B RESOURCE ACCOUNTING AND BUDGETING

INTRODUCTION

B.1 The first year of the 2002 Spending Review period saw the introduction of full resource budgeting. Budgets are now being prepared on an accruals basis. This change represented a major step in the most significant overhaul of public finances for over a century and has placed the UK at the forefront of public sector financial management. This annex describes the budgeting regime under full resource accounting and budgeting and highlights areas where this system has a significant impact on the numbers presented in this document.

Principles of resource accounting and budgeting

B.2 Resource based accounts and budgets provide more information on the full costs of service delivery because they capture the full economic cost of providing services. This is because costs score when they are consumed or "accrued" rather than when cash is actually spent. Therefore, they also capture non-cash costs such as:

- depreciation, representing the consumption of capital assets over their useful economic life;
- cost of capital charge, reflecting the opportunity and financing costs of holding capital; and
- provisions for future payments such as compensation payments or early retirement liabilities.

B.3 Departments have been required to produce resource accounts audited by the National Audit Office (NAO) since 2001-02. Resource Accounts are based on Generally Accepted Accounting Practice (UK GAAP), adapted where necessary for the public sector. Any adaptation must be approved by the independent Financial Reporting Advisory Board (FRAB), which reports directly to Parliament. Departments are required to lay their accounts before Parliament and they are scrutinised by the Public Accounts Committee (PAC).

Benefits of resource budgeting

B.4 The benefits of using resource-based information as the basis for controlling public expenditure are as follows:

- better information for public services managers on the costs of providing services, supporting the delivery of key government targets including efficiency;
- creation of incentives to actively manage assets, supporting the Government's plans for locking in previous growth in investment; and
- better incentives to manage the cost of liabilities more effectively.

B.5 This resource-based information has been a key input in the preparation of spending plans for 2005-06, 2006-07 and 2007-08. Departments' Spending Review submissions were prepared on a full resource basis and included forecast balance sheet information, which was considered by the Treasury in discussion with departments.

Public Expenditure Control Framework

B.6 The resource budgeting framework has been developed to fit with the wider frameworks for outcome-focused public spending control. Departments are set discrete resource (current) and capital budgets. Resource and capital budgets are split into Departmental Expenditure Limits (DELs) and Annually Managed Expenditure (AME). DELs are firm spending plans set for three forward years in biennial Spending Reviews. Expenditure that is volatile and demand-led and cannot be controlled on a long-term basis is in AME and is subject to careful bi-annual monitoring and control. Social security benefits are the largest programme in AME.

B.7 Resource budgets not only include the cost of service provision by central government (department, agencies and non-departmental public bodies (NDPBs)) but also most of the transactions departments have with their public corporations. The resource budget measures the current costs of service delivery on an accruals basis and therefore also includes:

- non-cash costs such as depreciation and impairments, cost of capital charge (currently 3.5 per cent of net assets) and provisions for future costs; and
- investment grants paid to the private sector – for example companies and housing associations. This treatment of investment grants reflects the fact that under resource accounting and budgeting spending is only treated as capital if it creates an asset on the Government's balance sheet.

B.8 The capital budget includes departments' and NDPBs' expenditure on fixed assets, capital grants to local authorities as well as net lending. It can be reconciled to the national accounts based measure public sector net investment by adjustments such as including investment grants to the private sector.

Cash equivalent of budgets

B.9 The amount of non-cash provision within a department's budget is determined by the department's overall balance sheet, in particular the asset base. In the case of some departments the inclusion of non-cash numbers has a significant impact on their resource budget. For example, the Ministry of Defence has a significant asset base and incurs substantial charges for holding and using capital in the defence budget. Similarly, health spending contains a relatively large proportion of non-cash costs as a result of the significant NHS estate and provisions for clinical negligence liabilities.

B.10 For the purposes of comparison, Table B.1 shows the underlying cash equivalent budgets for each department. The cash equivalent Resource DEL is derived by netting off non-cash charges.

Table B.1: Departmental Resource and Capital DELs on a cash equivalent basis

£ billion	Baselines		Plans	
	2004-05	2005-06	2006-07	2007-08
Resource Budget				
Education and Skills	23.8	26.7	28.1	29.6
Health	65.9	71.6	78.1	85.3
of which: NHS	61.6	67.2	73.7	80.9
Transport	6.8	7.8	9.5	8.7
Office of the Deputy Prime Minister	4.6	4.9	5.2	5.6
Local Government	43.3	45.8	48.3	50.8
Home Office	11.6	12.0	12.7	13.4
Constitutional Affairs	3.4	3.5	3.7	3.8
Law Officers' Departments	0.6	0.6	0.7	0.7
Defence	20.2	20.6	21.7	22.4
Foreign and Commonwealth Office	1.3	1.4	1.5	1.5
International Development	3.8	4.5	4.9	5.0
Trade and Industry	4.7	5.6	5.9	6.0
Environment, Food and Rural Affairs	2.7	2.8	3.0	3.1
Culture, Media and Sport	1.3	1.4	1.4	1.5
Work and Pensions	7.7	8.1	8.1	8.1
Scotland	18.9	20.5	21.7	22.8
Wales	9.9	10.7	11.5	12.2
Northern Ireland Executive	6.5	6.9	7.3	7.6
Northern Ireland Office	1.1	1.2	1.1	1.1
Chancellor's Departments	4.5	4.8	4.8	4.8
Cabinet Office	1.5	1.6	1.7	1.7
Invest to Save Budget	0.0	0.0	0.0	0.0
Reserve	1.1	1.5	1.2	1.6
Total cash equivalent Resource Budget	**245.4**	**264.5**	**282.0**	**297.2**
Capital Budget				
Education and Skills	3.8	4.4	4.8	5.5
Health	3.5	4.4	5.3	6.3
of which: NHS	3.4	4.4	5.2	6.2
Transport	3.7	3.4	4.1	4.2
Office of the Deputy Prime Minister	2.3	2.4	2.5	2.5
Local Government	0.3	0.3	0.2	0.2
Home Office	0.9	1.0	1.2	1.3
Constitutional Affairs	0.1	0.1	0.1	0.1
Law Officers' Departments	0.0	0.0	0.0	0.0
Defence	6.3	6.9	7.0	7.6
Foreign and Commonwealth Office	0.1	0.1	0.1	0.1
International Development	0.0	0.0	0.0	0.0
Trade and Industry	0.2	0.3	0.5	0.5
Environment, Food and Rural Affairs	0.3	0.3	0.4	0.4
Culture, Media and Sport	0.1	0.1	0.1	0.1
Work and Pensions	0.4	0.2	0.2	0.1
Scotland	1.9	1.8	2.0	2.2
Wales	0.9	1.0	1.1	1.2
Northern Ireland Executive	0.4	0.4	0.5	0.5
Northern Ireland Office	0.1	0.1	0.1	0.1
Chancellor's Departments	0.3	0.3	0.4	0.5
Cabinet Office	0.2	0.2	0.2	0.3
Reserve	0.8	1.1	0.7	1.2
Total cash equivalent Capital Budget	**26.7**	**29.0**	**31.5**	**34.9**

Relationship with key fiscal aggregates

B.11 Total Managed Expenditure is the government's key spending aggregate, described in Annex A, which is measured on a national accounts basis. These are produced using internationally recognised statistical standards, which differ from those used to produce resource accounts. The differences include:

- national accounts do not include a cost of capital charge on net assets as actual debt interest is scored; and
- unlike in resource accounting and budgeting where provisions for future liabilities are recognised in the budget as the liabilities are incurred, National Accounts score the payments when they are made.

B.12 A series of accounting adjustments identified in Table A.10 are therefore needed to reconcile the GAAP based resource budgets and Total Managed Expenditure. More detailed public spending information and the impact of accruals budgets can be found in the *Public Expenditure Statistical Analysis*[1].

[1] Public Expenditure Statistical Analyses 2004, HM Treasury, April 2004.