



HOUSE OF COMMONS

Financial scrutiny uncovered

A guide for Members by the
Committee Office Scrutiny Unit

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Introduction

Why financial scrutiny matters

Each year Parliament authorises the raising of hundreds of billions of pounds of taxes, and the spending of hundreds of billions of pounds of taxpayers' money. How governments spend our money and the effectiveness with which Government policies are implemented affects us all. Parliament and select committees play a crucial role in scrutinising financial decisions, their value for money, and their outcomes.



What financial scrutiny involves

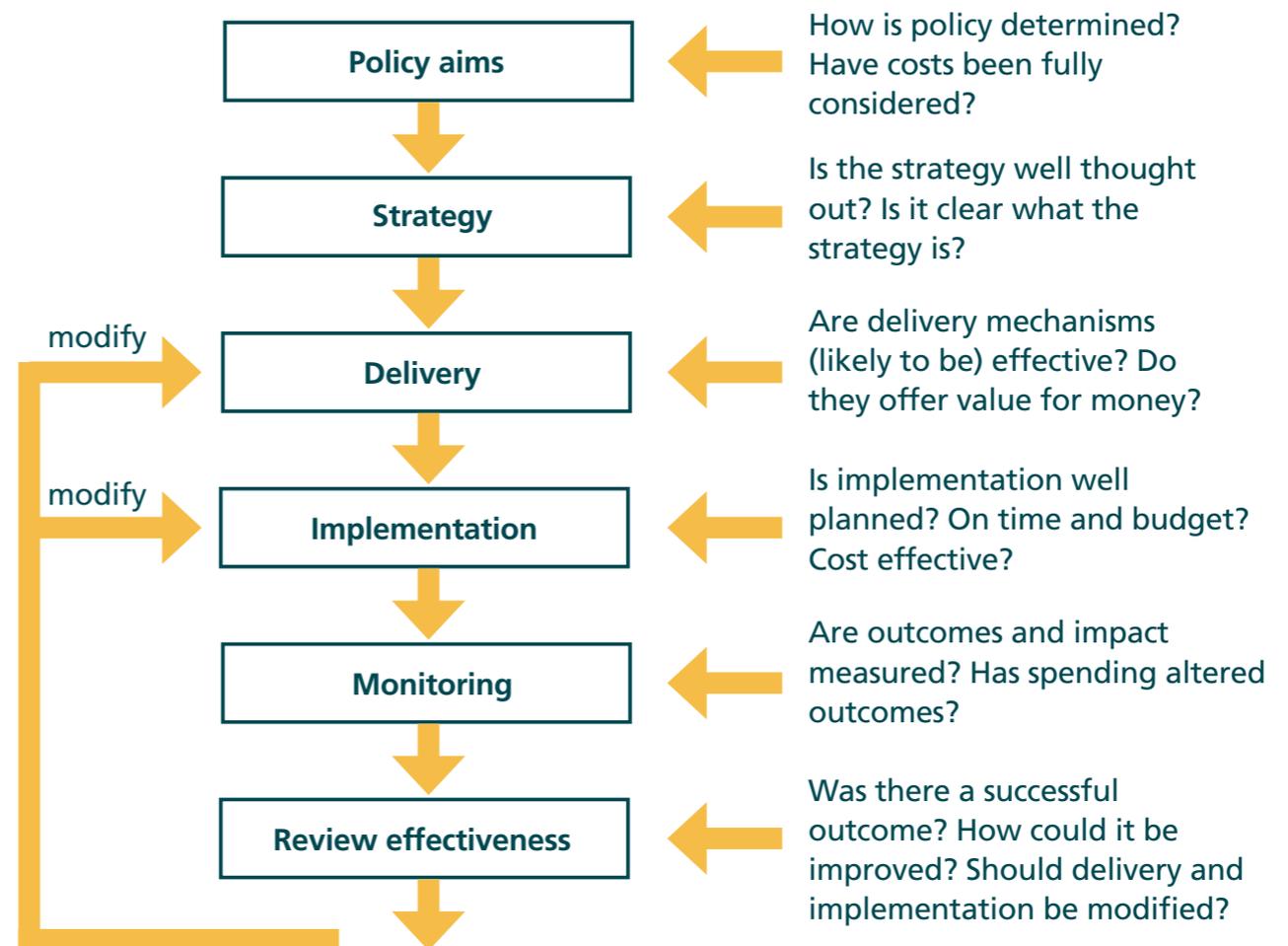
Financial scrutiny is a broad term that covers the examination, analysis and challenge of the whole process of how and why decisions are taken to spend money; how wisely and effectively that money is spent; and how effective the outcomes of that spending are.

Every spending proposal by Government consists of a series of decisions on policy aims, delivery and implementation that can be scrutinised individually or collectively (see diagram on next page).

Financial scrutiny of Government spending can include examination and challenge of any of these decisions, including:



- How policy is determined and whether the costs have been fully considered in reaching decisions;
- Whether the delivery mechanisms proposed are likely to prove an effective use of public money or whether alternative strategies or options might offer better value or be more effective;
- Whether there are suitable ways of ensuring that the impact and outcomes of the spending are measured to determine whether they are worthwhile, effective and good use of public funds;
- In the light of the outcomes, whether spending should continue, or plans should be modified, funding diverted to other more effective routes or pressing priorities, or be withdrawn altogether.

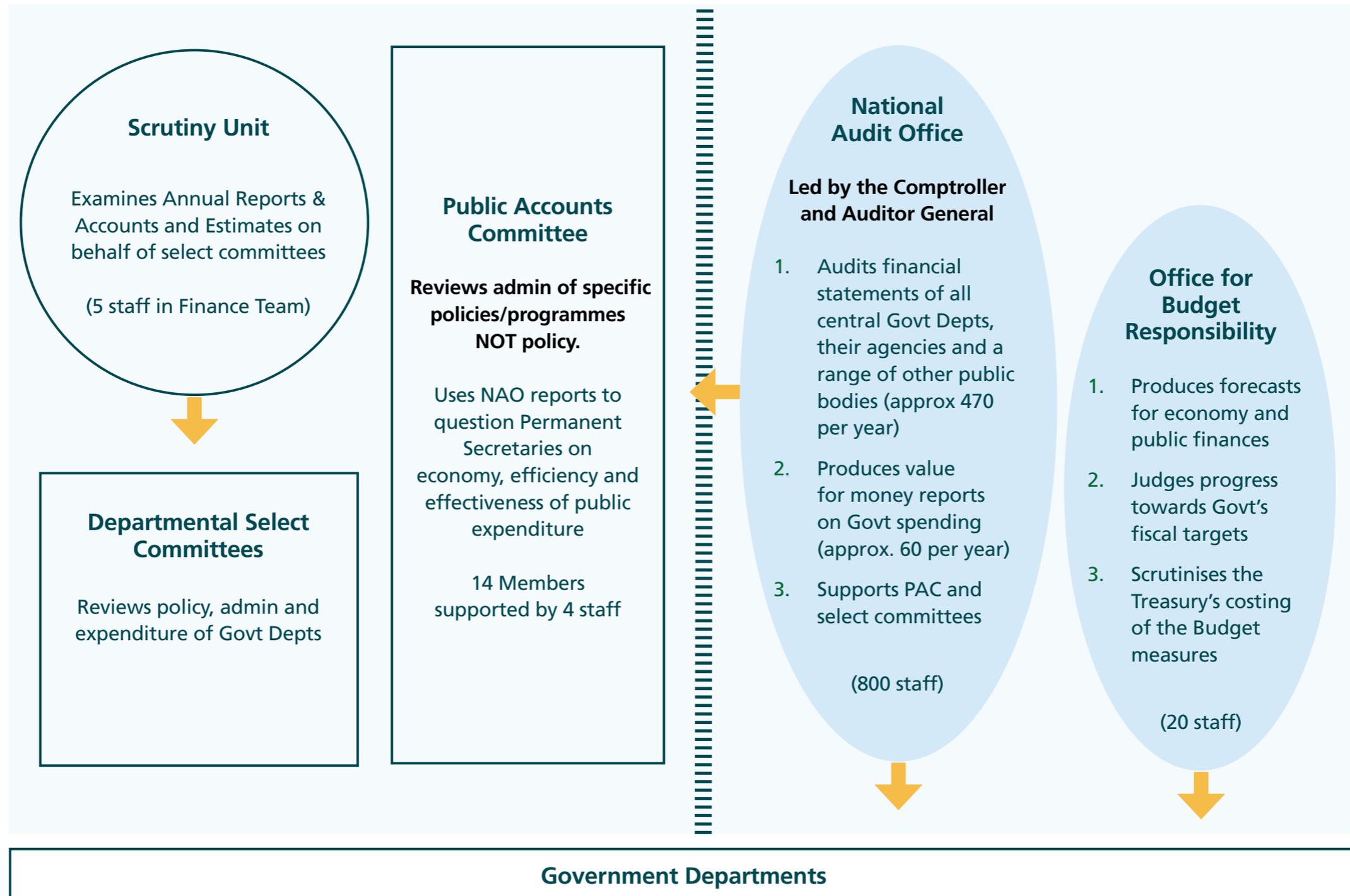


Parliamentary scrutiny of financial management

**Key players in the
scrutiny by Parliament of
financial management by
Government include:**



- **Departmental Select Committees:** There are departmental select committees for each of the main Government spending departments. Their membership reflects the party proportions of the House. The House as a whole elects select committee Chairs based on party allocations. Members within each party elect committee members. One of the core tasks of select committees is to examine the spending and performance of government departments. Committees conduct inquiries, leading to reports which often make recommendations to the departments. Recommendations often, directly or indirectly, relate to decisions on spending or taxation, which potentially have financial implications. Although departments do not have to implement the recommendations, reports often receive press coverage and are a crucial mechanism by which Parliament can influence Government and Government is held accountable to Parliament.



- **The Treasury Select Committee:** The Treasury Committee is one of the departmental select committees, and has a particular role in scrutinising the work of the Treasury, HM Revenue and Customs, the Bank of England, the OBR, the Financial Conduct Authority and the Government's overall fiscal policies and management of the economy, including the Government's fiscal mandates, borrowing, taxation, Spending Reviews, Budgets and Spring Statements (previously Autumn Statements).
- **The Public Accounts Committee:** The Committee of Public Accounts (or PAC) examines reports from the Comptroller and Auditor General (C&AG) - who heads the National Audit Office (NAO) - on value for money studies on the efficiency and effectiveness with which government departments and other bodies have used their resources to meet their objectives. The PAC also examines some accounts where the C&AG has qualified his audit certificate or made a specific report to the House. Unlike

departmental select committees, the PAC usually takes oral evidence from departmental officials rather than Ministers, because the PAC does not generally question policy. Instead, it examines the way in which policy is implemented.

- **The Scrutiny Unit:** The Scrutiny Unit was set up by the House in 2002 to assist the departmental select committees in their role of scrutiny, particularly in the areas of finance and draft legislation. It examines Supply Estimates and the publications reporting departmental financial performance and carries out pre-legislative scrutiny, assists committees in inquiries more generally, and responds to ad hoc requests from select committees for financial and legal expertise.



- **The National Audit Office:** The NAO is headed by the Comptroller and Auditor General (C&AG). The C&AG, supported by the staff of the NAO, audits the accounts of all government departments. The C&AG also produces value for money studies each year on the economy, efficiency and effectiveness of public expenditure. Most NAO reports form the basis of PAC evidence sessions. Although most of the NAO's work is channelled through the PAC, it also provides ad hoc briefings and reports for departmental select committees when requested.
- **The Office for Budget Responsibility:** The OBR was set up in 2010 as an independent fiscal watchdog, to produce forecasts for the economy and public finances, independently of the Treasury. The OBR also judges progress towards the Government's fiscal targets, assesses the long-term sustainability of the public finances and fiscal risks, and scrutinises the Treasury's costing of Budget measures (see page 17).

Taxation and public spending: An Overview

While the Government makes decisions, levies taxes and spends public money every day, it must operate within financial limits approved by Parliament.



Parliament also has a key role in holding Government to account for its decisions and for the way in which public money is spent. The formal processes of financial planning, approval and reporting can be broken down into a number of stages.

- **Planning and forecasting:** The Government operates within a fiscal mandate – rules for the management of public spending, taxation and borrowing which have been agreed by Parliament. Within Government, the Treasury determines overall spending plans for several years ahead consistent with this mandate. Around half of public spending is subject to Departmental Expenditure Limits agreed between the Treasury and government departments for several years ahead through Spending Reviews, with the remainder (generally demand led or more difficult to forecast spending, subject to regular reforecasting) known as Annually



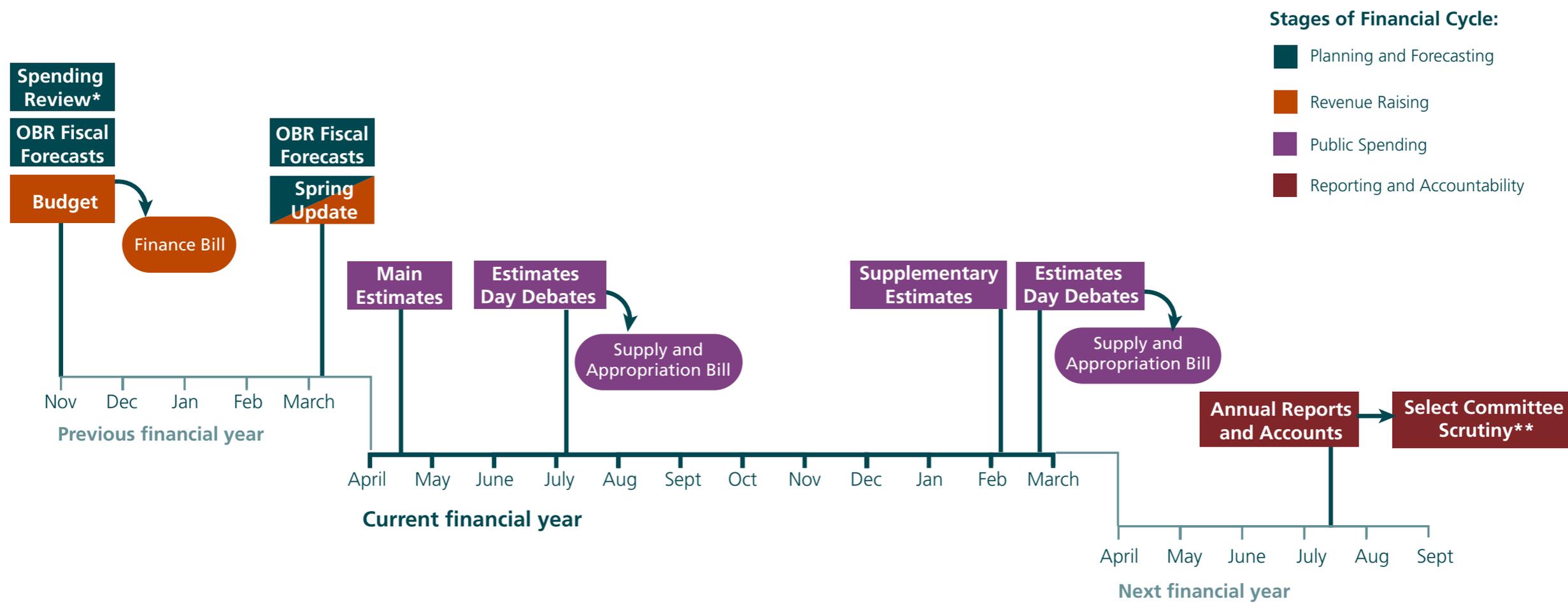
Managed Expenditure. Parliament has no direct role in approving Spending Review plans until later in the process, when it approves the annual spending plans of the Government.

The Office for Budget Responsibility (OBR) is required to produce regular Economic and Fiscal Outlooks, forecasting likely tax revenues, compliance with the fiscal mandate, and levels of likely public spending.

- **Raising revenues through taxation:** The Government sets out proposals to revise rules or rates of taxation in the Chancellor's annual Budget, now held in the autumn. Any changes, as well as the renewal of certain existing taxes, are included in the annual Finance Bill, which requires approval by Parliament.

- **Spending public money:** The Government must also obtain Parliamentary approval to its annual spending plans, which are set out in documents known as Estimates. Each government department produces a Main Estimate, at the beginning of the year, and may also later in the year publish a Supplementary Estimate seeking modifications to its plans. The Main Estimates are based on the spending limits agreed in previous Spending Reviews, alongside latest forecasts for less predictable spending outside of those spending limits programmes. Departments must include within each Estimate the total amounts of money for which approval is sought, and a list of what it is intended to be spent on. All Estimates must be approved by Parliament through Supply and Appropriation bills. (This Parliamentary approval process is sometimes known as "supply").

- **Accountability:** At the end of each financial year, departments must each produce a consolidated Annual Report and Accounts, which sets out, for the department and all of its arm's length bodies, the spending in the financial year just ended and balance sheet position at year end (rather like a company's balance sheet and profit and loss account). The senior official in each department is designated its Accounting Officer and must personally approve the accounts which are also submitted to the National Audit Office for its opinion before being published. Annual Reports and Accounts should also set out strategic priorities and include updates on performance.



Notes:
 * Spending Review happens once every 3-4 years
 ** Select Committee Scrutiny of Departmental Annual Reports and Accounts may continue well into the financial year

Planning and forecasting

The Government operates within a fiscal mandate, set out in a Charter for Budget Responsibility, which the Government must lay before Parliament.

The Charter for Budget Responsibility sets out the government's approach to managing fiscal policy transparently and responsibly.



The Office for Budget Responsibility is required to regularly assess the government's specific plans against the Charter and any mandate it contains.

The Treasury determines future overall levels of public spending consistent with the Charter and mandate several years ahead. It does this in two ways:

- **For more predictable and manageable types of spending:** Through multi-year Spending Reviews. Departments and the Treasury agree annual **Resource and Capital Departmental Expenditure Limits** for several years ahead. The individual departments decide how to allocate available funding to different programmes within the limits. Departments can reallocate within the totals at a later point if required at any time.



- **For specific less predictable and more difficult to forecast spending programmes (such as welfare spending):** The Treasury does not set fixed limits for many years ahead, and spending is re-forecast at least annually. This type of spending is known as **Annually Managed Expenditure**.

The sum of the Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME) is known as **Total Managed Expenditure (TME)**.

The Fiscal Mandate and Charter for Budget Responsibility

The 2016 Autumn Statement revised the Charter for Budget Responsibility and set out the following targets for the 2015-20 Parliament:

- A mandate to reduce cyclically-adjusted borrowing below 2% of GDP (Gross Domestic Product) by 2020-21
- A supplementary target for debt as a percentage of GDP to be falling in 2020-21
- A further target to ensure that expenditure on welfare in 2021-22 is contained within a predetermined cap and margin set by the Treasury

Devolved administrations

In recent years decisions on a growing proportion of spending in Scotland, Wales and Northern Ireland have been devolved to the Scottish Parliament, the National Assembly of Wales and the Northern Ireland Assembly. The precise powers in each case vary. However in broad terms, all devolved administrations are responsible for health, education, housing and local government. Whereas the UK Parliament retains control over defence and foreign affairs.

The Scottish, Welsh and Northern Irish Governments receive most of their funding in the form of block grants which are included in Estimates voted by the Westminster Parliament.

The amounts received in block grants are based on the "Barnett formula". The Barnett Formula calculates the change in the devolved

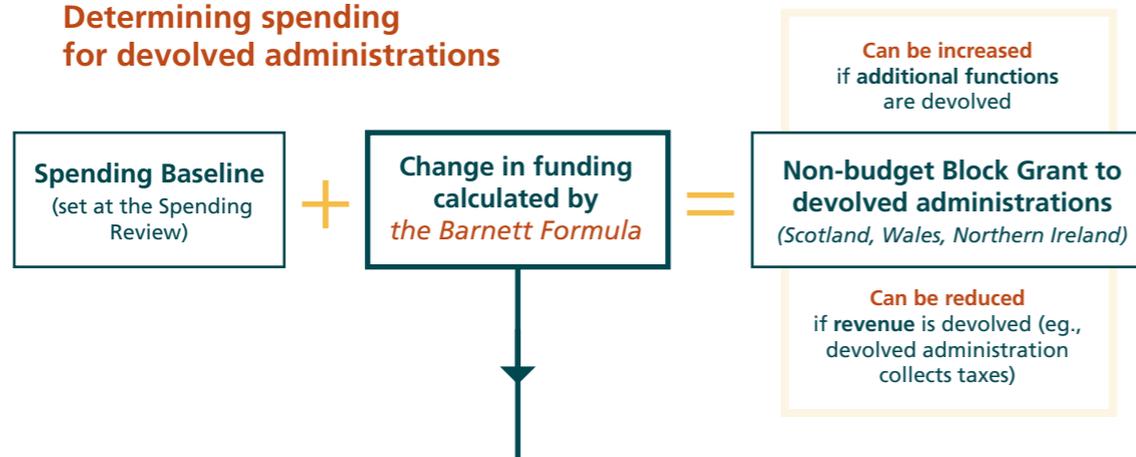
administration's block grant based on changes in UK department funding, the extent to which that UK department's funding is devolved and each country's population. Deductions to block grant are made where taxes have also been devolved. For Wales, from 2018-19 a needs based factor will be also be included in the Barnett Formula to reflect the characteristics of the population in Wales.

The devolved administrations are free to allocate block grant funding received towards any activity which is devolved. The only restriction is they may not use capital funds for resource purposes.

The devolved administrations also have agreements in place with the UK Parliament regarding borrowing, cash reserves and how much spend they can carry over from one year to the next.



Determining spending for devolved administrations



The Barnett Formula

Example for Scotland:

£ Increase of £100m in UK Departments' Resource DEL budget → £ 25% are UK reserved functions 75% relates to functions which are devolved;

£ 75% of £100 million × Population share (compared to England or England and Wales) 9.85% (Scotland's population compared to England) = Extra £7.388m to Scottish Government

These funds can be spent on any devolved function

The Office for Budget Responsibility

<http://budgetresponsibility.independent.gov.uk/>

The Office for Budget Responsibility was created in 2010 to provide independent and authoritative analysis of the UK's public finances. It is one of a growing number of official independent fiscal institutions around the world.

- It publishes five-year forecasts twice a year in the Economic and Fiscal Outlook (EFO) publication, at the time of the Government's Budget and Spring Statement (previously Autumn Statement). An annual forecast evaluation report also examines what lessons can be learned so that forecasting techniques can be improved in the future.

- It judges progress towards the Government's fiscal targets and in the EFO, assesses whether there is a greater than 50 per cent probability of hitting these targets under current policy. It also tests how robust this judgement is, given the uncertainty inherent in all fiscal forecasts.
- It sets out long-term projections for different categories of spending and revenue. It publishes a Fiscal Sustainability Report once every two years, allowing for updated ONS population predictions, which provides an analysis of the sustainability of the public finances in the long term, the public sector's balance sheet and different indicators of long-term sustainability. It also publishes a Fiscal Risks Report once every two years, which highlights risks to public finances in both the short and long term from economic, financial system, tax, spending and balance sheet pressures.
- It scrutinises the Treasury's costing of policy measures in the Budget and Spring Statement (previously Autumn Statement): during the run-up to Budgets and other policy statements, it subjects the Government's

draft costings of tax and spending measures to detailed challenge and scrutiny. It then states in the EFO and the Treasury's costing documents whether it endorses the costings that the Government finally publishes as reasonable central estimates.

Budget Exchange

If departments expect to underspend against their budget at the end of the financial year, the Treasury operates a system called Budget Exchange, whereby departments may surrender their underspend in one year in return for an increase in the budget in the following year. There are limits on the amount departments can carry forward, depending on the size of the department's DEL budget.



Departments with total DEL budgets of below £2bn are allowed to carry forward between 2% resource and 4% capital; with total DEL between £2bn and £14bn are allowed to carry forward 1% of resource DEL and 2% of capital DEL; and for bigger DEL budgets 0.75% resource and 1.5% capital. Also, to ensure that spending power is not allowed to accumulate over time, departments are not allowed to carry forward under spends by more than one year. Further Parliamentary authority, usually through a Supplementary Estimate, is required to alter annual spending limits, where government departments make changes under the Budget Exchange scheme.

Scrutiny in practice

The Treasury Committee usually conducts an inquiry and produces a report on each Spending Review.

Other select committees will also look at the impacts of Spending Review decisions on their own particular department, whether through a specific inquiry, or as part of their other inquiries. To assist them in this the House of Commons Scrutiny Unit provides briefings for each major department.

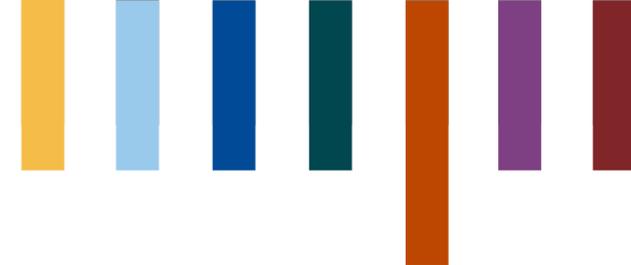
Revenue raising

In order to spend public money, the Government needs to raise revenue, which it does primarily through taxes. The Government must make judgements both on how much tax to raise, and how best to levy that tax. Parliament has a key role in approving and scrutinising the raising of taxes.

The Budget

The Chancellor's Budget speech is delivered in the autumn and generally falls into two parts: a summary of the economic situation and a detailed account of the measures needed to raise the revenue required. It is also accompanied by an Economic and Fiscal Outlook by the Office for Budget Responsibility.





The Finance Bill

At the end of the Budget speech, a resolution is usually moved to give immediate provisional effect to some of the proposals (for example, increases in duty on tobacco, alcoholic drinks and petrol).

This enables the new rates of duty to take effect immediately for a specified period. The subsequent Finance Act provides full statutory authority for these temporary measures, as well as including provisions for other measures.

Other revenue-related measures included in the Finance Bill may include:

- changes to levels and types of taxation;
- changes to administration of the tax system; and
- renewal of taxes already in force.

The Bill is split into two parts for its scrutiny process. Clauses relating to the most significant and controversial proposals are referred to the whole House of Commons. The rest of the Bill is referred to a public bill committee, typically comprising thirty to forty members.

As a “money bill”, the Finance Bill is considered only by the House of Commons, not by the House of Lords.

Devolved administrations

Historically, the UK Government has been responsible for raising the majority of its taxes and making decisions on tax policy. However recent legislation has devolved more taxation powers to the devolved administrations. The devolved assemblies also control other smaller taxes; stamp duty, landfill tax and business rates. Devolved administrations have their own Budgets where they set out taxation policies and expenditure plans for their particular jurisdiction.

Scrutiny in practice

The Treasury Committee reviews the Budget by gathering evidence from external experts, the Office for Budget Responsibility and the Government. The committee produces a report with recommendations for the Government that the Government has to respond to.



Public spending

In order to incur expenditure, the Government needs to obtain approval from Parliament for its spending plans.

Supply Estimates are the main means by which departments obtain this approval.

Separate Supply Estimates are presented for each government department, usually twice a year:

- The Main Estimates set out spending plans for each department for the coming year.
- The Supplementary Estimates present in-year revisions to these plans.

Both require the approval of Parliament.





Each Estimate contains two key elements:

1. An “ambit” - a description setting out what money is to be spent on; and
2. Spending limits - limiting the amounts that may be spent.

A small, specified number of areas of spending, do not require annual approval of Parliament, as the original statutes specify them as “Consolidated Fund Standing Services”. These include judges’ salaries and certain election costs.

Vote on Account

Before the start of the financial year in April, the Government seeks Parliament’s approval to an

advance of funding based on 45% of the spending levels of the previous year. This is normally approved by Parliament in March.

Main Estimates

The Main Estimates set out the Government’s proposals for spending for the new financial year, following the advance which departments receive for the start of the year through a Vote on Account.

The Main Estimates are presented to Parliament within five weeks of the Budget, usually in April (July in General Election years).

Each department’s Main Estimate includes an ambit setting out the purposes for which funding is

sought, and the proposed limits on spending under a number of categories (see diagram on page 30). Up to six possible spending limits may be sought:

- The net resource DEL required
- The net capital DEL required
- The net resource AME required
- The net capital AME required
- The net non-budget required (used for block grant to the devolved administrations)
- The net total cash required to cover all of this spending

Under Standing Orders, the scope for the House of Commons to amend the proposals for spending set out in Main Estimates is limited to proposing

reductions, not increases. The House of Lords has no role in the process.

Before the funding sought in Main Estimates can be made available, the House of Commons must approve the spending plans contained in the Estimates. Parliament does this through Supply Resolutions, which are followed by a Supply and Appropriation Act.

The overall Departmental Expenditure Limits included in the Main Estimates are essentially those which the Government has previously set out in the Spending Review (see chapter 4), adjusted for relatively minor changes or transfers of funding between departments which have been agreed in the interim.



Government departments are free to switch or “vire” funding between spending limits during the year, without reference to Parliament, providing they keep within the overall spending limits Parliament has already approved.

Supplementary Estimates

Supplementary Estimates are used where departments wish to draw down additional funding beyond that already authorised in the Main Estimates. They are also necessary if a department takes on new functions during the financial year.

Supplementary Estimates are usually published in February, although exceptionally they may be published at other times during the year.

As with Main Estimates, the Supplementary Estimates are put into effect through Supply Resolutions, followed by a Supply and Appropriation (Anticipation and Adjustments) Act.

Any additional funding provided through Supplementary Estimates is not available until the approval of Parliament is obtained, and the scope for the House of Commons to propose amendments to the Estimates is limited to reductions, not increases. Government departments remain free to switch or vire resources within approved limits at any time.

Additional resources in Supplementary Estimates will have been agreed between the department concerned and the Treasury before being presented to Parliament. Often they will involve no net increase - a movement of funds between

two different departments, or a take up of unspent funds from prior years.

Devolved administrations

Devolved administrations receive most of their funding through the Estimates voted by the UK Parliament. The funding is in the form of block grants, plus, in some cases, shares of taxes which the UK Government has agreed to pass on, and is included in the Estimates of the Scotland, Wales and Northern Ireland Offices (shown as “Non-Budget Expenditure”).

Memoranda accompanying the Estimates of these departments explain how the block grant has been calculated, using the Barnett formula.

Block grant is effectively a cash transfer between the UK and devolved governments. Devolved governments have freedom to spend the block grant on any devolved functions they choose, although the Treasury prevents the use of capital funding for resource purposes (as it does for the UK).

How is public spending categorised?

The Treasury sets the rules on categorisation of public spending. Departments are required to abide by these rules.



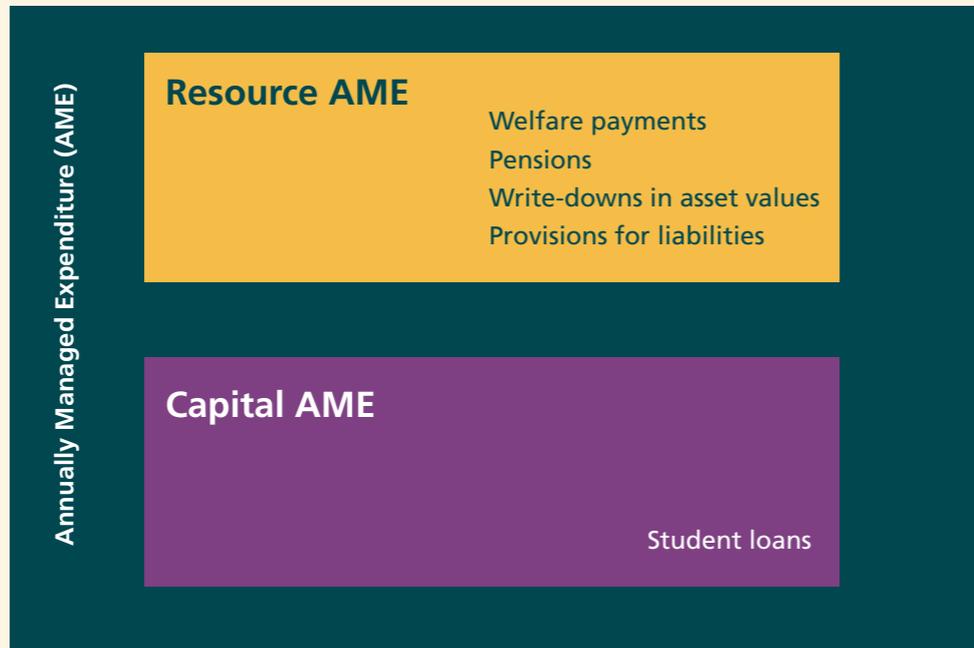
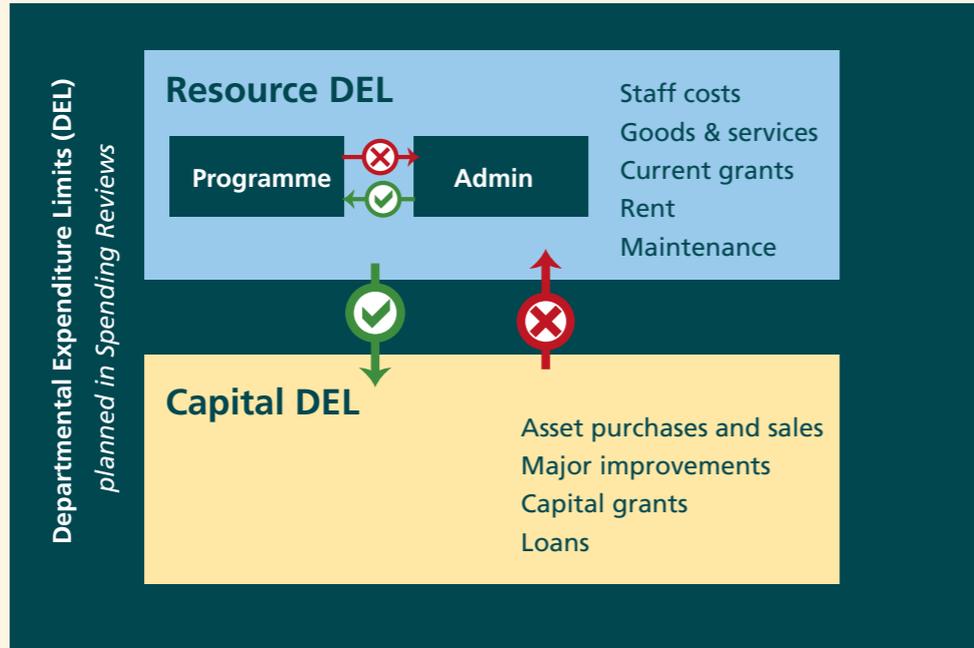
- **Resource DEL** - current spending (staff and other administration costs, grants supporting running costs, purchase of goods and services, depreciation). Spending is subdivided into administration and programme spending
- **Capital DEL** - capital spending (acquisition or improvement of assets, grants to support asset acquisition or improvement, loans)
- **Resource AME** - demand-led resource spending (welfare costs, provision for liabilities, write downs in asset values)
- **Capital AME** - demand-led capital spending (student and certain other loans)

Virement (switching of funding between budgets)

Government departments may “vire” (i.e. transfer) budgets between different activities within each of the DEL and AME totals, without reference to Parliament.

Changes to Resource or Capital, DEL or AME totals require Parliamentary approval through a Supplementary Estimate. The Treasury will not normally allow departments to submit Supplementary Estimates to Parliament which seek to switch funds from AME to DEL, from capital to resource DEL, or from programme to administration costs (within Resource DEL).

TOTAL MANAGED EXPENDITURE



- ✓ Switch from one budget to another allowed
- ✗ Switch from one budget to another not allowed (or allowed under exceptional circumstances)

Excess votes and Statement of Excesses

Excess votes arise when any of the spending limits are exceeded, or spending takes place beyond the activities (the “ambit”) authorised by Parliament.

In such cases the National Audit Office prepares a report for the Public Accounts Committee, which will in turn normally question the Department’s Accounting Officer (usually the Permanent Secretary) in public on the causes of the excess, corrective actions and lessons learned.

Formally, the excess vote needs also to be retrospectively approved through the



Statement of Excesses (SoE), which is published alongside the Spring Supplementary Estimates.

Timings (see timeline on page 13)

The main publication events in the public spending calendar are as follows:

1. **February before the year starts:** the Vote on Account, seeking advances of funding for the forthcoming financial year is presented to Parliament. Authorised by Parliament in March.
2. **April (later in election years):** The Main Estimates, seeking authority for the new year's spending, are presented to Parliament. Authorised by Parliament in July.
3. **February: Supplementary Estimates,** seeking amendments to in-year budgets, are presented to Parliament. Authorised by Parliament in March.
4. **February after the year ends:** The Statement of Excesses is presented to Parliament, following the production of the accounts for the year ended the previous April, setting out any areas where spending exceeded Parliamentary authority the previous year. Any excess spending is retrospectively authorised by Parliament in March.

Scrutiny in practice

Estimate Memoranda

At the same time as the Estimates are placed before Parliament, departments send an explanatory memorandum on their Estimate (the Estimate Memorandum) to the relevant select committee. The memorandum explains the differences between the current and previous Estimates, as well as the impact of the changes sought, and enables committees to carry out a more rigorous scrutiny of Estimates. The Scrutiny Unit has been active in assisting departmental select committees to scrutinise and improve the quality of the memoranda. On the basis of these Memoranda, departmental select committees will also ask questions to the department.

Estimates day debates

These are days which are allotted for debates in the House of Commons to consider the Estimates. Three days are allotted in each Parliamentary session to debate Estimates, one for the Main Estimate and two for the Supplementary Estimates and Vote on Account. Estimates Days can also be used to explore a major financial issue in depth, a relevant select committee report or departmental spending priorities as a whole.

Spending announcements

While planning and forecasting, revenue raising, spending and reporting operate on a regular cycle, in reality day to day decisions on spending take place throughout the year at different times. Following the announcement of the three or four year Spending Review settlement, a department is unlikely to have a hugely detailed plan for



spending of every pound it has been allocated, although it will know its broad intentions for the balance of funding being different spending areas under its control. However even within the year, events, changing priorities, and the success or otherwise of differing programmes will affect how funding is distributed.

As a consequence, Government ministers and departments often make spending announcements - of differing degrees of detail - throughout the year. Normally, these will simply be allocations or reallocations of money within the existing announced Spending Review DEL totals; occasionally the Treasury will offer a department additional money.

Where the overall DEL or AME totals for the department for the year are affected, this will be reflected in the Main Estimate presented

to Parliament, or if it happens in year, it will be reflected in the Supplementary Estimate. If an internal reallocation is involved, there may not be any change needed to an Estimate, as departments will be free to switch resources within the total, sometimes requiring the agreement of the Treasury, but not needing Parliament's agreement. In order to conduct effective scrutiny, select committees need to have an understanding of how departments are reallocating resources to meet their priorities. Often they can only get this information through asking pertinent questions at the Main Estimate and Supplementary Estimate stages.

Accountability, performance and reporting

Single Departmental Plans

The Government currently sets out its plans and priorities in a document known as the Single Departmental Plan (SDP). Government has undertaken to revise and update these from time to time. (Past governments have generally presented similar business plans or strategies, although the precise titles have varied over time).

Parliament has no direct role in approving these plans, which have no legal meaning or effect in themselves. But the plans are one indication of Government proposals for policy and spending priorities, and also give some pointers as to what measures of performance the Government thinks are important.





Priorities

The SDPs are intended to set out the Government's priorities and give some indication of how the Government intends to implement them, and measure its performance.

Key performance indicators and targets

The Government has set out in SDPs a number of Key Performance Indicators (KPIs) - relevant statistics measuring outcomes and metrics against which Government can assess its performance. These KPIs are published and updated periodically online, and annually in Annual Reports and Accounts. Select committees may make use of these KPIs to scrutinise the performance of departments and the effectiveness of spending in support of policy objectives.

Annual Report and Accounts

Departments publish an Annual Report and Accounts (normally a combined document) on a yearly basis. These are normally presented to Parliament around mid to late July. Occasionally, publication may be delayed, although this should only happen exceptionally and be notified to the departmental select committee. By law, accounts must be presented at the very latest by the end of January, ten months after the end of the financial year to which they relate. The Annual Report and Accounts includes three core elements:

- A performance report;
- An accountability report; and
- Financial statements

The performance report summarises overall

performance, spending and delivery of objectives. This section includes management commentary and performance analysis, including updates on key performance indicators and delivery against targets.

The accountability report gives reports on corporate governance, remuneration and a comparison of actual spending against the amounts approved by Parliament the previous year (known as the Statement of Parliamentary supply).

The financial statements follow a format similar to those for private sector companies (International Financial Reporting Standards). They include a statement of comprehensive net expenditure (similar to a profit and loss account or income statement), a statement of financial position

(balance sheet) and a cash flow statement, along with notes giving further detail.

The accounts are accompanied by an audit certificate from the Comptroller and Auditor General giving an opinion on the accounts, and are prepared on an “accruals” basis (see page 37).

Devolved administrations

The governments of the devolved administrations set their own strategic objectives. They also produce their own set of accounts for reporting purposes, which comply with international standards.



Accruals accounting

Departmental accounts are based on what is known as “accruals” accounting principles. This records spending as it is incurred, and income as it is earned, rather than simply movements of cash.

- **Accruals accounting avoids distortions in spending patterns caused by the timing of cash payments. It also includes a measure of the usage of assets over time (depreciation), and an assessment of assets and liabilities at year end (a balance sheet).**
- **Accruals accounting is standard practice for the production of commercial accounts.**

Scrutiny in practice

The Scrutiny Unit analyses Annual Reports and Accounts on behalf of select committees. Select committees often hold an oral session on the Annual Report and Accounts and/or follow up by submitting questions to the department on them.

Finance glossary

Note: This glossary focuses in particular on financial terms relevant to the UK Government.

A

Accounting Officer

The senior official ultimately responsible for all spending of a government department or arm's length body. The Accounting Officer for a government department is usually the Permanent Secretary. The Accounting Officer must personally sign off the Annual Report and Accounts of the body s/he has responsibility for, and may be called to appear before a select committee to answer questions on financial management.

Accounts Direction

A written document instructing officials how to prepare accounts.

Accruals Accounting

A method of recording expenditure as it is incurred (i.e. when the activity which generates the costs arises), and income as it is earned, rather than when cash is paid or received. This method of accounting is now used in the UK throughout the public and private sectors (with the exception of very small charities and businesses). In the public sector context it is also sometimes known as 'Resource'

accounting. UK Government Budgets (the DEL and AME limits) are also set in accruals rather than cash terms, and although departments still have to forecast cash movements, they are free to seek as high a cash requirement in their Estimates as is necessary to support the accruals budgets allocated.

The principal advantage of accruals accounting over cash accounting (where cash movements are all that is recorded) is that accruals accounting allows better financial management and scrutiny by:

- matching expenditure in any period to revenues earned and

obligations incurred in that period; and

- matching the cost of assets to the period in which they are used or consumed, by charging depreciation on them.

Administration budget

Budget limits controlling the resources set aside for the running costs (largely staff and associated costs) of a government department, and which form part of its Resource Departmental Expenditure Budget (DEL). Administration budgets are ring-fenced budgets, set at the time of a Spending Review. The other part of the

Resource DEL, outside of the Administration Budget is referred to as programme expenditure. If the department's administration budget is breached, the department's accounts will be qualified by the auditor (see qualified accounts).

Ambit

A description of what the funding sought in the Estimate will be spent upon. Departments can only incur expenditure that is reflected in the relevant ambit. The accounts will be qualified by the auditor if expenditure is incurred which falls outside the ambit. Income outside the

ambit cannot be used to offset expenditure within the budgetary limits, but must be surrendered as a Consolidated Fund Extra Receipt (CFER).

Annually Managed Expenditure (AME)

Spending included in departmental budgets, but which is difficult to predict, manage or forecast, so, unlike DEL, is not subject to multi-year spending limits set in Spending Reviews. Main categories of AME include demand led funding such as social security benefits, pensions and tax credits for individuals, and difficult to forecast items

such as impairments in asset value, and provisions for liabilities. Once the AME forecast is put before Parliament within Estimates it becomes a fixed limit, and any excess of spending over budget becomes an excess vote. There are separate Resource and Capital AME budgets.

Annual Report and Accounts

Published statutory documents of government departments and other public bodies produced annually, presenting details of the spending and performance of a government department or public body over the last year.

Departments publish and present their Annual Report and Accounts to parliament each year, usually within four months of the end of the financial year.

Annual Report and Accounts includes three core elements:

- A performance report, which summarises overall performance, spending and delivery of objectives;
- An accountability report, which gives reports on corporate governance, remuneration and a comparison of actual spending against the amounts approved by Parliament; and

- Financial statements, which include the Statement of Comprehensive Net Expenditure, Statement of Financial Position (Balance Sheet) and Cash Flow Statement, and associated notes.

The accounts are audited, usually by the National Audit Office. Some smaller public bodies may be audited by other auditors.

Appropriations in Aid (A in A)

Income recorded in Estimates and which is allowed to be used to support spending of a government department or other body. A in A will usually

be receipts of a commercial nature such as contributions from partners, sales, etc. A in A is distinct from income known as CFERs, which are surrendered to the Treasury.

Arm's length bodies (ALBs)

Public sector bodies which while not forming part of a government department, are consolidated into the departments' Estimates and Accounts. ALBs are often established, under specific legislation, to be semi-autonomous, or at "arm's length", from their departments, although their overall spending is usually tightly controlled

by means of budgets set by departments. Non-Departmental Public Bodies are a type of ALB.

B

Balance sheet

One of the core financial statements within the Annual Report and Accounts. Its formal name is now the "Statement of Financial Position" and it shows the total assets and liabilities of an organisation at the end of the year.

Budget Exchange

A mechanism which allows departments to surrender an underspend in advance of the end of the financial year in return for a corresponding increase in the following year, subject to a prudent limit. While essentially a set of rules determined by the Treasury, Government Departments still need to formalise the changes in Estimates and gain Parliamentary approval to changes in the normal way by presenting a Supplementary Estimate reducing budgets in one year, and including the additional funds in a Main or Supplementary Estimate in a subsequent year.

C

Capital

A body's net assets, which may include fixed capital (machinery, buildings, and so on) and working capital (cash held at the bank). May also refer to capital expenditure (see below).

Capital expenditure

In the context of Government, investment expenditure (controlled through capital DEL and AME limits), including net spending on the acquisition of assets, grant to support acquisition of assets, and loans paid out, less assets sales and loan repayments.

Cash Accounting

A method of accounting which records cash payments and cash receipts as they occur in an accounting period. While cash accounting was used for UK Government Departments and other public bodies for many years it was replaced by accruals accounting in the UK in 2002. Cash accounting is still used around the world by the majority of governments to control and record public spending, although its use in the private sector internationally and within the UK is much more limited.

Cash Flow Statement

One of the core financial statements within the Annual Report and Accounts. It shows the total cash held at the beginning of the year, cash flows in and out, and cash held at year end. While government departments' budgets are now measured on an accruals basis, departments still need to monitor and record cash movements and not exceed the total amount of cash they forecast as a net cash requirement within their Estimates. The cash flow statement is audited, usually by the NAO.

Charter for Budget Responsibility

A document, approved by Parliament, which sets out the government's aims in its management of the economy and against which the OBR assesses government performance - sometimes known as the "fiscal mandate". The Charter remains in place until amended by Parliament.

Comptroller and Auditor General (C&AG)

The head of the National Audit Office, and an officer of Parliament, who is wholly independent of Government.

He gives an opinion ("certifies") the accounts of all major Government departments and many ALBs.

Comprehensive Statement of Net Expenditure

One of the core financial statements within the Annual Report and Accounts. It sets out the total spending and income of the Department or body concerned. It is equivalent to the Income Statement or Profit and Loss Account for private sector companies. It is audited, usually by the NAO.

Consolidated Fund

Equivalent to the Government's current account. Government revenue from taxes and other sources is collected daily and paid into the Consolidated Fund. Government Departments draw down cash from the Consolidated Fund, subject to the limit of their annual Net Cash Requirement, to make all their payments.

Consolidated Fund Extra Receipts (CFERs)

Receipts which are outside the ambit of the Estimate and cannot be used to support expenditure of a Department. Instead they

are recorded and passed to the Treasury's Consolidated Fund. These include taxes collected by Departments.

Consolidated Fund Standing Services (CFSS)

Spending which doesn't require annual approval by Parliament because other legislation provides for its funding without annual approval in Estimates. CFSS includes judges' salaries and some election costs. Shown as "non-voted" within Estimates.

Contingencies Fund

A fund used by the Treasury to support emergency spending in advance of approval by

Parliament. Advances from the Contingencies Fund should be notified to Parliament through a Ministerial Statement.

Contingent liabilities

Liabilities which it is possible, but are unlikely, to arise. The Estimates and the Accounts contain details of a Department's contingent liabilities.

Cyclically adjusted

Adjusted to take account of the economic cycle i.e. fluctuations in economic growth.

D

Debt

Accumulated borrowings over time. Annual deficits add to debt. The main measure of debt used by the UK government is Public Sector Net Debt (PSND).

Deficit

The shortfall between spending plans and taxation revenue, which has to be funded through borrowing.

Departmental Expenditure Limit (DEL)

Expenditure which is subject to limits set in Spending Reviews,

and which it is assumed Government Departments can control. Separate DELs are set for each Government Department's Resource and Capital spending each year.

Departmental Unallocated Provision (DUP)

A part of a Government Department's budget which has been set aside as a contingency. DUP forms part of a Department's Resource or Capital DEL, and is included within the Estimate. DUP may be vired to other budgets in the same department's DEL, reallocated in a Supplementary Estimate;

or surrendered for possible carry forward into a future year through Budget Exchange.

Depreciation

A measure of the wear and tear of a fixed asset arising from use. It spreads the cost of an asset over its time in use and is often estimated in terms of the value of an asset and its useful life. Departments and other bodies are required to set a depreciation policy for each type of asset which they hold. The most common depreciation policy is "straight-line" and simply means dividing the value of an asset over its estimated

useful life. Sometimes the depreciation policy allows for a residual value to the asset, which is generally the amount which an organisation can sell the asset for after it is no longer useful to it. Depreciation scores in the Resource DEL budget (where it is ring fenced) or in some specific cases, against Resource AME.

E

Estimates Days

Days which are allotted for debates in the House of Commons to consider the Estimates. Certain Estimates

are selected for debate by Parliament, although the actual debate may in reality be only about one aspect of the Estimate, or relate to a select committee report on a policy area for which funding is provided in the Estimate. Members may propose amendments reducing expenditure for Estimates selected for debate on Estimates Day.

Estimates

See Supply Estimates.

Excess vote

Where a Department has spent more - as recorded in its audited end year accounts -

than was voted by Parliament in Estimates, or has spent beyond the coverage of its ambit i.e. its voted authority has been exceeded. This can be against any one of the individual voted totals - Resource DEL, Capital DEL, Resource AME, Capital AME, non-budget expenditure or the net cash requirement. In such cases Parliament retrospectively authorises the departmental overspends, approving a Statement of Excesses. Excess votes automatically lead to accounts being qualified by the Comptroller and Auditor General, which will often lead to a hearing by the Public Accounts Committee.

F

Finance Bill

A bill which gives permanent legal effect to the Budget Resolutions and is generally presented at the end of the debate on the Budget. The Finance Bill deals with the revenue side of government finances. It includes changes to levels and types of taxation; changes to administration of the tax system; renewal for taxes already in force.

Financial Reporting Advisory Board (FRAB)

An independent committee overseeing financial reporting standards in the public sector. It considers forthcoming changes to International Financial Reporting Standards and whether any adaptations are necessary for the public sector before incorporation in the Financial Reporting Manual (FReM). FRAB members include representatives from the accounting profession, Government Departments and ALBs, academia, the NAO, the Office for National Statistics and Parliament.

Financial Reporting Manual (FReM)

The authoritative statement of accounting guidance against which Departments' accounts are prepared and audited. The manual is based on International Financial Reporting Standards as adapted and interpreted to take account of the public sector context. The Financial Reporting Manual (FReM) is produced by the Treasury and endorsed by the independent Financial Reporting Advisory Board.

Fiscal mandate

The Government's aims for management of the economy,

which it sets out in the Charter for Budget Responsibility.

G

Grant-in-aid

A grant made by a Government department from voted money to a particular body, usually an Arm's Length Body (ALB). Grant-in-aid can be used in any way towards an ALB's objectives i.e. it is not linked to specific activities.

Gross Domestic Product

A measure of economic activity which captures the value of goods and services that a

country produces during a given period. GDP can be measured through output, income or expenditure approaches, and can be expressed in nominal or real terms.

I

International Financial Reporting Standards (IFRS)

A set of standards for producing accounts and which are widely used throughout the world. In the UK, the FRAB advises on possible adaptations to IFRS before they are adopted in the public sector.

K

Key Performance Indicators (KPIs)

Measures of performance which are considered to be good indicators of a department or other body's success or otherwise in meeting its targets or objectives. These are published periodically by Government online, in updates to the Single Departmental Plans and in the Annual Report and Accounts.

M

Main Estimate

The first set of full proposed budgets produced for the financial year, covering the expected spending of a department, including its arm's length bodies, for the whole financial year, April to March. The Main Estimates are presented to Parliament – usually in April, or sometimes later in a General Election year. Once approved they become that year's budgets, unless and until they are amended later in the year by means of a Supplementary Estimate.

Managing Public Money

The government's guidance to departments on managing public money effectively. The guide sets out rules and responsibilities, as well as guidance on best practice to achieve value for money.

Ministerial Direction

A written document from Minister/s instructing officials to pursue a certain course of action. Sometimes these may be sought from the Accounting Officer if s/he has doubts over the value for money or propriety of a spending proposal.

N

National Accounts

A statistical measure of public sector spending used by the Treasury, OBR and ONS. Figures for borrowing, debt and total spending quoted by the Chancellor are usually measured according to the National Accounts. National Accounts follow the European Standards of Accounts as set by Eurostat. The National Accounts give a different picture of total public spending and debt to the Whole of Government Accounts, which are compiled according to different standards (IFRS).

National Accounts do not for instance include public sector pension liabilities, or make provision for liabilities where payment has yet to be made.

National Audit Office

The body which audits and scrutinises public spending on behalf of Parliament. It audits the accounts of all central government departments and agencies, as well as a wide range of other public bodies, and reports to Parliament on the economy, efficiency and effectiveness with which they have used public money. It is totally independent of

Government. The NAO is headed by the Comptroller and Auditor General.

Net Cash Requirement

The total cash which is estimated to be required in support of the spending by a Government Department. Departments calculate their estimated net cash requirement based on the total DEL, AME and non-budget spending limits, which all record spending on an accruals basis, adjusted to take account of non-cash items (such as depreciation) and timing differences e.g. where cash is paid in advance or arrears of a service being provided.

Once the Net Cash Requirement has been voted it is a fixed total and can only be amended by a Supplementary Estimate. Cash drawn down in excess of the Net Cash Requirement at year end constitutes an excess vote.

Net operating cost

A sum comprising the total of the net administration costs and the net programme costs included in Statement of Comprehensive Net Expenditure. It is not a control or voted total, but an accounting measure. It is broadly similar to the sum of the Resource DEL plus the Resource AME, with some adjustments e.g. the addition of capital grants.

Non-budget expenditure

Expenditure included in the Estimates, but which is not part of a UK Government department's budget (DEL or AME). The main elements are cash grants to devolved administrations. These cash grants, sometimes known as block grant, provide the cash to support spending by the devolved governments. Devolved governments score their actual spending, on an accruals basis, against their own DEL and AME totals, which are voted by their own Parliaments/Assemblies.

Non-Departmental Public Body (NDPB)

A public sector organisation which has a role in the process of government but which is not in itself either a government department or part of a department. It can incur expenditure on its own account and is usually financed primarily from public funds via grant-in-aid from a sponsor department. Generally now known, along with some other types of bodies which are also not part of a department, as “arm’s length bodies”. NDPBs are colloquially known as “quangos” or “quasi non-

governmental organisations”. NDPB expenditure scores against the DEL or AME of a specified relevant government department, is consolidated into the department’s Supply Estimate, and included in the consolidated Annual Report and Accounts of the Department – being treated in a similar way to subsidiaries within a “Company Group”.

Notes to the accounts

Numbered notes which give additional information on individual figures in the accounts or provide further disclosure, as required by the Financial Reporting Manual. They are

included in the Annual Report and Accounts.



Office for Budget Responsibility (OBR)

An arm’s length body set up in 2010 as an independent fiscal watchdog to forecast public spending. It judges progress towards the Government’s fiscal targets, assesses the long-term sustainability of the public finances, scrutinises the Treasury’s costing of Budget measures and produces forecasts for the economy and public finances.

Office for National Statistics (ONS)

A public body which provides independent authoritative statistics for the UK, and which is independent of Government Departments.

P

Programme expenditure

The resources that the Department uses directly to deliver its policy objectives, excluding spending within a Department's administration budget. Programme expenditure may still include or support

staff costs, but generally only those of staff involved in front line services. The dividing line between programme and administration spending is determined by the Treasury for each Department. Programme budgets within Resource DEL may not be used to support spending within the administration budget in Resource DEL.

Provision for liabilities

A cost, recognised when an organisation takes on a liability, often not actually payable for many years to come. Provisions normally score against Resource AME. Notable provisions in

government include the provision for nuclear decommissioning, and a provision for medical negligence. When some or all of the payment is actually made, Resource AME is credited, and the cost scores against Resource DEL in the normal way in order to avoid the same spending being measured twice. Liabilities recognised through Provisions must be probable, unavoidable and quantifiable at the time they are recognised. If they are less certain they are not recognised as costs, but noted as contingent liabilities instead i.e. they do not count as spending until and unless they become more certain.

Public Expenditure Statistical Analyses (PESA)

The annual publication of statistical information on government spending. It gives information on spending by Department, function and region over a number of years.

Q

Qualified accounts

Accounts which are considered by the auditor in some way deficient, incomplete or unsupported fully by evidence, and which the auditor has been unable to consider present

a true and fair view of the organisation's affairs.

Accounts may be qualified when the auditor deems:

- there is insufficient appropriate audit evidence obtained;
- the financial statements have not been prepared in accordance with accounting standards;
- the financial statements are affected by significant uncertainties;
- the financial statements do not give a true and fair view; and

- there is irregular expenditure (i.e. it does not conform with Parliamentary intention).

If accounts are qualified, this is clearly indicated in the auditor's certificate within the department's accounts. A qualification of a Government department's accounts will tend to reflect badly on the department and its management. It will usually be regarded as an indication of weakness in financial management, its seriousness depending on the cause and nature of the qualification.

R

The Reserve

A small central funding pot held by the Treasury, which is used to top up Departmental DEL budgets in exceptional circumstances, usually at Supplementary Estimates.

Resource Accounts

A department's annual accounts or financial statements, prepared on an accruals basis, consolidating the expenditure of a department and its arm's length bodies. They form part of the Annual Report and Accounts. Resource Accounts are prepared

on the basis of International Financial Reporting Standards and the Government Financial Reporting Manual (FReM). They are audited, usually by the NAO.

Roll up motion

The motion put before the House of Commons for approval of all Estimates which are not the subject of Estimates day debates. Most Estimates are included within the roll up motion and cannot therefore be amended by Parliament, although theoretically the whole motion, covering most of public spending, could be rejected by the House of Commons.

S

Scrutiny Unit

A team within the Committee Office in the House of Commons responsible for providing specialist expertise to select committees, especially (but not exclusively) on financial matters.

Single Departmental Plan

A plan set out by the Government, stating government priorities, objectives and key performance indicators. It is updated online from time to time.

Spending Review

Internal Government reviews of future spending plans held every few years. The outcome of a Spending Review is announced in Parliament, and sets out the proposed Resource and Capital DEL limits for each department for each of a number of years ahead, The Spending Review totals form the basis of subsequent Main Estimates voted by Parliament.

Statement of Cash Flows

See "Cash flow statement".

Statement of Comprehensive Net Expenditure

One of the core financial statements within the Annual Report and Accounts. It is similar to the income statement (formerly known as the profit and loss account in a company's accounts) and shows resources consumed during the year by the department in providing its services. It is audited, usually by the NAO.

Statement of excesses

A document presented to Parliament detailing the extent to which, exceptionally, a Department has exceeded

spending limits or spent outside its ambit in a past year. It is voted on and approved by Parliament in the year after it arose, giving formal retrospective approval from Parliament to overspends which have already happened.

Statement of Financial Position

One of the core financial statements within the Annual Report and Accounts. Formerly (and colloquially still) known as the "balance sheet", it shows the total assets and liabilities of an organisation at the end of the year. It is audited, usually by the NAO.

Statement of Parliamentary Supply

A statement within the Annual Report and Accounts which compares outturn (actual expenditure or “actuals”) with the Estimate (budget) for both resource expenditure and the overall cash requirement. It is audited, usually by the NAO. This forms part of the Accountability report within the Annual Report and Accounts.

Supply and Appropriation Acts

Legislation which gives formal legal authority for departments to spend money. In addition, these Acts limit the ways in

which money can be used by prescribing the services particular budgets are used for. Both spending limits and spending amounts included in the Supply and Appropriation Acts are derived from relevant Estimates presented to Parliament. The Main Estimate is approved by Parliament through a Supply and Appropriation (Main Estimates) Bill/Act. The Supplementary Estimate is passed through a Supply and Appropriation (Anticipation and Adjustments) Bill/Act.

Supplementary Estimate

Documents presented to Parliament when Government departments wish to change their voted budget limits or cash requirement after a financial year has started and Main Estimates have been approved. Supplementary Estimates are also necessary if a department takes on new functions during the financial year, including functions transferred under Machinery of Government changes, or to draw down money unspent from past years through Budget Exchange. Supplementary Estimates are normally only presented to Parliament on one occasion each year, usually in February.

Supply

The overall term for the means by which Parliamentary authority is secured for most government spending i.e. the Estimates and Appropriation process.

Supply Estimates

The documents presented by the Treasury to the House of Commons in which a department seeks approval for its spending for the coming financial year. The Estimates summarise the resources, capital and the cash required. The two types of Supply Estimates are the Main Estimates (setting initial budgets) and

Supplementary Estimates (in year adjustments to budgets).

T

Total Managed Expenditure (TME)

A Treasury budgeting term which covers all current and capital spending carried out by the public sector (i.e. not just by central Government departments). It comprises the sum of Departmental Expenditure Limits (DELs) and Annually Managed Expenditure (AME), less depreciation.

Trading Fund

Public bodies which make most of their money through trading rather than voted funds. Trading Funds may however receive voted funds from time to time, usually for specific purposes.

V

Value for Money Studies

Studies examining the economy, efficiency and effectiveness of public spending. The National Audit Office (NAO) has a programme of VFM reports every year, many of which form the basis for subsequent hearings and reports by the Public Accounts Committee.

Virement

The use of savings on one budget to fund increased spending against another, without reference to Parliament, or the need for a Supplementary

Estimate. A Department may only vire resources within a particular Estimate (i.e. within a Department's area of responsibility and not to another Department or Estimate) and within a particular year.

Funding is allowed to be vired within Resource DEL, Capital DEL, Resource AME or Capital AME budgets or between Resource DEL and Capital DEL, and from the administration budget to programme spending within Resource DEL.

Funding may not be vired from Capital to Resource, from Programme to Administration

budgets or between AME, DEL and non-budget expenditure. Departments may still have to explain in their accounts reasons for variations in expenditure at year end if spending varied significantly from published budgets, even where virement was within the rules.

Voted funds or Votes

Funds for which Parliamentary authority is required on an annual basis, through Supply and Appropriation Acts. The majority of funds shown within an Estimate are voted. The exceptions are a few "non-voted" items of spending,

where legal authority is obtained through other means e.g. Consolidated Fund Standing Services, and which are included for completeness in Estimates, but labelled as “Non-voted”.

Vote on Account

Money advanced by Parliament to carry on public services from 1 April of the forthcoming financial year until the passing of the Supply and Appropriations (Main Estimates) Act (usually in July). Normally the Vote on Account is calculated based on 45% of the previous year’s budgets. Votes on Account are approved by Parliament before the start of

the new financial year begins in April, usually in March.

W

Whole of Government Accounts (WGA)

An annual set of consolidated financial statements covering the whole of the public sector, prepared by the Treasury, and following accounting standards. WGA includes many bodies: central government funds, departments and agencies, Non-Departmental Public Bodies, trading funds, the NHS, devolved administrations, local

authorities, fire authorities, police authorities, waste authorities, passenger transport authorities and academies. Parliamentary bodies (including the House of Commons, the House of Lords and the National Audit Office) are not included. WGA follows the Financial Reporting Manual and comply with International Financial Reporting Standards, as adapted for the UK public sector context by FRAB. The accounts are audited by the NAO. WGA follows different standards to the National Accounts, and unlike those accounts, is not generally used for economic or fiscal purposes.

