Scrutiny Unit **April 2012**

An Overview of Recent Changes in Government Financial Management

Over the past two years, there have been some marked changes in the way the Government manages its finances and departments report on their finances and performance to Parliament. Some of the changes such as alterations in the Government's fiscal rules and the way departments monitor their performance have occurred as a result of policy shifts introduced by the Coalition Government. Other changes such as a reduction in the number of Supplementary Estimates that departments are allowed to present to Parliament in the year have occurred as a result of ongoing reforms in Government financial management, notably the *Alignment Project*.[1] At the end of this paper, we have included a diagram showing the bodies now involved in financial scrutiny and also the timeline with the main events in the financial cycles.

The major changes in the Government's financial management are outlined below and set out in a table in the Annex:

- The Government's fiscal rules which set targets for the deficit and Government debt are now judged over a fixed time period (up to 2015–16) rather than over the economic cycle. The Government currently has what it terms a *Fiscal Mandate*: achieve a cyclically-adjusted current balance by the end of the rolling five year forecast (2015–16) and a supplementary target for public sector net debt as percentage of GDP to be falling in 2015–16.

- In 2010, the Government created a 'fiscal watchdog', the Office for Budget Responsibility (OBR). The OBR judges the Government's progress towards its fiscal targets. It also produces forecasts for the economy and public finances, assesses the long-term sustainability of the public finances and scrutinises the Government's costing of budget measures. Previously, these tasks were the sole responsibility of the Treasury, though the National Audit Office did audit some of the assumptions made by the Treasury.

- The Alignment Project has made some changes to the Estimate process. There is now only one opportunity for departments to present Supplementary Estimates.[2] Previously Supplementary Estimates could be submitted three times a year – Summer (May), Winter (November) and Spring (February). (Summer Supplementaries were rare because they must be presented to Parliament very soon after the Main Estimates). There is now one Estimate Day allotted to the Main Estimate in May and two Estimate Days allotted to the Supplementary Estimates presented in January/February. The Estimate Day for the Supplementary Estimates can also be used for the Vote on Account.[3]

- The Government has tightened the rules on how departments can carry forward under-spend from one year to the next. Under the previous Government, End-Year Flexibility allowed

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[1] The aim of the Alignment Project was to align budgets, Estimates and accounts in a way that allows Treasury to control what is needed to deliver the fiscal rules and to combine and/or align the timing of publication of government financial reporting documents in order to avoid duplication and make them more coherent.

[2] Supplementary Estimates are used where departments wish to draw down additional funding beyond that already authorised in the Main Estimates or transfer funding between Request for Resources (group of similar activities within Estimate)

[3] Money granted by Parliament to carry on public services from 1 April of the forthcoming financial year until the passing of the Supply and Appropriation (Main Estimates) Bill around April/May.

departments to carry forward unspent provision in the Departmental Expenditure Limit into the next year, subject to Treasury approval. The new system of Budget Exchange is more restrictive. There will be no scope to carry forward under spends that are not forecast in advance of the Supplementary Estimate. There are also limits on the amount departments can carry forward. For instance, departments with a DEL between £2bn and £14bn will be allowed to carry forward 1% of resource DEL and 2% of capital DEL. Also, to ensure that spending power is not allowed to accumulate over time; Budget Exchange will only be permitted from one year to the next. To make this work, any carry-forward from the previous year will be netted off the amount that can be carried forward into the next year.

- The key performance tools for departments are *structural adjustment priorities* and *structural adjustment plans*. Structural adjustment priorities describe the Department's main objectives. Structural adjustment plans give details of how each of the Structural Adjustment Priorities for the department will be achieved in the form of an action plan with dates and statuses against each action. Departments also have input and output indicators which monitor whether Departmental outcomes are being achieved. The structural adjustment priorities, structural adjustment plan and input and output indicators all form part of the Department's overall *business plan*. Previously departments' performance was monitored through Public Service Agreements (PSAs) that described what a department planned to deliver in the form of measurable targets over the spending period. Towards the end of their term, the Labour Government made PSAs cross-departmental with one department taking the lead for each PSA. Along with PSAs, individual departments had Departmental Strategic Objectives with indicators. The focus in the performance regime appears to have shifted from monitoring performance via progress against several targets to monitoring performance via whether the Department has completed set tasks in time to achieve structural adjustment objectives (though Department still have input and output indicators which monitor performance).

- The Alignment Project was initiated primarily because the measures Government used to control public expenditure (budget) did not match those which Parliament used to authorise such expenditure (estimates). There were also mismatches between both of these measures and the way expenditure is reported, after the year end, in the Resource Accounts. In April 2010 the legislation necessary for alignment (The Constitutional Reform and Governance Bill) received Royal Assent as part of the pre-election wash-up. On 5 July 2010 a debate and vote on a motion approving the alignment reforms was passed in the House of Commons. The Alignment Project made the following reforms to better align the financial data in the accounts, the Estimates and budgets:

    - Parliamentary controls on expenditure in the Estimate are on a net basis rather than a gross basis to line up with budgetary controls. However, details of income are still shown in the Estimates and the types of income to be used in support of expenditure are restricted to those included within a detailed income description within the Estimate.

    - Net expenditure of executive Non-Departmental Public Bodies and equivalent bodies is now consolidated within the Estimates and from the financial year, 2011–12 will also be consolidated within the accounts of the sponsoring department. This will mean that treatment of NDPBs in the accounts and Estimates will be the same as that in the budgets.

Even after the Alignment Project there will be some discrepancies between budgets, Estimates and accounts. This is because £19 billion of capital grants to the private sector and local authorities and £2billion of decommissioning costs of the Nuclear Decommissioning Authority is treated as resource expenditure in the resource accounts reflecting IFRS[4] requirements, as they do not create an asset on the departmental balance sheet. They are, however, treated as capital spending in budgets and Estimates, reflecting National Accounts treatment, which measures the impact of spending across the economy.

- As part of the Alignment Project the Government has aligned the timing of publications in the estimate and reporting cycle. The Government aims for there to be three main publication events in the year (timings are approximate):

  (1) **April/May** – The Main Estimates booklet and Public Expenditure Statistical Analyses (PESA)[5] to be presented to Parliament by the Treasury
  (2) **June** – Annual Report and Accounts published by each department
  (3) **January –**Supplementary Estimates booklet presented to Parliament by the Treasury which would also incorporate the Statement of Excesses for the previous year[6] and the Vote on Account for the following year.[7]

[4] International Finance Reporting Standards
[5] PESA is the regular publication of information on government spending. It is based on the budgeting and Total Expenditure on Services (national accounts) framework**.**
[6] The Statement of Excesses seeks authority for any spending by departments in the previous financial year that was outside of the plans contained in Estimates and authorised by Parliament.
[7] Money granted by the Parliament to carry on public services from 1 April of the next financial year until the passing of the Supply and Appropriation (Main Estimates) Act which approves the Main Estimate.

ANNEX

Post 2010	Pre 2010
Fiscal Rules	
Fiscal Mandate: achieve a cyclically-adjusted current balance by the end of the rolling five year forecast (2015–16) **Supplementary target**: public sector net debt as percentage of GDP to be falling at a fixed date, 2015–16. The Government has also set in place a fiscal watchdog, the Office for Budget Responsibility. One of its roles is to judge the Government's progress towards the fiscal targets. It assesses whether the Government has 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. Note: *whereas previously the fiscal rules were set according to the economic cycle, now the Government has set a deadline when to achieve them, 2015–16.*	**The Golden Rule**: Over the economic cycle, the Government will borrow only to invest and not to fund current spending; and **The Sustainable Investment Rule**: Net public debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level [The Government introduced new fiscal policy objectives for a short time after the financial crisis]
Supplementary Estimates	
Only one supplementary a year in January/February.	Supplementary Estimates could be submitted three times a year – Summer (May), Winter (November) and Spring (February). (In practice Summer Supplementaries were rare because they had to be presented to Parliament very soon after the Main Estimates).
Budget	
Autumn Statement in autumn and Budget in spring. The Autumn Statement focuses on the latest growth and economic forecast published by the Office for Budget Responsibility.	Pre-Budget Report in autumn and Budget in spring
Reporting	
Annual Report and Accounts audited by the NAO. Annual Report highlights progress against the Department's Structural Adjustment Plan including number of actions which were not completed on time and also progress against impact indicators.	Departmental Reports which show progress against the Department's Public Service Agreement targets. Departments also had indicators against their Departmental Strategic Objectives. Autumn Performance Report which reported against PSAs mid-year. Annual Report and Accounts audited by the NAO.

<table>
<tr><th>Post 2010</th><th>Pre 2010</th></tr>
<tr><td colspan="2" align="center">Performance Tools</td></tr>
<tr><td>The Departments’ Business plan sets out:

- the Department’s vision

- coalition priorities (structural reform priorities) – these are the department’s objectives

- structural reform plan (this sets out the set of actions with timescales that will enable the Department to achieve its structural reform priorities). All the departments’ business plans are available on the no. 10 website.

- expenditure over the 2010 Spending Review period and

- data which can be used to measure the department’s performance (input and impact indicators</td><td>Departments’ performance was monitored against Public Service Agreements (PSAs).

PSAs describe what a department plans to deliver in the form of measurable targets over the public expenditure review period, in return for its resource.

In the latter years of the Labour Government, departments also had Departmental Strategic Objectives with indicators</td></tr>
<tr><td colspan="2" align="center">Carry-over of under spends</td></tr>
<tr><td>Budget Exchange

A mechanism that allows small amounts of DEL, identified at Supplementary Estimate stage to be carried forward and used in the following year.

• There will be no scope to carry forward under spends that are not forecast in advance of the Supplementary Estimate.
• Limits on the amount departments can carry forward, depending on size of DEL budget. Departments with DEL between £2bn and £14bn will be allowed to carry forward 1% of resource DEL and 2% of capital DEL.
• To ensure that, spending power is not allowed to accumulate over time, Budget Exchange will only be permitted from one year to the next. To make this work , any carry-forward from the previous year will be netted off the amount that can be carried forward into the next year.</td><td>End-year Flexibility (EYF)

A mechanism which allowed unspent provision within Department Expenditure Limits declared in the Provisional Outurn White Paper (June/July), to be carried forward and used in subsequent years. EYF was brought to an end a few months into 2010.</td></tr>
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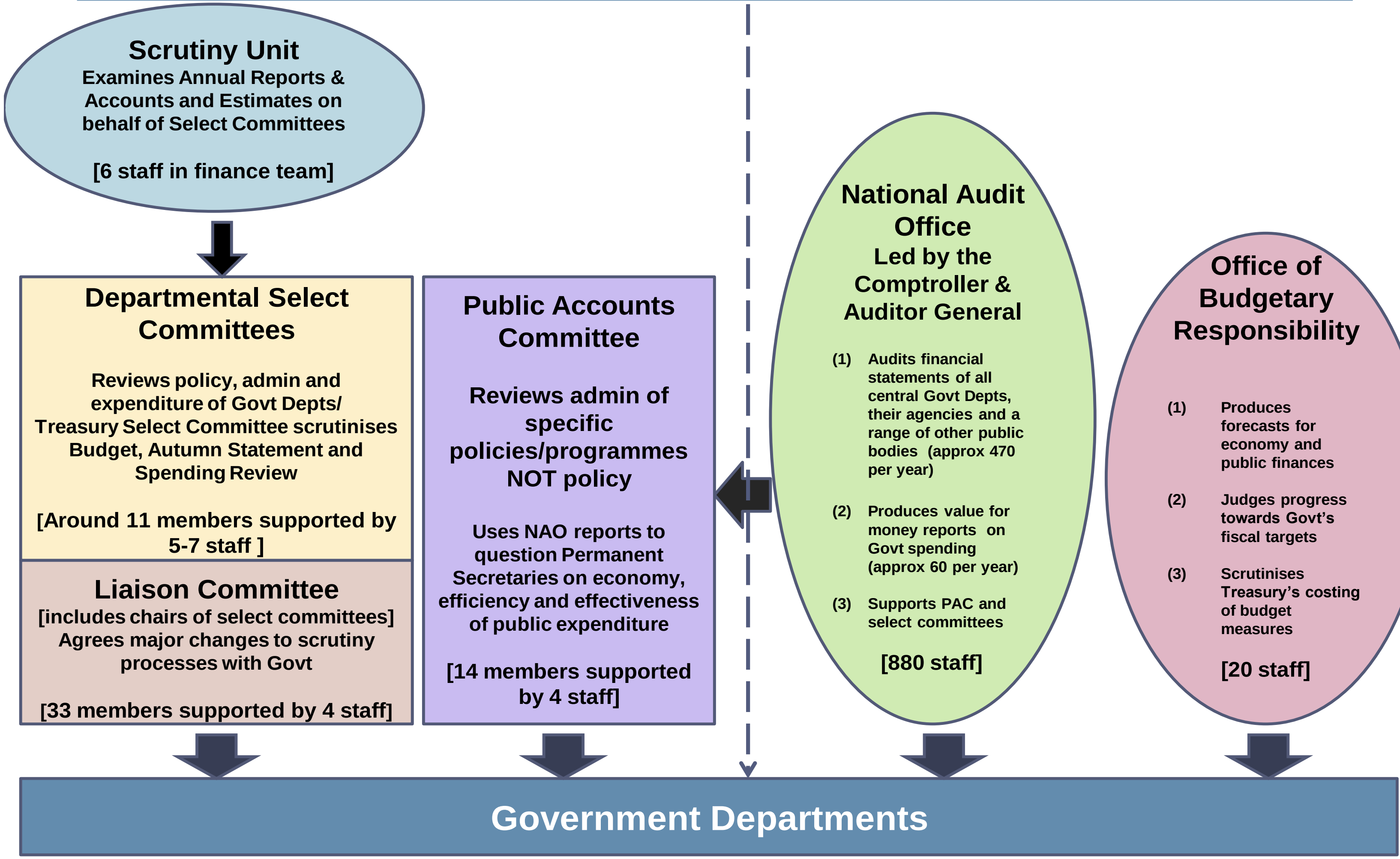
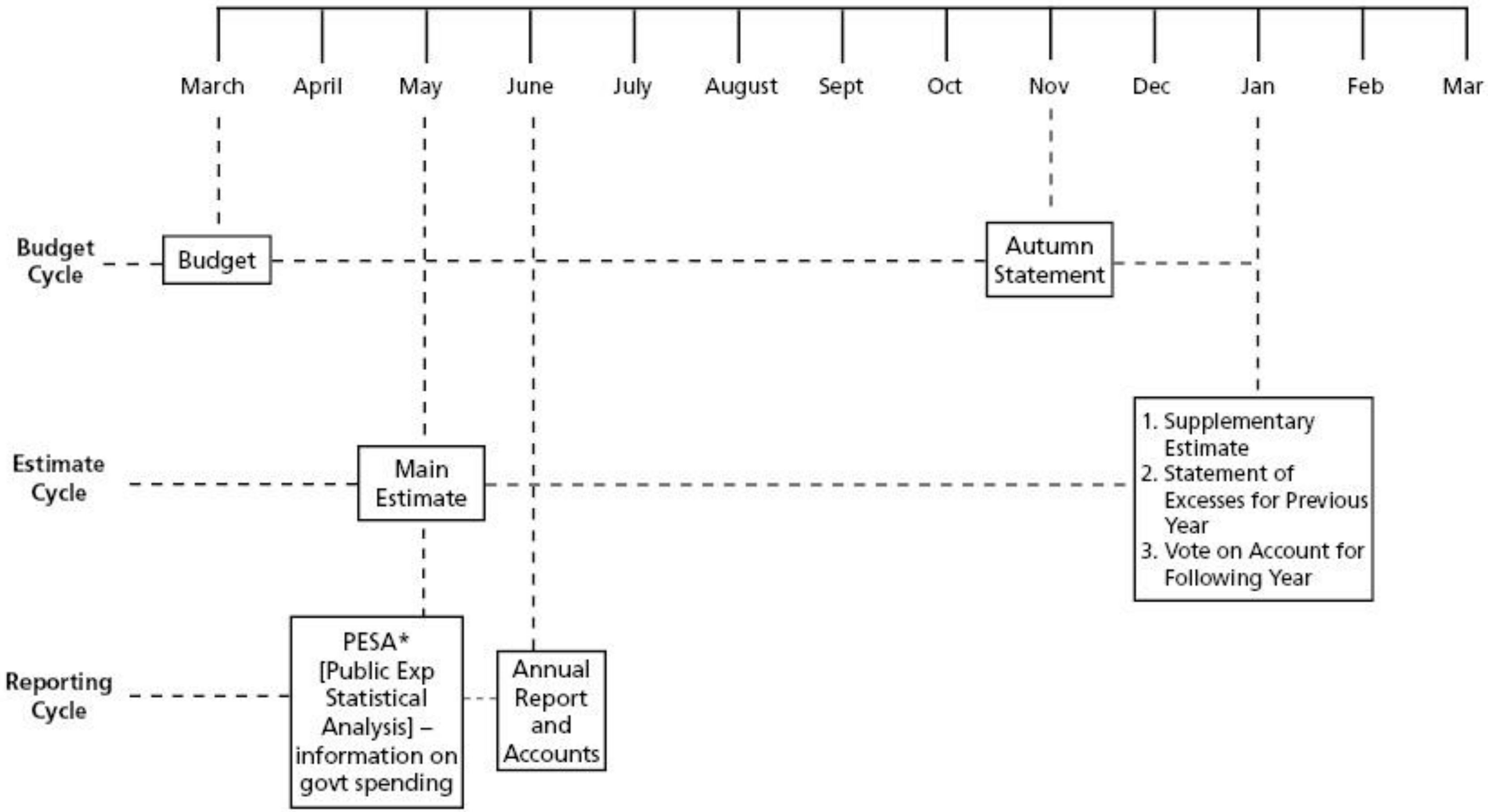
Post 2010	Pre 2010
Government Auditors	
Under current changes proposed by the Coalition Government, the Audit Commission will be abolished. Local government will in future appoint their own auditors, via independent audit committees, and some Audit Commission functions including drawing up the scope of local audit and national value-for-money studies will pass to the National Audit Office. The National Audit Office's responsibilities regarding central government departments remain the same.	The National Audit Office audits the accounts of all government departments and agencies and many other public bodies. It also produces value-for-money reports. The Audit Commission had the responsibility for reporting on local authority public spending. It was the regulator, commissioner and major provider of local government audit services undertaking 70% of the local government audit and commissioning the remaining 30% under contract from five private audit firms

Parliamentary Scrutiny of Government Finances



Timeline – Parliamentary Scrutiny of Government Finances



*This used to be published in July. It is now proposed that it will be published in May.

NOTE: Timings of events are approximate and can vary by a month