

H M Treasury

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Dear Accounting Officer

RESOURCE ACCOUNTING MANUAL 2002-03: GUIDANCE ON THE INCLUSION OF AN OPERATING AND FINANCIAL REVIEW IN AN ANNUAL REPORT

Purpose of this DAO letter

The purpose of this letter is to ensure that departments continue to reflect best practice in their performance reporting. It sets out the guidance that departments should follow to satisfy the requirement of paragraph 11.2.1 of the Resource Accounting Manual (RAM) for 2002-03 for the inclusion of an operating and financial review in a department's annual report. The guidance itself is given in the attached annex.

Action and enquiries

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

Scope of the DAO letter

4. The guidance applies only to departments. It does not apply to agencies (or agencies that are whole departments), trading funds or NDPBs. These entities should follow the Cabinet Office's guidance "Next Steps Agencies – Guidance on Annual Reports" (January 2003), which has been revised to reflect similar operating and financial review reporting requirements. Relevant references are given for:

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



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- b. Trading funds, in chapter 3 of the Trading Funds Accounts Guidance;
- c. Non-departmental Public Bodies (NDPBs), in chapter 2 of the Executive Non-Departmental Public Bodies Annual Reports and Accounts Guidance.

Background

5. The Accounting Standards Board (ASB) published on 9 January 2003 a revised form of its Statement, “Operating and financial review”. The revised Statement replaces that of October 1993 which formed the basis for the departmental reporting requirements for 2001-02 set out in DAO(GEN)09/02, which is now superseded.

6. The ASB’s revised Statement differs from the 1993 version principally in giving greater prominence given to discussion of the business overall, including its objectives and strategy, and its strengths and resources. This is reflected also in a change in focus from ‘results’ to a wider notion of ‘performance’, as measured using the key performance indicators (non-financial as well as financial) that are used in managing the business.

7. The guidance for departments for 2002-03, as set out below, reflects the same approach as that for 2001-02. It reflects the ASB’s Statement’s focus on the principles to be followed rather than on the content. This is to leave departments scope to flesh out their OFRs in the way that best suits their circumstances.

8. The process of preparing this guidance has included the normal RABIG consultation appropriate for RAM amendments. The Financial Reporting Advisory Board approved the guidance on 20 March.

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RESOURCE ACCOUNTING MANUAL (RAM) 2002-03 – GUIDANCE ON THE INCLUSION OF OPERATING AND FINANCIAL REVIEWS IN ANNUAL REPORTS

1. A section, headed “Operating and financial review” (OFR), will be included in each annual report produced to meet the requirements of sub-section 11.2.1 of the RAM. The new section in the annual report will be placed to follow the “Scope” section and precede the “Management” and “Public interest and other” sections. The RAM’s requirements for those existing three sections in the annual report will continue to be met, as set out in sub-paragraphs 11.2.1.a to 11.2.1.r of the RAM for 2002-03, other than in sub-paragraphs:

- a. 11.2.1.g, in which the reference to the departmental report should be taken to be to both the main departmental report to be published in April and later the autumn supplementary performance information report;
- b. 11.2.1.g, because disclosures in relation to pension liabilities and the statements of the relevant pension schemes will be given in the notes to the accounts, to meet the requirements of FRS 17.

2. The new section will meet the requirements of the ASB’s revised Statement “Operating and Financial Review”, January 2003, to the extent that it is meaningful and appropriate in the public sector context. Reference should be made to the ASB’s Statement for a full understanding of its requirements.

3. The precise content of an OFR is for the department to consider, but its objective should be to set out an analysis by its management of its business, in order to provide a historical and prospective analysis of the reporting entity ‘through the eyes of management’. It should include discussion and interpretation of the performance of the business and the structure of its financing, in the context of known or reasonably expected changes in the environment in which it operates.

4. In addition, the preparation of the OFR should reflect the application of each of the ASB’s Statement’s six principles, which cover: the purpose of the OFR; its audience; the time-frame it addresses; the reliability of the information given; the comparability of that information; and measures of performance.

5. The ASB’s Statement gives guidance on the application of its principles, in relation to: the business, its objectives and strategy; the operating review - performance in the period; returns to shareholders, dynamics of the business, investment for the future; financial review - capital structure and treasury policy, cash flows; and current liquidity. This guidance should be interpreted to reflect the public sector context where relevant. This is principally because:

- a. annual reports and accounts form only a part of the process of accountability, particularly to Parliament and the public;

- b. authority for, and substantially the financing of, departments' activities is provided by Parliament which does not have as its ultimate objective the achievement of financial returns thereby.

6. The cycle of accountability to Parliament and the public also includes other published documents such as Spring Departmental Reports, Autumn Performance Reports, Spending Review Settlements, and Estimates. To avoid unnecessary duplication of detail, references may be made in OFRs to these other documents. This may, for example, be in relation to progress on PSA targets and to Departmental Investment Strategies. Where such references are given, however, summary information should still be given in the OFR.

7. In addition, reference should be made to relevant Parliamentary control information in Schedule 1 and to the information on resources and objectives in schedule 5. Likewise, discussion of the financing implications of significant changes in a department's objectives and activities, its investment strategy and its long-term liabilities, including significant provisions and PFI and other leasing contracts, should be set in the context of the its spending review settlement. There should not normally be either a discussion of current liquidity or a going concern statement.