

# Consolidated budgeting guidance from 2008-09

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January 2008



HM TREASURY





HM TREASURY

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# FOREWORD : NEW FOR 2008-09

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## YEARS OF APPLICABILITY

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1. This budgeting guidance applies to in-year control from 2008-09 and to baselines for the next Spending Review.

## SUBSTANTIVE CHANGES TO BUDGETS

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2. This section sets out the main areas where the guidance has been changed for 2008-09:
  - The budgeting treatment of **NHS Provider Trusts** has been amended, to simplify it and bring the Trusts onto full Central Government recording – see chapter 12
  - The guidance has been expanded to cover **coverage agreements** on disposal of an asset and clarify that any benefit would score to department's capital budgets – see chapter 7
  - As a result of changes made in the CSR, MoD's budgeting has been simplified and several exceptional treatments have been removed.
    - In previous years certain small **MoD NDPBs** have been recorded on a grant-in-aid basis, in future they will move to full NDPB recording – see chapter 9
    - In SR04 MoD had a unique **near/non-cash control regime**; this will no longer apply – see chapter 5
    - For the first time MoD will move to the same **admin/programme** control regime as all other departments – see chapter 4
  - The ceiling for **capitalisation directions** has been reduced – see chapter 10
  - The guidance has been updated to better reflect current government policy on take-up of **grants from the EU** – see chapters 3 and 7
  - The requirement to make **netting-off** cases as part of the spending review process has been relaxed – see chapter 3

## OTHER CHANGES TO THIS GUIDANCE

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3. This section includes changes to the coverage of the guidance:
  - The guidance has been expanded to cover **coverage agreements** on disposal of an asset and clarify that any benefit would score to department's capital budgets – see chapter 7
  - The guidance has been expanded to clarify the recording of **capital grants in kind** – see chapter 6

## CHANGES IN THE FORMAT OF GUIDANCE

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4. The guidance has in some places been updated to reflect changes in the control regime since it was issued.
5. We have also clarified a number of budgeting policies where we have been asked questions. These are not changes in the budgeting system, but are existing rules that may not have been well known. So some of this guidance may be new to some departments, even where the text has not been flagged up as a change in the previous section.

## CHANGES SINCE 14 DECEMBER DRAFT

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6. On 14 December 2007 the Treasury sent a draft of this guidance to Finance Directors for comment as to the clarity and comprehensiveness of the guidance. We have tidied up the drafting in a number of places throughout the document. The main substantive changes since that draft are:
  - A clarification has been added to point departments towards **Fees and Charges** guidance when setting the level of fees – see chapter 3
  - The guidance has been updated to reflect the three-year settlements agreed with **local government** from 2008/09 – see chapter 10
  - The rules surrounding **EYF drawdown** and the interaction with control totals have been clarified – see chapter 15

## FURTHER CHANGES TO COME

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7. As the budgeting system develops in year, we will amend the Consolidated Budgeting Guidance and inform departments of changes.
8. Such changes may reflect changes in accounting requirements for departmental resource accounts to which departments will have been alerted through the normal RABIG-based consultation process.

# OVERVIEW - INTRODUCTION TO BUDGETING

## PURPOSE OF PUBLIC EXPENDITURE CONTROL

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- 1.1** The budgeting system has two main objectives:
- To support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the Government's fiscal framework; and
  - To provide good incentives for departments to manage spending well so as to provide high quality public services that offer value for money to the tax-payer.
- 1.2** In addition, we try to keep down the compliance costs of the budgeting system and of the overall public spending control framework.

## Fiscal Framework

- 1.3** The government has two fiscal rules:
- The golden rule: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
  - The sustainable investment rule: public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level.
- 1.4** So the fiscal rules inform the balance between current and capital public expenditure and the amounts that the Government has to raise by taxes and other revenues and by borrowing.
- 1.5** Achievement of the fiscal framework is measured using the National Accounts. These are prepared in accordance with the internationally agreed framework 'European System of Accounts' (ESA 95). ESA95 in turn is consistent with the System of National Accounts (SNA93), which was prepared under the auspices of the United Nations and is in use across the globe. The Office for National Statistics (ONS), acting as an independent agency, is responsible for the national accounts.
- 1.6** Key fiscal aggregates, measured at the level of the public sector, are:
- The **Surplus on the Current Budget** is used to measure achievement of the Golden Rule. It aims to measure current revenues and expenditure on an accruals basis. It includes a measure of depreciation and does not include provisions.
  - **Public Sector Net Debt** (PSND) is a measure of the stock of debt that includes the government's financial liabilities (such as gilts and National Savings) less liquid assets. Finance leases and on-balance sheet PFI, lending under financial transactions made for policy reasons, such as lending to students, increase PSND. Placing surplus money on deposit creates a liquid asset, which offsets gross debt.

## Comparison with Departmental Resource Accounts

**1.7** Departmental resource accounts (DRAs) are based on UK Generally Accepted Accounting Practice (UK GAAP). Many transactions are treated in the same way in DRAs and national accounts: pay is a current expense in any system of accounts. But there are a number of differences between the two systems of accounts, for example:

- Capital grants are treated as part of capital expenditure in national accounts, but are resources (i.e. current operating expenditure) in DRAs;
- Provisions score in DRAs when they are created and charged to the Operating Cost Statement; subsequent transactions are dealt with on the balance sheet. National accounts score expenditure that takes place when the costs against which the provision had been created crystallise;
- While national accounts include depreciation, the ONS uses its own model for calculating depreciation, which gives a different measure from that in DRAs. ONS are expected to use the DRA measure in the national accounts at some point in the future. When they do so, it is likely that some but not all impairments and revaluations that pass through the DRA operating cost statement will affect the national accounts measure of the golden rule;
- DRAs do not differentiate between income from taxes, rents, transfers and sales of services; national accounts do. That may lead to differences in the budgeting treatment of different sorts of income and in the timing of recording of income;
- GAAP accounts include balance sheet asset categories of pre-payments, debtors and creditors. The national accounts balance sheet also includes trade creditors/ debtors. However, the fiscal framework measure of Net Debt is almost a pure cash measure. So we need to keep an eye on cash. Normally, the accruals measures offer adequate control of cash. However, the budgeting rules may bring large movements in working capital and some other flows into the control regime even if they would normally be excluded from accruals-based controls;
- National accounts cover sectors of the economy, while DRAs follow the departmental boundary, as defined in the FREM. It follows that certain transactions appear differently, or not at all, in the national accounts or DRAs. For example, the national accounts ignore transactions between NDPBs and departments, because both are in the central government sector and offset each other, while DRAs show transactions with NDPBs as external transactions and include them in their Operating Cost Statements and Balance Sheets.

**1.8** These differences in accounting treatment explain some of the cases where DRAs and budgets treat transactions differently, since budgets are trying to achieve objectives expressed in terms of the national accounts rather than GAAP accounts.

**1.9** Annex A lists the main differences between budgets and DRAs.

## Management Incentives

**1.10** The budgeting system tries to ensure that departments have good incentives to manage their business well, to prioritise across programmes, and to obtain value for money.

**1.11** So, for example departments are given three-year budgets with end-year flexibility to allow sensible planning. Departments face a charge for the cost of capital. Provisions score in budgets close to the time that decisions are taken. And there are rules allowing departments to offset certain income against budgets when that helps good management.

## Compliance Costs

**1.12** We try to keep down compliance costs by basing the budgeting rules on the DRAs that departments draw up for parliamentary and public reporting purposes.

**1.13** However, where it is desirable either because of the need to support the fiscal framework or because controlling spending against information in DRAs would not provide the right incentives for departments, the budgeting rules have a different treatment from DRAs.

## ROLE OF HM TREASURY

**1.14** The Treasury is responsible for the design of the budgeting system. We will always be happy to explain the budgeting rules. It is only the Treasury who may finally determine the budgeting treatment of a transaction.

**1.15** The guidance does not cover every case. Sometimes we have deliberately kept the guidance simple for departments because certain transactions are rare or typically small. But there might be cases where if a large instance of such a transaction were to take place it would impact on achievement of the fiscal framework. So we will sometimes impose restrictions even if the guidance does not provide for them to protect the fiscal framework or to provide better incentives for departments. If departments face new circumstances, which might lead to difficulties for the fiscal framework, they should contact their Treasury spending team before they undertake the transaction.

**1.16** Sometimes departments' or public bodies' consultants offer them suggestions for ways round the spending control framework. We have no interest in such schemes. Departments are asked to go with the spirit of the spending control framework. If a transaction is clearly just a way round the letter of the rules, then departments should follow the spirit of the rules. If you are in doubt, talk to your spending team.

**1.17** Treasury Ministers have the right to modify the budgeting guidance at any time, although in practice we try to keep changes to a minimum and we generally consult departments before making significant changes.

## BUDGETING POLICIES

### Resource and Capital Budgets; Near-Cash in Resource DEL and Administration Budgets

**1.18** Departments have separate budgets for

- **Resources** – current expenditure such as pay and including the current costs resulting from the ownership of assets, such as depreciation and a cost of capital charge. Within the Resource Budget DEL there are separate budgets set in Spending Reviews for:
  - Near-Cash within Resource DEL – expenditure that impacts directly on the Golden Rule, for example pay and current procurement; and
  - Administration Budgets – expenditure on running central government departments but excluding their frontline activities.

Note that while these two budgets overlap, they are separate control totals; they are not cumulative. So departments need to stick within their Administration Budget and within their near-cash within Resource DEL budget. However, they do not have a specific limit for the near-cash element of the Administration Budget.

- **Capital** – for new investment and net policy lending.

**1.19** Appendix 1 to this chapter summarises the contents of budgets. Appendix 2 sets out the control totals diagrammatically. Appendix 3 presents diagrammatically the link between the budgeting aggregates and the fiscal framework. Appendix 4 sets out a list of the control totals – departments and their Treasury spending teams should at all times have a shared understanding of what the control totals are and how the department's spending matches up against them. Appendix 5 sets out the criteria for AME treatment of levy funded bodies. Appendix 6 gives the details of how Prior Period Adjustments (PPAs) should be treated in budgets.

**1.20** Cash is not controlled directly through the budgeting system. However, indirect control is exercised particularly through near-cash control totals for resource and capital DEL and the management of near cash in AME. In addition the Net Cash Requirement for Supply Expenditure is controlled through the Supply Estimates processes. Changes in the expected level of use of cash provide useful monitoring information. Departments should discuss the reasons for planned increases in the level of cash spending with their Treasury Spending Teams.

### Purpose of Budgetary Control Totals

**1.21** These controls support the achievement of the fiscal framework and provide management incentives for departments.

**1.22** **Near-Cash within Resource Budget DEL** is a control aggregate close to the measure of current spending that impacts on the current balance used to assess the Golden Rule. It excludes non-cash items such as depreciation (although depreciation impacts on the current balance, it is measured on a different basis), cost of capital charges (not in the current balance) and movements in provisions (not in the current balance, but expenditure that in GAAP terms is financed by release of provisions is in the current balance and is in near-cash). In order to support achievement of the Golden

Rule departments have to go through certain procedures if they wish to make significant increases in near-cash by transfers from non-cash within Resource Budgets.

**1.23 Resource Budget** includes both near-cash and non-cash current spending. Departments are expected to manage non-cash costs like other costs, because this reflects their management of department's assets and liabilities, and changes in depreciation and provisions convey useful information to managers. So if necessary departments have to make offsetting savings in any part of their resource budget if non-cash items rise. Similarly, where material savings on non-cash reflect management action, the Treasury will consider allowing switches of provision to near-cash in order to maintain incentives to manage non-cash costs (see passage on switches below).

**1.24 Administration Budgets** are controlled to ensure that as much money as practicable is available for front line services and programmes. Provision in the Resource Budget that is not in Administration Budgets is termed programme spending.

**1.25 Capital budget** spending is controlled because net investment increases Net Borrowing and hence the level of debt. We need to ensure that Net Debt remains at or below sustainable levels.

**1.26** Within each of these control totals, departments are expected to pursue efficiencies and prioritise expenditure in order to optimise the value for money of spending.

## Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME)

**1.27** Departmental Resource and Capital Budgets are divided into:

- **DEL** – firm three-year plans are set in the Spending Review. Departments may not exceed the limits that they have been set.
- **AME** – the Treasury reviews programmes twice a year with departments in the run-up to the Budget and the Pre-Budget Report. Departments need to monitor AME closely and should account in full to the Treasury for any changes in AME projections, or significant risks and challenges that may arise.

### Criteria for Treatment in DEL or AME

**1.28** All programmes are in DEL unless the Chief Secretary has determined that they should be in AME. The Chief Secretary may agree to put programmes into AME if:

- They are demand-led or exceptionally volatile in a way that could not be controlled by the department and where the programmes are so large that departments could not be expected to absorb the effects of volatility in their DELs; or
- For other reasons they are not suitable for inclusion in firm three year plans set in the spending review. For example: Lottery spending is the product of the hypothecated tax on the National Lottery and may not be reprioritised elsewhere. Certain levy-funded bodies, which serve particular industries, are in AME – see Appendix 5 to this chapter.

**1.29** Not all departments have AME programmes.

**1.30** The Treasury regularly reviews whether programmes in AME are still suitable for AME treatment. Where appropriate programmes are moved into DEL.

**1.31** Normally, a programme will have both its resource and capital budget impact in either DEL or AME, but there are some exceptions. Where a department agrees an exception with Treasury it should be included in their settlement letter during the spending review process.

**Management of DEL Programmes**

**1.32** Both DEL and AME programmes need to be managed to maximise effectiveness, efficiency and economy in the use of public funds. For programmes in DEL that is well understood. Because DEL programmes compete for resources within a fixed envelope departments are under a clear pressure to review programmes, re-prioritise and pursue efficiency measures.

**1.33** Where appropriate in the management of DEL programmes:

- The impact of DEL spending on AME spending needs to be considered. For example, DEL usually includes the cost of administering AME programmes and the quality of administration can have a significant impact on AME expenditure. And some DEL and AME programmes are complementary;
- If a proposed DEL spending changes has extra costs for AME spending, then the proposal needs to be cleared with the Treasury before being implemented.

**Management of AME Programmes**

**1.34** AME programmes are spending like any other. They impact on the fiscal framework in the same way as DEL spending. They need taxes to be raised to finance them. So careful monitoring and management is just as important as it is with DEL. And the nature of certain AME programmes means that some aspects of management, e.g. forecasting, are more important than with most DEL programmes.

**1.35** The management of AME programmes serves the same ends as the management of DEL programmes, but the system for managing AME programmes is different. AME programmes are often demand-led or otherwise volatile programmes when it would be unreasonable to expect departments alone to bear the risks associated with variations in demand or spending. The volatility of many AME programmes means that careful management is important.

**1.36** Departments are reminded that with AME programmes also, just as with DEL, they need to:

- Put in place processes to monitor spending in year, to identify longer-term trends in spending, and to provide robust projections of future spending. Early identification of changes in AME spending are needed to allow risks to be managed effectively;
- Review AME programmes regularly to ensure that they are helping to achieve Government objectives effectively and efficiently. Departments should discuss with the Treasury proposals for optimising AME spending programmes;
- Agree with HM Treasury prior to implementation any policy change which would increase AME spending;
- Consider carefully the impact of DEL spending on AME spending and vice versa. For example, DEL usually includes the cost of administering AME programmes and the quality of administration can have a significant impact on AME expenditure. And some DEL and AME programmes are complementary;

- If a proposed DEL spending change has extra costs for AME spending, then the proposal needs to be cleared with the Treasury before being implemented;
- Consider with the Treasury whether to take steps to support fiscal discipline and value for money if spending on AME programmes rises above expectation; and
- Monitor the balance of non-cash and near-cash spending in Resource AME and ensure that they take steps where appropriate to prevent undue increases in spending that affects the Surplus on the Current Budget.

## Switches

**Switches and Classification Changes** **1.37** Switches are real changes in provision reflecting real world changes in spending or plans. They need to be distinguished from classification changes, which restate budgets to reflect new ways of scoring an unchanged activity.

**1.38** Suppose a department has activity X which costs £50m and which is within administration budgets:

- If the department cuts the costs of activity X by £10m, it has made a real reduction in spending. It then has £10m that it may reallocate to other spending in administration budgets or that it may switch to programme spending;
- If the Treasury agrees that activity X should no longer be in administration budgets, then budgets are restated: the administration budget is reduced by £50m, and the programme budget increased by £50m within an unchanged Resource Budget DEL. The reclassification does not create spending headroom within the administration budget.

**1.39** There is a passage below on Types of Adjustment to Budgets.

**Restrictions on Switches** **1.40** So that the control totals can work, departments are restricted in the switches they may make between them:

- Departments may not switch provision from AME to DEL. Such switches would prejudice the functioning of firm three-year budgets for DEL. If Departments believe there is a good case for transfer, they should discuss this with their Treasury spending team. Where the actions/inaction of a Department increase AME, they may be called upon to fund the increases in AME by reductions in their DEL budgets;
- Departments may not switch provision from Capital Budgets to Resource Budgets<sup>1</sup>. Such switches would mean that money that had been earmarked for investment was used for current spending. Such switches would also prejudice achievement of the Golden Rule. Departments may switch provision from the Resource Budget DEL (both non-cash and near-cash) to the Capital Budget DEL;
- Departments are expected to manage their Resource Budget: DEL as an integrated whole, optimising spending across programmes (including programmes managed by NDPBs and those involving public corporations)

<sup>1</sup> The devolved administrations may switch up to 3% of Capital DEL into Resource DEL.

and across economic categories of spending. In order to encourage value for money and to support achievement of the fiscal framework, there are two general restrictions on the freedom to move provision across Resource DEL:

- Departments may not switch from programme budgets to Administration Budgets unless the Chief Secretary to the Treasury agrees the change. Such switches would mean increasing provision for back-office or policy staff at the expense of front-line staff and programmes. Departments are free to switch provision from Administration Budgets to programme budgets; and
- Departments may switch from non-cash to near-cash within Resource Budget DEL in accordance with the procedures set out in the relevant chapter in this budgeting guidance. These procedures are designed to ensure that increases in near-cash from savings on non-cash are the result of good management, and, where necessary, to protect achievement of the Golden Rule. Departments may freely switch provision from near-cash to non-cash.
- There are restrictions on switching into and out of support for local authorities – see chapter 10.
- Where policy ring fences have been set in the SR, switches are restricted by the rules applying to the specific ring-fences.

## Policy Ring-fences

**1.41** In addition, as part of the SR settlement, some spending might be subject to specific ring-fences. If so, departments may not move money across the ring-fence, except as specified in the SR settlement. Departments will normally need to track separately the EYF of provision subject to a policy ringfence. Ring fences are normally set at the level of RDEL or CDEL. However, closer controls (e.g. on Near-cash) may be set.

## End Year Flexibility

**1.42** End Year Flexibility (EYF) is a mechanism whereby departments may carry forward unspent DEL provision into later financial years. Entitlements to EYF are calculated each year and published in the Public Expenditure Outturn White Paper. The EYF chapter in this guidance sets out more details on the scheme.

## Departmental Unallocated Provision

**1.43** Departments are encouraged not to allocate their DELs fully against their programmes at the start of a financial year but to hold some provision back to deal with unforeseen pressures that emerge subsequently, including their known contingent liabilities. This Departmental Unallocated Provision (DUP) is published in Main Estimates and Supplementary Budgetary Information.

## The Reserve

**1.44** Departments are expected to manage their DEL budgets so as to stay within them. If pressures arise in one part of a DEL, departments should respond by:

- Managing the pressures down

- Using their DUP
- Re-prioritising and making offsetting savings elsewhere in the budget
- Deferring spending elsewhere in the budget; and
- Transferring provision from Resource DEL to Capital DEL (if the pressure is in Capital DEL).

**1.45** Exceptionally, a department may make a claim on the Reserve. As part of the sending plans announced in Spending Reviews, the Government allocates a Reserve for genuinely unforeseen contingencies that departments cannot absorb within their DELs. Separate Reserves are held for Resource and Capital DEL; both are small. Increases to departments' Resource or Capital DELs arising from Reserve claims are non-recurrent i.e. they do not affect departments' SR baselines. Increases are generally set aside when baselines are agreed for Spending Reviews.

**1.46** Non-cash claims on the Resource DEL Reserve are treated equally seriously by the Treasury as near-cash claims which have an immediate impact on the fiscal framework. That is because many non-cash Reserve claims reflect future impacts on the fiscal framework that need to be managed. And both sorts of Reserve claims call into question the quality of departmental management.

**1.47** Departments that think they might make a claim on the Reserve should contact their Treasury spending team early so that alternative courses of action can be fully discussed while there is still time to put them into effect. Department's proposals should set out:

- The size of the pressure
- The cause of the pressure and why it was unforeseen
- The offsetting actions they have taken and plan to take to manage the pressure and to absorb it
- The next further actions that could be taken
- The residual pressure, split into capital and resource, and within resource identifying separately the near-cash and non-cash elements and the Administration Costs and programme elements
- The corrective actions they mean to take if a Reserve claim is agreed, as regards the substance of the policy, improved financial management, and paying back the amount of the claim.

**The Reserve and EYF** **1.48** If a department in receipt of additional DEL funded from the Reserve subsequently underspends, its EYF entitlement to be carried forward will be reduced up to a maximum of the level of the Reserve claim. See the EYF chapter in this guidance for more information.

**The Reserve and Contingent Liabilities** **1.49** Departments are required to report contingent liabilities to Parliament. This process is separate from budgeting. The recording of contingent liabilities does not guarantee departments' access to the Reserve. If a contingent liability matures, the normal budgeting procedures apply. That is, departments are expected to cover the costs by making offsetting savings as normal.

## Keeping Track of the Numbers

**1.50** Departments are expected to keep track of their authorised control totals as these change with Machinery of Government changes, other classification and transfer changes, issues from central funds, authorised transfers to near-cash, and – exceptionally – issues from the Reserve. Departments and spending teams should at all times have a common understanding of the authorised levels of:

- Resource Budget DEL and within it:
  1. Near-cash – after allowing for the flexibilities set out in the relevant chapter below
  2. Administration Budgets
- Capital Budget DEL

**1.51** Departments and spending teams should also have a common understanding of the planned levels – and risks of variances to plans – of:

- Resource Budget AME
- Capital Budget AME

**1.52** Departments are expected to monitor spending against plan and to share information with their Treasury spending team (via bilaterally agreed information supply) and the Treasury collectively (via COINS).

## Retaining Income/ Receipts

**1.53** Only some of the income that come to a department benefits budgets. Separate chapters in respect of Resource and Capital Budgets set out when departments may set income against DEL spending. That covers both which sorts of income count as negative RDEL/ CDEL and also when departments may obtain the benefit of income higher than the levels taken into account in the SR.

## Breaches of Budgetary Limits

**1.54** Any breach of a budgetary limit is treated seriously, and departments need to take remedial action. Note that breaches can arise as a result of past errors treated as Prior Period Adjustments in accounts.

**1.55** This passage sets out the process to follow where a department's final outturn breaches the final level set for any of the following limits:

- Resource Budget – DEL
- Near-cash in Resource DEL (see below for determining final limit)
- Administration Budget
- Capital Budget - DEL

**1.56** The responsible Minister should write to the Chief Secretary as soon as practicable after the end of the year setting out:

- The size of the breach;
- Why it occurred; and
- The remedial action that the department is proposing, including:

1. An offsetting reduction in the limit for the year following the year of the breach;
2. Improvements in financial management to deal with the specific cause of the breach;
3. Improvements in financial management to improve overall forecasting and control of the department's control totals; and
4. Information that will be provided to the Departmental Board and to the Treasury to evidence these improvements.

**1.57** Departments should discuss with their Treasury spending teams their proposals before their Minister writes.

**Determining the Final Limit for Near-Cash in Resource DEL**

**1.58** In the case of Near-Cash in Resource DEL, departments are free to increase provision within an unchanged Resource Budget DEL by an immaterial amount (see subsequent Chapter in this guidance). Larger increases are permitted by agreement with the Treasury, either by a transfer from non-cash provision within Resource DEL or where – exceptionally – a claim on the Reserve has been allowed.

**1.59** Where departments' outturn for near-cash in RDEL is higher than the amount as provided for above, the same procedure should be followed as for breaches of Resource Budget DEL.

**Departmental AME**

**1.60** Plans for Departmental AME are not control totals in the same way as DEL plans are, and spending above plan is not a breach. Unforeseen changes in spending may, however, indicate poor management by departments. The Treasury would expect to be notified as soon as departments identify a risk.

**1.61** Where spending has been markedly higher than expected, departments should discuss with the Treasury:

- Why the spending was higher than expected and why this excess had not been forecast;
- Measures to improve forecasting; and
- What might be done to mitigate the risk of this higher spending continuing in future

**POLICIES THAT AFFECT OTHER DEPARTMENTS' SPENDING**

**1.62** One department's policies may affect the spending of another department. Sometimes the link is obvious, for example where several departments have joint responsibility for a PSA target. In other cases the link may be less clear: for example, the creation of a new offence may impose burdens on the police, prosecutors, legal aid, and offender management budgets. European Community directives may also impose costs on a range of departments.

**1.63** There has been a long standing set of general principles governing the question of policy changes with resource implications affecting more than one department. These include:

- Any department proposing new policies, in whatever context, must always quantify the effects on public expenditure prior to a policy decision being made. In doing so, it must assess the effects not only on its own spending

but also on the spending of other government departments, the devolved administrations for Scotland, Wales and Northern Ireland, and local authorities;

- Decisions on how to finance a new proposal must be taken simultaneously with the policy decision. It is for the department proposing a change to consult those concerned (including HM Treasury) and agree new policy, including the finance of that policy, before a proposal goes forward for collective consideration;
- The agreement on financing the downstream costs of new policy on another department may provide either that the costs be met by the originating department or that they be met by the department on which those costs fall;
- In the absence of explicit agreement to the contrary, the normal presumption is that the originating department will absorb the cost;
- Where consultation has not taken place, the strong presumption is that all costs, including those affecting other departments, will be absorbed by the department responsible for the new policy;
- Where the originating department absorbs the cost it should make budget transfers to affected departments covering the whole of the SR period;
- Where the costs fall, or come fully on stream, in the next SR period, it is for the department(s) that will meet the costs to conduct the SR discussions with the Treasury on funding in the next SR period. Where that department is the originating department, it should make budget transfers after the conclusion of the SR;
- These arrangements include cases where a department's policies impact on the AME spending of another department. The originating department may be expected to make DEL offsets to cover increases in AME spending (see passage on Management of AME Programmes above);
- Treasury agreement is needed for all new policies with expenditure implications (see Government Accounting, chapter 2.4.4). However, the Treasury does not arbitrate between departments on the question of who should bear downstream costs and will not provide funding where no agreement has been reached.

**1.64** Where a department A has or introduces a policy that benefits another department B it may seek a contribution to the costs from that other department B. There is however no obligation on B to pay.

### Charging for Services

**1.65** Where a department introduces charges for a service previously provided for free, or moves from a subsidised service to full cost recovery, it should normally transfer DEL cover to any customers in the central government sector to leave them no better and no worse off.

### New Burdens on Local Authorities

**1.66** Where departments add to the burdens of local authorities they need to make funding available to local authorities by a budget transfer.

**1.67** The policy applies to any new burden imposed on local authorities except for policies, which apply the same rules to local authorities and to private sector bodies (for example a change in the rate of employers' National Insurance contributions).

**1.68** Departments contemplating a new burden should contact DCLG on the procedures to be followed – see Annex B for contacts.

## Transactions between Departments

**1.69** Transactions between public sector bodies should be constructed simply. For example, where Department A buys an asset from Department B the purchase price should normally be paid in full in cash on the day of completion. Departments should not enter into or spend money on complex deals which do not have a clear justification in fairness or incentives as these are unlikely to be good value for the public sector overall. Departments should not seek to exploit differences in cost of capital charge or budgeting rules between different public sector entities. Where departments are unsure how best to construct a transaction with a public sector body they should consult HMT.

## Budget Tax Increases

**1.70** Where the Chancellor announces tax increases that impact on departments the normal rule is that tax lies where it falls.

## TYPES OF ADJUSTMENTS TO BUDGETS

**1.71** Adjustments to departments' overall budgetary limits fall into three categories. In summary:

- **Policy / Plan adjustments** reflect deliberate decisions by departments to increase or decrease spending in a particular policy area, or in the way a policy is delivered (i.e. moving to a charging regime);
- **Classification adjustments** reflect changes in budgetary totals driven by changes in the way the Treasury account or budget for spending rather than by actual changes in the level of activity or an increase/ decrease in spending. For example the changes in budgeting policy announced in this guidance will be implemented as classification adjustments. Classification adjustments also include Machinery of Government changes where responsibility for spending moves from one central government body to another. Accounting policy changes – whether driven by the department or by the National Audit Office – also count as classification changes; note that these changes need the agreement of the Treasury. Changes in estimation or valuation techniques count as policy / plan adjustments or effect levels of spending against unchanged limits;
- **Inter departmental adjustments / Budget cover transfers** reflect changes in detailed spending plans as a result of an agreed transfer of budgetary cover from one Department to another. Examples of where a transfer is appropriate is where there is an allocation from a 'shared pot', for example, the Criminal Justice Reserve, or when a Department agrees to transfer cover to another Department to cover one-off costs incurred as a result of a change in policy.

**1.72** The changes are implemented in different ways in budgets:

- Departments are expected to accommodate the effects of **policy / plan adjustments** in their budgets, making offsetting cuts or utilising EYF if available and benefiting from reductions in spending;
- **Classification adjustments** lead to budgets being restated, normally across all the 8 or 9 open years on the COINS system;
- **Interdepartmental adjustments / Budget cover transfers** lead to restated limits of the departments concerned.

**1.73** In addition departments may record changes to their expenditure numbers as **Budgetary Outturn adjustments**, which are not a change to the budget – they are used to describe changes against final budget allocations and are used for recording outturn.

**1.74** It is the Treasury that determines finally what type of adjustment a change is. Departments that are in doubt should contact their Treasury spending team.

**1.75** Annex C sets out where to find further guidance on types of adjustment.

## **PUBLIC SECTOR AND PUBLIC BODIES**

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**1.76** The public sector in the national accounts comprises central government and local government, which together make general government, and public corporations (bodies which are publicly owned or controlled and which operate in a market or which trade). Budgeting rules apply to all bodies in the public sector.

**1.77** It is the Office for National Statistics (ONS) that determines whether a body is in the public sector. You can look up the sector classification of bodies where that has been determined by the ONS in their publication MA23 (see Annex C for the link).

**1.78** The Treasury publishes a guidance note on sector classification (see Annex C for the link). In broad terms, bodies are in the public sector if they are owned or controlled by public sector bodies. A body will be controlled for example if the sponsoring department appoints a majority of Board members. Sometimes a lesser degree of influence can still be held to give control. The legal form of a body does not tell you what sector it is in. So, for example, if an NDPB sets up a wholly owned subsidiary in the form of a limited company under the Companies Act that body would be public sector because it would be wholly controlled by the NDPB.

**1.79** Subsidiaries, interests in associates and joint ventures classified to the public sector are consolidated with parent bodies for budgeting. So if an NDPB sets up a public sector non-trading body it will be part of the NDPB's DEL allocation from the parent department.

**1.80** Departments and public bodies who are in doubt about an actual or proposed body's sector classification should approach the Treasury for advice. The ONS should only be approached via the Treasury. That restriction on direct access to the ONS is so that the Treasury can:

- Advise departments on the interaction of classification and policy (the ONS do not involve themselves in policy formulation),
- Consider the implications for budgeting of any proposal, and

- Provide the right information to ONS in the right way, without lobbying, and respecting the ONS' operational independence.

**1.81** Departments that are setting up a new body that will be or might be in the public sector should contact the Treasury's budgeting and classification branch with their proposals for budgeting, accounting and recording the body. The Treasury will pass the information on to:

- The ONS;
- The Treasury's FRP team (see below); and
- The Cabinet Office (see the section on Non-Departmental Public Bodies (NDPBs) below) who are responsible for ensuring proper governance, which includes accountability and financial management, of central government public bodies and PCs.

**1.82** Departments should not spend money on consultancy advice on national accounts sector classification and should discourage their sponsored bodies from doing so. Sector classification is unlikely to be an area where consultants have expertise. The Treasury will provide advice on request.

**GAAP and the National Accounts**

**1.83** Normally the decision whether a body is a subsidiary under GAAP and whether it is a public sector body in the national accounts under ESA95 will be consistent, although differences may arise.

**1.84** Note that DRAs are drawn up under adapted accounting rules that exclude a number of bodies that would be subsidiaries under pure GAAP accounts. So exclusion from DRAs is not always a good guide to whether a body is in the public sector. Differences may also arise in the treatment of associates under GAAP, since ESA95 does not have such a category.

**1.85** In any case where the decision under GAAP and the decision under the national accounts are different it is the treatment in the national accounts that is binding for the fiscal framework, and hence that determines the budgeting.

**Whole of Government Accounts (WGA)**

**1.86** The Government is preparing WGA, GAAP-based accounts that are a consolidation of the accounts of most public sector bodies. Because of the treatment of subsidiaries in DRAs mentioned above, WGA will include bodies that are excluded from DRAs, for example: public corporations.

**1.87** Departments that are setting up new public sector bodies should inform the Treasury of how they mean to account for the body and they think it should be accounted for in WGA. In many cases that will mean the department obtaining separate accounting advice as regards WGA and their DRAs.

**1.88** The Treasury will discuss the WGA treatment with the NAO's WGA team. Departments should discuss with the Treasury's FRP team how to ensure that their discussions with NAO on DRA treatment and the Treasury's on WGA and ONS treatment are synchronised.

**Non-Departmental Public Bodies (NDPBs)**

**1.89** The Cabinet Office determines which of the bodies that have been classified as central government by the ONS are NDPBs. Designation as an NDPB means that certain rules need to be followed on public appointments and other non-financial matters. The Cabinet Office designates central government bodies into the various categories of NDPB and other public bodies.

**1.90** Where departments are setting up a new body that might be an NDPB they should contact the Cabinet Office to discuss the governance arrangements.

## BUDGETS, ESTIMATES AND ACCOUNTS

**1.91** Budgets differ from accounts and Estimates. These three elements of the framework serve different purposes and contain different numbers.

**1.92** In broad terms however, in order to keep down compliance costs for departments, the budgeting treatment of items is generally based on the treatment in departmental resource accounts. Annex A sets out the main differences between DRAs and budgets, including how to treat Prior Period Adjustments, but that list is not complete: there are other smaller differences, and some department-specific differences.

**1.93** In practice therefore when considering how to score a transaction you should:

- Start by considering the treatment of the transaction in the GAAP DRAs;
- Consider whether the budgeting treatment is the same as the DRA treatment or different, and so establish the budgeting treatment;
- Once you know the accounting and budgeting treatment you can determine the Estimates treatment.

### Accounts

**1.94** Departments and other public bodies have to produce audited accounts that report for the public and for parliament on how they have used the resources at their disposal (defined in terms of accounting aggregates rather than budgeting aggregates). These accounts are normally for the body in question, and for subsidiaries or other bodies within the accounting boundary.

**1.95** The underlying rules for departmental accounts are specified in the Financial Reporting Manual (FRoM), produced by the Treasury and based on generally accepted accounting practice (UK GAAP). UK GAAP in DRAs provides a different cut of information from that used for budgeting or the fiscal framework.

**1.96** Department's accounts are audited annually by the Comptroller and Auditor General of the National Audit Office (NAO), who reports his findings to parliament.

**1.97** Accounting rules change from time to time. When they do, we consider the impact on budgets. Sometimes changes to accounting rules are not carried through into budgets. Departments are consulted on changes to accounting through the RABIG process.

**1.98** Departments should determine the accounting treatment, checking in cases of doubt with their NAO auditors on the application of the FRoM in specific cases and with the Treasury's FRP team on the interpretation of the FRoM more generally. A link to where you can find full guidance on accounts is given in Annex C.

**1.99** In some places this Budgeting Guidance summarises or describes accounting rules. That is done to provide context for the definitive statement of the budgeting rules. However, the only authoritative description of the accounting rules is in the FRoM, and the summary in this budgeting guidance should be seen as indicative only.

**International Accounting Standards** **1.100** The Treasury's general approach to public sector GAAP-based reporting is to follow the strategy of the UK Accounting Standards Board (ASB) for convergence with International Financial Reporting Standards (IFRS), which involves a timetable for the adoption of IFRS requirements. Some sponsored bodies outside the remit of the FReM intend to produce accounts under IFRS ahead of the convergence timetable. Even so, it is the results under 'converged' UK GAAP that should be taken for budgeting. Departments should consult the Treasury where any sponsored body is contemplating moving to IFRS ahead of the ASB conversion timetable.

## Supply Estimates

**1.101** Estimates are the mechanism by which Parliament authorises departmental spending. A link to where you can find full guidance on Estimates is given in Annex C.

**1.102** Note that while the treatment in budgets influences the treatment in Estimates, the reverse does not apply. So for example:

- In Estimates, you may normally only appropriate income that is negative DEL in budgets in aid of DEL expenditure. So you need to know the budgeting treatment of income before you can work out the Estimates treatment;
- That income has been appropriated in aid or treated as a Consolidated Fund Extra Receipt (CFER) does not tell you anything about the budgeting treatment. You may have negative DEL CFERs and non-budget Appropriations in Aid. So you need to address the budgeting treatment separately from the Estimates treatment.

## PRESENTATION OF TOTAL SPENDING

### Total Managed Expenditure

**1.103** The Government's main measure for reporting overall public spending is Total Managed Expenditure (TME), a measure drawn from the national accounts. TME may be defined as the sum of the public sector's current and capital expenditure. Capital expenditure is presented as net of sales proceeds.

**1.104** Capital expenditure may be divided into

- The element that replaces the extent to which the capital stock has depreciated; and
- Net investment.

**1.105** Therefore, TME may be defined as the sum of public sector current expenditure, net investment, and depreciation.

**1.106** TME is also the sum of DEL, Departmental AME and non-Departmental AME (including accounting adjustments).

### Resource Budget, Capital Budget

**1.107** A department's Resource Budget is the sum of the Resource Budget: DEL and the Resource Budget: AME. The Capital Budget is the sum of the Capital Budget: DEL and the Capital Budget: AME.

**1.108** Neither the Resource Budget nor the Capital Budget is a control total, since departments may not make switches from AME to DEL.

**1.109** But they are useful numbers to present since they show the total current and capital spending in the budgets of the department. And they remind readers of spending data that both DEL and AME spending are spending; both need to be financed by taxes and borrowing.

### **Total DEL**

**1.110** In addition to the control totals, there is a presentational aggregate; Total DEL. Total DEL is not a control total. It is a standard way of showing total current and capital spending in DEL. It is defined as:

- Resource Budget: DEL
- *Plus* Capital Budget: DEL
- *Less* Depreciation in DEL

**1.111** Depreciation here includes impairments, release from donated assets reserve and release from government grants reserve.

**1.112** Depreciation is excluded from Total DEL because adding together depreciation and investment may be seen by some as in a sense double counting.

## **RECORDING INCOME AND EXPENDITURE**

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**1.113** Transactions should be recorded accurately on COINS. COINS supplies information for a wide range of users and uses:

- The Treasury's planning and control of public spending;
- The Treasury's monitoring and forecasting of spending against the fiscal framework;
- Treasury publications, such as Public Expenditure Statistical Analyses;
- Operational publications, such as Main and Supplementary Estimates;
- Departmental publications, such as the common core tables in Departmental Reports;
- The national accounts, including measures of the fiscal framework; and
- The input side of ONS' measures of public sector productivity.

**1.114** You can see that often departments themselves are directly affected by the accuracy of information on COINS.

**1.115** Where to find the guidance on recording is shown in Annex C.

## APPENDIX I TO CHAPTER I: SUMMARY CONTENT OF BUDGETS

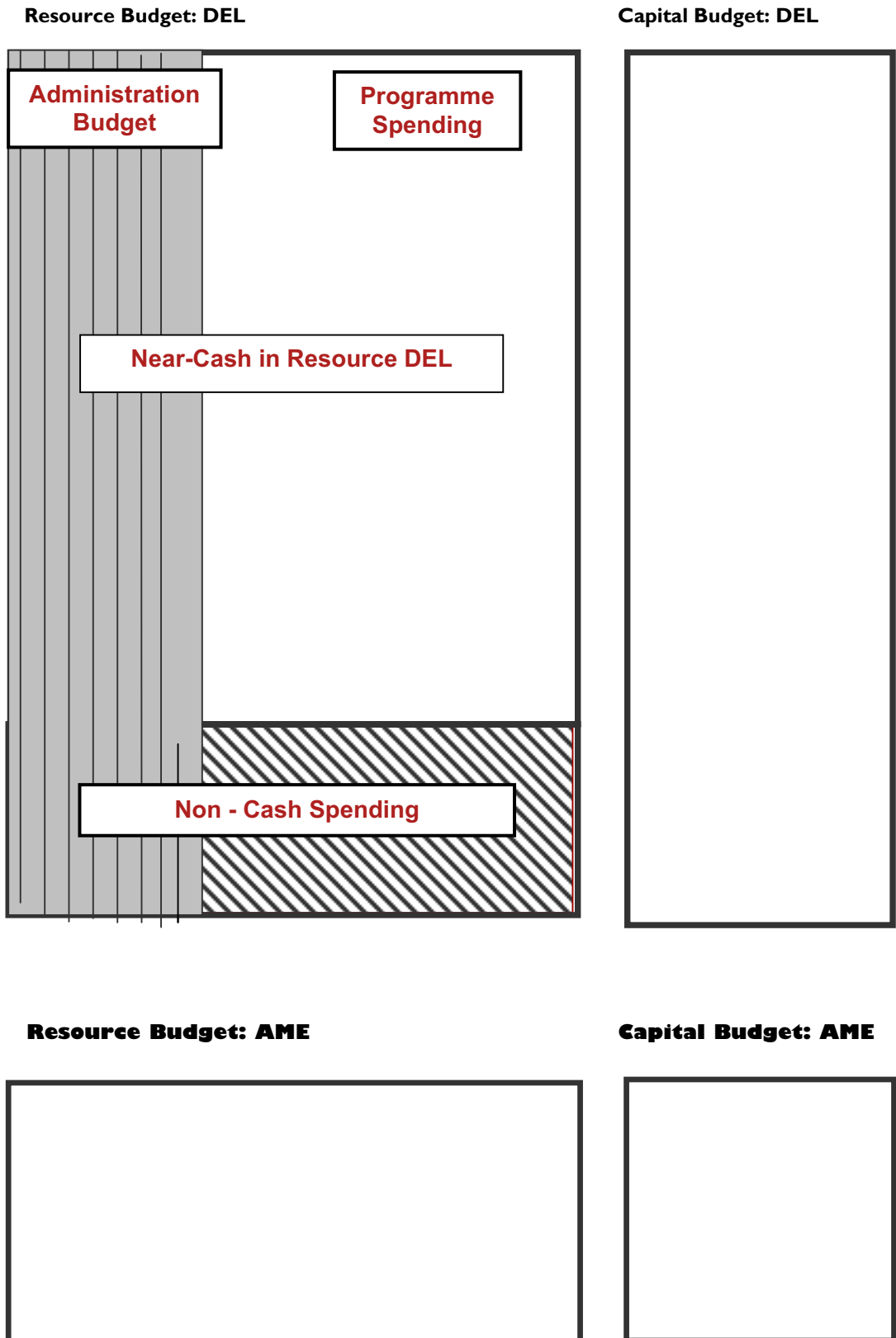
**I.116** This table summarises the main standard contents of resource and capital budgets. Budgets are divided into DEL and AME. The Resource Budget DEL is divided into Administration and Programme, and into Near-Cash and Non-cash.

	Resource Budget	Capital Budget
<b>Department's own transactions with the private sector</b>	<p>Expenditure on an accruals basis, including administration costs, pay, accruing superannuation liability charges and other pensions contributions or current service pensions costs, grants to individuals, subsidies to private sector companies</p> <p>Take-up of provisions movement in value of provisions, and release of provisions (as well as the expenditure offset by the release of the provision) - except provisions related to capital grants</p> <p>Bad debts</p> <p>Cost of capital charges and credits in respect of assets and liabilities</p> <p>Depreciation and impairments on the department's assets</p> <p>Less income treated as negative DEL/ AME, for example sale of services</p> <p>Note: Excludes revaluations charged to revaluation reserve</p>	<p>Expenditure on new fixed assets on an accruals basis. Includes assets bought under finance leases and transactions that are in substance borrowing (i.e. on-balance sheet PFI deals)</p> <p>Less Net book value of sales of fixed assets</p> <p>Net policy lending to the private sector</p> <p>Capital grants to the private sector and take-up etc. of associated provisions</p> <p>Profit/ loss on disposal of assets</p>
<b>NDPB transactions with the private sector</b>	<p>As the department</p> <p>Note: the department's grant in aid to the NDPB is excluded from budgets</p>	<p>As the department</p>
<b>NHS Trusts (England)</b>	<p>As the department</p>	<p>As the department</p>
<b>Support for Local Authorities</b>	<p>Current grants to local authorities</p>	<p>Capital grants to local authorities</p> <p>Supported capital expenditure (revenue)</p>

<b>Public Corporations (external finance basis)</b>	Cost of capital charge in respect of public corporations	Investment grants paid to public corporations
	Subsidies paid to public corporations	Net lending to public corporations (Voted and NLF)
	Less Interest and dividends received from public corporations	Public corporations' market and overseas borrowing (including on-balance-sheet PFI)
		Less equity withdrawals from public corporations
<b>Public Corporations (consolidation basis)</b>	Cost of capital charge in respect of public corporations	Expenditure on fixed assets
	Subsidies paid to public corporations	Less sale proceeds of fixed assets
	Less profit / plus loss of public corporations	Additions to stocks (net)
	Take-up, revaluation, less release of provisions in respect of subsidy, grant or other amounts payable	

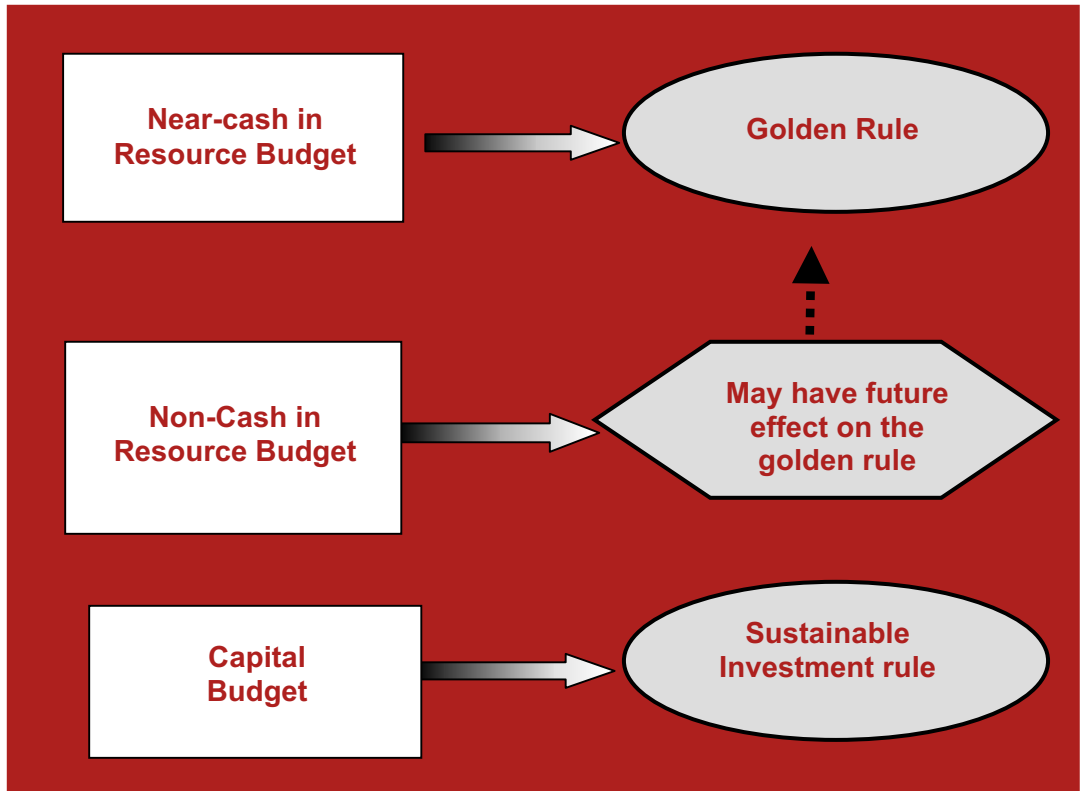
**APPENDIX 2 TO CHAPTER 1:**

**DIAGRAM OF MAIN BUDGETARY CONTROL TOTALS**



**APPENDIX 3 TO CHAPTER 1:**

**RELATIONSHIP OF MAIN BUDGETARY CONTROL TOTALS TO THE FISCAL FRAMEWORK**



## APPENDIX 4 TO CHAPTER 1:

### THE DEPARTMENT'S CONTROL AND PLANNING TOTALS

**1.117** Departments and their Treasury spending teams should at all times have a shared understanding of what their control and planning totals are, whether the department's spending is on track to stay within limits, and what the risks are.

**1.118** The control totals are:

- Resource DEL
- Near-cash in Resource DEL
- Administration Budget
- Capital DEL
- Any department-specific ring fenced budget

**1.119** The planning totals are:

- Resource Departmental AME
- Near-cash in Departmental AME
- Capital AME

## APPENDIX 5 TO CHAPTER 1:

### CRITERIA FOR AME TREATMENT OF LEVY FUNDED BODIES

**1.120** The Chief Secretary has determined that the spending of a number of levy-funded bodies should be in AME rather than DEL. The Chief Secretary takes such decisions case by case. The AME treatment of individual bodies is kept under review.

**1.121** AME treatment is only a relevant option where the levy income is not treated as negative DEL – see Chapter on Income and Resource Budgets below.

**1.122** While the Treasury has no plan to recommend to the Chief Secretary that any further levy-funded bodies should have AME treatment, the criteria that the Chief Secretary uses are set out below.

#### Criteria for deciding whether a levy-funded body should score in AME

1. The body should in broad terms provide services (“services” could include a compensation fund) to an industry or group of industries or the workforce in that industry.
2. The body should be wholly or mainly funded by a levy on the industry. There should be substantial industry consensus involved in the setting of the levy or the direction of the expenditure or both.
3. The expenditure must be suitably ring-fenced. Normally, that would mean that the whole body should fall into this category.
4. The body should be self-financing in cash terms, with no recourse to departmental grants or subsidies. Where, exceptionally, grants or subsidies are paid (including grants financed by the EC), they would score in DEL.
5. Draw-down of reserves should be permitted, and normal short term modest sized overdrafts. But the bodies should not normally borrow long term. Where, exceptionally, borrowing other than short-term overdrafts finances expenditure, it would normally score in DEL.
6. The body should meet relevant efficiency and other criteria:
  - The licence or levy is appropriate, i.e. applied in the economically most advantageous way in the circumstances;
  - Introducing the levy or licence should not materially restrict the Government’s fiscal policy;

## APPENDIX 6 TO CHAPTER 1: PRIOR PERIOD ADJUSTMENTS

**1.123** Prior period adjustments (PPAs) are material adjustments applicable to prior periods arising from changes in accounting policies or from the correction of fundamental errors. PPAs are treated differently in the Operating Cost Statement (OCS), Estimates and Budgets. Suppose that in year 2 a fundamental error is discovered in the accounts for year 1:

- **Accounts:** the asset or liability value on the balance sheet would be restated, and the effect taken in reserves. Nothing passes through the OCS - in accordance with the FREM
- **Budgets:** in the budgets, the year 1 figures will be restated on the database so that they are right. Changes in DEL budget outturns would affect accumulated end-year flexibility entitlements, and so need to be discussed with the Treasury. Changes in budget outturns could also mean that departments turn out to have been in breach of budget limits, in which case appropriate corrective action would need to be taken (see Chapter 1);
- **Estimates:** for Estimates, appropriate provision needs to be made during year 2 in order to obtain the spending authority that should have been sought for year 1. It follows that a PPA needs to be voted.

**1.124** It is clear therefore that a PPA as an item of expenditure in year 2 is solely an Estimates concept. In accounts opening balances are adjusted without recognition of a cost in the OCS. In budgets the restated level of spending should be shown in the year to which it belongs – so a PPA is a reason for restating the prior years numbers on COINS. So although the PPA is shown on COINS for Supply purposes, it is outside of budgets – but the budget number for the previous year should be restated.

### Example

Assume that depreciation on a major type of asset had been incorrectly calculated and was, as a result, grossly understated to the extent that this was a fundamental error.

- In budgets, the figure in year 1 would be restated, leading to higher expenditure against an unchanged limit which will effect accumulated EYF and could lead to a DEL breach, (but note that where a new accounting policy is implemented then back years outturns are restated through a classification change).
- The year 1 accounts would not be altered (as they would be closed), instead the asset value on the balance sheet in year 2 would be restated.
- In Estimates, the PPA needs to appear as a specific item outside of budgets, and be voted by Parliament

**1.125** Where there has been a PPA in the Estimates for a previous year, the PPA itself will not appear in the provision/ outturn columns in later year Estimates. Instead, the underlying numbers in the previous year will have been restated, and it is the restated numbers that will appear in the provision/ outturn columns.



# 2

## RESOURCE BUDGET - CENTRAL GOVERNMENT'S OWN EXPENDITURE

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### OVERVIEW

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**2.1** The resource budget scores most of the department's current expenditure. Expenditure is recorded on an accruals basis. So the Resource Budget includes expenditure on pay, current procurement, current grants and subsidies, depreciation, cost of capital charges and the take-up, revaluation and release of provisions (as well as the cash payments associated with the release of the provision – which are recorded by economic type, i.e. pay, current procurement etc as above).

**2.2** Since the resource budget includes the resource consequences of acquiring and owning assets departments should consider the inter-relationship of the resource and capital budgets when planning and monitoring expenditure. That inclusion should also help departments manage their entire asset stock as well as considering annual changes to the stock through new investments or disposals.

**2.3** This chapter covers in detail the treatment of some specific items of departmental expenditure in the Resource Budget. NDPB expenditure scores in budgets in the same way as departments' – see also chapter on NDPBs. See next chapter for the treatment of income in resource budgets. See separate chapters for the resource budget implications of loans to the private sector, PFI deals, support for local authorities and support for public corporations. See also separate chapters for the rules governing the division of the resource budget into administration budgets/ programme expenditure and near-cash /non-cash.

**2.4** In general, items of central government's own expenditure taken through the operating cost statement (OCS) score in the Resource Budget. Care should be taken however as not all items in the OCS score in the Resource Budget. For example, capital grants to the private sector go through the OCS and do not score in the Resource Budget. Instead they score in the Capital Budget. See Annex A for a table of the main differences between accounts and budgets.

### GRANTS AND SUBSIDIES

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**2.5** DRAs do not distinguish between current grants and subsidies and capital grants. However, the national accounts do, with current grants and subsidies affecting the current balance and capital grants not. Therefore departments have to distinguish between current and capital grants according to national accounts principles. Current grants and subsidies score in the Resource Budget; capital grants score in the Capital Budget.

**2.6** Current grants are paid to individuals and to not for profit bodies serving households. Subsidies are current payments paid to profit making bodies designed to influence levels of production, prices or wages.

**2.7** Capital grants are unrequited transfer payments, which the recipient has to use to:

- Buy capital assets (land, buildings, machinery etc.); or
- Buy stocks; or
- Repay debt (but not to pay early repayment debt interest premia).

**2.8** Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants or subsidies.

**2.9** Normally, debts are written off because the department is unable to enforce the debt against the debtor. Capital grants are imputed in the national accounts in those cases where debts are written off "by mutual consent", that is, where for policy reasons the creditor department chooses not to enforce the debt. See section on bad debts below.

**2.10** Payments of compensation to owners of capital goods destroyed or damaged by acts of war or natural disasters count as capital grants.

**2.11** Major payments in compensation for extensive damage or serious injuries not covered by insurance policies may also count as capital grants – departments should consult the Treasury.

**2.12** Pensions bulk transfer payments are treated as capital transactions in the national accounts and pass through the resource budget (albeit offset by the release of the provision) – see pensions chapter.

### **Provisions in Respect of Capital Grants**

**2.13** Where departments take provisions in respect of an obligation to pay a capital grant, the take-up, revaluation and release of the provision should score in the Capital Budget, as well as the grant itself.

**2.14** Cost of capital credits on such provisions should normally score in the Capital Budget - see the chapter on Capital Budgets for more information.

## **RESOURCE BUDGET CONSEQUENCES OF ASSET OWNERSHIP**

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### **Tangible and Intangible Fixed Assets**

**2.15** The impact of tangible (e.g. land, buildings, IT systems) and intangible (e.g. patents, trademarks) fixed assets on the Resource Budget is through depreciation, capital charges and impairments, which score in the Resource Budget, and in DEL or AME as set out in this guidance. Gains or losses on the disposal of tangible and intangible fixed assets score in the Capital Budget (DEL) from 2007/08. Further guidance on the treatment of new capital spending on tangible and intangible fixed assets and investments and on the disposal of assets (including profit or loss on disposal) can be found in the Chapter on Capital Budgets.

### **Investments**

**2.16** Investments are treated in the same manner as other fixed assets. As they are not depreciated, they normally only impact on the resource budget through the setting of an appropriate cost of capital charge, which scores in the Resource DEL.

**2.17** They should be recorded on the department's balance sheet at market value with any fluctuations in value being dealt with through the revaluation reserve. However, where no revaluation reserve exists the movements should score to the department's DEL budget. Where an investment suffers an impairment (i.e. a permanent write-off of value) this amount should be included in the resource budget. For further detail on the treatment of different types of investments in public sector

bodies outside the departmental boundary, or other financial instruments, please refer to the FREM.

## Depreciation

**2.18** Depreciation is a measure of the wearing out, consumption or other reduction in useful life of a fixed asset, whether arising from use, passage of time or obsolescence through technical or market changes. Depreciation is charged on fixed assets annually and scores in the resource budget

**2.19** Accounting policies for depreciating assets are chosen by the Department, as set out in the FREM. Both the Treasury and the external auditor (in most cases the National Audit Office) must agree changes in the rate of depreciation on given class of assets.

**2.20** Depreciation should always be a positive number. If a department nonetheless believes that negative depreciation is appropriate, they are asked to write to their designated contact in the Financial Reporting Policy Team, HM Treasury, explaining the circumstances before tallying their data.

**2.21** To calculate the depreciation charge for budgeting purposes, departments should include all depreciation on all assets, however they were originally funded. In some cases it is appropriate to score an offsetting release from a donated asset or government grant reserve (see below).

## Donated/Government Grant Reserve

**2.22** In the case of assets funded from the Lottery or from a Donation from the Private Sector, the depreciation charge will be offset in the accounts and budgets by a release from government grant reserve or the donated asset reserve as appropriate. This is consistent with the special treatment set out in Section 3.3 of the FREM. There is therefore no overall impact on the department's Resource budget. Despite this offsetting item, depreciation for these items must be recorded in budgets like any other depreciation so that the correct overall level of depreciation is recorded in the National Accounts.

**2.23** With regards to EC funded assets, under the FREM, this special treatment applies where a government department receives a grant from the EC towards funding of a fixed asset. The depreciation charge on these assets is offset in the operating cost statement and the Estimate by a release from the government grant reserve. Again, the National Accounts will include depreciation on such assets, so this number needs to be recorded in budgets (albeit then offset).

## Impairments

**2.24** Impairments are recorded where there is the permanent loss or write-off of recoverable value of an asset below the value recorded on the balance sheet in the accounts. Impairments score in the Resource Budget alongside the depreciation charge, but are separately identified. Further, impairments need to be identified by type of asset and reason for impairment, as some score to DEL and some to AME.

**2.25** Where an impairment is applied to fixed asset investments or current asset investments, it will score in Resource DEL as a non-cash charge.

**2.26** Where an impairment is applied to tangible fixed assets or leased tangible fixed assets, the budgeting treatment is dependant on the reason for incurring the

impairment. The same budgeting treatment applies to intangible fixed assets, but where a department believes an intangible asset should be impaired it should first contact HMT.

**2.27** In order to provide support for departments' management decisions, impairments are split into six different categories, some of which score in AME and the others in DEL. The definitions of the categories of impairments are included in the FReM, the budgeting guidance for these categories is included below.

**2.28** The following types of impairment score in DEL budgets:

- Loss or Damage resulting from normal business operations – Scores as DEL. The department has a choice about how it manages assets to reduce the risk of damage, accident and theft.
- Abandonment of projects – Scores as DEL. Abandonment results from managerial decisions, and can be an indicator that a stronger project approval process and business case evaluation are necessary.
- Gold plating – Impairments due to originally gold plating an asset scores as DEL. Gold plating is the unnecessary over specification of assets, this could be prevented through improved control processes. Construction to a necessarily high standard for legitimate reasons (security for example) should not be considered gold plating.

**2.29** The following types of impairment score in AME budgets:

- Loss caused by a catastrophe – Scores as AME. This sort of loss is outside the normal experience of a department, so the only trade-offs that should be made are between the capital cost of replacing this asset and doing other capital work. Where a department believes an impairment should score as catastrophic loss it should first contact the relevant authority, as these are rare events.
- Unforeseen obsolescence – Scores as AME, as the obsolescence is unforeseeable and there seems little benefit in trade-offs with other current spending. Where the asset has been rendered obsolete by the acquisition of a new technologically advanced asset the investment appraisal of the new asset should have covered the option of continuing to use the old one. Unforeseen obsolescence can also arise as a result of changes to legislation. When a department believes an impairment should score as unforeseen obsolescence it should first contact the relevant authority.
- Other – Scores as AME. This category includes:
  - write downs of development land to open market value;
  - write downs where an asset is to be used for a lower specification purpose than originally intended;
  - Write downs of specialised properties held at depreciated replacement cost to open market value immediately prior to sale (where a non-specialised asset is to be written down it should be treated as accelerated depreciation or profit/loss on disposal as appropriate);
  - write downs as result of asset being seized without compensation provided (usually by other governments);

- write downs of newly constructed specialised properties to depreciated replacement cost on the initial professional valuation.

When a department believes an impairment should score in the 'other' category and it is not included on this list they should contact HMT.

**2.30** The impairment of stocks would be treated differently depending on the budgeting treatment of stocks:

- the normal budgeting treatment of stocks is that stock acquisition does not score in budgets, but use and write-off do score. In this case, all impairment or write-off of stock would score in RDEL whatever the cause;
- exceptionally, the acquisition of some stock scores in capital budgets (see chapter 6). In that case, stock is generally analogous to tangible fixed assets, and the rules for the DEL/AME treatment of impairments would follow the treatment for tangible fixed assets.

## Revaluations

**2.31** FRS 15 allows for tangible fixed assets to be held at historical cost or current value. The option to hold such assets at historical cost has been withdrawn by the FRM and all assets within the central government sector should be held at current value where this is materially different to historical cost. Assets held at current value are subject to the revaluation requirements of FRS 15.

**2.32** Where a revaluation results in a fall in value of an asset it will be necessary to establish whether any of the fall in value is as a result of;

- consumption of economic benefit (e.g. physical damage) or a deterioration in the quality of service provided by the asset, or;
- a change in market price.

**2.33** A fall in value relating to a consumption of economic benefit or deterioration in the quality of service provided by the asset should be treated as an impairment and currently is always taken to the OCS and would score in DEL (see earlier section on impairments). A fall in value relating to changes in market price should first be offset against a revaluation reserve (for the asset in question), and once that element of the reserve is exhausted the fall in value should be taken to the OCS.

**2.34** The treatment of revaluations in budgets mirrors the treatment in accounts. Where an asset is revalued on a department's balance sheet, and no revaluation reserve exists, the department must score a cost/benefit in its budget. If the revaluation applies to an investment asset then the revaluation will score as DEL, revaluations of all other asset types score as AME in budgets.

**2.35** In resource accounts revaluations of certain types of financial asset are taken directly to the OCS, rather than any revaluation reserve. The budgeting treatment reflects this, and revaluations of these assets should score to non-cash DEL .

## Theft

**2.36** Theft of assets is treated either as stock write down or impairment of fixed assets (i.e. permanent loss of its recoverable value), depending on what is stolen. Either way,

the write down or impairment will be shown in the Resource budget DEL (Loss or Damage resulting from normal business operations).

## Cost of Capital Charge

**2.37** There is a cost to the government from holding assets. In economic terms this is the opportunity cost of not undertaking an alternative investment. At the margin this will be the social time preference rate (explained further in the "Green Book" – see Annex C). In financial terms, it could be the interest government incurs on borrowing to finance investment.

**2.38** To ensure that the full cost of services is reflected in accounts and budgets, this opportunity cost is devolved to departments as a cost of capital charge. The charge reflects the opportunity costs of holding assets or committing exchequer funds, and scores in the department's Resource Budget.

**2.39** The purpose of including the charge is so that departments take management decisions which take account of the value tied up in the assets that they use. Departments have an incentive to dispose of unneeded or under-utilised assets in order to free up spending power within their budgets by saving future cost of capital charges. But a pure sale and lease-back transaction does not bring such a benefit as the department swaps a cost of capital charge for a rental charge that includes the contractor's cost of capital.

**2.40** Cost of capital charges apply to the assets of the department and other bodies within the departmental budgeting boundary. Cost of capital credits arise from liabilities and reduce the overall cost of capital charge. So the cost of capital charge applies to net assets (assets minus liabilities). The charge is calculated as a percentage of the balance sheet values of assets and liabilities.

**2.41** The normal rule is that the cost of capital charge is calculated using average values. However, the FReM also permits departments to use adjusted opening values where they apply the same basis for calculating depreciation/ amortisation. This option is designed to facilitate in-year control of capital charges for budgeting.

**2.42** Currently the cost of capital charge is normally levied at 3.5% real rate (changes in the rate are notified in a PES paper). But there are some exceptions:

- The cost of capital charge on student loans is set at the same rate as the discount rate used for long term liabilities (see separate chapter on loans);
- For loans / equity made to the private sector, it is likely that a higher cost of capital will be appropriate. Departments are asked to agree a suitable cost of capital charge with their spending team in HMT;
- For trading bodies, particularly public corporations, the cost of capital charge incurred by the department will be higher. Please refer to the chapter on Public Corporations; and
- A nil rate applies to certain assets as specified in the FReM, including donated assets, certain additions to heritage collections and certain balances with the OPG, the Bank of England, the Consolidated Fund and the Contingencies Fund.

**2.43** Cost of capital charges on DEL programmes score in DEL, and those on AME programmes score in AME. The only exceptions are the cost of capital charges

associated with the roads network and nuclear decommissioning, as well as certain programmes run by the Northern Ireland Executive. These remain in AME because of their volatility

**Differences between Accounts and Budgets on Cost of Capital Charges**

**2.44** The cost of capital charge in resource budgets is the same as that in the accounts with these exceptions:

- Charges in respect of public corporations where the department has no investment or where a different capital base is used – see PC chapter;
- Cost of capital credits on provisions in respect of capital grants normally score in capital budgets (note that where a liability corresponding to a capital grant is classified as a creditor the corresponding cost of capital credit should score in the resource budget in the normal way) – see chapter on Capital Budgets below;
- Cost of capital charges on assets outside budgets do not score in budgets. However, departments may include them in the DEL spending if it is not worth the hassle of separating them out. Departments need to operate this policy consistently and not dip in and out of DEL; and
- No asset funded by a grant from the Lottery or by a grant from a local authority attracts a cost of capital charge in budgets. Accounts will show a cost of capital charge for such assets.

**Budgeting Treatment of Current Assets and Liabilities**

**Stocks 2.45** In general terms, stocks will impact on the resource budget only when they are consumed or written off, and through the cost of capital charge on stock holdings. In exceptional instances certain purchases treated as increases in stocks are included in the capital budget – see separate chapter on Capital Budgets.

**2.46** The total value of stock purchases will be included in a department’s net cash requirement (NCR), which is voted in Estimates. The value of stocks consumed during the year should be included in the resource budget, as should any amounts for stock items that are written off. Stocks should be valued at cost (or current replacement cost). If they will not be used they should be written down to their net realisable value, i.e. the actual or estimated net sale proceeds. This write-down scores in the Resource DEL.

<b>Example:</b>		
Opening balance:	30	
Purchases:	20	(NCR: 20)
Use of stocks	(23)	(Resource DEL: 23)
	==	
Closing balance:	27	

**Cash 2.47** Cash balances do not convey spending power. They only impact on the budget where there is a cost of capital charge.

**Debtors – General 2.48** Debtors are assets, and typically arise when the department has delivered goods and services, but is yet to receive payment, or has prepaid for goods or services.

Changes in debtors generally represent a movement in working capital. Debtors in general terms therefore only impact on the budgeting framework through the cost of capital charge, provisions for bad debt, and write-offs.

**Debtors – Long Term Debtors and Pre-Payments** **2.49** However in certain cases movements in debtors are more akin to net lending, for example in complex contractual scenarios over an extended timeframe (that is, more than one year). In these cases the budgeting system scores movements in debtors in the capital budget of the department concerned. That scoring is intended to capture and control the impact of what is in effect lending on Public Sector Net Debt, the measure of the Sustainable Investment Rule.

**2.50** Accordingly, departments should treat, as net lending, in their capital DEL the whole amount of transactions that meet both of the following criteria:

- First, the transaction is either:
  - A long-term debtor or pre-payment (that is a debtor that will last over 12 months at the point that the prepayment is made), or
  - A short-term debtor or prepayments where there is an expectation that it will be renewed so that it is in effect long term;
- Second, the total value of the debtor / prepayment involved is above £20m (where there is a related group of pre-payments, the £20m limit applies to the group).

**2.51** There is further guidance on the treatment of pre-payments and debtor assets in budgets in the chapter on capital budgets below.

**2.52** Note that the OCS will show a cost of capital charge on the asset, and in addition if the prepayment is discounted a credit entry as that discount unwinds (the credit entry represents an interest payment from the holder of the prepaid cash). Both these transactions score in the resource budget.

**Creditors** **2.53** Creditors are liabilities, and typically arise where a department is yet to pay for goods or services it has consumed or it has received payment in advance of providing the goods or services to which the payment relates. Creditors also affect the resource budget through a cost of capital credit.

## PROVISIONS

**2.54** Provisions are one of the most puzzling aspects of accounting for non-accountants. At the same time, the budgeting treatment of provisions is something that many accountants struggle to get to grips with. So provisions is one area in particular where budgeting officers and accountants will need to work closely together in order to arrive at the right result.

### What a Provision is

**2.55** A provision is a liability of uncertain timing or amount. A cost is recognised in the departmental resource account when a department has a present obligation (legal or constructive) as a result of a past event, when it is probable that a transfer of economic benefits will be required to settle this obligation, and when a reliable estimate can be made of the amount of the obligation (e.g. early retirement costs). For further guidance on when provisions should be recognised and how to value them please refer to the FREM.

## The stages of a provision's life cycle

**2.56** The resource budget recognises this cost at the same time that the accounts do. When recording provisions in the resource budget there are 3 key stages:

- The initial take-up, and any revaluation (such as the unwinding of the discount, or writing back down of the liability), score in the resource budget;
- The actual payment of cash to extinguish the liability (or recognition of bad debt) also scores in the resource; and
- The **release of the provision** scores as an equal and opposite (negative) amount in the resource budget. These last two items net to zero in the resource budget to prevent both the initial take up (and any revaluations) and the subsequent draw down counting in the resource budget. See however the treatment for the purpose of controls on non-cash and near-cash in Resource DEL in a following chapter.

## What the Budgeting System is trying to achieve

**2.57** In departmental accounts the draw down of the provision and the release of the provision are simply a cash movement on the balance sheet (debit liabilities / credit cash).

**2.58** However, the budgeting system recognises these entries as well as the initial take up and any revaluations that appear in the OCS (or P&L account).

**2.59** This dual recognition is because in the national accounts (the set of economic accounts used to define and measure the fiscal rules) the initial recognition of the liability does not score upfront, rather the actual transfer scores when the cash is paid. Scoring the separate elements to the transaction in this way ensures that the information required for the national accounts is available and allows us to control spending in support of the fiscal framework.

**2.60** This need to support the fiscal framework is a key consideration when looking at the impact of provisions on near-cash and non-cash in Resource Budgets (see later chapter).

## DEL and AME

**2.61** Provisions in respect of DEL spending normally score in DEL, provisions in respect of AME spending score in AME, and in provisions in respect of non-budget spending do not score in budgets.

**Split Treatment Provisions** **2.62** In respect of certain DEL programmes, the initial take up of the provision scores in AME, as does the release of the provision. This means that only the cash payment scores in DEL. These provisions are referred to as Split Treatment Provisions<sup>1</sup>. This treatment is only applicable in certain circumstances agreed with HM Treasury, and is only used exceptionally where the provision would be volatile or otherwise unmanageable in DEL.

<sup>1</sup> Split treatment provisions have the treatment that all provisions had under Stage 1 of Resource Budgeting.

## Provisions in respect of capital spending

**2.63** Certain provisions in respect of capital spending score in Capital Budgets – see chapter on capital budgets.

### Scoring Examples

**2.64** The examples below illustrate the scoring of provisions and related expenditure, in this case making a payment. Note that the transactions in provisions are non-cash and the associated expenditure is normally in near-cash – see chapter on near-cash in Resource Budget DEL below.

#### Example 1 – Standard Provision in Respect of DEL spending

Year 1 – Take-up of provision	RB: DEL	+ £10
Year 2 – Revalue provision upwards	RB: DEL	+ £2
Year 3 – Release provision	RB: DEL	- £12
Make a payment	RB: DEL	+ £12
	Net RB:DEL	£0

#### Example 2 – Split Treatment Provision

Year 1 – Take-up of provision	RB: AME	+ £10
Year 2 – Revalue provision upwards	RB: AME	+ £2
Year 3 – Release provision	RB: AME	- £12
Make a payment	RB: DEL	+ £12
	Net RB:DEL	+ £12

## Student Loans

**2.65** These rules do not apply to provisions in respect of student loans, whose treatment is set out in the later chapter on loans.

## CONTINGENT LIABILITIES

**2.66** Amounts for contingent liabilities are not included in the resource budget, but they are contained in notes to the accounts, and not recognised as actual liabilities on the balance sheet. Departments should consider in the course of drawing up their budget whether any contingent liabilities are likely to crystallise. If so then these amounts should be treated as creditors or as a provision as appropriate and an expense scored in the Resource budget accordingly.

## BAD DEBTS

**2.67** Where a department writes off a debtor, or other financial asset, the OCS will record a charge in respect of that write off and the balance sheet value of the asset will be reduced to zero. The cost in the OCS is a charge to the resource budget.

**2.68** For the national accounts we need to distinguish between bad debts extinguished “by mutual consent” and those extinguished unilaterally.

### Unilateral write off

**2.69** The vast majority of debt write-offs will be because it has become uneconomic to seek to settle the debt, or the debtor has in some way disappeared – through insolvency etc. Where the asset is written off because the asset has become un-collectable this is termed a unilateral write off in the national accounts. No special treatment is recorded for these write-offs – the bad debt scores only in resource budgets in the normal way.

### Debts written off by mutual consent

**2.70** In other cases, the department may choose to write off a debt that the debtor could repay. In these cases, the department has taken a policy decision to write off the debt to free up resources for the recipient; in effect the department has given a gift to the recipient. So these cases are viewed in the national accounts as the giving of a capital grant to the recipient, who on receipt of the grant uses the proceeds to repay the outstanding debt.

**2.71** Although these debts are termed write-offs “by mutual consent” there does not need to be a formal agreement with the debtor. It is enough for the department not to pursue a debt that could economically be recovered.

#### Effect on the Fiscal Rules of Debts Written Off by Mutual Consent

**2.72** The effect on the fiscal rules of a debt write-off by mutual consent is the same as the effect of a unilateral debt write-off: the Government’s debt position is worse off relative to what it would have been had the debt been repaid. The charge to the department’s non-cash resource budget is therefore the same in both cases. However debts written off by mutual consent are recorded separately on COINS so that the imputed capital grant can be shown in the national accounts. That is because a capital grant scores in certain measures that do not include loan repayments, in particular: Total Managed Expenditure, Public Sector Net Borrowing and General Government Net Borrowing.

#### Budget Treatment of Debts Written Off by Mutual Consent

**2.73** The charge to the department’s resource budget is the same for both types of grant write-off: the resource budget records a non-cash cost.

#### Information to HM Treasury

**2.74** Where departments are considering large write-offs of debts by mutual consent – say more than £200m – they are asked to inform the Treasury beforehand. That gives the Treasury warning of the effects on the fiscal numbers.

## INSURANCE

**2.75** Generally departments and public sector bodies do not insure because government as a whole is well placed to absorb the risk, rather than paying to lay off that risk to the private sector. However in certain circumstances departments will have insurance. Payments of insurance premia are current costs in resource DEL.

**2.76** Where an insured asset is lost, stolen or otherwise written off, a charge will be recognised in the OCS and resource budget to reflect that cost. The subsequent

payment from the insurance company should be recognised as income in the OCS and resource DEL in the accounting period in which it was recognised.

**2.77** Replacement of the asset will require the appropriate (most likely capital) budgetary cover.

### NOTIONAL INSURANCE PAYMENTS

**2.78** Under paragraph 4.5.2 of the FREM, notional insurance should not be shown in the Operating Cost Statement (OCS) or the Vote. Any department that is recording notional insurance should therefore remove it.

**2.79** If any department believes that it should record notional insurance in the OCS or the Vote or the Budget they are asked to write to their normal Treasury spending team explaining the circumstances in order to obtain agreement before submitting data.

### TAX CREDITS

**2.80** Tax credits are transfers of resources made through the tax system. Some tax credits only reduce the amount of tax that an individual or enterprise needs to pay ("non-payable tax credits"). Others may lead in some cases to a cash payment to an individual or enterprise where the amount of the tax credit exceeds the tax liability ("payable tax credits").

**2.81** Tax credits are included in budgets on the OECD basis of scoring. That is, only the payable element of a tax credit scores in budgets. The payable element means the amount that is paid out in cash to the beneficiary as opposed to being set against their tax liability. Tax credits in budgets normally score in Departmental AME.

**2.82** Where the ONS has determined that for the purposes of UK national accounts a tax credit should be treated as not being integral to the tax system, the non-payable element of the tax credit scores as public expenditure in the national accounts. It is normally excluded from budgets (ie it is in non-Departmental AME).

**2.83** Tax credits are not included in the HM Revenue and Customs resource accounts. Both payable and non-payable tax credits are accounted for in the Trust Statement that reports on tax revenues on the OECD basis.

	Departmental Budget (usually AME)	Other AME	TME	DRA's	Trust Statement
Tax Credits treated as integral part of the Tax System for National Accounts					
Non-Payable Tax Credit					
Payable Tax Credit – amount offsetting tax					
Payable Tax Credit – payable amount					
Tax Credits not treated as integral part of the Tax System for National Accounts					

	Departmental Budget (usually AME)	Other AME	TME	DRA's	Trust Statement
Non-Payable Tax Credit					
Payable Tax Credit – amount offsetting tax					
Payable Tax Credit – payable amount					

**NOTIONAL AUDIT FEES**

**2.84** Notional audit fees score in the department's DEL as resource expenditure within administration costs. The expenditure needs to be separately identifiable on the COINS database in order that it can be removed in the AME accounting adjustments to line up with TME as measured by the National Accounts.



# 3

## INCOME AND THE RESOURCE BUDGET

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**3.1** Departments may not set income against budgets except where permitted.

**3.2** This chapter:

- Gives an overview of treatment
- Lists the income that may be set against the Resource Budget
- Lists income that may not be set against Resource budgets
- Describes some of the rules respecting certain sorts of income in more detail
- Sets out guidance on the timing of recording income
- Sets out guidance on the relationship of Estimates and budgeting treatment
- Sets out when departments may obtain the benefit of additional negative DEL income above the levels taken into account in the SR.

**3.3** The same rules apply to NDPBs as to Departments. A separate chapter deals with income in the capital budget. The chapter on loans covers departments' income in respect of loans. The chapter on Public Corporations covers the budget treatment of departments' income from PCs.

**3.4** It follows that income that passes through the DRA OCS may be in Resource Budgets, in Capital Budgets, or excluded from budgets. Income that scores in budgets scores in DEL or AME along with the associated expenditure.

### INCOME OVERVIEW

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**3.5** In the national accounts some income reduces public expenditure and some finances it. For example, income from payments for goods and services reduces public spending (negative public expenditure), while tax receipts are shown on the revenue side of the government's account and finance spending. The distinction is carried through into budgets following these principles:

- Income from taxes and other revenue should be pooled so that the spending it finances can be prioritised across the range of government activities; and
- Departments that obtain income should spend it where that provides good management incentives.

**3.6** It is the Office for National Statistics acting as an independent agency that determines the treatment of income in the national accounts. Annex C gives links to some guidance notes describing the national accounts treatment of income. Then Treasury determines the budgeting treatment of income. If you are in doubt about the national accounts treatment or the budgeting treatment you should approach HM Treasury.

## INCOME TREATED AS NEGATIVE PUBLIC EXPENDITURE IN THE RESOURCE BUDGET

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**3.7** All current income that is classified as negative current public expenditure in national accounts is netted off resource budgets, (although please see section on delegated limits). In addition, certain other income, revenue in the national accounts, is netted off the resource budget. To be netted off Resource Budget DEL the income needs to arise in connexion with a DEL programme.

**3.8** The following forms of departmental income are treated as a benefit to the resource budget:

- Sales of goods and services \*
- Royalties and associated payments to use Intellectual Property Rights \*
- Sales of some licences where the ONS has determined that there is a significant degree of service to the individual applicant \*
- Income from licences and levies, treated as revenue in the national accounts, where the Chief Secretary to the Treasury has agreed that they may be netted off budgets
- Income from fines and penalties where the Chief Secretary to the Treasury has agreed that they may be netted off budgets
- Income from insurance payments \*
- Receipts in respect of compensation (where the ONS treat the income as impacting on the current budget)
- Interest and dividends where the department is paying the appropriate cost of capital charge on the associated financial asset, for example a loan made to the private sector
- Income from rent of buildings \* and land
- Those donations that are treated as current in the national accounts (donations can be capital as well)
- Income obtained from National Lottery distributing bodies that finances current expenditure
- Income from the EC that finances current expenditure
- Business \* and Non-Business VAT refunds

**3.9** Income that is negative current public expenditure in the national accounts is marked with a \*

**3.10** Note that profits on disposal of assets (and losses on disposal) score to the capital budget, not the resource budget.

**3.11** Also note that where appropriate, charges should be set using the principles of the Fees and Charges Guide.

## INCOME THAT MAY NOT BE SET AGAINST RESOURCE BUDGETS

**3.12** The following income may not be treated as negative in resource budgets:

- Taxes, licences treated as revenue in the national accounts and levies, unless the Chief Secretary has agreed to negative DEL treatment
- Fines and penalties, unless the Chief Secretary has agreed to negative DEL treatment
- Economic rents, other than those classed as rent of land
- Income treated as capital including:
  1. Developer contributions that are capital in nature
  2. Income from the EC that finances capital expenditure
  3. Equity withdrawals / super dividends

## FURTHER GUIDANCE ON INDIVIDUAL TYPES OF INCOME

### Sales of Goods and Services

**3.13** Sales of goods and services count as negative public expenditure in the national accounts, and hence in budgets, provided they meet certain criteria. In brief:

- There is a clear and direct link between the payment of the charge and the acquisition by the payer of specific goods and charges. In other words, the transaction should be rather like shopping. The issue of regulatory licences may count as the sale of a service if there is a direct benefit to the person paying for the licence such as providing them with an objective measure of fitness or suitability. And
- Unless the good or service is being sold in an open competitive market, the price should not exceed the cost of production (on a full cost basis, including depreciation and cost of capital, but excluding capital expenditure).

**3.14** See Annex C for a link to the guidance note on when transactions are sales of goods and services in the national accounts.

### Royalties and Economic Rents

**Royalties 3.15** Royalties is a term from national accounts. Annex C contains a link to a guidance note on the national accounts treatment.

**3.16** In brief, royalties are payments for the right to use produced assets made and sold in an open market, such as inventions given patent protection, computer software, copyright material, artistic and literary originals, and the income from allowing use of a government agency's logo by a commercial organisation.

**3.17** For something to be a produced asset, it should be of a sort that is or could be produced by the private sector. So an invention made in a government scientific laboratory could be an open market asset, since a private sector firm could have run such a laboratory and made the invention, even if in practice firms do not do research

in this area. But if the government has for example a legal monopoly, which has led to the creation of the asset, then it is less likely to be seen as an open market asset.

**3.18** Royalties from the use of intangible assets made and sold in an open market are treated as income from the sale of good and services. The allowable cost is the market value of the royalty – in essence, what the market will pay. So the whole of the amount paid for the asset, good, or service may be treated as negative public expenditure.

**Capital or Current?** **3.19** It may be difficult to tell whether a one-off payment covering a number of years is for the sale of an asset or an upfront payment in respect of a number of years' royalty. Similarly, it may be hard to test whether a payment spread over a number of years is for the sale of an asset or a current royalty.

**3.20** The tests used by commercial or GAAP accountants applying Financial Reporting Standard 5 - Reporting the Substance of a Transaction, will be a guide as to whether a capital asset has been sold or rented out. For larger cases, departments should consult the Treasury to ensure that they are treating the income in accordance with the national accounts.

**3.21** In general:

- A sale leading to a current receipt - royalty for the use of an asset - would be a sale offering the user a right to use the asset for a period of time, but underlying ownership of the asset or resource would stay with the vendor. Changes in the value of the asset would not normally affect the user as they would not be able to sell on their rights; but
- Capital income - sale of an asset - would be when the buyer had obtained:
  1. All significant rights or other access to benefits relating to that asset; and
  2. All significant exposure to the risks inherent in those benefits.

**3.22** Ownership rights would typically include unimpeded use of the asset, right to resell the asset and benefit or suffer from changes in the value of the asset. Typically, capital income is shown as a single entry in the accounts at the time of sale, but the cash may come in tranches (deferred consideration). Where the asset has been sold outright, the income is capital and the whole of the income is to be treated as negative public expenditure.

**Economic Rents and other Cases that are not Royalties** **3.23** “Royalty” may be used in a number of cases other than the national accounts meaning of the term. These cases may not be netted off budgets as royalties: Royalties/ sales/ rents in respect of assets created in nature, e.g. North Sea Oil, the radio spectrum, or water. Such income is normally classified as economic rent, and i

- Royalties/ sales/ rents in respect of assets created in nature, e.g. North Sea Oil, the radio spectrum, or water. Such income is normally classified as economic rent, and is revenue in the national accounts (but see “rent of land” below); and
- Royalties / sales in respect of concessions or franchises given by the government to run a commercial or government operation.

## Taxes, Licences (treated as revenue in the national accounts) and Levies

**3.24** Taxes, licences treated as taxes, and levies are compulsory unrequited payments to general government. “Unrequited” means that the payer obtains nothing personal in return. That includes not only obvious taxes like Income Tax, but also cases where a tax is hypothecated, perhaps to provide services generally for business in an area, or to recover costs from businesses that are in general the cause of some harm that needs to be remedied (e.g. pollution).

**3.25** In exceptional cases, the Chief Secretary to the Treasury may agree that taxes be netted off budgets. The Chief Secretary will bear in mind the criteria below when considering applications:

### Criteria to be applied to licences and levies:

1. The service delivered should be closely linked to the payer of the licence or levy, either because they are the beneficiaries of the service, or because they are the cause of the expenditure being incurred;
2. The licence or levy is appropriate, i.e. applied in the economically most advantageous way in the circumstances;
3. Introducing the levy or licence should not materially restrict the Government’s fiscal policy (as currently embodied in the Golden Rule, and the Sustainable Investment rule);
4. The activity financed by the levy or licence must further the Government’s economic goals;
5. Netting off the income would improve the efficiency with which resources are allocated e.g. because of a difficulty in otherwise matching resources to unpredictable changes in externally driven demand. There needs to be a clear advantage over DEL funding.
6. Where appropriate, charges should be set using the principles of the Fees and Charges Guide, and surpluses would have to be surrendered;
7. There should be adequate efficiency regimes in place to keep costs down, including stretching targets and regular efficiency reviews, often tied in with the biennial Spending Review;
8. Day-to-day decisions on the level of charges and an efficient level of costs should be taken separately from the body raising the levy, to prevent abuse of its monopoly power. Normally this would be by the departmental minister.
9. There will be periodic reviews involving the Treasury, of the operation of the licences and levies, including: whether they should exist at all; whether netting off remains the most appropriate means of funding; what scale of activity is appropriate; and the level of charges set. The periodicity of the review shall be set as part of the agreement to allow netting off

**3.26** Departments who wish to propose that tax income be netted off DEL should contact the Treasury for advice as to how a submission should be compiled. See Annex B for contact details.

## Fines and Penalties

**3.27** Fines and penalties are compulsory unrequited payments to general government that are in the nature of a punishment.

**3.28** In exceptional cases, the Chief Secretary to the Treasury may agree that fines and penalties be netted off budgets. The Chief Secretary will bear in mind the criteria below when considering applications:

**Criteria to be applied to fines and penalties:**

1. Will performance against policy objectives, e.g. crime fighting and prevention, be likely to be improved?
2. Are arrangements in place, which will ensure that the activity will not lead to the abuse of fine and penalty collection as a method of revenue raising, and that operational priorities will remain undistorted?
3. Will revenues always be sufficient to meet future costs, with any excess revenues over costs being surrendered?
4. Can costs of administering the programme be readily identified and apportioned without undue bureaucracy, and with interdepartmental and inter-agency agreement, where necessary?
5. Can savings be achieved through the change (from a normal DEL funding regime to a netting off regime), and are adequate efficiency regimes in place to control costs, including regular efficiency reviews. The periodicity of the review shall be set as part of the agreement to allow netting off, and will involve the Treasury. It will consider whether the fines and penalties should exist at all; whether netting off remains the most appropriate means of funding; what scale of activity is appropriate; and the level of fine set.

**3.29** Departments who wish to propose that fine income be netted off DEL should contact the Treasury for advice as to how a submission should be compiled. See Annex B for contact details.

## Dividends and Equity Withdrawals

**3.30** A dividend is a payment made to a shareholder in consideration of having put equity finance into a body. The equity finance may be in the form of Companies Act shares, Public Dividend Capital or the implied equity in a statutory public corporation. Public sector bodies may hold equity in other public sector bodies or in private sector organisations. Dividends are payments made out of current earnings.

**3.31** If dividends are greater than the profits of the current and two previous years – super-dividends - they count as equity withdrawals in the national accounts (a financial transaction as opposed to a current receipt in the National Accounts). Equity withdrawals count as capital income for budgeting. A more detailed definition of when a payment is a dividend as opposed to a withdrawal of equity for budgeting purposes is given in the PC chapter.

**3.32** In DRAs, reductions of equity in the form of sales of shares or PDC reductions would not normally go through the OCS. But special payments from bodies that are not accompanied by actual reductions in equity holdings would go through the OCS; they may be termed super-dividends. Such super-dividends would be equity withdrawals in the sense above.

**3.33** “Dividends” received from bodies within central government, including joint ventures classified to the central government sector, are not dividends but transfers within government and as such are not generally treated as negative in budgets.

## Rent of buildings / land

**3.34** Income from the rent of buildings and land counts as negative expenditure in budgets.

**3.35** In addition to the rent of land, this heading includes rents payable to the owners of inland waters and rivers for the right to exploit such waters for recreational and other purposes. Rent of land does not include rents on sub-soil assets, or of other natural assets (spectrum etc.).

**3.36** Any proposal to treat as negative DEL rent other than the conventional rent of land or buildings needs explicit Treasury agreement

**3.37** Note that rent of land is treated as a benefit to the resource budget, even though it is revenue in the National Accounts.

## Note on Treatment of Asset Sales in the National Accounts and profit / loss on sale of assets as recorded in financial accounts.

**3.38** DRAs divide the proceeds from the sale of an asset into an element that covers book value and a profit or loss on disposal.

**3.39** The book value is a benefit to the capital budget. The profit / loss on sale is also scored to the capital budget, and **not** the resource budget.

### Treatment of Asset Sales in the National Accounts

**3.40** In the national accounts, capital expenditure is recorded net of income from sales of capital assets. The national accounts do not separate the profit/loss on disposal from the book value element of sales income. Both of those components of the transaction are taken through the capital account of the national accounts. In other words the disposal at open market value reduces total capital expenditure in aggregate.

**3.41** Therefore profit/loss on disposal is not an influence on the Golden Rule, since achievement of the Golden Rule is measured by reference to transactions on the current account, measured with reference to the national accounts. Budgeting for this item in capital budgets therefore aligns the budgeting treatment with national accounts in order to help manage the overall fiscal position.

## Donations

### Donations that may be netted off

**3.42** Donations may benefit either resource or capital budgets: capital donations are dealt with in chapter 7. Donations in kind are not normally included in budgets.

**3.43** Donations have to be entirely voluntary. They have to be unrequited - that is the donor should receive no direct benefit in return. They also have to come genuinely from outside the body that receives them, i.e. not be financed or backed in some way by the recipient. Departments and public bodies may net off the donations that are made to finance expenditure for the common good and that are directed by the donor to a specific project, programme or body, for example:

- A current gift left in the collection box of an individual museum to be spent at that museum's discretion;
- Sponsorship funds raised for a specific venture to the benefit of the public.

**Donations that may not be netted off** **3.44** Departments should exclude such donations from budgets. Examples of donations that may not be netted off include:

- Donations which related to income that would otherwise be classified as revenue anyway, for example, conscience money (people guiltily and voluntarily paying over money in respect of past unpaid tax); and
- Donations that relate directly to the public sector's balance sheet - e.g. legacies to reduce the national debt.

### **Income from National Lottery distributing bodies**

**3.45** The Government's hypothecated income from the National Lottery is a tax. The spending by the National Lottery distributing bodies counts as expenditure in AME.

**3.46** Where a Government department or NDPB that is not a National Lottery distributing body obtains income from a distributing body to finance spending in the Resource Budget DEL it should take the income into budgets as negative Resource Budget DEL

### **Income from the European Community**

**3.47** Income from the EC may be netted off Resource Budget DEL if it is in support of DEL spending and if it supports current expenditure.

**3.48** Departments are reminded that income from the EC Budget is not free to the UK. The budget is funded by Member States, including the UK. Income received from the budget incurs a cost to the UK Exchequer, both by increasing the UK's gross contribution to the budget and by reducing the UK's budget abatement. In practice each £1 received costs the Exchequer about £0.72.

**3.49** It is particularly important that departments take this into account and ensure that they claim discretionary EC income only in support of programmes that are good value for money.

### **VAT Refunds**

**3.50** Departments' budgets should be set net of any recoverable VAT. Departments may retain VAT refunds for business activities and also for certain non-business activities.

### **WIDER MARKETS INITIATIVE**

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**3.51** Income may be generated from activities under the Wider Markets Initiative – see Annex C for the link to the main policy paper. To decide whether such income should be set against budgets, please refer to this chapter, in the same way that you would for all other income. That the income is generated from Wider Markets activities does not of itself determine the correct treatment.

### **TIMING OF RECORDING OF INCOME**

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**3.52** In general, for sales of goods and services, interest, and dividends, departments should record income for budgets at the same time as they record it for accounts.

**3.53** Taxes and economic rents that are in budgets should be recorded for budgeting purposes at the time that the income falls due, that is, the period of assessment for the tax.

**3.54** In some cases where for example taxes are closely hypothecated, DRAs may record taxes so as to match the timing of work done by the department, rather than the timing of the period of assessment. In cases where departments are trying to match income to expenditure in each year, and the difference in recording in DRAs is simply reflecting the inevitable minor mismatches of income and expenditure, departments may follow the DRA treatment.

**3.55** However, where departments are as a matter of policy seeking to advance or delay the collection of taxes compared with the timing of spending, departments must record taxes for budget purposes in the period of assessment, even if that opens up a difference from DRAs.

**3.56** Taxes and economic rents are not separately identified in DRAs. Departments should use the national accounts categorisation of income to identify which income counts as taxes or economic rents. That may include not only obvious taxes but also certain licence fees and similar income.

## BUDGET AND ESTIMATES TREATMENT OF INCOME

**3.57** Note that while the budgeting treatment of income influences the treatment in Estimates, the reverse does not apply. So for example:

- In Estimates, income may normally only be appropriated-in-aid against related expenditure in the same part of the Estimate. That restriction normally means that the income is given the same budgeting treatment as the expenditure to which it relates. So, income that is negative DEL in budgets may be appropriated-in-aid of related DEL expenditure in the Estimate. The same would apply to income and expenditure in AME, or even outside of budgets. But income that is outside budgets may not normally be appropriated in aid of DEL spending. So you need to know the budgeting treatment of income before you can work out the Estimates treatment;
- However, whether income has been appropriated-in-aid or treated as a Consolidated Fund Extra Receipt (CFER) does not necessarily tell you anything about the budgeting treatment. You may have negative DEL CFERs and non-budget appropriations-in-aid. So you need to address the budgeting treatment separately from the Estimates treatment.

**3.58** “Appropriation in Aid” and “CFER” are Estimates terms. They are often misused to indicate budgeting treatment (A-in-A for negative DEL and CFER for non-budget). However, since the budgeting treatment does not follow from the Estimates treatment that usage risks confusion. We recommend using distinct terms for budgets, such as “negative DEL” or “non-budget” income when describing the treatment of such flows in respect to budgets.

## WHEN DEPARTMENTS MAY KEEP ADDITIONAL NEGATIVE DEL INCOME

**3.59** In many cases current income does no more than cover the costs of production of the activity to which it relates. For example, fees and charges are typically set so as to

recover no more than current costs, including depreciation and cost of capital charges (refer to the fees and charges guide for further detail).

**3.60** To ensure that they obtain the right level of income from such sources, Departments will want to consider whether they have any services where less than full costs are currently recovered and which should move towards full cost recovery, or other services which may be appropriate candidates for the introduction of user charging.

**3.61** In other cases, income can generate returns that far exceed current costs of production, for example licensing the exploitation of an invention in the open market. In these cases the Government has to balance two considerations:

- Departments should be encouraged to obtain such income by being allowed to retain and spend it; and
- Government funds should be prioritised across the whole range of spending to where they would do most good.

**3.62** And we need to keep the rules simple.

**3.63** Departmental budgets are set in the SR net of negative RDEL income. So the SR settlement has to be informed by the expected level of negative RDEL income. So, the SR process should be used to identify the expected level of Department's income, any expected changes, and an assessment of the potential for new income. That will look especially at the prospects of moving under-performing services towards full cost recovery and/or identifying new sources of income from user charging. The SR settlement will include an explicit statement of the expected level of income in the years of the SR period.

**3.64** The Treasury encourages Departments to engage in **Wider Market** activities. Not only does the income they generate support public spending, but also undertaking pioneering or inventive activity can enhance the skill set of civil servants, and can lead to more innovative provision of public services. The SR provides an opportunity for challenging departments' expected level of such activities and encouraging departments to exploit spare capacity. At this stage in the evolution of the Wider Markets initiative, the Treasury believes that it creates a helpful incentive for Departments to be allowed to keep wider markets income that scores as negative DEL, and will set Departmental Expenditure Limits in this spirit.

**3.65** Departments will be allowed to keep the negative DEL income that they obtain in the SR period up to the amount that was taken into account in the SR. Income cannot be predicted wholly accurately, and the Treasury wishes to encourage departments to find new income streams where appropriate. Departments may therefore in any year also retain negative RDEL income up to 20% above the level envisaged for that year as part of the SR settlement without an adjustment to budgets.

**3.66** Negative DEL income in respect of co-funded NDPBs that originated from other departments does not count towards the 20% limit.

**3.67** Where the CSR settlements did not clearly set out an expected level of income, departments may in any year retain total negative RDEL income up to 5% of spending in Resource DEL without an adjustment to budgets.

**3.68** If departments expect to obtain more negative RDEL income than provided for above, they should talk to the Treasury about whether they may retain all or part of the

income without an adjustment to budgets. When considering proposals, the Treasury will wish in particular to encourage Wider Markets activity where opportunities could not be foreseen at the time of the SR and other cases where the additional income represents the results of positive management action, as opposed to under-forecasting.



# 4

## ADMINISTRATION BUDGETS

### WHAT ARE ADMINISTRATION BUDGETS?

**4.1** In Spending Reviews, Administration Budgets are set for most central government departments (incorporating their agencies) unless specific exemptions have been agreed. At present, the Export Credits Guarantee Department, the Forestry Commission and trading funds are excluded from the regime. Although devolved administrations are not set Administration Budgets in Spending Reviews, these bodies operate their own arrangements for constraining the costs of running central government.

**4.2** Expenditure that does not fall within Administration Budgets set in Spending Reviews is known as programme expenditure.

### THE BOUNDARY BETWEEN ADMINISTRATION BUDGETS AND PROGRAMME SPENDING

**4.3** Administration Budgets cover the costs of all central government administration other than the costs of direct frontline service provision or support activities that are directly associated with frontline service delivery. In practice Administration Budgets include activities such as provision of policy advice, business support services, back-office administration of benefits, advice on and administration of grant programmes, technical or scientific support, and the work of the Government's Regional Offices.

**4.4** To illustrate the boundary between front line and other staff, the table below sets out some of the activities that have recently been reclassified out of administration budgets along with the rationale. The Chief Secretary to the Treasury approved the reclassifications.

Activity	Rationale
Consular services	The Consular service offers front line consular assistance to UK nationals in difficulty or distress abroad.
Immigration and nationality work	Asylum caseworkers and immigration officers at ports and airports provide frontline services.
Prison establishments	Keeping in custody those who have been committed by the courts represents a front line service. In addition, with the creation of the National Offender Management Service the scoring of prison establishment costs needed to be aligned with the costs of the probation service (which already scored outside administration costs).
Administration of NHS pensions	In effect, part of the direct costs of managing the NHS. Other such NHS management costs already score as programme
ACAS	ACAS provides information, advice, training and works on the front line with employers and employees to solve problems and improve performance. In addition, ACAS is an NDPB, nearly all of which are in programme already.

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Crown Prosecution Service	Public prosecution (including lawyers working in courts and counsel) represents a front line service. Prosecutors also work directly with police and other services, which are mainly funded from outside administration costs.
Court Service	The equivalent costs for magistrates' courts are outside admin budgets and consistency is needed for the creation of the Unified Courts administration.

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**4.5** To keep the number of reclassifications to manageable levels, the Treasury is only willing to consider cases that represent a substantial body of on-going work. Also, the merits of very substantial reclassifications need to be weighed against the potential effects on the Administration Budgets regime overall as well as presentational and timing issues.

**4.6** Where a department believes that expenditure should be reclassified from administration spending to programme spending, they should contact their Treasury spending team. All reclassifications from administration budgets need to be approved by the CST and lead to restated limits.

## DEFINITION OF ADMINISTRATION BUDGETS

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**4.7** Administration Budgets are simply a sub-set of Resource DEL and share most of the characteristics of DEL. They are set net of negative DEL that relates to administration expenditure. The chief components of expenditure within Administration Budgets are:

- **Employee costs**, including civil service pay, superannuation, training, travel and subsistence;
- Current expenditure on **accommodation**, including rent, rates and maintenance;
- Current expenditure on **office services** including stationery, postage, telecommunications and computer maintenance, etc.;
- Current expenditure on comparable **contracted-out services** (including some consultancy costs, see below);
- **Depreciation and cost of capital** charges incurred carrying out activities falling within administration costs (and where fixed assets are used for both administration and programme work, these costs should be apportioned);
- **Cost of capital charges on working capital** related to activities falling within administration costs (and where it is not possible to analyse the cost of capital between administration and programme expenditure, these costs should be charged to the more significant of the two); and
- **Other non-cash items** such as auditors' remuneration and expenses, and provisions for early departure costs.

**4.8** Payments to staff as a result of early exit, where a case explicitly linked to improved efficiency has been agreed in advance with the Treasury, may exceptionally be excluded from Administration Budgets and scored to programme.

## Consultancy costs

**4.9** Consultancy fees and contract charges should be charged against Administration Budgets where the consultancy relates to some component of administration expenditure listed above, or where the work carried out might otherwise be carried out by staff funded from Administration Budgets<sup>1</sup>. The presumption should be that consultancy spending should be scored within Administration Budgets. Where a department believes consultancy spending associated with a particular programme should be classified as programme spend they should agree this with their Treasury spending team. Administration expenditure should include:

- Any costs associated with out-sourcing of support services. For example: payroll services, omnibus building service charges under PFI or other accommodation contracts, departmental switchboards, etc.
- Provision of policy advice or support by consultants employed in substantially the same role as if a civil servant was carrying out the work.

**4.10** This rule is designed to avoid any perverse incentive to contract out functions, or use consultants in place of civil servants, simply because the resulting work would then be charged under programme costs. Decisions on how support or policy services should be supplied should be made purely on an assessment of what offers the best combination of value for money and effectiveness, rather than because programme cover may be more readily available than administration cost cover or vice-versa.

## Allowable income

**4.11** Departments may offset negative Resource Budget DEL income relating to administration costs against their Administration Budget. This includes income from NDPBs and other UK public sector bodies that are outside the administration costs regime.

## Comparability with Departmental Resource Accounts

**4.12** Departmental Resource Accounts must include a note reporting outturn against final Administration Budgets.

**4.13** The element of net operating costs that falls with Administration Budgets is reported in the Operating Cost Statement as net administration costs. The only differences between outturn against Administration Budgets and net administration costs are the differences that apply generally between the Operating Costs Statement and Resource Budget set out in Table 1 of Annex A. Differences will not generally arise from scoring of NDPBs, local Authorities, public corporations or NHS trusts as these all fall outside Administration Budgets.

## APPROVAL FOR CHANGES TO ADMINISTRATION BUDGETS

**4.14** All changes to Administration Budgets – including changes to expenditure and income provision within Administration Budgets – require Treasury approval.

**4.15** HMT spending teams may give approval at official level for:

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<sup>1</sup> 'Consultancy' should be taken to include all professional services as defined by the Professional Services Forum (see Annex C for the link)

- Some increases to the Administration Budget, including:
  1. Funds allocated under the Invest to Save Budget;
  2. Transfers between departments where the overall effect is neutral; and
  3. Draw-down of Administration Budget End-Year Flexibility.
- Changes to expenditure and income provision within Administration Budgets where the Administration Budget itself remains unchanged or is reduced.

**4.16** Approval from the Chief Secretary to the Treasury is required for most other increases to the Administration Budget. In particular:

- Increases involving claims on the DEL Reserve (other than the draw down of Administration Budget EYF);
- Transfers from programme funds.

## IN-YEAR CONTROL

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**4.17** As with all spending, departments or agencies and their Accounting Officers have to take ultimate responsibility for ensuring an outturn within Administration Budgets. Outturn, which exceeds an Administration Budget, constitutes the breach of a budget and will be subject to the arrangements set out in Chapter 1.

**4.18** Administration Budgets include both non-cash and near-cash spending in Resource Budget DEL. Switches between these components are allowed provided they do not conflict with the overall controls on near-cash and non-cash set out in a subsequent Chapter.

## END YEAR FLEXIBILITY

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**4.19** Departments are eligible for 100 per cent End Year Flexibility (EYF) on their Administration Budgets. Administration Budget EYF is held separately from other Resource and Capital DEL EYF. Normally neither other Resource nor Capital DEL EYF may be used to supplement administration costs budgets in future years. However, any Resource underspending (on Administration Budget or other Resource DEL) will be used, in the first instance, to recoup Resource DEL Reserve claims.

**4.20** Where Departments agree with the Treasury a transfer of functions out of Administration Budgets into programme costs then an adjustment will need to be made to their EYF distribution. Administration Budget EYF should be reduced (and programme EYF increased accordingly) in proportion to the amount of expenditure being moved from administration costs.

## ESTIMATES & ADMINISTRATION BUDGETS

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**4.21** The Estimates treatment of income (i.e., whether the income is appropriated-in-aid or CFERed) does not impact on whether or not the income is treated as negative administration budgets. Departments must note that, although the administration budget is not specifically voted as a limit by Parliament, it is included within the department's Supply Estimate and any breach of the limit will lead to an Excess Vote. Detailed guidance on administration costs and Estimates is available in the Supply Estimates manual (see annex C for link).

# 5

## NEAR-CASH IN RESOURCE DEL

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**5.1** This chapter applies to the element of Resource Budget DEL which impacts directly on the Golden Rule – near-cash. Near-cash in Resource DEL is a control total.

**5.2** The chapter should also inform the management of Resource Budget AME programmes, which include material amounts of both non-cash and near-cash spending. The budgeting system does not distinguish between these concepts in Capital Budgets.

### WHAT WE ARE TRYING TO ACHIEVE

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**5.3** The framework for managing public spending has two objectives:

- To support the fiscal rules; and
- To enable public spending to be planned and controlled in a way that improves the quality and cost-effectiveness of public services.

**5.4** The fiscal rules are measured on a national accounts basis. Although national accounts are mostly consistent with the GAAP basis we use for Departmental Resource Accounts, there are some differences, including:

- A different measure of depreciation is used;
- National accounts do not include cost of capital charges;
- Rather than scoring the creation and revaluation of provisions, national accounts score the related cash flows.

**5.5** Near-cash is that element of Resource Budgets that corresponds most closely to the measure of current expenditure that affects the current balance in the national accounts, used to assess performance against the Golden Rule. So we aim to control near-cash to support the fiscal rules.

**5.6** The fiscal rules are concerned with how much needs to be raised now by way of taxation and borrowing. They are measured on an accruals basis. So they generally focus on spending that normally involves a cash payment at, or near to, the time the expenditure is made. For example, staff costs accrue as the time is worked and staff are paid soon after i.e. at the end of the month. So pay is an expenditure item in the measurement of the Golden Rule.

**5.7** Near-Cash is defined as accruals measures of transactions that normally turn into cash flows soon. So the main components of near-cash in resource budgets are: pay, current procurement, grants and subsidies to the private sector and subsidies to public corporations. Near-cash also covers amounts paid out that are covered in accounting terms – and at the level of the Resource Budget - by the release of provisions (see Appendix 2 for worked examples). A full table of definitions is at Appendix 1 to this chapter.

**5.8** Non-cash items are included in budgets to ensure that departments' budgets reflect the full economic cost of their activities even though there is not a direct link to departments' cash flows in the relevant period. These will either never require a cash payment as such (e.g. cost of capital charges, which have an indirect correspondence

with the Government's debt interest charges) or will only give rise to cash payments years into the future (e.g. provisions).

**5.9** Depreciation is in the calculation of the Golden Rule, but on a different measurement basis from the figure in DRAs. So for the purposes of the control regime depreciation in budgets is outside near-cash.

**5.10** Appendix 2 to this chapter shows how the main non-cash costs score in accounts and budgets.

**5.11** At the same time, we wish to encourage good management. Departments are expected to manage non-cash costs with the same rigour as all other elements of their budgets.

**5.12** So, where ongoing savings in the level of non-cash are made as a result of improved decision-making, the savings in Resource DEL should be deployed where they will do most good, whether non-cash or near-cash, subject to the constraints set out below.

## NEAR-CASH IN RESOURCE DEL AND THE SPENDING REVIEW

**5.13** Near-cash in Resource DEL is a control total. The expected level of all near-cash spending (on a slightly different definition from that in this guidance) was set out in departments' CSR settlement letters.

## FLEXIBILITY BETWEEN NEAR-CASH IN RESOURCE DEL AND NON-CASH ELEMENTS OF RESOURCE DEL

### Non-Cash to Near-Cash in Resource DEL

**5.14** Where ongoing savings in the level of non-cash are made as a result of improved decision-making the Treasury will not block a managerially worthwhile switch except in those cases where the switch really represents a risk to the fiscal framework.

**5.15** Departments may therefore make switches resulting from improved management decisions of up to £20m in total per financial year without specific Treasury approval. However, Departments and Treasury spending teams should track such changes so that they always know what the approved level of Near-Cash in Resource DEL spending is. In the normal way the Estimates approval process may provide a suitable opportunity, as spending teams will need to approve any resulting increase to the Net Cash Requirement.

**5.16** All other switches must be agreed with the Treasury. Unless they threaten achievement of the Government's fiscal rules, the Treasury will not, in general, block switches which:

- Represent departments' legitimate responses to the very incentives Resource Accounting and Budgeting is intended to bring; or
- Are the manifestations of better financial management within departments.

**5.17** Thus, for example, unless it is unaffordable fiscally, the Treasury is likely to be sympathetic to switching into near-cash where non-cash resource are freed up due to:

- Reductions in depreciation and/or cost of capital arising from changes that both represent value for money and are consistent with discussions departments have had with Treasury in Spending Reviews and subsequently about capital expenditure plans (e.g. an improvement in the management of

assets which lengthens real asset lives, faster than expected progress on stock or fixed asset disposal plans, the disposal of assets that had previously been rented out, lower than expected capital expenditure while still meeting PSA targets for service delivery or changes arising from acceleration of a policy on PFI);

- Higher forecasts of downward revaluation of provisions compared to plans where these changes arise from beneficial management action (e.g. action which has reduced the level of bad debts or legal claims against the department); or
- A change in accounting policy that had already been agreed with HMT or where there is a clear improvement in the quality in accounting.

**5.18** The corollary is that the Treasury would not be sympathetic to switches where reductions in non-cash requirements arise from inadequate forecasting, poor data or changes in accounting treatments which are not driven by virtuous rationales.

**5.19** The Treasury will also consider sympathetically non-cash to near cash switches where a liability is discharged by a pensions bulk transfer to a real fund.

**5.20** In some cases, the interaction of the near-cash switching rules and the treatment of provisions leads to instances of double hits to near-cash budgets within an SR period. Some of these instances may be unjustified. Any department facing such a double hit should discuss it with the Treasury.

### **Near-Cash in Resource DEL to Non-Cash**

**5.21** Departments are free to move provision from near-cash in Resource DEL to non-cash within Resource DEL.

### **Policy Ring-Fences**

**5.22** Where spending is subject to specific policy ring-fences, these apply as well as the general restrictions on moving money between near-cash and non-cash.

**5.23** So savings on ring-fenced provision may not be used to increase spending elsewhere (except under the conditions laid out in paragraph 1.41).

**5.24** However, unless a closer control has specifically been provided for, the policy ring-fence applies at the level of the Resource Budget / Capital Budget. So if provision for near-cash within a ring-fenced budget is switched to provision for non-cash within the ring-fenced budget, non-ring-fenced near-cash provision may rise by the same amount. Departments may be asked to demonstrate that the non-cash element within the ring-fenced budget is needed for that programme. The same point applies to administration expenditure within policy ring fences.

## **OUTTURN AGAINST PLANS**

**5.25** Outturn higher than the final level of near-cash provision (i.e. after making use of the flexibilities and any agreed in-year switches) would be subject to the same breach procedures as for Resource Budget DEL (see Chapter 1).

**5.26** Overspending on non-cash Resource Budget DEL would not be regarded as a breach provided it did not lead to an overspend on Resource DEL as a whole.

## END-YEAR FLEXIBILITY

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**5.27** End Year Flexibility attributable to Near-cash in Resource DEL is identified separately in the Public Expenditure Outturn White Paper. Departments are not permitted to apply non-cash EYF to near-cash spending in Resource DEL.

## CASH AND NEAR-CASH

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**5.28** Cash is not the same as Near-Cash. Near-Cash is an accruals measure of certain spending in the resource budget, as described in this chapter, while cash is cash.

**5.29** Note that measures of cash (including “cash required by operations” in accounts and the Net Cash Requirement (NCR) in Estimates) will have a different coverage from Near-Cash in Resource Budget DEL. For example, capital expenditure impacts on the NCR and capital grants on cash required by operations; neither cash measure is divided into DEL and AME.

**5.30** Therefore, departments should monitor and control Near-Cash in Resource Budget DEL directly, just as they do Resource Budget DEL overall and Administration Budgets.

**5.31** However, departments may find it helpful to monitor cash and use unexpected increases in cash outflows as a trigger to check whether Near-Cash spending is rising above expectation. However, because of the differences referred to above, that cash outflows are in line with expectations does not prove that Near-Cash is under control.

## APPENDIX I TO CHAPTER 5:

### ECONOMIC CATEGORY RECORDING

**5.32** On COINS the economic substance of a transaction is described by the account code, as defined in the SCOA. Spending may also be divided into near-cash and non-cash according to groupings of economic categories. The tables below show the standard attribution to near-cash and non-cash of the main economic categories. This attribution is consistent with the attribution to budget category tags shown above.

**5.33** When using the tables:

- There are some economic categories not listed below. Where departments use such codes for spending within Resource DEL they should refer to the Treasury for guidance on whether the spending would be near-cash or non-cash;
- In spite of inclusion in the list below, some of these economic categories, e.g. W15, are only exceptionally to be used in RDEL;
- Where a department has unallocated non-cash expenditure they are asked to talk to their Treasury spending team;
- Where a department identifies special circumstances, which suggest that the attribution of ECs to near-cash or non-cash in the tables is not appropriate, the department should contact HM Treasury.

### Near Cash

A15	Pay and pension costs
B35	Current expenditure on goods and services
B45	Receipts treated as negative DEL and as revenue in national accounts
B60	Payments and receipts of rent of land (not buildings)
B80	Receipts of donations
C10	Subsidies to the private sector.
C20	Subsidies to central government and local authority market kind of activity units, and quasi corporations
C35	Subsidies to public corporations
C50	Subsidies that are generally available to the private sector
D10	Current grants to the private sector
D20	Current transfers abroad
D40	Public sector occupational pension schemes: pensions in payment/receipts of pensions contributions

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D90	Departmental Unallocated Provision/ current expenditure to which an EC cannot be assigned
E20	Renewals maintenance expenditure (use with HMT approval only)
K30	Dividends paid to or received from the private sector and the Bank of England
K40	Dividends paid by public corporations to central government
M10	Current grants to local authorities within AEF/AEG
M15	Current grants to local authorities outside AEF/AEG
M20	Uncapitalised grants to local authorities covering loan charges
M30	Current grants made by the European Communities to local authorities
M40	Non-Domestic Rates
S10	Payments of interest to and receipts of interest from the private sector
S15	Payments of interest to and receipts of interest from local authorities
S20	Central government's payments of interest to and receipts of interest from public corporations
S25	Payment of interest to, and receipts of interest from, abroad
S30	Interest payable on finance leases (to the private sector)
T30	Public corporations' profits or losses
W15	Grant in aid to Non-Departmental Public Bodies in the central government sector
W16	Payments by one central government body to another, and corresponding receipts
W40	Interest payments/receipts within central government

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### Non-cash

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B38	Notional audit fees
B85	Bad debts relating to pay, procurement and capital
B86	Bad debts relating to loans, grants and transfers
B90	Depreciation (departments, agencies and NDPBs)
B92	Release from Donated Assets Reserve
B95	Impairments of fixed assets
B98	Cost of capital charge relating to loans and public dividend capital in respect of public sector bodies
B99	Cost of capital charges other than B98
D30	Preferential loans to persons: Grant implied in lending. (Use with HMT approval only).

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F20	Write-offs of stocks
L10	Provisions relating to pay, procurement etc and associated income: take-up and revaluations only
L11	Provisions relating to pay, procurement etc and associated income: release of provision only
L15	Provisions for pensions for staff where body has own unfunded pension scheme: take-up and revaluations only
L16	Provisions for pensions for staff where body has own unfunded pension scheme: release of provision
L20	Provisions relating to grants and associated receipts: take-up and revaluations only
L21	Provisions relating to grants and associated receipts: release of provision only
L30	Provisions relating to bad debts on loans: take-up and revaluations only
L31	Provisions relating to bad debts on loans: release of provision only
L40	Provisions for pension costs excluding interest on liabilities (pensions schemes under FRS17): take up and revaluation only
L45	Provisions for pension costs - interest on scheme liabilities only (pensions schemes under FRS17): take up and revaluation only
L46	Provisions for pension costs (pensions schemes under FRS17): release only

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## APPENDIX 2 TO CHAPTER 5: SCORING OF CERTAIN TRANSACTIONS IN ACCOUNTS AND BUDGETS

**5.34** The following table illustrates how the each of the main non-cash items in Resource DEL typically scores in budgets, accounts and cash.

	BUDGETING			ACCOUNTING		CASH
	RDEL <sup>1</sup>		CDEL	OCS I	Balance sheet	
	Near- cash	Non- cash				
<b>PROVISIONS</b>						
Create a provision		20		20	(20)	
Revalue the provision downwards		(5)		(5)	5	
Cash paid out against the provision <sup>2</sup>	4	(4)			4	(4)
<b>DEPRECIATION</b>						
Buy an asset			10		10	(10)
Depreciate over its life		7		7	(7)	
Sell it for £2 – that is for less than its residual value			(3) I	I	(3)	2
<b>COST OF CAPITAL</b>						
Buy an asset			29		29	(29)
Charge cost of capital each year @ 3.5%		I		I		

<sup>1</sup> Charges to the Operating Costs Statement (OCS) for these non-cash items normally equal the (net) charge to RDEL.

<sup>2</sup> A faster than expected rate of payments against a set of provisions on the balance sheet has no net effect on Resource Budget DEL but means that non-cash requirements will be lower and near-cash requirements higher than planned. Note that if the eventual total bill is higher than the total amount of the relevant provision on the balance sheet, then the excess scores in the Resource Budget DEL as well as in near-cash because there is no provision to release against the cash payment.

**5.35 Provisions.** The examples below copy the table in chapter 2 with the addition of a column to show non-cash and near-cash.

<b>Example 1 – Standard Provision in Respect of DEL spending</b>		
Year 1 – Take-up of provision	RB: DEL + £10	Non-cash
Year 2 – Revalue provision upwards	RB: DEL + £2	Non-cash
Year 3 – Release provision	RB: DEL - £12	Non-cash -£12
Make a payment	RB: DEL + £12	Near-cash +£12
	Net RB:DEL £0	
<b>Example 2 – Split Treatment Provision</b>		
Year 1 – Take-up of provision	RB: AME + £10	Non-cash
Year 2 – Revalue provision upwards	RB: AME + £2	Non-cash
Year 3 – Release provision	RB: AME - £12	Non-cash
Make a payment	RB: DEL + £12	
	Net RB: DEL + £12	Near-cash +£12



# 6

## CAPITAL BUDGET - CENTRAL GOVERNMENT'S OWN EXPENDITURE

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**6.1** This chapter sets out guidance on specific issues relating to central government's own expenditure in the Capital Budget.

**6.2** NDPBs' capital expenditure scores in budgets in the same way as departments'. See next chapter for the treatment of income in capital budgets. See separate chapters for the capital budget implications of loans to the private sector, PFI deals, support for local authorities and support for public corporations.

### CAPITAL BUDGETS OVERVIEW

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**6.3** New capital spending by departments and NDPBs scores in the capital budget at the same value and with the same timing as in accounts. Some areas can give rise to tricky decisions on whether they are capital or not, and departments should check carefully the treatment of

- In-house capital formation, including Research and Development expenditure and in house production of IT; and
- Software purchases.

**6.4** Capital budgets are net of any income that is treated as negative expenditure in capital budgets – see separate section. Capital spending includes expenditure on tangible and intangible fixed assets, howsoever financed.

**6.5** In addition capital budgets include net acquisitions of financial assets (e.g. movements in loans to the private sector) that score as movements in fixed assets on the balance sheet. In exceptional cases movements in debtors or other current assets (stocks / prepayments) may be included in the capital budget.

**6.6** When budgeting for capital expenditure, departments should consistently follow agreed accounting policies when deciding what costs of a project should be capitalised (in most cases this should be uncontroversial but there are a few categories of expenditure, such as some consultancy costs, that could be either capital or resource).

**6.7** Capital budgets include capital grants.

### ASSET MANAGEMENT STRATEGIES

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**6.8** Departments' agreed capital spending plans following CSR were detailed in their Asset Management Strategies (AMS), published following the Spending Review. AMS include asset management plans, disposal plans and plans for all sorts of assets.

**6.9** The AMS is a way of ensuring that the capital budget effects of spending and the consequential for the resource budget (e.g. depreciation) are considered together.

### PREDICTING CAPITAL VALUES

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**6.10** In line with the FReM, fixed assets are carried at current values rather than being based on historical costs. This policy normally requires land and buildings and other fixed assets to be valued professionally every five years and to use indices in the interim years.

**6.11** Departments need to make assumptions about future expected disposals and acquisitions of fixed assets and movements in the value of fixed assets held, to be able to budget for the resource consequences (depreciation and cost of capital charge) of holding these items.

**6.12** Whilst the departments latest audited balance sheet will provide the starting point for forecasting fixed asset balances, the Departmental Investment Strategy should set out any major investment or disposal programmes which are planned.

**6.13** Past trends and movements in indices should provide evidence to support the revaluation of assets. The Treasury issues forecast indices that may be used by departments for estimating future capital values. These indices were issued under cover of PES papers (most recently in PES(2007)03).

**6.14** As the assumptions used in forecasting fixed asset values will no doubt change over time, departments should regularly review their continued appropriateness and bring any significant changes to the early attention of their spending team.

## **PROFIT / LOSS ON SALE OF ASSETS**

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**6.15** DRAs divide the proceeds from the sale of an asset into an element that covers book value and a profit or loss on disposal.

**6.16** The book value is a benefit to the capital budget.

**6.17** The profit / loss on sale is in the capital budget. Profit is a benefit to the capital budget (negative spending) while loss is a cost (positive spending).

**6.18** When calculating profit and loss departments should include the value, where it can be measured, of any financial assets created in the terms of sale. This is most commonly in the form of overage agreements (see Chapter 7 for details).

## **STOCKS TREATED AS CAPITAL BUDGETS**

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### **When Stocks are treated as Capital in Budgets**

**6.19** DRAs do not treat purchases of stocks as investment in fixed assets. Rather, stock movements are treated as changes in current assets. Normally, budgets follow accounts in their treatment of stocks, and stocks are excluded from budgets until they are used, disposed of or written off.

**6.20** The net acquisition of stocks is an item of capital spending in national accounts and increases TME. Therefore it would be appropriate to score all net acquisitions of stocks in capital budgets. However in the interest of keeping down compliance costs we normally ask departments to follow the treatment in DRAs.

**6.21** Different budgeting rules are however appropriate where the item being acquired for stock would be the acquisition of a fixed asset if it were not being acquired for stock.

**6.22** For example, land acquired by English Partnerships for reclamation and development scores as capital expenditure in capital budgets.

**6.23** Similarly, if stock acquisitions are large, or set to increase significantly, it may be appropriate to score them in capital budgets.

**6.24** Where departments are aware of stock acquisitions that might fall into the categories above, they should consult the Treasury on whether treatment in capital budgets would be appropriate.

### **How to Score Stocks Treated as Capital in Budgets**

**6.25** Where stocks score in Capital Budgets they score like fixed asset transactions. The costs of purchase and improvement of land treated as stocks score in the capital budget. Disposal scores at net book value as a benefit in the capital budget. Any write offs prior to disposal should be treated in accordance with the rules on impairments detailed in the chapter on resource budgets. Any profit / loss on disposal score in the capital budget, but separately from the book value.

### **DEBTORS AND PRE-PAYMENTS TREATED AS CAPITAL IN BUDGETS**

**6.26** Normally, movements in debtors and pre-payments are treated as working capital and do not impact directly on budgets – see Chapter 2.

### **When Long-term Debtors and Pre-payments are treated as Capital in Budgets**

**6.27** Debtors and prepayments are assets, and typically arise where a department has delivered goods and services, but is yet to receive payment, or where the department has prepaid for goods or services, Changes in debtors generally represent a movement in working capital, that in general terms only impacts on the budgeting framework through the cost of capital charge or if written off.

**6.28** However in certain cases movements in debtors are more akin to net lending, for example in complex contractual scenarios over an extended timeframe (that is, more than one year). In these cases the budgeting system scores movements in debtors in the capital budget of the department concerned. That scoring is intended to capture and control the impact of what is in effect lending on Public Sector Net Debt, the measure of the Sustainable Investment Rule.

**6.29** Accordingly, departments should treat, as net lending, in their capital DEL the whole amount of transactions that meet both of the following criteria:

- First, the transaction is either:
  - A long-term debtor or pre-payment (that is a debtor that will last over 12 months at the point that the prepayment is made), or
  - A short-term debtor or prepayment where there is an expectation that it will be renewed so that it is in effect long term;
- Second the total value of the debtor / prepayment involved is above £20m (where there is a related group of pre-payments, the £20m limit applies to the group).

### **How to Score Debtors and Pre-payments Treated as Capital in Budgets**

**6.30** The scoring in such cases would be:

- Capital budgets would score as net lending the full amount of such pre-payments;
- Any increase in the value of the prepayment as the discount unwinds scores as increased net lending (i.e. a cost)
- As the pre-payment is utilised, the capital budget would take a benefit (i.e. negative net lending).

**6.31** In other words, the treatment would be on a net basis like the treatment of loan principal.

**6.32** Note that the transaction financed by the prepayment would also score in budgets in the normal way. For example a payment of rental costs scores in the resource budget in the year the services are consumed, whether prepaid or not. In the case of capital budget transactions, the utilisation of the pre-payment would provide an element of budget cover.

**6.33** Note that the OCS will show a cost of capital charge on the asset, and in addition if the prepayment is discounted a credit entry as that discount unwinds (the credit entry represents an interest payment from the holder of the prepaid cash). Both these transactions score in the resource budget.

## CAPITAL GRANTS TO THE PRIVATE SECTOR AND ABROAD

**6.34** DRAs do not distinguish between current grants and subsidies and capital grants. However, the national accounts do, with current grants and subsidies affecting the current balance and capital grants not. Therefore departments have to distinguish between current and capital grants according to national accounts principles. Current grants and subsidies score in the Resource Budget; capital grants score in the Capital Budget.

**6.35** Capital grants are unrequited transfer payments, which the recipient has to use to:

- Buy capital assets (land, buildings, machinery etc.); or
- Buy stocks; or
- Repay debt (but not to pay early repayment debt interest premia).

**6.36** Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants or subsidies.

**6.37** Capital grants are imputed in the national accounts (but not in budgets – which show loan write-offs) where debts are written off “by mutual consent”, that is, where the debtor could repay the loan or debt but for policy reasons the creditor department chooses not to enforce the debt. See the section on Bad Debt in Chapter 2 for more information.

**6.38** Payments of compensation to owners of capital goods destroyed or damaged by acts of war or natural disasters count as capital grants.

**6.39** Major payments in compensation for extensive damage or serious injuries not covered by insurance policies may also count as capital grants – departments should consult the Treasury.

**6.40** Pensions bulk transfer payments are treated as capital transactions in the national accounts and pass through resource budgets (albeit offset by the release of the provision) – see chapter on pensions.

### Capital grants in kind

**6.41** Where a fixed asset is gifted by a department, capital budgets will show no net impact. However departments are requested to note that gifting an asset does not represent a write-off or a loss on disposal – gifts made in this manner are treated as capital grants in kind, they are a transfer of value from the department to a third party. To achieve the correct recording needed to represent this within the System of National Accounts departments must make up to three entries:

- A capital grant, as a cost to the capital budget equal to the open market value of the fixed asset being gifted.
- The disposal of asset, as a benefit to the capital budget equal to the net book value of the asset.
- (only if necessary) Profit/loss on disposal. This should be the difference between the open market value and the book value.

### Provisions in respect of capital grants

**6.42** Where departments take provisions in respect of an obligation to pay a capital grant, the take-up, revaluation and release of the provision should score in the Capital Budget, as well as the grant itself. If so, then normally the payment of the grant itself should be offset by the release of the provision.

### Cost of Capital Credit on Provisions in Respect of Capital Grants

**6.43** Provisions attract a cost of capital credit. That credit in a sense offsets the increase in value of the provision as the discount unwinds year by year. Departments should therefore include the cost of capital credit in their capital budgets.

**6.44** Where a department believes that separating out these cost of capital credits is more trouble than it is worth, the department may include the cost of capital credit in its resource budget along with other cost of capital charges and credits. Departments should make the same choice for all cost of capital credits on capital grants. Having made a choice, departments should not alter it without the agreement of the Treasury.

**6.45** Note that where a liability corresponding to a capital grant is classified as a creditor the corresponding cost of capital credit should score in the resource budget in the normal way, as there is no unwinding of the discount to take into consideration.

### CAPITALISED PROVISIONS

**6.46** Provisions are liabilities of uncertain timing or amount that, as a result of a past event, will more likely than not require the transfer of economic benefits from one party to another. In most cases incurring a liability will lead to a cost in the I&E or OCS of the party recognising the liability.

**6.47** However in some - highly unusual - cases, the recognition of that liability is also the trigger point to recognise access to future economic benefits for the holder of the

liability. In those cases it may be appropriate not to show a cost in the I&E / OCS. Instead the accounts would show an increase in fixed assets as well as the liability.

**6.48** If a department believes that it should be capitalising their provisions in this way they should seek clarification from their usual Treasury Financial Reporting Policy Team contact in the first instance.

**6.49** In cases where HMT's FRP team have agreed that capitalising the provision is the correct treatment in the DRA the capital budget will score the recognition of the liability.

**6.50** When the actual cash payment is transacted this will score in the Capital Budget too but it will be offset by the release of the provision so there is no further overall net impact on the capital budget.

### Resource budget implications

**6.51** The Resource Budget scores the items that score in the OCS in DRAs:

- Depreciation on the asset,
- Cost of capital charge on the asset,
- Cost of capital credit on the liability, and
- The unwinding of the discount.

### Creditors in respect of capital assets

**6.52** No special treatment applies where a department has a creditor in respect of the acquisition of a capital asset. In other words the capital expenditure scores in the capital budget at the same time as the asset is recognised in the accounts and any cost of capital charges / credits fall on the resource budget as normal. The cash transaction is then a movement in cash and creditors in accounts and outside the budgeting framework.

### MoD – SINGLE USE FIGHTING EQUIPMENT AND DUAL PURPOSE EQUIPMENT

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**6.53** National Accounts differentiates between single and dual use military equipment. Spending on single use military equipment is classified as current expenditure. Single use military assets are those that could not be used by civilian organisations for the production of goods and services (i.e. weapons and equipment that supports and delivers such weapons).

**6.54** Expenditure on dual use military equipment is treated as capital in National Accounts. Dual assets are those that could be used by civilian organisations for the production of goods and services such as airfields, docks, roads and hospitals. Expenditure on almost all fixed structures will be treated as capital expenditure in the national accounts as is that on types of equipment which have alternative non-military uses - such as transport equipment, computers and communication equipment and hospital equipment.

**6.55** This distinction is not however maintained in the capital budget, and all spending by MOD on both single and dual use asset that leads to an increase in their fixed assets scores in the capital budget in the normal manner. However in order to

ensure that the national accounts record spending correctly, and HMT can budget effectively this distinction must be maintained, and recorded separately.



# 7

## INCOME AND THE CAPITAL BUDGET

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**7.1** This chapter covers the treatment of Capital income in budgets. The same rules apply to NDPBs as to Departments. A separate chapter deals with income and the resource budget. The chapter on loans covers departments' income in respect of loans.

**7.2** The chapter sets out which income benefits the Capital Budget, comments on the timing of income and explains when departments may retain income above the level set in the SR.

### INCOME THAT MAY NORMALLY BE SET AGAINST BUDGETS

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**7.3** The following items of capital income may normally be set against capital budgets within the terms set out below. Only income in connexion with DEL programmes scores in capital budget DEL:

- Income from capital asset sales – the book value plus any profit/loss on disposal scores as income in the capital budget.
- Income from sale of stocks that score in the capital budget (see section on stocks in CDEL in chapter 6)
- Capital grants from the private sector including developer contributions and capital donations
- Income obtained from National Lottery distributing bodies that finances capital expenditure
- Capital Grants from the EC
- Capital Royalties
- Privatisation proceeds (always in AME not DEL)
- Income received from exercising an overage (clawback) agreement

### FURTHER INFORMATION ON CERTAIN TYPES OF INCOME

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#### Disposal of Capital Assets

**7.4** When a department or NDPB disposes of an asset, the net book value of this asset scores as negative capital DEL. Profit/loss on disposal also scores in capital DEL but is recorded separately from the book value. Profits are a benefit so are negative, and losses are a cost so will be positive capital DEL.

#### Income from National Lottery Distributing Bodies

**7.5** The Government's income from the National Lottery is a tax. The spending by the National Lottery distributing bodies counts as expenditure in AME.

**7.6** Where a Government department or NDPB that is not a National Lottery distributing body obtains income from a distributing body to finance spending in the Capital Budget DEL it should take the income into budgets as negative Capital Budget DEL.

## Capital Grants from the EC

**7.7** Income from the EC may be netted off Capital Budget DEL if it is in support of DEL spending and if it supports capital expenditure.

**7.8** Departments are reminded that income from the EC Budget is not free to the UK. The budget is funded by Member States, including the UK. Income received from the budget incurs a cost to the UK Exchequer, both by increasing the UK's gross contribution to the budget and by reducing the UK's budget abatement. In practice each £1 received costs the Exchequer about £0.72.

## Royalties - Capital or Current?

**7.9** It may be difficult to tell whether a one-off payment covering a number of years is for the sale of an asset or an upfront payment in respect of a number of years' royalty. Similarly, it may be hard to test whether a payment spread over a number of years is for the sale of an asset or a current royalty.

**7.10** The tests used by commercial or GAAP accountants applying Financial Reporting Standard 5 - Reporting the Substance of a Transaction, will be a guide as to whether a capital asset has been sold or rented out. For larger cases, departments should consult the Treasury to ensure that they are treating the income in accordance with the national accounts.

**7.11** In general:

- A sale leading to a current receipt - royalty for the use of an asset - would be a sale offering the user a right to use the asset for a period of time, but underlying ownership of the asset or resource would stay with the vendor. Changes in the value of the asset would not normally affect the user as they would not be able to sell on their rights; but
- Capital income - sale of an asset - would be when the buyer had obtained:
  1. All significant rights or other access to benefits relating to that asset; and
  2. All significant exposure to the risks inherent in those benefits.

**7.12** Ownership rights would typically include unimpeded use of the asset, right to resell the asset and benefit or suffer from changes in the value of the asset. Typically, capital income comes as a single receipt at the time of sale, but the cash receipt may come in tranches (deferred consideration). Where the asset has been sold outright, the income is capital and the whole of the income is to be treated as negative public expenditure.

## Privatisation Proceeds

**7.13** Privatisation proceeds score in AME, even where the asset or business being sold was on a DEL programme.

## Proceeds from Disposal of Shares in Public Private Partnerships (PPPs)

**7.14** Sale of shares in a **private sector PPP** is the disposal of a financial asset by the department. As a form of privatisation, the income scores as a benefit to the Capital Budget: AME.

**7.15** Sale of shares in a **public sector PPP** is a form of public sector borrowing from the market, whether it is undertaken by the PPP or by the department. So any cash received by the borrower is not a benefit to budgets. (Market borrowing by a public corporation is a cost in budgets; departmental spending financed by borrowing is a cost in budgets.)

### Overage Agreements

**7.16** When a department disposes of surplus property, it will enter into an agreement with the purchaser; it is common for these agreements to contain a clause on overage / clawback. The intention of an overage clause is to allow the department to gain some benefit if the purchaser should sell the property on in the future for a profit above that envisaged at the time.

**7.17** This clause represents a financial asset and should be recorded on the department's balance sheet accordingly. The amount and timing of this financial asset will be subject to uncertainty, and departments may find it difficult to value. In these circumstances departments should refer to accounting guidance and use the same valuation in budgets.

**7.18** Since this financial asset comprises part of the value of the property being disposed of, in effect, allows the public sector to retain part of the value of the property. So on disposal the scoring in CDEL should be:

- Total OMV of the disposed asset (negative CDEL)
- The OMV of the overage agreement (positive CDEL)

These two effects together will benefit CDEL by the amount of the agreed sale price.

**7.19** When the financial asset is disposed of, either because of maturity or open market sale, the amount received by the department will score as negative CDEL.

### TIMING OF RECORDING OF INCOME

**7.20** In general, departments should record capital income for budgets at the same time as they record it for accounts.

**7.21** Income from capital transfers (i.e. grants, developer contributions and donations received) other than income from the EC should be recorded for budgeting purposes at the time that the income falls due, that is, when the cash is due to be paid. That may be different from the recording in DRAs if exceptionally the accrual of the income has been related to work done at a quite different time.

**7.22** Capital transfers from the EC should be recorded for budgets in line with DRAs. Departments are encouraged, where appropriate, to accrue income from the EC to match the payments that the income finances. The reason for the different treatment is that where income from the EC finances a payment to a third party it is treated for the national accounts as a direct payment from the EC to the third party recipient. By accruing the income to the date of the payment it is easier to derive the national accounts number.

## WHEN DEPARTMENTS MAY RETAIN ADDITIONAL NEGATIVE DEL INCOME

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**7.23** In some cases capital income does no more than cover the costs of replacing the asset disposed of. For example, a department might sell one office block and spend the money on moving into another that suits it better.

**7.24** In other cases, income can be large in comparison with the needs for replacement, or there may be no replacement. Examples are selling an invention in the open market, or when a department moves from an expensive building into a cheaper one. In these cases the Government has to balance two considerations:

- Departments should be encouraged to obtain such income by being allowed to retain and spend it; and
- Government funds should be prioritised across the whole range of spending to where they would do most good.

**7.25** And we need to keep the rules simple.

**7.26** Departmental budgets are set in the SR net of negative CDEL income. The expected level of negative CDEL income should inform the SR settlement. So, the SR process should be used to identify the expected level of Department's income, any expected changes, and an assessment of the potential for new income. The SR settlement will include an explicit statement of the expected level of income in the years of the SR period. And Departments should reflect that level of income in their Departmental Investment Strategies.

**7.27** Departments should therefore ensure that their SR proposals and Departmental Investment Strategies set out their asset management and disposal strategy. That strategy should reflect a number of strands, including:

- The **Lyons review** into the better management of public sector assets recommended that departments and their sponsored bodies, as part of their wider business and improved asset management strategies, should seek to dispose of capital assets that are no longer required as a contribution to the Government's objective of securing £30 billion of asset disposal by 2010;
- Departments should set out how they might alter their mix of capital assets, to retain high levels of efficiency;
- Departments should not hold on to assets unnecessarily – the cost of capital charge is an incentive to dispose of unneeded assets; and
- The Treasury encourages Departments to engage in **Wider Market activities**. Not only does the income they generate support public spending, but also undertaking pioneering or inventive activity can enhance the skill set of civil servants, and can lead to more innovative provision of public services. The SR provides an opportunity for challenging departments' expected level of such activities and encouraging departments to exploit spare capacity. At this stage in the evolution of the Wider Markets initiative, the Treasury believes that it creates a helpful incentive for Departments to be allowed to keep wider markets income classified as negative DEL, and will set Departmental Expenditure Limits in this spirit.

**7.28** Departments will be allowed to keep the negative DEL income that they obtain in the SR period up to the amount that was taken into account in the SR. Income cannot be predicted wholly accurately, and the Treasury wishes to encourage departments to find new income streams where appropriate. Departments may therefore in any year retain negative CDEL income up to 20% above the level envisaged for that year as part of the SR settlement and set out in their DIS without an adjustment to budgets.

**7.29** If departments expect to obtain more income than provided for above, they should talk to the Treasury about whether they may retain all or part of the income without an adjustment to budgets. When considering proposals, the Treasury will wish in particular to encourage Wider Markets activities and Lyons asset disposals where opportunities could not be foreseen at the time of the SR and other cases where the additional income represents the results of positive management action, as opposed to under-forecasting.



# 8

## LOANS TO THE PRIVATE SECTOR

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**8.1** This chapter applies to loans to the private sector and overseas bodies. For loans to public corporations see the PCs chapter.

**8.2** Loans are payments made to another party where the expectation is that the payment will be wholly repaid, normally with interest, and normally to a fixed regular payment schedule.

**8.3** Loans need to be distinguished from deposits:

- Policy lending is where the department lends money as an act of policy. So, for example, we lend to students or to certain sorts of business because we wish to support them in this way; and
- Deposits are also a form of lending, but are made because the public body has spare cash and needs to put it somewhere. Typically deposits are placed with a bank in order to obtain the maximum risk-weighted rate of interest. There is no intention to support the institution holding the deposit.

**8.4** This chapter is concerned with policy lending only. The making and withdrawing of deposits do not score in budgets, though deposits themselves may attract a cost of capital charge.

### LOANS OTHER THAN STUDENT LOANS

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**8.5** The budget treatment is:

- The Resource Budget will score:
  1. An appropriate cost of capital charge (which may differ substantially from the standard 3.5% depending on the circumstances),
  2. Less interest income,
  3. New provisions for bad debts and increases or decreases in the value of provisions, and
  4. Bad debts less the release of provisions (these two transactions may offset each other);
- The Capital Budget will score:

Net lending (i.e. transactions in loan principal).

**8.6** Normally, lending scores in DEL. where exceptionally a loan scheme is in AME (e.g. Social Fund), generally the associated resource transactions will score in Resource AME.

**8.7** For loans made to the private sector or for equity invested in the private sector a higher cost of capital will normally be appropriate than the cost of capital used for the department's standard assets. Departments are asked to agree a suitable cost of capital charge with their spending team in HMT for each scheme of loans or equity investments.

## STUDENT LOANS – MAIN PROVISION

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**8.8** Student loans score in the following way that follows entirely the accounting.

**8.9** Resource Budget DEL:

- The following items are a cost to departments budgets:
  1. Set-up and revaluation of provision in respect of the implied subsidy the student receives on the loan (i.e. the difference between the discount rate and interest receivable)
  2. Unwinding of the discount on provisions
  3. Inflation adjustment
  4. Cost of capital charge on the asset
- The following items are a benefit to departments' budgets:
  1. Interest income receivable
  2. Amount credited to the OCS from the provision for the subsidy
  3. Cost of capital credit on the provision

**8.10** The accounts should be recorded so as to ensure that there is only a cost in year 1, with interest receivable, cost of capital credit, and the amount credited to the OCS from the balance sheet covering the unwinding of the discount, cost of capital charge and the inflation adjustment in subsequent years.

### Student Loans – provision for bad debts

**8.11** In addition to the main provision the accounts and budgets should recognise a separate provision for bad debt, recorded as described in the section on provisions in this guidance. Moreover any bad debts that are realised are deemed to be policy write offs, and as such are treated as debt write offs by mutual consent. So they should be recorded in a way that allows them to be identified as capital transfers to the private sector (see COINS recording guidance).

## NON-DEPARTMENTAL PUBLIC BODIES

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### COVERAGE OF THIS CHAPTER

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**9.1** This chapter applies to the budgeting of all bodies in the central government sector (as defined by the Office for National Statistics) other than Government departments (including executive agencies), and NHS producer trusts (England) and bodies referred to in the following two paragraphs. It applies whether or not the Cabinet Office has designated a body as a Non Departmental Public Body (NDPB - see the NDPB section in Chapter 1). So in this chapter we are using "NDPB" as convenient shorthand, rather than in the strict Cabinet Office sense of the word, although the majority of bodies to which the chapter applies will be true NDPBs.

**9.2** Some smaller NDPBs, typically **advisory bodies**, are treated as part of the department for expenditure control and are within the resource accounting boundary. They would naturally fall to be budgeted for like the department itself and so there is no need for the guidance in this chapter to apply. Similarly, the **Crown NDPBs** that are on vote for their income and expenditure will also fall naturally to be budgeted for like departments, and so there is no need for this chapter to apply.

**9.3** This chapter does not apply to **public corporations**. Most **trading funds** are public corporations, but some may be central government bodies. This chapter applies to any trading fund that is a central government body.

### OVERVIEW

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**9.4** NDPBs' resource consumption and capital expenditure score in the departments' resource and capital DEL in the same way as the department's own spending. So departments should normally use the output from the NDPB's own accruals accounts as the basis for working out the NDPB's impact on budgets. That should help to ensure that non-cash items in particular are recorded.

**9.5** Budgets include expenditure that NDPBs finance themselves from income that is not negative DEL, use of reserves or borrowing (where, exceptionally, permitted).

**9.6** The grant in aid paid by the department and any other financing facilities made available by the department are outside the department's budget.

### SUBSIDIARIES

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**9.7** Where an NDPB has a subsidiary that is itself a body in the central government sector that subsidiary will be consolidated with the NDPB for budgeting purposes.

**9.8** Where an NDPB has a subsidiary that is a public corporation, that subsidiary will score in budgets like public corporations accountable directly to Ministers and the public corporation will impact on the parent department's overall DEL. Departments may place the DEL impact in the DEL allocated to the NDPB.

**9.9** Where an NDPB enters into a joint venture, departments need to be clear whether the joint venture is classified to the public or private sector. If to the public sector departments need to be clear where the budgeting impact falls.

## PLANNING AND MONITORING

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**9.10** Departments are expected to set their NDPBs firm Resource and Capital DEL budgets for the year ahead. Departments are generally advised to set firm or indicative budgets for forward years to help NDPBs plan.

**9.11** Departments should monitor in-year both:

- The NDPB's draw-down of cash grant in aid; and
- The NDPB's expenditure in budgets.

## NDPB INCOME AND RECEIPTS

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**9.12** The NDPB's impact on the department's Resource Budget DEL is made up of its gross resource consumption less its negative DEL income. Similarly, the Capital Budget DEL is net only of negative DEL income. Whether NDPB income / receipts are negative DEL follows the same rules as for departmental receipts (see separate chapters). So, for example, charges for the sales of goods and services are typically negative DEL and the receipt of taxes are typically not. Expenditure financed in cash terms by non-budget income scores gross in budgets.

**9.13** Where a NDPB obtains income that is not negative DEL, the department may arrange for the NDPB to pass the cash to the department for surrender to the consolidated fund. Alternatively, the cash may be retained by the NDPB and offset the NDPB's need for cash grant in aid. Either way, income that is not negative DEL does not convey spending authority.

## BORROWING

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**9.14** Normally, NDPBs are not allowed to borrow. Where exceptionally they are allowed to borrow the spending financed by borrowing scores gross in budgets. This applies whatever the source of borrowing (department, market, European Investment Bank). The cash raised by borrowing does not score as negative DEL.

**9.15** Use of reserves – ie the run-down of savings – has the same effect overall as borrowing. So expenditure financed by the use of reserves counts as spending in budgets.

## CORPORATION TAX

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**9.16** Exceptionally, some NDPBs pay Corporation Tax. Such payments are non-budget, because payments within central government of taxes on income are consolidated out. NDPBs should not devote resources to tax minimisation or tax planning.

## DEPRECIATION

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**9.17** Depreciation charges are only offset by the release from the government grants reserve in cases where the grant would qualify for such treatment if it was in the hands of the department. Grant in aid is normally treated in accounts as financing and not credited to a government grant reserve, and there is no release from this reserve to cover related depreciation charges. To ensure consistency this also applies to other grants from departments to their agencies, not classified as grant-in-aid.

## CO-FUNDED NDPBs

**9.18** Where an NDPB receives grant-in-aid from more than one department then the budgeting treatment should follow one of three models. The treatment should be agreed with the relevant Treasury spending team. The models are represented diagrammatically in the Appendix to this chapter.

**9.19** The three models are:

**9.20 Model A: Vote to Vote.** Department A makes a voted cash payment to Department B. It is for the departments concerned to decide whether Department A's payment should cover a share of depreciation and cost of capital charges. Department B is the sponsor of the NDPB and pays it a single grant-in-aid, including an element in respect of the payment made by Department A. Department B takes responsibility for the budgetary impact of the NDPB's expenditure. The NDPB's expenditure should score in department B's Budgets (resource / capital and DEL/AME as appropriate). Department B's grant-in-aid to the NDPB scores outside the budget in the normal way. Department A's payment to department B scores in department A's DEL as a cost, and in department B's DEL as a benefit – thereby sharing the budgetary impact.

**9.21** In the numerical examples:

- Department A contributes £100. There are no non-cash costs associated with these activities; and
- The NDPB's total spending in DEL from all sources is £950 and it needs cash of £850.

Department budget	A's	Department B's Budget		Department B's grant in aid to the NDPB
		Departmental element	NDPB element	
£100		-£100	£950	£850

**9.22 Model B: Direct funding of the NDPB.** Department B is the sponsor of the NDPB. Department A may fund the NDPB direct (i.e. without going through Department B's Estimate). It is for the departments concerned to decide whether Department A's cash payment should cover a share of depreciation and cost of capital charges. If Department A's payment provides more cash than the NDPB needs, Department B can adjust the cash that it provides accordingly. The whole of the NDPB's resource consumption (net of any negative DEL income) should score in the sponsor department B's Resource budget, and capital expenditure in the Capital Budget. As in Model A, Department B's grant-in-aid does not score in its budget, but Department A scores its payment to the NDPB in its budget. Exceptionally, when the NDPB receives the payment from Department A, it should be treated as negative DEL.

Department budget	A's	Department B's Budget		Department B's grant in aid to the NDPB
		Departmental element	NDPB element	
£100		-	£950 - £100 = £850	£750

**9.23 Model C: Virtual NDPBs.** Departments could agree that where funding from each department is clearly attributable to a specific programme of work, for budgeting purposes the NDPB should be divided into two virtual NDPBs, one answerable to Department A and the other to Department B. Each department funds its share of the NDPB, including non-cash items such as capital charges: here, each department shows the costs of a virtual NDPB, being its share of the NDPB's activities. Each department would include in its resource budget the NDPB's resource consumption in respect of the activities it carries out for that department, and would include the depreciation and cost of capital charge for the assets used for the department's policies. Each department therefore also scores its grant-in-aid outside its budget.

Department A's budget (NDPB element)	Department A's grant in aid to the NDPB	Department B's Budget (NDPB element)	Department B's grant in aid to the NDPB
£100	£100	£850	£750

**9.24** How to choose between the models:

- **Models A and B** both have the same budgeting impact (the minor department's payment to the NDPB scores in that department's budget and benefits the sponsoring department's overall budget) but the Estimates mechanics are different:

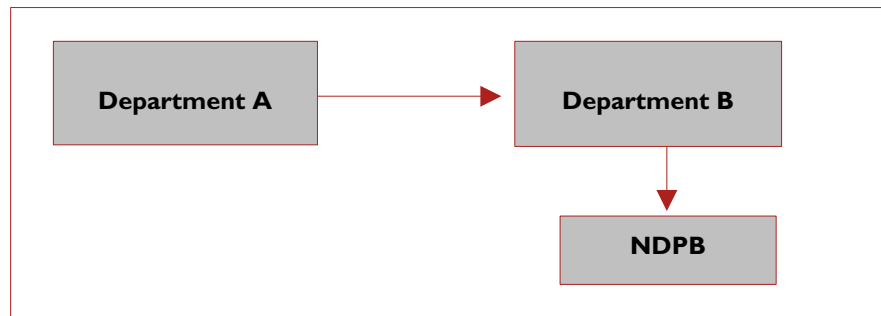
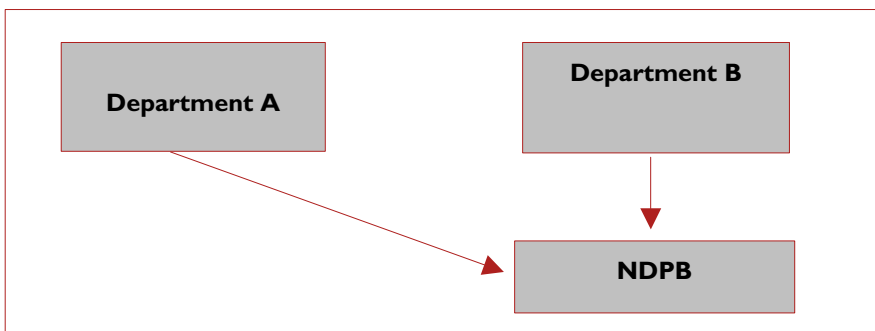
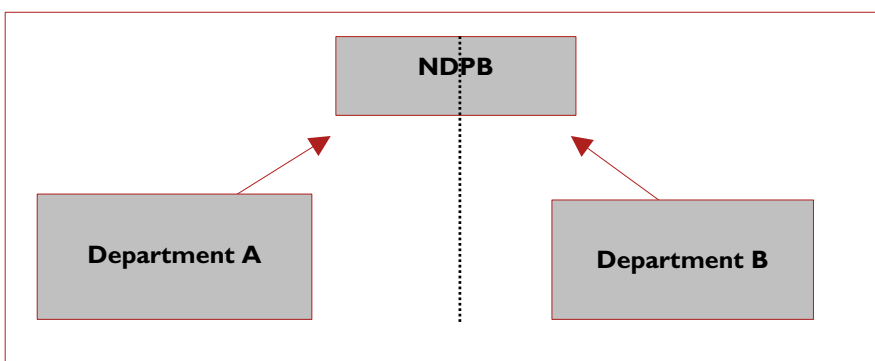
**Model A** should generally be favoured as it is the most transparent way of sharing the appropriate budgetary costs between departments and least likely to go wrong when ensuring that all the NDPB's expenditure is budgeted for in one department. Where a department favours models b or c they should discuss this with their spending team.

**Model B** is only appropriate where department A's contribution is minimal as there is the risk of confusion with the exceptional negative DEL treatment of a payment from a department to an NDPB.

- **Model C** will be difficult to realise if the NDPB does not clearly delineate which functions are pursued for which department. If departments follow Model C, the various departments need jointly to establish a mechanism to ensure that the whole of the NDPB's resource consumption appears in the resource budgets of the various departments when added together. The NDPB should be asked to produce a budget reconciliation, showing its total effect on DEL and how this is apportioned amongst the various departments.

## CERTAIN LEVY-FUNDED BODIES

**9.25** The spending of a number of levy-funded bodies, defined against the criteria in Appendix 5 to Chapter 1, is in AME, rather than DEL.

**APPENDIX I TO CHAPTER 9:****DIAGRAMS REPRESENTING THE MODELS FOR CO-FUNDED NDPBs****Model A****Model B****Model C**



**OVERVIEW**

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**10.1** Departmental budgets include Government support for local authorities. They do not include self-financed local authority spending.

**RESOURCE BUDGET**

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**10.2** The resource budget includes current grants to local authorities.

**10.3** DRAs do not distinguish between current and capital grants. Both go through the OCS. National accounts do distinguish between current and capital grants, and the budgeting treatment follows the national accounts distinction, with capital grants going through the capital budget.

**CAPITAL BUDGET**

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**10.4** Capital budgets include:

- Supported Capital Expenditure (Capital)
- Supported Capital Expenditure (Revenue)

**Supported Capital Expenditure (Capital)**

**10.5** Supported Capital Expenditure (Capital) is the local government finance term for capital grants. Capital grants may be distinguished from current grants in that capital grants have to be used by local authorities to:

- Buy capital assets (land, buildings, machinery etc.); or
- Buy stocks; or
- Pay capital grants to an individual or enterprise in the private sector or to a public corporation.

**10.6** Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants.

**10.7** Payments of compensation to local authorities for capital goods destroyed or damaged by natural disasters count as capital grants.

**Supported Capital Expenditure (Revenue)**

**10.8** Supported Capital Expenditure (Revenue) (SCE(R)) is the local government finance term for a promise by government to make available a stream of current support for local authority borrowing (including on balance sheet PFI) for the purpose of acquiring capital assets.

**10.9** Departmental budgets score the capital value of SCE(R). The current support is paid by DCLG (Local Government) as part of the Revenue Support Grant.

**10.10** For certain outturn years, departments score the capital values of the predecessor regime, credit approvals.

**10.11** Self-financed borrowing by local authorities under the prudential borrowing regime that is not supported by Government does not score in departmental budgets.

## **SWITCHING BETWEEN SUPPORT FOR LOCAL AUTHORITIES AND OTHER SPENDING**

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**10.12** From the financial year 2008-09 local government will be subject to its first full three-year settlement. This covers the period 2008-09 to 2010-11. Three-year settlements serve to increase certainty and assist local authority financial planning. They set the annual levels of Revenue Support Grant and redistributed business rates available to local authorities over the period

**10.13** Departments will, as far as possible, also allocate specific revenue and capital grants on the same basis. This means that levels of support for local authorities will effectively be set and will not be open to change.

**10.14** Where departments wish to add to support through creation of a new grant, or to alter the basis of an existing grant, they should consult the Treasury and DCLG. Departments should, however, note that the Government's policy is to reduce the amount of additional specific grants to local government, and in particular is committed to reducing the number of ring-fenced specific grants.

## **DEBT REPAYMENT GRANTS**

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**10.15** Grants to enable local authorities to repay debt principal do not score in budgets. Any payment of such a grant requires specific Treasury approval. Normally, approval of such a grant will be associated with offsetting budgetary adjustments.

**10.16** Where a department gives a grant that covers both debt repayment and the payment of any associated debt interest premia by the Local Authority to the debt provider the two elements of the grant should be separated. The element that covers premia should score as a current grant in budgets.

**10.17** Where a Local Authority uses a debt repayment grant to repay debt and receives a discount on that debt because of that then:

- In the majority of cases the department will have paid a grant to the Local Authority that was less than the amount of debt principal. The whole of the grant would count as a debt repayment grant;
- If the department shares in the value of the discount in the form of a payment from the LA this income will score outside budgets.

## **NDPB SUPPORT TO LOCAL AUTHORITIES**

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**10.18** NDPBs support to Local Authorities is treated in the same way as support for Local Authorities provided by departments.

## **PFI CREDITS**

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**10.19** PFI Credits are a promise by government to make available a stream of current support for local authorities that undertake PFI schemes that are off balance sheet. PFI credits are a proxy for the level of capital expenditure undertaken in a given PFI scheme

and the stream of current support represents the cost of financing that capital expenditure.

**10.20** PFI credits are outside budgets. However, as part of the SR settlement departments are allocated a specific amount of PFI credits. Departments may not exceed this amount except as provided below.

**10.21** The current support is paid by DCLG (Local Government).

### **Switching between PFI Credits and Supported Capital Expenditure**

**10.22** Departments may not switch PFI credits into Supported Capital Expenditure (Capital).

**10.23** Departments may freely switch Supported Capital Expenditure (Revenue) into PFI Credits. Departments' CDEL cover would be reduced and their non-budget provision for PFI Credits would be increased. Talk to your Treasury spending team if you wish to make such a switch.

### **PUBLIC CORPORATIONS ACCOUNTABLE TO LOCAL AUTHORITIES**

**10.24** Transactions between Local Authorities and their public corporations are recorded as transactions between those two sectors. If a department provides grants to a local authority which it in turn uses to support its public corporations then the transaction at the departmental level should be recorded as a transaction between central and local government, in resource or capital budgets as appropriate.

**10.25** Similarly, where a department provides SCE(R), which is for ultimate use by a public corporation accountable to a local authority it will score in the department's budget in the usual way.

### **CAPITALISATION DIRECTIONS**

**10.26** DCLG and the devolved administrations have the power to issue directions to local authorities to capitalise certain expenditure. Such directions do not change the nature of the expenditure from current to capital. Rather, they allow local authorities to borrow in order to finance current spending.

**10.27** There may be arguments for allowing local authorities to spread the incidence of certain lumpy current expenditure payments such as large redundancy payments in order to smooth the path of Council Tax. However, capitalisation directions contravene the principles of the golden rule.

**10.28** To protect the golden rule and manage the threat from capitalisation a ceiling of £100 million per annum was placed on the level of local authority capitalisation in England from 2008-09 onwards. A similar proportionate level may be agreed with the devolved administrations.

### **NEW BURDENS ON LOCAL AUTHORITIES**

**10.29** Where departments add to the burdens of local authorities they need to make funding available to local authorities by a budget transfer. Departments contemplating

a new burden should contact DCLG on the procedures to be followed – see Annex B for contacts.



# PUBLIC CORPORATIONS

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## DEFINITION OF PUBLIC CORPORATIONS

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**11.1** Public Corporations (PCs) are defined for the National Accounts by the Office for National Statistics (ONS). ONS publish a list of PCs in the publication MA23 (see Annex C for links). If a body is not listed in MA23 and you are in doubt as to whether it is a PC, or if you are considering setting up a body that might be a PC, you should contact HM Treasury.

**11.2** PCs are bodies that are controlled by government or another public corporation and that are market bodies, i.e. their income comes mainly from trading activities. Certain regulatory activities may count as trading.

**11.3** PCs may take various legal forms, including statutory bodies and Companies Act companies. Not all statutory bodies or Government-owned Companies Act companies are PCs, they may be NDPBs for example.

**11.4** Most **trading funds** are PCs. However, trading fund is a legal designation leading to a particular Estimates treatment. The ONS need to consider separately whether a particular trading fund meets the national accounts criteria for PC status. This chapter applies to trading funds that are PCs, with some special features – see below. Those trading funds that are not PCs are budgeted for as departments or NDPBs as appropriate. At present the only trading fund that is not a PC is DVLA.

**11.5** Some **Public Private Partnerships** (PPPs) may be PCs - see the passage on PPPs below. If they are PCs they are budgeted for like other PCs.

**11.6** Certain special arrangements apply to **self-financing public corporations** (SFPCs), which are set out below in this chapter.

**11.7** This chapter applies to public corporations answerable to Ministers. UK subsidiaries of a public corporation are included within the budgeting controls of the parent public corporation. Departments should discuss with the Treasury the budgeting arrangements for non-resident subsidiaries of a public corporation. These budgeting rules also apply to public corporations that are a joint venture of one or more public corporations accountable to Ministers. Different arrangements apply to public corporations answerable to local authorities (see chapter on support for local authorities).

## THE OBJECTIVES OF THE BUDGETING SYSTEM

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**11.8** The **aims of the budgeting framework** with regards to public corporations are:

- To support the government's fiscal objectives;
- To provide sensible and transparent incentives to managers in public corporations and in departments. This implies both:
  1. Ensuring that public corporations and their sponsoring departments face good incentives for the PC to generate the right return on capital; and

2. Appropriate levels of freedom to exercise commercial judgement, within appropriate delegated authority arrangements that protect departments.

**11.9** In addition, the budgeting framework aims to reduce compliance costs for departments by being based as far as is practicable on entries in departmental resource accounts and the PCs' accounts.

**11.10** The Government's **fiscal framework** applies to the whole of the public sector, that is general government (central and local government) and public corporations. In the fiscal framework:

- PCs' gross operating surplus is a benefit to the current balance used to measure the golden rule. Payments of interest and dividends to the private sector and depreciation make the current balance worse; and
- PCs' investment increases Net Borrowing, and their liabilities contribute to net debt.

**11.11** The EU's debt and deficit measures apply to general government. So they exclude the performance and spending of public corporations but include certain of departments' transactions with public corporations. That helps to explain why we need accurate measures of government's dealings with public corporations even though domestically we measure performance at the public sector level.

**11.12** It is for departments to manage their relationship with their public corporations in the way that best meets their needs. Departments should take advice from the **Shareholder Executive** where appropriate. The Shareholder Executive are based in the BERR but operate both in an executive function for departments in relation to some PCs and as advisors alongside departmental shareholder team for others. The Treasury issues guidance on public corporations policy in general and on trading funds policy.

**11.13** Departments are expected to set PCs clear objectives and challenging targets covering return on capital employed, dividend levels, efficiency, and quality of goods and services. The corporate plans of PCs should be subject to agreement by the department. That is particularly important where PCs have been under-performing against profits targets; face risks to performance, or might generate substantial levels of excess cash.

## TWO BASES FOR SCORING PUBLIC CORPORATIONS

**11.14** There are two bases for scoring public corporations:

- Most corporations score on an external finance basis;
- A few public corporations score on the consolidation basis.

**11.15** The effect on budgets and public corporations of the two bases is similar though not identical:

- In both cases, the department bears a cost of capital charge in respect of the public corporation;
- In both cases, the cost of capital charge is offset by means of a return from the public corporation which scores in the Resource Budget, though the return comes in different forms:

- Interest and dividends, in the case of public corporations scored on an external finance basis; and
- Profit, in the case of public corporations scored on the consolidation basis.

Where the department cannot obtain a return from the public corporation that covers the cost of capital, the department will suffer a shortfall in its Resource Budget. If the return exceeds the cost of capital, the department obtains a benefit to the Resource Budget;

- In both cases Subsidies would score in the Resource Budget;
- Capital budgets differ in their scoring:
  1. The external finance basis scores sources of finance (capital grants, borrowing) that supplement the public corporation's internal resources, and leaves public corporations free to spend self-generated funds on capital;
  2. The consolidation basis scores the public corporation's capital expenditure.

**11.16** Departments should use the external finance basis except where the Treasury has agreed that the consolidation basis may be used. A reason for using the consolidation basis is where there is no legal power to obtain from the public corporation payments of interest, dividend or sums of an equivalent nature to cover the cost of capital.

**11.17** This guidance now sets out the treatment of the common elements in budgeting:

- The capital base and the cost of capital charge, and
- Subsidies.

**11.18** The guidance then sets out separately the scoring of:

- The external finance basis,
- The consolidation basis, and
- The treatment of Self Financing Public Corporations, where the DEL/AME treatment is different from other public corporations, but which otherwise score on the same bases as other PCs.

**11.19** The table below sets out the main elements of the two bases of scoring in budgets in summary form:

	Resource Budget	Capital Budget
<b>External finance basis</b>	Cost of capital charge in respect of public corporations	Investment grants paid to public corporations
	Subsidies paid to public corporations	Net lending to public corporations
	Less Interest and dividends received from public corporations	Public corporations' market and overseas borrowing (including on balance sheet PFI)
		Less equity withdrawals from public corporations
<b>Consolidation basis</b>	Cost of capital charge in respect of public corporations	Capital expenditure of public corporations net of book value of sales of capital assets
	Subsidies paid to public corporations	
	Less profit/ plus loss of public corporations	

## CAPITAL EMPLOYED AND THE COST OF CAPITAL CHARGE

**11.20** Departments bear a cost of capital charge in respect of their ownership of, or responsibility for, a PC, based on their share of the underlying net assets (Capital Employed) of the PC.

**11.21** The charge is payable where:

- A department has an actual investment in a PC (normally equity or loans including PDC where applicable); and
- Where a department has no equity investment in a PC, except where the Treasury has agreed that it would be clearly inappropriate to include a cost of capital charge.

### Cost of Capital Charge and Accounts

**11.22** Where there is a cost of capital charge in accounts, the charge in budgets will be the same.

**11.23** Where budgets include a cost of capital charge and accounts do not the charge is worked out in the same way as for PCs where a cost of capital charge is shown in accounts.

### Setting the Rate of Return on Capital Employed

**Weighted Average Cost of Capital** **11.24** Departments should begin by establishing an appropriate post-tax Weighted Average Cost of Capital (WACC) for the PC. To work out the WACC, departments should

consider the whole of the Capital Employed in the PC, not just the department's share.

**11.25** Looked at from funding, Capital Employed comprises total equity, reserves, debt including all interest bearing liabilities and un-funded or under-funded pension liabilities.

**11.26** The appropriate WACC should be calculated using a cost of equity and cost of debt commensurate with the returns equity and debt investors would expect to receive from investing in a comparable private sector business with the same level of risk.

### Setting a Target Rate of Return

**11.27** A PC should be set a target return to earn at least its WACC multiplied by the overall Capital Employed. You should use the average Capital Employed over the year.

**11.28** In the case of PCs performing essentially government-type functions, 3.5% real will normally be appropriate. A PC competing in the market should typically be expected to return a higher rate to reflect the prevailing market rate. In 2007-08 these rates are in the range 5.5% to 15%.

**11.29** Where a PC has a monopoly, departments should ensure that the rate of return set is not exploitative.

**11.30** The right rate for the PC should be agreed with the Treasury when a new PC is set up and as part of the SR process.

### The Department's Cost of Capital Charge

**11.31** Once the total Capital Employed and target rate of return has been worked out, the department's cost of capital charge is calculated by deducting those elements on which the public corporation owes a return to another funder.

**11.32** In principle, the calculation is total rate of return:

- *Less* returns owed on loans from the private sector, including finance leases and other interest bearing liabilities;
- *Less* returns owed on the value of private sector equity stakes in the business;
- *Less* returns owed on unfunded or under-funded pension liabilities (which are a sort of debt owed to the private sector). Typically, we would expect these returns to be equal to either ASLC contributions or the return on corporate bonds.
- *Less* the amount of interest that the PC has to pay on any NLF loan (since the departmental asset in respect of a NLF loan is matched by a liability to the NLF).

### Regulated Businesses

**11.33** Budgets are set net of other departmental receipts. As a result, departmental allocations will take the expected receipts from PCs into account. In order to provide visibility of the cost of capital charge to Parliament and the public, the same amount is also scored as a non-cash cost of capital charge in resource budgets. Effectively, the non-cash cost of capital charge and near cash income have a neutral DEL impact.

**11.34** For example, if a department had agreed a total spend of £500m for 07/08, and it had a PC with expected interest and dividend payments to the department of £30m, the net resource budget would be equal to £470m. To increase the visibility of the cost of

capital charge, a non-cash charge of equal size to the expected receipts (£30m) will also be included in the budget.

**11.35** For some regulated businesses it may be appropriate to use a Regulatory Asset Base or Regulatory Capital Value (RCV) in respect of all or part of the PC as the Capital Base upon which a cost of capital charge is levied. If you think that would be the appropriate Capital Base you should talk to HM Treasury.

## Tax Planning

**11.36** The Government obtains a return from public corporations partly through the normal tax on corporations and partly as owner. Public corporations may undertake normal tax planning but should not incur wasteful expenditure on tax mitigation.

**11.37** The passage on WACC above assumed that public corporations have not operated in a way designed to reduce their tax bill. Where public corporations have undertaken tax mitigation – in particular where public corporations have high levels of interest-bearing debt – departments should consult the Treasury on how to work out the WACC so as to counter-act the effects of tax mitigation.

**11.38** DAO(GEN)08/03 gives more guidance to departments and NDPBs on tax planning.

## Trading Funds

**11.39** Trading funds that are public corporations are normally budgeted for exactly like other public corporations.

### Trading Funds that are Departments in their Own Right

**11.40** There are some special points to note about how to obtain this equivalent budgeting treatment where the trading fund is a department in its own right.

**11.41** Here, a **cost of capital charge** will be shown in the budget of the department that is treated as parent department for budgeting purposes (even though there may be no parent department for accounting purposes).

**11.42** As with other PCs, where the trading fund borrows directly from the National Loans Fund the amount of the capital charge is abated by the interest it pays on that borrowing.

**11.43** There are differences in the treatment of **loans made directly by the National Loans Fund to a Trading Fund** that is a department in its own right:

- For accounting purposes, the parent department does not recognise the loans arranged by the Trading Fund directly with the NLF. The parent department would recognise the value of its investment in the Trading Fund at the historical cost of the PDC.
- But for budgeting, borrowing by the Trading Fund scores in the parent department's capital DEL. That includes NLF loans. Loan repayments - although made directly to the NLF - score as a credit to the parent department's Capital DEL.

## Subsidies

**11.44** Subsidies are unrequited current payments to trading bodies:

- “Unrequited” payments should be distinguished from payments for goods and services, where the department obtains something direct in return for the payment. That the department obtains a general policy benefit from a subsidy does not stop it being unrequited.
- DRAs do not distinguish between subsidies and capital grants. Departments need to do so for budgets following national accounts principles. The distinction is needed because subsidy and expenditure financed by capital grants score differently in the fiscal framework: in effect subsidies affect the current balance used to measure performance against the golden rule, while capital grants do not. Capital grants are unrequited transfer payments that are intended to finance investment by the PC (see below).

## Under-performance

**11.45** Departments have to obtain a return from their PCs that covers the cost of capital charge agreed with the Treasury. Depending on the scoring basis, the return either comes in the form of interest and dividend income from the PC or in the form of profit. In order to be able to pay the necessary amount of interest and dividends, the PC needs to make enough profit, and the department should ensure that the PC is set a sufficiently challenging profits target and that it meets it. A dividend policy should then be agreed between the PC and its department as shareholder.

**11.46** If the PC does not make enough profit to cover the cost of capital charge or to enable it to pay the right level of interest and dividends, the department should pay a near cash subsidy to the PC so that it can make those payments. The reason for this requirement is to make it transparent to Parliament and public that a PC is under-performing and needs a subsidy to be paid. Where a department has no power to pay a subsidy or where such a subsidy would represent state aid, the overall effect on budgets is still the same, since it is the initial shortfall in PC performance against the cost of capital that impacts on the Budget.

**11.47** No subsidy need be paid if the Treasury and the department agree that the PC’s underperformance was due to normal volatility.

**11.48** It is important to make clear to PCs that only making the expected levels of profit after receiving a general subsidy is not good enough. The payment of a subsidy needs to be accompanied by the PC’s development of a recovery plan to get performance back on track.

## Social Policies

**11.49** Where a department wishes a PC to perform a social policy function then it should pay for that explicitly out of its budget rather than seeking to recover the costs by accepting PC underperformance or by over-charging PC customers. A department has two choices:

- It may pay a subsidy to the PC; or
- It may treat the PC as a handling agent. Here the department would pay the PC for its services in handling a transaction, while the transaction itself would score in the books of the department acting as principal. This route should be used when PCs are involved in the payment of grants to the private sector or local authorities, since grant-giving is not a market activity appropriate to PCs.

**11.50** It may be appropriate for subsidies to be paid by a department other than the sponsoring department where it is the other department that wants the social policy function to be carried out.

**11.51** Where a department wishes a PC to perform a social policy function and does not have legal power to pay a subsidy the department should contact HM Treasury to establish how best to obtain transparency.

**11.52** Departments should ensure that payment of subsidies is compatible with EU state aid legislation. [If in doubt, the BERR state aid team should be consulted.]

## Early Debt Redemption

**11.53** Where a department supports a PC to repay debt early and the PC has to pay an interest rate premium, the element of grant that covers the premium scores as a subsidy.

**11.54** That is the case even if the department makes a single grant payment in support of both principal repayment and early redemption premia: the two elements must be divided into a subsidy and a capital grant.

**11.55** Where the department is supporting only a part of the PC's total payment covering debt repayment and premium, the grant should be divided into subsidy and capital grant in the same proportions as the total payment by the PC is divided into premium and debt principal repayment.

## EXTERNAL FINANCE BASIS

**11.56** This section sets out the resource budget and capital budget scoring of public corporations on an external finance basis.

### Resource Budget

**11.57** For a public corporation the departmental Resource DEL scores:

- Subsidies paid to the PC (near cash)
- A cost of capital charge (non cash)
- *Minus* interest and dividend income received by departments from PCs (including interest on NLF loans) plus interest payable to the NLF (near cash)
- *Plus* a charge for bad debt for any loans from the department to the PC that have been written off because the PC is unable to repay them (non cash)
- *Plus* a charge for the impairment of any investment in PCs if it falls below historic cost (non cash)

**Interest 11.58** When debts are repaid early,

- Interest premia received from the PC count as current income in the DRA alongside other interest
- Interest rate discounts paid by the department to the PC count as current payments in resource DEL alongside other payments of interest a department may make.

**NLF Interest 11.59** Where a department's accounts show interest payable from PCs in respect of NLF loans and the subsequent payment of interest to the NLF then both should be reflected in the resource budget.

**Dividends 11.60** A dividend policy should be agreed between the PC and its department as shareholder. The department may choose not to recover the full cost of capital charge as a dividend (in order to allow for reinvestment of its profits by the PC). But, if it does not cover the cost of capital charge, the difference will be a charge on its Resource DEL.

**11.61** Note that the Operating Cost Statement (OCS), and budgets, will in Year 1 record the dividends expected to be received in respect of year 1, even though the cash will not be received until Year 2. That way dividend income covers the cost of capital charge for the year to which it relates.

**11.62** Not all receipts treated as dividends in DRAs count as dividends for budgeting. Please see the section on equity withdrawals below.

## Capital Budget

**11.63** The capital budget scores:

- Capital grants paid by the department to the PC
- Loans to the PC (includes voted loans, National Loans Fund loans and Public Works Loan Board loans), net of repayments
- Public Corporations Market and Overseas Borrowing net of repayments (PCMOB)
- Injections of equity into PCs net of repayments of equity by PCs. Equity includes Companies Act shares and Public Dividend Capital
- *Minus* equity withdrawals.

**11.64** Loans score in the capital budget whatever their purpose, that is whether they have been taken out to finance working capital or fixed assets investment.

**11.65** Note that the capital budget does not score capital expenditure by the PC, only the external support for capital expenditure. Subject to their agreeing their business plans with their department as shareholder, PCs are therefore free to invest insofar as they are able to finance their investment from asset sales, income that covers depreciation and a level of profits that exceeds what is needed to pay interest and dividends as agreed with the department.

**Capital Grants 11.66** Capital grants are unrequited transfer payments that are intended to finance investment by the PC. Investment includes the acquisition of any capital asset (land, buildings, vehicles, machinery etc.) and any financial asset (lending, company securities etc.). Grants to finance stock building should also be treated as capital grants. Grants to refinance pension funds are capital grants.

**11.67** Capital grants should be paid whenever the NLF has made a loan to a PC that the PC would otherwise be unable to repay – this demonstrates transparency to Parliament. For voted loans, follow the procedures in Government Accounting.

**11.68** Capital grants should also be paid where a department wishes a PC not to be burdened by a loan that it could repay, perhaps as part of a restructuring.

**11.69** Where a department supports a PC to repay debt early and the PC has to pay an interest rate premium, only the element of grant support that covers debt principal scores as a capital grant. The element that covers the premium scores as a subsidy.

**11.70** Grants from the department to make good a shortfall in a real pension fund score as capital grants in budgets and may need special recording. Departments contemplating such a grant should contact the Treasury.

**Public  
Corporations'  
Market and  
Overseas  
Borrowing  
(PCMOB)**

**11.71** Expenditure financed by PCMOB scores in the Government's fiscal framework like any other expenditure. Therefore PCMOB should be controlled. Where PCs wish to borrow on the market or overseas, departments should discuss proposals (other than for overdrafts) with HM Treasury. Approval for borrowing from the private sector will be permitted only in exceptional cases.

**11.72** PCs may normally only borrow from the market or overseas where at least one of the following applies:

- A facility is not provided by the public sector, for example overdrafts, and that facility is either necessary to the normal conduct of business or offers better value for money than other forms of finance;
- It would be cheaper for the PC to borrow on the market than for the government to borrow – this will almost never be the case, although some bodies may offer cheap loans, for example the European Investment Bank. Where a PC or department believes that a body's borrowing would be cheaper than the Exchequer's cost of borrowing it should first verify the assessment with the Treasury;
- It would be better value for money for the PC to borrow on the market than to borrow from Government. This might apply to some on balance sheet PFI procurement, for example;
- There is no power for government to lend to the PC.

**11.73** PCMOB scores in budgets as external finance.

**11.74** PCMOB does not include movements in PCs' bank deposits. PCMOB also does not include policy lending, that is lending undertaken in pursuit of the policy objectives of the Public Corporation rather than as a purely money management transaction.

**11.75** Further details of the Treasury's approach to lending to PCs, particularly ensuring an appropriate lending rate is used, can be found in DAO(GEN)13 / 04 – see Annex C for the link.

**Excess Cash  
Balances and  
Equity  
Withdrawals**

**11.76** Departments should ensure that PCs do not build up excessive cash balances. Cash balances are excessive if they are more than the amount needed to fund expenditure in the next three years as set out in the corporate plan that has been agreed with the department. Excess cash balances should be taken out of PCs so that the spending power that they represent is prioritised across the departmental group as a whole. Excess cash balances are normally taken out by means of equity withdrawals.

**11.77** Equity withdrawals benefit Capital Budgets. So a department may in effect borrow spending power from its PC, extracting cash in one year (obtaining a Capital DEL benefit) and making spending power available to the PC through Capital DEL in a later year.

**11.78** Equity withdrawals are exceptional payments from accumulated reserves or cash balances. They should be distinguished from dividends in that dividends should be paid out of the profits of the current year or the two previous years.

**11.79** Equity withdrawals do not need to result in an actual repayment of shares or PDC. That is, they may simply be a cash transaction.

**11.80** In DRAs, equity withdrawal of this type will go through the OCS as special dividends, in the same way as ordinary dividends. There is no impact on the department's balance sheet other than the increase in cash. However because of the differing treatment in national accounts and budgets departments need to distinguish equity withdrawals from dividends according to the principles described above.

**11.81** In the national accounts for general government, income from dividends scores as current income, while income from equity withdrawals scores 'below the line' as a financial transaction. They thus have a different impact on certain of the fiscal measures.

**11.82** Where equity withdrawals do result in an actual repayment of shares or PDC then there is no difference in treatment between DRAs and budgets. The double entry in DRAs would be to reduce fixed assets and increase cash. Where a profit is taken to the OCS the department should discuss proposals with their Treasury Spending team.

## CONSOLIDATION BASIS

**11.83** Only two public corporations score on the consolidation basis, Forest Enterprises and London Continental Railways.

### Resource Budget

**11.84** For a public corporation on the consolidation basis the departmental Resource DEL scores:

- Subsidies paid to the PC
- A cost of capital charge
- The PC's profit (negative sign, i.e. benefit to the Resource Budget) or loss (positive sign, a cost in the Resource Budget); and
- *Plus* a charge for bad debt for any loans from the department to the PC that have been written off because the PC is unable to repay them.

**11.85** It follows that interest and dividend income from public corporations is a non-budget transaction.

**Calculation of Profit / Loss** **11.86** The definition of profit or loss should normally be based on that used in the public corporation's own published accounts. The accounts basis should be current cost where this information is available. The following rules apply:

- Profit should be struck after taking account of any subsidy received (ie treating subsidy alongside trading income);
- Profit should be struck after payment of tax;

- Profit should be struck after interest income on deposits and other loans made by the public corporation (different rules apply to some trading funds);
- Profit should normally be struck before payment of interest and dividend to the department, but after payment of interest on NLF loans;
- Profit should be struck after payment of interest and dividends to the private sector and abroad;
- Profit should be struck after non-cash items such as depreciation, impairments and movements in provisions;
- Where the public corporation has a pension fund deficit, the profit measure should be after the deduction of implied interest on that deficit. Implied interest should be worked out by applying the cost of debt (used in the WACC) multiplied by the amount of the pension deficit;
- Profit should be struck after reversing the benefit of any release from the public corporation's donated assets reserve (or similar) where the grant was provided by the sponsor department or the European Community (public corporations should benefit in the profit and loss account from the release from the donated assets reserve (or similar) for donations from the private sector and for Lottery grants)
- Profit should be on a global basis after consolidating all subsidiaries. If a UK company is treated for the national accounts as a subsidiary of the public corporation then it should be treated as a subsidiary for budgeting. Overseas subsidiaries should also be consolidated; and
- Where profit includes a component for profit or loss on disposal of fixed assets, this should be removed as it is treated as a capital transaction in budgets (see 11.89).

**Monitoring Provisions** **11.87** Public corporation profit/ loss is treated as near-cash in budgets. Generally that is the appropriate treatment. It can go wrong, however, if the calculation of profit is heavily influenced by the take-up of provisions, or if there is a significant utilisation of provisions leading to cash outflows being charged to the balance sheet.

**11.88** Departments are therefore asked specifically to monitor the movements in provisions of public corporations and to talk with their Treasury spending team if these movements become significant.

## Capital Budget

**11.89** The parent department's Capital DEL scores:

- Capital expenditure by the PC;
- *Less* book value of disposals;
- *Less* profit and loss on disposals (profit being a benefit and loss a Capital cost).

**11.90** It follows that the department's capital transactions with the PC (capital grants, loans, equity withdrawals) are non-budget transfers. PCMOB does not score in budgets, but the capital expenditure that is supported by external finance (including on balance

sheet PFI - see later chapter) does score. Should departments be considering making non-budget capital grants to PCs scored on this basis to repay PCMOB then they should first discuss this with the Treasury.

**11.91** However, grants from the department to make good a shortfall in a real pension fund score as capital grants in budgets. That is the case even where the grant is paid to the PC, because it will not score in the PC's own capital expenditure. Departments contemplating such a grant should contact the Treasury.

## Excess Cash Balances

**11.92** As with other PCs, departments have a duty to ensure that PCs do not build up excess cash balances. The extraction of cash balances from a PC on a consolidation basis has no effect on budgets. Similarly, if the PC later needs cash from the department to finance capital expenditure the cash transfer will have no cost in budgets, though the capital expenditure will score.

## PFI

**11.93** For the treatment of PFI in budgets, please see the chapter on PFI.

## TREATMENT OF SELF-FINANCING PUBLIC CORPORATIONS

**11.94** Certain PCs have been designated by the Treasury as SFPCs and have special scoring. The scoring affects the AME or DEL treatment of spending. All SFPCs at present are scored on the external finance basis as set out above.

### Rationale and Criteria for SFPCs

**11.95** The main rationale underpinning SFPCs is that the Spending Review is used to prioritise spending financed by taxes. Where public corporations expect to recover expenditure from fee-payers in a competitive open market that expenditure may be excluded from the SR prioritisation process.

**11.96** However, SFPCs are still public bodies, their spending is still public spending, their activities impact on the fiscal framework, and their liabilities contribute to net debt. They therefore need to be managed and monitored.

**11.97** It is for the Chief Secretary to the Treasury to designate an SFPC where it is appropriate to the Treasury's conduct of the SR. The criteria that guide the Chief Secretary include:

- The PC must have traded profitably for a number of years, not requiring subsidies, and must be able to demonstrate that this state of affairs will continue into the future;
- The PC must be selling goods and services into an open market. It should not be selling regulatory services;
- The PC must either:
  1. Be selling primarily to customers outside general government; or
  2. Be a publicly announced candidate for privatisation or a PPP in the private sector.

## List of SFPCs

**11.98** The following PCs have been designated as SFPCs: Royal Mail Holdings plc, , BNFL, Commonwealth Development Corporation, Channel 4, Crown Estate, the Royal Mint and the Tote.

## Control of SFPCs

**11.99** Departments control Self-Financing Public Corporations in the same way as other PCs. In the SR, departments agree a forward plan in respect of the SFPCs alongside but not in the normal SR process. At this point, the status of the SFPC as self-financing should also be reviewed as to whether it still fulfils the classification criteria. As with other spending in AME, performance against the plan is monitored formally by departments and the Treasury in the run-up to each Budget and Pre-Budget report.

**11.100** The plan will include the appropriate cost of capital and the arrangements for underperformance, see below.

## Scoring in Budgets

**11.101** Self-Financing Public Corporations face the same budgeting rules and are scored in the same way as set out above, except that certain transactions score in AME rather than DEL. So, for SFPCs budgeted for on the external finance basis:

- Resource AME scores:
  1. A cost of capital charge (non cash)
  2. Minus interest and minus dividends paid by the SFPC to the department (and minus loan arrangement fees, where payable and where not excessive);
- Resource DEL scores:
  1. Any subsidy paid by the department
  2. Underperformance charges
- Capital AME scores:
  1. Loans to SFPCs (net)
  2. Equity injections in SFPCs (net)
  3. Purchase or sale of the shares of SFPCs
  4. Minus capital repayments made by SFPCs
  5. Minus equity withdrawals
  6. Plus PCMOB (net)
- Capital DEL scores:
 

Any capital grants paid to SFPCs

**11.102** The subsidy formally paid to the Crown Estate to cover certain administration costs scores in Resource AME. Dividend income received from the Crown Estate is outside budgets.

## Underperformance by SFPCs

**11.103** SFPCs should cover the cost of capital through their payments of interest and dividends.

**11.104** When returns from the SFPC fall short of the department's cost of capital charge, a near-cash underperformance charge equal to the short-fall will be charged to departmental DEL. This underperformance charge reflects the budgeting guidelines for PCs and is intended to incentivise departments to manage SFPCs appropriately as well as provide visibility of underperformance to Parliament and the wider public.

**11.105** In other words, the underperformance charge will be equal to

- The Department's cost of capital charge (as in Para 11.32)
- *Plus* retained loss after interest and dividend payments, if applicable
- *Less* any interest and dividends that the SFPC has paid to the department.

**11.106** During the SR period, departments may be able to negotiate a cap on their exposure to underperformance charges. On an exceptional basis, e.g. if the SFPC is undergoing a restructuring programme, it may also be possible to use a recovery target rate of return for calculation of the underperformance charge. However, when an SFPC underperforms on an ongoing basis, reclassification as a PC should be considered as part of the SR process.

## PUBLIC PRIVATE PARTNERSHIPS

**11.107** PPPs that are entities in their own right may be classified by the ONS to the public or private sectors. In some PPPs, shares may be sold and the PC remains in the public sector. In other cases (e.g. NATS), shares may be sold and the PC may move into the private sector. The ONS takes into account a range of factors when considering classification and not simply the percentage of government shareholding.

### Private Sector PPPs

**11.108** The holding of shares in a private sector PPP is the holding of an investment. The cost of capital charge scores in the Resource Budget DEL in the normal way, as does interest and dividend income.

**11.109** Purchase of shares in a private sector PPP and net lending to a private sector PPP scores in Capital Budget DEL like other financial transactions.

**11.110** Sale of shares in a private sector PPP is the disposal of a financial asset by the department. The income scores as a benefit to the Capital Budget: AME.

### Public Sector PPPs

**11.111** Sale of shares in a public sector PPP is a form of public sector market borrowing, whether it is undertaken by the PC or by the department. So any cash received by the borrower is not a benefit to budgets. PCMOB is a cost in budgets.

**11.112** In the case of SFPCs, PCMOB may only be undertaken in line with the agreed forward plan. The plan will set out what should be done with the sum realised by a share sale. In default of other arrangements, the sum should be taken out of the SFPC by way of an equity withdrawal in order to offset the PCMOB.

## PRIVATISATION

**11.113** Sale of shares on the privatisation of a public corporation is the disposal of a financial asset by the department. The income scores as a benefit to the Capital Budget: AME.

## SUPPLEMENTARY INFORMATION ON PUBLIC CORPORATIONS

**11.114** Departments are asked to provide certain financial information about PCs in addition to the budget data.

### Capital Expenditure

**11.115** Even though for most PCs capital expenditure does not score in budgets we ask departments to obtain information about all PCs' outturn and plan capital expenditure and to pass it on to the Treasury via COINS using a non-budget identifier.

**11.116** This information needs to be accurate and kept up to date because:

- It is information that departments should use in any event as part of their monitoring of PCs
- The information feeds into the national accounts measures of spending and borrowing, including the fiscal framework
- The information is published in PESA separately for each PC and is used in the functional and regional analyses of public sector spending, including tables that appear in Departmental Reports.

**11.117** The information that is required is:

- Gross capital expenditure, including land, buildings, vehicles and machinery
- *Less* (actual) sales proceed
- Additions to stocks (net)

### Gross Operating Surplus

**11.118** In addition, for the larger public corporations, the Treasury seeks special non-COINS returns of outturn and plan gross operating surplus (broadly, profit before depreciation).

**11.119** This information is useful to the Treasury as gross operating surplus is an item on the revenue side of the Surplus on the Current Budget, used to measure achievement of the Golden Rule.

# 12

## NHS TRUSTS

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**12.1** NHS trusts are central government bodies. In previous years Trusts have been subject to special budgeting arrangements, in 2007/08 this treatment was ended and the treatment was changed to match other central government bodies (such as NDPBs).

### NHS TRUSTS

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#### Primary Care Trusts

**12.2** NHS primary care trusts and other purchasing bodies score in budgets in the same way as other central government bodies – departments or NDPBs.

**12.3** Their and DoH's payments to NHS producer trusts score as procurement spending or, exceptionally, subsidies. Capital grants and net lending to producer trusts do not score. Dividends and interest received from NHS trusts do not score in budgets.

**12.4** The element of procurement that covers producer trusts' depreciation charges scores as near-cash in resource DEL. Prior to 2006/07 this amount scored outside of budgets.

#### Provider Trusts

**12.5** This passage applies to NHS Foundation Trusts, NHS Hospital Trusts, NHS Ambulance Trusts and other NHS trusts that provide health care.

**12.6** Originally Trusts were classified as PCs so scored on the consolidation basis reporting only their profit/loss. Following a reclassification to CG in 2003, the scoring of Trusts has been amended.

**12.7** The treatment of NHS Trusts has now changed to bring it into line with the rest of central government. Provider Trusts now score in DH's budget on the same basis as NDPBs and Primary Care Trusts. This change was made during 2007/08.

**12.8** Payments from PCTs to Provider Trusts should be treated as sales of services by the Trusts. This will net-off within DH's budget.

### NHS TRUSTS (SCOTLAND, WALES AND NORTHERN IRELAND)

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**12.9** NHS trusts in Scotland, Wales and Northern Ireland score in budgets in the same way as NHS Trusts in England.

### PFI

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**12.10** PFI deals undertaken by NHS Trusts are treated in the same way as deals undertaken by NDPBs or departments.



**13.1** This chapter has separate sections for the following cases:

- A: Employing departments and NDPBs who contribute to multi-employer un-funded pension schemes
- B: Departments and NDPBs who contribute to and run funded pension schemes
- C: Departments and NDPBs who run their own un-funded, by analogy, pension schemes – that is schemes run by analogy to the multi-employer pension schemes
- D: Administrators who run multi-employer un-funded pension schemes
- E: Bulk transfers to funded schemes

### **SECTION A: EMPLOYING DEPARTMENTS THAT CONTRIBUTE TO MULTI-EMPLOYER UN-FUNDED PENSION SCHEMES**

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**13.2** Departments are required to recognise in their budgets the accruing cost of their existing staffs' pension liabilities that will need to be met in future periods. For those departments whose staff are members of the large un-funded multi-employer schemes (such as the PCSPS) FRS 17 allows departments to account only for the contributions payable to the pension scheme administrator (the accruing superannuation liability charge or ASLC).

**13.3** The employing department bears the cost of that ASLC in its Resource Budget DEL, as part of its salary bill.

**13.4** The department bears no further liability in respect of pensions.

**13.5** The employee may also pay a contribution into the scheme. Such payments are made by the employee out of her or his pay. The department will have shown pay as a cost in its Resource Budget DEL. It should not show anything further in respect of the employee contribution.

### **SECTION B: DEPARTMENTS AND NDPBs WHO CONTRIBUTE TO AND RUN FUNDED PENSION SCHEMES**

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**13.6** Some departments and NDPBs run pension schemes with a real fund (as distinct from a notional fund). Such departments and NDPBs also have to comply with the accounting standard FRS17.

**13.7** FRS17 covers the position where:

- There is a deficit in the pension fund - i.e. there is a shortfall in the value of the assets of the scheme over the present value of the scheme's liabilities;
- The deficit is identifiable as belonging to the employer and
- The employer has a legal or constructive obligation to make good a deficit in the pension fund.

In these circumstances, the employer should recognise that deficit in the fund as a liability on their balance sheet.

**13.8** The cost in the departmental budget is the same as that shown in the accounts of the department or NDPB under FRS17. Specifically the movement in the pension scheme liability as recorded in the OCS / I&E account scores as a cost in the non-cash resource budget. Any actual contributions<sup>0</sup> to the scheme that serve to reduce the liability score in the cash subsection of the resource budget offset by a negative non-cash amount. An example is given below.

Department or NDPB accounts	Resource Budget		Total
	Non-cash	Cash	
Increase in scheme liabilities			
Cr pensions liability	(110)		
Dr OCS / I&E	110	110	110
Contribute cash to scheme			
Dr liability	100	(100)	(100)
Cr cash	(100)	100	100
		10	100
			110

*Example assumes that the contributing department pays 100 cash to the scheme but that the accruing cost of the pensions liability is 110*

**13.9** It follows that there will be an associated cost of capital credit in the Resource Budget for any such liability.

**13.10** The non-cash costs would normally fall to AME, whilst the near-cash costs would fall to DEL. This is more analogous to the costs borne by those departments who contribute to unfunded schemes, and reduces the scope for volatility in departmental resource DELs. Where there is a serious or structural deficit the scheme actuary will ultimately suggest higher contributions or a one-off payment to rectify affairs. This would score against DEL like normal contributions.

**13.11** Where there is a surplus in the scheme, the department or NDPB should recognise that surplus as an asset if the conditions in paragraph 37 and onwards of FRS 17 are satisfied, ie to the extent that employers can recover that surplus either through reduced contributions in future or through or through refunds from the scheme. There will be a benefit to the resource budget in AME, as well as a cost of capital charge on the asset. Movements in the value of the surplus then impact on the OCS and resource budget.

## SECTION C: DEPARTMENTS AND NDPBs WHO RUN THEIR OWN UN-FUNDED, BY ANALOGY, PENSION SCHEMES

**13.12** “By analogy” means schemes run by analogy to the multi-employer pension schemes. The budgets of departments or their NDPBs that run un-funded by-analogy pension schemes should recognise the accruing cost of their existing staff’s pension liability that will need to be met in future periods. Such schemes should be accounted for on an FRS 17 basis as adapted for the unfunded schemes in the Central Government sector.

**13.13** The department or body that employs the staff recognises a provision on the balance sheet in respect of the accruing liability to pay pensions in the future, and a cost in their budget based on the change in that liability.

### Expenditure and Income scored in Resource Budget DEL

**13.14** To ensure parity between those bodies who pay into multi-employer schemes and those bodies that run their own un-funded by-analogy schemes the costs borne by the by-analogy schemes in resource DEL are equivalent to those paid by departments who pay into the multi-employer schemes. Accordingly the following transactions score in the resource budget DEL:

- **Expenditure:**
  1. Increases in provisions due to current service cost
  2. Increases in provisions due to any bulk / individual transfers in
  3. Increases in provisions due to purchases of added years
- **Income:**
  1. Income from bulk / individual transfers in (funds the increase in the provision due to transfers in)
  2. Income from employees – normal (goes part way to fund the increase in the provision due to the current service cost)
  3. Income from employees - added years (funds increase in the provision due to added years).

**13.15** This treatment is broadly analogous to the costs born by a department that contributes a multi-employer scheme because the current service cost borne by the department is broadly equivalent to the ASLC that would be paid to multi-employer pension scheme administrators.

### Charges to Departmental AME

**13.16** To ensure parity in the DEL treatment between those departments who pay into the multi-employer schemes and those that run their own un-funded by analogy schemes certain transactions score in Departmental AME:

- Pensions benefits paid, offset by the release of a provision from the balance sheet
- Pensions benefits paid, if they are not charged to a provision on the balance sheet.

- The accounts - and therefore budgets - score the increase in the liability due to the unwinding of the discount rate. This increase is sometimes termed the interest on the scheme liability. The discount rate is based on AA corporate bond rates, which is advised annually, and a 2.5% inflation assumption.
- The provision liability attracts a cost of capital credit, the rate of which is set at 3.5% real.

## Pensions Payable

**13.17** Pensions payable and bulk and individual transfers out are charged to the provision and as such do not hit the departmental resource accounts. Nor do they have a net hit to budgets as expenditure.

**13.18** However, the pensions in payment count as near-cash spending, and the release of the provision counts as non-cash. Normal rules on near-cash and non-cash switching apply (see Chapter above).

**13.19** Bulk transfers to the private sector score as capital transactions in the national accounts and are treated as a cost in the resource budget offset by the release of provision.

**13.20** As is the case with other provisions, COINS needs to record both these payments and the offset by the release of the provision. These data are needed for the national accounts.

**13.21** Where payments are not covered by an existing provision they do score as charges in the near cash resource AME budget.

## Board Members

**13.22** Un-funded broadly by-analogy arrangements for chairs, vice-chairs, board members and other holders of public appointments are also subject to FRS17 as adapted for unfunded schemes in the Central Government sector and should be included in any measure of a body's un-funded liabilities.

## Unfunded schemes that join the PCSPS / other multi-employer public sector unfunded pension scheme

**13.23** Where an unfunded scheme joins the PCSPS it will be required to make a cash payment equivalent to the value of the liability that is being transferred. For the transferring body that has previously recognised a liability in its balance sheet in respect of its unfunded pensions liability, this will be a balance sheet transaction – a movement in cash and liabilities – with no impact on the OCS / I&E. It follows that there is no impact on budgets. However any amount of cash that is required above or below the liability previously recognised on the transferring body's balance sheet will be a cost / benefit to the OCS / I&E.

**13.24** Budgetary cover for this debit or credit will be provided for as an AME item. The cash required for the transfer will be provided in the appropriate manner - either through supply or grant in aid to the body transferring the liability with no further impact on budgets.

**13.25** For an unfunded scheme joining the PCSPS that has not previously recognised a provision on its balance sheet it follows that any payment it makes will be a cost in its OCS / I&E. Budgetary cover for this cost will be provided for in AME.

## **SECTION D: ADMINISTRATORS WHO RUN MULTI-EMPLOYER UN-FUNDED PENSION SCHEMES**

**13.26** This section of the budgeting guidance applies to the administrators of the multi-employer pension schemes:

- PCSPS
- NHS pensions schemes
- Teachers pension schemes
- Armed forces pension scheme
- Judicial pensions scheme
- UKAEA superannuation schemes
- DfID overseas superannuation scheme

**13.27** This section applies to the budgeting of the schemes themselves. It does not cover employing departments' contributions to the schemes – see Section A of this Chapter.

**13.28** The transactions of these schemes are scored in AME. The transactions follow those that are recorded in the Resource Accounts, and are as follows:

### **Expenditure:**

- Current service cost (defined as “the increase in the present value of the scheme liabilities expected to arise from employee service in the current period”.)
- Past service costs (normally expected to be zero)
- Interest on scheme liabilities (the unwinding of the discount on the scheme liability)
- Increase in future liability arising from employees purchase of added years and group and individual transfers in
- There may be occasions where actual pensions benefits paid pass through the revenue account if they are not charged to a provision on the balance sheet.

### **Income:**

- Employers' contributions
- Employee contributions – normal
- Employee contributions – purchase of added years
- Group and individual transfers in

**13.29** Please note that there is no cost of capital credit recorded in the accounts for these schemes, and subsequently no cost of capital credit is scored in budgets either. This contrasts to bodies that run their own by analogy schemes, which do show a cost of capital credit on the liability in both accounts and budgets.

### **Pension benefits payable**

**13.30** Both pension benefits payable to retired members and group and individual transfers out of the scheme that score in the accounts only on the balance sheet as a movement in cash and liabilities have no subsequent impact on the budgets. However it is necessary to score these transactions separately on COINS, and to ensure that they are balanced by an equal and opposite release of provision, so that the cash requirement can be calculated, and so that the correct information is recorded for the national accounts. Bulk transfers to the private sector need to be identified separately.

**13.31** Where payments are not covered by an existing provision they do score as charges in Departmental Resource AME.

### **SECTION E: BULK TRANSFERS TO FUNDED SCHEMES**

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**13.32** Where a public sector body makes a bulk transfer into a funded scheme this cash payment increases TME. Where departments are considering such payments they must contact HMT to obtain consent for the transfer. This is the case whether the transferring body has previously provided for the liability or not, or whether they have been making contributions to a public sector multi-employer scheme or not.

**13.33** Departments should contact the Treasury early in the process of considering such transfers.

# 14

## PRIVATE FINANCE INITIATIVE

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**14.1** The chapter sets out:

- The objectives of the Private Finance Initiative (PFI)
- The accounting for PFI
- The budgeting for PFI separately for departments and NDPBs, PCs and NHS trusts; and separately for on and off balance sheet projects
- Barter deals
- Reversionary interest
- Termination payments
- The treatment of refinancing gains

### PFI – OBJECTIVES

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**14.2** PFI is a means of procuring services with significant asset content. The choice of means of procurement should be driven entirely by **value for money** considerations. So:

- PFI should be used where – and only where - it offers better value for money than other means of procurement. Departments may not use off balance sheet PFI procurement if it does not offer better value for money than conventional procurement just because a project is unaffordable within a department's Capital DEL;
- Similarly, own-build and other non-PFI means of procurement should be used where – and only where – they offer better value for money than PFI;

**14.3** Departments must follow the detailed methodology laid out in the PFI VfM Assessment Guidance when determining whether a prospective PFI project will be value for money (see link in annex C).

**14.4** In some cases, PFI deals are called **Public Private Partnerships** (PPPs). If so, they should be scored like other PFI deals. Not all PPPs are PFI deals. PPP can also be a name for certain sorts of public corporation (see separate chapter on public corporations) or private sector body (in which case the department will have an investment – see chapter 6).

### ACCOUNTING FOR PFI

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**14.5** The budgeting treatment for PFI projects normally follows the way in which they are accounted for in GAAP-based accounts. However, it is the ONS who determine treatment for the fiscal framework. ONS normally follow the GAAP treatment, but may adopt a different treatment where appropriate. If there is a difference between the GAAP treatment and the ONS treatment it is the ONS treatment that counts for budgeting. Departments should in practice assume that the ONS will adopt the GAAP treatment, except where departments have been notified to the contrary.

**14.6** The GAAP accounting is based on two standards:

- Whether a project is treated as a finance lease under Statement of Standard Accounting Practice 21; and
- Whether a project is in substance borrowing (TSB) under FRS 5. The Treasury has published a technical note providing guidance on the interpretation of FRS 5 in PFI deals.

**14.7** If a project is either a finance lease or in substance borrowing then it is held to be on balance sheet. On balance sheet projects are in effect capital expenditure by the purchasing authority that has been financed by borrowing from the contractor. Off balance sheet projects are purchases of services by the purchasing authority from the contractor who has created an asset in order to deliver the services.

**14.8** It is the department's responsibility to obtain the views of its auditor on the expected classification of a project. If the auditor changes her or his mind at a late stage in the project it is the department that bears the risk. Departments are encouraged to agree protocols with their auditors in order to guard against this risk.

**14.9** In the fiscal framework, on balance sheet projects:

- Score in Public Sector Net Investment and Public Sector Net Borrowing;
- Have scored in Public Sector Net Debt since September 2006; and
- Score in the Maastricht general government measure of the deficit and stock of debt (the latter on the basis of estimated numbers).

**14.10** The budgeting system reflects the distinction between on and off balance sheet projects, with technical differences in the way that the distinction impacts on:

- Departments and NDPBs;
- Public corporations; and
- NHS Trusts.

## BUDGETING – DEPARTMENTS AND NDPBs

### On Balance Sheet Projects

**14.11** On balance sheet projects score in Capital Budgets like capital expenditure undertaken directly by the department / NDPB. The value of the capital expenditure and the timing of recognition should follow the GAAP accounting.

**14.12** Annual repayments under the PFI contract, i.e. the unitary charge, will be treated in the Resource Budget as a mix of:

- Service charges (in budgets);
- Repayment of the imputed loan to the private sector (outside budgets); and
- The full amount of interest charged on the loan (in budgets).

**14.13** In addition, the resource budget will show:

- Depreciation of the asset
- Cost of capital charge on the asset

- Cost of capital credit on the loan from the contractor

### Off Balance Sheet Projects

**14.14** Where the project is off balance sheet the department is purchasing services. Any associated capital expenditure is an investment by the private sector and does not appear on the procuring authority's books. The only entries in the budget of the department or NDPB are the payments under the unitary charge, which are payments for services and score in the Resource Budget.

## BUDGETING – PUBLIC CORPORATIONS

### On Balance Sheet Projects

**14.15 PCs scored on the External Finance Basis.** For most public corporations the budgeting system scores their external finance. External finance includes Public Corporations' Market and Overseas Borrowing (PCMOB). On balance sheet PFI is a form of PCMOB and is treated in the same way:

- The borrowing implied by on balance sheet capital expenditure of public corporations scores in the Capital Budget;
- As the debt is reduced the capital budget of the sponsor department is credited back
- In the calculation of the cost of capital charge to be applied in respect of public corporations, the PFI repayment liability should to some degree offset the capital base to which charges are applied; and
- The profit that public corporations make should be calculated after the payment of the interest and service elements of service charge on the finance lease and after the deduction of depreciation on the PFI financed asset.

**14.16 PCs scored on the Consolidation Basis.** On balance sheet PFI would score as capital expenditure in budgets. The effects on cost of capital are as for other public corporations. The profit that scores in budgets should be calculated after the payment of the interest and service elements of service charge on the finance lease and after the deduction of depreciation on the PFI financed asset.

### Off Balance Sheet Projects

**14.17** Off balance sheet projects do not score in capital budgets and do not affect the cost of capital charge. The public corporation's payments of the unitary charge are a cost of doing business in the calculation of profits like any other purchase of services.

## BARTER DEALS

### Definition of barter

**14.18** A barter transaction is one in which party A disposes of an asset, good or service to party B; party A then receives an asset, good or service in return from party B. Money is not used as the medium of exchange, or is used for only a proportion of the

transaction. Barter deals can involve the creation of financial assets and liabilities such as loans, if the goods and services are exchanged at different times.

### Example of a barter deal

**14.19** Sale and lease back deals are an example of barter deals. In this scenario a department disposes of buildings to a private sector company at no charge or at a price below the normal market value. In return the company provides the department with serviced office accommodation at below market price for a number of years. The reduction in the cash charge for service payments is a way for the department to obtain value from its asset, instead of getting the full market value in cash.

**14.20** In effect part of the value of the building is bartered for future serviced office space. The reduction in the selling price is in effect a pre-payment of rentals. You can view this as a loan to the private sector company financed from the receipt from the disposal of the building.

**14.21** However, this is only one example, and these general principles apply equally to barter deals that do not involve property or the PFI.

### Principles of recording barter deals

**14.22** Large barter deals should be recorded as if the exchanges had taken place in cash at current market prices. This recording applies to accounts, budgets and in the national accounts.

**14.23** National accounts aim to score transactions at the Open Market Value (OMV). Scoring barter transactions at zero or another price would not reflect the economic substance of the transactions and misstate the balance of expenditure between sectors of the economy.

**14.24** In the example given above, the real economic value of the asset disposed of is the OMV not nil or just the cash sum received; the annual running costs should also be measured at the OMV cost of accommodation and not just the cash sum paid.

**14.25** If the delivery of bartered assets, goods and services occur at different times it might be necessary to record a financial transaction. For example, if a department sells a building at below OMV in return for reduced future rents, there is in substance a loan from the department to the company. The reduction in the selling price is a prepayment of rents, and represented as such in the resource accounts.

**14.26** For a barter transaction to be a viable proposition, the reduction in sale price would have to be at least equal to the net present value of the future rent reductions – using a discount rate reflecting the cost of capital of the government. So the imputed future rents have to be recorded as being equal to the cash actually paid, plus the amount being financed by the prepayment, plus an extra amount (representing a finance charge on the prepayment).

### Open Market Value

**14.27** OMV is the price of the asset, good or service that would be paid in an open market transaction without any element of barter. When assets, goods or services are bartered it is necessary to determine their OMV so that accounts can be recorded properly (i.e. using OMVs) and also for investment appraisal to ensure that the barter deal is good value for money.

**14.28** It is for departments to determine and record OMVs.

**14.29** Broad information for establishing OMVs should be available from information in the investment appraisal undertaken before the department decided to structure the deal in a particular way, in the supplier's bid documentation, and in the contract documentation and supporting papers.

**14.30** For accounts, it should be assumed that the goods bartered have equal value. This means that once the OMV has been determined for the assets, goods or services supplied, the value of the assets, goods or services received in exchange will be known. For example, consider the case of a building being sold at below OMV in return for being able to pay reduced rents (i.e. at below OMV) in the future. The OMV of the building could be estimated as the cash price paid plus the net present value of the future rent reductions (using 3.5% discount rate); or the rent reductions could be estimated from the difference between the cash received and OMV of the building sold; or if both components can be estimated reliably the residual would be the implied discount rate for the financing charge. The method used should be agreed with Treasury.

**14.31** Note that the OMV of an asset for this purpose may differ from the amount recorded in the department's balance sheet if that has not been updated recently. In such cases the difference between the balance sheet figure and OMV would be recorded in resource accounts and budgets as a loss/gain on sale. The difference between the OMV and the cash amount actually received as a result of the barter deal (i.e. that part of the value of the building that is bartered) would not be recorded as a loss on sale, in our example this would be shown as a prepayment.

**14.32** For investment appraisal it is of course necessary to measure as directly as possible the OMV of all components - to identify which option is best value for money.

### **Budgeting for a sale and lease back deal comprising of a bartered element – off balance sheet**

**14.33** This section of the budgeting guidance assumes that accounting tests (for example SSAP21) have determined that the new rental contract is not a finance lease. If the department continues to bear most of the risks and rewards associated with ownership then this suggests that the new rental contract is in fact a finance lease and the provisions of this section of the guidance do not apply (see separate section).

### **Treatment in Resource Accounts and Budgets**

**14.34** Barter deals should be scored in departmental accounts and budgets as though they were separate transactions made at the OMV.

**14.35** In the example above departments should record:

- The sale of the assets at their open market value comprising;
  1. Actual cash received, plus
  2. The difference between cash received and the open market value (this creates a debtor on the balance sheet - a prepayment of rentals)
- The full annual costs for accommodation: this has three parts
  1. Actual cash paid

2. The amount financed by the prepayment
3. A capital charge on the outstanding prepayment asset

**14.36** The profile through time of the unwinding of the prepayment will depend on the discount rate assumed and the desired profile of the imputed additions to the service charges (could be flat or perhaps increase with inflation). In the rest of the example a 3.5% discount rate is used, and the imputed additions to the service charges are constant. In other words, the sum of the loan repayment and the capital charge on the amount outstanding is constant.

**14.37** Capital DEL scores as a benefit the book value on disposal. Capital DEL also scores profit/loss on disposal as a benefit/cost respectively.

**14.38** The Resource Budget includes the full cost as reflected in the OCS comprising.

- Actual cash paid
- The amount financed by the prepayment
- A capital charge on the outstanding prepayment asset

**14.39** The balance sheet will show an asset (prepayment) for the difference between the cash received and the OMV of the asset as determined by the barter deal.

**14.40** So in the example given above suppose:

- The open market value of the building was £300m;
- The net book value of the building was also £300m;
- The department sold it for a cash receipt of £200m;
- The market value of the service element of the deal was £64m per year. The department took the benefit of the remaining £100m of the value of the building by agreeing to reduce this charge by £20m per year. The remainder of the service charge was to be included in the rental.
- The sale took place and the receipt came in year 0 and occupation began,
- And rent became payable, from year 1 to 5:

Capital DEL	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Disposal of asset at OMV	-300					
Prepayment	100.00					
Repayment of prepayment		-20.00	-20.00	-20.00	-20.00	-20.00
<i>calculated as</i>						
<i>Debtor (prepayment) - end year</i>	<i>100.00</i>	<i>80.00</i>	<i>60.00</i>	<i>40.00</i>	<i>20.00</i>	<i>0.00</i>
<b>Total CDEL</b>	<b>-200.00</b>	<b>-20.00</b>	<b>-20.00</b>	<b>-20.00</b>	<b>-20.00</b>	<b>-20.00</b>
Resource DEL						
OMV of rental		64	64	64	64	64
<i>financed by</i>						
<i>cash paid</i>		40.85	41.55	42.25	42.95	43.65
<i>reduction in value of prepayment</i>		20.00	20.00	20.00	20.00	20.00
<i>notional interest on prepayment</i>		3.15	2.45	1.75	1.05	0.35
cost of capital charge		3.15	2.45	1.75	1.05	0.35
<b>Total RDEL</b>		<b>67.15</b>	<b>66.45</b>	<b>65.75</b>	<b>65.05</b>	<b>64.35</b>
Accruals to Cash Adjustment						
Net Resource Requirement		67.15	66.45	65.75	65.05	64.35
Capital	-200.00	-20.00	-20.00	-20.00	-20.00	-20.00
cost of capital charge		-3.15	-2.45	-1.75	-1.05	-0.35
Notional interest on prepayment		-3.15	-2.45	-1.75	-1.05	-0.35
<b>Net Cash Requirement</b>	<b>-200.00</b>	<b>40.85</b>	<b>41.55</b>	<b>42.25</b>	<b>42.95</b>	<b>43.65</b>

## Budgeting for a sale and lease back deal including a bartered element – on balance sheet

**14.41** Appendix 1 to this chapter shows a worked example of the accounting and budgeting for a sale and lease back deal that includes a bartered element, where the deal is on balance sheet.

## REVERSIONARY INTEREST

**14.42** Some deals involve the legal transfer of the asset to the public sector at the end of the deal period. In some cases the asset will not be expected to have a value and in other cases it will. Where the asset is expected to have a value the department is said to have a reversionary interest (RI).

**14.43** In many cases the existence of a reversionary interest will point to the public sector having the whole of the asset on its balance sheet for the life of the deal, as the public sector is taking residual value risk. In that case the reversionary interest rules are irrelevant.

**14.44** However in some cases the deal may be judged to be off balance sheet and the department to have a reversionary interest.

## Accounting and budgeting for the Reversionary Interest

**14.45** Where a department has an RI it will build up an RI asset on its balance sheet over the life of the contract. At the end of the contract the asset will revert to the department who will debit fixed (infrastructure) assets and credit the RI asset. In other words the RI asset built up over the life of the contract will finance the acquisition of the infrastructure asset at the end of the period. The RI asset can therefore be viewed as a loan to contractor, who at the end of the period repays the loan to the department. In turn, the department uses the proceeds to purchase the asset from the contractor.

**14.46** In order to build up the RI over the life of the contract part of the unitary payment will be capitalised. This results in a lower OCS cost and an increase in the RI asset on the balance sheet.

**14.47** The budgets follow the accounts.

**14.48** Capital DEL shows the following

- Movement in the RI on the balance sheet over the life of the contract, and
- The acquisition of the asset at the end of the period.

**14.49** The resource budget simply shows the costs that are in the OCS, i.e.

- The unitary payment less the amount that is capitalised as the RI.
- Cost of capital charge on the RI asset

## TERMINATION PAYMENTS

**14.50** Termination payments may be payable if a PFI contract is ended early.

**14.51** In the case of on balance sheet PFI, termination payments could represent just the extinguishment of the liability, and so not be shown in budgets, or in addition to the repayment of debt there could be a cost in budgets. That difference in treatment would depend upon the level of the balance sheet liability compared with the termination payment and what, if any, other assets come on the balance sheet.

**14.52** Where the amount of cash paid is different to the outstanding liability, and the department is not gaining any other assets, then the national accounts treat this element of the payment (difference between liability on the balance sheet and cash paid) as a capital grant to the contractor. This is a cost (or potentially a benefit) in the departmental capital budget (DEL).

**14.53** Where the department is receiving additional assets as part of the termination deal then it may be appropriate to capitalise the cash payment above the value of the liability. In effect the department is purchasing the additional assets from the contractor, and the price paid is the value of the cash payment above the liability that is being extinguished. Departmental budgets treat this in the same way as any other capital addition, i.e. in capital budgets (DEL).

**14.54** Termination payments paid under off-balance sheet deals lead to a cost in the OCS / P&L and a charge to the resource budget (assuming no asset is assumed in return).

**14.55** Any department facing a termination payment should contact your normal Treasury spending team to seek advice.

## REFINANCING GAINS

**14.56** This section of the guidance briefly sets the background and the policy of sharing refinancing gains on PFI deals, and details the treatment of the associated transactions in the national accounts, resource accounts and budgets. The guidance deals with the scenario where the PFI contractor goes to the private sector debt markets to refinance their debt.

### Background

**14.57** When a private sector contractor enters into a PFI deal they will borrow from the market to finance the capital expenditure they are undertaking. The market will charge the contractor a certain interest rate on that borrowing; this will be based on many things including the amount of risk perceived by the lender. The contractor will take this rate of interest into account when setting the unitary charge that is charged to the public sector for the use of the infrastructure created under the PFI contract.

**14.58** It is common practice for the PFI contractor to refinance or restructure their debt once the project is up and running. The contractor will, at this point, be able to negotiate a lower interest rate, as they can demonstrate that the amount of risk has reduced.

**14.59** The OGC has issued guidance on how departments with existing PFI contracts should be able to access these gains and split the benefit with the private sector partner (“Refinancing of Early PFI transactions”). The sharing of refinancing gains for more recent deals is laid out in the standardised PFI contract (“SoPC3”), supplemented by guidance issued by HM Treasury (“Application Note – value for Money in Refinancing”). The benefit could be in the form of either be a drop in the unitary charge or an increased level of service, or the gain may be shared via an upfront lump sum.

**14.60** In general departments benefit in their budgets from what they can negotiate.

### Refinancing

**14.61** The contractor’s cost of providing the service drops thanks to the restructured debt profile. This is passed on to their customers (the public sector) via a reduced price to buy the service or as a one off payment.

**14.62** Where the gain is shared via a cheaper service cost this is simply less current expenditure in the national accounts, resource accounts and resource budget over the remaining life of the contract.

**14.63** Where the gain is shared via a one-off windfall payment to the public sector we risk distorting measures of GDP in the economy if we record this as less consumption by the public sector in one year. It is more correct to view the lump sum as a portion of the on-going savings to the contractor, which has been rolled up and then split between the parties. The view in such a situation is that the private sector has lent the public sector cash upfront and has an asset on their balance sheet, each month this would unwind to finance the reduction in the unitary charge. In effect the contractor is prepaying a reduction in the service charge.

**14.64** This means that the refinancing gain is recorded as a benefit to the public sector matched to the time frame in which it is viewed to have accrued. A simple example ignoring any discounting is given below.

- Public sector receives lump sum of £15m in respect of a refinancing gain, to be accounted for over 15 years, the remaining life of the contract.
- Suppose that the public sector continues to pay a unitary charge of £10m per annum for 15 years.
- The cash lump sum should be recorded as a financial transaction – in effect borrowing from the private sector. The department would show cash of £15m and a matching liability. Each year the public sector continues to pay the contractor a £10m cash unitary charge for the year.

## Accounts and Budgets

**14.65** On receiving the cash the department shows an increase in liabilities (creditors). Then annually;

- The OCS score £9m unitary payment, and
- Cash out the door would be £10m and the liability would reduce by £1m.

**14.66** The budgets follow the accounts. In other words the upfront receipt of the cash does not benefit the resource budget, but the lower annual service charge does. The department would also receive a cost of capital credit on the outstanding liability.

## APPENDIX I TO CHAPTER 14: SALE AND LEASEBACK

**14.67** This appendix sets out the accounting and budgeting treatment for a sale and lease back deal including a bartered element where the deal is on balance sheet.

### Background

**14.68** Department Yellow enters into a PFI deal for a new headquarters building with the Reader Sinclair Consortium. The consortium will design and build and then operate the HQ for a period of 30 years from the date of occupation. In addition, the consortium will provide the IT Systems for seven years, after which that part of the contract will terminate. The building will revert to Department Yellow at no cost at the end of the contract period. This is determined to be an on-balance sheet PFI deal.

**14.69** The cost to Department Yellow comprises two elements: annual Unitary Payments (UP) and the transfer of properties (Barter Deal). The transfer of properties under Barter Deal results, over time, in lower service payments. Annual UPs cover capital, a finance charge, and a service payment. The Barter Deal comprises the transfer of five properties at various stages throughout the project, including two prior to occupation of the new HQ. The final transfer can be deferred by five years. If Department Yellow opts for deferral, the Department will pay compensation to the Consortium in the form of an upfront cash payment equal to the value of the property under the contract at the original transfer date. Upon vacation of the property, the Consortium will repay to Department Yellow the value of the property at that date.

**14.70** The contract takes effect from 1 April YEAR0. The new HQ will be occupied from 1 April YEAR3. The schedule of Barter Deal transfers is:

Plot 1	1 April YEAR0	Land only
Plot 2	1 April YEAR1	Land only
Plot 3	1 April YEAR2	Land only
Plot 4	1 April YEAR4	Land and Buildings
Plot 5	1 April YEAR10 (with possible deferral to 1 April YEAR15)	Land and Buildings

**14.71** The total value of the new HQ and IT is £250 million. It is estimated that £229 million is in respect of the new HQ and £21 million relates to the IT element. In addition, the UP includes total interest of £320 million and total service costs of £15 million. (Total value of UP over 30 years is £560 million). The values of the five plots included in the Barter Deal are shown below. The year YEAR-1 is the year prior to the contract coming into effect.

	Book values	Barter Deal Values				
	1 April YEAR-1	1 April YEAR0	1 April YEAR1	1 April YEAR2	1 April YEAR4	1 April YEAR10
<b>Plot 1</b>	4.5 million	4 million				
<b>Plot 2</b>	2.5 million		3 million			
<b>Plot 3</b>	4 million			4 million		
<b>Plot 4</b>	1.5 million				1 million	
<b>Plot 5</b>	13 million					13 million

**14.72** The schedule of UPs is as follows, starting in year beginning 1 April YEAR3.

1 April	31 March	£m	
YEAR3 -	YEAR4	23.5	1 year at 23.5 = 23.5
YEAR4 -	YEAR10	23.25	6 years at 23.25 = 139.5
YEAR10 -	X029	17.25	23 years at 17.25 = 396.75
		0.25	Balancing payment
		560	Total

### Accounting for the Barter Deal – asset valuations

**14.73** The value of the plots in Department Yellow's accounts needs to be adjusted for 1 April YEAR0 to reflect the Barter Deal value at the future date of transfer, taking account of projected movements in value in the intervening period, during which the plots continue to be recognised as fixed assets by the Department. (Note: this assumes that the values have been agreed at the time the contract is signed.)

At	31 March	YEAR0	Budget impact	Resource accounts
(the end of year YEAR-1)				
<b>Plot 1</b>	The value is written down by £0.5 million		Resource DEL hit with write down in value	Dr Revaluation reserve or OCS (FRem 5.2.34) Cr Fixed assets
<b>Plot 2</b>	Upwards revaluation to £3 million		None	Dr Fixed assets Cr Revaluation reserve
<b>Plot 3</b>	No change		None	None

<b>Plot 4</b>	<p>The split between land and buildings is £0.75 million land and £0.75 million buildings. Without the PFI deal, the buildings had a remaining economic useful life of 10 years, with a residual value of £0.3 million. It is assumed that the value of the plot at 1 April YEAR4 will comprise land at £0.75 million and buildings at £0.25 million. Department Yellow has four years' use of the property. The value of plot 4 is written down to £1.20 million, comprising land at £0.75 million and buildings at £0.45 million. Over the four years ending March YEAR1, YEAR2, YEAR3 and YEAR4, depreciation of £0.05 will be charged annually.</p>	<p>Resource DEL hit with the write down of £0.3 million</p>	<p>Dr Revaluation reserve or OCS (FReM 5.2.34)  Cr Fixed assets</p>
		<p>Routine depreciation is reflected in non-cash</p>	<p>Routine accounting entries</p>
<b>Plot 5</b>	<p>The split between land and buildings is £10 million land and £3 million buildings. Because the transfers are not due to take place until YEAR10, the value at YEAR-1 is agreed as proxy for the value at YEAR10, taking into account increases in land values offset by changes in the value of the buildings on the site.</p>	<p>None</p>	<p>None</p>

## Accounting for the Barter Deal – transfers of property prior to occupation

**14.74** Department Yellow accounts for the plots as they are transferred to the Consortium prior to the occupation of the new accommodation as follows:

	Date of transfer	Value	Budget impact	Resource accounts
<b>Plot 1</b>	1 April YEAR0	£4 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets

<b>Plot 2</b>	I	April	£3 million	Negative CDEL for the NBV of the transfer	Dr Prepayments assets	Cr Fixed assets
	YEAR1					
<b>Plot 3</b>	I	April	£4 million	Negative CDEL for the NBV of the transfer	Dr Prepayments assets	Cr Fixed assets
	YEAR2					

## Accounting for the occupation of the new building

**14.75** When Department Yellow occupies the new accommodation, the property is valued at £250 million (see background section) and is brought on balance sheet.

**14.76** The accounting entries are:

- Dr Fixed assets
- Cr Long-term lease creditor of £250m

**14.77** The £250 million is a capital DEL hit.

## Accounting for the transfer of Plot 4

**14.78** Department Yellow accounts for the transfer of Plot 4 after the occupation of the new building as follows:

	Date of transfer	Value	Budget impact	Resource accounts
Plot 4	I April YEAR4	£1 million	Negative CDEL for the NBV of the transfer	Dr Prepayments (if prepayment against service / interest charges) Cr Fixed assets

## Subsequent accounting

**14.79** Each year until the end of the lease, there will be a cash requirement in respect of the UP. There will be a resource DEL hit equal to costs in the OCS, i.e. an amount in respect of the service element of the UP and of the difference between an interest rate of 3.5% and the imputed interest rate, but note that the interest up to 3.5% and the cost of capital credit are outside budgets (these amounts are equal and opposite) As the building is on balance sheet, depreciation and the cost of capital charge on the asset also score in both the OCS and Resource DEL. The capital repayment, i.e. the movement in the long-term creditor is outside of budgets.

**14.80** The accounting entries are:

- Dr Long-term lease creditor for capital element of UP
- Dr Operating Cost Statement for service and interest elements of UP
- Cr Cash

(In addition to the service and interest elements, depreciation and cost of capital charges and credits also pass through the OCS.)

**14.81** In addition, Department Yellow can now start to release the prepayment. Because it represents the lower service payment, it should be released over the period of the reduced service payment (in this example, considered to be the life of the contract).

**14.82** The accounting entries are:

- Dr OCS
- Cr Prepayment

The release of the prepayment has no budgetary impact – as noted it is the full OCS costs that are reflected in the budget.

### **Department Yellow defers the final stage of the Barter Deal**

**14.83** In X008, Department Yellow determines that it needs to retain Plot 5 beyond YEAR10. Under the contract, therefore, the Department will have a cash requirement of £13 million to pay to the Consortium.

**14.84** The accounting entries are:

- Dr Long-term lease creditor
- Cr Cash

**14.85** Since the value of the Plot 5 is included in the overall valuation of the new accommodation, there is no DEL hit involved in the deferral, as the cash is used to repay the creditor. *(Note: the accounting entries do not deal with Supply in respect of the net cash requirement.)*

**14.86** During the five years of the deferral, the Department will continue to revalue and depreciate Plot 5 in the normal manner.

### **Final deal**

**14.87** Under the terms of the contract, Department Yellow has to vacate the property in X015, and the Consortium pays to the Department the value of the property at that date.

**14.88** The accounting entries are:

- Dr Cash
- Cr Fixed Assets

**14.89** There is a negative capital DEL impact in respect of the disposal of the asset.



**15.1** End Year Flexibility (EYF) is a mechanism whereby departments may carry forward unspent Departmental Expenditure Limit (DEL) provision into later financial years. There is no limit on the amount of unspent DEL that may be carried forward as EYF. Along with other flexibilities, EYF allows departments to manage their DEL effectively across a number of years.

### **CALCULATION OF EYF**

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**15.2** All expenditure and income, which was classified within DEL within a particular financial year, is eligible for carry forward into the following financial year if it remains unspent. This includes voted and non-voted DEL and unspent DUPs. EYF entitlements are published annually in the Public Expenditure Outturn White Paper (PEOWP).

**15.3** Detailed guidance on the calculation of EYF is contained in the annual PES paper produced by HM Treasury for the compilation of EYF entitlements for PEOWP. However, the following arrangements usually apply:

- Any EYF entitlement generated in a particular year or accumulated from previous years but not taken up will automatically be rolled forward as part of the compilation of PEOWP;
- EYF carryover may only be generated where there is an underspend at control total level. So, for example, underspends in near-cash must first be applied to non-cash overspends before generating carryover. See chapter 1 for details of control totals;
- Departments must notify the Treasury of any changes arising from differences between, for example, Year X provisional outturn (which was used to calculate Year X+1 EYF entitlements) and final outturn. These will then be taken into account in the calculation of Year X+2 EYF entitlements.

### **EYF CARRYOVER AND THE RESERVE**

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**15.4** The interaction between EYF and the DEL Reserve is as follows:

- Where, exceptionally, departments submit in-year bids to increase their DELs above the level already agreed in Departmental plans, offsetting savings from existing provision should be identified, including from any unused EYF, to avoid or minimise new claims on the DEL Reserve; and
- If access to the Reserve is agreed and a department's DEL is increased in a particular year, the additional provision will normally be recouped from any underspending that emerges in that year or future years. This will be effected by a reduction in EYF entitlements when they are calculated for PEOWP. Capital Reserve claims would be recouped from both capital and resource underspends while resource claims will only be recouped from resource EYF (admin/programme and near/non-cash rules apply with the normal restrictions).

## TAKE-UP OF EYF

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**15.5** Take-up of EYF carry over is subject to normal Treasury scrutiny on the basis of need and realism, and the wider fiscal position.

**15.6** For Voted spending EYF take-up will normally be effected by means of a Supplementary Estimate

**15.7** Once the Treasury has agreed the take-up of EYF and the new level of Resource and Capital DEL, near-cash and Administration budgets Parliament needs to be told by means of a Ministerial Written Statement. Statements should be cleared in draft with HM Treasury and made at the earliest practicable time.

## SEPARATE CATEGORIES OF EYF

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**15.8** When taken up, EYF may be applied to any category of expenditure subject to the following limitations:

- **Capital DEL EYF** may only be taken up on capital programmes;
- Resource DEL EYF generated on programme expenditure may not be used to increase **Administration Budgets**.
- Resource DEL EYF generated on **non-cash expenditure** may not be taken up on **Near-Cash Resource DEL**, except as provided for under the rules for switching from non-cash to near-cash– see chapter 1.
- **Resource DEL EYF** – whether non-cash or near-cash, and whether administration or programme - may be **taken up in Capital Budgets** (which are not divided into non-cash and near-cash spending). Where departments wish to take up Resource DEL EYF in their Capital DEL they should convert it to Capital EYF and apply it directly as Capital DEL, and not take it up first as Resource DEL and then switch to Capital DEL.
- EYF generated from a **cross-cutting programme** or from a programme subject to a **policy ringfence** may have restrictions on the use of the resulting entitlement agreed between the Chief Secretary and departmental Ministers. Where departments have underspends generated by such programmes they should, for each programme, consult their spending team to confirm whether any restrictions apply to take up.

**15.9** To reflect these limitations, EYF entitlements published in PEOWP will identify separately resource DEL, within which Administration Budgets and near-cash, and capital DEL.

**15.10** EYF may not be drawn down from one category in order to generate EYF in a different category. So in a given year a department may not draw down EYF in non-cash and generate EYF in near-cash – the underspend in near-cash should be applied across the Resource DEL control total before any claim on EYF is considered.

## CASCADING END YEAR FLEXIBILITY

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**15.11** Departments are encouraged to cascade EYF entitlements to their NDPBs and Agencies wherever practicable. Cascading ensures that the incentives EYF brings to

manage resources to best effect are applied to lower level budget holders also. PES(2000)25 provides further guidance.

**15.12** We recognise that departments have a responsibility to keep their overall spending within the DEL, and to manage unexpected pressures. Central control of EYF along with Departmental Unallocated Provisions (DUP) gives departments a margin of flexibility to respond to changing priorities. Local underspends may arise because of shifts in demand, or overprovision, and leaving funding with local budget holders may not always give best value from the department's point of view. Moreover, claims by the department against the DEL Reserve are deducted from any departmental EYF that may emerge, so in some circumstances they cannot afford to leave full EYF with delegated budget holders. EYF policy at a departmental level should give delegated budget holders more certainty and better incentives, while recognising the need for departments to manage their DEL as a whole.

**15.13** The first step is to give budget holders some certainty on forward year budgets. This is desirable in itself, as it allows better forward planning. But it is also a good base for EYF since budget holders will tend to avoid any underspend if they fear that budget allocators will use it as a reason for giving them less money next year. So EYF entitlements should normally be considered as additions to fixed baselines in the following year. (However EYF can improve incentives even with one year budgets, since budgets are normally set before the extent of any underspend is known.)

**15.14** There are a variety of approaches that departments can use in seeking to reconcile their own budget management requirements with greater entitlement for budget holders to EYF. For example:

- **Full EYF entitlement with 'fines' on overspenders:** one risk that departments face is that where some budget holders spend over budget, and the underspenders have full EYF, the department's total net EYF entitlement will be less than the EYF entitlement of the underspenders. So the DEL for the following year could be at risk. One way of dealing with this is to 'fine' the overspenders by reducing their budget for the following year by an amount equal to the overspend. Careful attention needs to be paid to the cause of overspending to ensure that pressures are not just being shifted forward.
- **Partial EYF:** there are several variants here. Departments could allow full EYF up to some ceiling (say 5% or 10% of the budget); or carry forward of a proportion (say 50%) of any underspend.
- **Qualified EYF:** the department could allow 100% EYF but make clear that this be subject to review of specific cases where an underspend may be indicative of a continuing reduction in spending needs. Alternatively the department could ask for forecast underspends before the end of the financial year, and only allow carry forward of the amounts declared at that stage. This approach seeks to take account of the need for EYF to fit in with a total budgetary strategy.



# A

## DIFFERENCES BETWEEN ACCOUNTS AND BUDGETS

Table 1 below shows the main differences between the Operating Cost Statement (OCS) in Departmental Resource Accounts and the Resource Budget. Table 2 shows the main difference between Capital Budgets and additions to fixed assets and investment in DRAs.

**TABLE 1: The main differences between the Operating Cost Statement and Resource Budgets**

<b>General</b>	Resource Budget is divided into DEL and AME; OCS includes some but not all DEL and AME spending, and also some non-budget income and expenditure
	Resource Budget DEL is divided into non-cash and near-cash; the OCS is not.
<b>Departments' own spending</b>	Cost of capital charges on non-budget items may be excluded from budgets.
	No asset funded by a local authority attracts a cost of capital charge in budgets; they do in accounts.
	OCS includes capital grants and the take-up and revaluation of provisions in respect of capital grants; these score in Capital Budgets.
	Both the OCS and budgets score the creation of, increases in, and revaluations of provisions. In DRAs, the spending when the risk that a provision had been taken against crystallises and the use of the provision to meet that spending are purely balance sheet transactions. However, Budgets include entries for the release of provisions and the expenditure that the release of provisions finances (Note: where both sides of this pair of transactions are in Resource DEL, they will have different non-cash/ near-cash treatment; in a few cases these two transactions may not have the same DEL/AME treatment).
	Budgets include spending on the payable element of tax credits. These are excluded from DRAs and taken through trust statements.

<b>Departments' income</b>	OCS includes all income that passes through a department, except for income taken through a trust statement. Resource budgets include only income that is negative DEL, and which does not score to the capital budget. In particular taxes and fines will go through the OCS, and will only exceptionally pass through budgets.
	Equity withdrawals from PCs may score in the OCS if they are treated as special dividends and would in all cases score in Capital Budgets.
	Income that is classified as a capital grant, such as a donation that is to be used to finance acquisition of a capital asset, scores in the Capital Budget.
	For income that is a tax or rent in the national accounts, the timing of recording of the income may differ for budgets and for OCS.
<b>Administration Budgets</b>	No difference from administration costs in the OCS, other than the differences that apply generally between OCS and RB
<b>NDPBs</b>	The department's operating cost statement shows the cash grant in aid paid to the NDPB and any cash received from the NDPB; budgets show the expenditure less negative DEL income of the NDPB.
<b>Support for Local authorities</b>	Capital grants to LAs score in the OCS and in Capital Budgets
<b>Public Corporations</b>	Capital grants to PCs score in the OCS and in Capital Budgets for PCs on the external finance basis
	Equity withdrawals from PCs may score in the OCS as special dividends and will in all cases score in Capital Budgets for PCs on the external finance basis
	Departments bear a cost of capital charge in budgets in respect of nearly all their PCs, in accounts only on those PCs where they have an investment (loans or equity).
	Budgets include the profit or loss of PC budgeted for on the consolidation basis
<b>On balance sheet PFI</b>	Termination payments under off balance sheet PFI deals score in the resource budget (assuming the department does not take economic ownership of the asset). However termination payments under on-balance sheet deals are treated differently in the national accounts. Any amount paid in excess of the liability (PFI creditor) being extinguished is considered a capital grant (assuming that no other assets are being acquired), and so score in the capital budget.
<b>Departmental Specific items (example)</b>	Cost of interest forgone by DfID when debts written off under Retrospective Terms Agreements

**TABLE 2: The main differences between the Capital Budget and the departmental resource account entries for total net additions to fixed assets and investments**

<b>General</b>	Capital Budget is divided into DEL and AME; DRAs include some but not all DEL and AME spending, and also some non-budget income and expenditure
<b>Departments' own spending</b>	Capital Budgets include capital grants and the take-up and revaluation of provisions in respect of capital grants; these score in the DRA OCS
	Certain large pre-payments are taken through the Capital Budget, while scoring as movements in current assets on the balance sheet
	In a limited range of cases, purchase and disposal of stocks scores in Capital Budget, but are not transactions in fixed assets in the DRA, which treats the transaction as dealing in current assets.
<b>Departments' income</b>	Income that counts as capital transfers in the national accounts, such as a donation to finance construction of an asset, passes through capital budgets
	Income from capital transfers (other than from the EC) scores when the cash is due to be paid, which may be different from the timing in DRAs
	There are limits on the quantum of income from the sale of assets that departments may keep in their budgets
<b>NDPBs</b>	Capital budgets show the expenditure less negative DEL income of the NDPB on the same basis as the department. DRAs do not include NDPB capex, but the department's operating cost statement shows the cash grant in aid paid to the NDPB
<b>Support for Local authorities</b>	Capital grants to LAs score in the OCS and in Capital Budgets
	Capital Budgets include Supported Capital Expenditure (Revenue) which does not feature in DRAs
<b>Public Corporations</b>	Capital grants to PCs scored on the external finance basis score in the OCS and in Capital Budgets
	Budgets for PCs on the external finance basis include PCMOB which is not included in DRAs
	If a department is an intermediary between the National Loans Fund and a sponsored public corporation or trading fund, then the DRA will show both the loan asset and a liability to the NLF. Budgets will show borrowing net of repayments.
	If a trading fund that is a department in its own right borrows from the National Loans Fund the "parent" department for budgeting purposes will show no accounting entry. However, its budget will show borrowing net of repayments.

	Equity withdrawals from PCs may score in the OCS as special dividends and will always score in Capital Budgets for PCs on the external finance basis
	Budgets include the Capital Expenditure of public corporations scored on a consolidation basis, which is not in DRAs and exclude loans to them which are in DRAs
<b>On balance sheet PFI</b>	No difference

# B

## TREASURY AND OTHER CONTACTS

This annex gives details of Treasury and other officials who may be contacted for further advice:

Issue	Contact	Team	Telephone/ E-mail
Initial contact for any aspect of the public spending control system	Your normal Treasury spending team contact		
<b>Resource &amp; Capital Budgeting</b>			
Resource Budgeting Policies	Sam Caughey	GEP	020 7270 4623 Sam.Caughey@hm-treasury.gsi.gov.uk
Non-Cash/ near-cash	Heather Miller	GEP	020 7270 4678 Heather.Miller@hm-treasury.X.gsi.gov.uk
Administration Budgets	Richard Knox	GEP	020 7270 5439 Richard.Knox@hm-treasury.X.gsi.gov.uk
End-Year Flexibility	Gideon Holland	GEP	020 7270 5967 Gideon.Holland@hm-treasury.X.gsi.gov.uk
Capital Budgeting	Sam Caughey	GEP	020 7270 4623 Sam.Caughey@hm-treasury.gsi.gov.uk
<b>Classification of Bodies and Transactions</b>			
National Accounts classification of flows;	Sam Caughey	GEP	020 7270 4623 Sam.Caughey@hm-treasury.gsi.gov.uk
In which sector of the economy is a body?	David Bailes	GEP	020 7270 4464 David.Bailes@hm-treasury.gsi.gov.uk
Treatment of receipts and income in the national accounts and in budgets	David Bailes	GEP	020 7270 4464 David.Bailes@hm-treasury.gsi.gov.uk

Issue	Contact	Team	Telephone/ E-mail
Designation as an NDPB	Rob Wall	Cabinet Office	020-7276-0269 Rob.Wall@cabinet-office.x.gsi.gov.uk
<b>Resource Estimates</b>			
Resource Estimates (for CO, MOD, FCO, COI, Chancellor's departments, DWP, DFT, and Pensions)	Gary Hansman	GEP	020 7270 5533 Gary.Hansman@hm-treasury.x.gsi.gov.uk
Resource Estimates (for DFES, DCMS, DCLG, DIUS, BERR, ECGD, DFID, DEFRA, NIO, and DH)	David Ash	GEP	020 7270 5528 David.Ash@hm-treasury.x.gsi.gov.uk
Resource Estimates (for HO, MOJ, Legal departments & parliamentary)	Debbie McNicholas	GEP	020 7270 4483 Debbie.Mcnicholas@hm-treasury.x.gsi.gov.uk
	Michael Mulvaney	GEP	20 7270 5532 Michael.Mulvaney@hm-treasury.x.gsi.gov.uk
<b>Public Corporations and Trading Funds</b>			
Public Corporations policy	Robert Epstein	CPF	020 7270 5497 Robert.Epstein@hm-treasury.gsi.gov.uk
<b>Local Authorities</b>			
New Burdens Rules	Tamira Lynsky	LG	020 7270 4945 Tamira.Lynsky @hm-treasury.gsi.gov.uk
<b>Accounts</b>			
Resource Accounting	Departments' own resource accounting advisors (who		

Issue	Contact	Team	Telephone/ E-mail
	may contact Treasury CA Team)		
Whole of Government Accounts	Kieran Rix	GFIR	020 7270 5887  Kieran.Rix@hm- treasury.gsi.gov.uk
<b>Recording</b>			
Recording Resource budgets on COINS	Sam Caughey	GEP	020 7270 4623  Sam.Caughey@hm- treasury.gsi.gov.uk
	Liz de Freitas	GEP	020 7270 5338  Liz.deFreitas@hm- treasury.x.gsi.gov.uk
COINS Database: New Program Objects, database maintenance, database operations & data updates.	Jim Williamson	GFIR	020 7270 5639  James.Williamson@hm- treasury.gsi.gov.uk
<b>PES Papers</b>			
PES papers	Vaishali Sadrani	GEP	020 7270 5663  Vaishali.Sadrani@hm- treasury.x.gsi.gov.uk
<b>Broken Links</b>			
If a link in Annex C does not work, please notify	Vaishali Sadrani	GEP	020 7270 5663  Vaishali.Sadrani@hm- treasury.x.gsi.gov.uk



The contact for notifying broken links is listed in Annex B.

The Treasury's GSI page gives access to information for practitioners on **budgeting, PES papers** (which may include updates to the budgeting system), **the SR**, performance, pay policy,

<http://www.hm-treasury.gsi.gov.uk/psd/index.htm>

ONS publish MA23 which lists many bodies and sets out what **sector of the economy** they are in:

[http://www.statistics.gov.uk/downloads/theme\\_economy/MA23.xls](http://www.statistics.gov.uk/downloads/theme_economy/MA23.xls).

The Cabinet Office publishes a range of material about **Non Departmental Public Bodies**

Public Bodies: A Guide for Departments is at

<http://www.civilservice.gov.uk/about/public/bodies.asp>

The Treasury publishes a range of **classification guidance notes covering national accounts treatments**

[http://www.hm-treasury.gov.uk/documents/public\\_spending\\_reporting/budgeting\\_classification/psr\\_bac\\_classification\\_papers.cfm](http://www.hm-treasury.gov.uk/documents/public_spending_reporting/budgeting_classification/psr_bac_classification_papers.cfm)

Guidance on **Supply Estimates** is available at the HM Treasury public website

[http://www.hm-treasury.gov.uk/documents/public\\_spending\\_reporting/estimates/estimates\\_index.cfm](http://www.hm-treasury.gov.uk/documents/public_spending_reporting/estimates/estimates_index.cfm)

Guidance on **COINS** and **recording transactions** can be found at the COINS website and on HM Treasury's GSI site:

COINS system guidance

<http://www.coins.gsi.gov.uk/coins/>

COINS recording guidance

[http://www.hm-treasury.gsi.gov.uk/psd/PES\\_database/classification/081707coins\\_recording\\_guidance.doc](http://www.hm-treasury.gsi.gov.uk/psd/PES_database/classification/081707coins_recording_guidance.doc)

**Public Expenditure Statistical Analyses** gives information on public spending analysed by reference to the budgetary control framework, sectors of the economy, government functions (irrespective of which organisation is spending the money), and the country or region of the UK, which has benefited from public spending. Appendices describe the control framework. One of the appendices is a **glossary of public expenditure terms**:

[http://www.hm-treasury.gov.uk/economic\\_data\\_and\\_tools/finance\\_spending\\_statistics/pes\\_publications/pes\\_pub\\_index.cfm](http://www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pes_publications/pes_pub_index.cfm)

The Treasury's Government Financial Management Directorate GSI website links to **Government Accounting** and information on **accounting, audit and risk**

<http://www.hm-treasury.gsi.gov.uk/GFM/index.htm>

The **Government Financial Reporting Manual (FReM)** contains the technical accounting guidance used for public funds. It is available on its dedicated website

[www.financial-reporting.gov.uk](http://www.financial-reporting.gov.uk)

**Dear Accounting Officer letters** give guidance on a range of subjects:

[http://www.hm-treasury.gov.uk/documents/public\\_spending\\_reporting/governance\\_risk/psr\\_governance\\_dao\\_letters.cfm](http://www.hm-treasury.gov.uk/documents/public_spending_reporting/governance_risk/psr_governance_dao_letters.cfm)

Information on **Whole of Government Accounts** is at:

<http://www.wga.gov.uk/>

The **PFI/PPP** area of the Treasury's website gives access to the main policy document on PFI/PPP Meeting the Investment Challenge, the value for money guidance and guidance on refinancing:

[http://www.hm-treasury.gov.uk/documents/public\\_private\\_partnerships/ppp\\_index.cfm](http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm)

The Treasury's guidance on the **wider markets initiative** is at:

<http://www.partnershipsuk.org.uk/Information/commercialisation/Selling%20into%20Wider%20Markets.pdf>

The address of the Treasury website section on the **Green Book** on option appraisal is given below. The **Social Time Preference Rate** is discussed in Annex 6.

[http://www.hm-treasury.gov.uk/economic\\_data\\_and\\_tools/greenbook/data\\_greenbook\\_index.cfm](http://www.hm-treasury.gov.uk/economic_data_and_tools/greenbook/data_greenbook_index.cfm)

The Cabinet Office's website for **pensions** is at:

<http://www.civilservice-pensions.gov.uk/menu.asp>

The link to the **Professional Services Forum** is at:

[http://www.ogc.gov.uk/professional\\_services\\_forum\\_faq.asp#3](http://www.ogc.gov.uk/professional_services_forum_faq.asp#3)

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# D

## LIST OF ABBREVIATIONS

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A glossary of public expenditure terms is published as an appendix in Public Expenditure Statistical Analyses – see Annex C for the link

<b>AME</b>	Annually Managed Expenditure
<b>CDEL</b>	Capital Departmental Expenditure Limits
<b>CFER</b>	Consolidated Fund Extra Receipt
<b>COCC</b>	Cost of Capital Charge
<b>COINS</b>	Combined On-Line Information System
<b>DEL</b>	Departmental Expenditure Limits
<b>DfID</b>	Department for International Development
<b>DIS</b>	Departmental Investment Strategy
<b>DOH</b>	Department of Health
<b>DRA</b>	Departmental Resource Accounts
<b>DUP</b>	Departmental Unallocated Provisions
<b>DWP</b>	Department for Work and Pensions
<b>EC</b>	European Communities
<b>EC</b>	Economic Category
<b>ESA95</b>	European System of Accounts (1995 version)
<b>FRP</b>	HMT Financial Reporting Policy Team
<b>EYF</b>	End Year Flexibility
<b>FReM</b>	Financial Reporting Manual
<b>GAAP</b>	Generally Accepted Accounting Practice
<b>I&amp;E</b>	Income and Expenditure account
<b>MOD</b>	Ministry of Defence
<b>NAO</b>	National Audit Office
<b>NCR</b>	Net Cash Requirement (in Estimates)
<b>NDPB</b>	Non Departmental Public Bodies
<b>NLF</b>	National Loans Fund
<b>OCS</b>	Operating cost statement
<b>OGC</b>	Office of Government Commerce
<b>OMV</b>	Open Market Value

<b>ONS</b>	Office for National Statistics
<b>PCMOB</b>	Public Corporations' Market and Overseas Borrowing
<b>PCs</b>	Public Corporations
<b>PEOWP</b>	Public Expenditure Outturn White Paper
<b>PFI</b>	Private Finance Initiative
<b>PPA</b>	Prior period adjustments
<b>PPP</b>	Public Private Partnerships
<b>PSND</b>	Public Sector Net Debt
<b>RCV</b>	Regulatory Capital Value
<b>RDEL</b>	Resource Departmental Expenditure Limits
<b>RI</b>	Reversionary Interest
<b>SCE(R)</b>	Supported Capital Expenditure (Revenue)
<b>SCOA</b>	Standard Chart of Accounts
<b>SFPC</b>	Self Financing Public Corporations
<b>SR</b>	Spending Review
<b>TME</b>	Total Managed Expenditure
<b>TSB</b>	Transactions that are in Substance Borrowing
<b>WACC</b>	Weighted Average Cost of Capital

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