounts so as to achieve consistency in coverage and form as appropriate. The White Paper CM 194 comments that "the form of accounts suitable for each Agency will need to reflect its characteristics, though suitable reporting of assets and liabilities as well as cashflows .....will normally be required as soon as the data is robust enough to be auditable". Thus it should be possible in due time to extend the reporting of assets under government control in addition to the current cash flow based reporting of actual expenditure against the Vote, which is the normal standard for supply-financed departments' Appropriation Accounts.

Government Funds

Finally, annual accounts for the central government Funds themselves, ie the Exchequer, are prepared. These Funds each serve a particular administrative purpose (and are more fully discussed in Chapter 8). They include the Consolidated Fund, National Loans Fund, Contingencies Fund, Redundancy Fund and National Insurance Fund. Each Fund is provided with income from a particular source and is subject to its own administrative procedures for authorising the use of its resources - within any statutory limitations expressed by Parliament.

Classification of public corporations and other government corporate holdings in central government accounts

Complexities can arise in understanding government accounts because of the way the accounts of public corporations (including nationalised industries) and of other corporate bodies wholly or partly owned by government are dealt with.

Not all government owned companies are classified as being in the public sector at all. Purchases of shares in companies have been made for a number of reasons which may influence their categorisation; mere ownership itself is not the sole or main influence. Companies (or interests in them) have been purchased with political philosophy, strategic interest, control, survival or orderly rationalisation of particular entities or industries in mind. Examples of government interests in companies over the years include shares in BP (initially purchased before the first world war as a strategic holding), Rolls Royce, Rover Group and British Nuclear Fuels. Because of their particular characteristics, these have not been treated as nationalised industries, nor even as part of the public sector, although the majority of the shares have in some cases been owned in a legal sense by government. Other bodies have changed their classification from public to private sector, such as certain Port Authorities, as the particular factors governing these entities change.

The criteria used in distinguishing public from private sector bodies are "control" and "ownership". Control means active control over broad policy decisions such as investment, borrowing and pricing. In broad principle, where the "directors" or board members (or a significant block of them) are appointed by the public sector, or where there are specific controls over pricing or activities, especially where the public sector in effect guarantee the debts of the body, it is usually (but not always) classified as in the public sector. Where a majority of shares is owned by the public sector and even board members are appointed by Ministers, but the control is renounced, the body can be treated as in the private sector.

The basic definition of what should be treated as included in the public sector is different from the private sector definition of what should be consolidated in a group of companies. In both sectors, great store is set by the concept of control. However, in the public sector mere ownership is insufficient as an indicator of control to ensure that a body is included in the public sector. In the private sector, ownership has become such a strong indicator of control that groups are defined in terms of ownership. The emphasis on control as determined by other

attributes can make the question of what is included in the public sector particularly subjective. Company law has been formulated using legal ownership rather than other attributes to determine control as the primary criterion for defining "groups" as it is more objectively determined. However, the concept of control or influence is having an increasing impact on determining accounting treatment in the private sector where legal ownership alone does not fully reflect the economic reality. Thus ownership is not the exclusive determinant of control in the private sector which it once was. The concept of ownership may also become more important in the public sector as its accounting principles develop, thereby narrowing the gap between the two sectors.

## THE NATURE OF THE POLITICAL PROCESS

### Demand for information

Clearly, government is different from other organisations in terms of size and power. The basic objective of a public company is to make the most profitable use of its resources for the benefit of its shareholders and the results can be seen clearly and objectively in the return achieved. The assessment of a government's success or otherwise in its spending of the proceeds of the taxation it has imposed is quite a different matter. In most cases it involves subjective, political judgements rather than measurement. Furthermore the "shareholders" are not voluntary contributors.

A consequence of this is that attempts by the governed to control their governors, and in particular the latter's propensity to spend, have been with us since early times; Magna Carta was an early example. The accounting system now in place reflects the desire of Parliament to be able to obtain detailed information about planned and actual spending, both its amount and how the community benefited from it. As befits the control of such a huge proportion of GDP, the system of accountability for expenditure has many more facets than, for example, the system for reporting company results through the accounts and annual general meetings.

At general meetings of companies, legitimate questions may be asked, for example, about matters of profit, security of the business, assets and the propriety of particular transactions. Matters of detail are dealt with in companies by the directors or an audit committee, normally privately within the organisation; only in extreme cases are Inspectors appointed by the Department of Trade who may publish reports on the results of their investigations into companies. Companies must also obey laws relating to environmental matters, safety, treatment of employees etc. Inspectorates or tribunals within central and local government may take action if these regulations are broken.

The Committee System

The accountability of government is much more public than that of directors. There is no parallel outside the confines of a company itself for the routine system of published Parliamentary questions or the inquisitorial role of the Public Accounts Committee (PAC), whose proceedings are normally held in public. Ultimately the effectiveness of these procedures depends on MPs, the PAC or other committees asking the right questions. To help the PAC do this, not only does the Comptroller and Auditor General with the National Audit Office (NAO) prepare the audit reports for Parliament but he also briefs the Committee (and particularly the Chairman), for its hearings. The audit reports, and the briefing of the PAC, cover the government's expenditure and its economy, efficiency and effectiveness. The NAO's role on behalf of Parliament is thus greater than that of the external company auditor on behalf of the shareholders, actual or potential. It is more akin to a combination of external auditor and internal auditor, reporting on management of resources both to shareholders and the audit committee of directors. Furthermore, because it represents the political composition of the House of Commons, the PAC is made up of members of all parties and is chaired by an opposition MP. Collectively it may not always share the aspirations of the government of the day. Its limitations are that it has limited time and consists of only a handful of MPs, who themselves may not have enough time to master the detail and technical content of all of the matters which come before it. It is nonetheless a

powerful force, given the expertise available to it from the NAO and the Comptroller and Auditor General.

The departmental Select Committee system, dating from the early 1970s, is a further element in the accountability of government. Once again, each contains MPs from all parties whose role is to question spending plans and performance of individual departments and their programmes. This element of accountability has developed considerably in recent years, and greatly increases the capacity of Parliament to debate and question planned and actual expenditure.

The main difference between the all purpose PAC and the specific departmental Committees is that the former is strictly for the purpose of examining retrospectively the economy, efficiency and effectiveness and, where necessary, regularity and propriety of expenditure on the government of the day's stated policies, whereas the latter may look at the merits of the policies underlying such expenditure and at prospective future expenditure. An important effect of this is that the PAC, being audit based, has the benefit of the auditor's access to departmental records which underlie his reports and briefing, while the departmental Committees have to provide themselves with briefing from their own independent advisers, who have no such access to departmental papers.

Parliament's creation of these Committees for examining government expenditure reflects the fact that government has had control, through its majority, of programmes and the actual amount of spending on them. There is therefore a need for Select Committees which can act as a counter-balance, openly debating the decisions of departments and Ministers. There is much more certainty of government getting decisions through Parliament in the British system than there is of the US President forcing his decisions through Congress. Indeed, in the US, there is no necessary structural relationship between the Executive and the Legislature such as there is in the British House of Commons.

Timescale and presentation

There is a pressure on public quoted companies to perform up to the levels of stock market expectation, on an annual basis. Governments too have to achieve demonstrable results, and although the four to five year span between elections gives a different emphasis to the timing, there is still a pressure on governments to report progress. For example, the annual Vote system requires annual reports to enable Parliament to vote on each year's Estimates; the Finance Bill is required annually to secure revenue, and is traditionally presented in the Budget Speech at the same time as a commentary on the economy.

Performance has, however, to be measured or assessed. In companies, indicators of performance are often purely financial. Private sector management is required to secure financial progress for investors and may be judged successful if turnover, profits and dividends rise consistently by comparison with other companies and in relation to capital invested. This will lead, in turn, to higher share prices and greater wealth and security for investors. Underneath and contributory to these visible indicators lies success in innovation, production, marketing, personnel relations, and other aspects of directing the company's business and operations; but these matters are not normally subject to specific published performance reports or public debate.

"Progress" in government is not so easy to comprehend. First, what one section of the community may judge to be progress, another will find undesirable - sometimes even before it is begun. The ordering of policy priorities is crucial.

A large absolute amount of spending is only a crude indicator of policy intentions and no indicator of success in the achievement of objectives; it may in fact merely indicate waste. In view of this, the measurement of "progress" or success has to depend on comparison of achievement with the priorities of the government of the day. It is impossible to find a consistent series of universal indicators accepted by all political parties as appropriate. For example, for all companies, profit is the basic motive and serves as the main accepted indicator of

success. However, if one takes this commercial analogy to the public sector, the aim of one group of Ministers may be to minimise "profit" in the belief that it is more important to pay more to the employees or to reduce charges, whereas another group may set out to maximise the return to taxpayers. Accounting in government has therefore to take more diverse forms than in companies, since the scope of policy objectives is greater. This diversity is inevitably confusing. Claims may be made that the government is using the "wrong" indicators, or is not giving consistent information about what is being achieved.

Second, consistency is important to aid clarity and understanding. For instance, a target may take the form of certain economic aggregates such as public sector borrowing or the Public Expenditure Planning Total. The definition of these targets is thus of great importance, and yet is not incontrovertibly obvious or clear. Moreover, different administrations choose different targets to achieve. To the extent that success is defined as achieving certain objectives, the political importance of meeting these targets is great; so there is pressure in Parliament to improve presentation and accountability. There is a great number of presentational issues: what should be presented, how and in how much detail, and where should the focus lie? The diversity and complexity of ever-changing indicators (which must often change as policy priorities change) could themselves become a shield to government. Consistency, while it may be difficult to achieve, is thus an important principle of government accounting in enabling proper public scrutiny.

These issues are of importance because the nature of the political process is such that, although Parliament can demand what it wants in the accounts, the government of the day has significant influence over presentation and timing.

The ultimate indicator of the government's success is re-election through popularity on election day.

## THE RELATIONSHIPS BETWEEN THE PROVIDERS AND CONSUMERS OF OUTPUT AND RESOURCES

### Relationships in exchange

The main feature of most commercial organisations is that there is an exchange relationship between buyers and sellers. The buyer agrees to take the output at a price. The output only has a value in terms of what buyers are prepared to pay for it and, to survive, a business' costs must be less than sales revenues in the longer term.

This set of relationships does not operate in the non-trading activities of governments, which in this sense are more akin to those of charities. Government's final output is not normally valued or purchased in an exchange in such cases as health, defence or education. This fact has a number of consequences. Because of the lack of priced marketable output, signals of quality (such as high or low demand related to price) may be missing, and inefficiency may not be evident. Most important, turnover and profit cannot serve as indicators of success at all, and other indicators of performance must be used to show whether the "production" is economic, efficient and effective as well as proper, popular and useful.

Governments are often either monopolies or quasi-monopolies in relation to particular services supplied. This fact also has significant consequences for consumers. By definition, they will be unable to express dissatisfaction by using alternatives. Other means of obtaining better services, for instance through complaints procedures, may be ineffective. If there are no other suppliers, the consumer may not even appreciate whether the service is poor or good except in relation to foreign comparisons or past experience.

Another result of the lack of marketable output is that, in terms of the accounts of any service, there is no necessary relationship between revenue and

expenditure as there is in a commercial organisation, since one does not cause the other in the same way as sales figures have some proportional relationship to cost of sales. A higher than anticipated cost of providing health care of a certain standard does not immediately result in higher taxes. This arises in part from the redistribution which is an essential feature of much government activity. Those who pay for services are often a different set of people from those who receive them and, so far as any individual user of "free" services is concerned, there is no relationship between the amount paid and the services received. Thus the financial outturn of government (revenue and borrowing less expenditure) is only an indicator of how taxes and other annual revenue, sales of assets, charges and borrowing have met cash expenditure. These results are not, in contrast with corporate profits or return on investment or growth, an indicator of the success of the underlying spending policies, or of whether they should be continued.

Powers of government

As noted earlier, the power to tax, and to borrow against the strength of the economy, is a significant feature of government which is difficult to put into a set of accounts. This power means that the possibility of meeting future liabilities as they fall due does not directly result from present cash spending policies (save, for example, where these are deliberately aimed at reducing expenditure or generating economic growth). Nor is the accumulated value of government assets (not all of which can be given a meaningful value in accounting terms) more than a partial indicator of public sector wealth available to meet those liabilities. Rather, the ability to pay depends on the taxable capacity of the economy and the wealth of savings available at the time when the liabilities mature. In certain types of company, too, borrowing may finance valuable but written off intangible assets; profit potential may be represented by "losses", for example, expenditure not capitalised on research, development or exploration. Profit potential may not be represented in accounts at all (for example where the company's principal asset is its personnel or its client list). In these cases, as in the public sector, the potential for generating resources is poorly represented by a cost based balance sheet using normal accounting

conventions. Hence the attempt to value brands or goodwill gathers momentum when such deficiencies become obvious in times of significant takeover activity.

However, the assets which are disclosed in a company balance sheet are normally based on cost, modified by views about their future life and potential for earnings or realisation. They can normally be valued. In a government, the fixed assets which might be recorded in its balance sheet (such as buildings and monuments, public parks or "shares" in nationalised industries) are not usually available to repay debts and are not the main indicator of the financial "strength" of the government or its ability to meet liabilities as they fall due. The real asset - the power to raise money from taxes levied on a healthy economy - is not readily represented in conventional balance sheet terms.

Relationships and roles of decision-makers in the public and private sectors

It is tempting to liken Parliament, PAC, the NAO, government bodies and Ministers respectively to shareholders, audit committees, the auditors, a company and its directors. But the relationships are not the same, although the functions have certain things in common. The principal difference is the motives. In a company shareholders invest in order to make a profit for themselves. But taxpayers do not invest in public expenditure in the same sense; they are more like customers who consent to expenditure of their money by government because they are persuaded that it is necessary for their general good. Parliament, representing taxpayers, votes money annually for governments to spend, but this does not result in profit or return on assets which, in a company, would allow the shareholders to judge performance. There needs to be a much more complicated set of mechanisms for securing the economy, efficiency and effectiveness of government expenditure. There are, however, similarities: governments, like companies, need management accounts for detailed control and for administration, more aggregated financial accounts for planning and control at a higher level and published documents to explain and justify their actions to Parliament and the public.

## NATURE OF CAPITAL ASSETS

The nature of public sector capital assets can be difficult to tie down, since normal accounting conventions, based on the prudent deferral of expenditure incurred so as to match expense with income and thus allocate cost over useful life, cannot be applied easily to many of the assets created in the public sector. Some of these assets are intended to give a boost to certain economic sectors and generate a "return" over a much longer time horizon than the private sector would accept - indeed that is the reason why the government is involved at all. Thus regional economic programmes may create factories or housing which have an immediate market value much lower than cost, but which may prove to be the key to economic regeneration in time. The same is true of much education and research spending; certain expenditure on education might not be capitalised at all but education spending in all its aspects represents investing in the future of the economy whether it is on teachers' salaries or on "capital" projects at individual schools.

By contrast, expenditure on ships or buildings may naturally be thought of as capital in the private sector whereas each might be better written off in the public sector if the assets concerned are frigates or monuments. Furthermore, many capital assets belonging to government, such as parks or monuments, are not "productive" and although it is possible to value them for an alternative use, it is difficult to do so sensibly and consistently. It is also difficult in many cases to see what accounting purpose such a valuation would serve. Alternative methods of valuing benefits (such as the valuation of travel costs and time spent by visitors to public amenities) are being discussed for use in other contexts such as cost benefit analysis.

The rate of return on capital must be viewed differently in the public sector when considering non-trading expenditure. First, an asset will normally be capitalised in commercial accounts when it represents a potential future economic resource which is expected to generate a profit. Profit can, in turn, be related to asset cost - ie it is possible to calculate a return on capital. However, many public sector

assets generate a stream of benefits which is difficult to quantify financially and which cannot easily be related in accounting terms to the specific asset itself (eg roads, schools or hospitals). From the responsible department's point of view, such assets may, of course, generate a stream of future operating expenditure which can be related to the asset, and thus the future cash costs can be appraised - which would be a deterrent to capital spending in the private sector! The main point to note is the lack of an accounting rate of return which one can use to justify a value for the asset concerned, and thus the decision to undertake the spending must be based on other factors and analysis.

Although a distinction is drawn in some government and national accounts between capital and current spending in the public sector, using broadly commercial definitions of capital, the capital expenditure is not, as in the private sector, written off or depreciated over periods of more than one year. Since the government's summary accounts take a form similar to a commercial cash flow statement, the notion of capital spending as expenditure whose write off may be deferred is not relevant. However, the distinction between capital and current expenditure is sometimes important in political terms and for control purposes in government spending. It is used to compile data on economic categories used both for public expenditure reporting to Parliament and in the national accounts. Since it is used for control purposes, there is often pressure from spenders to stretch the definition. For example, certain local authority housing repairs may be defined as "capital" for the purposes of particular legislation governing lending so that the authorities may borrow to fund them.

There are several ways in which the concept of "capital" is used in government accounting, serving a variety of purposes. However, the less tangible "assets" mentioned above (such as education) are not so treated or even valued. The concept of movement in the value of the public stock of assets is not represented because there is no public sector balance sheet; the focus is always on the new spending. Although many of the definitions used are based on commercial practice, the definition of "capital" in public sector accounts is different

depending on its purpose and the context in which it is used. For example, capital spending shown in the public sector tables of the national accounts might include purchase of existing buildings whereas, in the government's expenditure plans, these would be excluded because they are not relevant to "capital formation"; the construction industry is concerned only with new building and this is a factor which the expenditure plans might seek to highlight.

Conclusion

All the factors discussed in this chapter mean that the nature of information in published public sector financial documents can be very different from what is published in private sector ones. Different, more diverse, information is given. Annual reports of companies designed for the purposes of shareholders (to whom they are addressed), creditors, tax authorities and other interested parties are required by law to show a "true and fair view" of the profit and the state of affairs according to certain accounting conventions and laws, although even these conventions can conflict; for instance, commercial profit statements may try to reflect economic performance, but may be constrained merely to reflect distributability of profit. Public sector documents, although obviously similarly intended to present fairly what they describe, often do not have a statutorily laid down basis for that. Different documents have different purposes, and the format and style of those produced as supporting material for its expenditure plans can be changed by the government of the day without legislation (though if Parliament were dissatisfied it would undoubtedly say so through its Committees or, *in extremis*, by refusing the government the funds it was seeking). Central government departments' accounts and summary reports are thus not designed to give a standardised view of performance in conventional accounting terms, but are designed to account for cash spending against its intended objective. The forward looking documents explain plans together with trends from the past (emphasising the priorities of the government of the day) - a feature not required to be quantified in normal published corporate reporting.

However, where appropriate, some individual government controlled bodies (for example trading funds) are required to show a conventional true and fair view of their income and expenditure and balance sheet, as well as giving other specified information on performance, although they are not required to publish budgets in detail. The development of similar diversity, if added to the basic true and fair objective, might well benefit private sector accounts, where the impact of accounting conventions and company law has had a stultifying effect on the development of useful reporting of the affairs of companies; in the private sector there is an over-emphasis on stewardship and creditor protection at the expense of reporting performance and less tangible indicators such as the nature and strength of the company's workforce or the goodwill inherent in a strong customer list or research programme. One has only to read the defence documents produced by the management of companies subject to a contested takeover to realise the deficiencies of annual corporate accounts.

The diversity which is a strength of government accounting can, however, also be a weakness, and can serve to confuse. The flexibility of the accounting framework means changes can occur regularly. Furthermore, successive governments with different priorities may adopt new procedures and information to suit their ideology and changed circumstances. This may lead to too much complexity of form, complete with sometimes unnecessary information which continues to be produced because it was once requested. The outsider may feel that there are too many ways of looking at the key concept of public expenditure for ease of understanding, and that too many documents are produced for many different purposes, whose links with each other and styles of preparation are obscure or require too much specialist knowledge to comprehend. In some ways this is an inevitable result of the complexity of government operations and the tendency of information to proliferate over time. Although recent developments have simplified and improved many of the links between documents and improved the format of some of the information presented, fundamental changes of emphasis (such as removing local authorities' expenditure of their own resources from the Public Expenditure Planning Total - see Chapter 5) are

confusing to outsiders who may feel that information has been lost or eliminated unnecessarily. It may be easier to understand the present structure in the context of how it developed. The next chapter therefore describes the main developments over the last century. This said, development of public sector reporting could no doubt still benefit from more consistency of reporting, over time and between different government entities, and a more transparent and easily comprehensible hierarchical structure.

# *CHAPTER 4*

## HISTORICAL SURVEY OF DEVELOPMENTS IN GOVERNMENT REPORTS

The system of government accounting was not designed as a whole but grew to meet perceived needs as they were seen to arise. This has resulted in a plethora of documents and procedures. Over time, these have changed in relative importance, with new forms superseding old, and old ones sometimes now serving different or less important purposes from those originally envisaged.

The main need for financial information about central government has, historically, been to control the supply of funds raised by taxation. The process of Parliamentary control of supply of funds, (as originally made available to the monarch, and now voted to the government of the day) is at the root of the whole system of central government accounts. Parliament is in charge, and ultimately it decides what documents and explanations it wants to support the government's requests for the supply of funds. Tempering this control is the fact that the party in power predominates in Parliament and, if secure in its position, the government can usually get the supply it wants to carry out its policies. If this seems obvious, it is worth remembering again that the US President does not have the same degree of control over US finances.

Early control and framework of government accounts

Attempts were made in the early nineteenth century to improve control over expenditure and accounting. But the central government administrative framework which was inherited from earlier times was quite inadequate for the task. From about 1688 the Treasury kept yearly revenue books from which it was possible to derive balanced accounts of income and expenditure. The system of keeping the public accounts in those days meant that every separate head of receipt and the produce of every particular tax was specifically appropriated by law to the discharge of particular heads of expenditure, each one kept under a distinct head of account. Thus under the Customs head, in 1785, there were over

70 distinct accounts, in each of which the Exchequer balances, receipts, and issues were separately shown. The Commissioners of Public Accounts, in 1785, referred to the difficulty and confusion caused by this complicated system and recommended not only that one head of Customs should cover the whole of this revenue but also:

> "the formation of one Fund, into which shall flow every stream of the public revenue, and from whence shall issue the supply for every public service".

It was this recommendation that led to the establishment of the Consolidated Fund on 10 May 1787 under the Act 17 Geo 3, c13. As a matter of fact, this was not the first "consolidation of funds" but this Act established the Consolidated Fund which continues to be the principal government Fund to this day. However, its control was not complete and there was no strong mechanism for aligning the spending of departments with government policy, or ensuring that money voted by Parliament was spent as intended.

One nineteenth century measure, for which William Pitt is remembered in history books, was the setting up of a Sinking Fund to repay the National Debt which had risen during the Napoleonic wars. The concept of such a fund is dependent on a budgetary surplus, and, during the nineteenth and early twentieth centuries, thrift bringing about a budget surplus was thought to be a "good thing". Tax minimisation was also thought to be economically desirable, and in the best interests of business. Control of public expenditure may thus have been designed to minimise the amount of tax required rather than with some global economic motive in mind, but control of spending of itself was also an objective which found favour in the social and political climate of the day.

Significant reforms of government accounting were undertaken in the nineteenth century to achieve better control of spending. One was the presentation of balanced annual accounts of income and expenditure to Parliament; this started in

1822. But the Treasury controlled the detail of these accounts and Parliamentary control was weak. True, Parliament appropriated funds to particular purposes, but it did not have a mechanism whereby to pursue government spending and to ensure that it was spent as intended. Nor did it insist on the proper presentation of actual expenditure compared to estimate.

The next step to improve control was a procedure instituted for the Admiralty in 1831 by Sir James Graham. He required an account comparing actual Navy expenditure with estimate to be presented to Parliament, although the latter was not required to pass judgement on it. This procedure was a model for the major reforms of the 1860's. Tax collection was improved by requiring all taxes, not only excise and customs dues, to be paid into the Consolidated Fund through which all spending was then channelled. Previously, certain taxes still passed directly to spending departments.

Gladstone's reforms

Revenue was now better dealt with but the control of spending from the Consolidated Fund required further steps, which were taken in Gladstone's reforms of the 1860's. The first of these (resulting from a recommendation by the Select Committee on Public Moneys, appointed in 1856) was the creation by Parliament of its Public Accounts Committee (PAC) in 1861 to scrutinise the detailed expenditure of government for "regularity". This Committee (of members of the House of Commons only) was set up by Standing Order of the House of Commons; apparently, one reason for the use of this mechanism was that the Committee's establishment by statute could have entailed apparently undesirable interference in its constitution and procedure by the House of Lords. Its main function was to report to the House on the audited accounts presented to the House and referred to the Committee under the terms of the Standing Order.

Gladstone also started the ritual of presenting "the Budget" as an annual summary of public finances, a reform remembered today because of his famous

red budget box. The Budget Statement covered the year about to end (both revenue and expenditure set against the Estimates), showed Estimates for the year just beginning and finally summarised any changes required to taxes levied. For control purposes, Gladstone was determined to improve the "annuality" of the finances, ensuring that all receipts and payments within any fiscal year were completely reported and authorised, and that there was no blurring of the annual authority for spending by carrying over unspent balances from one year to the next.

This rigid annual framework which has, in essence, remained in place ever since, gives Parliament absolute control in principle but is not always ideal in practice. Accordingly there has often been pressure for its relaxation, particularly where longer term projects are concerned. Further problems arise over annuality when the timing of receipts related to expenditure cannot be predicted precisely. More importantly, strict annuality can lead to wasteful spending, particularly near year ends, so that continuation of the level of a particular budget is demonstrated to be necessary. Some flexibility at year ends, enabling departments to carry forward unspent spending authority (within prescribed limits) is occasionally permitted nowadays, however, and various other procedures have been initiated to ameliorate the effects of too strict a doctrine of annuality, but the basic principle of annual spending authority expiring if unspent at the end of each fiscal year remains intact.

The Exchequer and Audit Departments (E&AD) Act of 1866 was Gladstone's main accounting control measure. It laid down the basic framework of administration to ensure proper accounting for, and audit of, voted cash expenditure and required the presentation of the Comptroller and Auditor General's reports to Parliament. All such reports were, as described above, referred to the PAC by Standing Order of the House. The E&AD itself worked with the Treasury and the PAC to improve accounting, eliminate irregularities and ensure that proper accounts were rendered: statements of miscellaneous cash

receipts - fines, fees etc - "appropriated in aid" of departmental objectives and statements of gross cash expenditure under suitable headings were required by the Act. Once the fiscal year ended, the Act required unexpended balances of cash to be physically surrendered back to the Consolidated Fund.

1921 Reforms

Over the next 50 or 60 years, the accounting process developed, as did the size of the public sector. During the last twenty years of the nineteenth century the practice and position of the PAC also changed. Irregularities had by then become much fewer than in the early days of the arrangements made in 1866 and the detailed examination of expenditure became more a function of the administrative E&AD. The PAC took more of a broad look at departmental spending and its general economy and efficiency. It began to deal with questions of waste and extravagance in carrying out a given policy rather than irregularities in spending the money voted. This role of the PAC has continued and further developed to the present day and now embraces the concept of the third "e", effectiveness. It is essential to understand that the PAC was, and is still, not designed to question the validity of the government's policy itself since this would undermine the democratic process of policy making.

After half a century, the 1866 Act was reviewed and parts were repealed and replaced by the E&AD Act 1921. Some details of the 1866 Act had become obsolete, eg the physical surrender of balances to the Consolidated Fund became inconvenient and was not really necessary. However, the basic nineteenth century system was retained: expenditure for which supply was voted and issued was required to be proposed to Parliament on an annual cash basis, first in the form of Supply Estimates requesting authority to spend, and subsequently in the form of an account of spending against Parliament's appropriations to show that the authority for each type of spending had not been exceeded. The framework for raising taxation was in place under the system of annual Finance Acts, and all income from taxation (and much else besides) was required to be dealt with *via*

the Consolidated Fund. Payments out of the Fund had to be requested by the Treasury and were authorised daily by the Comptroller and Auditor General (acting here as Comptroller) strictly in accordance with the Parliamentary authority granted in the Votes of supply. All was dependent on the notion of annual control of cash and this same system of accounting for raising and spending money continues broadly in the same form to this day.

The 1921 Act dealt with a number of matters. For example the C&AG was to certify Appropriation Accounts in a particular form. The Act also enabled the Treasury to require departments to prepare accounts of their trading activities, together with balance sheets and profit and loss accounts. These accounts were regarded as necessary to ensure economy and proper charging because they exhibited the total cost of the operations concerned in the same way as those of a commercial company, including notional costs for items not charged directly to departments in cash (such as depreciation, superannuation, interest on capital and insurance) as well as the actual cash expended within the year.

Cash or commercial accounting?

At the end of the first world war the question was raised as to whether or not accruals accounting would be a better system for all government accounts, not just the trading activities. During and immediately after the war, a number of accountants had been recruited to departments like the Ministry of Munitions. They and others were critical of the cash basis of Appropriation Accounts. First, these accounts did not value the services provided, or liabilities at each year end. Second, the division of Votes and subheads according to the nature of the outlay (eg wages) rather than their purpose (eg defence) was thought to be uninformative from the point of view of describing expenditure. These criticisms resulted in proposals for "commercialised" government accounts which were put to the Select Committee on National Expenditure in 1918. The Committee's Seventh Report recommended radical change. In addition to cash estimates, expenditure estimates on the basis of actual costs should be reported; accounts

should comprise a department's total expenditure, including the cost of services rendered to it by other departments; estimates should be grouped by purpose; finally there should be one comprehensive series of accounts for each service of the state. Supplementary and subsidiary accounts (which had proliferated) should be discontinued; at all levels (sectional, departmental and Parliamentary), the accounts should use like units of cost enabling cross comparisons to be made. Effective criticism, it was said, would only be possible by summarising the broad lines of expenditure, not by "massing infinite details".

These changes were made in a pilot scheme from 1 April 1919 for the War Office and throughout the Army. They aimed at showing the true cost of consumption of resources in each year, on both an aggregate and an army unit basis; they would hopefully result in decentralising decision making to unit commanders, and thus demonstrate the efficiency of the service. If all went well, it was hoped that income and expenditure accounts on an accruals basis would ultimately replace the cash system throughout Government.

The Committee's hopes were not fulfilled. In particular, the necessary valuation of assets proved difficult to achieve. Moreover, it was thought at the time that Army expenditure was not susceptible to commercial accounting treatment, mainly because the objective of commercial accounts was the reporting of profit whereas the idea of military efficiency (which was not an economic concept) was not thought to be easy or even possible to appraise purely in terms of money. A further significant factor was that, as the whole government did not move over to an accruals based system, the Army had to keep its books both in cash and in accruals terms, resulting in significant extra expense. Thus, after five years or so, it was proposed that the accounting system should revert to cash, although the PAC recommended that supporting information should be prepared on a full cost basis.

This was the first time that a replacement for cash accounting was seriously considered for the main Parliamentary control system. The complexities of asset valuation and the considerable labour involved in extra accounting were the main practical hurdles. The financial position of the War Office in terms of liabilities does not seem to have been an issue. Moreover, a number of judgemental issues such as setting appropriate lives for assets and, most critical, the difficulty of control of resources using an accruals based accounting system, were never addressed. However it was recognised that the management of services requires accounting techniques different from the cash system which was the basis of Parliamentary control. Economy and efficiency require decisions to be based on full cost figures, while overall resource allocations for any one year are more directly controlled by Parliament on a cash basis.

The Crick Committee Report on the Form of Government Accounts

The Crick Committee undertook the next major review of government accounts in the late 1940's. It was set up to report on the departmental accounting system. The terms of reference required it to assume that the system for Parliamentary accounting would remain in place. However subject to this, the desirability of accounting on an "income and expenditure" basis was to be considered. The Committee reported in 1950, but its report was reprinted 23 years later and is still referred to, so lasting were its conclusions. These broadly suggested that:

a) accruals accounting should be restricted to trading activities, partly due to the insuperable practical difficulties of valuing fixed assets;

b) the main Parliamentary control framework should be on a cash basis because of the importance of the Consolidated Fund, in cash terms, to Parliamentary control;

c) large permanent trading organisations should be constituted as trading funds, or reported in trading accounts if not so constituted;

d) notwithstanding the basic recommendations to use a cash based system, the Revenue and Excise departments should publish statements of taxes receivable; the Appropriation Accounts should publish statements of departmental assets and liabilities; finally a statistical summary of central government monetary assets and liabilities, holdings of shares and certain fixed assets, and a statement of deferred, contingent or actuarial liabilities should also be published;

e) a reference guide to government accounts should be published, giving a key to where information could be found;

f) a statement of "consolidated [financial] relations" of departments and central government agencies with the public should be published annually and possibly quarterly.

Crick's last major recommendation was that the methods of government accounting should be kept under constant review in the light of modern developments. Current perceptions of the need for more efficient and economical government have lent added weight to this recommendation and the pace of change and development of resource management requirements has quickened during recent years, bringing with them the need to consider asset accounting further, particularly for management purposes and not only for trading activities.

Many of Crick's recommendations have been put into effect, although some not as a direct result of the Report itself; for example government trading funds came about under a 1973 Act (partly as a result of the 1968 Fulton Committee report on the Civil Service). Some of Crick's other recommendations have not been taken up but are still relevant; for example enumeration and valuation of assets and accounting for commitments were rejected at the time because of the enormity of the task of accounting for them on a continuing basis. Computers

have made many of these tasks easier today, although it may appear no less daunting to start the necessary procedures by taking stock. The most appropriate basis of valuation of many government assets is still the subject of considerable debate, but now some departments are developing asset recording systems for management purposes. However, accounting for and reporting the build up of liabilities facing tomorrow's taxpayers has received less attention in government accounts, although it is very important facet of accountability.

National Audit Act 1983

The gradual development in the practice and purposes of government accounting, accountability and audit since 1921 were given a new statutory framework by the National Audit Act 1983 which provided for "value for money" (VFM) audits and the setting up of the National Audit Office (NAO) to replace the Exchequer and Audit Department. The NAO works under the direction of the Comptroller and Auditor General (C&AG); the latter is an Officer of the House of Commons reporting to the PAC rather than being responsible to a government Minister. A formal right of access to most government papers for the purpose of his audit is given to the C&AG.

The effect of this Act was largely to codify existing practice whereby the C&AG's reports regularly commented on economy, efficiency and effectiveness of operations in government departments and certain other bodies to which government money is granted. VFM examinations had been carried out since the end of the last century, but the Act provided a statutory basis for such work. One effect of the examinations has been to underline the importance of good management accounting systems within departments, to complement the systems for reporting cash spent.

Developments in planning and control

So far we have dealt with retrospective reporting. However, control depends on effective planning and monitoring, as much as on accountability after the event.

## HISTORICAL SURVEY OF DEVELOPMENTS IN GOVERNMENT REPORTS

The growth in the scale of government activity this century has led to an ever increasing awareness of the need to plan expenditure in advance. This need has been reinforced by high levels of inflation.

Government financial planning processes and related documents have developed much over the last 25 years, as a result both of changes in government thinking and of the promptings of Parliamentary and other independent Committees. However, a very significant force for change was the inexorable rise of public spending after 1940. The most important post-war development was establishing the Public Expenditure Survey Committee in the early 1960's, and the annual Public Expenditure Survey (PES), which has been much studied throughout the world as a budgeting system. Its original purposes were twofold: first, it was to give politicians a view of the spending implied by present policies set in the context of likely future financial resources, and second, it would enable a comparison of the different expenditures proposed. Thus, in theory, Ministers would be able to make rational decisions about spending priorities within a certain level of total government spending.

The PES grew out of a backlash against public spending. More than this, it was a backlash against automatic unplanned increases in spending. Spending had risen during the second world war, and continued to rise thereafter, a consequence of the welfare state and nationalisation of major enterprises, with no apparent adverse consequences. Furthermore the advent of Keynesian economics, which dispelled for a time the old nineteenth century orthodoxy about the balanced budget, meant that there was no visible annual yardstick to limit spending as there had been previously. A small budget surplus was no longer considered necessarily to be a "good thing". Furthermore the social and political philosophy which had underlain pre-war government, to the effect that spending was basically undesirable, no longer held sway. But concern increased during the 1950s. If spending grew at a greater rate than national output, it would only be a matter of time before output was entirely used up in public spending. There

were other worries as well. Spending programmes which had begun on the basis of a small estimated cost tended to grow faster than originally anticipated, once under way. Cuts attempted on an annual basis were inefficient and wasteful, but nonetheless projects, once commenced, sometimes had to be halted midstream. The strict ideas of cash control embodied in Gladstonian annuality just did not work well in practice, as a control system, when programmes stretched far on into the future. By the time next year's spending decisions were taken formally by Ministers and then by Parliament, it was at least two years too late to change direction significantly.

The Plowden Report

So it was necessary to consider the future and cost programmes for more than one year at a time. This had been done before, particularly for defence, but what was needed was a systematic planning process, setting out all programmes for a period of years ahead and allowing Ministers to trade off one item of expenditure against others in the context of spending plans taken as a whole. In 1959, an internal government inquiry was set up (with the support of the Chancellor) partly as a response to calls by the then Select Committee on Estimates for an independent one. It was chaired by Lord Plowden, and there were three independent members; the Committee was assisted by senior Treasury officials, whose ideas were presented in the report. The key recommendation was that "decisions involving substantial future expenditure should always be taken in the light of public expenditure as a whole, over a period of years, and in relation to prospective resources".

Public expenditure and the PES system

The PES system as it evolved worked initially like this. Plans were based on Treasury forecasts of key economic assumptions sent to departments around November. By February, departments submitted their initial forecasts for the balance of the current year to March plus four years ahead. By May the Treasury and departments had agreed certain statistical assumptions, detailed what the

prices and levels of service were to be and agreed the likely cost. The initial report was prepared by June in the Treasury and set against the Treasury forecast of likely resources. The bilateral discussions between Treasury and departments then began, ending in Cabinet decisions by November, reported in the White Paper on Public Expenditure published in January. The Estimates supporting the White Paper were published in March, thus setting plans for the year commencing in April. The whole procedure was iterative and was in continuous process. Most of the timing of the PES is still the same because it is necessarily geared to the production of the Estimates in time for the Parliamentary timetable.

The development of the PES in the early 1960's (the first Survey was in 1961) was a natural springboard for developments in the way expenditure plans were reported to Parliament. The first published version of the PES was for 1963/64. Annual Expenditure White Papers were used from 1969, following a government discussion paper (the first "Green" Paper, Cmnd 4017) on presenting expenditure. Parliamentary scrutiny was improved at the same time by the formation of the Select Committee on Expenditure, which dealt with all aspects of expenditure, not just Supply Expenditure.

The new PES system took some time to develop as a tool during its early years. The key to planning sensibly was to make realistic estimates, not only of likely future expenditure but of likely future resources as well. In the 1960s both were miscalculated. Public expenditure rose as a percentage of Gross Domestic Product from around 39% in 1963 to over 46% in 1968. Economic growth, forecast at over 4% per annum, failed to materialise. So *ad hoc* spending cuts had to be made. The PES planning process did not perform well as a financial control procedure. Indeed it was never intended to be one; it was a political decision-making model set up to allow ministers to take decisions on the appropriate level of public expenditure. The first few PES exercises showed expenditure for the plan year and for the fifth year on in the cycle. After 1967,

the intervening years were filled in to show the spending "path". In the late 1960s there was an attempt to make year 3 a "focal year", on the grounds that years 1 and 2 were almost fixed, and years 4 and 5 too vague. Year 3 thus became firm, and years 4 and 5 provisional.

Real control of spending by the PES Committee in its original formulation was however impossible. Two significant problems were first, that the Survey was conducted in constant price terms based on certain volumes of inputs, and second, that it was based on programmes not departments. Constant price forecasts meant that one year's plans for more than one year ahead could not be directly compared to the next year's plans for the same year since, with inflation, the unit of account was different. Moreover, inflation was not accounted for as a specific adjustment in the plans. On the second point, programmes cut across departmental responsibility and accountability for spending, so responsibility for cost overruns was difficult to tie down and report. As PES became the main focus of departmental thinking it eclipsed the well tried Estimates procedure (which of course continued to be the formal authorisation process), but was not of itself a good mechanism for control. The PES concentrated on the future, never taking a formal backward glance in public. Rather it assumed, and to work well required, a certain consistency and predictability for both spending plans and external factors such as economic growth and inflation. Furthermore it aimed at stability in public expenditure paths as an important policy objective.

The annual Public Expenditure White Paper (PEWP) developed in the early 1970's partly as a result of the developments in thinking about the control of expenditure. The White Paper began to show actual outturn alongside the plan for past years. As public expenditure began to exceed available resources in the mid-seventies, resulting, for example, in the need to arrange credit with the International Monetary Fund, controls became still more important. One of the most significant developments of the 1970s was the concept of cash limiting certain programmes; this was first used in 1975. The cash limits had to be applied in the context of the constant priced (so called "volume based") estimates

of expenditure contained in the PES, but the significance of the development was that a real control feature was embedded in the process, which had hitherto concentrated on planning. One particular financial aggregate also began to be used as a target - the Public Sector Borrowing Requirement (PSBR). This was, in a sense, another control feature. By 1977, the PEWP document had developed, and appeared in two volumes giving respectively a general overview and details of particular programmes which could be accommodated within the target borrowing requirements. But, from a public accountability standpoint, it was still difficult to see the connection between the PEWP and traditional government Estimates and Appropriation Accounts. They were, in effect, parallel systems.

The fact that public expenditure continued to rise above expectation during the 1970s was due to several causes. The most important was unexpected inflation, and the upheaval in the world economy caused by the oil price rise of the early 1970s. But there were others: output fell in the developed world partly as a result of the oil price rise. High wage demands and interest rates combined with other factors to produce a combination of unpredicted inflation and recession that was just not dealt with well enough in the context of the PES system. PES emphasis lay on decision making based on forward planning which assumed a more predictable and stable environment. The PES used constant prices and volume based estimates, and planning totals were not translated into cash control figures. The cash cost of public expenditure had increased for three reasons during the 1970s. The quantity of services provided (ie volume) had increased by some 40%; this was planned in the PES to match hoped for economic growth. There were also "unplanned" increases caused both by general and by relative price inflation; in addition to general prices rising at rates which were often in excess of 12% pa, high wage demands had increased public sector wages relative to general wage levels by about 2% pa.

The PES itself did not deal with general inflation at all after the Survey period had begun, although relative prices were considered and a further step was made by the cash limit system in 1975. Planning public spending on the basis of the price levels prevailing 18 months before the start of the plan period when inflation was running at annual rates in excess of 12%, and in some years even 20%, has something of a fairy tale quality about it; the units used in the system were nicknamed "funny money" perhaps unsurprisingly. The PES system assumed that Ministers would make a proper reduction in spending when the "prospective resources" referred to by Plowden did not materialise through small or negative growth, and "the survey of public expenditure as a whole" in volume terms was subjected to strong inflationary pressure. That required difficult political decisions in the short term to ensure a long term benefit; it is always difficult for a spending Minister to shake off a loyalty to his department and its programmes in order to support collective calls for spending reductions in aid of the common weal. In effect, a decision to deal only with the cost (at constant prices) of a desired volume of services amounted to a decision to spend an unknown sum on inflation, irrespective of the inflation rate or the resources which would be available. Not until 1975 were cash outturns published in the National Accounts Blue Book which could be compared to the plans. But although these helped analysis and accountability, the PES system of the 1970's itself neither clearly exposed the facts upon which political decisions ought to have been taken, nor forced decisions to be taken as a result of the comparisons of plan and outturn.

Cash versus volume planning

The most significant change in the way government prepared spending plans in the early 1980's was the change from planning in constant priced volume terms, or "funny money", to cash in 1981. Cash limits, which were a step towards cash

had been used for five years by this time. The change to cash

e actual outturn to be compared to the plan in the White Paper

ably confusing adjustments which had been necessary to adjust

plan or survey prices to actual cash at price levels when spent. Estimates of resources could also be made straightforwardly in cash terms on the basis of tax rates applied to economic forecasts of income after allowing for anticipated inflation.

Cash planning requires an assumption about inflation to be built into the forecast. The accuracy of this assumption is critical in a number of ways. First, if it errs on the side of estimating too low a rate, the government would in fact have to cut the real value of services or let the cash plans be exceeded. Which of these alternatives is chosen depends on many political factors, but it is obviously an important discipline not to exceed stated cash targets if cash is the basis on which plans are presented. By contrast, where plans are presented in volume terms, it may be politically easier to stick to these and let cash plans slip. Second, there is considerable political significance in indicating future expected rates of inflation. These may become minimum wage rise targets and there is thus a certain pressure to set the rate at a low "target" level. Inflation rates were low during the mid 1980s and the inflationary pressures on the system were less than they were during the 1970s. Higher inflation rates obviously place stress on a cash based system since inflation is accounted for, by contrast with a constant price one where it is not.

Cash limits

Cash limits have developed during the 1980s. For instance they covered some 60% of Supply Estimates in 1987. Cash limits in conjunction with cash planning have become significant control features of the public expenditure planning and monitoring process. Non-cash limited programmes are called "demand-led". These are programmes where a certain level of payment or benefit is made if given external criteria are met; the government then has no control over the amounts paid out. Such programmes include, for instance, unemployment benefit, NHS drugs and redundancy pay.

Departmental structure of Estimates and PEWP

A further important development between 1983 and 1987 was the move from a programme basis to a departmental basis of compiling the PEWP and the better linkage of PEWP and the Estimates. This has required considerable changes to government's internal accounting mechanisms. With the previous system, the PEWP was structured on the basis of programmes - eg higher education, housing etc - whereas the information flows came *via* the departments concerned (ultimately summarised in the Appropriation Accounts); more complex programmes required inputs from several departments. However Parliamentary accountability for central government spending of voted expenditure is departmental, based on the Accounting Officer's responsibility for his department's vote. Thus, linking the outturn of the direct voted spending with success or failure of the programmes was very difficult. Government expenditure plans and Estimates are both now prepared on a departmental basis, and the programmes are described in departmental plans. The links between overall expenditure plans and the Estimates are thus easier to follow. The basis of overall plans and the Estimates can, of course, never be the same since the Estimates cover only voted central government spending, including transfers to other spending agencies (such as local authorities etc), whereas the planning documents have a wider coverage and consolidate spending by central and (until 1990) local government, together with adjustments for public corporations.

Financial Management Initiative (FMI) and output measures

The FMI, introduced in 1982, was designed to decentralise and delegate decision making to lower levels so as to improve management of resources. This initiative is concerned to promote changes in management approach and style. To complement this, indicators of success or failure at each level of decision making are desirable, and this has been central to the development of measures of output and performance within certain departments. There is a particular difficulty, mentioned earlier, that the principal difference between public and private sector activity is the lack, in the public sector, of turnover and profit

(quantified in monetary units) as measures of output and performance. The FMI was designed to introduce remedies for this difficulty by encouraging departments to devise a range of output and performance measures. Many of these are now used in internal reporting and some are reported in the planning documents. Indeed the PEWP had by 1990 itself developed from the brief summary document of the late 1970's into a much larger paper with a short description and comment on the work of each department together with a summary of total expenditure on programmes, aims and objectives. The development of performance measures has proceeded steadily and a range of measures covering various aspects of departmental work is now published. However they are not complete, and work on a comprehensive and meaningful set of indicators covering all key areas of operation remains a major task.

Another development during the 1980's has been the change of emphasis from manpower costs in departments to overall running (ie administration) costs. This change, in line with the philosophy of the FMI, allows managers to focus on the total cost of operations, not just a part. Manpower targets have, to some extent, been replaced by budgeted overall running costs. These changes reflect a desire, as part of the FMI, to delegate responsibility for running departments efficiently and economically to their managers, leaving them to decide how to achieve aims and obtain the best value for money. Similar changes are taking place in managing the main programmes of each department.

Summary

The last century or so has seen great changes in the size, complexity and nature of government operations. These have been matched by equally fundamental changes in the way accounts are prepared and presented, and by fundamental changes in their content and uses for control purposes. Because of the size of the task, the changes in presentation and accounting have not always been fast enough to match the pace of change in operations or external factors. Parliamentary mechanisms for achieving changes are slow and there is

sometimes no consensus on what is desirable. There are, too, subjective and awkward questions of coverage and constitutional rights which make for extra difficulties in accounting for government. Definition of what should be included in "the accounts" is much more hazy than for a commercial company. Difficulties of deciding what control targets can feasibly or ought to be set, given the inherent problems of measuring output, will always permeate government accounts. For example: to what extent should the activities of NDPBs or government trading activities be fully covered (ie consolidated) in government accounts? How far can or should central spending and other controls be applied to local authorities, or even certain independent public corporations such as the BBC - both are in some senses set up to be separate from, and even a counterbalance to, the power of central government. Changes require a strong enough motive and, ultimately, the cooperation and agreement of the government of the day; the latter is not necessarily pre-disposed to favour changes which involve greater accountability or exposure of sensitive areas. Furthermore, there are good reasons for changing systems only gradually after due thought, to make sure that any change is cost effective and meets real needs. However, new initiatives (some of which may be necessarily experimental in nature) are always required to keep ahead of developments of a similar nature in the private sector, and the cost of not changing systems may in the long run be much greater than the initial costs of change. No doubt this monograph will require regular revision!

# *CHAPTER 5*

## WHAT IS PUBLIC EXPENDITURE?

The developments of government accounting have reflected the preoccupations of governments over the last one and a half centuries, mirroring political concern with control and spending. First, the regularity, propriety and legality of public expenditure were dealt with in a series of measures culminating in Gladstone's reforms of the 1860's. Developing from these was a second objective of getting value for money spent. This concern led to the evolution of the modern role of the Public Accounts Committee (codified in the 1983 National Audit Act) and the now pervasive VFM "audits" of economy, efficiency and effectiveness by the National Audit Office. Such audits are also carried out by the Audit Commission for Local Authorities in England and Wales, which replaced the old District Audit system in 1983. The Accounts Commission in Scotland, established earlier in 1973, has recently received statutory powers to carry out similar VFM exercises. Over the last few years, there have been more concentrated efforts to develop performance and output measures with VFM aims in mind. Third, of greater importance in the last fifty years, has been the more positive approach to active management of the economy. Linked initially to Keynesian ideas about the management of aggregate demand and the possibility of counter-cyclical activity by the government have been the development of several key economic aggregates or measures. Each of them is watched more or less closely depending on the prevailing economic philosophy, the political priorities of government and, to some extent, the economic fashion of the day. These include, for instance, measures of aggregate demand, public sector borrowing, the balance of trade and money supply.

One measure which has been given particular and increasing attention by all post-war British governments is public expenditure. This is partly because of its sheer size and growth in relation to Gross Domestic Product (currently around 40%) and partly the influence such a volume of spending has on the economy.

In addition to the economic effects of such a level of spending, there are many policy implications involved in deciding what the spending programmes are to achieve individually. Public expenditure is the key variable once decisions are made on plans for taxation and borrowing in the light of the economic forecast and strategy (now called the Medium Term Financial Strategy or MTFS). It is set in the context of revenue and borrowing plans in the Financial Statement and Budget Report. Because it has become such a focus of attention, many of the summary level financial documents which are produced by government (and described in this book) focus on and analyse it. It is the subject of special publications for Parliament, in particular the Autumn Statement and the supporting statistical supplement.

Growth in the public sector

In essence, public expenditure ought to be a fairly simple measure equal to the amount of public tax revenue and borrowing. However the growth of the public sector has brought complications to the measurements used. In the early nineteenth century, there were few publicly owned enterprises to complicate matters, and the bulk of public sector activity consisted of raising taxes and borrowing to fund a limited range of public services through a small number of authorities. Central government dealt with defence, and home and foreign affairs. Local justices and town and parish government bodies dealt with local matters. Then the public sector grew. A number of new *ad hoc* bodies was created in England and Wales which increased the activity of the public sector - municipal corporations after 1835, elected Boards of "Guardians of the Poor", Highways Boards to create roads to link into the railways, School Boards after 1870, and Sanitary Boards after 1872, the latter following many cholera epidemics over the previous half century. Local authorities (county, borough and district councils) followed, and these then took over the functions of the *ad hoc* bodies. Various nationally based insurance schemes were commenced in the early years of the 20th century before the first world war covering health, unemployment and then pensions. These were consolidated and expanded into a more comprehensive

integrated system in the late 1940s, although central government's role in supervising the social security system had been growing earlier.

Public sector economic and trading activities grew in parallel with the increase in its social welfare role. The Post Office was the main nineteenth century central government "trade". Local authority trading was then encouraged - water, gas, electricity and transport. Most important ultimately was subsidised public sector housing, which developed in the 1920s. Central government growth was marked between the two world wars (for instance in the creation of the agricultural marketing boards), and was followed by the purchase of whole enterprises through nationalisation during the 1940s. From 1946, the Bank of England was also owned by the government. So by 1950 the public sector had grown to include the administrative activities of central departments and the social security system, the local authorities' administration and trading activities, and the economic and trading activities of central government and the nationalised industries.

Measurement of public expenditure

Several ways of measuring public sector activity can be envisaged. One might consider a commercial parallel. Most companies measure their activity levels in terms of turnover, ie output in monetary terms. If several companies together form a group, their turnover is added together in consolidated accounts, and turnover between group members is eliminated. The resulting total represents group sales to outsiders. But there is little possibility in government of measuring activity by using uniform measures of output; it is difficult to quantify output except in terms of spending (or tax receipts and borrowing used to fund spending) and it is, in any event, spending, as a total *per se*, which governments seek to limit. Early definitions of public sector activity were thus devised to control and measure public expenditure defined as payments from the public sector to the private sector.

A number of variations of this basic definition of public expenditure can be used, and the definitions have changed over the years. The more important it has become as a political objective to control expenditure, the more important it is to be clear what it is that the government seeks to control. Partly to clarify what the government can and cannot influence directly, two aggregates have come into regular use. They are the Public Expenditure Planning Total (PEPT) and General Government Expenditure (GGE). PEPT is the focus of the government's expenditure plans, outlined in the Autumn Statement; it is formulated as an intermediate target and indicates direct planning and control objectives; it uses certain figures which are capable of being more easily monitored than some elements of GGE. The definitions and presentation of the PEPT also reflect the particular political concerns of the administration of the day and thus they are changed from time to time. For instance, one concern has been to point up the receipts from "special" sales of assets, ie privatisation proceeds, and another to emphasise the level of capital spending on new assets. More recently, the definition of PEPT has been changed to exclude local authority expenditure from its own resources.

GGE is the more comprehensive definition of expenditure and is used for reporting outturn in the national accounts; it is also shown in the government's expenditure plans. GGE is a statistical tool whose broad definitions are subject to international conventions, so it can be used for international comparisons, (see, for example, A manual on Government Financial Statistics published by the IMF in 1986). Both definitions have the same basic core, and can be reconciled; the purpose of the PEPT is to identify elements of public expenditure for control and monitoring purposes. Naturally if the PEPT formulation differs too greatly from GGE it will cease to be an effective intermediate target in trying to achieve a particular level of GGE.

There is a third aggregate to explain, which is part of the main public expenditure total. This is Supply Expenditure, which is expenditure directly financed by money voted annually by Parliament. Supply Expenditure is the

bulk of expenditure by central government from the Consolidated Fund. Most of the rest of central government spending is on social security financed separately by the National Insurance Fund.

*Sectors in the economy*

The relationship of general government to the other sectors of the economy in national accounts terms is as follows:

| | | | |
|---|---|---|---|
| Domestic Economy | Central government<br>Local government<br>Public corporations | General government | Public sector |
| | Industrial and commercial companies<br>Financial companies and institutions<br>Personal sector | | Private sector |
| Rest of the world | | | |

The public sector thus includes:

Central government, including departments and other non-trading bodies (including most NDPBs), and trading bodies;

Local government, including the elected authorities, joint boards, residuary bodies and other non-trading bodies and local authority trading bodies; and

Public corporations, including nationalised industries, trading funds and certain NDPBs.

The first two components make up general government, and the first three together the public sector; everything else is in the private sector. Whether or not a body is classified to the private sector depends, as outlined above in Chapter 3, on both ownership and control. If the government distances itself from control, mere ownership does not result in public sector classification.

Control means active control over policy on investment, pricing and borrowing, not necessarily day to day control.

The importance of "trading" is that, with trading bodies, attention is focused on the bodies' surpluses or deficits and ability (or otherwise) to finance their activities from trading, whereas with non-trading bodies the focus is on total expenditure. Trading bodies' surpluses are shown as part of general government income (even if in deficit) whereas, in the case of non-trading activities, their expenditure (net of any sundry income) is shown as part of public expenditure.

*GGE and PEPT*

The essence of General Government Expenditure is that it is all the expenditure of central and local government, excluding transfers between them, and net of receipts specifically related to the expenditure (treated as "negative" expenditure). The definition of expenditure incurred in the pursuit of trading activities within government, recognised as such, is based on revenue subsidies to, and capital expenditure of, such bodies. However, public corporations, the trading bodies outside general government and the private sector in the case of all grants, loans or subsidies to such bodies are treated as expenditure by government.

As an intermediate target, the PEPT focuses on expenditure controllable by central government, and excludes general government gross debt interest and a number of other items, such as VAT paid by government on goods and services supplied to it but refunded. The PEPT includes the external finance of most public corporations (ie government finance in the form of grants and loans plus market and overseas borrowing). For a small number of public corporations capital expenditure is included instead of grants and loans. A very significant change described in HM Treasury's publication, "A New Public Expenditure Planning Total" (CM441) issued in the light of the introduction of the Community Charge, is to exclude from PEPT that expenditure which local authorities will finance or determine for themselves. This includes the proceeds of the Community Charge and capital receipts.

General Government Expenditure is, in essence, a gross measure of payments from the public to the private sector. However, where government departments or the public sector undertake trading activities, there is an argument for eliminating the effect of such activities from the measure of "payments to the private sector" since the proceeds of sales to the private sector (called "charges") reduce the amount paid to it. Thus, as noted above, some trading and sundry receipts are netted off expenditure. Furthermore, if trading activities are formally recognised, their "gross trading surplus" is then shown as part of income and has no effect on public expenditure at all.

The make up of public expenditure is not designed to give an indication of public sector levels of activity (as company turnover does). It seeks instead to measure the call on general public funds from government activity (net of charges for specific supplies). Where the extent of charges is small in relation to the total expenditure, the use of net expenditure affects neither planning or control decisions nor public understanding generally. However, if expenditure totals are of themselves important irrespective of how they are financed, the net measure could distort the picture. For instance, one might for some purposes be concerned more with the total spent on health, than who paid for it. For others, it is more important to understand the funding arrangements which finance the gross total of health expenditure, eg prescription charges, sales of health service assets and taxation.

The following table shows how General Government Expenditure is built up in the national accounts. These accounts are structured so that all items of public income and expenditure are classified as current or capital, thus:

## WHAT IS PUBLIC EXPENDITURE?

| INCOME | EXPENDITURE |
|---|---|
| Current | Current |
| eg tax on income and expenditure (net of repayments) | eg wages and salaries |
| licence fees | social security payments |
| rates | subsidies |
| fines | expenditure on current goods and services |
| dividends and interest | less: negative expenditure (charges and the like) |
| * "gross" trading surpluses net of deficits | |
| Capital | Capital |
| eg capital taxes (eg inheritance tax) | eg purchase of land and buildings (net of sales) |
| capital transfers | lending (net of repayments) |
| | purchases of company securities (net of sales) |
| General government income | General government expenditure |

* these represent income less expenditure of the trades concerned.

*Public expenditure and Gross Domestic Product*

The public and private sectors of the economy described above together produce output which can be quantified by measuring the sum of the community's final expenditure on consumption. If intermediate expenditure (such as the manufacturing cost of production) were also measured, this would be counted twice, once at the manufacturing stage and once when consumed.

Thus Gross Domestic Product (GDP) comprises the following major items:

All consumers' expenditure
General government final consumption of goods and services (including wages of public service employees as a proxy for the value of their service)
Capital expenditure of all sectors (including stock increases)
Exports less imports.

Public expenditure, on the other hand, includes both final and some intermediate elements of expenditure. For example, in addition to general government final consumption, GGE includes grants and net lending to the private and public corporation sectors. The relationship between public expenditure and GDP is described further below.

Since public expenditure is measured net of receipts related to expenditure it is obviously quite different from, say, the gross outflows from the bank account of a company. The measure includes most net cash flows through various public sector spending authorities, and also a number of items which are not cash flows to government at all (eg capital consumption in the case of GGE and, in the case of PEPT, external "market" loans to some public corporations and certain receipts foregone). GGE excludes, however, a number of cash flows through public sector spending authorities, most obviously transfers to other parts of the public sector and also the cash flows of trading activities.

Classification of income

Clearly one of the most crucial distinctions lies in which flows are treated as revenue (mainly consisting of taxation), and which are treated as negative expenditure (ie netted off expenditure), thus reducing it. This area is of some complexity.

Most money received by government is revenue, that is to say taxation, being amounts which are levied, or which arise, in a way that is not related to the purpose for which it is raised. Besides taxes (on income and expenditure) items treated as income include net trading receipts (including rent) net of trading expenditure - "gross trading surplus" as described above - dividends, interest and royalties, agency payments (normally agricultural levies), national insurance contributions, and certain capital receipts. In the Public Expenditure Planning Total, negative expenditure (and thus income) is treated broadly in the same way as in the national accounts, although there are some differences. Some examples of negative expenditure and income are given below.

Charges for goods and services

Charges for goods and services are a form of negative expenditure and are deemed to be amounts arising where:

a) there is a clear and direct link between the charge made and the acquisition by the consumer of specific goods and services; and

b) the size of the charge relates to (ie is a high proportion of) the cost of providing the goods or service.

Certain legal requirements (eg licences for guns and cars, and foreign travel passports) result in government income not negative expenditure. Pure compulsion to pay for a right is not treated as a service supplied. Activities which give rise to government income in excess of cost would normally be treated as taxation or as trading income as to the excess.

Trading receipts

In line with this philosophy, where government does not merely charge for incidental goods or services but carries on a trade, normally through a particular trading organisation, the current expenditure of the trading account is outside public expenditure. Any net surplus is treated as income, and is not netted off public expenditure. This treatment is accorded to trading entities such as the Forestry Enterprise and the Tote.

Sales of assets and loan repayments

These items are the reverse of purchase of physical or financial assets and loans made. Since purchases would have been treated as public expenditure, sale of assets etc are thus treated as negative public expenditure to achieve symmetry. Since sales of assets are normally very large items, GGE is often quoted excluding privatisation proceeds.

EC payments and receipts

Contributions to and from the EC are made through the Consolidated Fund out of VAT levies in the UK and are treated as public expenditure.

## PUBLIC EXPENDITURE PLANNING TOTAL vs GENERAL GOVERNMENT EXPENDITURE IN THE NATIONAL ACCOUNTS

As noted above, there is a number of areas where the planning total (PEPT) is struck on a different basis from General Government Expenditure in the national accounts. In the context of the new system for producing local authority income (Community Charge and business rates) the planning total comprises the following elements:

- central government's own expenditure
- grants provided to local authorities by central government, and consents authorising local authorities to incur expenditure financed by borrowing and other forms of credit
- the financing requirements of public corporations, usually their external finance
- payments to local authorities from the yield of non-domestic rates
- a reserve to provide a margin for uncertainties
- Less privatisation proceeds.

Debt interest and VAT refunded are excluded. Certain receipts from the sales of shares and loan repayments are treated as "transactions in financial assets" in the national accounts. In the PEPT, such receipts of privatisation proceeds (net of expenses of sale) are given a separate heading and are deducted from expenditure. In line with the philosophy and purpose of PEPT concentrating on items controllable by central government, and to emphasise their separate responsibilities, expenditure of local authorities financed from the Community Charge is excluded from PEPT. Such items are, however, included in general government income and expenditure in the national accounts. It is GGE which government includes in its Medium Term Financial Strategy so as to monitor its relationship with GDP and national income.

Public corporations

Public corporations are also treated differently for GGE and the PEPT. The basic treatment of both national accounts and PEPT is to include loans made by government as government spending. In principle, as represented in national accounts, public corporations only have an impact on general government if they receive grants or loans or pay dividends and loan repayments. The surpluses retained by public corporations are not treated as part of general government income (by contrast with trading bodies). But the inclusion or exclusion of public corporations' activities, where they are controlled by government, can distort public expenditure trends. If, say, loans to public corporations from the National Loans Fund (from government) are "in", and borrowings by public corporations from the market (under an implicit government guarantee) are "out", there is a difficulty in comparing the effect of activities of corporations on expenditure, taking one year with another, depending on their source of finance. In order to remove this distortion, market and overseas borrowings of most public corporations (ie all nationalised industries and certain other public corporations) which governments seek to control in order to control the Public Sector Borrowing Requirement, are treated as part of public expenditure for the purpose of the PEPT. However, such borrowings are not a financial flow through government at all, and general government measures in the national accounts do not include them. The difference simply reflects the differing purposes of the PEPT and GGE.

Governments control all public corporations to a degree, but some are controlled in different ways to the external finance control of the majority, for a variety of reasons. These are identified for reference in the government's expenditure plans. Instead of using net external or NLF borrowing as the measure of public corporations' expenditure, in a few cases the PEPT uses their capital expenditure, since, in general, borrowing by public corporations is only used to finance capital expenditure. Any current deficit would normally be met by a subsidy which would be part of public expenditure anyway. The treatment of including

capital expenditure would be inappropriate if these corporations financed a large part of their fixed assets from internal sources or depreciation, since one objective of including these public corporation flows is to show how such corporations' expenditure impacts on the Public Sector Borrowing Requirement. The number of such corporations not subject to the preferred external finance treatment is reducing, but for those remaining the treatment is different as between PEPT and national accounts definitions.

There are certain other differences between the national accounts concepts (which build up to statistics for the national economy) and PEPT (which seeks to measure what governments seek to control directly). The nature of these is detailed each year in the expenditure plans; one such list is at Appendix 3.

Capital expenditure

The difficulty in defining capital meaningfully in the public sector has already been discussed. The absence of a visible rate of return on many assets makes them difficult to value for existing use, and there is no regular reporting of assets owned by the public sector to act as a base line for record purposes. However the concept of capital spending as a part of public expenditure is very important. Indeed the distinction between capital and revenue has been drawn for decades and used to be based on the somewhat old-fashioned idea that capital spending could be financed by borrowing whereas, as a matter of prudence, revenue spending ought not to be so financed.

Expenditure tends to lie in a spectrum ranging from current items through to capital items, with several shades of grey in the middle. The basic definition of capital expenditure for physical assets follows normal commercial accounting principles (the criteria being that the assets purchased are tangible and productive and will yield continuous service beyond the accounting period in which they are purchased). The reported aggregate of such expenditure is measured net of sales proceeds of similar items. Other capital expenditure includes actual expenditure

increasing the level of stocks (eg Intervention Board expenditure on agricultural produce), and expenditure on capital grants to the private sector or public corporations.

The total of capital spending reported is based on this core but adapted depending on the purpose of the report. The Autumn Statement includes net lending and net purchase of company securities as capital, whereas the national accounts regard these as financial transactions rather than allocating them as either capital or current. The PEPT includes the market and overseas borrowings of public corporations as discussed above, whereas these are excluded from GGE altogether.

Finally, the analysis of capital spending in the plans adopts a grouping of categories different to the grouping in the national accounts, and uses a concept called "public sector capital spending" designed to show the extent of both renewal and increases in the stock of physical assets, and work provided to capital goods industries. The purchase of land and existing buildings (net of sales) is excluded from this definition, but defence assets (on the NATO definition which includes equipment and construction) and the capital expenditure of most public corporations are included. This contrasts with the national accounts concept of "gross domestic fixed capital formation" where purchases of land and buildings are included, but defence assets are excluded since they are not capital in nature. This is another example of the fact that these documents serve different purposes. The expenditure plans are designed to show what activities create jobs, and therefore transfers of existing assets are of little interest; the national accounts seek to give a picture of the economy as a whole.

Public expenditure as a percentage of GDP

The expenditure plans report public expenditure as a percentage of GDP, and this relationship is given considerable weight by policy makers. The publication "A New Public Expenditure Planning Total" in 1988 emphasises the importance of GGE as a total and its relationship to GDP in the context of the government's

financial planning. As can be seen from the basic definition of public expenditure, much of it consists of transfers from public to private sectors and thus does not represent a claim by the public sector on private sector resources; it merely reflects a redistribution of them. General government final consumption on current and capital accounts amounts to only just over half of the total of "public expenditure", around 23% of GDP. The rest of public expenditure is made up of transfer payments. Thus, although the changes in public expenditure measured as a proportion of GDP are useful as one measure of the changing impact of government on the life of the nation, the ratio does not represent the extent of government activity (since it nets off changes and does not count trading activity in the total), nor does it represent the expense of government and its services to the nation, (since it includes transfer payments). A table showing how general government final consumption and PEPT are calculated is at Appendix 4.

# *CHAPTER 6*

## THE PLANNING DOCUMENTS

The main cycle of central government financial documents is the set of publications comprising the Financial Statement and Budget Report (FSBR); the government Expenditure Plans described in the Autumn Statement and a Statistical Supplement thereto; departmental reports; Supply Estimates; and Appropriation Accounts and Fund Accounts. They comprise a cycle of documents in which the FSBR sets out overall economic conditions prevailing, describes the government's medium term financial strategy and explains how revenue forecasts, expenditure plans and prospective borrowing or debt repayment meshes with the strategy. The documents dealing with expenditure plans give details of proposed, and a comparison with past actual, expenditure.

The FSBR and the Autumn Statement and until recently the Public Expenditure White Paper (PEWP) (now replaced by a Statistical Supplement and departmental reports) have become known as the planning documents; they are documents in which government records its economic aims, policy objectives, and taxation and spending plans. These plans are analysed in financial terms by spending authority (central government, local authorities and the rest of the public sector). They also contain, at a summary level, forecasts of financial outturn for the current year and record actual outturn for earlier years. They have thus become documents which give not only plans but also historical and trend data for the better understanding of the plans and past performance. The historical data is restated annually for any classification and definition changes in order to ensure that meaningful trend information is presented. Tables will also be changed in successive years to reflect new data which has become available since the previous year. The planning documents are presented to Parliament in order that it can note the government's intentions and review its past actions as a prelude to considering the Supply Estimates and The Budget. Parliament is not required to approve the planning documents although a debate normally takes

place when the plans are presented. This is to give Parliament the opportunity of expressing its views on the overall plans before considering and voting on the Supply Estimates and tax proposals at the next stage.

The Supply Estimates and Appropriation and Fund Accounts are the formal parts of the control of expenditure by Parliament. They are considered in the next chapter. A diagram showing the timing of these documents and the related procedures is shown at figure 8.2 in Chapter 8.

An important feature of the background information in the planning documents is a series of figures for expenditure and, to a lesser extent, income for a number of past and future years. Both past and future figures in relation to any given year can change in successive documents. These figures change mainly to maintain consistency with the presentation of government's forward plans. Each year, the documents reflect changes of definition of public expenditure and reallocations or reclassifications of expenditure - eg reallocations from one department to another to reflect changed responsibilities or reclassifications of certain kinds of expenditure as either "in" or "out" of the total reported. Additional information may also be gained about the past, and the figures are then adjusted accordingly.

The form and content of the planning documents have developed considerably since their inception - in particular the supporting information putting the plans into context. Since the form and content of these documents are not laid down by statute, they can change quite frequently. In the period from 1988 to 1991, the format of presenting the government's Expenditure Plans has changed. Formerly, these plans were presented in summary in the Autumn Statement and an increasingly bulky book (latterly a series of booklets), the Public Expenditure White Paper (PEWP), gave financial analyses and details of departmental performance.

One difficulty of the planning documents, particularly the PEWP, was that the increasing volume of data on departmental performance as well as plans made them unwieldly. The logical result of this was to separate overall plans for government as a whole from a retrospective review of individual departmental results. As a result recent changes have been made to bring forward to the Autumn Statement much of the material previously found in the PEWP; from 1991 a Statistical Supplement will be published in January (instead of the PEWP) analysing expenditure by function and economic category. The Autumn Statement in November will thus become the principal means of giving expenditure plans to Parliament. It is proposed that the departmental chapters of the PEWP - previously the largest part of the material in it - will instead be replaced by individual departmental reports in March. These reports will aim for an improved balance of reporting achievements in the past as well as describing future plans, aims and objectives. The effect of these changes is explained in more detail in Chapter 9.

Medium Term Financial Strategy (MTFS)

The published planning cycle commences in the Spring when the government publishes the MTFS as a chapter in the FSBR published on Budget Day ; the MTFS provides the financial framework for future economic policy. The MTFS, which was first published in the FSBR in 1980-81, sets out the policy objectives and details the combination of monetary and fiscal policy which will be followed to achieve these objectives. The discussion of fiscal policy explains the Public Sector Borrowing Requirement or Debt Repayment (PSBR/DR), and therefore deals with the composition of receipts and expenditure over the period covered by the MTFS, normally four years.

The MTFS chapter includes tables showing GGE (comprising, as explained in Chapter 5, the Public Expenditure Planning Total, gross debt interest and other adjustments) and the main elements of general government receipts (being taxes, national insurance contributions and other receipts). These figures are given for the previous year, as forecast for the current year about to end, and for the

following four years. Plan figures are given for the "fiscal adjustment" and for anticipated public corporations' market and overseas borrowings or repayments which (with income and expenditure figures) are needed to derive Public Sector Debt Repayments (PSDR) or the PSBR. The "fiscal adjustment" represents the balancing figure necessary to equate the government's policy objective for the PSBR/PSDR with the arithmetic sum of the elements of income, expenditure and borrowing making it up. It reflects the scope available to the Chancellor for higher expenditure or tax cuts if the forecasts for the other items remain valid. The MTFS provides the first quantification of the government's intentions for total of public sector spending planned in the fourth year given in the cycle, and suggests how that spending might be financed.

An annex to the MTFS chapter highlights any major revisions made to the assumptions used in the previous year's MTFS with a brief explanation as to why the change has occurred, eg the effect of world oil price movements on the UK economy or changes in money supply. The effects of the revised assumptions on receipts and expenditure are quantified and shown by component in order that a user can follow the main adjustments made from the first announcement of intended general government expenditure and receipts for a particular year through revised plans to the actual outturn.

The rest of the contents of the FSBR is discussed later in this chapter at the appropriate point in the cycle.

The Autumn Statement

Following the publication of the MTFS chapter in the FSBR the next document in the planning series is the Autumn Statement. This is published in November shortly after the final decisions in respect of the Public Expenditure Survey (PES) have been endorsed by the Cabinet. The expenditure plans are expressed in cash terms and the aggregate target of planned spending (referred to as the "Public Expenditure Planning Total" (PEPT) or "planning total") is intended to be an upper limit on those expenditure elements which are included in it. These

targets are set as far as possible in the form of cash limits for control purposes. However, it must not be forgotten that the PEPT is an intermediate objective and formulates its expenditure analysis in the way in which the government expects to monitor and control it. The ultimate objective is to achieve a controlled level of General Government Expenditure which is also estimated in the Autumn Statement.

*The PES process*

The PES is prepared against the background of the MTFS published in the previous FSBR. Bids for spending budgets from individual Ministers and their spending departments have to be balanced against the government's strategy for overall spending, taxation and borrowing in the context of the latest macro-economic forecasts. The PES process, whose final stages are conducted over the Summer and Autumn months, is an adversarial one. Spending Ministers seek to match their spending power with their perception of the needs of programmes in their area of responsibility while the Treasury seeks to constrain the total within the MTFS. A Minister may be judged to some degree on the extent to which he is successful in prising extra cash from the Treasury where a conflict arises. In principle, the Cabinet takes collective responsibility for spending decisions. However, there is usually a need to compress a quart of bids into a pint pot and individual Ministers may find it difficult to agree to reductions in their bids. In order to ensure that there is an orderly system for deciding on spending priorities in the face of competing demands from spending departments, a small sub-group of senior Ministers has been formed into a committee nicknamed the "Star Chamber" (after Henry VIII's special summary court) to resolve any difficulties remaining after the negotiations between the Chief Secretary to the Treasury (the Minister responsible for overall public expenditure levels) and the spending departments have been taken as far as possible.

The final outcome of the PES for the "plan" year (commencing the following April) is first announced in the Autumn Statement, which also gives the overall planning totals for the next two forward years covered by the survey and a

forecast for the current year to March. These totals are analysed by department (including local authorities and nationalised industries' external finance) and a brief explanation is given on changes in priorities which have led to changes in expenditure plans from those published previously.

*Contents of the Autumn Statement*

The Autumn Statement covers expenditure by department; plans for the final year of the forward three year plan are published for the first time (although a forecast of the total expenditure was included in the previous MTFS). The Autumn Statement includes an estimated outturn for the current year and this can be compared with expenditure plans published in the previous November. Accordingly, all three years of planned expenditure included previously are updated in the Autumn Statement and an explanation is given for major differences. Supporting tables in the Statement cover separately central government spending, central government funding for local authorities and public corporations, and also departmental cash spending compared to "real terms" spending for a run of eleven years or so (4 plan or forecast, 7 actual). Real terms spending is cash spending adjusted to current price levels by the GDP deflator. Linkage between the current and previous expenditure plans is also important, and the Autumn Statement contains information at the planning total level which highlights how the planning totals and outturns compare with the plans when first set. This table gives a run of nine years, which includes the five completed years, the current year and the three plan years ahead.

*The Reserve*

The planning total contains an amount set aside as a "reserve". The reserve provides a margin to meet uncertainties and unforeseen requirements. It is intended to cover any additions to spending arising from policy changes, innovations, demand-led programmes such as social security and, of course, unforeseen events. (This planning reserve should not to be confused with the Contingencies Fund, which is a kind of overdraft facility for central government and which is explained in Chapter 8 - advances from the Fund always have to be

repaid in due course via Supplementary Estimates). It is normal to allocate part of the planning reserve to departments as plans are rolled forward and finalised, so it reduces as each forward year gets nearer and plans get firmer. Calls on the reserve are monitored each year as it progresses. The main users of this reserve during the 1980's have been local authorities (who have overspent despite tighter controls on them), and social security, due to the demand-led nature of much of its spending and higher than anticipated levels of unemployment.

*Publication of economic prospects*

A section of the Autumn Statement is devoted to the economic prospects for the year ahead. This section meets the requirements of the Industry Act 1975, under which twice a year HM Treasury has to publish forecasts of the level of Gross Domestic Product, unemployment, balance of payments, retail price index, average earnings and other economic variables considered by the Treasury to be appropriate. The second set of figures required by the Act is published in the FSBR. The economic prospects section of the Autumn Statement includes details of recent developments and up to date forecasts of a variety of economic indicators including inflation, unit manufacturing costs, exchange rates, the world economy, balance of payments, commodity prices, demand, productivity and the labour market. The section also includes details of GGE, receipts and public sector borrowing for the previous and current year together with a note of changes from the MTFS estimates published in the FSBR.

*National insurance changes*

The Autumn Statement incorporates the main proposals of the Secretary of State for Social Services on changes to the rate of national insurance contributions and the estimated effect of these changes. Full details of the changes proposed are set out in a separate statement made by the Secretary of State and laid before the House.

*Tax ready reckoner*

Finally the Autumn Statement includes a taxation revenue ready reckoner. This enables the cost or yield that would result from changes to allowances, tax rates or thresholds etc to be estimated in broad terms.

Public Expenditure White Paper - the government's expenditure plans

*Autumn Statement and PEWP*

After finalisation in the Autumn Statement, individual programmes within departmental totals are further refined between November and January. Until 1991, their detailed presentation followed in the PEWP (published in January).

This document is phased out from 1991 onwards but is described here as an indication of what the new regime will produce (although in different form). The Autumn Statement now contains fuller information so as to give Parliament more time to absorb and discuss it than was the case when publication of detailed expenditure plans did not appear until January. Most of the information described below will appear in the Statistical Supplement to the Autumn Statement to be published annually in January once the PEWP ceases.

The Autumn Statement and related documents are a public statement of the government's planned public sector cash spending (the Public Expenditure Planning Total) for the three years ahead and the overall aims and objectives of public expenditure. The Autumn Statement is a public commitment by individual spending departments to Ministers' collective decisions and by the government to a ceiling on public expenditure. However, this ceiling includes the government's spending plans for a number of programmes which are not fixed in cash terms in advance. For instance, some of the programmes are demand-led, such as unemployment benefit, claims on which cannot be cash limited; and economic circumstances may change so as to make public expenditure rise above (or fall below) the estimate given despite the availability of the reserve.

*PEPT and GGE*

In the PEWP, the overall total of the PEPT was reconciled to the figure for GGE in one table. Reconciling items included general government gross debt interest, shown as a memorandum item outside the planning total because it is not allocated to individual departments (government borrowing is by the Treasury alone), and because it is not subject to the same degree of control as other expenditure. However gross debt interest paid is of course included in GGE reported under the National Accounts definitions. Other items reconciling the PEPT to GGE are usually shown as a single figure. Details of the adjustments taken from the 1990 PEWP are shown at Appendix 3.

*Analyses*

Accompanying the tabulation of public spending by department is a brief sketch of the overall aims and main objectives of the expenditure programmes. There are (in addition to the planning total analysed by department, in real and cash terms) analyses in cash terms:

- by spending authority (ie central government departments, local authorities, nationalised industries and other public corporations);
- by economic category (eg purchases of goods and services, public sector pay, departmental running costs and details of capital spending); and
- by function (eg health, defence, social security etc).

The analyses by spending authority and function have changed since the local authority elements which are under their own control are excluded from PEPT and thus from the expenditure plans. In analyses by spending authority, headings for local authorities will deal with the central government grants to them, rather than the total of local authority expenditure, as was previously the case. This treatment will also be reflected in analyses by function, eg education,

where a precise allocation of central government grants to local authorities would be meaningless.

The present analysis by function differs from that by department mainly because spending in the "territories" (Scotland, Wales and Northern Ireland) is re-analysed functionally to be grouped under the same headings as spending in England.

Capital spending, as defined in the PEPT, is measured net of asset sales such as individual items of plant and council houses, but complete undertakings sold by the public sector as going concerns are not netted off and are shown separately as privatisation proceeds.

*Departmental running costs*

The PEWP has been the most widely read planning document and efforts have been made in recent years to increase its readability and the links with other published information. Coloured graphs and pie charts are now used frequently to present financial information in planning documents.

An innovation in 1986/87 in the management of departments was the use of overall departmental running costs as a control total. Running costs are made up mainly of wages and salaries, accommodation costs, personnel overheads, goods and other services. The use of running costs as a control is designed to improve financial management in departments with the object of keeping administrative costs to a minimum and obtaining best value for money - partly by allowing departmental managers to substitute one form of spending on such items for another. The PEWP details the running cost target for each department and, at the time of presenting Supply Estimates to Parliament, limits on running costs are set. The PEWP also details public sector manpower by department although these tables have not been used as planning targets since 1988.

*Format*

The PEWP splits into various chapters. The content and description of these chapters varied from year to year but contained analyses of overall plans (described above), and individual chapters summarising:

- Spending plans for local authorities
- Financing of public corporations (including nationalised industries)
- Historical trends
- Notes and glossary of terms

Spending plans and performance indicators for each main department, chapters in the PEWP, have been published (from 1989) as separate booklets but the new system of departmental reports will start in 1991.

The PEWP is hierarchical in structure and most of the summary tables given at the front are analysed by department, enabling the reader to follow through to the departmental booklets (compiled by the departments concerned). In such a summary document, the "trail" is not always fully explained and some other source may be required to follow all the way through the figures; for example, the reason for changes in amount and presentation of previous years' figures. This detailed information might be sought by a Parliamentary Select Committee or by a Parliamentary Question. One advantage of the new Public Expenditure Planning Total will be to align it more closely with the Vote structure and thus reduce one source of difficulty in following the trail.

The revision or reclassification of the expenditure of completed years in subsequent Expenditure Plans, although often minor, is disconcerting and complex at first sight. These revisions are due mainly to changes in definition and allocation of public expenditure; past years are adjusted so as to provide meaningful comparative information enabling the trends to be understood. The Statistical Supplement will (as the PEWP does) provide details of differences which have arisen from the previous plans. These differences are shown by

department, programme and spending authority. While classification changes are likely to occur between plans the major differences arise from the allocation of the reserve to departmental programmes for the immediately completed year.

As well as providing details of changes from the previous plans, many other tables are provided, detailing spending by department, authority, economic category and function, together with tables on privatisation proceeds, running costs and capital spending. Most of the tables given provide data for eleven year runs and therefore include seven years' actual outturns (reclassified for changes in definition and classification) with the current year estimates and the three plan years.

A most useful linking table in the plans shows the analysis of the planning total by spending authority detailing the amounts which Parliament will be asked to vote through the medium of the Supply Estimates. This table also shows the extent of spending which will be subject to cash limits. The table provides a link to the summary and guide to the Estimates (and thence to the Estimates themselves) which are published at the time of the Budget. The relationship between supply expenditure and the planning total is complex as explained in Chapter 2.

*Local authorities*

Information provided in the local authority expenditure chapter of the PEWP concentrates on displaying current expenditure and capital expenditure by function and territory. Various controls over local authority spending, such as rate capping and capital spending controls, have been used by government with the object of constraining the spending of local authorities within its plans. Despite this, local authority spending has been independent of specific government control and difficult to predict and control indirectly; and it has been common for the planning total as previously defined to be exceeded. Changes have been made to the definition of the planning total so that it targets only spending more directly under government control (see Chapters 5 and 9).

*Public corporations*

For public corporations, including the nationalised industries, details are given of the financing requirements, capital requirements and current cost profits. Significant receipts and payments, capital grants from government, government loans and third party loans are also shown. This information is given for three years, the previous year's actual outturn, the current year's estimated outturn and the forecast outturn for the first plan year. Unlike private companies, nationalised industries thus publish a profit and cash plan for the year ahead.

*Other information*

This section of the PEWP also sets out the financial targets for the plan year. The PEWP thus states objectives for each industry, and sets out the outturns against financial targets in the previous year, and explains major differences in the relevant departmental booklet. Other output and performance indicators are also published in the PEWP.

Finally the PEWP provides the reader with a glossary of terms which, in view of the amount of jargon involved and the varying definitions employed, is much needed.

*Departmental booklets*

The departmental booklets as part of the PEWP provide further analysis of spending, and give totals by Vote type, by spending authority function, and by economic category. Other analysis has been provided as departments believed necessary. These booklets commence with a section on aims and objectives which helps the reader to follow the rationale of spending. The departments provide various details of individual programmes, indicating in some cases the success or otherwise of programmes over the years; the performance indicators and targets are set out for current and plan years. The inclusion of output and performance data is particularly useful in demonstrating achievements, where such measures have been devised. Departments can be selective in setting out in detail their output and performance achieved compared to the original plans, since

the format of any department's chapter is under its own control. The PEWP is not a formal accountability document like the Appropriation Accounts, scrutinised and reported on by the Comptroller and Auditor General; but it has been one of the main documents used by government to communicate its view of the achievements of government expenditure. The material contained within the PEWP will be developed for publication by the various departments in Departmental Reports under the new system. Select Committees, Parliamentary Questions and general scrutiny by Parliament are means by which the public may continue to obtain further information on departmental plans and achievements.

Financial Statement and Budget Report

The planning documents are completed with the FSBR published in March and this in turn is accompanied by the Estimates (described in Chapter 7). The FSBR supplements the Chancellor's Budget statement and as the name suggests gives the government's tax proposals. As well as detailing the tax measures proposed, the FSBR shows the estimated effect of these proposals on receipts for the following two years. In addition, as in the Autumn Statement, the FSBR contains a section on recent developments in the economy and the economic prospects for following year.

In public sector finances the planning documents concentrate on expenditure although summarised details of general government income are provided in the economic outlook sections in both the FSBR and Autumn Statement. Section 1 of the FSBR contains a table showing the finances of the public sector. This table gives an analysis of general government receipts and expenditure, comparing the previous budget with the latest estimate for the current year, together with the forecast for the year ahead. This table provides a summarised consolidated Income and Expenditure Account, following the style of those published by the Central Statistical Office (CSO) in the National Accounts Blue Book (Table 7.1) and Financial Statistics, but using a different format. Appendix 1 illustrates what appears in Table 7.1.

General government receipts are shown in the FSBR as revenue from income and capital taxation, customs and excise duties and VAT, vehicle excise duties, local authority rates, royalties from oil, national insurance and other contributions, interest and dividend income, gross trading surpluses and other miscellaneous receipts. The taxation receipts are produced on an accruals basis to relate to the taxation proposals. This is the same as in the national accounts. Other government receipts in the nature of fees and charges are of course deducted from departmental expenditure and are therefore netted in the Public Expenditure Planning Total.

The expenditure side of the table shows estimated spending by departments, less privatisation proceeds and the reserve. These components make up the Public Expenditure Planning Total. To the planning total is added gross debt interest, local authorities' expenditure from their own resources and other "national accounts adjustments" to give GGE. The other national accounts adjustments (which account net for 7 - 8% of PEPT) are not explained in the FSBR but will be found in the Statistical Supplement to the Autumn Statement (formerly in the PEWP); they consist of items such as VAT refunds, the imputed value of non-trading capital consumption and accruals adjustments for certain government expenditure. A reconciliation of the actual outturn of the Public Expenditure Planning Total (as defined for the purposes of the planning documents) to GGE (as reported using national accounts definitions) can be found in Table 2.4 in the CSO publication Financial Statistics, to be summarised in the Statistical Supplement (see Appendix 3).

The difference between general government receipts and expenditure equals the general government borrowing requirement (or debt repayment) which, when added to the public corporations' net market and overseas repayment or borrowing, gives the Public Sector Borrowing Requirement or Debt Repayment. Further details of the components of this figure are provided in the FSBR in the chapters dealing with public expenditure and public sector transactions.

*Public expenditure*

The latest figures for public expenditure, on which the Estimates published on Budget Day are based, are given in a chapter of the FSBR: changes since previous publications are summarised.

*Budget tax and national insurance proposals*

The Budget details given in the FSBR are summarised and concentrate on general descriptions of legislative changes and details of changes in percentage rates or monetary limits. These general statements are supplemented by Inland Revenue press releases, which flesh out the detail of the proposals for legislative change. A few weeks after the Budget, the Finance Bill gives the full detail of the proposals.

The chapter on the Budget tabulates the expected effect of the changes.

*Public sector's finances*

The public sector's finances chapter shows the sectoral composition of the PSBR/PSDR. This is further analysed to show the major components of the receipts and expenditure of central government, local authorities and public corporations. These analyses are given for the current year and for the following year and are accompanied by brief comments explaining why projections vary from those contained in the MTFS and forecasts published in the previous FSBR. The estimated revenue of the Consolidated Fund differs from that contained in the main FSBR chapters as the Fund data is based on cash received whereas the sectoral analyses are given using national accounts definitions and therefore include the main categories of revenue on an accruals basis. Consolidated Fund expenditure cannot be easily reconciled to the Public Expenditure Planning Total. The funds flow in the public sector is described in Chapter 8.

However the FSBR does show how much is estimated to be paid out of the Fund for supply issues and therefore this total approximates to the Supply Expenditure Estimates (differences being due to timing).

# *CHAPTER 7*

## SUPPLY ESTIMATES AND APPROPRIATION ACCOUNTS

Parliamentary Control

The main principle of Parliamentary control is that all revenues should be paid into the Consolidated Fund and no money may be withdrawn from this Fund without specific statutory authority. An exception is those revenues which Parliament authorises to be accounted for as appropriations in aid. To obtain authority to withdraw money from the Consolidated Fund the government presents Estimates of the amounts required from the Fund for each service. When passed, these Estimates become Votes although the two terms are used within government more or less interchangeably.

A particular department and individual is accountable to Parliament for each Supply Vote. The specification of a Vote's purpose is given in the "ambit" at the front of the Vote and expenditure from that Vote may only be made for that particular purpose. The person responsible for ensuring that money spent is within the ambit of the Vote, and accounting for it in the Appropriation Accounts, is the Accounting Officer, who is normally the head of the department concerned. A major function of the Comptroller and Auditor General is to ensure that spending has only been made as sanctioned by Parliament in the ambit of the Vote.

The primary function of the Estimates is to request funds for specific purposes and to obtain Parliament's authority for spending. They also support the request by providing considerable detail about how the money will be spent. They thus serve as an important stage in the government's internal management and control of spending, by detailing each department's spending intentions, thus enabling the Treasury and Ministers collectively to monitor actual spending against budget throughout the year. Treasury authority (and sometimes a new Parliamentary Vote) is required for any variation from the stated intentions.

Summary and Guide to the Estimates

The Estimates are summarised in the Summary and Guide to the Estimates published on Budget day. This booklet contains tables listing the provisions in each Estimate and summary tables giving information on any changes in the level of departmental provision notified in the Autumn Statement or later planning documents. It also shows cash limited components of Supply Estimates (and various other supporting tables) and summarises details of the format of the Estimates and Parliamentary procedure.

Classes

The Estimates are presented in classes and each class contains a group of individual Estimates. For instance, in 1989-90 the classes were divided up by departmental responsibility as follows:

| | |
|---|---|
| I | Ministry of Defence |
| II | Foreign and Commonwealth Office |
| III | European Communities (for which no funds were sought) |
| IV | Ministry of Agriculture Fisheries and Food (including Forestry Commission) |
| V | Department of Trade and Industry |
| VI | Department of Energy |
| VII | Department of Employment |
| VIII | Department of Transport |
| IX | Department of the Environment - Housing |
| X | Department of the Environment - Other environmental services |
| XI | Home Office and Legal Departments |
| XII | Department of Education and Science |
| XIII | Office of Arts and Libraries |
| XIV | Department of Health |
| XV | Department of Social Security |
| XVI | Scotland |

| | |
|---|---|
| XVII | Wales |
| XVIII | Northern Ireland |
| XIX | Departments of the Chancellor of the Exchequer (eg Inland Revenue, Customs & Excise, COI, HM Treasury and several others) |
| XX | Other Departments (eg Paymaster General's Office, Cabinet Office, Secret Service, Office of population census, House of Commons' members' salaries etc) |

There are two separate Votes:

| | |
|---|---|
| XXA | House of Commons: administration |
| XXB | National Audit Office |

Each Estimate is divided into subheads. These set out, in some detail, the proposed expenditure of the total made available to departments in the Public Expenditure Survey. Classes, Votes or subheads may vary from year to year according to administrative convenience and the needs of control. Condensing them into too few headings would weaken Parliamentary control; on the other hand too great a proliferation of Votes and sub-heads would be confusing and inconvenient to Parliament. There is not enough time to examine all Estimates in detail and sub-dividing Votes also has a tendency to inflate them as requirements tend to be "rounded upwards" and allow a margin for error etc.

Form of Supply Estimates

These are published in March at the time of the Budget, and each contains the Estimate for the ensuing year commencing in April, the Estimate and forecast outturn for the current year, and the actual expenditure for the previous year. Most Votes are subject to a cash limit (ie a government undertaking that no more than a certain sum is to be expended in a particular year). But some cannot be cash limited, as we have seen earlier, because they are "demand-led".

The Treasury requires departments and Accounting Officers to account for their expenditure under the "subheads" within the Vote. With government (ie

Treasury) approval, excess expenditure on one subhead may be offset against savings in a different subhead within a Vote. This is called "virement". The government's ability to "vire" between subheads arises because Parliament only formally authorises the total of a Vote as broadly described in the ambit. By long-standing custom, the Treasury exercises the discretion of virement between subheads. Parliamentary authority will always be required to increase the total amount of a particular Vote, even although there may be corresponding savings in another Vote. Virement would not be exercised in respect of such a substantial change in the distribution of a Vote as might be held to invalidate the description of requirements on the basis of which it was voted. Instead a token supplementary Estimate would be presented.

Estimates are in prescribed form. Part I states the ambit, the net amount of the supply requested, and the department or people who will account to Parliament for it. Part II gives supporting detail - amounts of gross expenditure and any income estimated to be receivable. As noted earlier, negative public expenditure is used as "appropriations in aid" where it partly finances the objective of the expenditure. Any other income is paid into the Consolidated Fund and called Consolidated Fund Extra Receipts (CFERs). The appropriations in aid procedure simply short circuits, with Parliamentary authority, the basic principle of the Consolidated Fund that all receipts are due to it. Estimated CFERs are also analysed in Part III of a Vote for Parliament's information.

The provision of funds may be raised by the presentation of supplementary Estimates during the course of the year.

Appropriation Accounts

The form of Appropriation Accounts, which are normally published in the autumn (after Parliament has returned from the summer recess) is not set in any great detail. In general, the Parliamentary Grant, or Vote including any supplementary Votes during the year, is compared with the actual expenditure, under the subheads as given in the Estimates. The accounts similarly compare the estimated receipts authorised to be used as appropriations in aid with the

realised amount applied. The notes to the Appropriation Accounts explain any significant variation between estimate and outturn and also give other notes, for example any significant losses borne or special payments made through the Vote concerned. The Appropriation Accounts lead to a balance of the Vote which will be either unused, and which must then be surrendered to the Consolidated Fund at the end of the year, or exceptionally to an "Excess" (ie overspending above the amount of a Vote authorised) for which Parliamentary authority will be required in the following year. Authority is secured by a Statement of Excesses presented to Parliament, which is examined and reported on by the Public Accounts Committee. The PAC's report is the basis on which Parliament then passes an Excess Vote to meet the excesses. The procedure is, in effect, a retrospective supplementary Estimate procedure and does not usually involve more than perhaps half a dozen Votes out of some 200 each year.

Accounting policies

The Estimates are prepared on a cash basis and do not recognise (although they may occasionally note) changes in the values of assets and liabilities over the period. Appropriation Accounts are prepared on a like basis, comparing the Vote with outturn in cash terms and stating the residual amount for surrender (or the deficit to be met by Excess Vote). The Estimates and Appropriation Accounts are not intended to reveal the value of goods or services used in the public sector. They are simply the means by which Parliament keeps control of the cash disbursed by government in any year. The future effects of commitments made within the year are not shown in general. However, where one department reimburses another for services or goods provided, their cost is generally calculated (and paid for) on the basis of "full cost" including, for example, notional depreciation, insurance and interest charges. Thus the providing department will recover more cash than it will have spent by providing the services concerned. If total receipts for the Vote as a whole exceed gross expenditure any "surplus" will be surrendered by the providing department to the Consolidated Fund. The purpose of full cost charging is to ensure that the consumer of services recognises their full cost in allocating the resources.

Audit - The Comptroller and Auditor General

The Appropriation Accounts are audited by the C & AG, who heads the National Audit Office and is an Officer of the House of Commons. The C & AG produces both a "report" and a "certificate". He states in his report at the front of each class whether he has any observations to make on the accounts and may write an essay about any of the accounts and the expenditure concerned if he wishes. His "report" is not in a standard form like a Companies Act audit report, and may contain any additional information which the C & AG feels is relevant to Parliament. The certificate is attached to the accounts of each Vote, and is in a more or less standard form. It will cross refer to the "report" if any significant observations are to be found there. In addition the C & AG is empowered to carry out economy, efficiency and effectiveness reviews of government operations at any time, ie not specifically linked to the Appropriation Accounts. These are reported separately and published during the year as House of Commons Papers.

Public Accounts Committee

The C & AG's reports are addressed to the House of Commons and are referred under its Standing Orders to the all party Public Accounts Committee of the House of Commons, which can raise any question about the accounts presented to Parliament, and any matters raised by the C & AG in particular. The Committee meets twice a week while Parliament is sitting and will normally select for consideration reports in which the C & AG has made observations requiring further discussion. The Committee has the power to send for persons, papers and records and summon the Accounting Officer concerned to appear before it. Most of its hearings nowadays concern the C & AG's reports on economy, efficiency and effectiveness and the C & AG briefs the Committee before each hearing. Its deliberations are then summarised in a PAC report to the House giving its conclusions and recommendations. The department concerned, in conjunction with the Treasury, then responds to the PAC report in a formal document called a "Treasury Minute" agreed with the Treasury and, like

the PAC report, addressed to the House of Commons. The PAC's reports and the Treasury Minutes in response to them are then available for debate in the annual PAC Debate which usually concentrates on some six or eight reports each year, selected by the Committee.

Accounting Officer

The Accounting Officer, appointed by the Treasury, is normally the permanent secretary of the department. However, for large departments, additional Accounting Officers may be appointed, eg second permanent secretaries. In certain grant aided bodies, the senior full time officer is similarly appointed Accounting Officer for the grant in aid by the Accounting Officer of the sponsor department. The Accounting Officer of a department is responsible to his Minister for the propriety and regularity of expenditure in his department, and for its prudent and economical administration. He signs the accounts laid before Parliament and is normally the department's principal witness before the PAC on matters arising from any C & AG's report concerning his department. There is the further development in 1989 of Accounting Officers who are given responsibility for the new Executive Agencies described in Chapter 3.

# *CHAPTER 8*

## CENTRAL GOVERNMENT INCOME AND EXPENDITURE AUTHORISATION, CASH FLOW AND FUNDS

Income and borrowing

Central government's income arises in several ways. Taxation is the main source, but there are other forms of annual income such as rents, interest and dividends. Certain departments receive income (or charges) for services provided to the public. As discussed in Chapter 5, this is normally treated as an offset to government spending in the expenditure "head" concerned.

At this point we should perhaps remind ourselves that any excess of expenditure over income must be met by central government borrowing. Likewise, an excess of income can be used to repay government debt. Taxation is levied on an annual basis, not under a standing authority. Bases and rates of tax are amended annually in the Finance Act, without which certain taxes cannot be levied. Borrowing by the Treasury is authorised under the National Loans Act 1968; there are no limits to the amounts of money which government is authorised by Parliament to borrow.

Expenditure

Public money cannot be spent by central government without Parliamentary authority, because all income is due to statutory central Funds and cannot be issued from them without statutory authority. This procedure provides Parliament with an effective administrative control over spending from the public purse. Such control is a matter for the House of Commons. Under long established constitutional practice, it is for the government (acting for the Crown) to demand money, the Commons to grant it and the Lords to assent to the Grant. This is why the Queen's Speech to Parliament each year on the presentation of Estimates is addressed only to the House of Commons.

## CENTRAL GOVERNMENT INCOME AND EXPENDITURE AUTHORISATION, CASH FLOW AND FUNDS

Parliamentary authority for central government provision of funds comes in two forms, depending on the type of expenditure concerned: first, the annual Vote system, which culminates in Consolidated Fund and Appropriation Acts, and second, specific Acts which allow certain types of expenditure to be undertaken on the basis of standing authority. The latter authorities cover a number of heads of spending such as the Civil List and judges' salaries from the Consolidated Fund and spending from the National Insurance Fund on pensions and social security.

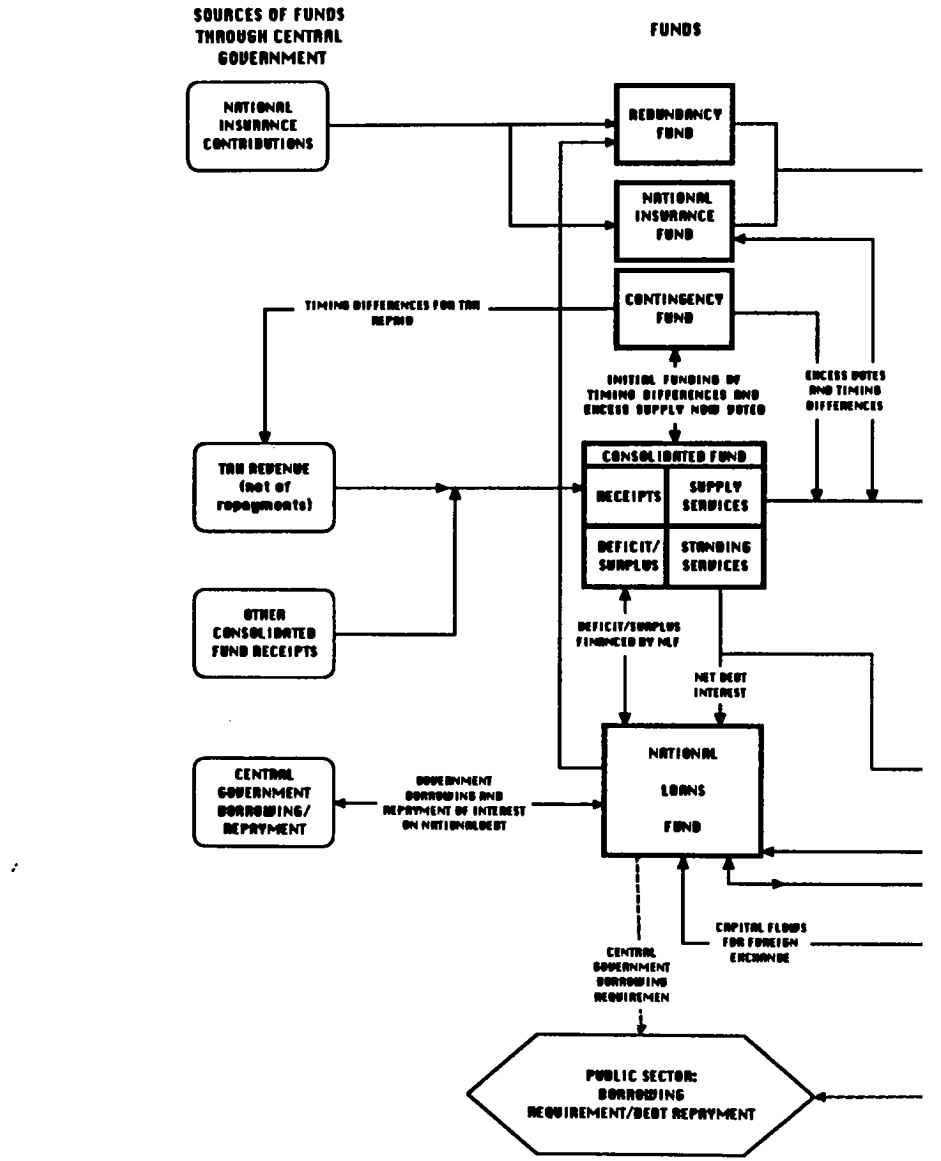
Cash flows in the public sector - Funds

The diagram shown at figure 8.1 explains the relationships between the main central government Funds, their sources of cash and the uses of cash spent from them. Some supply services are partly paid for by specific charges - and only the subsidy is treated as expenditure out of tax revenue. Such charges are therefore not shown in the diagram, nor are the sales revenues of trading organisations such as nationalised industries.

The Funds themselves are shown in bold square blocks at the centre of the diagram. On the left of the diagram are shown the main general income flows to central government, most of which are due to the Consolidated Fund, which meets the cost of annually voted Supply Expenditure and of standing services (payments made from the Consolidated Fund under standing legislation). Certain flows are separately accounted for - principally those inflows from national insurance contributions, which are a large part of the funding of the National Insurance and Redundancy Funds.

If there is a shortfall in the Consolidated Fund, the deficit is met by the National Loans Fund (NLF) from public borrowing. Likewise, the NLF can withdraw budget surpluses from the Consolidated Fund to repay the Bank of England for

# CENTRAL GOVERNMENT INCOME AND EXPENDITURE AUTHORISATION, CASH FLOW AND FUNDS

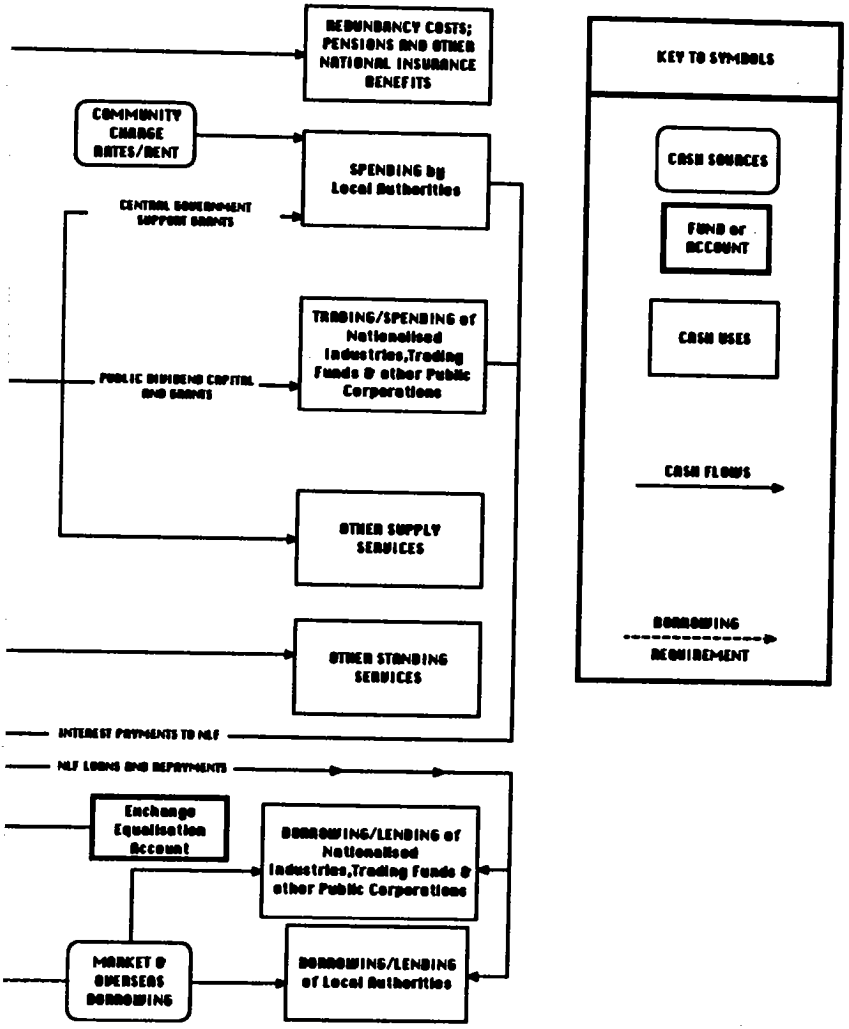


# CENTRAL GOVERNMENT INCOME AND EXPENDITURE AUTHORISATION, CASH FLOW AND FUNDS

OTHER SOURCES

USES OF FUNDS

Figure 8.1



repurchases of loans to government such as Treasury Stock etc. Actual net borrowing by the NLF is shown as a flow from the left hand side of the diagram. The proceeds of all issues of stock are paid into the NLF until used, and will earn interest when placed in the markets by the Bank of England; the NLF can also be used to purchase commercial bills in order to reinject cash into the economy. The NLF was set up by the National Loans Act of 1968, to hive off from the Consolidated Fund the government's borrowing, as distinct from taxation. But the two Funds are so interlinked that taken together they can be regarded as "The Exchequer". In addition to meeting any Consolidated Fund deficit, the NLF provides funds to the Exchange Equalisation Account and on loan to other (mainly public sector) bodies as shown at the bottom of the diagram. The Exchange Equalisation Account is held by the Bank of England and is used to hold government's reserves of foreign currency. Most of the other bodies funded by NLF lending are public corporations or local authorities. The NLF may not be used for expenditure and if one of its loans has to be "written off" this has to be achieved *via* a Supply Grant, with Parliamentary authority, from the Consolidated Fund, which is used to repay the NLF.

The total Public Sector Borrowing Requirement (PSBR) or Public Sector Debt Repayment (PSDR) is shown at the bottom of the diagram being the sum of the requirements or surpluses of the NLF, together with the net market and overseas borrowings of public corporations and local authorities. The PSBR/PSDR is thus a residual amount but it is quite possible that extra government securities will be issued over and above the actual borrowing requirement in the interests of economic management.

On the right hand side of the diagram are shown the uses of cash, mainly for supply services, social security and in other parts of the public sector such as local authorities. Some payments from the Consolidated Fund are thus transfers within the public sector to local authorities or public corporations and others are expenditure on final consumption of central government. The same is true of issues from the National Loans Fund. There is thus a significant difference between the total of cash flows out of central government Funds and public expenditure, as explained in Chapter 5.

Consolidated Fund

The Consolidated Fund is governed by the Exchequer and Audit Departments Act 1866 (as amended by the National Loans Act 1968) which provides that the gross tax revenue (less repayments) and certain other public monies shall be paid into one general fund - the Consolidated Fund, kept by the Treasury at the Bank of England and the Bank of Ireland (Belfast). This is "The Account of Her Majesty's Exchequer" and the Consolidated Fund is, at any point, the balance of this Exchequer Account, as it used to be called. The Consolidated Fund receives most central government revenue, comprising all receipts from taxation and certain miscellaneous revenue. Miscellaneous revenue covers several types of receipt, including income from broadcast receiving licences, interest and dividends payable, revenue from operating services, repayment of loans originally made from Votes, proceeds of sales of assets etc. All such receipts are in principle due to the Consolidated Fund, and cannot be used unless "voted" out of it again.

Where relevant receipts can be forecast, however, the process of paying them into the Consolidated Fund and then voting them out again may be short circuited by obtaining Parliament's authority to use the receipts (instead of issues from the Consolidated Fund) to finance the expenditure. This is the appropriation in aid procedure described earlier. It involves no loss of control for Parliament as

## CENTRAL GOVERNMENT INCOME AND EXPENDITURE AUTHORISATION, CASH FLOW AND FUNDS

Parliament votes the net expenditure plus expenditure financed from the estimated receipts in advance. In certain circumstances services may be authorised by a net subhead in a Vote and in such a case there is no specific Parliamentary control over the receipts although they will of course remain subject to the Comptroller and Auditor General's audit. Any receipts not authorised to be used must still be paid into the Consolidated Fund and are known as Consolidated Fund Extra Receipts (CFERs).

Payments out of the Consolidated Fund may be of two types:

a) *Consolidated Fund Standing Services.* In these cases, Parliament has decided once and for all by statute that certain services will be paid from the Consolidated Fund and are not to be subject to the annual Vote authorising Supply Expenditure. The largest item here is the cost of servicing the national debt interest (which is paid through the National Loans Fund). Other items include the Civil List, certain net payments to the EC (mainly to fund the UK's legal obligations to the European Community, under the Treaty of Rome) and the salaries of the Judiciary, the Comptroller and Auditor General, the Speaker of the House of Commons and UK members of the European Parliament.

b) *Supply Services.* Issues from the Fund for these services are voted by Parliament annually for a particular financial year. The statutory authority is given annually in the Consolidated Fund Acts and the Appropriation Act. The latter formally appropriates the issues authorised by Consolidated Fund Acts to the purposes intended, ie those stated in the Estimates as the "ambits" of the proposed expenditure. It is actually presented to Parliament as a Consolidated Fund (Appropriation) Bill but when enacted is known as the "Appropriation Act". Daily transfers to departments' accounts at the Paymaster General's Office are made against this authority, under the

supervision of the Comptroller and Auditor General. The expenditure of these issues is accounted for by the Accounting Officer in the annual Appropriation Accounts, audited by the Comptroller and Auditor General and his National Audit Office (NAO), which are presented to Parliament in the Autumn.

National Loans Fund

All money raised by the creation of national debt (ie borrowing by government) is paid into the NLF and such debt is repaid from it. Consolidated Fund payments of debt interest are also channelled through the NLF.

Loans from the NLF must be only to public institutions authorised by Parliament to borrow from it and must bear an interest rate based on market rates current at the time so as to match the cost of borrowing. Thus NLF lending may in principle only be made to viable bodies, and if such a loan has to be written off the Fund must be reimbursed from the Consolidated Fund, usually on the authority of a Vote for the purpose as explained above. Other issues out of the NLF include eg subscriptions to the International Monetary Fund, which are, in principle, loans. Generally borrowing from the NLF is authorised in tranches by Parliament for specific borrowers. Within whatever limit is set, individual loans are made by the Treasury. The only loans made by HMG not accounted for through the NLF are those made from voted money, either because there is to be an interest rate subsidy (eg overseas aid loans) or where there is some doubt about their full repayment. Repayments and interest receipts connected with loans from Votes are received by the Consolidated Fund as CFERs.

Authorisation for issue

The Consolidated and National Loans Funds are under the control of the Treasury, which is accountable for them, but the C & AG's (somewhat anachronistic but constitutionally important) function as "comptroller" requires

him specifically to authorise each requisition for funds which he, once satisfied that it is statutorily authorised, passes to the Bank of England. The whole process is controlled by the preparation of daily accounts of both funds for the C & AG.

Accounts of the Funds

The Treasury is required by statute to prepare annual accounts of these two Funds and present them to Parliament. The accounts comprise:

(a) A statement of their transactions (audited by C& AG)

(b) A supplementary statement of certain assets (such as holdings in companies), liabilities and further information (unaudited). This statement covers a relatively small number of assets and liabilities which are recognised conventionally as adhering to the Fund, not by any means the whole of government's assets such as land holdings etc.

The Accounting Officer responsible for the Funds is the Permanent Secretary of the Treasury.

Other Funds

Certain other Funds which have been created by Parliament fall outside the general purpose Consolidated and National Loans Funds. These are confined to the specific purposes of the Acts which set them up. They normally have their own particular sources of income. They are accounted for separately to Parliament and are under the control of the relevant Ministers. They have been deliberately separated from the general Exchequer Funds for reasons specific to them. They include:

a) *Trading Funds (under the Government Trading Funds Act 1973)*
These, which were described earlier (in Chapter 3), are usually financed by Public Dividend Capital and/or loans from the NLF. Public Dividend Capital is subscribed (except where deemed to be issued) from the Votes of the relevant central government department; it does not carry a fixed coupon. The essence of a Trading Fund is that, once initially funded, it should be self-financing and pay a reasonable dividend on the basis of trading receipts for its product after paying fully for goods and services supplied to it. In short trading funds are the means of financing some government departments on a commercial basis.

b) *National Insurance Fund (under Social Security Act 1975)*
This Fund receives its income from the national insurance contributions from employers, employees and the self employed, supplemented by an annual payment from a Department of Social Security Vote. The main payments are pensions and unemployment benefit (to which contributions have been made by recipients) plus costs of administration. The Government Actuary reports every five years on the long term status of the Fund, in view of likely demands on it.

c) *Contingencies Fund (under the Contingencies Fund Act 1974)*
The Contingencies Fund amounts to an "overdraft" facility (interest free) and is primarily used to overcome timing difficulties. It is authorised to advance up to 2% of the previous year's voted total of Supply Estimates when it is impractical to secure prior Parliamentary authority or when cash is not available from regular sources. Such advances must always be repaid, usually from a Parliamentary Vote which in effect gives retrospective authority. This Fund is used to overcome difficulties when: (a) cash is required to meet commitments but is not yet available in the orthodox ways (eg VAT repayments at quarter ends - this money is repaid to the Fund from

future receipts); (b) Excess Votes are required because expenditure has exceeded the amount authorised by Parliament to be supplied (eg where demand-led expenditure exceeds the amount voted in the Estimates) - advances must be repaid when Parliament approves the Excess Votes in the following year; (c) it is necessary to anticipate Parliamentary authority when Parliament is not sitting or in some emergency situation. The Fund is strictly controlled by the Treasury, which is accountable for it.

d) *Other Funds*

These include the Redundancy Fund, which receives income as a fixed portion of national insurance contributions. The Redundancy Fund may also borrow money from the NLF. There is also a Forestry Fund, which receives an annual Vote of supply and spends it on grants for forestry and administration of the Forestry Authority.

Supply procedure

Moneys are made available under the authority of the Appropriation Act or Consolidated Fund Acts for the year to 31 March. Any money authorised but not spent within the year must be surrendered to the Consolidated Fund. Supply Estimates are prepared by departments and examined by the Treasury. They are carefully tied into the government's spending plans as outlined in the Public Expenditure White Paper. The Financial Secretary to the Treasury presents them to Parliament on Budget day, with the exception of Estimates for the House of Commons: Administration (dealing with MPs' salaries and other House expenses) and for the NAO, which are presented by Officers of the House and the NAO respectively on the same day.

Consolidated Fund and Appropriation Acts

Consolidated Fund Acts give the Treasury the authority to issue cash from the Consolidated Fund. Although there may be several Consolidated Fund Acts, in

the course of the year they are all rolled up and subsumed within the Appropriation Acts which appropriate the sums authorised to the purposes intended, usually once a year. The Summer Consolidated Fund Bill is presented as the "Consolidated Fund (Appropriation) Bill" and serves both the purpose of providing funds and also that of appropriating not only those funds but also all funds provided since the last Appropriation Act, as the dual purpose Bill is known when it has become an Act.

Part I of each Estimate describes the purposes for which it is intended and is incorporated in the Appropriation Act. This Act is usually passed before the Summer Recess and also specifies the amounts of receipts which may be used as appropriations in aid. Supplementary Estimates are normally presented in June (and appropriated with the original Estimates in the Appropriation Act), and November and February (funded by further Consolidated Fund Acts, but not appropriated until the next Appropriation Act). Proceedings on Consolidated Fund Bills are formal, ie not open to debate in Parliament.

Votes on Account are required because of the timing problem that the Estimates are not actually voted until the Appropriation Act is passed in July for the year commencing the previous April. Thus the winter Consolidated Fund Act covers not only the winter supplementary Estimates but also a Vote on Account for the year commencing in the following April. The main Estimates then seek provision for the balance to complete the year's requirements. This balance is provided in the Appropriation Act which (since it incorporates previous Consolidated Fund Bills) also appropriates the full annual provision to individual Votes.

The procedure can be shown as a table supplementing the diagram in figure 8 2:

| Year | Notified to Parliament | Vote for | Bill | Act |
|---|---|---|---|---|
| July/ August Yr 1 | Budget day (March) | Main Estimates Yr 1 | Consolidated Fund (Appropriation) Bill | Appropriation Act |
| | June | Summer Supplementaries Yr 1 | | |
| Nov Yr 1 | November | Vote on account Yr 2 | Winter Consolidated Fund Bill (CFB) | Winter Consolidated Fund Act (CFA) |
| | | Winter Supplementaries Yr 1 | Winter CFB | Winter CFA |
| Feb Yr 1 | February | Spring Supplementaries Yr 1 | Spring CFB | Spring CFA |
| | | Excess votes Yr 0 | Spring CFB | Spring CFA |

Timetable of submission to and authorisation by Parliament

Financial submissions, and the authorisation of spending, broadly follow the same timetable each year to meet Parliamentary requirements. The chart shown at figure 8.2 shows the timing, for a particular financial year (shown as a bold block), of:

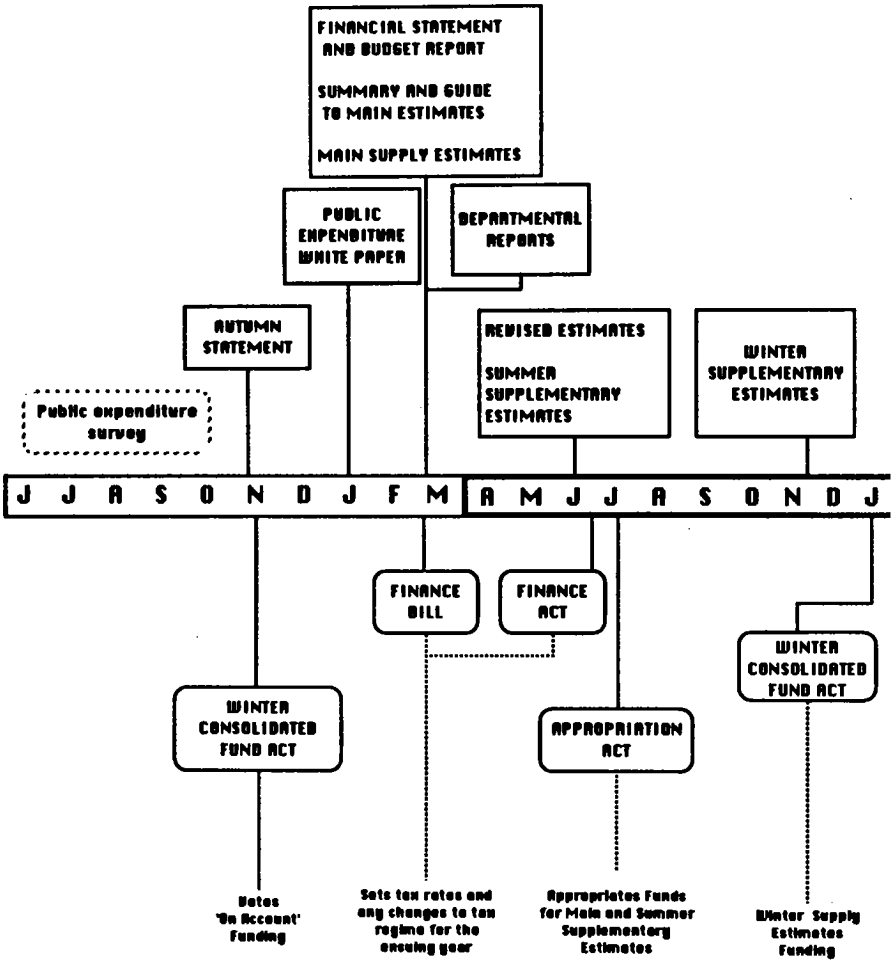
- The Public Expenditure Survey (PES) which is the process by which the total of public expenditure (and how it is to be spent) is decided by Ministers;

- the main reports and financial documents produced by central departments; and

- the Bills and Acts of Parliament authorising spending and taxation

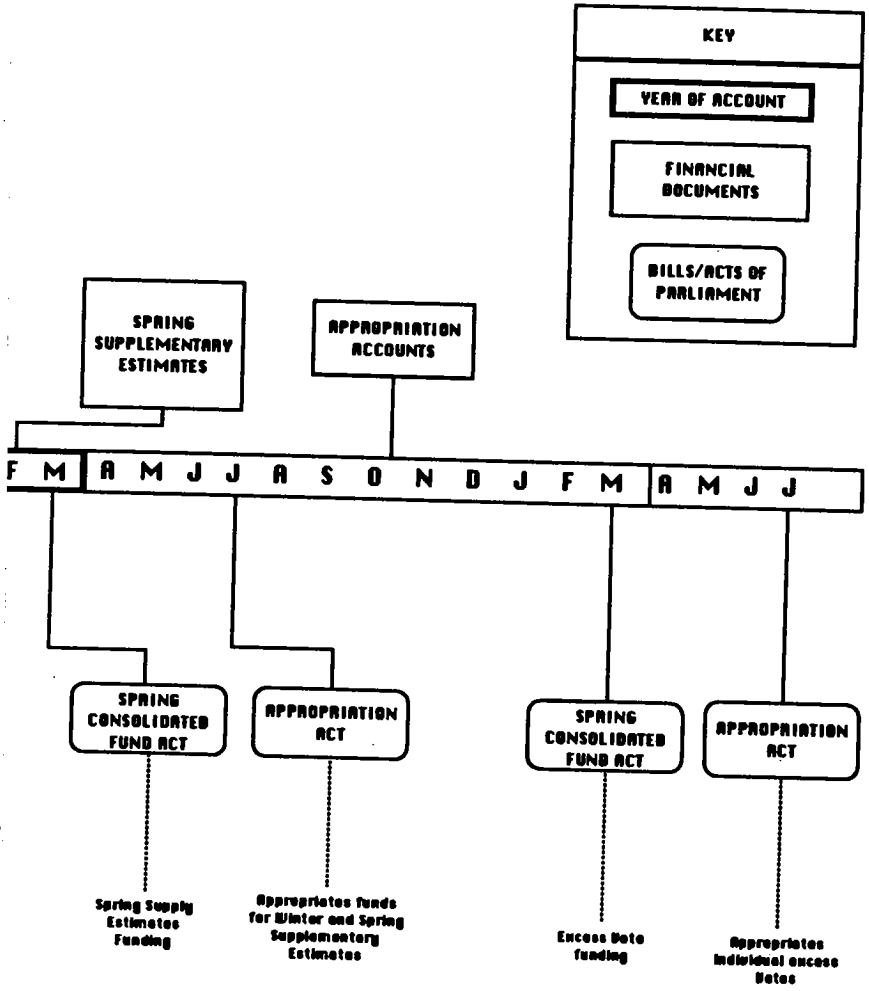
The diagram shows the main reports to Parliament on the upper side of the calendar, and the main Acts of Parliament which approve spending and taxation annually underneath the calendar. The PES is shown as of a few months duration at the left hand end of the calendar. The PES is of course an iterative process each year being further refined until the Estimates for a particular year of account are published on Budget day; final negotiations on prospective spending for that year are conducted within government (mainly between the Treasury and individual spending departments) in the few months leading up to the publication of the Autumn Statement. A revised diagram incorporating the changes proposed from 1990 is included in Chapter 9.

## PARLIAMENTARY AND LEGISLATIVE REPORTING CYCLES




[Adapted from chart published in Central Government: Financial Accounting and Reporting Framework - HM Treasury December 1988]

Figure 8.2


KEY
YEAR OF ACCOUNT
FINANCIAL DOCUMENTS
BILLS/ACTS OF PARLIAMENT
SPRING SUPPLEMENTARY ESTIMATES
APPROPRIATION ACCOUNTS
F M A M J J A S O N D J F M A M J J
SPRING CONSOLIDATED FUND ACT
APPROPRIATION ACT
SPRING CONSOLIDATED FUND ACT
APPROPRIATION ACT
Spring Supply Estimates Funding
Appropriates funds for Winter and Spring Supplementary Estimates
Excess Vote funding
Appropriates individual excess Votes

# *CHAPTER 9*

## FINANCIAL REPORTING TO PARLIAMENT FROM 1990: SUMMARY OF CHANGES IN PROSPECT

As explained in earlier chapters the documents reporting public spending plans to Parliament have been the Autumn Statement (in November), the Public Expenditure White Paper (in January) and the detailed Estimates (in March).

The Autumn Statement has been developed in content to the extent that the broad outlines of public expenditure plans are contained in it, leaving little to say on the broad picture in later documents. Nonetheless the Public Expenditure White Paper (PEWP) duplicated some of this information in its first volume. The second volume of the PEWP contained supplementary analyses which gave a great deal of further information on the overall picture, and also devoted a chapter to each department enabling it to describe its aims and objectives, and give a limited amount of output and performance information about past achievements.

In addition to a certain amount of duplication, the timing of publication of much of this information in January left little Parliamentary or Select Committee time for consideration and debate of the proposals. So there were recommendations from PAC and the Treasury and Civil Service Committee to give more detailed information earlier. As a separate point, publication of separate departmental reports would enable each department to go into greater detail about its activities and performance than hitherto and would also give greater scope for clear linkage of departmental programme plans and the requests for supply which Parliament is asked to approve.

## FINANCIAL REPORTING TO PARLIAMENT FROM 1990: SUMMARY OF CHANGES IN PROSPECT

The system for 1990/91 and later years (described in the 1988 White Paper "Financial Reporting to Parliament" - CM375) is as follows (diagrammatically represented in figure 9.1):

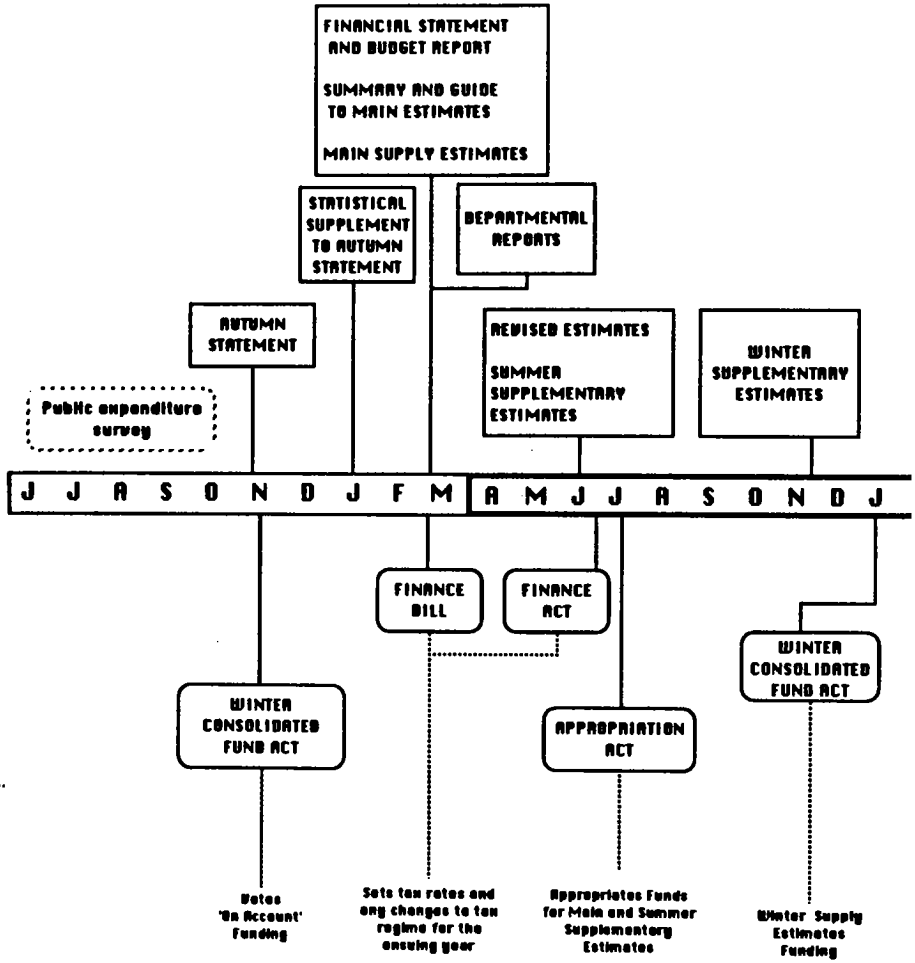
a) The Autumn Statement will be slightly expanded to include material from the first volume of the PEWP, giving the broad picture of public expenditure decisions a few days after the Cabinet has made them.

b) Departmental chapters of Volume II of the PEWP will be published in March as separate departmental reports in conjunction with the publication of Supply Estimates. They will describe departmental plans, give a summary of the Estimates and provide further information to enable Parliament to understand the reasoning for the supply being requested. The Estimates themselves will continue to be presented to Parliament in separate booklets by the Treasury, thus preserving the latter's traditional financial function to control and compile the Estimates.

c) The remaining material in the PEWP, such as tables of the breakdown of departmental figures by sub-programmes, which enable the "territorial" plans to be aggregated with those in England, cannot be published until all the figures have been broken down and collated in the Treasury computer. Such material would be included in a statistical supplement to the Autumn Statement, to be published in January.

d) Departmental reports would contain: a basic core of financial information, drawn from a common database linked to the Autumn Statement; a statement of objectives; an array of indicators of performance and output measures (work on which has been in progress for some years), compared to plans and targets; information about manning costs and manpower; and finally a clear link with the Estimates. The volumes would aim to have a similar structure and presentation across departments.

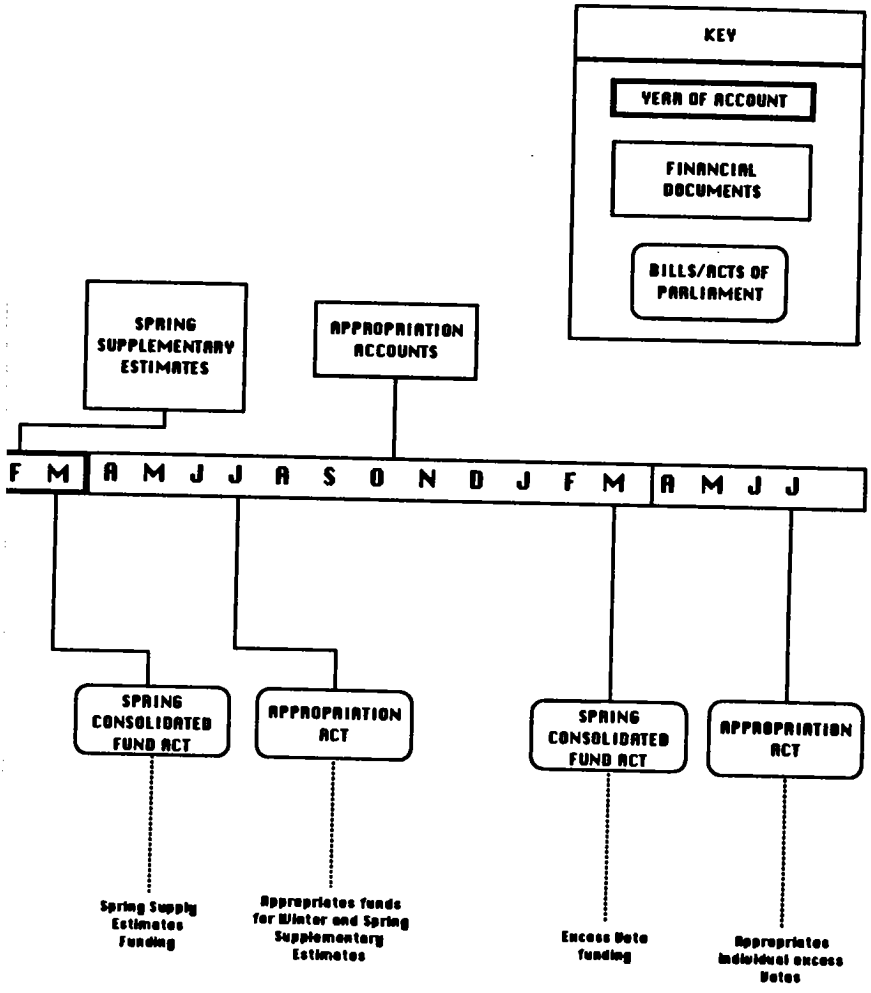
## PARLIAMENTARY AND LEGISLATIVE REPORTING CYCLES




[Adapted from chart published in Central Government: Financial Accounting and Reporting Framework - HM Treasury December 1988]

# FINANCIAL REPORTING TO PARLIAMENT FROM 1990: SUMMARY OF CHANGES IN PROSPECT

Figure 9.1



Occurring at the same time as these changes in accounting and planning arrangements are the proposals described in the HM Treasury publication "A New Public Expenditure Planning Total" - CM441. These changes will remove the expenditure financed directly by the local authorities from the planning total. This approach represents a change in emphasis since the early 1980's, when the desire to control expenditure in the public arena generally, as part of the drive to reduce inflation, led to a very broad definition of public expenditure in defining the Public Expenditure Planning Total. The change is designed to improve the allocation of responsibility for controlling expenditure as between local and central government and to remove, or at least reduce, the inference that overspending by local authorities must be attributed to a failure by central government to control planned public expenditure. These changes will have an impact on the way expenditure plans are analysed. For instance, no longer will it be meaningful to analyse expenditure on local government in the planning total by function - eg education, since the planning total will represent only part of the relevant expenditure.

Many developments in recent years have improved the quality and comprehensibility of central government reporting. We should, however, recognise that, in any comprehensive system of accountability, there will always be a place for *ad hoc* reports and questions such as are contained in reports to the Public Accounts Committee, and in Parliamentary Questions, each of which can address any area of government accounting. We should thus not expect the summary statements, as described in this book, to answer questions at levels of detail with which they cannot deal.

However further developments might be helpful in providing a greater understanding of what government accounts actually mean. For instance there is a need for a greater amount of information on resource consumption and commitments, as opposed to mere cash expenditure. Once capital is spent on

fixed assets or stocks, the timing of using these resources is not evident from cash flow statements. As Crick's report suggested (see Chapter 4) more important still is reporting commitments made which will not result in cash expenditure until future years; the cash system does not disclose the build up of unfunded burdens being placed on future taxpayers by commitments made today. Reports on these aspects of financial affairs will hopefully be developed under the new system of departmental reports. A system for reporting significant unfunded commitments and assets as part of the summary level account might also be put in place, in time.

It will obviously be helpful for the new departmental financial reports to link consistently among all departments to the summary financial statements of central government, in a clear hierarchical structure. The Financial Management Initiative, described in Chapter 2, may result in databases of assets being maintained which could be used for departmental reporting purposes. Many non-departmental public bodies, of course, currently report their assets in conventional commercial accounting form.

Finally, it is difficult to comprehend some of the numbers involved because of their sheer size. An important development to promote some public understanding will be to continue the trend towards publishing consistent and realistic comparative measures of significant statistics such as public spending, debt and income; these might show, for example, how total spending relates to income tax rates, and what levels public spending and borrowing have reached per head of population.

In conclusion, this monograph indicates the continuous state of change in government accounting. Accounting needs and structures develop all the time as new policies or practices demand new forms of report. It is inevitable that more changes are in prospect!

# APPENDIX 1

## NATIONAL ACCOUNTS:
## CENTRAL GOVERNMENT SUMMARY ACCOUNT
## TABLE 7.1 - NATIONAL ACCOUNTS BLUE BOOK

| COMPONENT | SOURCE |
|---|---|
| **Current receipts** | |
| Taxes on income | Inland Revenue |
| Taxes on expenditure | Customs & Excise, Inland Revenue, Departmental returns |
| Social Security contributions | Government Actuary's Department |
| Gross trading surplus | Apex* |
| Rent, dividends and interest, etc | Apex, National Loans Fund, Departmental returns |
| Miscellaneous current transfers | Apex |
| Imputed charge for consumption of non-trading capital | CSO estimate |
| **Total** | |
| **Current expenditure** | |
| Final consumption | Department returns, Apex |
| Subsidies | Apex, Department and Public Corporation returns |
| Current grants to personal sector | Apex, Government Actuary's Department |
| Current grants to local authorities | Apex |
| Current grants paid abroad (net) | Departmental returns |
| Debt interest | Apex, National Loans Fund, Departmental returns |
| Total current expenditure | |
| Balance: current surplus/deficit | |
| **Total** | |

# APPENDIX 1

| | |
|---|---|
| **Capital receipts** | |
| Current surplus | |
| Taxes on capital and other capital receipts | Inland Revenue |
| **Total** | |
| **Capital expenditure** | |
| Gross domestic fixed capital formation | Apex, Departmental returns |
| Value of physical increase in stocks | Apex |
| Grants and transfers to other sectors | Apex |
| Total capital expenditure | |
| Balance: financial surplus or deficit | |
| **Total** | |
| **Financial Account** | |
| Transactions in financial liabilities | Bank of England and other sources |
| Transactions in financial assets | Apex, National Loans Fund |
| Net total financial transactions | |
| **Balancing item** | |

* Government accounting information from the Paymaster General's Office.

# APPENDIX 2

## ECONOMIC AND FINANCIAL PLANNING, MONITORING AND ACCOUNTING DOCUMENTS PRESENTED TO PARLIAMENT

| Purposes | Document | Month published [Prepared by] |
|---|---|---|
| **Macro-Economic Strategy and Planning Financial Strategy (Phase 1)** | | |
| Explains the basis of macro-economic strategy for 3 years ahead. | Financial Statement and Budget Report (FSBR) | March [HMT] |
| **Planning (Phase 2)** | | |
| Public expenditure plans and objectives for balance of current year and 3 years ahead | Autumn Statement | November [HMT] |
| Public expenditure plans and objectives for a run of 5 years plus estimate for current year and 3 years ahead | Statistical supplement to Autumn statement. | January [HMT] from 1991 |
| | Public Expenditure White Paper (PEWP) | January [HMT] until 1990 |
| Explains departments' plans | Departmental reports | March [Departments] |
| **Monitoring and control (Phase 3)** | | |
| Detailed supply expenditure limits requiring annual Parliamentary approval | Summary and Guide to the Estimates. | March [HMT] |
| | Main Supply Estimates | March [HMT] |

| Content | Coverage |
| --- | --- |
| Summary figures relating to medium term financial strategy;<br>Recent economic indicators;<br>Inflation;<br>Balance of payments;<br>Economic forecasts | Monetary targets and borrowing objectives;<br>Revenue projections;<br>Public expenditure planning totals;<br>Revenue and expenditure accounts for a cycle of years. |
| Overall public expenditure figures and departmental plans.<br>Recent economic indicators and forecast. | Overall expenditure planning totals; Departmental analysis; Economic prospects; National Insurance rates. |
| Analysis of public expenditure figures. | Analyses by spending authority and economic category. |
| Detailed public expenditure figures and main objectives for each main area and department | Departments' specific expenditure plans;<br>Overall aims and main objectives;<br>Specific targets;<br>Analyses by spending authority and economic category. |
| Departmental aims, objectives and targets | Departmental specific expenditure plans. |
| Links with Autumn Statement. | Voted central government expenditure. |
| Detailed analysis of expenditure to be voted for departments. | Purpose of expenditure (ambit);<br>Detailed figures;<br>Cash and running cost limits. |
| Shows a summary of the Estimates, as revised in March from figures published in January in PEWP, and some further explanation. | |

| Purposes | Document | Month published [Prepared by] |
|---|---|---|
| | Supplementary Estimates | June, November and February [HMT] |
| Control of public expenditure, cash flows and borrowing | Economic Trends | Monthly [CSO] |
| | Financial Statistics | Monthly [CSO] |
| | Autumn Statement | November [HMT] |
| | PEWP | January [HMT] |
| | FSBR | March [HMT] |
| **Accountability (Phase 4)** | | |
| Reporting of achievements, payments and receipts and/or financial results | Financial Statistics | Monthly [CSO] |
| | *Appropriation Accounts | October [Departments] |
| | Cash Limits White Paper | July [HMT] |

| Content | Coverage |
| --- | --- |
| Detailed analysis of additional (in-year) departmental requirements | Purpose of expenditure;<br>Detailed figures;<br>Cash limit; running cost limit. |
| Monthly/quarterly outturn estimates | Broad estimates of general government receipts and expenditure;<br>Borrowing requirement; |
| Monthly/quarterly outturn estimates | Central government current, capital and financial accounts;<br>Borrowing requirements;<br>Supply expenditure;<br>Public expenditure planning total.<br>(Using National Accounts data). |
| Forecast of outturn of current's year revenue and expenditure | Departmental analysis |
| Updated forecast of current year's outturn | Overall and departmental figures;<br>Estimate of outturn of running costs. |
| Estimate of outturn for current year | Overall public expenditure figures;<br>Analysis of revenue and expenditure by economic category; Summary of estimated accounts of Consolidated and National Loans Funds. |
| Consolidated Fund;<br>National Loans Fund. | |
| Audited Supply expenditure | Expenditure voted and appropriated by Parliament. |
| Cash limit outturn to 31 March | Comparison of outturn with final limits; overall and by department. |

| Purposes | Document | Month published [Prepared by] |
|---|---|---|
| | PEWP | January [HMT] until 1989 |
| | Departmental reports | March [Departments] from 1990 |
| | ** National Blue Book | September [CSO] |
| | * Consolidated Fund and National Loans Accounts | December [HMT] |
| Reporting of achievements, payments and receipts and/or financial results | Supplementary Statements | December [HMT] |
| | Accounts relating to issues from the National Loans Fund | December [HMT] |
| | National Insurance Fund Account | December [DSS] |
| | * Accounts of the Contingencies Fund | November [HMT] |
| | * Redundancy Fund | March [DEmp] |

| Content | Coverage |
| --- | --- |
| Analysis of achievements against objectives and targets<br>Expenditure outturn. | Overall and by departments. |
| Report of performance.<br>Analysis of achievements against objectives.<br>Expenditure outturn. | Departmental results and expenditure |
| National outturn estimates (annual) | Central, local and general government current, capital and financial accounts. |
| Payments into and issues out of the Consolidated Fund and National Loans Fund.<br><br>Lists of assets and liabilities of these Funds and certain existing contingencies | Consolidated Fund;<br>National Loans Fund. |
| Sums received by Ministers and others and disposal of those sums | Loans from the National Loans Fund. |
| Receipts from Consolidated Fund and National Insurance contributions and payments for benefits and administration.<br>Statement of assets. | |
| Advances on account of sundry Votes (including the previous years Excess Votes) and advances to Customs & Excise/Inland Revenue, etc and repayments. | |
| Redundancy payments to employees etc and receipts from employers, NI contributions and loans from NLF. | |

| Purposes | Document | Month published [Prepared by] |
|---|---|---|
| **Annual Accounts of Other Bodies funded by Government and presented to Parliament** | | |
| | (*) Trading Funds<br>&<br>(*) Trading Departments<br>(*) Non Departmental Public Bodies<br>(*) Nationalised Industries<br>(*) Sundry others | Normally June to December |

* Subject to external audit by Comptroller and Auditor General (C&AG)

(*) Most bodies subject to external audit by C&AG or other external auditors

** Not laid in Parliament

| Content | Coverage |
| --- | --- |
| Report and accounts of management. | |
| Report of financial results (often in broadly commercial style, showing income and expenditure and balance sheets). | Normally prepared by and for the body concerned under an accounts direction from the sponsor department in terms of the enabling legislation. |
| Performance aims and achievements; outturn against any targets set. | Shows extent of public funding in income and expenditure account with links to the Vote concerned. |
| Summary of Performance Indicators. | |

# APPENDIX 3

## ADJUSTMENTS TO PUBLIC EXPENDITURE PLANNING TOTAL TO ARRIVE AT GENERAL GOVERNMENT EXPENDITURE IN NATIONAL ACCOUNTS

Example 1988/89 outturn of PEPT, reconciled to GGE (from Expenditure Plans Chapter 21 - published January 1990 - CM 1021).

| | | £ million 1988 -89 |
|---|---|---|
| Central government's own expenditure (including voted and non-voted expenditure) | | 116,284 |
| Central government support for local authorities | | |
| | Revenue/Rate support grant | 12,846 |
| | Non domestic rates | 10,446 |
| | Current specific grants | 8,902 |
| | Capital grants | 545 |
| | Credit approvals (ie authority to borrow) | 3,698 |
| | | 36,437 |
| | Financing requirements for public corporations (including nationalised industries) | (138) |
| | Privatisation proceeds | (7,073) |
| PUBLIC EXPENDITURE PLANNING TOTAL | | 145,510 |
| Deduct | central government support for local authorities | (36,437) |
| Add | local authority expenditure in total | 46,767 |
| | | 10,330 |
| Add | Central government debt interest | 17,554 |
| | Capital consumption | 2,941 |
| | VAT refunded | 1,743 |
| | Pension increase payments | 887 |
| | Adjustment for public corporations | 3,162 |
| Deduct | Local authority debt interest paid to central government | (4,115) |
| Add | Other | 739 |
| GENERAL GOVERNMENT EXPENDITURE | | 178,751 |

# APPENDIX 4

Relationship of Public Expenditure, Government Final Consumption and Gross Domestic Product

Using the 1988 National Accounts Blue Book, the following table explains how the amounts of public expenditure and government final consumption are derived for the 1987 calendar year. These figures may differ slightly from those in government financial documents, which use the fiscal year figures. The main difference between these two columns is that Public Expenditure includes many items which are transfers to or from the private sector, not just items of final expenditure.

| | Government expenditure on goods and services £m | General Government Expenditure £m | Source table (blue book) |
|---|---|---|---|
| Current Expenditure by general government | | | 9.4 |
| Current expenditure on goods and services: | | | |
| Wages and salaries | 51,453 | 51,453 | |
| Other | 31,587 | 31,587 | |
| | 83,040 | 83,040 | |
| Capital consumption | 2,732 | 2,732 | |
| Subsidies to private sector | | 5,762 | |
| Current grants to sector | | 52,478 | |
| Current grants abroad | | 3,287 | |
| Gross debt interest | | 17,667 | |
| | 85,772 | 164,966 | |

# APPENDIX 4

| | | | |
|---|---|---|---|
| Capital Expenditure by general government | | | |
| Gross domestic fixed capital formation | 6,911 | 6,911 | |
| Increase in stocks | (612) | (612) | |
| Capital grants | | 3,104 | |
| | 6,299 | 9,403 | |
| Net lending to other sectors | | (641) | |
| Cash expenditure/income from corporate securities (privatisation etc) | | (5,678) | |
| | 92,071 | 168,050 | |
| Gross Domestic Product at market prices | 414,455 | 414,455 | 1.1 |
| % of Gross Domestic Product | 22% | 41% | |

# APPENDIX 5

## STRUCTURE AND ORGANISATION OF HM TREASURY

HM Treasury is administered by a number of Ministers who are supported by their civil servants. Treasury Ministers' function is to decide on national financial policy in the light of overall government policy and advice received from their civil servants. The civil servants involved then carry out the wishes of the government as transmitted by Ministers.

The Lord High Commissioners of HM Treasury are:

The First Lord of the Treasury (the Prime Minister);
The Chancellor of the Exchequer; and
five Junior Lords.

This Board of Commissioners is assisted by:

The Chief Secretary to the Treasury

whose responsibilities include control of public expenditure; general business of the public services and industry groups; overseas aid; and efficiency in the public services (value for money);

The Financial Secretary

whose responsibilities include Inland Revenue duties and taxes; privatisation; industrial casework; and Parliamentary financial business (including the largely formal procedures for the voting of funds by Parliament);

# APPENDIX 5

The Economic Secretary

whose responsibilities include monetary policy; Treasury responsibilities for the financial system (banks and other financial institutions); international financial issues and institutions (not including the European Community); Treasury interest in general accountancy issues; and the legislative programme; in addition he is responsible for certain government departments and bodies including the Department of National Savings, Registry of Friendly Societies and HMSO;

The Paymaster General

who has responsibility for civil service pay, superannuation, recruitment and personnel management; Customs and Excise duties and taxes; European Community business; and the Paymaster General's Office together with a number of other duties.

These ministerial duties change slightly from time to time depending on government priorities and also on whether the Minister concerned is in the House of Lords (in which case he will need a deputy in the House of Commons).

Ministers are assisted by the permanent civil service, headed by the Permanent Secretary to the Treasury, two Second Permanent Secretaries (responsible for public expenditure and finance respectively), the Head of the Government Economic Service and Chief Economic Adviser to the Treasury, and the Chief Accountancy Adviser to the Treasury and Head of the Government Accountancy Service. These four permanent officials are supported in turn by Deputy Secretaries responsible for public services, economic advice, public finance, pay, industry and overseas finance. The various areas of policy advice under Deputy Secretaries' control are then sub-divided into areas for which Under Secretaries (supported by Assistant Secretaries and Principals) are responsible.

Details of the people holding the various positions and the responsibilities concerned are given annually in the Civil Service Year Book published by HMSO for the Cabinet Office. This book also gives addresses and contact telephone numbers.

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* The author acknowledges this source for figures 8.2 and 9.1 together with Appendices 1 and 2 which were adapted for use in this monograph.

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## GOVERNMENT ACCOUNTING

This monograph is an introductory text designed to explain to the non-specialist reader the basics of central government financial planning, control and reporting. It provides an important insight into an area which impacts on all our lives but about which most of us have little knowledge.

Chris Fletcher, a member of The Institute of Chartered Accountants of Scotland, is a partner in the Edinburgh office of KPMG Peat Marwick McLintock.

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