

H M Treasury

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Dear Accounting Officer

RESOURCE ACCOUNTING MANUAL 2001-02: GUIDANCE ON THE INCLUSION OF AN OPERATING AND FINANCIAL REVIEW IN AN ANNUAL REPORT

Purpose of this DAO letter

This letter sets out the guidance that departments should follow to satisfy the requirement of paragraph 11.2.1 of the Resource Accounting Manual (RAM) for 2001-02 for the inclusion of an operating and financial review in an annual report. The guidance itself is given in the attached annex.

Action and enquiries

2. The content of this letter should be drawn to the attention of relevant staff.
3. Enquiries should be addressed to Andrew Carpenter in the Central Accountancy Team (phone 020 7270 4495; email: andrew.carpenter@hm-treasury.gov.uk).

Scope of the DAO letter

4. The guidance applies only to departments. It does not apply to agencies (or agencies that are whole departments), trading funds or NDPBs for which existing requirements remain (until these requirements are revised in the context of the Cabinet Office's current review of its guidance "Next Steps Agencies – Guidance on Annual Reports", October 1998) as set out for:

- a. On-vote agencies (or agencies that are whole departments), in the following parts of the RAM:
 - 11.1.2, for agencies' annual reports;



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- the “Scope”, “Management” and “Public interest and other sections” in paragraph 11.2.1, where relevant, and paragraph 11.2.2, in what agencies should continue to include as “Forewords”;
- b. Trading funds, in chapter 3 of the Trading Funds Accounts Guidance;
 - c. Non-departmental Public Bodies (NDPBs), in chapter 2 of the Executive Non-Departmental Public Bodies Annual Reports and Accounts Guidance.

Background

5. Departmental resource accounts summarise the results of much varied activity and are complex in their construction. The inclusion of narrative information and analysis in the annual report would help the reader understand better what the accounts show and how they reflect what the department is trying to achieve.

6. The Accounting Standards Board (ASB) published in 1993 a statement entitled “The operating and financial review”, which was designed as a formulation and development of best practice in providing such information, for use by listed companies and other large corporations of public interest. The statement is not an accounting standard, and it is persuasive rather than mandatory for those entities. However, the implementation of revised arrangements for departmental reporting make it necessary to provide supporting narrative to resource accounts. We consider the ASB’s statement to be the most appropriate basis, subject to recognition of the special characteristics of public sector bodies.

7. The ASB is currently reviewing its OFR statement, which is likely to be wider in its scope as a result, and related changes may be made to company law reporting requirements which the DTI is reviewing. The outcome of these reviews will be taken into account in the RAM in due course, as will departments’ experience in applying the guidance set out below (in the resource accounting post-mortem for 2001-02).

8. The guidance set out below concentrates on the principles to be followed, with a minimum prescription of content. This is so as to leave departments scope to flesh out their OFRs in the way that best suits their circumstances.

9. The guidance process has included the normal RABIG consultation appropriate for RAM amendments. The Financial Reporting Advisory Board approved the guidance on 11 March.

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RESOURCE ACCOUNTING MANUAL 2001-02 – GUIDANCE ON THE INCLUSION OF OPERATING AND FINANCIAL REVIEWS IN AN ANNUAL REPORT

1. A new section, headed “Operating and financial review”, will be included in each annual report produced to meet the requirements of sub-section 11.2.1 of the RAM. The new section in the annual report will be placed to follow the “Scope” section and precede the “Management” and “Public interest and other” sections. The RAM’s current requirements for those existing three sections in the annual report will continue to be met, as set out in sub-paragraphs 11.2.1.a to 11.2.2.q of the RAM for 2000-01, other than in sub-paragraphs:
 - a. 11.2.1.f, in which the reference to the departmental report should be taken to be to both the main departmental report to be published in April and the supplementary performance information report to be published later in the year, as announced in PES (2001) 30;
 - b. 11.2.1.g, because disclosures in relation to pension liabilities and the statements of the relevant pension schemes will be given in the notes to the accounts, to meet the requirements of FRS 17.
2. The new section will meet the requirements of the ASB’s statement “Operating and financial review”, to the extent that it is meaningful and appropriate in the public sector context, so as to provide an objective discussion that analyses and explains the main features underlying the results and financial position shown in the accounts. Reference should be made to the statement for a full understanding of its requirements.
3. Adaptations of the statement’s requirements are needed to reflect that:
 - a. departments do not have the same primary objective as that of the reporting entities addressed by the statement, being to achieve returns for the entities’ shareholders;
 - b. authority for, and substantially the financing of, departments’ activities is provided by Parliament.
4. Hence, for example, references to profits and returns attributable to shareholders should be interpreted as being references to the relevant Parliamentary control totals, as reflected in the accounts, and to other relevant entries such as in Schedule 5 and in the statement of recognised gains and losses. Likewise, the discussion should cover, in the context of the department’s current spending review settlement and beyond, the financing implications of significant changes in its objectives and activities, its investment strategy and its long-term liabilities, including significant provisions and PFI and other leasing contracts. It should not normally be necessary either for there to be a discussion of current liquidity or for a going concern statement to be given.

5. The aim of the OFR is to enable the reader to understand the main influences on the overall results and how they interrelate, and their impact in the future. The OFR should be concise and may include references to other published documents in which more detailed information is to be found; for example, the Departmental Report and Departmental Investment Strategy.

6. The precise content of an OFR is for the department to consider, but the OFR should discuss the main:

- a. Features of operating and financial performance for the year reflected in the results reported in the financial statements. This should include significant developments in the department's activities and the environment in which it operates and in its financial position, and identifying trends reflected in the results, and explaining variances against Estimate (building on the brief descriptions at the foot of Schedule 1);
- b. Factors and influences that may have an effect in future periods, particularly on future financing requirements, whether or not they were significant in the period under review, and including any substantial risks and uncertainties such as potential environmental liabilities and contingent liabilities, and post balance sheet events;
- c. Ways in which the department has sought to invest in the future, including through its current and planned capital expenditure, its research and its development of new or improved ways to deliver against its objectives, and the likely benefits of this investment.