

TRANSITIONAL ADJUSTMENTS FOR 2001-02 DEPARTMENTAL RESOURCE ACCOUNTS

Introduction

1. This annex concerns additional adjustments and treatments to be adopted in resource accounts in order to account properly for the transition from the old to the new basis of parliamentary Supply. The treatments are necessary to preserve parliamentary control and to deal appropriately with cash balances held by departments. Where departments' accounts for 2001-02 have already been signed without adopting such treatments, action is not required to re-open them. In these (few) cases, further advice will be issued in due course to effect adjustments in 2002-03.

Treasury letter DAO(GEN) 08/02

2. Treasury letter DAO(GEN) 08/02 issued on 19 March 2002 provides guidance on adjustments that may need to be made to balances recognised in resource accounts at 31 March 2001, relating to departments' indebtedness to the Consolidated Fund. Review and, as necessary, adjustments are needed to ensure 'continuity' between the 'old' and 'new' systems of Supply, so that opening balances (adjusted, as necessary) in the 2001-02 resource accounts accurately reflect the closing position on the Appropriation Accounts for 2000-01. They are then a sound basis for settlement between departments and the Consolidated Fund. Parliamentary control is otherwise at risk. Auditors should therefore establish that the review and adjustments have been properly carried out.

Other transitional adjustments - working capital balances

3. There are two other areas not referred to in the Treasury letter where the transition to the new basis of Supply requires a 'one off' accounting treatment for 2001-02. The treatment, which has been discussed and agreed with the National Audit Office (who will be issuing their own guidance on the same basis), is set out below. The areas both relate to the treatment of other balances brought forward at 1 April 2001. They concern certain types of debtor and creditor balances and their treatment as working capital for the purposes of determining the Net Cash Requirement in Schedule 1 of the accounts.

Adjustment 1: Exclusion, for Schedule 1 purposes, of certain opening balances for working capital

4. For the purpose of determining the working capital movement in Schedule 1, for the reasons set out in paragraphs 7 to 9 below, the opening debtors and creditors should **exclude** items that represent closing balances on the Assets and Liabilities (A&L) Statement accompanying the associated Appropriation Account(s) for 2000-01. (Such items, with some exceptions – see paragraph 6 below - are nonetheless properly included in debtor and creditor balances brought forward onto the balance sheet at 1 April 2001, and should be taken into account in the overall working capital movements recognised in Schedule 4, the Cash Flow Statement.)

5. Typically the balances to be excluded will comprise 'suspense account' items such as advances made or received by the department or indebtedness between departments. **In effect, for many departments, all balances on the A&L Statement except those relating to cash (in hand, at bank or with the Paymaster General) and to the Consolidated Fund (ie Supply and Supply Surpluses, Excess Appropriations in Aid and other Consolidated Fund Extra Receipts) should be excluded from opening balances in the Schedule 1 working capital computation.**

6. However, all A & L Statement balances need to be reviewed before taking such action, because they may include some that require additional or different treatment. For example, where suspense accounts were used under appropriation accounting to account for ‘third party’ monies (such as prisoners’ monies held by the Prisons Service), the balances on such accounts should not in any case be included on the balance sheet, because they are required by the Resource Accounting Manual (RAM), section 8.9, only to be disclosed by way of a Note. If this proper treatment has been adopted, it follows that they will not be included in working capital in Schedule 1. In addition, however, the cash that represents those balances should also be removed from the balance sheet, and we should see that **both** these actions have been properly carried out.

Explanation for excluded balances

7. These balances should be excluded because they comprise the net asset (or liability) which, together with ‘cash’ (in all its forms), represent the surplus Supply from 2000-01 to be surrendered. Departments require these assets to settle the liability to the Consolidated Fund. They do not represent working capital available for 2001-02. The reverse is also true in reverse where departments have a net credit balance. This will be evident from the fact that the ‘cash’ balance at 31 March 2001 relating to the Supply surplus to be surrendered (as now required by RAM 3.14.3b to be separately disclosed) will generally not equate to the Consolidated Fund creditor for this item.

8. If departments fail to make this adjustment then, to the extent of such a net debit balance, they will ultimately either lack the cash with which to settle the liability to the Consolidated Fund – or be ‘short’ by that amount when the surplus is rolled forward to become part of next year’s Supply. Or, if the net balance is a credit, departments will have a permanent ‘surplus’ cash balance not matched by a liability to the Consolidated Fund. Both have the effect of distorting the Net Cash Requirement met from the Fund.

9. The adjustment is needed because under cash-based Supply, advances received or paid that did not resolve into a charge against the Appropriation Account for the year did not represent voted expenditure. They were thus surrenderable to the Consolidated Fund as if they were part of the unspent Surplus. Under resource-based Supply system, provision is made in the Net Cash Requirement for ‘working capital’, which will include advances made and received among other things. (Such advances of course continue to be governed by the Government Accounting rule that payments should not be made in advance of need.) Because of this change, the adjustment is needed as a ‘one off’ to effect the transition.

Impact of the adjustment – matching cash to the Consolidated Fund liability

10. Once the transitional adjustment has been made, the creditor to the Consolidated Fund for unspent Supply at 31 March 2002 should directly match this element of the department’s cash balance. Both are required to be disclosed separately in the accounts (RAM 3.14.3 b(i) and 3.14.6) and we should look to see that they indeed match.

Adjustment 2: Inclusion of debtors for amounts due as appropriations in aid

11. All debtors at 31 March 2001 for sums due in respect of income which by its nature is available to be appropriated in aid, **may properly be included** as part of the opening working capital for the purpose of determining the Net Cash Requirement. In other words, the cash inflows from such debtors can legitimately be used towards financing the department’s expenditure, as an offset against the Net Cash Requirement met from the Consolidated Fund.

12. This is notwithstanding that, under the previous ‘shadow’ resource estimates, some of the income giving rise to such debtors may have been regarded as ‘Excess’ appropriations in aid and thus surrenderable to the Consolidated Fund. Such ‘shadow’ limits do not truly apply, and

DAO(GEN) 08/02 requires (at paragraphs 5 and 6 of the Annex) the creditor to the Consolidated Fund for excess appropriations in aid to be adjusted as necessary to the 'cash based' excess derived from the 2000-01 Appropriation Accounts. This treatment of opening debtors is not made explicit in the Treasury's letter but is an implied corollary to the adjustment for balances due to the Consolidated Fund.

Audit impacts and accounting requirements

13. Almost undoubtedly the treatment of debtors for appropriations in aid set out at paragraphs 11 and 12 above will have been presumed by departments. No further accounting or audit action should be needed, other than to accept such treatment where it has been adopted.

14. However, the adjustment required for balances on the A& L Statement set out in paragraphs 4 to 10 may well not have been perceived by departments. The National Audit Office may well draw departments' attention to this as soon as possible and discuss with them the need for it and the accounting implications, including impacts on the Net Cash Requirement.

15. Among the impacts of the adjustment will be that movements in working capital taken into account in Schedule 4, the Cash Flow Statement, will differ from the movement recognised in Schedule 1, the Summary of Resource Outturn. The former will comprise **all** working capital movements whereas the latter, because of the adjustment, will be only a 'subset'. (The latter will routinely be only a subset, because it will also exclude working capital items that relate to Consolidated Fund Extra Receipts - including Excess Appropriations in Aid. But the adjustment is an additional 'exceptional' item.)

Implementation of adjustments

16. To implement the adjustment in the financial statements, two actions are required:

- **X)** the account Note setting out the 'Movements in working capital other than cash' (note 14 in Department Yellow at Annex 4 to the RAM) should be further analysed as set out below (or some other means adopted to provide equivalent disclosure); and:
- **Y)** an additional reconciling item needs to be introduced in the 'Financing' note to the Cash Flow Statement.

Thus:

In the Notes to the accounts:

X) Movements in working capital other than cash

(Decrease)/increase in stocks/work in progress

(Decrease)/increase in debtors

Decrease/(increase) in creditors

Total movement in working capital.....

Adjustments:

Movements not relating to voted Resource consumption (net), being movements on debtors/creditors not related to Supply

Transitional adjustment, being adjustment for outstanding balances relating to the department's Appropriation Accounts for 2000-01

Working capital movement recognised in Schedule 1.....

In the Cash Flow Statement:

Y) Analysis of Financing and reconciliation to the Net Cash Requirement

[Final item] 'Transitional adjustment' (Note ref to Working Capital Note)

Net Cash Requirement (Schedule 1).....

Action if 2001-02 accounts have been signed

17. Where departments have already signed their 2001-02 resource accounts without making the adjustment for balances recorded on the 2000-01 Appropriation Account A & L Statement as set out above, other steps will need to be taken to correct the situation in 2002-03. Further guidance on this will be issued, but it would be appropriate to note this in the Management Letter as a point to keep in view. If, regarding the second of these transitional treatments, departments have not brought forward into their Schedule 1 working capital debtors for appropriations in aid as at 31 March 2001, no further action is required unless an excess vote on the Net Cash Requirement would arise solely as a result of this. This situation is perhaps unlikely, but in such circumstances the department should consult the Treasury Officer of Accounts team (Debbie Edwards, 020 7270 5363, email debbie.edwards@hm-treasury.go.uk), and auditors should advise the Financial Audit Support Team, to determine what action should be taken.

Effect on Executive Agency Accounts

18. The recognition of unspent Supply cash and the corresponding creditor to the Consolidated Fund (or, more rarely, a cash deficit and a debtor due from the Consolidated Fund) has potential implications for on-vote Executive Agencies - for their 'share' of such surpluses or deficits and the way they are represented. A variety of practices appear to have been adopted by Agencies in the past for dealing with such balances. And the introduction of a Net Cash Requirement that covers the whole of a department without dis-aggregating the elements relating to its agencies, creates new issues regarding the financing 'entitlement'. (For example, in the event of a 'shortfall' in the draw-down of financing there is the question as to what additional entitlement if any may be recognised and accrued.)

19. Most Agency accounts are already signed or close to completion for pre-Recess laying and it is not intended that any adjustments should hold up that process. As necessary, therefore, past practices should be adhered to. However, the Treasury are to review the way that balances related to financing should be represented in Executive Agency accounts. This will be the opportunity to rationalise the various treatments that have developed. However, the key requirement for 2001-02 is that, whatever the treatment within their Executive Agencies' accounts, a reciprocal treatment in the disclosures relating to non-agency parts of departments, where these are produced, should bring about full and fair recognition of the Supply funding, consumption and balances in the consolidated departmental resource account. Generally, therefore, any such issues should not be a reason for **departments** to defer taking the steps at paragraphs 2-6 above and applying the examples in paragraph 16 above.