

Accounting consequences of Machinery of Government changes

Background

1. The application of these changes to the Supply Estimate and Appropriation Procedures will not affect the present application of FRS 6 (Acquisitions and Mergers) to the merger of two or more departments, or the transfer of functions from the responsibility of one part of the public sector to another. These should be accounted for using merger accounting as described in FRS 6, the main requirements of which are summarised within the *Resource Accounting Manual* (section 8.8)
2. However the introduction of 'Negative Supplementary Estimates' will remove a number of mechanical entries required to align the accounting treatment with Parliamentary Estimates.
3. At present the departmental accounts record a transfer in of a function as Appropriations in Aid within Schedule 1 of the accounts and a transfer out of a function as Gross Expenditure within Schedule 1 of the accounts. Schedule 2 records the transfer under merger accounting FRS 6. The difference in treatment between the two Schedules requires reconciliation items in a number of the notes within the accounts.
4. Following the introduction of 'Negative Supplementary Estimates' the accounting treatment of transfers within Schedules 1 and 2 will be aligned and the necessity for the present reconciliation items within the accounts will be removed.
5. The following adjustments will **not** be required within Departmental accounts:
 - The transfer in of a function will not be recorded within the Summary of Resource Outturn (Schedule 1) as Appropriations in Aid. The income and expenditure will be recorded in line with merger accounting principles;
 - The transfer out of a function will not be recorded within the Summary of Resource Outturn (Schedule 1) as Gross Expenditure. The income and expenditure will be recorded in line with merger accounting principles;
 - Within the 'Reconciliation of resources to cash requirement' (Schedule 1) the line 'Transfer of functions – difference between resource and cash transfers' will not be required^[1];
 - 'The Analysis of the operating cost statement between the function transferred from Department X and other functions for the year ended 31 March XXXX' table within Note 3^[2] to the accounts will not be required;
 - The 'Transfer of Estimate cover from Department X' column within Note 8 will not be required;
 - Neither additional rows recording the 'Transfer of Functions' nor the 'Transfer of estimate cover' line within the Reconciliation to Operating Cost Statement will be required within Note 12 to the accounts;
 - No reference to a Transfer/Machinery of Government Debtor or Creditor will be

required in Notes 19, 20 or 21; and

- Under Parliamentary Funding within Note 23 to the accounts the line 'Transfer to/from Department X in respect of transferred function A' will not be required.

Illustration of Departmental Accounting requirements with a Negative Supplementary Estimate

- Department Yellow transfers Agency Blue to Department Pink on 1/10/0X.
- In budgetary terms this results in Department Yellow's cash, resource and capital allocation being reduced.
- Department Yellow should amend its estimate for 0X/0Y (downwards, which it can now do) to reflect the removal of Agency Blue from its departmental activities. Department Pink should amend its estimate upwards to reflect the new resource, capital and cash requirements of Agency Blue.
- Internally Department Yellow needs to identify any in year resource expenditure of Agency Blue, any cash payments made for Agency Blue items within the accounting year and the Balance Sheet balances held at the transfer date. This information should be provided to Department Pink.
- Department Yellow need to ascertain the net cash position on Agency Blue since 1/4/0X – i.e. all cash out in relation to Agency Blue activities less any cash in as the result of Agency Blue activities. This balance becomes an inter-departmental debtor from Department Pink (or creditor to Department Pink).
- This inter-departmental Creditor/Debtor will need to be settled by a cash transfer between the departments.

Calculation of Net Cash Requirement within the Supplementary Estimate

In amending the Net Cash Requirement within the Supplementary Estimate the Departments should ensure that the assumptions made as to when any interdepartmental debtors/creditors will be settled are consistent between the departments. In particular, departments should agree when they expect such balances to be settled in relation to the end of the financial year. If one department assumes that a departmental debtor/creditor will be settled before year end whereas another department assumes that the debtor/creditor will be settled after the year end, the estimated net cash requirements of the two departments will not increase/decrease by the same amount.

Consider the following scenario:

- Department Yellow's main estimate has a NCR of £20m. Of this £10m relates to Agency Blue activities and £10m to the rest of the department. Department Pink's main estimate has a NCR of £15m.
- Agency Blue is transferred to Department Pink on 1/10/0X. At the point of transfer Department Yellow has made net cash outlay on Agency Blue (since the 1/4/0X) of £5m. Department Yellow has also drawn down the full £20m of its NCR from the Consolidated Fund.

- The transfer of Agency Blue is reflected in the supplementary estimates by an increase in Department Pink's net resource expenditure and a corresponding and equal fall in Department Yellow's net resource expenditure.
- The departments will also need to adjust their Net Cash Estimate Requirements to reflect the transfer. Department Pink should increase its NCR by £10m to reflect the additional cash expenditure resulting from Agency Blue – giving a total NCR estimate of £25m.
- Department Yellow should reduce its NCR by £10m to reflect the reduction of cash expenditure resulting from Agency Blue. However at the time of the transfer Department Yellow will need also to increase its NCR by £5m to reflect the increase in Debtors from Department Pink. The net effect is that its NCR will reduce by £5m only – giving a total NCR estimate of £15m.
- The overall NCR of both departments has actually increased by £5m. This is because the departments are preparing their estimates on different assumptions.
- Department Yellow has at the time the supplementary estimate is laid an inter-departmental Debtor of £5m (owed for pre-transfer expenditure) and will submit a NCR on the basis that this debtor is still outstanding at the year-end and hence forms part of its NCR outturn. Department Yellow is assuming the inter-departmental balance is not paid by the year-end.
- However, Department Pink has at the time the supplementary estimate is laid an inter-departmental Creditor of £5m. This should be paid in a timely manner. Department Pink should therefore submit an estimate on the basis that this creditor will be paid by the year-end and hence will form part of its NCR outturn. Department Pink is assuming the inter-departmental balance is paid by the year-end.
- At the year-end the outturn can only be one of these scenarios and the NCR outturn figures of the two departments will therefore not reflect any double counting.
- However unless inter-departmental balances have been settled at the time the supplementary estimate is laid both departments should ensure the estimate level is sufficient to cover their cash expenditure under both potential outcomes.
- It should also be noted that under this scenario Department Yellow's new NCR is £15m, but it has drawn down £20m by the point of transfer. Department Yellow must re-pay this £5m to the Consolidated Fund. Until the repayment is made the £5m is over-issued supply and should be recorded within Department Yellow's ledger and a Consolidated Fund Supply Creditor.

[1] This line was required as the result of the cash and resource transfers between departments being different.

[2] The number of the notes referred to above reflect their numbering within Department Yellow, Annex 4 to the Resource Accounting Manual.