ALIGNMENT ("CLEAR LINE OF SIGHT") PROJECT

Memorandum submitted by HM Treasury

SUMMARY

1. The Government announced in its July 2007 Green Paper "The Governance of Britain" (Cm 7170) that it would simplify its financial reporting to Parliament, ensuring that it reports in a more consistent fashion, in line with the fiscal rules, at all three stages in the process – on plans, Estimates and expenditure outcomes.

2. This Memorandum outlines the Government’s emerging thinking on how this commitment can best be delivered. The Government is not at this stage seeking the Committees’ approval of the individual proposals described below, which will be the subject of a further, more detailed Memorandum to the Committees planned for early 2009. The Government would, however, welcome an early indication of the Committees’ endorsement of the broad approach and underlying principles outlined in this Memorandum, to inform the development of more detailed proposals.

Why change is needed

3. Under current arrangements, there are a number of different systems for presenting Government expenditure. The Government uses budgets to plan what it will spend; it then presents Estimates to Parliament for approval; and finally, after the year end, it publishes resource accounts. There are two main issues with these arrangements:

i. there is significant misalignment between the different bases on which financial information is presented to Parliament; and accordingly

ii. Government financial documents are published in different formats, and on a number of different occasions during the year, making it difficult to understand the links and inter-relationships between them.

4. Against this background, the Government’s "Vision" for the Alignment Project is:

“to create a single, coherent financial regime, that is effective, efficient and transparent, enhances accountability to Parliament and the public, and underpins the Government’s fiscal framework, incentivises good value for money and supports delivery of excellent public services by allowing managers to manage".

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Advantages of the new system

5. Delivering this Vision will bring a number of benefits for both Parliament and Government. It will mean:

- A simpler system, with a single set of numbers, which is more transparent, more comprehensible and easier to use, and which improves public debate and understanding through enhanced scrutiny of government spending.
- Better government through improved democratic involvement for, and accountability to, Parliament and the public.
- A significantly enhanced ability by government to maintain firm control over public spending, while not altering the way the fiscal rules are defined.
- Building into the system the right incentives to deliver better value for money.
- A more coherent presentation of financial reporting documents that meets the needs of government and Parliament, is consistent with best practice in the private sector and does not create complexity elsewhere.
- A rationalisation of the number of occasions each year on which Government presents financial reporting documents to Parliament, resulting in greater coherence and comprehensibility in the Government’s reporting to Parliament.
- A financial regime which is burden-reducing for departments and promotes greater administrative efficiency, thereby enabling departments to focus on making substantive improvements to the value for money of their spending.

6. This ambitious programme of change is fully consistent with the recommendations of both the Treasury Committee\(^1\) and the House of Commons Liaison Committee\(^2\), that the Government should provide Parliament with better and more coherent financial information.

Key changes needed to deliver better alignment

7. Consistent with the Vision for the project, the main changes that the Government considers are needed to deliver a better aligned framework are as follows:

- All non-voted expenditure and income within budgets is brought within the coverage of Estimates.
- Parliamentary controls in Estimates are on a net (rather than both gross and net) basis, to line up with budgetary controls, with details of income shown in the Estimates and appropriate safeguards in place so that firm control is maintained over the use of income by departments.
- The Estimates and accounting boundaries are extended to accommodate NDPBs and other bodies classified to the central government sector.

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The budgeting concepts of “near cash” and “non cash” are removed so that there is a single Resource DEL budget.

Parliamentary controls are changed to reflect the alignment of the Estimates and budgeting boundaries.

Resource accounts are, as far as practicable, based on IFRS, as adapted for the public sector context.

The number of departmental and HM Treasury expenditure documents is reduced to just two “publication events” each year.

**Conclusion**

8. The Government believes that these changes represent a coherent set of reforms, which should be regarded as a single package. Achieving better alignment between budgets, Estimates and accounts, and streamlining the Government’s financial publications, will require radical change, but there are very significant benefits to be gained. It will be important, in taking forward the Alignment Project, to continue to focus on the “big picture”, in order to ensure that the full benefits of better alignment are secured. All stakeholders in the project will need to be prepared to balance the overall aim of achieving the benefits associated with a better aligned framework, with the potential difficulties associated with change. Otherwise the prize will be lost.

9. As noted earlier, the Government is not at this stage seeking the Committees’ approval of the individual proposals described in this Memorandum. The Government would, however, welcome an early indication of the Committees’ endorsement of the broad approach and the underlying principles, to inform its further work.

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THE GOVERNMENT’S PROPOSALS FOR BETTER ALIGNMENT

10. The remaining sections of this Memorandum outline in more detail the Government’s emerging thinking on how its commitment in Cm 7170 to simplify its financial reporting to Parliament can best be delivered.

11. The following paragraphs begin with a brief outline of the context for the Alignment Project, the “Vision” for what we are trying to achieve and the challenge we face in seeking to develop a clearer and more coherent expenditure framework. They then describe in more detail the underlying principles we are applying in order to get there, and the key changes to the present system that we believe are needed in order to achieve better alignment. The Memorandum ends with a brief description of the next steps in taking the project forward and a summary and conclusions.
CONTEXT

12. A key role of Parliament, and of the House of Commons in particular, is to hold Government to account for expenditure and the collection of taxes and the raising of income. The April 2008 report by the House of Commons Liaison Committee “Parliament and Government Finance: Recreating Financial Scrutiny”\(^3\) usefully defined the purpose of financial scrutiny by the House of Commons as being:

- to make the Government’s financial decisions transparent, including the relationship between its stated priorities and its funding decisions;
- to engage bodies and individuals outside Parliament and give them the opportunity to comment;
- to have the opportunity to influence the Government’s financial decisions;
- to hold the Government, individual Departments and other public bodies to account for their financial decisions and financial management; and thereby
- to contribute to an improvement in the quality of Departments’ financial decisions and management and improved value for money in public services.

13. Under current arrangements, there are a number of different systems for presenting Government expenditure. The Government uses budgets to plan what it will spend; it then presents Estimates to Parliament for approval; and finally, after the year end, it publishes resource accounts. There are two main issues with these arrangements, which are explained in more detail in this Memorandum:

- there is significant misalignment between the different bases on which financial information is presented to Parliament; and accordingly
- Government financial documents are published in different formats, and on a number of different occasions during the year, making it difficult to understand the links and inter-relationships between the bases on which financial information is presented.

14. The Government has already implemented a number of significant changes over recent years in the way in which financial information is reported, with the aim of making the public expenditure system more transparent. These changes have included:

- the publication of three year spending plans, following each Spending Review, linked to the achievement of clear objectives set out in Public Service Agreements;
- the implementation of Resource Accounting and Budgeting (RAB), which brought the highest standards of the private sector into financial reporting by the public sector and was intended to create new value for money incentives

\(^3\) Second Report 2007-08 (HC 426) published on 21\(^{st}\) April 2008.
for departments. The implementation of International Financial Reporting Standards (IFRS) in 2009-10 will build on this; and

- significant improvements in the closure of departmental resource accounts, so that the accounts are available much earlier in the year. This has enabled an increasing number of departments to publish combined Departmental Reports and Resource Accounts before the summer recess, providing more coherent information about the department’s spending.

15. Building on these improvements, and recognising the importance of financial scrutiny by the House of Commons, the Government announced in Cm 7170 that it would simplify its reporting to Parliament, with the aim of making it easier to understand how Government has used the resources voted to it, and thus to hold Government to account. This will involve addressing misalignments between budgets, Estimates and accounts and changing the configuration of financial reporting documents presented to Parliament.

16. This Memorandum sets out the broad approach, and underlying principles, for how the Government proposes to achieve, through the Alignment Project, the objectives set out in Cm 7170.

THE “VISION”

17. As noted earlier, the Government’s “Vision” for the Alignment Project in delivering its commitment in Cm 7170 to simplify its financial reporting to Parliament is:

“to create a single, coherent financial regime, that is effective, efficient and transparent, enhances accountability to Parliament and the public, and underpins the Government’s fiscal framework, incentivises good value for money and supports delivery of excellent public services by allowing managers to manage”.

18. Delivering this Vision will bring a number of benefits for both Parliament and Government, as outlined in paragraph 5 above.

19. This ambitious programme of change is fully consistent with the recommendations of both the House of Commons Liaison Committee in HC 246, and of the Treasury Committee in HC 279, that the Government should provide Parliament with better and more coherent financial information. It is also in line with similar conclusions in the Hansard Society’s July 2006 report “The Fiscal Maze: Parliament, Government and Public Money”, and with proposals for improving Parliamentary scrutiny of Government spending in a press notice issued by the Committee of Public Accounts (PAC) in July 2006⁴.

20. Government currently controls and manages public spending against a variety of frameworks:

- **National Accounts** – which are an integrated set of economic accounts covering the whole of the economy. These accounts are produced by the Office for National Statistics (ONS), in accordance with the European System of Accounts (ESA) 1995. National Accounts are used to determine performance against the fiscal rules.

- **Budgets** – which are defined by the Treasury and used to control public spending. Budgets are allocated by the Treasury in Spending Reviews and reported on at successive Pre-Budget Reports (PBRs) and Budgets. Certain elements of budgets are aligned to National Accounts definitions. Others, such as those introduced with the move to full Resource Accounting and Budgeting (RAB) in 2003-04, relate to more commercial-style accounting concepts and are designed to improve value for money incentives in departments.

- **Supply Estimates** – which seek annual Parliamentary authority for the expenditure of individual departments, following the plans announced in Spending Reviews. Estimates are largely, if not entirely, aligned to generally accepted accounting practice (GAAP) accounting definitions, rather than to National Accounts, although they do not encompass all of the departmental expenditure and income that would be accounted for under GAAP. There are significant differences between Estimates and budgets: around a third of departmental spending in budgets is not included in Estimates, and about a sixth of what is included in Estimates is not in budgets.

- **Resource accounts** – which report departments’ actual spending during a particular financial year, following UK GAAP, as adapted for the public sector. This means that there are some substantial differences compared with budgets and National Accounts. The Government announced in Budget 2008 its commitment to prepare financial statements for government departments and other entities in the public sector, from 2009-10, using International Financial Reporting Standards (IFRS), adapted as necessary for the public sector.

21. These frameworks have developed in different ways over the years for good reasons, since they serve different purposes. However, the result is significant misalignment between the different frameworks, with only about two thirds of government expenditure fully aligned across budgets, Estimates and resource accounts. Table 1 summarises the current resource misalignments between budgets, Estimates and resource accounts, in the context of total departmental resource spending plans for 2008-09 of £489 billion. This analysis reflects the outcome of a detailed “baselining” exercise carried out with departments, which has provided assurance that all current misalignments have been identified.
Table 1 – Current resource misalignments by amount

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<th>£bn</th>
<th>Budgets</th>
<th>Estimates</th>
<th>Resource Accounts</th>
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<td>In</td>
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<td>129</td>
<td>58</td>
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<tr>
<td></td>
<td>Estimates</td>
<td>86</td>
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<tr>
<td></td>
<td>Resource Accounts</td>
<td>82</td>
<td>67</td>
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Source: 2008-09 Plans as at August 2008

22. This means that a large number of reconciliations are needed to get from the figures in budgets to those in Estimates and accounts, as illustrated in Table 2:

Table 2 – Current resource misalignments by number

* These represent the main categories of reconciliations under which the vast majority of misaligned expenditure falls. Small amounts may fall under a variety of other reconciliations applicable only to one or two departments.

23. Current misalignments can broadly be broken down into two categories:

- Differences in the various boundaries – ie the entities and spending included in budgets, Estimates and accounts – covering both:
  - different types of income and expenditure within the budgets, Estimates and accounts boundaries – for example, Consolidated Fund Standing Services (CFSS), which are covered by separate legislation and are included in budgets and resource accounts, but not in Estimates;
  - different treatment of entities within the respective boundaries – for example, Non-Departmental Public Bodies (NDPBs). NDPBs’ spending

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5 Excludes devolved administrations data.
scores in budgets, but it is the grant-in-aid paid to these bodies which scores in Estimates and resource accounts.

- Differences in the policies – specific transactions are often treated differently between the three frameworks. Examples include capital grants, provisions and other non-cash items within budgets.

24. External stakeholders have commented that they find the present system overly complex, and that it is difficult to understand the different sets of expenditure numbers and how they relate to each other. The Treasury Select Committee recommended in HC 279 that:

“the Government set itself the ambition to replace the current system of authorisation based primarily on Estimates with one linked more clearly with the public expenditure planning and control system, so that the House of Commons would eventually be in a position to consider and, should it so choose, authorise Departmental Expenditure Limits and an annual total for Annually Managed Expenditure, giving greater relevance to subsequent consideration of expenditure in excess of such limits requiring subsequent approval.”

25. In addition, government spending documents are published in different formats, and on a number of occasions during the financial year, making it difficult to understand the links and inter-relationships between them. A list of current spending documents published by departments and the Treasury, split between Spring/Summer and Autumn/Winter publications, is shown in Table 3.

| Table 3 – Spending documents presented to Parliament by Departments and HM Treasury |
|----------------------------------------|------------------|
| **PUBLICATION**                        | **DATE PUBLISHED** |
| Spring/Summer publications             |                   |
| Main Estimates                         | Apr/May (5 weeks after Budget) |
| Supplementary Budgetary Information (SBI) | Apr/May (5 weeks after Budget) |
| Public Expenditure Statistical Analyses (PESA) | Apr/May (5 weeks after Budget) |
| Departmental Reports                   | May (just after Main Estimates) |
| Summer Supplementary Estimates         | June              |
| Departmental Resource Accounts         | June/July         |
| Public Expenditure Outturn White Paper (PEOWP) | July |
| Autumn/Winter publications             |                   |
| Winter Supplementary Estimates         | November          |
| Vote on Account                        | November          |
| Spring Supplementary Estimates         | February          |
| Statement of Excesses                  | February          |
26. Commenting on the complexity of the current system of Parliamentary authorisation of public spending, the Treasury Committee recommended in HC 279 that the Government:

“… commit itself to working with select committees of the House of Commons, the National Audit Office and other interested parties to improve the clarity, consistency and comprehensibility of the documents placed before the House of Commons to seek authorisation for expenditure and to report on that expenditure.”

27. The Government undertook, in its response to HC 279\(^6\), to take this recommendation forward as part of the Alignment Project.

**UNDERLYING PRINCIPLES IN DEVELOPING BETTER ALIGNMENT**

28. In order to deliver the Vision for the Alignment Project described above, the Government has established a number of ‘top down’ principles to be applied in developing an appropriate way forward to achieve alignment in individual cases. The principles are that:

- Alignment should not be pursued if the results are likely to be manipulable, or if doing so risks causing serious damage, bearing in mind that the different purposes of the various frameworks may lead to the conclusion that different treatments may, in certain cases, be legitimate.

- Alignment will not change the National Accounts, nor the way in which they measure economic performance or performance against the fiscal rules. There will be no increased residual risk to the fiscal framework – although the places where risk is managed, and the nature of the mitigations, may change.

- Flexibility may be needed in certain areas to achieve alignment:
  - For budgets, while the overriding need is to maintain firm control over public spending while incentivising value for money, it may be possible to achieve this in different ways in order to achieve better alignment.
  - For Estimates, the aim should be to align with whatever is needed in budgets to control public spending, consistent with the requirements of Parliament.
  - For resource accounts, if it is not desirable in the context of alignment to implement IFRS strictly in specific areas, it may be possible to achieve alignment in other ways through seeking adaptations to IFRS – in limited cases and subject to the agreement of the Financial Reporting Advisory Board (FRAB) – while still satisfying its overall intentions.

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• It is unlikely to be possible to achieve full alignment in all areas, given the different purposes for which the different frameworks have developed, for good reasons, over the years. In the absence of full alignment, the aim should be to ensure that any necessary reconciliation is kept as simple as possible.

29. There will inevitably be trade-offs to be made between risks and benefits in considering individual areas of misalignment. As work on the Alignment Project has proceeded, different ways of achieving alignment have emerged in certain areas, which have needed to be assessed. In such cases, the aim has been to apply a consistent ‘top down’ approach to securing the benefits of alignment, as outlined above, without increasing the residual risks to spending control, and then to look ‘bottom up’ at the various options for addressing existing areas of misalignment. The results of this process are summarised in the next section.

KEY CHANGES NEEDED TO DELIVER BETTER ALIGNMENT

30. Consistent with the Vision and underlying principles for the Alignment Project, the main changes that the Government considers are needed to deliver a better aligned framework are outlined below. The proposed changes reflect a wide consultation process with departments and other external stakeholders, which is continuing. The Government is not seeking the Committees’ formal agreement to the changes at this stage. The aim is, rather, to set out the main areas of reform by way of an illustration of what the Government believes to be the key components of a better aligned framework.

31. The Government believes that these changes represent a coherent set of reforms, which should be regarded as a single “package”. Achieving better alignment between budgets, accounts and Estimates, and streamlining the Government’s financial publications, will require radical change, but there are very significant benefits to be gained. These benefits will be considerably weakened if we adopt only part of the changes needed, and accept significant continued misalignments within the system. It will be important, therefore, to continue to focus on the “big picture”, in order to ensure that the benefits of better alignment are not lost. All stakeholders in the project will need to be prepared to balance the overall aim of achieving the full benefits associated with a better aligned framework with the potential difficulties associated with change.

32. The key changes that the Government believes are needed to deliver a better aligned framework are as follows:

a) All non-voted expenditure and income within budgets is brought within the coverage of Estimates

The current position is that not all expenditure that appears in budgets or resource accounts is voted annually in Estimates. Parliament has given separate standing legislative authority for certain expenditure to take place without further authorisation. This can be either particular types of expenditure called Consolidated Fund Standing Services, or expenditure financed from specific Funds other than the Consolidated Fund (eg the National Loans Fund and the National Insurance Fund).
The proposed approach is to widen the coverage of Estimates to include spending that is not currently voted annually through the Estimates process because it is covered by separate legislation – for example, payments from the National Insurance Fund and the National Loans Fund and Consolidated Fund Standing Services. To preserve the current statutory (and constitutional) position, the Estimate would be separated into two parts, distinguishing between the elements which require annual parliamentary and legislative authority (the voted element) and those which are included for information only (the non-voted element). The non-voted amounts would be clearly identified, so that the Estimate did not seek authority for either the non-voted resource requirement or the associated cash. The Estimate would make clear which elements were to be voted, and which were already subject to separate legislation.

The key benefit of this change is that the expenditure shown on the face of the Estimate would line up with Treasury’s controls over government spending, thereby reducing complexity and making Parliament’s role in scrutinising expenditure more meaningful and effective.

b) Parliamentary controls in Estimates are on a net (rather than both gross and net) basis, to line up with budgetary controls, with details of income shown in the Estimates and appropriate safeguards in place so that firm control is maintained over the use of income by departments

In the Government’s view, Parliament’s ability to scrutinise government expenditure and income would be enhanced, rather than reduced, through different, more effective ways of oversight than have been exercised in the past. This would allow Parliament to apply meaningful scrutiny and control of public spending, in the secure knowledge that comprehensive and effective safeguards are in place. Should Parliament continue to vote budgets on a gross basis, the voted control limits would be significantly different from those applied by the Treasury. This continued misalignment would weaken the coherence and comprehensibility of the new regime, would not meet the recommendations of Parliament and would mean that alignment could not happen in any meaningful way.

Under present arrangements, the treatment of income can be very different in budgets, Estimates and resource accounts:

- Budgets are set net of any income the department receives that is classified as being within budgets. Subject to a number of safeguards set by the Treasury, a department may retain such income, and any additional income of a similar kind it generates, and spend it.

- In Estimates, Departments can normally only retain the income (and related cash) if they have sought and obtained the authority of Parliament to “appropriate it in aid” of related spending. Parliament therefore places limits on both net expenditure and on income (thereby controlling gross spending also).
The Operating Cost Statement (OCS) in a department’s resource accounts includes all of its operating income that falls within the departmental boundary (ie income generated in pursuit of its activities or as part of managing its affairs), and makes no distinction between income which may or may not be classified as within budgets, or which may or may not be appropriated in aid of the Estimate.

The proposed approach is for Parliament to vote Estimates on a net basis, consistent with the treatment in budgets, supported and underpinned by a range of safeguards, described below, designed to ensure that firm control is maintained over the use of income. A full explanation of gross data, including details of planned operating and non-operating income, would continue to be included in the Estimate for information. It should be stressed that this proposal is concerned only with departmental income, and has no implications for tax revenues, which Parliament would continue to approve directly through Finance Bills.

The proposed approach carries a number of significant benefits:

- **It lines up parliamentary controls with Treasury controls over departmental spending.** This is not only clearer and simpler for departments to operate, but also reinforces control over spending and enables Parliament to vote Departmental Expenditure Limits (DEL) and Annually Managed expenditure (AME), as recommended by the Treasury Select Committee in HC 279. Should Parliament continue to vote budgets on a gross basis, the voted control limits would be significantly different from those applied by the Treasury, thereby weakening the coherence and comprehensibility of the new regime, and not meeting the recommendations of Parliament.

- **It will maintain incentives on departments to seek best value for money by maximising income, subject to appropriate safeguards and constraints on setting charges, or maintaining demand-led services.** For departments operating demand-led activities which are solely or largely financed through income, the current arrangements can be problematic to manage. The proposed approach would mean that departments could deal with increases in demand arising after the Supplementary Estimate without having to curtail the level of service or make sub-optimal savings in other programmes.

- **It means a much clearer presentation of outturn in resource accounts.** If Estimates continued to be controlled on both a gross and net basis, there would need to be a proliferation of columns in the Statement of Parliamentary Supply in resource accounts, compared with what would otherwise be the case, which would be difficult for the reader to follow.

As noted earlier, the Government would ensure that robust safeguards are in place, so that firm control is maintained over the use of income by departments. These safeguards include the following:
- The Estimate will continue to show, for information purposes, expected levels of income (resource and capital) in the same level of detail as at present. In voting DEL on a net basis, Parliament would therefore be fully aware of the level of income anticipated. Resource accounts would disclose actual income received, which could then be compared to the levels anticipated in the Estimates, and Select Committees would be able to investigate the basis of any prices that they suspected of having been raised excessively, and challenge departments on any significant change.

- There will be a like-for-like comparison between a department’s budget and its Estimate. This would mean increased transparency and enable more meaningful scrutiny by Parliament of a department’s performance. The resource accounts will provide a detailed comparison between Estimates provision and audited outturn. If Parliament wished, departments could be required to explain any significant differences between the expected level of income in the Estimate and outturn in the resource accounts.

- The ambit in Part I of the Estimate will be expanded to include a description of all types of income a department may use to finance its expenditure. This means that any categories of income not properly described in the ambit could not be retained by the department, so departments could not generate funds from new sources which Parliament had not approved. This gives formal parliamentary and legislative control over categories of income. Definitions of allowable income will be tightened and agreed with the NAO.

- The audit of the departmental resource accounts by the NAO would include the regularity of income raised, and the application of that income for approved purposes. The NAO would be in a position to verify that the income was of a type previously notified to Parliament in the ambit of the Estimate.

- The Treasury will retain control over “virement” between sections of the Estimate. Departments will still need to seek Treasury approval for switches between functional lines in the Estimate. Appropriate restrictions could be agreed with Parliament over when virement might be agreed by the Treasury in relation to spending financed by income.

- There are already restrictions on departments’ ability to increase charges to raise additional revenue, which will continue. Managing Public Money sets out clear guidelines, which are notified to Parliament, over how charges should be set when calculating fees in non-competitive settings. These rules will remain in place and will continue to be notified to Parliament.

- As part of the budgeting framework, the Treasury will retain control over the type of income that could be retained by departments, which will be consistent with the controls applied by Parliament. At present, there are no types of income that departments can retain within budgets
which would not be allowed by Parliament. The rules applied are the same, and this would continue.

These safeguards are intended to address any risks that departments might raise income of a type, or at a level, which was unacceptable to Parliament, and are intended to be considered alongside the significant benefits of the proposed change outlined above, in terms of lining up Parliamentary controls with Treasury controls over departmental spending; increasing incentives on departments to seek best value for money by maximising income where it is appropriate to do so; and providing a much clearer presentation of outturn in resource accounts.

c) The Estimates and accounting boundaries are extended to accommodate NDPBs and other bodies classified to the central government sector

The current position is that, while advisory NDPBs and tribunals are within the scope of the Vote, the majority of NDPB expenditure is channelled through executive NDPBs, and this expenditure is included in budgets but is not within the scope of the Estimate or departmental resource accounts. Instead, the grant in aid paid to NDPBs is voted by Parliament and included in the resource accounts.

The proposed approach is to consolidate the expenditure of NDPBs and other central government bodies into departmental Estimates and resource accounts. The misalignment of NDPBs is one of the largest differences between voted expenditure and budgets and is one of the main reasons why there is inconsistency between the aggregate measures. Changing the way in which Parliament votes funding for NDPBs is important, not because it is administratively neater, but because there is an important question of accountability for public money. Parliamentary scrutiny of expenditure plans and outturns can never be effective if the controls applied by government are different from those exercised by Parliament. This reform would mean giving better information to Parliament and enabling Select Committees to scrutinise expenditure more effectively.

There are also significant practical advantages. NDPB expenditure is already part of departmental budgets, and departments have responsibility within the existing financial management regime for ensuring that total spend (including budgets delegated to NDPBs) is within the agreed limits. At the same time, departments have to ensure that voted expenditure is within its separate limit. If the two mechanisms were aligned, financial management in departments would be simplified.

To facilitate implementation of this change, it is proposed that departments undertake “dry run” consolidations of their NDPBs into their resource accounts in each of the years leading up to implementation of the new aligned framework. This is intended to provide reassurance that this important reform can be successfully implemented.
d) **The budgeting concepts of “near cash” and “non cash” are removed so that there is a single Resource DEL budget**

As a consequence of the introduction of full Resource Accounting and Budgeting in 2003-04, a number of new concepts were introduced to budgets, namely: depreciation, cost of capital charges, impairments and provisions. These changes were intended to incentivise departments to maximise the use of their asset base, as the full cost of holding assets was for the first time recognised in budgets; and to budget for the long-term consequences of their decisions through the creation of provisions. However, these items do not score (or do not score in the same way) in National Accounts. To protect the fiscal position, the concepts of “near cash” and “non cash” were created in budgets in 2004-05, with these items ringfenced within resource DEL as a separate non-cash budget.

The current position is that while these items are, in theory, aligned in budgets, Estimates and resource accounts, the ringfenced treatment reduces incentives on departments to secure best value for money. The proposed approach is to dispense with the ringfences and the separate budgeting concepts of near-cash and non-cash, by including depreciation, impairments and provisions in Resource DEL or AME and removing cost of capital charges from budgets altogether. In addition to improving value for money incentives, these changes will simplify significantly the budgetary control system, the presentation in Estimates, and the relationship between the different control frameworks, while allowing public spending to be controlled in other ways and ensuring that departments continue to have appropriate incentives to manage their assets effectively.

e) **Parliamentary controls will be changed to reflect the alignment of the Estimates and budgeting boundaries**

The current position is that, for each department, Parliament authorises:

- Net resources in one or more Requests for Resources (RfRs) – over half of departments have only one RfR
- Operating Appropriations in Aid (AinA) for each RfR
- Total non operating AinA for the whole department
- The total Net Cash Requirement.

The proposed approach is for Parliament to authorise each department’s budgetary control limits, plus its overall voted cash requirement. The Parliamentary control limits would therefore be the department’s:

- Resource DEL
- Resource Departmental AME
- Capital DEL
- Capital Departmental AME
- Net Cash Requirement
It is suggested that expenditure within each of these limits should be broken down in broadly the same level of detail as at present, to ensure that the amount of information provided to Parliament is not reduced. In addition, it is proposed that a protocol is agreed with the Committees on the types of changes to the budgeting regime on which Parliament would be consulted.

This approach will offer significant benefits by bringing Parliamentary and budgeting controls into line, mutually reinforcing each other. It will also radically simplify the process for budgeting, voting and accounting for departmental spending, with benefits for departments and the Treasury, as well as for Parliament.

f) **Resource accounts are, as far as practicable, based on IFRS as adapted for the public sector context**

It is proposed that, consistent with the Government’s commitment in Budget 2008, the resource accounting rules will, as far as practicable, be aligned with IFRS, adapted as necessary for the public sector context. Any departures would need to be soundly based, and would need to satisfy the intentions of IFRS and be agreed with the Financial Reporting Advisory Board (FRAB).

g) **The number of departmental and HM Treasury expenditure documents is reduced to just two “publication events” each year**

As illustrated in Table 3 above, there are currently a large number of distinct but related spending publications, published sporadically throughout the financial year, which have significant overlap in terms of content. However, since the publications follow the different frameworks, it can be difficult for the reader to understand the links and inter-relationships between them.

The proposed approach is to consolidate the existing range of departmental publications into two main documents presented by each department to Parliament each year:

- An “interim” document published in January giving a provisional view of spend during the current financial year, including a single Supplementary Estimate. This document could coincide with publication by the Treasury of a “Summary Supplementary Estimates” document, which might also incorporate the Statement of Excesses for the previous year and the Vote on Account for the following year.

- An end of year document published in June giving a coherent view of departments’ forward plans, set in the context of the previous year’s spend and performance. It would provide a review of the previous year and forward look on a) progress against departments’ Public Service Agreements (PSAs) and Departmental Strategic Objectives (DSOs); and b) expenditure – ie outturn (resource accounts) for the previous year, budget plans looking forward (currently in the Departmental Report), and
the Main Estimate for the current year. This document could coincide with publication by the Treasury of a “Summary Main Estimates” document and Public Expenditure Statistical Analyses (PESA).

Thus, the proposed suite of spending documents to be presented to Parliament by departments and the Treasury under alignment is shown in Table 4.

Table 4 – Proposed suite of spending documents presented to Parliament under alignment

<table>
<thead>
<tr>
<th>Published by</th>
<th>June</th>
<th>January</th>
</tr>
</thead>
<tbody>
<tr>
<td>Departments</td>
<td>Single document incorporating:</td>
<td>Single document incorporating:</td>
</tr>
<tr>
<td></td>
<td>• Departmental Report</td>
<td>• Single Supplementary</td>
</tr>
<tr>
<td></td>
<td>• Resource Account</td>
<td>Estimate for the year</td>
</tr>
<tr>
<td></td>
<td>• Main Estimate</td>
<td></td>
</tr>
<tr>
<td>HM Treasury</td>
<td>Summary Main Estimates</td>
<td>Summary Supplementary</td>
</tr>
<tr>
<td></td>
<td>document</td>
<td>Estimates document also including:</td>
</tr>
<tr>
<td></td>
<td>PESA</td>
<td>• Vote on Account</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Statement of Excesses</td>
</tr>
</tbody>
</table>

These changes build on developments achieved over recent years. Departments have already made significant improvements in the quality and timeliness of their resource accounts, notably as a result of the “faster closing” initiative. 16 departments – around a third of the total – successfully published combined Departmental Reports and Resource Accounts for 2007-08.

Moreover, assuming that moves towards better alignment of budgets, Estimates and resource accounts are successful, this approach would also mean that it would be possible to cease production of two current publications, since the information contained in them would be redundant: the Supplementary Budgetary Information (SBI), since budgets and Estimates would by then be aligned; and the Public Expenditure Outturn White Paper (PEOWP), since departments’ audited outturns for the previous financial year would already have been published in the June document. It would also result in a single Supplementary Estimate round each year, rather than three as at present (Summer, Winter and Spring).

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7 It is proposed that departments would forward to their select committees “final” (albeit at that stage unpublished) versions of their Main Estimates several weeks before the June document is formally published and presented to Parliament, to give the committees sufficient time to scrutinise the Estimates before they are voted on in July.

8 The table currently included in the PEOWP showing departments’ end-year flexibility (EYF) entitlements could be published elsewhere, for example in the Treasury’s Summary Main Estimates document or on the Treasury website.
This proposal therefore offers considerable benefits in terms of improved coherence, transparency and simplicity of the Government’s spending documents.

Achieving the proposed new framework will, however, require a fundamental change in the way accounts are completed and the underlying systems are configured and used. To facilitate implementation of the new arrangements, it is proposed to introduce the changes on a phased basis, reflecting the varying degrees of progress departments have made in terms of rationalising and streamlining their spending publications over recent years. In setting targets, it is not the intention to constrain the level and time available for the audit process.

The Alignment Project is also aiming to simplify the language and terminology used in spending documents, with a view to bringing it more into line with commercial practice, where that is appropriate, and using a single common language, rather than three.

33. The key changes envisaged under the Alignment Project outlined in this section reflect full consultation with departments and other central government bodies. They have also benefited from detailed discussions with key external stakeholders, including the House of Commons Scrutiny Unit, Select Committee Clerks and other Parliamentary officials, as well as the NAO. These discussions have been extremely productive, and are continuing, and the Government very much welcomes the constructive engagement of all parties involved in this important reform.

34. If implemented, the changes outlined above would mean that budgets and Estimates would be fully aligned for the generality of departments. It is likely that the only outstanding misalignments in respect of Estimates presented to the Westminster Parliament would relate to the block grants paid by two departments (the Ministry of Justice and Northern Ireland Office) to the Devolved Administrations (DAs), reflecting the unique circumstances of those bodies. The separate budgeting and financial reporting processes of the DAs add a dimension where there is further scope for divergence in the treatment of expenditure and income. The Alignment Project is engaging with the DAs to ensure that treatments can be made as consistent as possible across the UK, without prejudice to legal or other constraints arising from the devolution settlements.

35. The budgeting framework would, moreover, be considerably simplified. Although some misalignments with resource accounts are likely to remain in a very limited number of areas where to enforce alignment would either cause damage or be manipulable, the number of such misalignments would be significantly reduced, making the necessary reconciliations much fewer and simpler than at present. Prior to implementation of the new framework, the Government will establish a Code so that, as different frameworks develop over time, there is a process in place for looking at changes across the piece in order to monitor, and maintain, alignment.
36. The impact of the proposed changes on the current areas of misalignment compared with the position shown in Table 1 is summarised in Table 5.

Table 5 – Revised resource misalignments by amount

<table>
<thead>
<tr>
<th>Not in</th>
<th>£bn</th>
<th>Budgets</th>
<th>Estimates</th>
<th>Resource Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>In</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budgets</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Estimates</td>
<td>0</td>
<td>16</td>
<td>16</td>
<td>0</td>
</tr>
<tr>
<td>Resource Accounts</td>
<td>16</td>
<td>16</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

37. In terms of the number of remaining misalignments, Table 6 shows that much fewer reconciliations would be needed between budgets/Estimates and accounts compared with the position in Table 2:

Table 6 – Revised resource misalignments by number

- Budgets/Estimates = aligned\(^{10}\) 3 reconciliations\(^{11}\) Resource Accounts

38. If, however, the “package” of changes outlined above were not implemented in full, with the result that budgets and Estimates were not fully aligned for the generality of departments, and there were further continuing misalignments between Estimates and accounts, the position would immediately become much more complex. In such circumstances, the benefits for Parliament and the public would be significantly reduced, since more reconciliations would be needed between budgets and Estimates and between Estimates and accounts. That is why we are proposing these changes as a package.

39. The implications for alignment would be particularly severe if misalignments remain which affect the majority of departments. If, for example, NDPBs were not consolidated in departments’ Estimates, this would result in a continuing misalignment, for all departments with NDPBs, between budgets and Estimates/Estimates.

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9 Excluding the DAs.
10 For the generality of departments.
11 It is envisaged that, with the exception of the block grants to the DAs mentioned above, residual reconciliations between budgets/Estimates on the one hand, and resource accounts on the other, would remain in respect of 3 areas only: capital grants to the private sector, local authorities and public corporations; non-budget income that is included in accounts (eg licence fee income); and any occasional Prior Period Adjustments resulting from errors/omissions, although these have occurred only very rarely in recent years.
resource accounts; or if it did not prove possible to secure agreement to moving to net control in Estimates, this would result in a continuing misalignment, for all departments, between budgets/ resource accounts and Estimates.

**NEXT STEPS**

40. The Government’s aim over the coming months is to complete the current consultation process with departments and external stakeholders, and to firm up the proposed framework under alignment, by the end of 2008. This will include taking forward the necessary legislative requirements to enable the consolidation of NDPBs into Estimates and accounts.

41. Subject to resolving these and other outstanding issues, it is the Government’s intention then to submit a further, more detailed Memorandum to the Committees in early 2009 containing final proposals for approval. The aim would then be to embark, in parallel, on implementation planning during 2009-10, with a view to starting a phased implementation of the new framework from 2010-11, subject to the Committees’ views and to resolving any outstanding issues.

42. This is a challenging timetable. In order to meet the 2010-11 deadline for beginning implementation of the new framework, the Government will need to ask for the Committees’ agreement to its detailed proposals by no later than July 2009.

**SUMMARY AND CONCLUSIONS**

43. This Memorandum has set out the Government’s emerging thinking on how it proposes to deliver its commitment in the July 2007 “Governance of Britain” Green Paper to simplify its financial reporting to Parliament by better aligning budgets, Estimates and resource accounts and streamlining the financial reporting documents it presents to Parliament.

44. There is a substantial prize and opportunity here in terms of making Parliament’s processes more meaningful and giving Parliament a proper and rewarding basis for scrutiny. Specifically, the current reforms aim to:

- modernise the public spending system to make it more accountable and transparent, enabling the Government to improve the way it manages the public finances and allowing Parliament to scrutinise public spending more effectively;

- simplify the reporting of public finances by reforming the way in which Government publishes budget and accounting information, making it more efficient and easier to understand; and

- improve the way that public spending is managed by bringing spending control in line with the way that departments manage their business and giving greater incentives for value for money.
45. The Government very much welcomes the support that Parliament has given, and continues to give, to the Alignment Project. This was evidenced most recently by the Liaison Committee in HC 426, which stated:

“We regard removing complexity from the Government’s financial system as fundamental to improving financial scrutiny, as well as to improving financial management in Departments. The Alignment Project offers the possibility of achieving this. In revising the basis of Parliament’s financial control and the system of reporting to Parliament, it is potentially an historic development in the long story of Parliament’s scrutiny of government finances.”

The Liaison Committee further commented that the Alignment Project was “highly ambitious”, noting that:

“… it is likely to result in proposals for changing the whole basis of Parliament’s financial control, shifting this to a system based on the controls currently used in budgets (Departmental Expenditure Limits, or DELs, and Annually Managed Expenditure, or AME, together with the Net Cash Requirement), and for a recasting and consolidation of the entire range of reporting documents”.

In commending the Alignment Project to the House, the Committee concluded:

“We emphasise the magnitude of the prize which is potentially available: a comprehensible and coherent system of planning, authorising and reporting government expenditure, making it possible for the House and select committees to scrutinise the Government’s finances far more effectively.”

46. The Government fully endorses the Committee’s views in all respects.

47. In order to ensure that there is a successful outcome to the Alignment Project, the Government has committed throughout to consulting widely on the detailed changes needed to deliver this major reform, and to fully involving key stakeholders in the process. Representatives from Parliament, the NAO, the ONS, CIPFA, the Better Government Initiative and the FRAB, as well as from key government departments and the devolved administrations, have, accordingly, been invited to serve on the Steering Committee and Project Board, and have made a valuable contribution. The continuing involvement and support of these and other key stakeholders will be crucial to the success of the project as the work proceeds. The inclusive approach that the Government has adopted in taking the project forward is intended to ensure that the outcome is accepted by all parties, and is sustainable.

48. The need for reform has attracted widespread support in principle, both inside and outside government. However, successful delivery of the project will require the continued cooperation, commitment and flexibility of all key stakeholders – in departments, the Treasury, Parliament and elsewhere – who will all need to “buy in” to the concept, and reality, of change, and be willing to compromise on the current position, to ensure that the overall objectives of the project can be delivered. There is a major prize to be achieved, but it will be important to keep a clear focus on the wider picture – otherwise the prize will be lost.
49. As noted earlier, the Government is not at this stage seeking the Committees’ approval of the individual proposals described in this Memorandum. The Government would, however, welcome an early indication of the Committees’ endorsement of the broad approach, and the underlying principles, outlined above, to inform its further work.

50. The Government will then put more detailed proposals to the Committee in a further Memorandum planned for early 2009, in the light of any initial views from the Committees, and once the internal and external consultation processes are complete.

HM Treasury
November 2008