



HM Treasury

Consolidated Budgeting

Guidance:

2019 to 2020

March 2019

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Foreword

Context

The fiscal mandate, against which the independent Office for Budget Responsibility judges the government's plans, is to return the public finances to balance at the earliest possible date in the next Parliament.

The Charter for Budget Responsibility 2017 commits the government to reducing the cyclically-adjusted deficit to below 2% of GDP by 2020-21 and having debt as a share of GDP falling in 2020-21. These rules will guide the UK towards a balanced budget by the middle of the next decade.

To achieve this, the government is committed to maintaining fiscal discipline.

Years of applicability

This budgeting guidance applies to in-year control from 2019-20.

Substantive changes to budgets

This section sets out the main areas where the guidance has been changed for 2019-20;

- chapter 3 has been updated to provide clarification on the implementation of IFRS 9 where applicable
- chapter 8 has also been updated to reflect clarifications to the implementation of IFRS 9 where applicable
- Annex B has been updated to reflect the current guidance on Debt Management

There are also many minor changes to clarify wording following comments received during the year.

Chapter 1

Overview - Introduction to Budgeting

Purpose of public expenditure control

- 1.1 The budgeting system has two main objectives:
- to support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the government's fiscal framework and
 - to provide good incentives for departments to manage spending well so as to provide high quality public services that offer value for money to the taxpayer
- 1.2 In addition, the Treasury tries to keep down the compliance costs of the budgeting system and of the overall public spending control framework.

Fiscal framework

- 1.3 The government's objectives for fiscal policy are set out in the Charter for Budget Responsibility. These rules will guide the UK towards a balanced budget by the middle of the next decade.
- 1.4 The means to achieving these objectives is through the government's fiscal mandate, which set out in the Charter for Budget Responsibility (2017):
- a target to reduce cyclically-adjusted public sector net borrowing to below 2% of GDP by 2020-21

The Treasury's mandate for fiscal policy is supplemented by

- a target for public sector net debt as a percentage of GDP to be falling in 2020-21
- 1.5 The mandate and the supplementary target for debt are measured with reference to two fiscal aggregates:
- **Cyclically Adjusted Public Sector Net Borrowing (PSNB)** which measures total managed expenditure less public sector current receipts, adjusted to show what it would be if GDP was growing at its potential level rather than its actual path or in other words if the output gap was zero
 - **Public Sector Net Debt (PSND)** is a measure of the stock of debt that includes the government's financial liabilities (such as gilts and National Savings) less liquid assets. Finance leases and on balance sheet PPP projects, lending under financial transactions made for policy reasons,

such as lending to students, increase PSND. Placing surplus money on deposit creates a liquid asset, which offsets gross debt

- 1.6 The government will use the ONS measures which exclude only public sector banks – now only Royal Bank of Scotland. These aggregates are measured using the National Accounts. These are prepared in accordance with the internationally agreed framework ‘European System of Accounts’ (ESA10). ESA10 in turn is consistent with the System of National Accounts (SNA08), which was prepared under the auspices of the United Nations and is in use globally. The Office for National Statistics (ONS), acting as an independent agency, is responsible for the National Accounts.

Comparison with departmental accounts

- 1.7 Departmental Accounts (DAs) are based on International Financial Reporting Standards (IFRS) as interpreted by the Financial Reporting Manual (FRM). Many transactions are treated in the same way in DAs and National Accounts: pay is a current expense in any system of accounts. But there are a number of differences between the two systems of accounts.
- 1.8 These differences in accounting treatment explain some of the cases where DAs and budgets treat transactions differently, since budgets are trying to achieve objectives expressed in terms of the National Accounts rather than IFRS accounts. The number of these differences has been reduced as a result of Treasury’s Alignment Project, which was implemented for budgets in 2010-11. Annex A lists the main differences between budgets and DAs.

Role of the department

- 1.9 The budgeting system tries to ensure that departments have good incentives to manage their business well, to prioritise across programmes, and to obtain value for money.
- 1.10 So, for example, departments are given Spending Review (SR) settlements that allow for sensible planning. There are rules allowing departments to offset certain income against budgets when that helps management.
- 1.11 The government has published a framework for improving spending control. This sets out the government’s priorities for spending control in terms of monitoring, managing and the scrutiny of public spending.

Compliance costs

- 1.12 Compliance costs are kept down by basing the budgeting rules on the DAs that departments draw up for Parliamentary and public reporting purposes. Treasury intends that the treatment of transactions should always be aligned between budgets, Estimates, and accounts where possible.
- 1.13 However, where it is desirable either because of the need to support the fiscal framework or because controlling spending against information in DAs would not provide the right incentives for departments, the budgeting rules have a different treatment from DAs. In such cases, departmental Estimates will normally follow the budgeting treatment.

Role of HM Treasury

- 1.14 The Treasury is responsible for the design of the budgeting system. We will always be happy to explain the budgeting rules. It is only the Treasury which may finally determine the budgeting treatment of a transaction.
- 1.15 The guidance does not cover every case. Sometimes we have deliberately kept the guidance simple for departments because certain transactions are rare or typically small. But there might be cases where if a large instance of such a transaction were to take place it would impact on the fiscal framework. So, we will sometimes impose restrictions, even if the guidance does not provide for them, to protect the fiscal framework or to provide better incentives for departments. If departments face new circumstances, which might lead to difficulties for the fiscal framework, they should contact their Treasury spending team before they undertake the transaction.
- 1.16 Sometimes departments' or public bodies' consultants offer them suggestions for ways around the spending control framework. We have no interest in such schemes. Departments are asked to go with the spirit of the spending control framework. If a transaction is clearly just a way around the letter of the rules, then departments should follow the spirit of the rules. If you are in doubt, talk to your spending team.
- 1.17 Treasury ministers have the right to modify the budgeting guidance at any time, although in practice we try to keep changes to a minimum and we generally consult departments before making significant changes.

Budgeting policies

Resource and capital budgets; administration budgets

- 1.18 Departments have separate budgets for
- **resource** – current expenditure such as pay or procurement and including depreciation, which is the current cost associated with the ownership of assets
 - **capital** – for new investment and net policy lending
- 1.19 Within the resource budget DEL there are separate administration controls set in Spending Reviews. **Administration budgets** cover expenditure on running central government entities but excluding their frontline activities.
- 1.20 Appendix 1 to this chapter summarises the contents of budgets. Appendix 2 sets out the control totals diagrammatically. Appendix 3 sets out a list of the control totals – departments and their Treasury spending teams should at all times have a shared understanding of what the control totals are and how the department's spending matches up against them. Appendix 4 details the criteria for AME treatment of levy funded bodies. Appendix 5 provides details of the treatment of Prior Period Adjustments (PPAs) in accounts, Estimates and budgets. Appendix 6 provides information on dealing with Machinery of Government changes.
- 1.21 Cash is not controlled directly through the budgeting system. However, the Net Cash Requirement for Supply Expenditure is controlled through the

Supply Estimates processes. Changes in the expected level of use of cash provide useful monitoring information. Departments should discuss the reasons for planned increases in the level of cash spending with their Treasury spending teams.

Purpose of budgetary control totals

- 1.22 These controls support the achievement of the fiscal framework and provide management incentives for departments.
- 1.23 **Resource budgets** are Treasury's control over the level of current spending. Within the resource budget some transactions will have an immediate or near-immediate impact on the fiscal position, for example pay and procurement. Other transactions will only have an effect in future periods, for example the take-up of provisions, or revaluation of assets. Both types of transaction fall within the resource budget.
- 1.24 **Administration budgets** are controlled to ensure that as much money as practicable is available for front line services and programmes. Provision in the resource budget that is not in administration budgets is termed programme spending.
- 1.25 **Capital budgets** are controlled because net investment increases net borrowing and hence the level of debt.

Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME)

- 1.26 Departmental resource and capital budgets are divided into:
- **DEL** – limits are set in the Spending Review. Departments may not exceed the limits that they have been set
 - **AME** – budgets are set by the Treasury and may be reviewed with departments in the run-up to the Budget. Departments need to monitor AME closely and inform Treasury if they expect AME spending to rise above forecast. Whilst Treasury accepts that in some areas of AME inherent volatility may mean departments do not have the ability to manage the spending within budgets in that financial year, any expected increases in AME require Treasury approval
- 1.27 Within each of these budgets departments are expected to pursue efficiencies and prioritise expenditure in order to optimise the value for money of spending.

DEL or AME

- 1.28 As mentioned in paragraph 1.25, some transactions in the resource budget do not have an immediate impact upon PSNB. In most cases these transactions will be recorded in resource AME in order to allow HMT to control transactions which will have an immediate impact on PSNB in DEL. These transactions include the take-up and revaluation of provisions, and revaluations.

- 1.29 Where a transaction does have an immediate impact on PSNB it will follow the standard criteria set out below to determine whether the programme should be recorded in DEL or in AME.

Criteria for treatment in DEL or AME

- 1.30 All programmes are in DEL unless the Chief Secretary has determined that they should be in AME. The Chief Secretary may agree to put programmes into AME if:
- they are not only demand-led but also exceptionally volatile in a way that could not be controlled by the department and where the programmes are so large that departments could not be expected to absorb the effects of volatility in their DELs or
 - for other reasons, they are not suitable for inclusion in firm multi-year plans set in the spending review. For example: lottery spending is the product of the hypothecated tax on the National Lottery and may not be reprioritised elsewhere. Certain levy-funded bodies, which serve particular industries, are also in AME – see Appendix 4 to this chapter
- 1.31 The Treasury regularly reviews whether programmes in AME are still suitable for AME treatment. Where appropriate programmes are moved into DEL.
- 1.32 Normally, a programme will have both its resource and capital budget impact in either DEL or AME, but there are some exceptions. Where a department agrees an exception with Treasury it should be included in their settlement letter during the spending review process.
- 1.33 The Treasury continues to look at what the options are to improve incentives to control AME.

Management of DEL programmes

- 1.34 Both DEL and AME programmes need to be managed to maximise effectiveness, efficiency and economy in the use of public funds. For programmes in DEL that is well understood. Because DEL programmes compete for resources within a fixed envelope, departments are under a clear pressure to review programmes, re-prioritise and pursue efficiency measures.
- 1.35 It is therefore important that departments produce and share with the Treasury accurate in-year monthly outturns and forecasts of DEL spending and risks. The key elements of the monthly financial data submitted on the Online System for Central Accounting and Reporting (OSCAR) must be consistent with internal financial management information, such as Board reports and management accounts. Any inconsistency arising from timing differences must be reconcilable.
- 1.36 Where appropriate in the management of DEL programmes:
- the impact of DEL spending on AME spending needs to be considered. For example, DEL usually includes the cost of administering AME programmes and the quality of administration can have a significant impact on AME expenditure. And some DEL and AME programmes are complementary

- if a proposed DEL spending change has extra costs for AME spending, then the proposal needs to be cleared with the Treasury before being implemented. The assumption is that any increases in AME will lead to matching reductions in DEL budgets

Management of AME programmes

- 1.37 AME programmes are spending like any other. They impact on the fiscal framework in the same way as DEL spending. They need taxes to be raised to finance them. So, careful monitoring and management is just as important as it is with DEL. The nature of certain AME programmes means that some aspects of management, e.g. forecasting, are more important than with most DEL programmes.
- 1.38 The management of AME programmes serves the same ends as the management of DEL programmes, but the volatility of many AME programmes means that careful management is important.
- 1.39 Departments are reminded that with AME programmes, just as with DEL, they need to:
- put in place processes to monitor spending in-year, to identify longer-term trends in spending, and to provide robust projections of future spending. Early identification of changes in AME spending is needed to allow risks to be managed effectively. In particular, departments should monitor spending in resource AME and ensure that they take steps where appropriate to prevent undue increases. Review AME programmes regularly to ensure that they are helping to achieve government objectives effectively and efficiently. Departments should discuss with the Treasury proposals for optimising AME spending programmes
 - obtain Treasury approval in advance for any changes which would increase AME spending (this includes both policy reforms and any administrative changes which impact on expenditure, for example measures to promote take-up) or if AME is likely to rise above expectation. Where the actions/inaction of a department increase AME, they are assumed to fund the increases in AME by reductions in their DEL budgets, or by identifying firm savings in AME. If AME spending is expected to come out higher than forecast, departments should also be prepared to discuss what steps should be taken to offset these increases. Whilst Treasury accepts that in some areas of AME inherent volatility may mean departments do not have the ability to manage the spending within budgets in that financial year, if the higher spending is likely to be permanent the department may be required to offset this elsewhere in their DEL or AME budgets and
 - consider carefully the impact of AME spending on DEL spending and vice versa, both within and across departments. For example, DEL usually includes the cost of administering AME programmes and the quality of administration can have a significant impact on AME expenditure. And some DEL and AME programmes are complementary.

Switches

Switches and classification changes

- 1.40 Switches are real changes in provision reflecting real world changes in spending or plans. They need to be distinguished from classification changes, which restate budgets to reflect new ways of scoring an unchanged activity.
- 1.41 Suppose a department has activity X which costs £50million and which is within administration budgets:
- if the department cuts the costs of activity X by £10million, it has made a real reduction in spending. It then has £10million that it may reallocate to other spending in administration budgets or that it may switch to programme spending
 - if the Treasury agrees that activity X should no longer be in administration budgets, then budgets are restated: the administration budget is reduced by £50million, and the programme budget increased by £50million within an unchanged resource budget DEL. The reclassification does not create spending headroom within the administration budget
- 1.42 There is a passage below on types of adjustment to budgets.

Restrictions on switches

- 1.43 So, that the control totals can work, departments are restricted in the switches they may make between them:
- departments may not switch provision from AME to DEL. Such switches would prejudice the functioning of firm four-year budgets for DEL. Where the actions/inaction of a department increase AME, they are assumed to fund the increases in AME by reductions in their DEL budgets
 - departments may not switch provision from capital budgets to resource budgets; such switches would mean that money that had been earmarked for investment was used for current spending. Departments may switch provision from resource budget DEL to the capital budget DEL but not from ring-fenced elements
- 1.44 Departments are expected to manage their resource budget DEL as an integrated whole, optimising spending across programmes (including programmes managed by ALBs and those involving Public Corporations). In order to encourage value for money and to support achievement of the fiscal framework, there are two general restrictions on the freedom to move provision across resource DEL
- departments may not switch from programme budgets to administration budgets. Such switches would mean increasing provision for back-office or policy staff at the expense of front-line staff and programmes. Departments are free to switch provision from administration budgets to programme budgets
 - depreciation and impairments are ring-fenced within RDEL (or exceptionally RAME) and budget cover may not be reprioritised from

within the ring-fence. Departments may freely switch provision from outside of the ring-fence to depreciation and impairments costs

- finally, there are also restrictions on switching into and out of support for local authorities

1.45 To relax any of the above restrictions could impact on the government's fiscal mandate or its administration costs target and would therefore need to be absorbed by the Reserve (see paragraphs 1.50 to 1.54 below). For this reason, any request to waive the above restrictions is viewed in the same way as a request for support from the Reserve and the same process (which is outlined below) will be followed. Note that requests to switch budget cover out of the RDEL depreciation ring-fence will not be approved.

Policy ring-fences

1.46 In addition, as part of the SR settlement, some spending might be subject to specific ring-fences. If so, departments may not move money across the ring-fence, except as specified in the SR settlement. Ring-fences are normally set at the level of RDEL or CDEL. However, closer controls (e.g. on administration spending) may be set.

Departmental unallocated provision

1.47 Departments are encouraged not to allocate their DELs fully against their programmes at the start of a financial year but to hold some provision back to deal with unforeseen pressures that emerge subsequently, including utilisation of provisions. This unallocated budget is referred to as the Departmental Unallocated Provision (DUP).

1.48 DUP is reported in the Main Estimate as the difference between budgetary limits and the amounts allocated to specific functions; it is included within its own separate Estimate Line (within voted DEL) but cannot be spent by the department unless it is subsequently reallocated to appropriate functions in the Supplementary Estimate. Note that there is no such concept as negative DUP: this is a way of disguising over programming and is forbidden.

The Reserve

1.49 Departments are expected to manage their DEL budgets so as to stay within them. If pressures arise in one part of a DEL, departments should respond by:

- managing the pressures down
- using their DUP
- re-prioritising and making offsetting savings elsewhere in the budget
- deferring spending elsewhere in the budget and
- transferring provision from resource DEL to capital DEL (if the pressure is in capital DEL)

1.50 Exceptionally, a department may seek support from the Reserve. As part of the spending plans announced in spending reviews, the government allocates a Reserve for genuinely unforeseen contingencies that departments

cannot absorb within their DELs. Separate Reserves are held for resource and capital DEL; both are small. Support from the Reserve to departments' resource or capital DELs is non-recurrent (i.e. it will not affect departments' SR baselines). Increases are generally stripped out when baselines are agreed for Spending Reviews. The failure to hold sufficient contingency will count against the department when decisions about granting support from the Reserve are taken.

- 1.51 If the Chief Secretary agrees to provide support to a department from the Reserve, then the amount may be repayable the following year by means of a reduction in the department's DEL.
- 1.52 Departments that think they might require support from the Reserve should contact their Treasury spending team early so that alternative courses of action can be fully discussed while there is still time to put them into effect. Departments' proposals should set out:
- the size of the pressure
 - the cause of the pressure and why it was unforeseen
 - the offsetting actions that have been taken and could be taken to manage the pressure and to absorb it, including cutting costs, cutting inefficiencies, cutting unnecessary programmes and cutting lower priority budgets
 - the residual pressure, split into capital and resource, and the administration costs and programme elements and
 - the corrective actions they mean to take if support from the Reserve is agreed, as regards the substance of the policy, improved financial management, and paying back the amount provided
- 1.53 The drawdown of funding from the Reserve is subject to an assessment of need, realism and affordability at the time at which the funds are released. Reserve claims approved by the Chief Secretary should therefore normally be voted at Supplementary Estimates when such an assessment can most easily be made.

The Reserve and contingent liabilities

- 1.54 Departments are required to report contingent liabilities to Parliament. This process is separate from budgeting. The recording of contingent liabilities does not guarantee departments' access to the Reserve. If a contingent liability matures, the normal budgeting procedures apply. That is, departments are expected to cover the costs by making offsetting savings as normal.

Keeping track of the numbers

- 1.55 Departments are expected to keep track of their authorised control totals on the Online System for Central Accounting and Reporting (OSCAR) as these change with Machinery of Government changes, other classification and transfer changes, issues from central funds, authorised transfers to RDEL, and – exceptionally – issues from the Reserve. Departments and spending

teams should at all times use OSCAR to have a mutual understanding of the authorised levels of:

- 1 resource budget DEL and within it
 - a) administration budgets
 - b) Non-ring-fenced resource budget DEL
- 2 capital budget DEL
- 3 departments and spending teams should also have a mutual understanding of the planned levels, and risks of variance to plans, of
 - a) resource budget AME
 - b) capital budget AME

1.56 Departments are expected to monitor spending against plan and to share information with their Treasury spending team (via bilaterally agreed information supply) and the Treasury collectively (via OSCAR).

Breaches of budgetary limits

1.57 Any breach of a budgetary limit is treated seriously, and departments need to take remedial action. Note that breaches can arise as a result of past errors treated as Prior Period Adjustments (PPAs) in accounts. See Appendix 5 for more details of how PPAs should be treated in budgets.

1.58 This passage sets out the process to follow where a department's final outturn breaches the final level set for any of the following limits:

- resource budget – DEL
- administration budget
- capital budget – DEL
- resource budget – AME
- capital budget – AME
- Non-budget expenditure - NBE

1.59 For breaches in DEL the responsible minister should write to the Chief Secretary as soon as practicable after the end of the year setting out:

- the size of the breach
- why it occurred and
- the remedial action that the department is proposing, including
 - improvements in financial management to deal with the specific cause of the breach
 - improvements in financial management to improve overall forecasting and control of the department's control totals and

- information that will be provided to the Departmental Board and to the Treasury to demonstrate these improvements
- 1.60 When departments overspend against their control totals, there may be an offsetting reduction in the corresponding control total in the following year.
- 1.61 Breaches in departmental AME do not automatically incur a penalty. However, unforeseen changes in spending may indicate poor financial management by departments. The department should therefore write to the Spending Team providing the same information as set out for breaches in DEL above. This should include the options for offsetting the higher spending through savings elsewhere in either the department's DEL or AME.
- 1.62 Departments should discuss with their Treasury spending teams their proposals before their Minister writes to the Chief Secretary.

Policies that affect other departments' spending

- 1.63 One department's policies may affect the spending of another department. Sometimes the link is obvious, for example where several departments have joint responsibility for a change to outcomes. In other cases, the link may be less clear: for example, the creation of a new offence may impose burdens on the police, prosecutors, legal-aid, and offender-management budgets. European Union directives may also impose costs on a range of departments.
- 1.64 There has been a long-standing set of general principles governing the question of policy changes with resource implications affecting more than one department. These include:
- any department proposing new policies, in whatever context, must always quantify the effects on public expenditure prior to a policy decision being made. In doing so, it must assess the effects not only on its own spending but also on the spending of other government departments, the devolved administrations for Scotland, Wales and Northern Ireland, and local authorities
 - decisions on how to finance a new proposal must be taken simultaneously with the policy decision. It is for the department proposing a change to consult those concerned (including HM Treasury) and agree new policy, including the finance of that policy, before a proposal goes forward for collective consideration
 - the agreement on financing the downstream costs of new policy on another department may provide either that the costs be met by the originating department or that they be met by the department on which those costs fall
 - in the absence of explicit agreement to the contrary, the normal presumption is that the originating department will absorb the cost
 - where consultation has not taken place, the strong presumption is that all costs, including those affecting other departments, will be absorbed by the department responsible for the new policy

- where the originating department absorbs the cost, it should make budget transfers to affected departments covering the whole of the SR period
 - where the costs fall, or come fully on stream, in the next SR period, it is for the department(s) that will meet the costs to conduct the SR discussions with the Treasury on funding in the next SR period. Where that department is the originating department, it should make budget transfers after the conclusion of the SR
 - these arrangements include cases where a department's policies impact on the AME spending of another department. The originating department may be expected to make DEL offsets to cover increases in AME spending (see passage on Management of AME Programmes above)
 - Treasury agreement is needed for all new policies with expenditure implications (see Managing Public Money). However, the Treasury does not arbitrate between departments on the question of who should bear downstream costs and will not provide funding where no agreement has been reached
- 1.65 Where Department A has or introduces a policy that benefits Department B, it may seek a contribution to the costs from Department B. There is however no obligation on Department B to pay.
- 1.66 Any new proposals, regardless of where they originate, fall to the department responsible for implementing the proposals.

Charging for services

- 1.67 Where a department introduces charges for a service previously provided for free, or moves from a subsidised service to full cost recovery, it should normally transfer DEL cover to any customers in the central government sector to leave them no better and no worse off.

Retaining income / receipts

- 1.68 Only some of the income that comes to a department benefits budgets. Separate chapters in respect of resource and capital budgets set out when departments may set income against DEL spending. That covers both which sorts of income count as negative RDEL / CDEL and also when departments may obtain the benefit of income higher than the levels taken into account in the SR.

New burdens on local authorities

- 1.69 Where a department wishes to impose burdens on local authorities, it is responsible for securing the necessary resources and fully funding them by budget transfer to ensure that there is no upward pressure on council tax levels. A new burden is defined as any policy or initiative which increases the cost of providing local authority services.
- 1.70 The policy applies to any new burden imposed on local authorities (including police and fire authorities) except for policies, which apply the same rules to local authorities and to private sector bodies (for example a change in the rate of employers' National Insurance contributions).

- 1.71 Departments contemplating a potential new burden should contact the Ministry of Housing, Communities and Local Government (MHCLG) Finance directorate at the earliest possible stage to discuss the procedures to be followed – see Annex D for contacts.

Transactions between departments

- 1.72 Transactions between public sector bodies should be constructed simply. For example, where Department A buys an asset from Department B, the purchase price should normally be paid in full in cash on the day of completion. Departments should not enter into or spend money on complex deals which do not have a clear justification in fairness or incentives as these are unlikely to be good value for the public sector overall. Departments should not seek to exploit differences in budgeting rules between different public sector entities. Where departments are unsure how best to construct a transaction with a public sector body they should consult HMT.

Tax impacts on departmental budgets

- 1.73 The rule is that tax lies where it falls. Budgets will not be changed as a result of changes in tax treatment. This includes where the Chancellor announces tax increases at a fiscal event that impact on departments.

Types of adjustments to budgets

- 1.74 Adjustments within or between departments' overall budgetary limits fall into three categories. In summary:
- **policy / plan adjustments** reflect deliberate decisions by departments to increase or decrease spending in a particular policy area, or in the way a policy is delivered (i.e. moving to a charging regime)
 - **classification adjustments** reflect changes in budgetary totals driven by changes in the way the Treasury account or budget for spending rather than by actual changes in the level of activity or an increase / decrease in spending. For example, the changes in budgeting policy announced in this guidance will be implemented as classification adjustments. Classification adjustments also include Machinery of Government changes where responsibility for spending moves from one central government body to another. Accounting policy changes – whether driven by the department or by the National Audit Office – also count as classification changes; note that these changes need the agreement of the Treasury. Changes in estimation or valuation techniques or those which affect levels of spending against unchanged limits, count as policy / plan adjustments
 - **inter-departmental adjustments / budget cover transfers** reflect changes in detailed spending plans as a result of an agreed transfer of budgetary cover from one department to another. Examples of where a transfer is appropriate is where there is an allocation from a 'shared pot' (e.g. the Criminal Justice Reserve), or when a department agrees to transfer cover to another department to cover one-off costs incurred as a result of a change in policy
- 1.75 The changes are implemented in different ways in budgets:

- Departments are expected to accommodate the effects of **policy / plan adjustments** in their budgets, making offsetting reductions in spending
 - **classification adjustments** lead to budgets being restated, normally across all the open years on the OSCAR system
 - **inter-departmental adjustments / budget cover transfers** lead to restated limits of the departments concerned
- 1.76 In addition, departments may record changes to their expenditure numbers as **budgetary outturn adjustments**, which are not a change to the budget – they are used to describe changes against final budget allocations and are used for recording outturn.
- 1.77 It is the Treasury that determines finally what type of adjustment a change is. Departments that are in doubt should contact their Treasury spending team.
- 1.78 Annex E sets out where to find further guidance on types of adjustment.

Public sector and public bodies

- 1.79 The public sector in the National Accounts comprises central government and local government, which together make general government, and Public Corporations (bodies which are publicly owned or controlled, and which operate in a market or which trade). Budgeting rules apply to all bodies in central government.
- 1.80 It is the Office for National Statistics (ONS) that determines whether a body is in the public sector. You can look up the sector classification of bodies where that has been determined by the ONS in their Sector Classification Guide publication (see Annex E for the link).
- 1.81 The Treasury publishes a guidance note on sector classification (see Annex E for the link). In broad terms, bodies are in the public sector if they are owned or controlled by public sector bodies. A body will be controlled, for example, if the sponsoring department appoints a majority of board members. Sometimes a lesser degree of influence can still be held to give control. The legal form of a body does not tell you what sector it is in. So, for example, if an ALB sets up a wholly owned subsidiary in the form of a limited company under the Companies Act, that body would be classed as public sector because it would be wholly controlled by the ALB.
- 1.82 Subsidiaries, interests in associates and joint ventures classified to the public sector are consolidated with parent bodies for budgeting. So, if an ALB sets up a public sector non-trading body it will be part of the ALB's DEL allocation from the parent department.
- 1.83 Departments and public bodies who are in doubt about an actual or proposed body's sector classification should approach the Treasury for advice. The ONS should only be approached via the Treasury. That restriction on direct access to the ONS is so that the Treasury can:
- advise departments on the interaction of classification and policy (the ONS do not involve themselves in policy formulation)
 - consider the implications for budgeting of any proposal and

- provide the right information to ONS in the right way, without lobbying, and respecting the ONS' independence
- 1.84 Departments that are setting up a new body that will be, or might be, in the public sector should contact the Treasury's budgeting and classification branch with their proposals for budgeting, accounting and recording the body. The Treasury will pass the information on to:
- the ONS
 - the Cabinet Office (see section on Arm's Length Bodies (ALBs) below) who along with Treasury has a role in the approval of central government bodies that may be classified as NDPBs, executive agencies and non-ministerial departments
- 1.85 Departments should not spend money on consultancy advice on National Accounts sector classification and should discourage their sponsored bodies from doing so. Sector classification is unlikely to be an area where consultants have expertise. The Treasury will provide advice on request.

Departmental accounts and the National Accounts

- 1.86 IFRS standards include criteria for judging when bodies should be regarded as subsidiaries; the Government Financial Reporting Manual (the FReM) has adapted the standards so that consolidation applies only to bodies classified to the Central government sector by the ONS. Where a reporting body has a subsidiary that falls within the FReM definition it should be consolidated within their group accounts. The criteria applied by IFRS (as adapted) are very similar to those used in National Accounts so normally the decision whether a body is a subsidiary under IFRS (as adapted) and whether it is a public sector body in the National Accounts under ESA10 will be consistent.

Whole of Government Accounts (WGA)

- 1.87 The Treasury produces WGA IFRS-based accounts that are a consolidation of the accounts of most public-sector bodies. Inclusion in WGA is based on the same National Accounts standards as budgets and departmental accounts. Since WGA includes the whole public sector, all bodies classified as central government, local government, or public corporations, within National Accounts will be consolidated by WGA.

Arm's length bodies (ALBs)

- 1.88 The term arm's length bodies (ALBs) is taken to include a department's NDPB's and Trading Funds where these bodies have been classified as being within central government by the Office for National Statistics (ONS).
- 1.89 For accountability and governance purposes the Cabinet Office has lead responsibility for the classification of ALBs and will designate bodies into the various categories using its own criteria. Where departments are setting up a new body they should contact the Cabinet Office to discuss the governance arrangements.

Budgets, Estimates and accounts

- 1.90 Budgets, Estimates and accounts have three distinct frameworks and are used by government for different purposes. In previous years, there have been significant differences between the figures recorded in each of the frameworks, with certain transactions and programmes being recorded differently according to different sets of rules.
- 1.91 Budgets, Estimates and accounts are now substantially aligned, and the vast majority of spending by departments and their ALBs scores in the budget and Estimate at the same value and with the same timing as in accounts.
- 1.92 In broad terms, however, in order to keep down compliance costs for departments, the budgeting treatment of items is generally based on the treatment in departmental accounts. Annex A sets out the main differences between DAs, Estimates and budgets.
- 1.93 In practice, therefore when considering how to score a transaction you should:
- start by considering the treatment of the transaction in DAs
 - consider whether the budgeting treatment is the same as the DA treatment or different, and so establish the budgeting treatment
 - once you know the accounting and budgeting treatment you can determine the Estimates treatment

Accounts

- 1.94 Departments and other public bodies have to produce audited accounts that report to the public and Parliament on how they have used the resources at their disposal. These accounts are normally for the body in question, and for subsidiaries or other bodies within the accounting boundary.
- 1.95 Departmental accounts are produced in accordance with the Government Financial Reporting Manual (FReM), developed by the Treasury and based on International Financial Reporting Standards (IFRS). IFRS in DAs provides in some cases a different cut of information from that used for budgeting or the fiscal framework.
- 1.96 Departments' accounts are audited annually by the Comptroller and Auditor General of the National Audit Office (NAO), who reports his findings to Parliament.
- 1.97 Accounting standards change from time to time. When they do, the Treasury consider the impact on budgets. Sometimes changes to accounting rules are not carried through into budgets. Departments are consulted on changes to accounting through FReM exposure drafts.
- 1.98 Departments should determine the accounting treatment, checking in cases of doubt with their NAO auditors on the application of the FReM in specific cases and with the Treasury's Government Financial Reporting (GFR) team on the interpretation of the FReM more generally. A link to where you can find full guidance on accounts is given in Annex E.

- 1.99 In some places this budgeting guidance summarises or describes accounting treatments. That is done to provide context for the definitive statement of the budgeting rules. However, the only authoritative description of the accounting treatments is in the FReM, and the summary in this budgeting guidance should be seen as indicative only.

Supply Estimates

- 1.100 Estimates are the mechanism by which Parliament authorises departmental spending.
- 1.101 Estimates require Parliament to vote limits for resource DEL, resource AME, capital DEL and capital AME, as well as any voted spending outside of budgets and the department's net cash requirement. These voted limits may differ from the figures in departmental budgets and Estimates, as elements of the department's budgets may fall within non-voted spending. The sum of voted and non-voted spending in DEL and AME will equal the figures in departmental budgets.
- 1.102 In the same way as budgets, Estimates are voted net of retained income. Any income treated as negative DEL or AME in budgets will net off against voted limits in the Estimate.
- 1.103 In rare cases, some income may be treated as a Consolidated Fund Extra Receipt (CFER), and will not be retained by the department but returned to the Consolidated Fund. This will most commonly occur when the department has failed to anticipate this category of income or has generated more income than is allowed to be treated as within budgets.
- 1.104 A link to where you can find full guidance on Estimates is given in Annex E.

Presentation of total spending

Total Managed Expenditure

- 1.105 The government's main measure for reporting overall public spending is Total Managed Expenditure (TME), a measure drawn from the National Accounts dataset. TME may be defined as the sum of the public sector's current and capital expenditure. Current expenditure is presented net of sales of goods and services while capital expenditure is presented as net of asset sales.
- 1.106 Capital expenditure may be divided into:
- the element that replaces the extent to which the capital stock has depreciated and
 - net investment
- 1.107 Therefore, TME may be defined as the sum of public sector current expenditure, net investment, and depreciation.
- 1.108 TME is also the sum of DEL, departmental AME and non-departmental AME (including accounting adjustments).

Resource budget, capital budget

- 1.109 A department's resource budget is the sum of the resource budget: DEL and the resource budget: AME. The capital budget is the sum of the capital budget: DEL and the capital budget: AME.
- 1.110 Neither the resource budget nor the capital budget is a control total, since departments may not make switches from AME to DEL. But they are useful numbers to present since they show the total current and capital spending in the budgets of the department. And they remind readers of spending data that both DEL and AME spending are spending: both need to be financed by taxes and borrowing.

Total DEL

- 1.111 In addition to the control totals, there is a presentational aggregate; Total DEL. Total DEL is not a control total. It is a standard way of showing total current and capital spending in DEL. It is defined as:
- resource budget: DEL
 - *plus* capital budget: DEL
 - *less* depreciation in DEL
- 1.112 Depreciation here includes DEL impairments.
- 1.113 Depreciation is excluded from total DEL because adding together depreciation and investment may be seen by some as double counting.

Recording income and expenditure

- 1.114 Transactions should be recorded accurately on OSCAR. OSCAR supplies information for a wide range of users and uses:
- the Treasury's planning and control of public spending
 - the Treasury's monitoring and forecasting of spending against the fiscal framework
 - Treasury publications, such as Public Expenditure Statistical Analyses
 - operational publications, such as Main and Supplementary Estimates
 - departmental publications, such as the common core tables in Departmental Reports
 - ONS publications based on the National Accounts, including Public Sector Finances which contains information for the fiscal aggregates and
 - the input side of ONS' measures of public sector productivity
- 1.115 You can see that often departments themselves are directly affected by the accuracy of information on OSCAR.
- 1.116 Guidance on recording on OSCAR is available to users within the CITRIX environment.

Appendix 1 to chapter 1: Summary content of budgets

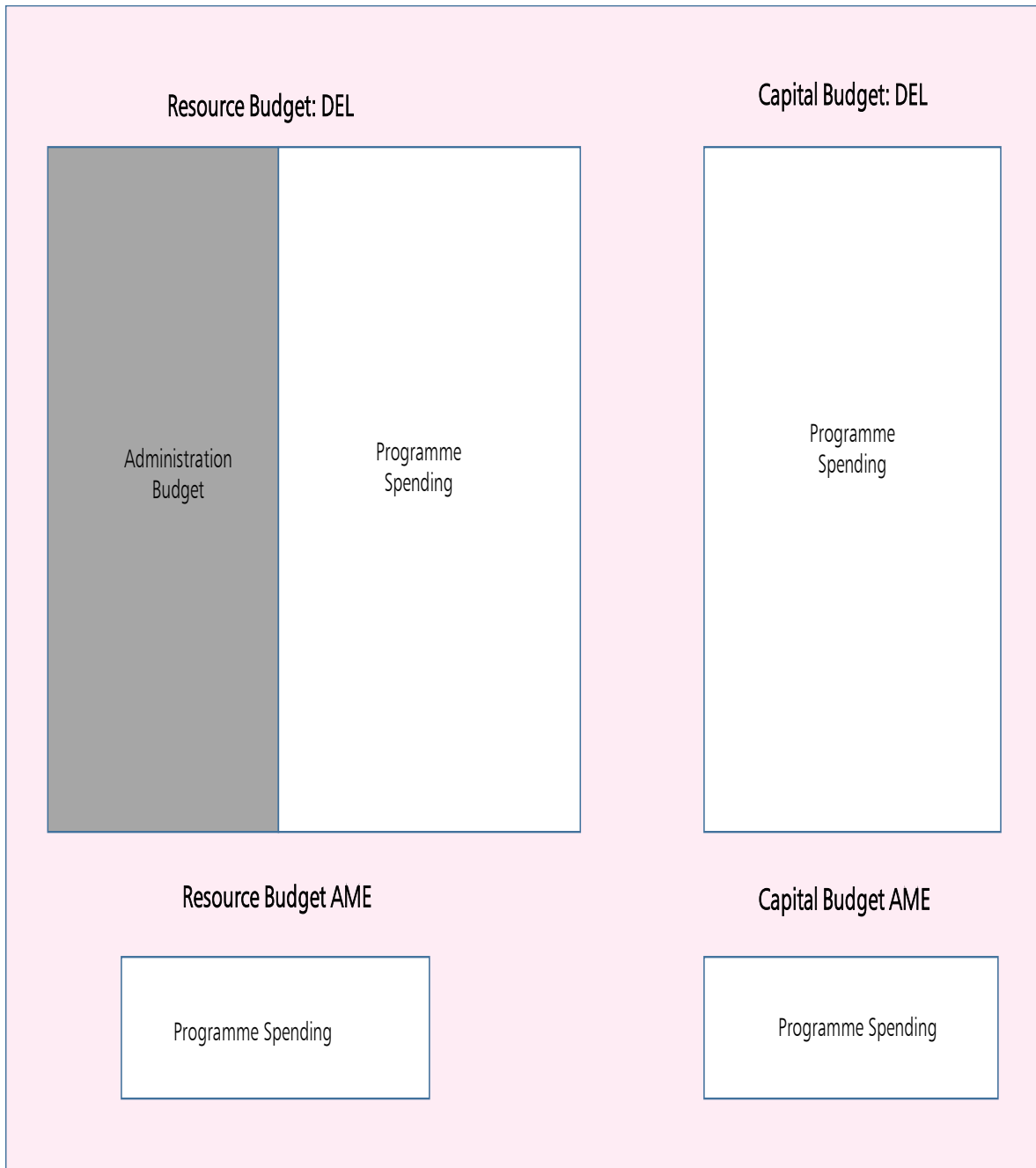
1.117 This table summarises the main standard contents of resource and capital budgets. Budgets are divided into DEL and AME. The resource budget DEL is divided into administration and programme.

Table 1.A: Content of budgets

	Resource budget	Capital budget
Department's own transactions with the private sector	<p>Expenditure on an accruals basis, including administration costs, pay, superannuation liability charges and other pensions contributions or current service pensions costs, grants to individuals, subsidies to private sector companies.</p> <p>Take up of provisions, movements in value of provisions, and release of provisions (as well as the expenditure offset by the release of the provision – except provisions related to capital expenditure).</p> <p>Profit/loss on disposal of assets.</p> <p>Depreciation and impairments on the department's assets.</p> <p><i>Less</i> income treated as negative DEL/AME, for example sale of services.</p> <p>Note: Excludes revaluations charged to revaluation reserve.</p>	<p>Expenditure on new fixed assets on an accruals basis includes assets bought under finance leases and transactions that are in substance borrowing (i.e. on-balance sheet PPP deals).</p> <p><i>Less</i> Net book value of sales of fixed assets.</p> <p>Net policy lending to the private sector.</p> <p>Capital grants to the private sector.</p> <p>Research and Development expenditure</p>
ALB transactions with the private sector	<p>As the department.</p> <p>Note: the department's grant in aid to ALBs is excluded from budgets.</p>	As the department
NHS Trusts (England)	As the department	As the department
Support for local authorities	Current grants to local authorities	Capital grants to local authorities Supported Capital Expenditure (revenue)

<p>Public Corporations</p>	<p>Subsidies paid to Public Corporations</p> <p><i>Less interest and dividends received from Public Corporations</i></p>	<p>Investment grants paid to Public Corporations</p> <p>Net lending to Public Corporations (Voted and NLF)</p> <p>Public Corporations' market and overseas borrowing (including on balance sheet PPP)</p> <p><i>Less equity withdrawals from Public Corporations</i></p>
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Appendix 2 to Chapter 1: Diagram of existing budgetary categories



Appendix 3 to chapter 1: The department's control and planning totals.

1.118 Departments and their Treasury spending teams should at all times have a shared understanding of what their control and planning totals are, whether the department's spending is on track to stay within limits, and what the risks are.

1.119 The control totals are:

- resource DEL
- administration budget
- capital DEL
- any department-specific ring-fenced budget

1.120 The planning totals are:

- resource Departmental AME
- capital AME

Appendix 4 to chapter 1: Criteria for AME treatment of levy-funded bodies

- 1.121 The Chief Secretary has determined that the spending of a number of levy-funded bodies should be in AME rather than DEL. The Chief Secretary takes such decisions case by case. The AME treatment of individual bodies is kept under review.
- 1.122 Where an AME treatment has been approved for spending, the income from the levy must also be recorded in AME by the body.
- 1.123 While the Treasury has no plan to recommend to the Chief Secretary that any further levy-funded bodies should have AME treatment, the criteria that the Chief Secretary uses are set out below.

Box 1.A: Criteria for deciding whether a levy-funded body should score in AME

- 4 the body should in broad terms provide services (“services” could include a compensation fund) to an industry or group of industries or the workforce in that industry
- 5 the body should be wholly or mainly funded by a levy on the industry. There should be substantial industry consensus involved in the setting of the levy or the direction of the expenditure or both
- 6 the expenditure must be suitably ring-fenced. Normally, that would mean that the whole body should fall into this category
- 7 the body should be self-financing in cash terms. With no recourse to departmental grants or subsidies. Where, exceptionally, grants or subsidies are paid (including grants financed by the EU), the expenditure funded by those grants would score in DEL
- 8 draw-down of reserves should be permitted and normal short term modest size overdrafts. But the bodies should not normally borrow long term. Where, exceptionally, borrowing other than short-term overdrafts, finances expenditure, it would normally score in DEL
- 9 the body should meet relevant efficiency and other criteria:
 - the licence or levy is appropriate, i.e. applied in the economically most advantageous way in the circumstances
 - introducing the levy or licence should not materially restrict the government’s fiscal policy
 - there should be adequate efficiency regimes in place to keep costs down, including stretching targets and regular efficiency reviews
 - suitable arrangements should exist to prevent the body from abusing its power to set the level of the levy. For example, the levy might need approval by the minister
 - there will be periodic reviews involving the Treasury of the operation of the levies, including whether they should exist at all, what scale of activity is appropriate, and the level of charges set

Appendix 5 to chapter 1: Prior Period Adjustments

1.124 Prior period adjustments (PPAs) are adjustments applicable to, and are required in, Estimates where data for an earlier year needs to be restated. As such PPAs are primarily an accounting concept. They negate the need to re-open accounts where a material error or omission is found from previous years, or where a department makes a material change to its accounting policies. All PPAs should be discussed with the auditor at the earliest possible opportunity.

PPAs in Supply Estimates

1.125 From a supply perspective PPAs fall into two categories:

- a restatement of data following a change in accounting standards or other changes to accounting policy outside the department's control or
- the correction of an error or omission in the previously recorded data

1.126 In terms of supply (the provision of resources, capital and cash from Parliament) and budgets the government is primarily interested in the *second kind* of PPA, where an error or omission has been discovered, or the department changes accounting policy on its own initiative (i.e. not an externally driven change in accounting standards). This is because changes initiated by the department, or an error in previous recording, have the potential to change net budgets and thus the reported outturn for previous years. In such cases HMT believes it is proper that Parliamentary authority is sought for the budgetary cover that should have been sought previously had the expenditure been identified correctly.

1.127 PPAs obviate any need to re-open accounts that have been signed off by the Comptroller and Auditor General (C&AG) of the National Audit Office (NAO), but also provide retrospective Parliamentary authority for the expenditure. PPAs must therefore be included in voted Supply in an Estimate.

Externally driven changes

1.128 Where a PPA results from a change in accounting standards, this is treated as a classification adjustment for budgets. There is therefore no need to seek Parliamentary authority, but the change and its impact should be identified in "Note F Accounting Policy changes" in the next available Supply Estimate.

PPAs in Supply Estimates

1.129 PPAs are most likely to occur where a department initiates a change in accounting policy as it is under the control of the department as to when it happens. The department should seek non-budget cover for the PPA, where the PPA accounts for all previous years' expenditure, ending at the resource accounting implementation year of 2001-02, subject to the availability of relevant financial information. This is required even when the department was in a position to fund the expenditure from budget cover if it had been recognised in the correct year initially (i.e. there were underspends in previous years).

1.130 If the need for a PPA is discovered whilst departmental accounts are being compiled, it will be allocated to the non-budget section of the Statement of

Parliamentary Supply (SoPS). The PPA should reflect the prior-year data only, but capped by the start of resource accounting in government (i.e. departments should not seek cover for events prior to 2001-02, the first full year of resource accounting).

Materiality

- 1.131 PPAs can only be made for genuine and material errors or changes in accounting policy. Budgetary and Estimates cover is only appropriate for known and costed PPA's. Cover should not be requested for PPA's that have not specifically been discovered but may come to light before the end of the financial year. Whilst there is no such concept of materiality in budgets (the database goes down to the nearest £1,000) if the NAO have accepted at the time of the preparation of the annual report and accounts that a PPA as being not material in accounting terms, to be absorbed in that year's budgets, then HMT will follow suit.

Excess Votes

- 1.132 Normally departments do not have any non-budget provision unless a genuine PPA is recognised when compiling an Estimate. PPAs discovered during the compilation of accounts could not have been foreseen: the lack of any or sufficient non-budget provision in the Estimate will lead to an Excess Vote. The normal process for regulating Excesses will then be followed.

Negative PPAs: no need for approval

- 1.133 Whilst it is possible to have negative PPAs in accountancy terms, Supply does not require Parliament to approve a smaller number. Parliament approves a ceiling for expenditure against which departments are judged; it has no need to vote something which is already within an approved limit. This is in contrast to increases, where Parliament wants to see a voted PPA.

Re-recording budgets on the database

- 1.134 Once the year in which the PPA features has passed, departments should re-state budgets to reflect the true budgetary hit (DEL or AME, resource or capital) in the years affected on the OSCAR database. This will ensure that the budget reflects the true outturn. Note that the database will only hold outturn for five previous years; any impact beyond that cannot be captured electronically but should be reported in the accounts and noted in the Estimate.

Appendix 6 to Chapter 1: Machinery of Government Change (MOG)

1.135 A Machinery of Government (MOG) change occurs when there is a transfer of function between one (or more) government departments and there is a resulting change in the Departmental Accounting Officer responsibility. Departments should begin the process of agreeing amounts and budgets to be transferred as soon as a MOG has been announced. In accounting a MOG change would be treated as a 'Transfer by Merger'. Departments should be aware of the following key points when reflecting a MOG change:

- a MOG in isolation should not affect the spending power of either the transferring or receiving department (i.e. no department should be left better or worse off as a result of the transfer of the budget)
- the transfer must completely net out between the two (or more) departments, (e.g. DEL budget being transferred by one department must be recorded as DEL by the receiving department). Each department involved in the MOG should ensure that the information being provided by them is checked and agrees with that being provided by the other department to ensure that information provided is complete, consistent and correct
- should the function (following the transfer) require provision in excess of the amount being transferred, the additional provision will not be part of the MOG and the receiving department should seek additional budget as normal

1.136 the Accounting Officer in the transferring department will have formal responsibility for the transferred function up until the relevant Supply Estimate and related legislation has received Parliamentary approval. From that point onward, the Accounting Officer in the receiving department will be fully accountable for the transferred function (ie, not only in the current and future year but also for the historical period). It is therefore essential that the Accounting Officer in the receiving department seeks assurance about the values of transferred items and that they receive all documentation relating to the function from the transferring department. Other transfers of functions within the public sector, for example, transfers between arm's length bodies within a single departmental group, (regarded as transfer by absorption in accounts) will not require historic restatement. The net impact of assets and liabilities transferring should not affect the spending power of the transferring or receiving department. Further guidance on the accounting treatment for all business combinations under common control is available on the FReM website. A link to the FReM is given in Annex E.

Chapter 2

Budget Exchange

- 2.1 Budget exchange is a mechanism that allows departments to carry forward a forecast DEL underspend from one year to the next. It is intended that Budget Exchange will provide departments with flexibility to manage their budgets, while strengthening spending control and providing greater certainty in order to support effective planning.
- 2.2 Under budget exchange, departments may surrender a forecast DEL underspend in advance of the end of the financial year (by means of a DEL reduction in the Supplementary Estimate) in return for a corresponding DEL increase in the following year, subject to a prudent limit.
- 2.3 There will be no scope to carry forward underspends that are not forecast in advance of the Supplementary Estimate.
- 2.4 Budget exchange will be available on all DEL control totals (including non-voted DEL), subject to the usual restrictions:
- a capital DEL underspend may not be carried forward as resource DEL
 - a resource DEL underspend generated on programme expenditure may not be used to increase administration budgets
 - an underspend within the resource DEL depreciation ring-fence may only be used to increase the resource DEL depreciation ring-fence and
 - underspends generated within a policy ring-fence will only be eligible for carry-forward within the same policy ring-fence
- 2.5 Separate arrangements will apply to the Devolved Administrations.

Approval process

- 2.6 Formal Treasury approval is required for any increase to DELs. However, it is intended that approval to utilise budget exchange will be granted automatically up to a prescribed limit and subject to the other conditions detailed below, though Treasury reserves the right to withhold approval in exceptional circumstances
- 2.7 The amounts that departments will be permitted to carry forward are set out in the table below, where the limit is expressed as a percentage of resource DEL and capital DEL in the year in which the underspend is forecast to occur. These limits vary by size of department in recognition of the difficulties faced by smaller departments in managing slippage between years and there are separate limits for resource DEL and capital DEL.

Table 2.A: Budget Exchange Limits

Size of Department	RDEL Limit	CDEL Limit
Total DEL ¹ less than £2billion	2%	4%
Total DEL greater than £2billion but less than £14billion	1%	2%
Total DEL greater than £14billion	0.75%	1.5%

2.8 RDEL carried forward through Budget Exchange may not be switched between administration and programme budgets or between the depreciation and non-depreciation ring-fences.

Preventing the accumulation of spending power over time

2.9 To further ensure that the fiscal cost of budget exchange is manageable, and that spending power is not allowed to accumulate over time, budget exchange will only be permitted from one year to the next. This works by any carry-forward from the previous year being netted off the amount that can be carried forward into the next year. A worked example is shown below for a department with £1 billion DEL each year:

- in year one the department forecast an underspend of £20million. It reduces its year one DEL to £980million and increases its year two DEL by a corresponding amount to £1,020million
- in year two the department forecasts an underspend of £30million (against its new DEL of £1,020million). It reduces its DEL by this amount, to £990million. However, the amount brought forward from year one must be netted off the amount that the department is allowed to carry into year three. Therefore, the department is only allowed to increase its year three DEL by £10million to £1,010million
- in year three the department forecasts an underspend of £10million (against its new DEL of £1,010million) and reduces its DEL by this amount, to £1,000million. However, it cannot carry anything forward to year 4 as the £10million carried-over from year two is netted off

2.10 In the above example, we assume ALL other budget exchange rules are in effect.

Timing

2.11 The budget exchange process will be run to a Supplementary Estimates timetable. The exact timing will be confirmed in a PES paper ahead of the Supplementary Estimate, but it is likely that departments will need to inform the Treasury of the amounts that they wish to carry forward by late November/early December.

¹ Where total DEL = Resource DEL excluding depreciation + Capital DEL as set out in Table A9 of the Spending Review 2010.

- 2.12 The in-year DEL reductions will be effected in the Supplementary Estimate, with the corresponding DEL increase awarded at the time of the Main Estimate the following year.

Budget Exchange and the Reserve

- 2.13 Departments may not generally carry-forward an underspend if they are simultaneously seeking to draw funds from the Reserve. As always, the drawdown of funds from the Reserve is subject to an assessment of need and so emerging underspends should be the first call for meeting pressures before additional funding is sought.

Overspends

- 2.14 There is no scope to change DELs after the Supplementary Estimate. Any department that uses budget exchange and then subsequently breaches a DEL control total will be treated like any other overspend and will be subject to the same process outlined in Chapter 1. Departments will need to take this into consideration when surrendering a forecast underspend. Departments are under no obligation to surrender their entire forecast underspend.

Flexibility for managing large capital projects

- 2.15 Managing large projects can pose significant challenges to departments, who currently have to manage spending within annual budgets which may have been set several years before the start of the project.
- 2.16 To recognise this challenge, departments will be offered greater flexibility to carry-forward CDEL underspends related to significant investment programmes:
- to qualify for additional flexibility, the programme must have a CDEL budget of over £50million in the year in question
 - carry forward will not count towards the standard CDEL budget exchange limits, but may not exceed 20% of the programme's CDEL budget in the year from which it is being carried forward
 - carry forward may be spread across multiple years
 - this will be subject to the following conditions:
 - a) the Treasury will consider each application on a case-by-case basis, taking into account the overall value for money of the programme and the likelihood of successful project delivery being enhanced by the carry forward. Departments will be expected to provide evidence to support their application
 - b) the programme in question must continue to be delivered to the originally agreed timescale
 - departments must notify their Treasury Spending Team 6 weeks ahead of a fiscal event if they wish to take advantage of this flexibility, to allow time for the effect on the fiscal aggregates to be assessed

Flexibility for the retention of income from asset sales

- 2.17 It can be challenging for departments to match asset-sale proceeds with capital expenditure perfectly on an annual basis. Therefore, building on the changes announced at Spending Round 2013, departments now have additional budget exchange flexibilities to carry forward the CDEL proceeds from the sale of tangible assets across multiple years so that they do not have to be spent in the same year. The Treasury will welcome proposals from departments.
- 2.18 The flexibility will be considered on a case-by-case basis, subject to the following conditions:
- the department can demonstrate clearly that it has approved capital projects in subsequent years on which to spend these receipts
 - that the additional CDEL carry forward does not exceed £200 million. The Treasury will consider requests to apply this flexibility to larger amounts – departments should discuss any examples of this with its Spending Team proactively as soon as such amounts are anticipated
 - the asset sale in question must actually have been completed before budgets will be adjusted and
 - receipts may not be switched between the general and financial transaction CDEL boundaries
- 2.19 In some cases, departments may prefer to keep the resource benefit that results from the Exchequer using asset-sale proceeds to pay down debt and hence reduce interest payments. Therefore, instead of keeping the proceeds from a tangible-asset sale, departments may surrender the proceeds in full to the Exchequer in exchange for an RDEL uplift equivalent to 3.5% of the proceeds surrendered. This would be a non-baselined uplift in each year of the period for which RDEL budgets had been set. The Treasury will consider each application on a case-by case basis.
- 2.20 In order that the Treasury can monitor the overall effect of these policies on the fiscal aggregates, departments should notify their spending team 6 weeks ahead of the Budget in each year if they envisage using either of these flexibilities on asset sales in that financial year.
- 2.21 These flexibilities do not affect any other rules around the retention and utilisation of asset sale income.
- 2.22 For areas of protected spend, the Treasury may not be able to offer the asset-sale flexibilities above. We invite you to discuss asset sales in areas of protected spend with your Spending Team directly.

Cascading Budget Exchange

- 2.23 Departments are responsible for deciding whether to cascade budget exchange, or an alternative system for carrying forward underspends, to their arm's length bodies (ALBs). Departments will be responsible for managing any pressures this would create within their DEL.

Chapter 3

Resource Budget

Overview

- 3.1 The resource budget scores most of the department's current expenditure. Expenditure is recorded on an accruals basis. So, the resource budget includes expenditure on pay, current procurement, current grants and subsidies, depreciation and the take-up, revaluation and release of provisions (as well as the cash payments associated with the release of the provision – which are recorded by economic type, i.e. pay, current procurement etc. as above).
- 3.2 Since the resource budget includes the resource consequences of acquiring and owning assets (depreciation and maintenance), departments should consider the inter-relationship of the resource and capital budgets when planning and monitoring expenditure. That inclusion should also help departments manage their entire asset stock as well as considering annual changes to the stock through new investments or disposals.
- 3.3 This chapter covers in detail the treatment of some specific items of departmental expenditure in the resource budget. ALB expenditure scores in budgets in the same way as departments' – see also chapter on ALBs. See next chapter for the treatment of income in resource budgets. See separate chapters for the resource budget implications of loans to the private sector, PPP deals, support for local authorities and support for public corporations. See also separate chapters for the rules governing the division of the resource budget into administration budgets / programme expenditure.
- 3.4 Items of central government's own expenditure score in the resource budget at the same value and with the same timing as in the Statement of Comprehensive Net Expenditure (SoCNE) in the departmental accounts. Care should be taken however as there are a couple of exceptions to this rule.

Grants and subsidies

- 3.5 Departmental accounts (DAs) do not distinguish between current grants and subsidies and capital grants. However, the National Accounts do, with current grants and subsidies affecting the current balance and capital grants not. Therefore, departments have to distinguish between current and capital grants according to National Accounts principles. Current grants and subsidies score in the resource budget; capital grants score in the capital budget.

- 3.6 Current grants are paid to individuals and to not-for-profit bodies serving households. Subsidies are current payments paid to profit making bodies designed to influence levels of production, prices or wages.
- 3.7 Capital grants are unrequited transfer payments, which the recipient has to use to either:
- buy capital assets (land, buildings, machinery etc.)
 - buy stocks
 - repay debt (but not to pay early repayment debt interest premia) or
 - acquire long-term financial assets, or financial assets used to generate a long-term return
- 3.8 Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants or subsidies. Both capital and current grants should be recognised when the payment is due to be made.

Debts, compensation and bulk pension transfers

- 3.9 Normally, debts are written-off because the department is unable to enforce the debt against the debtor. Capital grants are imputed in the National Accounts in those cases where debts are written-off "by mutual consent", that is, where for policy reasons the creditor department chooses not to enforce the debt. See section on impairments of financial assets below.
- 3.10 Payments of compensation to owners of capital goods destroyed or damaged by acts of war or natural disasters count as capital grants.
- 3.11 Major payments in compensation for extensive damage or serious injuries not covered by insurance policies may also count as capital grants – departments should consult the Treasury.
- 3.12 Pensions' bulk transfer payments are treated as capital transactions in the National Accounts and pass through the resource budget (albeit offset by the release of the provision) – see pensions chapter.

Resource budget consequences of asset ownership

Tangible and intangible fixed assets

- 3.13 The impact of tangible (e.g. land, buildings, IT systems) and intangible (e.g. patents, IT software, trademarks) fixed assets on the resource budget is through depreciation/amortisation, maintenance costs and impairments, which score in the resource budget, and in DEL or AME as set out in this guidance. Gains or losses on the disposal of tangible and intangible fixed assets also score in resource DEL (subject to the limits indicated in Chapter 4). Further guidance on the treatment of new capital spending on tangible and intangible fixed assets and investments and on the disposal of assets can be found in the chapter on capital budgets.

Investments

- 3.14 Financial investments are generally treated in the same manner as other fixed assets. As they are not depreciated, they normally only impact on the resource budget through returns received on the investment or valuation changes.
- 3.15 They should be recorded on the department's balance sheet according to the appropriate treatment in the FReM. Changes in the value of financial investments (as reported in the departmental accounts) which go through the department's SoCNE should score to the department's resource budget. For further detail on the treatment of different types of investments in public sector bodies outside the departmental boundary, or other financial instruments, please refer to the FReM.

Depreciation

- 3.16 Depreciation is a measure of the wearing out, consumption or other reduction in useful life of a fixed asset, whether arising from use, passage of time or obsolescence through technical or market changes. Depreciation is charged on fixed assets annually and scores in the resource budget.
- 3.17 Accounting policies for depreciating assets are chosen by the Department, as set out in the FReM. Departments should consult with the Treasury before changing significant accounting policies and estimation techniques where it appears that there could be a potential impact on budgets and on the National Accounts.
- 3.18 Depreciation should always be a positive number. If a department nonetheless believes that negative depreciation is appropriate they are asked to write to their designated contact in the Government Financial Reporting (GFR) Team, HM Treasury, explaining the circumstances before tallying their data.
- 3.19 To calculate the depreciation charge for budgeting purposes, departments should include all depreciation on all assets, however they were originally funded.
- 3.20 Depreciation usually scores in departments' resource DEL budgets. Within the resource DEL budget, depreciation scores to administration or programme depending on whether the underlying assets are used to support administration or programme delivery.

Depreciation ring-fence

- 3.21 The budgets for depreciation and impairments scoring in DEL are within a ring-fenced part of the RDEL budget. Departments should have a shared understanding with Treasury what part of their RDEL budget is within this ring-fence. RDEL provision can be switched freely into the ring-fence, but provision cannot be moved out to fund other RDEL spending. Also, departments cannot switch RDEL from within the depreciation ring-fence into CDEL. As well as scoring against the depreciation ring-fence, administration depreciation additionally scores to a department's administration control total.

- 3.22 The same principles apply in exceptional cases where Treasury has agreed that the depreciation scores to AME budgets.

Donated assets

- 3.23 Where the purchases of assets are either funded from the Lottery, from a capital grant, from the private sector, the asset was a donation in kind, or the asset was purchased from a donation, the depreciation should be recorded in AME rather than DEL. Where an asset is part-funded through capital grant, only that element of the depreciation that relates to the grant will be recorded in AME, the rest of the depreciation will be in DEL as normal.
- 3.24 The intention of this exceptional treatment is to ensure departments have appropriate incentives and budgetary flexibility to accept grants.
- 3.25 Chapter 7 contains further detail on the budgeting for receiving capital grants.

Impairments, write-offs and revaluations

- 3.26 The next sections in this chapter deal with the budgeting treatment for impairments, write-offs and revaluations. However, if the asset being impaired is a financial transaction please refer to the guidance in chapter 8 Financial transactions
- 3.27 Impairments have the same meaning in budgets as they do in departmental accounts and are recorded in budgets when they are recognised in resource

Impairments – tangible and intangible assets

- 3.28 Where an impairment is applied to tangible fixed assets, the budgeting treatment is dependent on the reason for incurring the impairment. The same budgeting treatment applies to intangible fixed assets, but where a department believes an intangible is subject to one of the categories of impairment below it should first contact HMT.
- 3.29 In order to provide support for departments' management decisions, impairments are split into six different categories, some of which score in AME and the others in DEL. The definitions of the categories of impairments are included in the FReM; the budgeting guidance for these categories is included below.
- 3.30 The following types of impairment relating to the consumption of economic benefit or service potential score in DEL budgets:
- loss or damage resulting from normal business operations. The department has a choice about how it manages assets to reduce the risk of damage, accident and theft
 - abandonment of projects. Abandonment results from managerial decisions, and can be an indicator that a stronger project approval process and business case evaluation is necessary
 - gold plating. Gold plating is the unnecessary over specification of assets; this could be prevented through improved control processes. Construction

to a necessarily high standard for legitimate reasons (security for example) should not be considered gold plating

3.31 The following types of impairment score in AME budgets:

- loss caused by a catastrophe. This sort of loss is outside the normal experience of a department, so the only trade-offs that should be made are between the capital cost of replacing this asset and doing other capital work. Where a department believes, an impairment should score as catastrophic loss it should first contact the relevant authority, as these are rare events
- unforeseen obsolescence. As the obsolescence is unforeseeable and there seems little benefit in trade-offs with other current spending. Where the asset has been rendered obsolete by the acquisition of a new technologically advanced asset, the investment appraisal of the new asset should have covered the option of continuing to use the old one. Unforeseen obsolescence can also arise as a result of changes to legislation. When a department believes an impairment should score as unforeseen obsolescence it should first contact the relevant authority.
- other – Scores as AME. This category includes:
 - write downs of development land to open market value
 - write downs where an asset is to be used for a lower specification purpose than originally intended
 - write downs as result of asset being seized without compensation provided (usually by other governments)
- When a department believes an impairment should score in the 'other' category and it is not included on this list they should contact HMT

3.32 A fall in value relating to changes in market price should first of all be offset against a revaluation reserve for the asset in question if there is one, and once that element of the reserve is exhausted the fall in value should be taken to the SoCNE and would score in AME. This type of impairment includes:

- write-downs of development land to open-market value
- write-downs of specialised properties held at depreciated replacement cost to open-market value immediately prior to sale (where a non-specialised asset is to be written down it should be treated as accelerated depreciation or profit/loss on disposal as appropriate) and
- write-downs of newly constructed specialised properties to depreciated replacement cost on the initial professional valuation

Impairment – stocks (inventory)

3.33 The impairment of stocks (inventory) would be treated differently depending on the budgeting treatment of stocks:

- the normal budgeting treatment of stocks is that stock acquisition does not score in budgets, but use and write-off do score. In this case, all impairment or write-off of stock would score in RDEL whatever the cause
- exceptionally, the acquisition of some stock scores in capital budgets (see Chapter 6). In that case, stock is generally analogous to tangible fixed assets, and the rules for the DEL/AME treatment of impairments would follow the treatment for tangible fixed assets

Impairments – investments

- 3.34 The same budgeting treatment applies to the impairment of investments as to the impairment of intangible assets, but where a department believes an investment is subject to one of the categories of impairment above it should first of all contact HMT.

Expected credit loss – debtors and financial assets

- 3.35 Impairments that relate solely to the application of the Expected Credit Loss (ECL) model will score in the DEL budget. Where departments apply the expected credit loss model, the forecast used should be robust and agreed with Treasury. When a department applies the ECL model, Treasury expects departments to offset the increase with a reduction in their DEL elsewhere – i.e. there will be no increase to RDEL budgets as a result of the ECL model being applied.

Write-offs

- 3.36 For the National Accounts and budgeting we also need to consider the treatment of write-offs of such financial claims. To do this we distinguish between debts and financial claims written-off “by mutual consent” and those extinguished unilaterally.

Unilateral write-off

- 3.37 Write-offs where it has become uneconomic to seek to settle the debt, or the debtor has in some way disappeared – through insolvency, etc. are termed a unilateral write-off in the National Accounts.

Debts written-off by mutual consent

- 3.38 In other cases, the department may choose to write-off a debt that the debtor could repay. In these cases, the department has taken a policy decision to forgo their claim, to free up resources for the debtor; in effect the department has given a gift to the recipient. These cases are viewed in the National Accounts as the giving of a capital grant to the recipient, who on receipt of the grant uses the proceeds to repay the outstanding debt.
- 3.39 Although these debts are termed write-offs “by mutual consent” there does not need to be a formal agreement with the debtor. It is enough for the department not to pursue a debt that could economically be recovered.

Effect on the fiscal position of debts written-off by mutual consent

- 3.40 The effect on the debt position of a debt write-off by mutual consent is the same as the effect of a unilateral debt write-off: the government’s debt

position is worse off relative to what it would have been had the debt been repaid. However, debts written-off by mutual consent are recorded separately to all the different DEL and AME treatments to be reflected..

- 3.41 Effectively, by writing-off a debt that is recoverable debt we are imputing a capital grant to the debtor by not calling in our debt. Capital Grants score in Total Managed Expenditure, Public Sector Net Borrowing and General Government Net Borrowing.

Information to HM Treasury

- 3.42 Where departments are considering large write-offs of debts by mutual consent – greater than £200million – they are asked to inform the Treasury beforehand. That gives the Treasury warning of the effects on the fiscal numbers.

DEL / AME treatment of write-offs

- 3.43 The DEL / AME treatment of write-offs depends on the asset concerned. The intention is to ensure that the impact on DEL reflects the fiscal consequences.
- 3.44 If the accrued income that gave rise to the debtor or other financial asset was originally scored in DEL, any write-off will also score in DEL. If the accrued income was originally scored in AME, the reason for the write-off will determine the budgetary impact. A unilateral write-off scores in AME but a write-off by mutual consent will score in DEL, reflecting the fact that this is a policy choice not to pursue a recoverable debt. The table below summarises the position.

Table 3.A: Budgeting treatment of a write-off

Expenditure/accrued income	Type of write-off	Original scoring	Write-off
Expenditure	Unilateral write-off	DEL	AME
		AME	DEL
	Mutual consent write-off	DEL	AME
		AME	DEL
Accrued Income	Unilateral write-off	DEL	DEL
		AME	AME
	Mutual consent write-off	DEL	DEL
		AME	DEL

- 3.45 If departments are in doubt as to whether a write-off should be recorded in DEL or AME they should contact Treasury for guidance.

- 3.46 The budgets for depreciation and impairments scoring in DEL are within a ring-fenced part of the RDEL budget. Departments should have a shared understanding with Treasury what part of their RDEL budgeting is within this rein-fence. RDEL budgets can be switched freely into the ring-fence, but ring-fenced RDEL cannot be moved out to fund other RDEL spending. Also, departments cannot switch RDEL from within the ring-fence into CDEL.
- 3.47 Where a department is wholly or substantially funded from income, impairments and write-offs will score in RDEL. This treatment will normally only apply to certain regulators.
- 3.48 Where a write-off scores in DEL, any previous impairments recognised in AME, must also be reflected in DEL to the full value of the write-off.

Revaluations

- 3.49 All changes in the value of fixed assets (as reported in the resource accounts) which result in a charge or credit to the SoCNE score in resource budgets. Changes in values which are not reflected in the SoCNE do not score in budgets.
- 3.50 Where a revaluation results in a fall in value of an asset it will be necessary to establish whether any of the fall in value is as a result of;
- consumption of economic benefit (e.g. physical damage) or a deterioration in the quality of service provided by the asset or
 - a change in market price
- 3.51 A fall in value relating to consumption of economic benefit or deterioration in the quality of service provided by the asset should be treated as an impairment and currently is always taken to the SoCNE and would score in DEL (see earlier section on impairments). A fall in value relating to changes in market price should first be offset against a revaluation reserve (for the asset in question), and once that element of the reserve is exhausted the fall in value should be taken to the SoCNE).
- 3.52 The treatment of revaluations in budgets mirrors the treatment in accounts. Changes in the value of the fixed assets recognised in the SoCNE score in resource budgets.

Revaluations – investments

- 3.53 In Departmental Accounts revaluations of certain types of financial asset (e.g. held for trading investments) are taken directly to the SoCNE, rather than any revaluation reserve. The budgeting treatment reflects this, and revaluations of these assets also score to Resource AME.

Theft

- 3.54 Theft of assets is treated either as stock write-down or impairment of fixed assets (i.e. permanent loss of its recoverable value), depending on what is stolen. Either way, the write-down or impairment will be shown in the

Resource budget DEL (loss or damage resulting from normal business operations).

Employee benefits

- 3.55 Under IAS 19 accrued employee benefits must be shown on the balance sheet. This includes any untaken leave of employees as a liability and prepayments of employee compensation as an asset. Net changes in the balance sheet position of accrued employee benefits will go through the SoCNE in the departmental accounts.
- 3.56 The net changes in the SoCNE will be reflected in budgets as a Resource cost in DEL.

Budgeting treatment of current assets and liabilities

Stocks (Inventory)

- 3.57 In general terms, stocks (inventory) will impact on the resource budget only when they are consumed or written-off. In exceptional instances, certain purchases treated as increases in stocks are included in the capital budget – see separate chapter on capital budgets.
- 3.58 The total value of stock purchases will be included in a department's net cash requirement (NCR), which is voted in Estimates. The value of stocks consumed during the year should be included in the resource budget, as should any amounts for stock items that are written-off. Stocks should be valued at the lower of cost and Net Realisable Value (i.e. the actual or estimated net sale proceeds). Any write-down scores in Resource DEL.

Table 3.B: Stocks example

Opening balance	30
Purchases:	20
Use of Stocks	(23)
Closing Balance	27

Cash

- 3.59 Cash balances do not convey spending power. A department may have cash reserves built up, but this does not translate into budget cover.
- 3.60 Note that measures of cash (including "cash required by operations" in accounts and the Net Cash Requirement (NCR) in Estimates) will have a different coverage from resource budget DEL. For example, capital expenditure impacts on the NCR and capital grants on cash required by

operations; neither cash measure is divided into DEL and AME. Therefore, departments should monitor and control resource budget DEL directly.

- 3.61 However, departments may find it helpful to monitor cash and use unexpected increases in cash outflows as a trigger to check whether spending is rising above expectation. However, because of the differences referred to above, that cash outflows are in line with expectations does not prove that RDEL is under control.

Debtors – General

- 3.62 Debtors are assets, and typically arise when the department has delivered goods and services, but is yet to receive payment, or has prepaid for goods or services. Changes in debtors generally represent a movement in working capital. Debtors in general terms therefore only impact on the budgeting framework through impairment provisions and write-offs.

Debtors – Long-term debtors and prepayments

- 3.63 However, in certain cases movements in debtors are more akin to net lending, for example in complex contractual scenarios over an extended timeframe (that is, more than one year). In these cases, the budgeting system scores movements in debtors in the capital budget of the department concerned. That scoring is intended to capture and control the impact of what is in effect lending on Public Sector Net Debt.
- 3.64 Accordingly, departments should treat, as net lending in their capital DEL, the whole amount of transactions that meet both of the following criteria:
- first, the transaction is either
 - a long-term debtor or pre-payment (that is a debtor that will last over 12 months at the point that the prepayment is made) or
 - a short-term debtor or pre-payment where there is an expectation that it will be renewed so that it is in effect long-term
 - second, the total value of the debtor / prepayment involved is above £20million (where there is a related group of prepayments, the £20million limit applies to the group)
- 3.65 There is further guidance on the treatment of prepayments and debtor assets in budgets in the chapter on capital budgets below.
- 3.66 Note that if the pre-payment is discounted, the SoCNE will show a credit entry as that discount unwinds (the credit entry represents an interest payment from the holder of the prepaid cash). This transaction scores in resource DEL.

Creditors

- 3.67 Creditors are liabilities, and typically arise where a department is yet to pay for goods or services it has consumed, or it has received payment in advance of providing the goods or services to which the payment relates.

Provisions

3.68 A provision is a liability of uncertain timing or amount. A cost is recognised as a provision in the Departmental Accounts when a department has a present obligation (legal or constructive) as a result of a past event, when it is probable that a transfer of economic benefits will be required to settle this obligation, and when a reliable estimate can be made of the amount of the obligation (e.g. early retirement costs) but where there is some uncertainty, either as to the amount or timing. For further guidance on when provisions should be recognised and how to value them please refer to the FRM.

The stages of a provision's life cycle

3.69 The resource budget recognises this cost in AME at the same time that the accounts do and in DEL when the provision is released. When recording provisions in the Resource budget there are three key stages:

- the initial **recognition**, and any revaluation (such as the unwinding of the discount, or writing back down of the liability), score in resource AME
- the actual **payment of cash** to extinguish the liability scores in the resource DEL budget and
- the **release of the provision** scores as an equal and opposite (negative) amount in resource AME. These last two items net to zero in the resource budget to prevent the initial take up (and any revaluations) and the subsequent draw down both counting in the resource budget. However, utilisation of the provision does not net to zero within DEL. The budgetary impact from the release is to be absorbed within existing DEL budgets

3.70 In rare cases the cash payment mentioned in the second bullet above will score in AME rather than DEL.

What the budgeting system is trying to achieve

3.71 In Departmental Accounts the drawdown of the provision and the release of the provision are simply a cash movement on the balance sheet (debit liabilities / credit cash).

3.72 However, the budgeting system recognises these entries as well as the initial recognition and any revaluations that appear in the SoCNE

3.73 This dual recognition is because in the National Accounts the initial recognition of the liability does not score upfront, rather the actual transfer scores when the cash is paid. Scoring the separate elements to the transaction in this way ensures that the information required for the National Accounts is available and allows us to control spending in support of the fiscal framework.

3.74 This need to support the fiscal framework is a key consideration when looking at the impact of provisions in resource budgets (see later chapter).

Provisions in respect of capital spending

3.75 Certain provisions in respect of capital spending score in capital budgets – see chapter on capital budgets.

Scoring examples

- 3.76 The example below illustrates the scoring of provisions and related expenditure, in this case making a payment. Note that the transactions in provisions are scored in AME and the associated expenditure is normally in DEL.

Table 3.C: Example of standard provision in respect of DEL spending

Resource budget Impact	Year 1	Year 2	Year 3	
Recognition of provision	+£10			Resource AME
Revalue provision upwards		+£2		Resource AME
Utilisation of provision			-£12	Resource AME
Make a payment			+£12	Resource DEL

Regulators

- 3.77 Regulators that are wholly or substantially funded from income will exceptionally score all provisions in DEL.

Student loans

- 3.78 These rules do not apply to provisions in respect of student loans, whose treatment is set out in the later chapter on financial transactions.

Contingent liabilities

- 3.79 A contingent liability is a liability that may be incurred depending on the outcome of a future event. Amounts for contingent liabilities are not included in the resource budget, nor recognised as actual liabilities on the balance sheet, but are contained in notes to the accounts. Departments should consider in the course of drawing up their budget whether any contingent liabilities are likely to crystallise and plan to absorb the impact of such a risk within the existing budget.
- 3.80 In some cases, departments find that they are responsible for contingent liabilities because of their position in government, in others the decision to take on a contingent liability is discretionary and represents a transfer of risk from the private sector. In these discretionary cases departments should discuss with Treasury whether taking on the liabilities is the best option.

- 3.81 Departments should refer to the requirements within Managing Public Money and the Contingent Liability Approvals Framework when considering taking on any contingent liabilities.

Insurance

- 3.82 Generally, departments and public sector bodies do not insure because government as a whole is well placed to absorb the risk, rather than paying to lay off that risk to the private sector. However, in certain circumstances departments will have insurance. Payments of insurance premia are current costs in resource DEL.
- 3.83 Where an insured asset is lost, stolen or otherwise written-off, a charge will be recognised in the SoCNE and Resource budget to reflect that cost. The subsequent payment from the insurance company should be recognised as income in the SoCNE and resource DEL in the accounting period in which it was recognised.
- 3.84 Replacement of the asset will require the appropriate (most likely capital) budgetary cover.

Notional insurance payments

- 3.85 Under standards set out in the FReM, notional insurance should not be shown in the SoCNE or the Estimate. Any department that is recording notional insurance should therefore remove it.
- 3.86 If any department believes that it should record notional insurance in the SoCNE or the Estimate or the budget, they are asked to write to their normal Treasury spending team explaining the circumstances in order to obtain agreement before submitting data.

Tax credits

- 3.87 Tax credits are transfers of resources made through the tax system. The recording of tax credits is complicated by the different demands for information in the National Accounts and in department's annual accounts and budgets. Classification of tax credits is based on two criteria:
- 3.88 **Integral to the tax system.** Tax credits must be classified to determine whether they are a refund of tax, or are more akin to payments made through the benefits system. The National Accounts judge this, in part based on whether the credit is integrated into the tax system or the benefits system. Determinants of whether the credits should be treated as "integral" include: alignment of measures of income with tax system, underpinning definition from tax system or benefits system, whether the credit evolved out of existing benefits, etc.
- 3.89 **Payable vs. non-payable.** Payable tax credits are those where the credits a) may exceed the tax liability, and b) if they do exceed the liability, will be paid anyway. If a credit is designed that it may not exceed the tax liability, then it is classified as non-payable.
- 3.90 The classification of tax credits, based on the above criteria, and the subsequent reporting is set out in the table below:

	Departmental Budget (usually AME)	Other AME	TME	DRAs	Trust Statement
Tax Credits treated as integral part of the Tax System for National Accounts					
Non-Payable Tax Credit	x	x	x	x	✓
Payable Tax Credit	✓	✓	✓	✓	x
Tax Credits not treated as integral part of the Tax System National Accounts					
Non-Payable Tax Credit	✓	x	✓	✓	x
Payable Tax Credit	✓	x	✓	✓	x

Those credits which are treated as public expenditure add to TME. The other credits which are recorded as a refund of tax net off government's income.

Notional audit fees

- 3.91 Notional audit fees score in the department's DEL as resource expenditure within administration costs. The expenditure needs to be separately identifiable on the OSCAR database in order that it can be removed in the AME accounting adjustments to line up with TME as measured by the National Accounts.

The CRC Energy Efficiency Scheme (CRC)

- 3.92 The CRC Energy Efficiency Scheme is a mandatory UK-wide trading scheme introduced in April 2010, which is designed to encourage the take-up of cost-effective energy-efficiency opportunities. The CRC scheme impacts on government departments and the devolved administrations as they are regarded as mandated participants, and also on other public sector entities that meet the CRC scheme's qualifying criteria. The CRC scheme is administered by the Environment Agency.
- 3.93 Links to information on the development of the scheme and full details of the administration of the scheme are given in Annex D.
- 3.94 The CRC scheme is currently in its introductory phase (Phase 1), where production of emissions by reporting entities covered by the CRC scheme will give rise to the recognition of a liability to later purchase and surrender allowances to match their emissions for that financial year. For the purposes of budgets this expense should be recorded as RDEL in the year that the emissions arise. From 2014-15, the purchase and surrender of allowances related to 2014-15 emissions is expected to occur within the same financial year.
- 3.95 If departments have any queries related to CRC spending they should contact their Treasury spending team. All other policy questions on CRC should be directed to the CRC team in DECC.

Counter party eliminations

- 3.96 The Estimate, as with the accounts, will be produced at the group level and will therefore normally need to remove any intra-group transactions. The financing of arm's length bodies (ALBs) (including NDPBs) through grant-in-aid is automatically excluded from budgets and Estimates, but any other intra-group transactions such as the purchase of shared services by an NDPB from the parent department, will need to be removed by the department and not recorded on the OSCAR database.
- 3.97 The Estimates must include all movements between various budgetary control limits. Therefore, if an intra-group transaction were to involve any such movement (for example, an NDPB, whose spending appeared in AME, purchased a service from its parent department, whose spending appeared in DEL) those transactions would need to be included in the Estimate.
- 3.98 Full guidance on the consolidation of intra-group transactions is given in the Supply Estimates Manual and a link is given in Annex E.

Gifts

- 3.99 Gifts will score as either resource grant or a capital grant depending upon how the original purchase of the asset arose.

Chapter 4

Income and the Resource budget

- 4.1 Departments and ALB's may not set income against budgets except where permitted. Separate chapters deal with income in the capital budget, income in respect of loans and departments' income from PCs.
- 4.2 Income that passes through the SoCNE in the Departmental Accounts should normally be recorded in resource budgets as either DEL or AME. Income passing through a department's trust statement would normally be outside of budgets.

Income overview

- 4.3 In Treasury presentations of public expenditure, the treatment of income streams is determined by the National Accounts classification of the type of receipt. For some classifications the income is presented gross, in others it is netted-off of expenditure. This breakdown has no fiscal effect and does not imply a specific budgetary treatment. It is not reflected in National Accounts presentations.

Negative public expenditure receipts

- 4.4 Receipts classified as negative public expenditure receipts are netted off, and hence reduce levels of total public spending.
- 4.5 The most common examples are payments for goods and services. However, negative PE receipts also include: royalties for intellectual property rights (IPR), income from insurance payments, and income from rent of buildings (but not land).

Revenue receipts

- 4.6 Revenue receipt refers to income that cannot be netted-off of public expenditure. It covers income that is used to finance expenditure rather than acting to reduce it.
- 4.7 The most common example of a revenue receipt is tax income. However, it also includes: fines and penalties, payments of compensation, economic rents, interest and dividends, donations and income from the EC.
- 4.8 It is the Office for National Statistics acting as an independent agency that determines the treatment of income in the National Accounts. Annex D gives links to some guidance notes describing the National Accounts treatment of income. Treasury then determines the budgeting treatment of income. If you are in doubt about the National Accounts treatment or the budgeting treatment you should approach HM Treasury.

Income treated as negative public expenditure in the resource budget

- 4.9 The following forms of departmental income are treated as negative in resource budgets:
- sales of goods and services *
 - royalties and associated payments to use Intellectual Property Rights *
 - sales of some licences where the ONS has determined that there is a significant degree of service to the individual applicant *
 - income from licences and levies, treated as tax in the National Accounts, where the Chief Secretary to the Treasury has agreed that they may be netted off budgets
 - income from fines and penalties where the Chief Secretary to the Treasury has agreed that they may be netted off budgets
 - income from insurance payments *
 - receipts in respect of compensation (where the ONS treat the income as impacting on the current budget)
 - interest and dividends where the department has financed the associated financial asset through DEL, for example a loan made to the private sector
 - income from rent of buildings * and land
 - those donations that are treated as current in the National Accounts (donations can be capital as well)
 - income obtained from National Lottery distributing bodies that finances current expenditure
 - profit (or loss) on disposal of capital assets
 - income from the EU that finances current expenditure.
- 4.10 Income that is negative current public expenditure in the National Accounts is marked with a *
- 4.11 Also note that where appropriate, charges should be set using the principles in Managing Public Money.

DEL / AME treatment

- 4.12 By default, income which is treated as a benefit to the resource budget will score as negative DEL in budgets. The income will score as negative AME where the associated programme or body responsible for the income is also recorded in AME.
- 4.13 Departments and ALBs may find that some of the expenditure incurred in generating income will fall in AME due to its transaction type (e.g. provisions, revaluations etc.). This does not mean that the income, or even a portion of the income, should be recorded in AME.

Income that may not be set against resource budgets

4.14 The following income may **not** be treated as negative in resource budgets:

- taxes, licences treated as tax in the National Accounts and levies, unless the Chief Secretary has agreed to negative DEL treatment
- fines and penalties, unless the Chief Secretary has agreed to negative DEL treatment
- economic rents, other than those classed as rent of land
- income treated as capital including
 - a) developer contributions that are capital in nature
 - b) income from the EU that finances capital expenditure
 - c) equity withdrawals / super dividends

4.15 The first three bullets above would normally be recorded in a Trust Statement by the department with responsibility for collecting the money (or the department with policy lead by agreement). There is an exception to this however, where Treasury agrees that this income may be netted-off of expenditure the income will be recorded as in DEL budgets and within the SoCNE. See sections later in this chapter for full details of netting-off of tax, and fines and penalties.

Further guidance on individual types of income

Sales of goods and services

4.16 Sales of goods and services count as negative public expenditure in budgets provided they meet certain criteria. In brief:

- there is a clear and direct link between the payment of the charge and the acquisition by the payer of specific goods and charges. In other words, the transaction should be rather like shopping. The issue of regulatory licences may count as the sale of a service if there is a direct benefit to the person paying for the licence such as providing them with an objective measure of fitness or suitability and
- unless the good or service is being sold in an open competitive market, the price should not exceed the cost of production (on a full cost basis, including depreciation but excluding capital expenditure)

4.17 See Annex E for a link to the guidance note on when transactions are sales of goods and services in the National Accounts.

Royalties and economic rents

Royalties

4.18 Royalties is a term from National Accounts. Annex E contains a link to a guidance note on the National Accounts treatment.

- 4.19 In brief, royalties are payments for the right to use produced assets made and sold in an open market, such as inventions given patent protection, computer software, copyright material, artistic and literary originals, and the income from allowing use of a government agency's logo by a commercial organisation.
- 4.20 For something to be a produced asset, it should be of a sort that is or could be produced by the private sector. So, an invention made in a government scientific laboratory could be an open market asset, since a private sector firm could have run such a laboratory and made the invention, even if in practice firms do not do research in this area. But if the government has for example a legal monopoly, which has led to the creation of the asset, then it is less likely to be seen as an open market asset.
- 4.21 Royalties from the use of intangible assets made and sold in an open market are treated as income from the sale of goods and services. The allowable cost is the market value of the royalty – in essence, what the market will pay. So the whole of the amount paid for the asset, good, or service may be treated as negative public expenditure.

Capital or current?

- 4.22 It may be difficult to tell whether a one-off payment covering a number of years is for the sale of an asset or an upfront payment in respect of a number of years' royalty. Similarly, it may be hard to test whether a payment spread over a number of years is for the sale of an asset or a current royalty.
- 4.23 The tests used by commercial accountants will be a guide as to whether a capital asset has been sold or rented out. For larger cases, departments should consult the Treasury to ensure that they are treating the income in accordance with the National Accounts.
- 4.24 In general:
- a sale leading to a current receipt - royalty for the use of an asset - would be a sale offering the user a right to use the asset for a period of time, but underlying ownership of the asset or resource would stay with the vendor. Changes in the value of the asset would not normally affect the user as they would not be able to sell on their rights but
 - capital income - sale of an asset - would be when the buyer had obtained
 - all significant rights or other access to benefits relating to that asset and
 - all significant exposure to the risks inherent in those benefits
- 4.25 Ownership rights would typically include unimpeded use of the asset, right to resell the asset and benefit or suffer from changes in the value of the asset. Typically, capital income is shown as a single entry in the accounts at the time of sale, but the cash may come in tranches (deferred consideration).

Economic rents and other cases that are not royalties

- 4.26 "Royalty" may be used in a number of cases other than the National Accounts meaning of the term. These cases may not be netted off budgets

as royalties, sales or rents in respect of assets created in nature, e.g. North Sea Oil, the radio spectrum, or water. Such income is normally classified as economic rent, and is outside of budgets.

- royalties, sales, or rents in respect of assets created in nature, e.g. North Sea Oil, the radio spectrum, or water. Such income is normally classified as economic rent, and is revenue in the National Accounts (but see “rent of land” below)
- royalties or sales in respect of concessions or franchises given by the government to run a commercial or government operation

Taxes, licences (treated as tax in the National Accounts) and levies

4.27 Taxes, licences treated as taxes, and levies are compulsory unrequited payments to general government. “Unrequited” means that the payer obtains nothing personal in return. That includes not only obvious taxes like income tax, but also cases where a tax is hypothecated, perhaps to provide services generally for business in an area, or to recover costs from businesses that are in general the cause of some harm that needs to be remedied (e.g. pollution).

4.28 In exceptional cases, the Chief Secretary to the Treasury may agree that taxes be netted off budgets. The Chief Secretary will bear in mind the criteria below when considering applications:

Box 4.A: Criteria to be applied to licences and levies

- 1 the service delivered should be closely linked to the payer of the licence or levy, either because they are the beneficiaries of the service, or because they are the cause of the expenditure being incurred
- 2 the licence or levy is appropriate, i.e. applied in the economically most advantageous way in the circumstances
- 3 introducing the levy or licence should not materially restrict the government’s fiscal policy (as measured by Public Sector Net Debt)
- 4 the activity financed by the levy or licence must further the government’s economic goals
- 5 netting off the income would improve the efficiency with which resources are allocated, e.g. because of a difficulty in matching resources to unpredictable changes in externally driven demand. There needs to be a clear advantage over DEL funding
- 6 where appropriate, charges should be set up using the principles of Treasury’s Managing Public Money guide, and surpluses would have to be surrendered
- 7 there should be adequate efficiency regimes in place to keep costs down, including stretching targets and regular efficiency reviews, often tied in with a Spending Review

- 8 day-to-day decisions on the level of charges and an efficient level of costs should be taken separately from the body raising the levy, to prevent abuse of its monopoly power. Normally this would be by the departmental minister
- 9 there will be periodic reviews involving the Treasury, of all the operation of the licences and levies, including: whether they should exist at all; whether netting off remains the most appropriate means of funding; what scale of activity is appropriate; and the level of charges set. The periodicity of the review shall be set as part of the agreement to allow netting off

- 4.29 Departments who wish to propose that tax income be netted off DEL should contact the Treasury for advice as to how a submission should be compiled. See Annex D for contact details.
- 4.30 Consideration of netting-off proposals should normally be linked to Spending Review discussions. Where this is not possible Treasury will consider proposals as they arise, but the strong presumption must be that any agreement on netting-off will not alter the level of funding agreed to in the last spending review. As such an agreement to net-off income will be reached, alongside agreement to reduce the department's DEL budget by a compensatory amount.
- 4.31 Transactions treated as tax in the National Accounts are normally recorded in a Trust Statement by the relevant department. However, where Treasury agrees to a netting-off treatment the accounting will follow the budgeting, and the tax will be recorded as income in the department's SoCNE.

Imputed tax and spend

- 4.32 The ONS has classified certain obligation-based levy-funded schemes as taxation and public spending in the National Accounts and impute these economic flows through the public sector. Tax and spend arising from these types of schemes should be monitored and controlled like any other departmental spending and included in departmental budgets. Departments should seek guidance from HM Treasury on the classification and budgeting treatment of such schemes and on the mechanism for reporting to Parliament. They should also consult Managing Public Money and their Treasury spending team when considering the design of new schemes. A specific example of the budgeting treatment of tax and spend can be found in the "Control framework for DECC levy-funded spending" (see Annex E for link).

Fines and penalties

- 4.33 Fines and penalties are compulsory unrequited payments to general government that are in the nature of a punishment.
- 4.34 In exceptional cases, the Chief Secretary to the Treasury may agree that fines and penalties be netted off budgets. The Chief Secretary will bear in mind the criteria below when considering applications:

Box 4.B: Criteria to be applied to fines and penalties

- 1 will performance against policy objectives, e.g. crime fighting and prevention, be likely to be improved
- 2 are arrangements in place which will ensure that the activity will not lead to the abuse of fine and penalty collection as a method of revenue raising, and that operational priorities will remain undistorted
- 3 will revenues always be sufficient to meet future costs, with any excess revenues over costs being surrendered
- 4 can costs of administering the programme be readily identified and apportioned without undue bureaucracy, and with interdepartmental and inter-agency agreement, where necessary
- 5 can savings be achieved through the change (from a normal DEL funding regime to a netting-off regime), and are adequate efficiency regimes in place to control costs, including regular efficiency reviews. The periodicity of the review shall be set as part of the agreement to allow netting-off, and will involve the Treasury. It will consider whether the fines and penalties should exist at all; whether netting-off remains the most appropriate means of funding; what scale of activity is appropriate; and the level of fine set

- 4.35 Departments who wish to propose that fine income be netted off DEL should contact the Treasury for advice as to how a submission should be compiled. See Annex C for contact details.
- 4.36 Consideration of netting-off proposals should normally be linked to Spending Review discussions. Where this is not possible Treasury will consider proposals as they arise, but the strong presumption must be that any agreement on netting-off will not alter the level of funding agreed to in the last spending review. As such an agreement to net-off income will be reached, alongside agreement to reduce the department's DEL budget by a compensatory amount.
- 4.37 Transactions treated as fines and penalties in the National Accounts are normally recorded in a Trust Statement by the relevant department. However, where Treasury agrees to a netting-off treatment the accounting will follow the budgeting and the fines will be recorded as income in the department's SoCNE.

Dividends and equity withdrawals

- 4.38 A dividend is a payment made to a shareholder in consideration of having put equity finance into a body. The equity finance may be in the form of Companies Act shares, Public Dividend Capital (PDC) or the implied equity in a statutory Public Corporation. Public sector bodies may hold equity in other public sector bodies or in private sector organisations. Dividends are payments made out of current earnings.

- 4.39 If dividends are greater than the profits of the current and two previous years – super-dividends - they count as equity withdrawals in the National Accounts (a financial transaction as opposed to a current receipt in the National Accounts). Equity withdrawals count as capital income for budgeting. A more detailed definition of when a payment is a dividend as opposed to a withdrawal of equity for budgeting purposes is given in the Public Corporations chapter.
- 4.40 In DAs, reductions of equity in the form of sales of shares or PDC reductions would not normally go through the SoCNE. But special payments from bodies that are not accompanied by actual reductions in equity holdings would go through the SoCNE; they may be termed super-dividends. Such super-dividends would be equity withdrawals in the sense above.
- 4.41 “Dividends” received from bodies within central government, including joint ventures classified to the central government sector, are not dividends but transfers within Government and as such are not generally treated as negative in budgets.

Rent of buildings / land

- 4.42 Income from the rent of buildings and land counts as a benefit to the Resource budget.
- 4.43 In addition to the rent of land, this heading includes rents payable to the owners of inland waters and rivers for the right to exploit such waters for recreational and other purposes. Rent of land does not include rents on sub-soil assets, or of other natural assets (spectrum, etc.).
- 4.44 Any proposal to treat as negative DEL rent, other than the conventional rent of land or buildings, needs explicit Treasury agreement.

Note on treatment of asset sales in the National Accounts and profit / loss on sale of assets as recorded in financial accounts.

- 4.45 DAs divide the proceeds from the sale of an asset into an element that covers book value and a profit or loss on disposal.
- 4.46 The book value is a benefit to the capital budget. The profit / loss on sale scores in the resource budget. Profit is a benefit to RDEL while loss is a cost. The level of profit on disposal scoring in resource DEL is limited to a maximum of £20million, or 5% of the net book value of the disposal, whichever is the lower. In cases where profit exceeds this maximum departments should contact Treasury to discuss the treatment; Treasury may require some or all of the additional profit to be retained in capital DEL.

Treatment of asset sales in the National Accounts

- 4.47 In the National Accounts, capital expenditure is recorded net of income from sales of capital assets. The National Accounts do not separate the profit/loss on disposal from the book value element of sales income. Both of those components of the transaction are taken through the capital account of the National Accounts. In other words, the disposal at open market value reduces total capital expenditure in aggregate.

Donations

Donations that may be netted off

- 4.48 Donations may benefit either resource or capital budgets: capital donations are dealt with in Chapter 7.
- 4.49 Donations have to be entirely voluntary. They have to be unrequited – that is the donor should receive no direct benefit in return. They also have to come genuinely from outside the body that receives them, i.e. not be financed or backed in some way by the recipient. Departments and public bodies may net off the donations that are made to finance expenditure for the common good and that are directed by the donor to a specific project, programme or body, for example:
- a current gift left in the collection box of an individual museum to be spent at that museum’s discretion
 - sponsorship funds raised for a specific venture to the benefit of the public
- 4.50 This treatment would include any donations in kind. However, donations in kind should have no net impact in budgets. To record a donation in kind the department should show two equal and opposite transactions:
- a capital grant received from the private sector equal to the market value of the donated asset as a benefit to CDEL and
 - a matching purchase of the assets as a cost to CDEL
- 4.51 Donations or grants going from one public sector body to another have a specific treatment in accounts and budgets. Refer to Chapter 7 for further details.

Donations that may not be netted off

- 4.52 Departments should exclude such donations from budgets. Examples of donations that may not be netted off include:
- donations related to income that would otherwise be classified as revenue anyway, for example, conscience money (people guiltily and voluntarily paying over money in respect of past unpaid tax) and
 - donations that relate directly to the public sector’s balance sheet – e.g. legacies to reduce the national debt.

Income from National Lottery distributing bodies

- 4.53 The government’s hypothecated income from the National Lottery is a tax. The spending by the National Lottery distributing bodies counts as expenditure in AME.
- 4.54 Where a government department or ALB that is not a National Lottery distributing body obtains income from a distributing body to finance spending in the resource budget DEL, it should take the income into budgets as negative resource budget DEL.

Costs of European Union spending

- 4.55 The UK makes financial contributions to the EU budget and receives funding covering a variety of policy areas. This creates a cost to the Exchequer, through increasing the UK's gross contribution to the budget and reducing the UK's abatement.
- 4.56 In order to maintain sound incentives on departments, the Treasury expects departments to be responsible for any additional costs to the Exchequer that arise from changes to EU spending proposals. This applies both to the EU annual budget and the Multiannual Financial Framework (MFF). In all cases, departments should engage with the Treasury at as early a stage as possible.

Multiannual Financial Framework negotiations

- 4.57 The Treasury may impose a charge within DEL on the relevant department (adjusting its budget downwards) to reflect the cost to the Exchequer of EU spending outcomes. Any reduction would reflect the baseline of the agreed UK negotiating position.
- 4.58 If appropriate, departments should expect the Treasury to take account of the cost to the Exchequer of EU spending outcomes as part of Spending Reviews, or through DEL reductions at Estimates. Treasury will assess this and take into account the positions adopted by departments in negotiations.
- 4.59 To facilitate monitoring, departments should inform the Treasury, as soon as possible, of all current or forthcoming proposals in their policy areas that may have significant fiscal consequences.

Annual budget negotiations

- 4.60 The mechanics of accounting for the receipt and costs of additional EU spending and income through annual budget negotiations depends whether the department in question receives the EU funding directly. However, whether EU funding is included inside or outside accounts, the principle that departments may be held responsible for additional costs to the Exchequer remains.

Funding inside accounts

- 4.61 In most cases where the EU provides funding for activities, it will be by way of a grant to the department. This grant will be recorded as income in Departmental Accounts.
- 4.62 In order to make the costs of additional income explicit the Treasury may adjust departmental DEL downwards, equivalent to the cost to the Exchequer of additional income from the EU. This will take place at the next appropriate Estimates. In some circumstances, the cost may be greater than the income.

Funding outside accounts

- 4.63 Departments may not include EU funding in their accounts for one of two reasons:

- while the department negotiates on the area of EU spending, the funds are distributed directly by the EU and never go to the department or
- the funding passes straight through the department, which is determined to be acting only as an agent in accounting terms

4.64 Since these transactions are outside of accounts they will also be outside of budgets. Such income and spending will nonetheless incur a cost to the UK, including through the impact on the abatement. The Treasury may choose to reflect this cost through a charge within DEL that reflects the cost to the Exchequer of any changes in EU spending.

VAT

4.65 Departments' budgets should be set net of any recoverable VAT. Departments may retain VAT refunds for business activities and also for certain non-business activities. Refunds would therefore not be included in budgets.

4.66 The actual cash paid corresponding to the VAT leads to an increase in debtors. When the VAT is repaid that leads to a decrease in the debtors and an increase in cash. The net movement in this debtor feeds into the departmental Net Cash Requirement and must be recorded in the additional information section of the Standard Chart of Accounts (SCOA) as a movement in working capital.

4.67 VAT output tax charged as an addition to the cost of services or goods supplied is outside the scope of budgets. Tax received results in an increase in creditors until paid over to HMRC (or offset against recoverable input tax). The payment then clears the creditor balance.

Timing of recording of income

4.68 In general, departments should record income for budgets at the same time as they record it in the Departmental Accounts.

Budget and estimates treatment of income

4.69 Both budgets and Estimates are set on a net basis. Any income that may be retained within budgets (as set out earlier in this chapter) may also be retained in Estimates, and will reduce the voted limits.

4.70 In some rare cases there will be exceptions to the above where income received by the department is recorded as being negative in DEL but must be returned to the Consolidated Fund in the Estimate. These exceptions are referred to as Consolidated Fund Extra Receipts (CFERs) and will most likely be the result of one of two scenarios:

- where income is in the departmental budget but is not of a type anticipated by the department and so isn't included in the income ambit and Analysis of Income note
- where departmental income is classed as non-budget by the Treasury but is not of a type to be included in a Trust Statement

4.71 Annex E contains links to further information on supply Estimates.

When departments may keep additional negative DEL income

- 4.72 In many cases current income does no more than cover the costs of production of the activity to which it relates. For example, fees and charges are typically set so as to recover no more than current costs, including depreciation (refer to Managing Public Money for further detail).
- 4.73 To ensure that they obtain the right level of income from such sources, departments will want to consider whether they have any services where less than full costs are currently recovered and which should move towards full cost recovery, or other services which may be appropriate candidates for the introduction of user charging.
- 4.74 In other cases, income can generate returns that far exceed current costs of production, for example licensing the exploitation of an invention in the open market. In these cases the Government has to balance two considerations:
- departments should be encouraged to obtain such income by being allowed to retain and spend it and
 - government funds should be prioritised across the whole range of spending to where they would do most good
- 4.75 And we need to keep the rules simple.
- 4.76 Departmental budgets are set in the SR net of negative RDEL income. So the SR settlement has to be informed by the expected level of negative RDEL income. The SR process should be used to identify the expected level of departments' income; any expected changes; and an assessment of the potential for new income. It will look especially at the prospects of moving under-recovering services towards full cost recovery and/or identifying new sources of income from user charging. The SR settlement will include an explicit statement of the expected level of income in the years of the SR period.
- 4.77 Departments will be allowed to keep the negative DEL income that they obtain in the SR period up to the amount that was taken into account in the SR. Income cannot be predicted wholly accurately, and the Treasury wishes to encourage departments to find new income streams where appropriate. Departments may therefore, in any year, where no other retention limit exists, also retain negative RDEL income up to 10% above the level envisaged for that year as part of the SR settlement without an adjustment to budgets.
- 4.78 Negative DEL income in respect of co-funded ALBs that originated from other departments does not count towards the 10% limit. It follows that income of ALBs – which is netted off in the Supply Estimate – does not contribute to the calculation of the 10% limit.
- 4.79 Where the SR settlements did not clearly set out an expected level of income, departments may in any year where no other retention limit exists, retain total negative RDEL income up to 5% of net spending in resource DEL without an adjustment to budgets

- 4.80 If departments expect to obtain more negative RDEL income than provided for above, they should talk to the Treasury about whether they may retain all or part of the income without an adjustment to budgets. When considering proposals, the Treasury will wish in particular to encourage additional income where this represents the results of positive management action, as opposed to under-forecasting.

Chapter 5

Administration Budgets

What are Administration budgets?

- 5.1 In Spending Reviews, administration budgets are set for entities classified as central government bodies for National Accounts purposes including executive agencies and other arm's length bodies (ALBs) that receive government funding unless specific exemptions have been agreed.
- 5.2 Although devolved administrations are not set administration budgets in Spending Reviews, they do operate their own arrangements for constraining the costs of running central government.
- 5.3 Expenditure that does not fall within administration budgets set in Spending Reviews is known as programme expenditure. Expenditure in AME is assumed to be programme.

The boundary between administration budgets and programme spending

- 5.4 Administration budgets cover the costs of all central government administration other than the costs of direct frontline service provision. In core departments support activities that are directly associated with frontline service delivery are considered to be programme, but in ALBs if there is no clear distinction between support for the frontline and for non-frontline activities, all support activities are deemed to be within administration budgets. In practice administration budgets include activities such as provision of policy advice, business support services, back-office administration of benefits, advice on and administration of grant programmes and technical or scientific support.
- 5.5 To keep the number of reclassifications to manageable levels, the Treasury is only willing to consider cases that represent a substantial body of on-going work. Also, the merits of very substantial reclassifications need to be weighed against the potential effects on the administration budgets regime overall as well as presentational and timing issues.
- 5.6 Where a department believes that expenditure should be reclassified from administration spending to programme spending, they should contact their Treasury spending team. All reclassifications from administration budgets lead to restated limits.
- 5.7 The split between administrative and programme expenditure happens above the level of the individual civil servant. Departments are encouraged to

classify spend according to the work of the business area rather than trying to split business areas along proportional lines.

Definition of administration budgets

- 5.8 Administration budgets are simply a sub-set of resource DEL and share most of the characteristics of DEL. They are set net of negative DEL that relates to administration expenditure. The chief components of expenditure within administration budgets are:
- **employee costs**, including civil service pay, superannuation, training, travel and subsistence
 - current expenditure on **accommodation**, including rent, rates and maintenance
 - current expenditure on **office services** including stationery, postage, telecommunications and computer maintenance, etc.
 - current expenditure on comparable **contracted-out services** (including some consultancy costs, see below)
 - **depreciation** charges incurred carrying out activities falling within administration costs (and where fixed assets are used for both administration and programme work, these costs should be apportioned)
- 5.9 Payments to staff as a result of early exit, where a case explicitly linked to improved efficiency has been agreed in advance with the Treasury, may exceptionally be excluded from administration budgets and scored to programme.

Consultancy costs

- 5.10 Consultancy fees and contract charges should be charged against administration budgets where the consultancy relates to some component of administration expenditure listed above, or where the work carried out might otherwise be carried out by staff funded from administration budgets¹. The presumption should be that consultancy spending should be scored within administration budgets. Where a department believes consultancy spending associated with a particular programme should be classified as programme spend they should agree this with their Treasury spending team. Administration expenditure should include:
- any costs associated with out-sourcing of support services. For example: payroll services, some types of accommodation contracts, departmental switchboards, etc
 - provision of policy advice or support by consultants employed in substantially the same role as if a civil servant was carrying out the work
- 5.11 This rule is designed to avoid any perverse incentive to contract out functions, or use consultants in place of civil servants, simply because the resulting work would then be charged under programme costs. Decisions on

¹ 'Consultancy' should be taken to include all professional services as defined by the Professional Services Forum (see Annex C for the link)

how support or policy services should be supplied should be made purely on an assessment of what offers the best combination of value for money and effectiveness, rather than because programme cover may be more readily available than administration cost cover or vice-versa.

Allowable income

- 5.12 Departments may offset negative resource budget DEL income relating to administration costs against their administration budget. This includes income from ALBs and other UK public sector bodies, where classified as administration income.

Comparability with Departmental Accounts

- 5.13 Departmental Accounts must include a note reporting outturn against final administration budgets.
- 5.14 The element of net operating costs that falls with administration budgets is reported in the SoCNE as net administration costs. The only differences between outturn against administration budgets and net administration costs are the differences that apply generally between the SoCNE and resource budget set out in Table A.1 of Annex A.

Approval for changes to administration budgets

- 5.15 All changes to administration budgets – including changes to expenditure and income provision within administration budgets – require Treasury approval.
- 5.16 HMT spending teams may give approval at official level for:
- some increases to the administration budget, including
 - a switch from programme to administration for the funding of redundancy costs in exceptional circumstances
 - transfers between departments where the overall effect is neutral and
 - changes to expenditure and income provision within administration budgets where the administration budget itself remains unchanged or is reduced
- 5.17 Approval from the Chief Secretary to the Treasury is required for most other increases to the administration budget:
- increases involving claims on the DEL Reserve
 - transfers from programme funds

In-year control

- 5.18 As with all spending, departments or agencies and their Accounting Officers have to take ultimate responsibility for ensuring an outturn within administration budgets. Outturn which exceeds an administration budget constitutes the breach of a budget and will be subject to the arrangements set out in Chapter 1.

Estimates & administration budgets

- 5.19 Departments must note that, although the administration budget is not specifically voted as a limit by Parliament, it is included within the department's Supply Estimate and any breach of the limit will lead to an Excess Vote. Detailed guidance on administration costs and Estimates is available in the Supply Estimates manual (see Annex E for link).

Chapter 6

Capital budget

6.1 ALBs' capital expenditure scores in budgets in the same way as departments'. See next chapter for the treatment of income in capital budgets. See separate chapters for the capital budget implications of loans to the private sector, PPP deals, support for local authorities and support for public corporations.

Capital budgets overview

6.2 New capital spending by departments and ALBs scores in the capital budget at the same value and with the same timing as in accounts. Some areas can give rise to tricky decisions on whether they are capital or not, and departments should check carefully the treatment of

- in-house capital formation, including Research and Development expenditure and in-house production of IT and
- software purchases

6.3 Capital budgets are net of any income that is treated as negative expenditure in capital budgets – see separate section. Capital spending includes expenditure on tangible and intangible fixed assets, howsoever financed.

6.4 In addition, capital budgets include net acquisitions of financial assets (e.g. movements in loans to the private sector) that score as movements in fixed assets on the balance sheet. In exceptional cases movements in debtors or other current assets (stocks / pre-payments) may be included in the capital budget.

6.5 When budgeting for capital expenditure, departments should consistently follow agreed accounting policies when deciding what costs of a project should be capitalised (in most cases this should be uncontroversial but there are a few categories of expenditure, such as some consultancy costs, that could be either capital or resource).

6.6 Capital budgets include capital grants.

6.7 In some cases transactions in financial assets or liabilities will have an impact on the fiscal aggregates. Where this occurs, the transaction is usually scored in capital budgets either as a benefit or a cost. Further detail is included in Chapter 8.

Predicting capital values

6.8 In line with the FReM, fixed assets are carried at fair values rather than being based on historical costs. Departments can use depreciated historical cost as

a proxy for fair value for assets with short lives or low values (or both). Otherwise, departments should use the most appropriate valuation methodology available (for example, professional valuations, indices, etc.).

- 6.9 Departments need to make assumptions about future expected disposals and acquisitions of fixed assets and movements in the value of fixed assets held, to be able to budget for the resource consequences (depreciation, maintenance and impairments) of holding these items.
- 6.10 Past trends and movements in indices should provide evidence to support departments' forecasts for the revaluation of assets. As the assumptions used in forecasting fixed asset values will no doubt change over time, departments should regularly review their continued appropriateness, and bring any significant changes to the early attention of their spending team.

Profit / loss on sale of assets

- 6.11 Departmental Accounts (DAs) divide the proceeds from the sale of an asset into an element that covers book value, which affects the balance sheet; and a profit or loss on disposal, which goes through the SoCNE.
- 6.12 The book value of the disposal is a benefit to the capital budget.
- 6.13 The profit / loss on a sale scores in the resource budget. Profit is a benefit to RDEL while loss is a cost. The level of profit on disposal scoring in Resource DEL is limited to a maximum of £20million, or 5% above the net book value of the disposal, whichever is the lower. In cases where profit exceeds this maximum departments should contact Treasury to discuss the treatment; Treasury may require some or all of the additional profit to be retained in capital DEL or some other budgetary boundary. For complex cases including sales of financial assets that result in gains (or losses) being recycled to profit and loss under applicable accounting standards, departments should contact the Treasury to discuss the appropriate budgeting treatment.
- 6.14 On disposal of assets, departments should also be aware of any financial assets created in the terms of sale. This is most commonly in the form of overage agreements (see Chapter 7 for details).

Stocks treated as capital budgets

When stocks are treated as capital in budgets

- 6.15 DAs do not treat purchases of stocks as investment in fixed assets. Rather, stock movements are treated as changes in current assets. Normally, budgets follow accounts in their treatment of stocks, and stocks are excluded from budgets until they are used, disposed of or written-off.
- 6.16 The net acquisition of stocks is an item of capital spending in National Accounts and increases TME. Therefore, it would be appropriate to score all net acquisitions of stocks in capital budgets. However, in the interest of keeping down compliance costs, we normally ask departments to follow the treatment in DAs.
- 6.17 Different budgeting rules are however appropriate where the item being acquired for stock would be the acquisition of a fixed asset if it were not

being acquired for stock. For example, land acquired by English Partnerships for reclamation and development scores as capital expenditure in capital budgets.

- 6.18 Similarly, if stock acquisitions are large, or set to increase significantly, it may be appropriate to score them in capital budgets.
- 6.19 Where departments are aware of stock acquisitions that might fall into the categories above, they should consult the Treasury on whether treatment in capital budgets would be appropriate.

How to score stocks treated as capital in budgets

- 6.20 Where stocks score in capital budgets they score like fixed asset transactions. The costs of purchase and improvement of land treated as stocks score in the capital budget. Disposal scores at net book value as a benefit in the capital budget. Any write-offs prior to disposal should be treated in accordance with the rules on impairments detailed in the chapter on resource budgets. Any profit / loss on disposal scores in RDEL.

Debtors and prepayments treated as capital in budgets

- 6.21 Normally, movements in debtors and pre-payments are treated as working capital and do not impact directly on budgets – see Chapter 3.

When long-term debtors and prepayments are treated as capital in budgets

- 6.22 Debtors and pre-payments are assets, and typically arise where a department has delivered goods and services, but is yet to receive payment, or where the department has pre-paid for goods or services. Changes in debtors generally represent a movement in working capital that in general terms only impacts on the budgeting framework if impaired or written-off.
- 6.23 However, in certain cases movements in debtors are more akin to net lending, for example in complex contractual scenarios over an extended timeframe (that is, more than one year). In these cases, the budgeting system scores movements in debtors in the capital budget of the department concerned. That scoring is intended to capture and control the impact of what is in effect lending on Public Sector Net Debt.
- 6.24 Accordingly, departments should treat as net lending in their capital DEL, the whole amount of transactions that meet both of the following criteria:
- first, the transaction is either
 - a) a long-term debtor or pre-payment (that is a debtor that will last over 12 months at the point that the pre-payment is made) or
 - b) a short-term debtor or pre-payment where there is an expectation that it will be renewed so that it is in effect long term
 - second, the total value of the debtor / pre-payment involved is above £20million (where there is a related group of pre-payments, the £20million limit applies to the group)
- 6.25 The scoring in such cases would be:

- capital budgets would score as net lending the full amount of such pre-payments
 - any increase in the value of the pre-payment as the discount unwinds scores as increased net lending (i.e. a cost)
 - as the pre-payment is utilised, the capital budget would take a benefit (i.e. negative net lending)
- 6.26 In other words, the treatment would be on a net basis like the treatment of loan principal.
- 6.27 Note that the transaction financed by the pre-payment would also score in budgets in the normal way. For example, a payment of rental costs scores in the resource budget in the year the services are consumed, whether prepaid or not. Pre-payments of PPP unitary charges would be treated in a similar way. In the case of capital budget transactions, the utilisation of the pre-payment would provide an element of budget cover.
- 6.28 Note that if the pre-payment is discounted the SoCNE will show a credit entry as that discount unwinds (the credit entry represents an interest payment from the holder of the pre-paid cash). Both these transactions score in the resource budget.

Capital grants to the private sector and abroad

- 6.29 DAs do not distinguish between current grants and subsidies and capital grants. However, the National Accounts do, with current grants and subsidies affecting the current balance and capital grants not. Therefore, departments have to distinguish between current and capital grants according to National Accounts principles. Current grants and subsidies score in the resource budget; capital grants score in the capital budget.
- 6.30 Capital grants are unrequited transfer payments, which the recipient has to use to:
- buy capital assets (land, buildings, machinery etc.) or
 - buy stocks or
 - repay debt (but not to pay early repayment debt interest premia)
- 6.31 Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants or subsidies.
- 6.32 Capital grants are imputed in the National Accounts (but not in budgets – which show loan write-offs) where debts are written-off “by mutual consent”, that is, where the debtor could repay the loan or debt but for policy reasons the creditor department chooses not to enforce the debt. See the section on impairments of financial assets in Chapter 3 for more information.
- 6.33 Payments of compensation to owners of capital goods destroyed or damaged by acts of war or natural disasters count as capital grants.

- 6.34 Major payments in compensation for extensive damage or serious injuries not covered by insurance policies may also count as capital grants – departments should consult the Treasury.
- 6.35 Pensions bulk transfer payments are treated as capital transactions in the National Accounts and pass through Resource budgets (albeit offset by the release of the provision) – see chapter on pensions.

Financial guarantees

- 6.36 Capital grants include payments to the private sector resulting from calls on financial guarantees. This applies to all financial guarantees and is not restricted to those financial guarantee contracts which are recognised by applicable accounting standards. The setting up of a financial guarantee contract is covered in Chapter 8.
- 6.37 Where the liability of a guarantee crystallises, or a cash payment is made, the cost will be recorded in CDEL as a capital grant.

Capital grants in kind donated

- 6.38 Where a fixed or intangible asset is gifted by a department, capital budgets will show no net impact. However, departments are requested to note that gifting an asset does not represent a write-off or a loss on disposal – gifts made in this manner are treated as capital grants in kind, they are a transfer of value from the department to a third party. To achieve the correct recording required for National Accounts, departments must make up to two equal and opposite entries:
- the disposal of asset, as a benefit to the capital budget equal to the net book value of the asset
 - a capital grant, as a cost to the capital budget equal to the disposal value
- 6.39 There are no resource consequences of this grant in budgets, but Departmental Accounts will show a cost in the SoCNE. The capital grant (and therefore the disposal of the asset) will be equal in size and timing as the impact in accounts.

Provisions in respect of capital expenditure

- 6.40 It is unusual for a department to need to record provisions in respect of capital spending that will be incurred; where provisions are taken up, they most commonly relate to capital grants the department is obligated to pay, or remedial work on fixed assets the department will need to carry out. In these cases, the take-up, revaluation and release will score to Resource budgets in the same way as provisions relating to resource spending. The utilisation will score in Capital budgets.
- 6.41 The example below illustrates the scoring of capital provisions and related expenditure.

Table 6.A: Example of Capital Provisions in respect of DEL spending

Budget impact			
	Year 1	Year 2	Year 3
Recognition of provision	+ £10		Resource AME
Revalue provision upwards		+ £2	Resource AME
Utilisation of provision			-£12 Resource AME
Make a payment			+£12 Capital DEL

- 6.42 Provisions are liabilities of uncertain timing or amount that, as a result of a past event, will more likely than not require the transfer of economic benefits from one party to another. In most cases incurring a liability will lead to a cost in the SoCNE of the party recognising the liability.
- 6.43 However in some highly unusual cases, the recognition of that liability is also the trigger point to recognise access to future economic benefits for the holder of the liability. In those cases it may be appropriate not to show a cost in the SoCNE. Instead the accounts would show an increase in fixed assets as well as the liability.
- 6.44 If a department believes that it should be capitalising their provisions in this way, they should seek clarification from their usual GFR team contact in the first instance.
- 6.45 In cases where HMT's GFR team have agreed that capitalising the provision is the correct treatment in the DA, the capital AME budget will score the recognition of the liability.
- 6.46 When the actual cash payment is transacted, this will score in capital DEL. The provision in capital AME will be released.

Resource budget implications

- 6.47 The resource budget scores the items that score in the SoCNE in the departmental accounts:
- depreciation of the asset
 - the unwinding of the discount

Creditors in respect of capital assets

- 6.48 No special treatment applies where a department has a creditor in respect of the acquisition of a capital asset. In other words, the capital expenditure scores in the capital budget at the same time as the asset is recognised in the accounts. The cash transaction is then a movement in cash and creditors in accounts and outside the budgeting framework.

Research and development costs

- 6.49 Departments should score as in capital budgets any development costs that are capitalised in departmental accounts. In addition, where costs (other than depreciation) do not meet the criteria to be capitalised in departmental accounts but meet the ESA10 definition of research and development, they should be recognised as capital spending in budgets. Departments will only recognise depreciation in budgets for assets recognised in departmental accounts.
- 6.50 The definition of Research and Development (R&D) under ESA10 is as follows:
- “Creative work undertaken on a systematic basis to increase the stock of knowledge, and use of this stock of knowledge for the purpose of discovering or developing new products, including improved versions or qualities of existing products, or discovering new or more efficient processes of production”.
- 6.51 When capitalising costs within the scope of the above definition departments should include all costs, other than depreciation, that are directly attributable to the activity and can be reliably measured. Further guidance on what falls within the ESA10 definition of R&D has been issued by the Treasury, and is replicated in Annex C.

MoD – single use military equipment and dual purpose equipment

- 6.52 Following implementation of ESA10, National Accounts no longer differentiates between single and dual use military equipment. Within ESA10 there is differentiation between (single use) military inventories and (single use) weapons systems. The former are durable military goods (i.e. ammunition, rockets, some missiles, bombs, torpedoes, etc.) and are treated as inventories. Spending on single use military inventories will be included within the capital DEL budget when the purchase of such equipment takes place. The value of inventories consumed during the year will be included with the resource DEL budget (and should be netted off in the capital DEL budget) as should any items that are written-off with a corresponding reduction in the CDEL budget.
- 6.53 Expenditure on weapons systems (such as ships, planes, tanks and other large single use capital items) is to be treated as capital spending in National Accounts like the spending on dual use military equipment discussed below. Spending on these items should be recorded on a staged payment basis in line with IFRS. In the National Accounts, these assets will be depreciated using a similar methodology to other balance sheet assets.
- 6.54 Expenditure on dual use military equipment is treated as capital in National Accounts. Dual assets are those that could be used by civilian organisations for the production of goods and services such as airfields, docks, roads and hospitals. Expenditure on almost all fixed structures will be treated as capital expenditure in the National Accounts as is that on types of equipment which have alternative non-military uses - such as transport equipment, computers and communication equipment and hospital equipment.

Chapter 7

Income and the Capital budget

Income that may normally be set against budgets

7.1 The following items of capital income may normally be set against capital budgets within the terms set out below. Only income in connection with DEL programmes scores in capital budget DEL:

- income from capital asset sales – the book value (not including any profit/loss on disposal) scores as income in the capital budget
- income from sale of stocks that score in the capital budget (see section on stocks in CDEL in Chapter 6)
- capital grants from the private sector including developer contributions and capital donations
- income obtained from National Lottery distributing bodies that finance capital expenditure
- capital grants from the EU
- capital Royalties
- privatisation proceeds (always in AME not DEL)
- income received from exercising an overage (claw-back) agreement
- income received from disposal of financial assets (where disposal would benefit PSND)

Further information on certain types of income

Disposal of capital assets

7.2 When a department or ALB disposes of an asset, the net book value of this asset scores as negative capital DEL. Any profit or loss on disposal, i.e. the difference between net book values and actual sale value, scores in the resource budget as either positive (loss) or negative (profit) DEL.

7.3 The level of profit on disposal scoring in resource DEL is limited to a maximum of £20million or 5% of the net book value of the disposal, whichever is the lower. In such cases, departments should discuss with Treasury spending teams the treatment of income above this level; Treasury may require some or all of the additional profit to be retained in capital DEL. It is anticipated that such occurrences will be very rare, since regular

revaluation of assets before disposal limits the difference between book value and sale proceeds.

Income from National Lottery distributing bodies

- 7.4 The government's income from the National Lottery is a tax. The spending by the National Lottery distributing bodies counts as expenditure in AME.
- 7.5 Where a government department or ALB that is not a National Lottery distributing body obtains income from a distributing body to finance spending in the capital budget DEL it should take the income into budgets as negative capital budget DEL.

Capital grants from the private sector and abroad

- 7.6 Capital grants are unrequited transfer payments, which the recipient (in this case government) has to use to:
- buy capital assets (land, buildings, machinery etc.)
 - buy stocks or
 - repay debt (but not to pay early repayment debt interest premia)
- 7.7 Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants or subsidies.
- 7.8 Departments should note that this definition does not match the accounting definition of a grant specified for capital purposes, as set out in the FReM.
- 7.9 Receipts of capital grants from outside of the public sector should be treated by departments as negative CDEL.
- 7.10 Where a department uses a capital grant to buy capital assets, the depreciation of those assets should exceptionally be recorded in AME. See section in chapter 2 on depreciation for further details.

Capital grants in kind received

- 7.11 Donated assets and gifts of capital assets should be recorded in the same way as an asset purchased by way of a capital grant. Budgets will show two equal and opposite transactions in the CDEL budget:
- a capital grant equal to the market value of the asset which should be recorded as negative CDEL
 - purchase of the capital asset at market value, this will score as positive CDEL
- 7.12 Where a department receives an asset by way of donation, the depreciation of the asset should exceptionally be recorded in AME. See section in chapter 3, paragraph 3.16, on depreciation for further details.

Capital grants from the EU

- 7.13 Departments are reminded that income from the EU Budget is not free to the UK. The budget is funded by Member States, including the UK. Income

received from the budget incurs a cost to the UK Exchequer, both by increasing the UK's gross contribution to the budget and by reducing the UK's budget abatement. As set out in Chapter 4, the Treasury may request Departments to cover any costs to the Exchequer from their DEL budgets. This will apply whether the capital funding is inside or outside of accounts.

Royalties – capital or current?

- 7.14 It may be difficult to tell whether a one-off payment covering a number of years is for the sale of an asset or an upfront payment in respect of a number of years' royalty. Similarly, it may be hard to test whether a payment spread over a number of years is for the sale of an asset or a current royalty.
- 7.15 The tests used by commercial accountants will be a guide as to whether a capital asset has been sold or rented out. For larger cases, departments should consult the Treasury to ensure that they are treating the income in accordance with the National Accounts.
- 7.16 In general:
- a sale leading to a current receipt - royalty for the use of an asset - would be a sale offering the user a right to use the asset for a period of time, but underlying ownership of the asset or resource would stay with the vendor. Changes in the value of the asset would not normally affect the user as they would not be able to sell on their rights but
 - capital income - sale of an asset - would be when the buyer had obtained:
 - all significant rights or other access to benefits relating to that asset
 - all significant exposure to the risks inherent in those benefits
- 7.17 Ownership rights would typically include unimpeded use of the asset, right to resell the asset and benefit or suffer from changes in the value of the asset. Typically, capital income comes as a single receipt at the time of sale, but the cash receipt may come in tranches (deferred consideration).

Overage agreements

- 7.18 When a department disposes of surplus property, it will enter into an agreement with the purchaser; it is common for these agreements to contain a clause on overage / claw-back. The intention of an overage clause is to allow the department to gain some benefit if the purchaser should sell the property on in the future for a profit above that envisaged at the time.
- 7.19 This clause represents a financial asset and should be recorded on the department's balance sheet accordingly. The amount and timing of this financial asset will be subject to uncertainty, and departments may find it difficult to value. In these circumstances departments should refer to accounting guidance and use the same valuation in budgets.
- 7.20 Since this financial asset comprises part of the value of the property being disposed of, in effect, allows the public sector to retain part of the value of the property. So, on disposal the scoring in CDEL should be:

- total book value of the disposed asset (negative CDEL)
- profit/loss on disposal of the asset (negative / positive RDEL)
- the Open Market Value (OMV) of the overage agreement (positive CDEL)

7.21 The accounting for revaluations and impairment of assets received in overage agreements is the same for other investments. When the financial asset is disposed of, either because of maturity or open-market sale, the amount received by the department will score as negative CDEL.

Timing of recording of income

- 7.22 In general, departments should record capital income for budgets at the same time as they record it in the Departmental Accounts.
- 7.23 Income from capital transfers (i.e. grants, developer contributions and donations received) other than income from the EU should be recorded for budgeting purposes at the time that the receipt, is due to be received. That may be different from the recording in DAs if exceptionally the accrual of the income has been related to work done at a quite different time.
- 7.24 Capital transfers from the EU should be recorded for budgets in line with DAs. Departments are encouraged, where appropriate, to accrue income from the EU to match the payments that the income finances. The reason for the different treatment is that where income from the EU finances a payment to a third party it is treated for the National Accounts as a direct payment from the EU to the third-party recipient. By accruing the income to the date of the payment it is easier to derive the National Accounts number.

When departments may retain additional negative DEL income

- 7.25 In some cases capital income does no more than cover the costs of replacing the asset disposed of. For example, a department might sell one office block and spend the money on moving into another that suits it better.
- 7.26 In other cases, income can be large in comparison with the needs for replacement, or there may be no replacement. Examples are selling an invention in the open market, or when a department moves from an expensive building into a cheaper one. In these cases the government has to balance two considerations:
- departments should be encouraged to obtain such income by being allowed to retain and spend it and
 - government funds should be prioritised across the whole range of spending to where they would do most good
- 7.27 And we need to keep the rules simple.
- 7.28 Departmental budgets are set in the SR net of negative CDEL income. The expected level of negative CDEL income should inform the SR settlement. So, the SR process should be used to identify the expected level of department's income, any expected changes, and an assessment of the potential for new income. The SR settlement will include an explicit statement of the expected level of income in the years of the SR period.

- 7.29 Departments will be allowed to keep the negative DEL income that they obtain in the SR period up to the amount that was taken into account in the SR. Income cannot be predicted wholly accurately, and the Treasury wishes to encourage departments to find new income streams where appropriate. Departments may therefore in any year, where no other retention limit exists, retain negative CDEL income up to 10% above the level envisaged for that year as part of the SR settlement and set out in their DIS without an adjustment to budgets.
- 7.30 If departments expect to obtain more income than provided for above, they should talk to the Treasury about whether they may retain all or part of the income without an adjustment to budgets. When considering proposals, the Treasury will wish in particular to encourage cases where the additional income represents the results of positive management action, as opposed to under-forecasting.

Chapter 8

Financial Transactions

- 8.1 Financial transactions are sometimes called net lending or policy lending. It includes loans given and shares purchased, net of repayments and sales of shares. Policy lending transactions are not capital expenditure in National Accounts as they are financial, as opposed to non-financial (i.e. spending) transactions. Policy lending excludes financial assets acquired to manage the department's liquidity such as bank deposits and balances in the Government Banking Service (GBS). If departments are unsure if the policy would be a financial transaction or other financial instrument, they should contact HMT for guidance. Budgeting guidance on other financial instruments that are not financial transactions can be found in chapter 3.
- 8.2 This chapter:
- gives an overview of financial transactions
 - details specific examples of transactions
 - provides guidance on budgeting and accounting treatments
 - describes some of the rules in respect of certain transactions in more detail
 - sets out guidance on the timing of recording transactions
- 8.3 Policy lending to the private sector adds to Public Sector Net Debt. Consequently, net lending to bodies outside the budgeting boundary scores to a department's capital budget even though the transactions are not classified as capital in National Accounts.
- 8.4 Policy lending excludes financial assets acquired to manage the department's liquidity such as bank deposits and balances in the Government Banking Service (GBS).
- 8.5 Financial transactions form a separate ring-fence within CDEL budgets. This is because unlike most general capital expenditure they only affect PSND and not PSNB. Departments may not switch budget cover out of the financial transactions ring-fence without the explicit approval of the Chief Secretary
- 8.6 There are three ways that financial instruments can be measured at initial recognition as set out in IFRS 9. These are
- financial assets measured at amortised cost (AC)
 - financial assets measured at fair value through other comprehensive income (FVOCI) and

- financial assets measures at fair value through profit and loss (FVPTL)

Loans other than student loans

- 8.7 Loans are payments made to another party where the expectation is that the payment will be wholly repaid, normally with interest, and normally to a fixed regular payment schedule. In certain circumstances, for policy reasons, some loans may be expected to result in a permanent transfer to the loan recipient. The budgeting system seeks to ensure that such transfers are controlled and where appropriate charged to the department designing and operating the loan scheme.
- 8.8 Loans need to be distinguished from deposits:
- loans include any debt-based financial assets acquired by the department, which are not treated as liquid in the National Accounts. Typically, these assets occur where the department lends money as an act of policy. So, for example, we lend to students or to certain sorts of business because we wish to support them in this way and
 - deposits are also a form of lending, but are made because the public body has spare cash and needs to put it somewhere. In National Accounts deposits are treated as liquid assets. Typically, deposits are placed with a bank in order to obtain the maximum risk-weighted rate of interest. There is no intention to support the institution holding the deposit
- 8.9 The making and withdrawing of deposits do not score in budgets, though deposits themselves may attract interest income which would score in budgets.
- 8.10 The budget treatment of a loan is:
- the resource budget will score
 - a) interest income (negative Resource DEL)
 - b) arrangement fees (negative resource DEL)
 - c) impairments (resource AME)
 - d) expected credit loss (resource DEL)
 - e) write-offs (resource DEL)
 - the capital budget will score
 - f) net lending (i.e. transactions in loan principal)
 - g) capitalised interest as appropriate
- 8.11 Normally, lending scores in DEL. Where exceptionally a loan scheme may score in AME (e.g. Social Fund), the associated transactions will score in resource AME. However, an exception to this is if the debt is written off by mutual consent, i.e. a policy decision has been taken not to pursue the debt. In such cases it scores in DEL, regardless of the initial loan being in AME.

Expected Credit Loss model

8.12 Under the Expected Credit Loss model, an entity calculates the allowance for credit losses by considering on a discounted basis the cash shortfalls it would incur in various default scenarios for future periods and multiplying the shortfalls by the probability of each scenario occurring. The allowance is the sum of these probability weighted outcomes. So the ECL represents possible outcomes weighted by the probability of their occurrence.

Impairments and revaluations of financial transactions

8.13 Financial transaction budgets are presented on a net basis, unless specifically stated otherwise and ring-fenced within CDEL. This means that income from repayments of loans may be recycled by departments, as long as the annual net financial transactions total is not exceeded

8.14 Impairments that relate solely to the application of the expected credit loss model will score to the DEL budget. Where departments apply the expected credit loss model, the forecast used should be robust and agreed with Treasury. When a department applies the ECL model, Treasury expects departments to offset the increase with a reduction in their DEL elsewhere – i.e. there will be no increase to RDEL budgets as a result of the ECL model being applied. See table below for an example

Table 8.A: Table Example of charges to DEL budgets for loans with ECL provisions

	CDEL (ringfenced FT)	RDEL
Creation of Loan	£100	
Initial expected credit loss valued at 10%		£10 non-cash (but no increase in overall RDEL control totals, these charges to the RDEL budget have to be absorbed by adjusting spending elsewhere)
ECL revalued at 20%		£10 non-cash (but no increase in overall RDEL control totals, these charges to the RDEL budget have to be absorbed by adjusting spending elsewhere)
ECL Crystallised		(£20) non-cash (but no increase in overall DEL as this covers half the Write-off)
Write-off of loan – now at 40%		£40 non-cash (£20 offset by the switch from the ECL)

Writing off loans

- 8.15 Where a department writes-off a financial asset such as a loan, we still need to distinguish between debts written off by mutual consent and those extinguished unilaterally. The same principles apply as set out in chapter 3. Where loans are written off by mutual consent and write offs are within the agreed ECL – departments should expect to be given cover in DEL budgets. Where this is above the ECL, departments will be expected to absorb the costs within existing budgets
- 8.16 Some financial transactions qualify as Official Development Assistance (ODA). The rules that govern the statistical reporting of ODA do not affect the recognition of measurement or flows as recorded in departmental budgets.

Student loans

Impairments

- 8.17 Because of the soft terms on which student loans are offered, the departments and devolved governments who issue student loans must calculate the impairment resulting from the cost at which the loans are delivered.
- 8.18 **Subsidy impairment** – Student loans are offered at a loan rate lower than the government’s cost of capital, as such over the lifetime of the loans there is an effective subsidy. The main student loans impairment is to account for this subsidy and will be valued as the difference between the expected income from the loans and the costs of delivering them the Government’s cost of capital (HM Treasury’s financial instrument rate)
- 8.19 **Impairment relating to policy write-offs** – The second impairment is to account for “policy” write-offs. When loans are issued, it is the policy of the department that these will be written-off in certain circumstances (e.g. death or disability of the debt owner, or age of the debt). These amounts are recognised at the point the loan is made. Where these debts are deemed to be policy write-offs, they will be recorded as capital transfers in the National Accounts at the time the loan is formally written-off; there is however no transaction in Departmental Accounts or budgets.
- 8.20 The arrangements described in this chapter for student loans are only applicable to loans owned by government and do not apply to loans which have been sold (such as the 1998-99 student loan book).
- 8.21 In August 2013, loans were introduced in further education for learners aged 24 and above, studying courses at level three and above. The following guidance applies to Further Education student loans, Higher Education student loans currently subject to a sale (Pre-2012 reform Income Contingent Repayment student loan book) and Higher Education student loans not subject to a sale. The following budgeting guidance will apply equally to England and, where appropriate, the Devolved Administrations.
- 8.22 In **period one**:
- the Treasury will set a target impairment for loans

- cash value of the loans issued are a charge on capital AME
- when loans are issued the impairments are charged to RDEL. The budget for this spending is ring-fenced within RDEL, which may not be reprioritised to other RDEL or CDEL spending, although transfers across from non-ring-fenced RDEL are allowable without Treasury agreement

8.23 In **period two**, and subsequent periods, budgets will record the following impacts:

- The interest receivable from the loans scores as a benefit to Resource AME. This is irrespective of the fact that no cash may have been received
- The interest receivable will be capitalised and a cost to Capital AME. This is equal and opposite to (4), and reflects the fact that capitalising interest is effectively new lending
- The recalculation of the impairment – i.e. the unwinding of the discount – scores as a benefit to Resource AME. The discount is created and unwound at the Government’s long term cost of borrowing (HM Treasury’s financial instrument rate)

8.24 In **period three**:

- Repayments of principal, or of capitalised interest, are treated as negative Capital AME

Revaluation of impairments

Further Education student loans and Higher Education student loans currently subject to a sale

8.25 Any revaluations of the impairment that occur periodically because the original values were based on forecasts that have turned out to be incorrect, or because of updates made to the student loans model, and which go beyond the target impairment set by the Treasury will be charged to RDEL, in the same way that the original impairment is charged to DEL.

Higher Education student loans not subject to a sale

8.26 Any revaluations of the impairment that occur periodically because the original values were based on forecasts that have turned out to be incorrect, or because of updates made to the student loans model, and which go beyond the target impairment set by the Treasury, will be charged to DEL over a 30-year period (unless departments decide to cover the costs from their DEL over a shorter timeframe). One thirtieth of the total cost will be charged to non-ring-fenced RDEL each year for 30 years, with the residual amount each year RAME. The net effect of these entries in RDEL and RAME each year will equal the annual impairment charge due to these forecast changes. Revaluations of the impairment that occur for any other reason will be charged to RDEL in full and in-year, in the same way that the original impairment is charged to RDEL.

8.27 In all cases any adjustments to the impairment arising from a change to the discount rate, where there is a change in accounting policy, will be treated

as a classification change in budgets. Such adjustments will be ring-fenced within RAME.

Equity transactions

- 8.28 Purchase and sale of shares or other equity in private sector bodies scores in capital DEL.
- 8.29 Note that purchase or sale of shares will affect the amount of control the public sector has over the corporate actions of a body. Where this transfer of control is significant then departments should consider the impact on classification of the body – see Chapter 1 for details of classification.

Privatisation proceeds

- 8.30 Privatisation proceeds score in AME, even where the asset or business being sold was on a DEL programme.
- 8.31 Sale of shares in a **private sector PPP** is the disposal of a financial asset by the department. As a form of privatisation, the income scores as a benefit to the Capital budget AME.
- 8.32 Sale of shares in a **public-sector PPP** increases the public sector's financial liabilities; this increase does not affect net debt as equity liabilities are excluded from measurement of PSND. As above, the income scores as a benefit to Capital AME.

Financial guarantee contracts

- 8.33 Where, under applicable accounting standards, departments are judged to have entered into a financial guarantee contract the treatment in budgets should generally follow the accounting. Budgeting will follow the resource accounting treatment for the initial recognition, and revaluation of these contracts on balance sheet.
- 8.34 Since neither contingent liabilities nor provisions are recorded in National Accounts, movements in guarantee contracts will have no impact on the fiscal position unless they are called. Financial guarantee contracts impact on budgets in the following ways:
- an initial Resource AME cost when the guarantee is provided; this will be recorded as the balance sheet value of the contract
 - a benefit to resource AME when the guarantee fees are recognised
 - where amortisation or revaluations of the guarantee liability go through the SoCNE they will be recorded as further Resource AME benefits / costs
 - the utilisation of the guarantee will score as a benefit in resource AME
 - when the contract is called, any payments out will score in departments' capital DEL budgets
- 8.35 For details on pay-out against financial guarantees see separate chapter on capital budgets.

All financial guarantees

- 8.36 Regardless of whether Departmental Accounts recognise a financial guarantee contract, any new financial guarantees or letters of comfort should be given the same consideration as entering into contingent liabilities as set out in Chapter 3.
- 8.37 Departments must also show that the budgetary implications of the guarantee will be affordable within existing budgetary allocations. At the point of making the guarantee, departments must make allocations in plans allowing sufficient CDEL to cover payments out against the guarantee. In particular departments should make an assessment of the probability distribution of different levels of pay-out and ensure that the planned CDEL is sufficient to cover this pay-out with a high degree of confidence.
- 8.38 Where pay-out against the guarantees will be outside of the current SR period, departments should discuss handling with Treasury.

Exchange rate movements

- 8.39 Departments may engage in transactions denominated in a foreign currency. Where there is a timing difference between the transaction being recorded in accounts and the cash being paid, any movements in the exchange rate with the foreign currency will affect the value of the creditor/debtor.
- 8.40 Departments should record movements in exchange rate as follows:
- at the point the income/expenditure is recognised in accounts, departments should record the impact in AME budgets
 - when exchange rates fluctuate the revaluations of the debtor/creditor should be recorded as income/cost in AME budgets with the same timing and value as shown in accounts
 - when the cash is paid there is no impact in the SoCNE, but the cumulative AME transactions should be switched to the DEL budget
- 8.41 Departments have the option to hedge against exchange rate risks to protect their budgets against adverse movements. Guidance on recording hedging is included below.

Exchange rate hedging

- 8.42 Where departments carry out transactions in foreign currencies, their expenditure or income will be subject to the risk of exchange rates moving unfavourably. Departments have the option of hedging against this risk to gain certainty on outcomes, and mitigate against the risk of unfavourable movements in the exchange rate. Managing Public Money contains more detail on the appropriateness of hedging.
- 8.43 National Accounts treats a forward contract used in a hedge in the same way as any other financial instrument. So any revaluations over the life of the contract would score to the revaluation account; and at maturity of the contract all flows are recorded as financial transactions.

- 8.44 In order to maintain hedging as a useable option in budgets, the budgeting does not follow the National Accounting treatment in this case. Instead the benefits / costs of a hedge are realised when the department incurs the associated expenditure or receives the income.
- 8.45 The following items must be recorded in budgets for exchange rate hedges:
- capital DEL
 - a) cost of purchasing the initial forward contract (usually this will be zero)
 - b) any capital expenditure funded through the forward contract. This should be valued at the daily spot rate at the point of purchase
 - c) the difference between the value of b and the value of the capital expenditure at the forward contract rate
 - resource DEL
 - d) any current expenditure funded through the forward contract. This should be valued at the daily spot rate at the point of purchase
 - e) the difference between the value of d and the value of the current expenditure at the forward contract rate
 - resource AME
 - f) revaluations of the contract whilst held by the department (for fair-value hedges); and transfers from the hedging reserve to the SoCNE on maturity (for cash-flow hedges)
- 8.46 This recording is necessary to capture the correct treatment in both budgets and National Accounts. A basic worked example of the recording of an exchange rate hedge is available in Appendix 1.
- 8.47 When hedging against a specific cost or income stream, departments may find that the timing of the budgeting impacts for exchange rate moves are different to the timing of the hedging impacts. Where departments find this creates pressure in their budgets they should discuss the correct treatment with Treasury.

Appendix 1 to chapter 8: Example exchange rate hedge

Date	Transaction	Exch rate £1 =	Budgeting Impact		
			RDEL (000's)	RAME (000's)	CDEL (000's)
1 April	Enter into contract to buy \$200,000 on 1 January at \$2 = £1	\$2			0
1 July	Exchange rate changes	\$1.50		-33.3	
1 October	Exchange rate changes	\$1.75		19	
1 January	Forward contract matures	\$1.75	-3.6		-10.70
	Spend \$150,000 on capital procurement				85.7
	Spend \$50,000 on current procurement		28.6		
	Totals		25	-14.3	75

Note: the £33,300 credit to AME represents the gain on the forward contract from the movement in the exchange rate. The subsequent £19,000 charge represents the loss on the subsequent exchange rate move. The ultimate credits to RDEL and CDEL represent the net gain, split by the ultimate use of the cash. In the example, the gain on the contract is £14,300 of which £3,600 has been used in RDEL and £10,700 in CDEL, matching the split of the expenditure of the forward contract was bought to cover.

Appendix 2 to chapter 8: Example revaluation of impairments – higher education student loans not subject to a sale

- 8.48 HM Treasury have set a figure of 28% as the target level of impairment, for loans issued which are not subject to a sale. A revaluation of the impairment had indicated that the level set will actually be above the target set by HM Treasury. The amount of this additional impairment is £30million. This sum (£30million) will be charged to the department's budget over a period of 30 years.
- 8.49 In the first year £1million (1/30th) will be charged to RDEL and the balance charged to RAME, in the second year a further £1million will be charged to RDEL, with the charge to RAME being reduced to £28million (effectively an AME/DEL switch). This treatment will continue until the full impairment has been charged to RDEL.

Budgetary impact of Additional Impairment beyond target						
Additional Impairment		Year 1	Year 2	Year 3	Year 4	Year 30
£30 million	DEL	£1million	£1million	£1million	£1million	£1million
	Cumulative AME	£29million	£28million	£27million	£26million	£0

- 8.50 In each year additional loans will be made which will possibly impact on the level of additional impairment to be charged.

Year	Additional Impairment	DEL	AME
Year 1	£30million	£1million	£29million
Year 2	£30million	£2million ¹	£28million
Year 3	£60million	£4million	£56million
Year 4	£60million	£6million	£54million
Year 30	Assuming no further impairments	£6million	-£6million
Year 31		£5million	-£5million
Year 32		£4million	-£2million
Year 33		£2million	-£2million

¹ Represents 1/30th of the existing impairment plus 1/30th of the "new" impairment.

Chapter 9

Arm's Length Bodies

9.1 This chapter applies to the budgeting of all bodies in the central government sector (as defined by the Office for National Statistics) other than government departments (including executive agencies), and bodies referred to in the following two paragraphs. An ALB could therefore be:

- an executive or advisory NDPB
- other advisory bodies
- a tribunal
- a commission
- expert committees
- an inspectorate
- an office holder etc

9.2 The term ALB refers to most non-government departments regardless of whether or not they have been classified by the Cabinet Office. This chapter does not apply to **public corporations**. Most **trading funds** are public corporations, but some may be central government bodies. This chapter applies to any trading fund that is a central government body.

Overview

9.3 ALBs' resource consumption and capital expenditure score in the departments' resource and capital DEL in the same way as the department's own spending. So departments should normally use the output from the ALB's own accruals accounts as the basis for working out the ALB's impact on budgets.

9.4 Budgets include expenditure that ALBs finance themselves from income that is not negative DEL, use of reserves or borrowing (where, exceptionally, permitted).

9.5 Grants and grant-in-aid paid by the department and any other financing facilities made available by the department are outside the department's budget. This treatment will align with the accounting which eliminates intra-group transactions between a department and its ALBs. The financing of ALBs through grant-in-aid is automatically excluded from Estimates and budgets, but other intra-group transactions, such as the purchase of shared services by an ALB from the parent department, will need to be removed by the department and not recorded on the OSCAR database. Full guidance on

the consolidation of intra-group transactions can be found in the Supply Estimates Manual. A link to the manual can be found in Annex E.

- 9.6 Following the 2010 Spending Review, ALBs were set administration budgets; these should be scored in the same way as the department's own administration budgets. See Chapter 5 for more detail on administration budgets.

Subsidiaries

- 9.7 Where an ALB has a subsidiary that is itself a body in the central government sector that subsidiary will be consolidated with the ALB for budgeting purposes.
- 9.8 Where an ALB has a subsidiary that is a public corporation, that subsidiary will score in budgets like public corporations accountable directly to Ministers and the public corporation will impact on the parent department's overall DEL. Departments may place the DEL impact in the DEL allocated to the ALB.
- 9.9 Where an ALB enters into a joint venture, departments need to be clear whether the joint venture is classified to the public or private sector. If to the public sector, departments need to be clear where the budgeting impact falls.

Planning and monitoring

- 9.10 Departments are expected to set their ALBs firm resource and capital DEL budgets for the year ahead. Departments are generally advised to set firm or indicative budgets for forward years to help ALBs plan.
- 9.11 Departments should monitor in-year both:
- the ALB's draw-down of cash grant-in-aid
 - the ALB's expenditure in budgets

ALB income and receipts

- 9.12 The ALB's impact on the department's resource budget DEL is made up of its gross resource consumption less its negative DEL income. Similarly, the capital budget DEL is net only of negative DEL income. Whether ALB income / receipts are negative DEL follows the same rules as for departmental receipts (see separate chapters). So, for example, charges for the sales of goods and services are typically negative DEL and the receipt of taxes are typically not. Expenditure financed in cash terms by non-budget income scores gross in budgets.
- 9.13 Where an ALB obtains income that is not negative DEL, the department may arrange for the ALB to pass the cash to the department for surrender to the consolidated fund. Alternatively, the cash may be retained by the ALB and offset the ALB's need for cash grant-in-aid. Either way, income that is not negative DEL does not convey spending authority.
- 9.14 Where a levy-funded body over recovers income due to an incorrectly set levy, any excess income should be classified as creditors as it should be

returned to the levy payers in due course. Such excess does not therefore form part of the budgetary income of the body.

Borrowing and use of reserves

- 9.15 Normally, ALBs are not allowed to borrow. Where exceptionally they are allowed to borrow the spending financed by borrowing scores gross in budgets. This applies whatever the source of borrowing (department, market, European Investment Bank). The cash raised by borrowing does not score as negative DEL.
- 9.16 Use of reserves – i.e. the run-down of savings – has the same effect overall as borrowing. So expenditure financed by the use of reserves counts as spending in budgets.

Corporation Tax

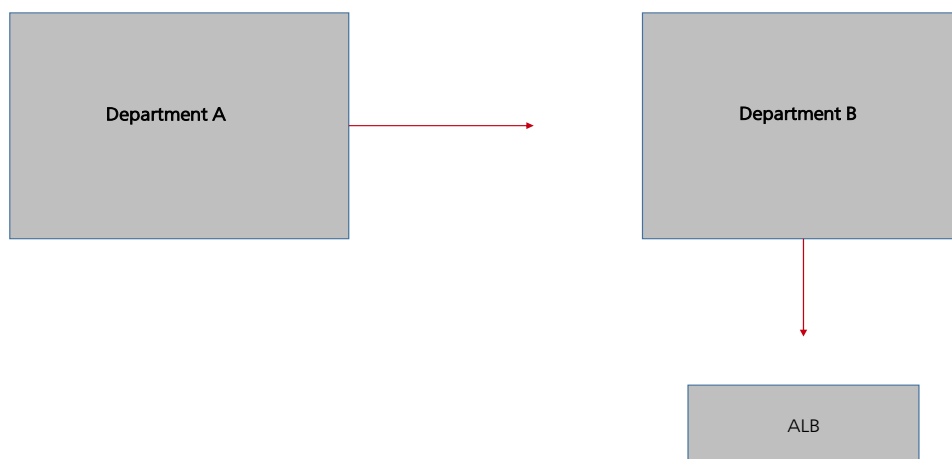
- 9.17 Exceptionally, some ALBs pay Corporation Tax. Such payments are resource AME, because payments within central government of taxes on income are consolidated out in National Accounts. ALBs should not devote resources to tax minimisation or tax planning.

Depreciation

- 9.18 Depreciation charges may only be recorded in AME for grant funded assets where the grant originated from the sponsoring department.

Co-funded ALBs

- 9.19 This section applies to all grants from a central government body to an ALB, regardless of whether they are grant-in-aid or capital. It does not apply to bodies purchasing services from ALBs.
- 9.20 Where an ALB receives grant from more than one department then the following budgeting treatment will apply.
- 9.21 Department A makes a voted cash payment to department B. It is for the departments concerned to decide how the ALBs costs should be apportioned, and therefore how large department A's payment should be. Department B is the sponsor of the ALB and pays it a single grant-in-aid, including an element in respect of the payment made by department A. Department B takes responsibility for the budgetary impact of the ALBs expenditure. The ALB's expenditure should score in department B's budgets (Resource / Capital and DEL / AME as appropriate). Department B's grant-in-aid to the ALB scores outside the budget in the normal way. Department A's payment to department B scores in department A's DEL as a cost, and in department B's DEL as a benefit – thereby sharing the budgetary impact.



9.22 In the numerical examples:

- department A contributes £100. There are no AME costs associated with these activities and
- the ALB's total spending in DEL from all sources is £950 and it needs cash of £850.

Department A's budget	Department B's budget		Department B's grant-in-aid to the ALB
	Departmental element	ALB element	
£100	-£100	£950	£850

9.23 This treatment will apply to all grants that move between CG budgeting boundaries. So, in the example above department A could just as easily be replaced by ALB A – the grant would still be required to go through department B.

Certain levy-funded bodies

9.24 The spending of a number of levy-funded bodies, defined against the criteria in Appendix 4 to Chapter 1, is in AME, rather than DEL.

NHS Trusts

9.25 All NHS Care Commissioning Groups and NHS Provider Trusts are central government bodies – this includes Foundation Trusts. CCGs are recorded in budgets in the same way as NDPBs, as set out earlier in this chapter. The budgetary treatment of NHS Provider Trusts (including Foundation Trusts) is set out below.

Resource budget

- 9.26 The departmental resource DEL and AME budgets score the majority of transactions in the same way as any ALB. The only items where the treatment of a transaction is different to the standard ALB model are:
- CCGs and DH's payments to NHS Provider Trusts are recorded as procurement in accounts but for National Accounts and budgets they are classified as grants
 - the element of procurement that covers Provider Trusts' depreciation charges scores in resource DEL. Unlike other depreciation charges, NHS Trust depreciation is not included in any ring-fence
 - corporation tax paid by Provider Trusts scores as a cost in RDEL budgets

Capital budget

- 9.27 All capital transactions of Provider Trusts are treated in the same way as capital transactions of ALBs. Capital transactions between the Trust and the department score in the same way as transactions between an ALB and its sponsor department.
- 9.28 For further information on the treatment of PPP in budgets, please see the chapter on PPP.

Devolved Administrations

- 9.29 NHS Trusts in Wales and Northern Ireland score in budgets in the same way as ALBs. NHS Trusts no longer exist in Scotland, and funding is channelled through NHS and special health boards.

Chapter 10

Support for Local Authorities

Overview

- 10.1 Departmental budgets include government support for local authorities. They do not include self-financed local authority spending.

Resource budget

- 10.2 The resource budget includes current grants to local authorities.
- 10.3 Departmental Accounts (DAs) do not distinguish between current and capital grants. Both go through the SoCNE. National Accounts do distinguish between current and capital grants, and the budgeting treatment follows the National Accounts distinction, with capital grants going through the capital budget.

Capital budget

- 10.4 Capital budgets include:
- Supported Capital Expenditure (Capital)
 - Supported Capital Expenditure (Revenue)

Supported Capital Expenditure (Capital)

- 10.5 Supported Capital Expenditure (Capital) is the local government finance term for capital grants. Capital grants may be distinguished from current grants in that capital grants have to be used by local authorities to:
- buy capital assets (land, buildings, machinery etc.)
 - buy stocks
 - pay capital grants to an individual or enterprise in the private sector or to a public corporation
 - acquire long-term financial assets, or financial assets used to generate a long-term return
- 10.6 Where grants are paid that may be used at the recipient's discretion either on capital or on current expenditure they should be treated as current grants.
- 10.7 Payments of compensation to local authorities for capital goods destroyed or damaged by natural disasters count as capital grants.

Supported Capital Expenditure (Revenue)

- 10.8 Supported Capital Expenditure (Revenue) (SCE(R)) is the local government finance term for the amount of borrowing which government is prepared to support. A stream of current support to cover local authority borrowing to this level is provided as non-ring-fenced revenue as part of the Revenue Support Grant Settlement. Ongoing revenue support for specific local government PPP projects that are on-balance-sheet for National Accounts is also SCE(R).
- 10.9 Departmental budgets score the capital value of SCE(R). The current support is paid by DCLG (local government) as part of the Revenue Support Grant.
- 10.10 For certain outturn years, departments score the capital values of the predecessor regime, credit approvals.
- 10.11 Self-financed borrowing by local authorities under the prudential borrowing regime that is not supported by central government does not score in departmental budgets.

Debt repayment grants

- 10.12 Grants to enable local authorities to repay debt principal score in capital AME budgets. Any payment of such a grant requires specific Treasury approval. Normally, approval of such a grant will be associated with offsetting budgetary adjustments.
- 10.13 Where a department gives a grant that covers both debt repayment and the payment of any associated debt interest premia by the local authority to the debt provider the two elements of the grant should be separated. The element that covers premia should score as a current grant in DEL budgets.
- 10.14 Where a local authority uses a debt repayment grant to repay debt and receives a discount on that debt because of that then:
- in the majority of cases the department will have paid a grant to the local authority that was less than the amount of debt principal. The whole of the grant would count as a debt repayment grant
 - if the department shares in the value of the discount in the form of a payment from the LA this income will score as negative capital AME

Arms Length Body support to Local Authorities

- 10.15 ALBs' support to local authorities is treated in the same way as support for local authorities provided by departments.

Support to LA PPP projects including PPP arrangements

- 10.16 As part of the SR settlement departments are allocated a specific amount of RDEL to fund the ongoing cost of local authority PPP projects

Public Corporations accountable to Local Authorities

- 10.17 Transactions between local authorities and their public corporations are recorded as transactions between those two sectors. If a department provides grants to a local authority which it in turn uses to support its public corporations then the transaction at the departmental level should be recorded as a transaction between central and local government, in resource or capital budgets as appropriate.
- 10.18 Similarly, where a department provides SCE(R), which is for ultimate use by a public corporation accountable to a local authority it will score in the department's budget in the usual way.

Capitalisation directions

- 10.19 DCLG (local government) and the devolved administrations have the power to issue directions to local authorities to capitalise certain expenditure. Such directions do not change the nature of the expenditure from current to capital. Rather, broadly, they allow local authorities to borrow or use capital receipts in order to finance current spending.
- 10.20 There may be arguments for allowing local authorities to spread the incidence of certain lumpy current expenditure payments such as large redundancy payments in order to smooth the path of Council Tax. However, capitalisation directions run contrary to Treasury's position to constrain PSNB.

New burdens on Local Authorities

- 10.21 Where a department considers that it requires additional resources to fund burdens on local authorities, it is responsible for securing those resources. If a department introduces offsetting measures at the same time to reduce other burdens on local authorities, it will need to fund the net additional cost.
- 10.22 Departments should not consider general efficiency savings within a local authority to be an available source of funding for new burdens, nor should they assume that authorities can absorb the cost of a new burden through reduced expenditure on existing functions. Such assumptions will result in increased pressure on council tax levels. Departments should inform DCLG (Local Government Finance directorate) at the earliest possible stage of any new policy affecting local authorities – see Annex D for contacts and Annex E for guidance.

Chapter 11

Public Corporations

Definition of Public Corporations

- 11.1 Public Corporations (PCs) are defined for the National Accounts by the Office for National Statistics (ONS). ONS publish a list of PCs in the publication Sector Classification Guide (see Annex E for links). If a body is not listed in the Sector Classification Guide and you are in doubt as to whether it is a PC, or if you are considering setting up a body that might be a PC, you should contact HM Treasury.
- 11.2 PCs are bodies that are controlled by government or another public corporation and that are market bodies (i.e. their income comes mainly from trading activities). Certain regulatory activities may count as trading.
- 11.3 PCs may take various legal forms, including statutory bodies and Companies Act companies. Not all statutory bodies or government-owned Companies Act companies are PCs; they may be ALBs for example.
- 11.4 Most **trading funds** are PCs. However, trading fund is a legal designation leading to a particular Estimates treatment. The ONS need to consider separately whether a particular trading fund meets the National Accounts criteria for PC status. This chapter applies to trading funds that are PCs, with some special features – see below. Those trading funds that are not PCs are budgeted for as departments or ALBs as appropriate. Some **Public Private Partnerships** (PPPs) may be PCs - see the passage on PPPs below. If they are PCs they are budgeted for like other PCs.
- 11.5 Certain special arrangements apply to **self-financing Public Corporations** (SFPCs), which are set out below in this chapter. Like other AME spending, departments are responsible for monitoring this spend and taking steps to prevent undue increases. As part of this, departments are expected to obtain all information about PC's planned spending (see paragraph 11.92)
- 11.6 This chapter applies to public corporations answerable to Ministers. UK subsidiaries of a public corporation are included within the budgeting controls of the parent **Public Corporation**. Departments should discuss with the Treasury the budgeting arrangements for non-resident subsidiaries of a public corporation. These budgeting rules also apply to public corporations that are a joint venture of one or more public corporations accountable to ministers. Different arrangements apply to public corporations answerable to local authorities (see chapter on support for local authorities).

The objectives of the budgeting system for Public Corporations

- 11.7 The **aims of the budgeting framework** with regards to public corporations are:
- to support the government's fiscal objectives
 - to provide sensible and transparent incentives to managers in public corporations and in departments. This implies both
 - ensuring that public corporations and their sponsoring departments face good incentives for the PC to generate the right return on capital
 - appropriate levels of freedom to exercise commercial judgement, within appropriate delegated authority arrangements that protect departments
- 11.8 In addition, the budgeting framework aims to reduce compliance costs for departments, by being based as far as is practicable on entries in departmental accounts and the PCs' accounts.
- 11.9 The government's **fiscal framework** applies to the whole of the public sector, that is general government (central and local government) and public corporations. In the fiscal framework:
- PCs' gross operating surplus is a benefit to the current balance. Payments of interest and dividends to the private sector and depreciation make the current balance worse
 - PCs' investment increases net borrowing, and their liabilities contribute to net debt
- 11.10 The EU's debt and deficit measures apply to general government. So they exclude the performance and spending of public corporations but include certain of departments' transactions with public corporations. That helps to explain why we need accurate measures of government's dealings with public corporations even though domestically we measure performance at the public sector level.
- 11.11 It is for departments to manage their relationship with their public corporations in the way that best meets their needs. Departments should take advice from **UK Government Investments** where appropriate. UK Government Investments is a Treasury-owned company but operate both in an executive function for departments in relation to some PCs and as advisors alongside departmental shareholder team for others. The Treasury issues guidance on public corporations policy in general and on trading funds policy.
- 11.12 Departments are expected to set PCs clear objectives and challenging targets covering Return on Capital Employed, dividend levels, efficiency, and quality of goods and services. The corporate plans of PCs should be subject to agreement by the department. That is particularly important where PCs have been under-performing against profits targets; face risks to performance, or might generate substantial levels of excess cash.

Treatment of PCs in budgets

- 11.13 Public corporations are recorded in budgets on an “external finance basis”. This means that the transactions of the PC are, in most cases, outside of the department’s budget. The budget of the sponsoring department will show all transactions between the department and the PC. Additionally, should the PC undertake any borrowing the financing raised will be recorded in the budget of the sponsoring department.
- 11.14 The table below sets out the main elements of scoring PCs on an external finance basis.

	Resource budget	Capital budget
External Finance basis		Investment grants paid to Public Corporations
	Subsidies paid to Public Corporations	Net lending to Public Corporations (voted and NLF)
	Less interest and dividends received from Public Corporations	Public Corporations’ market and overseas borrowing (including on balance sheet PPP)
		Less equity withdrawals from Public Corporations

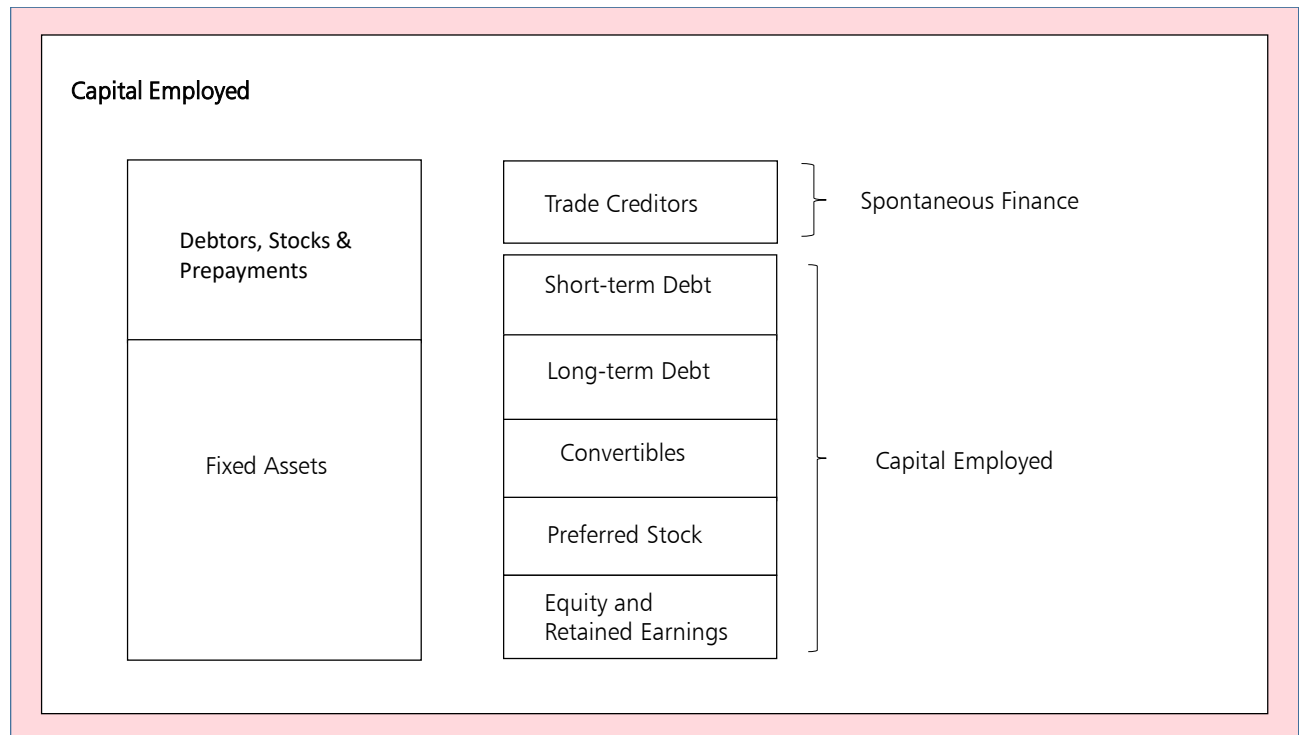
- 11.15 Most PCs are recorded on a consistent external finance basis as described above. However, a selected few bodies have been classified as self-financing public corporations (SFPCs) and these have a different treatment in budgets which places more transactions in AME. The detailed budgetary requirements for SFPCs are set out later in this chapter.

Setting the rate of return on Capital Employed

- 11.16 Public corporations, by definition, are market bodies majority financed by sales of goods or services. Where comparable bodies operate in the private sector they must achieve a return on investment appropriate to the risk of operating in that market. As such the sponsor department should require its PCs to generate a certain rate of return on the capital employed in producing services.
- 11.17 Departments must agree with Treasury on what is an appropriate rate of return for each of their PCs. This anticipated level of return should be considered alongside other sources of income at spending reviews - see Chapter 4 for details on income in the resource budget.
- 11.18 In exceptional cases a department may choose to subsidise a PC for policy reasons and collect a level of income lower than the level agreed with Treasury. In these cases spending review calculations should always use the agreed level of income rather than the subsidised level. Departments should be careful to comply with trading fund guidance on disclosure to Parliament where appropriate.

Weighted Average Cost of Capital

- 11.19 Departments should begin by establishing an appropriate post-tax Weighted Average Cost of Capital (WACC) for the PC. To work out the WACC, departments should consider the whole of the Capital Employed in the PC, not just the department's share.
- 11.20 Looked at from funding, Capital Employed comprises total equity, reserves, debt including all interest-bearing liabilities and un-funded or under-funded pension liabilities. This may not always match the figures reported on a department's balance sheet.



- 11.21 The appropriate WACC should be calculated using a cost of equity and cost of debt commensurate with the returns equity and debt investors would expect to receive from investing in a comparable private sector business with the same level of risk.
- 11.22 For some regulated businesses it may be appropriate to use a Regulatory Asset Base or Regulatory Capital Value (RCV) in respect of all or part of the PC as the Capital Base upon which a cost of capital charge is levied. If you think that would be the appropriate Capital Base you should talk to HM Treasury.
- 11.23 The Shareholder Executive will be able to provide support and expert advice to departments in determining the appropriate cost of equity or debt.

Setting a target rate of return

- 11.24 A PC should be set a target return to earn at least its WACC multiplied by the overall Capital Employed. You should use the average Capital Employed over the year.

- 11.25 In the case of PCs performing essentially government-type functions, 3.5% real will normally be appropriate. A PC competing in the market should typically be expected to return a higher rate to reflect the prevailing market rate.
- 11.26 Where a PC has a monopoly, departments should ensure that the rate of return set is not exploitative.
- 11.27 The right rate for the PC should be agreed with the Treasury when a new PC is set up and as part of the SR process.
- 11.28 Once the total Capital Employed and target rate of return has been worked out, the department's expected receipts are calculated by deducting those elements on which the public corporation owes a return to another funder.
- 11.29 In principle, the calculation is:
- total rate of return
 - *less* returns owed on loans from the private sector, including finance leases and other interest bearing liabilities
 - *less* returns owed on the value of private sector equity stakes in the business
 - *less* returns owed on unfunded or under-funded pension liabilities (which are a sort of debt owed to the private sector). Typically, we would expect these returns to be equal to either ASLC contributions or the return on corporate bonds
 - *less* the amount of interest that the PC has to pay on any NLF loan (since the departmental asset in respect of a NLF loan is matched by a liability to the NLF)

Regulated businesses

- 11.30 Budgets are set net of other departmental receipts. As a result, departmental allocations will take the expected receipts from PCs into account. For example, if a department had agreed a total spend of £500million for 12/13, and it had a PC with expected interest and dividend payments to the department of £30million, the net Resource budget would be equal to £470million.

Tax planning

- 11.31 The government obtains a return from public corporations partly through the normal tax on corporations and partly as owner. PC's may undertake normal tax planning but should not incur wasteful expenditure on tax mitigation.
- 11.32 The passage on WACC above assumed that public corporations have not operated in a way designed to reduce their tax bill. Where public corporations have undertaken tax mitigation – in particular where public corporations have high levels of interest-bearing debt – departments should consult the Treasury on how to work out the WACC so as to counter-act the effects of tax mitigation.

11.33 Managing Public Money (4.2.6 and Annex 4.4) gives more guidance to departments and ALBs on tax planning.

Trading funds

11.34 Trading funds that are public corporations are normally budgeted for exactly like other public corporations.

Trading funds that are departments in their own right

11.35 The budgeting for trading funds that are treated as departments is exactly the same as all other PCs. Where the PC is engaging in borrowing from the NLF or PCMOB then the amount borrowed must score in the CDEL budget of a parent department.

Subsidies

11.36 Subsidies are unrequited current payments to trading bodies:

- “unrequited” payments should be distinguished from payments for goods and services, where the department obtains something direct in return for the payment. That the department obtains a general policy benefit from a subsidy does not stop it being unrequited
- DAs do not distinguish between subsidies and capital grants. Departments need to do so for budgets following National Accounts principles. The distinction is needed because subsidy and expenditure financed by capital grants score differently in the fiscal framework: in effect, subsidies affect the current balance used to measure performance against the temporary operating rule, while capital grants do not. Capital grants are unrequited transfer payments that are intended to finance investment by the PC (see below)

Underperformance

11.37 Departments have to obtain a return from their PCs that covers the rate of return agreed with Treasury. The return comes in the form of interest and dividend income from the PC. In order to be able to pay the necessary amount of interest and dividends, the PC needs to achieve a high enough level of earnings, and the department should ensure that the PC is set sufficiently challenging targets and that they are met. A dividend policy should then be agreed between the PC and its department as shareholder.

11.38 If the PC’s level of earnings do not allow it to pay the right level of interest and dividends, the department should pay a subsidy to the PC so that it can make those payments. The reason for this requirement is to make it transparent to Parliament and public that a PC is under-performing and needs a subsidy to be paid. Where a department has no power to pay a subsidy or where such a subsidy would represent state aid, the overall effect on budgets is still the same, since it is the initial shortfall in PC performance against the cost of capital that impacts on the Budget. However, in these cases the department should still disclose the effective subsidy in a note to the accounts.

- 11.39 No subsidy need be paid if the Treasury and the department agree that the PC's underperformance was due to normal volatility.
- 11.40 It is important to make clear to PCs that only making the expected return after receiving a general subsidy is not good enough. The payment of a subsidy needs to be accompanied by the PC's development of a recovery plan to get performance back on track.

Social policies

- 11.41 Where a department wishes a PC to perform a social policy function then it should pay for that explicitly out of its budget rather than seeking to recover the costs by accepting PC underperformance or by over-charging PC customers. A department has two choices:
- it may pay a subsidy to the PC
 - it may treat the PC as a handling agent. Here the department would pay the PC for its services in handling a transaction, while the transaction itself would score in the books of the department acting as principal. This route should be used when PCs are involved in the payment of grants to the private sector or local authorities, since grant-giving is not a market activity appropriate to PCs
- 11.42 It may be appropriate for subsidies to be paid by a department other than the sponsoring department where it is the other department that wants the social policy function to be carried out.
- 11.43 Where a department wishes a PC to perform a social policy function and does not have legal power to pay a subsidy the department should contact HM Treasury to establish how best to obtain transparency.
- 11.44 Departments should ensure that payment of subsidies is compatible with EU state aid legislation.

Early debt redemption

- 11.45 Where a department supports a PC to repay debt early and the PC has to pay an interest rate premium, the element of grant that covers the premium scores as a subsidy.
- 11.46 That is the case even if the department makes a single grant payment in support of both principal repayment and early redemption premia: the two elements must be divided into a subsidy and a capital grant.
- 11.47 Where the department is supporting only a part of the PC's total payment covering debt repayment and premium, the grant should be divided into subsidy and capital grant in the same proportions as the total payment by the PC is divided into premium and debt principal repayment.

External finance basis

- 11.48 This section sets out the resource budget and capital budget scoring of public corporations on an external finance basis.

Resource budget

11.49 For a public corporation, the departmental resource DEL scores:

- subsidies paid to the PC
- *minus* interest and dividend income received by departments from PCs (including interest on NLF loans) plus interest payable to the NLF
- *plus* a charge for the impairment of any investment in PCs

Interest

11.50 When debts are repaid early,

- interest premia received from the PC count as current income in the DA alongside other interest
- interest rate discounts paid by the department to the PC count as current payments in Resource DEL alongside other payments of interest a department may make

NLF Interest

11.51 Where a department's accounts show interest payable from PCs in respect of NLF loans and the subsequent payment of interest to the NLF then both should be reflected in the resource budget.

Dividends

11.52 A dividend policy should be agreed between the PC and its department as shareholder. The department may choose not to recover the full rate of return (as agreed with Treasury) as a dividend (in order to allow for reinvestment of its profits by the PC). But, the eventual cost of this under recovery should be borne by the department. As such budgets should be set at spending reviews on the expectation that the full agreed rate of return will be achieved.

11.53 Note that the SoCNE, and budgets, will in Year 1 record the dividends expected to be received in respect of Year 1, even though the cash will not be received until Year 2.

11.54 Not all receipts treated as dividends in DAs count as dividends for budgeting. Please see the section on equity withdrawals below.

Capital budget

11.55 The capital budget scores:

- capital grants paid by the department to the PC
- loans to the PC (includes voted loans, National Loans Fund loans and Public Works Loan Board loans), net of repayments
- Public Corporations Market and Overseas Borrowing net of repayments (PCMOB)

- injections of equity into PCs net of repayments of equity by PCs. Equity includes Companies Act shares and Public Dividend Capital
 - *minus* equity withdrawals
- 11.56 Loans score in the capital budget whatever their purpose, that is whether they have been taken out to finance working capital or fixed assets investment.
- 11.57 Note that the capital budget does not score capital expenditure by the PC, only the external support for capital expenditure. Subject to their agreeing their business plans with their department as shareholder, PCs are therefore free to invest insofar as they are able to finance their investment from asset sales, income that covers depreciation and a level of profits that exceeds what is needed to pay interest and dividends as agreed with the department.

Capital grants

- 11.58 Capital grants are unrequited transfer payments that are intended to finance investment by the PC. Investment includes the acquisition of any capital asset (land, buildings, vehicles, machinery, etc.) and any financial asset (lending, company securities, etc.). Grants to finance stock-building should also be treated as capital grants. Grants to refinance pension funds are capital grants.
- 11.59 Capital grants should be paid whenever the NLF has made a loan to a PC that the PC would otherwise be unable to repay – this demonstrates transparency to Parliament. For voted loans, follow the procedures in Managing Public Money.
- 11.60 Capital grants should also be paid where a department wishes a PC not to be burdened by a loan that it could not repay, perhaps as part of a restructuring.
- 11.61 Grants from the department to make good a shortfall in a real pension fund score as capital grants in budgets and may need special recording. Departments contemplating such a grant should contact the Treasury.

Public Corporations Market and Overseas Borrowing

- 11.62 Expenditure financed by PCMOB scores in the government's fiscal framework like any other expenditure. Therefore, PCMOB should be controlled. Where PCs wish to borrow on the market or overseas, departments should discuss proposals (other than for overdrafts) with HM Treasury. Approval for borrowing from the private sector will be permitted only in exceptional cases.
- 11.63 PCs may normally only borrow from the market or overseas where at least one of the following applies:
- a facility is not provided by the public sector, for example overdrafts, and that facility is either necessary to the normal conduct of business or offers better value for money than other forms of finance

- it would be cheaper for the PC to borrow on the market than for the government to borrow – this will almost never be the case, although some bodies may offer cheap loans, for example the European Investment Bank. Where a PC or department believes that a body's borrowing would be cheaper than the Exchequer's cost of borrowing it should first verify the assessment with the Treasury
- it would be better value for money for the PC to borrow on the market than to borrow from government. This might apply to some on-balance sheet PPP procurement, for example
- there is no power for government to lend to the PC

11.64 PCMOB scores as a cost in capital budgets of the sponsor department.

11.65 PCMOB does not include movements in PCs' bank deposits or other liquid financial securities.

11.66 Further details of the Treasury's approach to lending to PCs, particularly ensuring an appropriate lending rate is used, can be found in DAO (GEN) 13 / 04 – see Annex E for the link.

Excess cash balances and equity withdrawals

11.67 Departments should ensure that PCs do not build up excessive cash balances. Cash balances are excessive if they are more than the amount needed to fund expenditure in the next three years as set out in the corporate plan that has been agreed with the department. Excess cash balances should be taken out of PCs so that the spending power that they represent is prioritised across the departmental group as a whole. Excess cash balances are normally taken out by means of equity withdrawals.

11.68 Equity withdrawals benefit capital budgets. So a department may in effect borrow spending power from its PC, extracting cash in one year (obtaining a capital DEL benefit) and making spending power available to the PC through capital DEL in a later year.

11.69 Equity withdrawals are exceptional payments from accumulated reserves or cash balances. They should be distinguished from dividends in that dividends should be paid out of the profits of the current year or the two previous years.

11.70 Equity withdrawals do not need to result in an actual repayment of shares or PDC. That is, they may simply be a cash transaction.

11.71 In DAs, equity withdrawal of this type will go through the SoCNE as special dividends, in the same way as ordinary dividends. There is no impact on the department's Statement of Financial Position other than the increase in cash. However, because of the differing treatment in National Accounts and budgets, departments need to distinguish equity withdrawals from dividends according to the principles described above.

11.72 In the National Accounts for general government, income from dividends scores as current income, while income from equity withdrawals scores

'below the line' as a financial transaction. They thus have a different impact on certain of the fiscal measures.

- 11.73 Where equity withdrawals do result in an actual repayment of shares or PDC then there is no difference in treatment between DAs and budgets. The double entry in DAs would be to reduce fixed assets and increase cash. Where a profit is taken to the SoCNE the department should discuss proposals with their Treasury spending team.

PPP and similar arrangements

- 11.74 For the treatment of PPP in budgets, please see the chapter on PPP.

Treatment of Self-Financing Public Corporations

- 11.75 Certain PCs have been designated by the Treasury as SFPCs and have special scoring. The transactions that score in budgets, and treatment of resource/capital, are consistent with all other PCs; but SFPCs place different transactions in AME or DEL.

Rationale and criteria for SFPCs

- 11.76 The main rationale underpinning SFPCs is that the Spending Review is used to prioritise spending financed by taxes. Where public corporations expect to recover expenditure from fee-payers in a competitive open market, that expenditure may be excluded from the SR prioritisation process.
- 11.77 However, SFPCs are still public bodies, their spending is still public spending, their activities impact on the fiscal framework, and their liabilities contribute to net debt. They therefore need to be managed and monitored.
- 11.78 It is for the Chief Secretary to the Treasury to designate an SFPC where it is appropriate to the Treasury's conduct of the SR. The criteria that guide the Chief Secretary include:
- the PC must have traded profitably for a number of years, not requiring subsidies, and must be able to demonstrate that this state of affairs will continue into the future
 - the PC must be selling goods and services into an open market. It should not be selling regulatory services
 - the PC must either
 - be selling primarily to customers outside general government
 - be a publicly announced candidate for privatisation or a PPP in the private sector

List of SFPCs

- 11.79 The following PCs have been designated as SFPCs: Commonwealth Development Corporation, Channel 4, the Crown Estate, and the Royal Mint.

Control of SFPCs

- 11.80 Departments control Self-Financing Public Corporations in the same way as other PCs. In the SR, departments agree a forward plan in respect of the SFPCs alongside but not in the normal SR process. At this point, the status of the SFPC as self-financing should also be reviewed as to whether it still fulfils the classification criteria. As with other spending in AME, performance against the plan is monitored formally by departments and the Treasury in the run-up to each Budget report.
- 11.81 The plan will include the appropriate rate of return and the arrangements for underperformance, see below.

Scoring in budgets

- 11.82 Self-Financing Public Corporations face the same budgeting rules and are scored in the same way as set out above, except that certain transactions score in AME rather than DEL. So, for SFPCs budgeted for on the external finance basis:
- resource AME scores
 - interest and dividends paid by the SFPC to the department (and loan arrangement fees, where payable and where not excessive)
 - resource DEL scores
 - any subsidy paid by the department
 - underperformance charges
 - capital AME scores
 - loans to SFPCs (net)
 - equity injections in SFPCs (net)
 - purchase or sale of the shares of SFPCs
 - minus capital repayments made by SFPCs
 - minus equity withdrawals
 - plus PCMOB (net)
 - capital DEL scores
 - any capital grants paid to SFPCs
- 11.83 The subsidy formally paid to the Crown Estate to cover certain administration costs scores in Resource AME. Dividend income received from the Crown Estate is outside budgets.

Underperformance by SFPCs

- 11.84 SFPCs should cover the agreed rate of return through their payments of interest and dividends.
- 11.85 When returns from the SFPC fall short of the department's rate of return, an underperformance charge equal to the short-fall will be charged to

departmental RDEL. This underperformance charge reflects the budgeting guidelines for PCs and is intended to incentivise departments to manage SFPCs appropriately as well as provide visibility of underperformance to Parliament and the wider public.

- 11.86 In other words, the underperformance charge will be equal to:
- the expected return, as calculated by the rate of return agreed between departments and Treasury
 - *plus* retained loss after interest and dividend payments, if applicable
 - *less* any interest and dividends that the SFPC has paid to the department
- 11.87 During the SR period, departments may be able to negotiate a cap on their exposure to underperformance charges. On an exceptional basis (e.g. if the SFPC is undergoing a restructuring programme), it may also be possible to use a recovery target rate of return for calculation of the underperformance charge. However, when an SFPC underperforms on an ongoing basis, reclassification as a PC should be considered as part of the SR process.

Public private partnerships

- 11.88 PPPs that are entities in their own right may be classified by the ONS to the public or private sectors. In some PPPs, shares may be sold and the PC remains in the public sector. In other cases (e.g. National Air Traffic Service (NATS)), shares may be sold and the PC may move into the private sector. The ONS takes into account a range of factors when considering classification and not simply the percentage of government shareholding.
- 11.89 In the case of SFPCs, PCMOB may only be undertaken in line with the agreed forward plan. The plan will set out what should be done with the sum realised by a share sale. In default of other arrangements, the sum should be taken out of the SFPC by way of an equity withdrawal in order to offset the PCMOB.

Privatisation

- 11.90 Sale of shares on the privatisation of a public corporation is the disposal of a financial asset by the department. The income scores as a benefit to the capital AME budget.

Supplementary information on Public Corporations

- 11.91 Departments are asked to provide certain financial information about PCs in addition to the budget data.

Capital expenditure

- 11.92 Even though for most PCs capital expenditure does not score in budgets, departments are responsible for monitoring this expenditure and taking steps to prevent undue increases. Departments are to obtain information about all PCs' outturn and plan capital expenditure and to pass it on to the Treasury via OSCAR using a non-budget identifier.
- 11.93 This information needs to be accurate and kept up to date because:

- it is information that departments should use in any event as part of their monitoring of PCs
- the information feeds into the National Accounts measures of spending and borrowing, including the fiscal framework
- the information is published in PESA separately for each PC and is used in the functional and regional analyses of public sector spending, including tables that appear in Departmental Reports

11.94 The information that is required is:

- gross capital expenditure, including land, buildings, vehicles and machinery
- *less* (actual) sales proceed
- additions to stocks (net)

Gross Operating Surplus

11.95 In addition, for the larger public corporations, the Treasury seeks special non-OSCAR returns of outturn and plan gross operating surplus (broadly, profit before depreciation).

11.96 This information is useful to the Treasury as gross operating surplus is an item on the revenue side of the Surplus on the Current Budget, used to measure achievement of the temporary operating rule.

Joint Ventures

11.97 Where the public sector engages in a joint venture with a private sector partner the new entity will be subject to the same classification considerations as any other new body (see chapter 1 for details). Annex E contains a link to guidance on the public sectors involvement in Joint Ventures.

11.98 Where it is determined that the public sector has engaged in a joint venture with a private sector partner and controls and voting rights are equally split, and if the joint venture is classified as a market body then it should be partitioned in half, and 50% of its expenditure, income, assets and liabilities should be treated as if a public corporation. The parent department will then reflect what it has to for a public corporation. If the joint venture is deemed to be a non-market body, then it should in its entirety should be classified to the central government sector and consolidated into its parent department's accounts.

11.99 If the body is not owned by exactly equal percentages by each of the public or private parties, the joint venture will be allocated to the party which holds the majority. If this would be the public body, then the joint venture will be classified within the government sector if it has a predominant non-market activity. If it is recognised as a market producer, then it will be treated as a public corporation and the parent department should then reflect what it has for a public corporation. Annex E contains a link to guidance on the public sector's involvement in joint ventures.

Chapter 12

Pensions

- 12.1 This chapter is split into separate sections for the following cases:
- a) unfunded pension schemes, covering employing departments and ALBs who contribute to multi-employer unfunded pension schemes
 - b) funded pension schemes: departments and ALBs who contribute to and run funded pension schemes
 - c) unfunded by-analogy arrangements: departments and ALBs who run their own unfunded, by-analogy, pension schemes – that is schemes run by-analogy to the multi-employer pension schemes

Section A: Unfunded pension schemes, used by employing departments that contribute to multi-employer unfunded pension schemes

- 12.2 Departments are required to recognise in their budgets the accruing cost of their existing staffs' pension liabilities that will need to be met in future periods. For those departments whose staff are members of the large unfunded multi-employer schemes (such as the Civil Service, Teacher's or NHS schemes) IAS19 allows departments to account only for the employer contributions payable to the pension scheme administrator (the accruing superannuation liability charge or ASLC).
- 12.3 The employing department bears the cost of that ASLC in its Resource budget DEL, as part of its salary bill.
- 12.4 The department bears no further liability in respect of pensions.
- 12.5 The employee may also pay a contribution into the scheme. Such payments are made by the employee out of her or his pay. The department will have shown pay as a cost in its resource budget DEL. It should not show anything further in respect of the employee contribution.
- 12.6 This section of the budgeting guidance applies to the administrators of the multi-employer unfunded schemes (schemes under Section A):
- Principal Civil Service Pension Scheme (PCSPS)
 - Alpha pension scheme
 - NHS pensions schemes
 - Teacher's pension schemes

- Armed forces pension schemes
- Judicial pension schemes
- UKAEA superannuation schemes
- DfID overseas superannuation schemes
- Royal Mail unfunded pension scheme

12.7 This section applies to the budgeting of the schemes themselves. It does not cover employing departments' contributions to the schemes – see earlier paragraphs of this Chapter.

12.8 The transactions of these schemes are scored in AME. The transactions follow those that are recorded in the Departmental Accounts, and are as follow;

Expenditure

- current service costs (defined as “the increase in the present value of the scheme liabilities expected to arise from employee service in the current period”)
- past service costs (normally expected to be zero) interest on scheme liabilities (the unwinding of the discount on the scheme liability)
- increase in future liability arising from employees purchase of added years and group and individual transfers in
- there may be occasions where actual pensions benefits paid pass through the revenue account if they are not charged to a provision on the balance sheet

Income

- employers' contributions
- employee contributions – normal
- employee contributions – purchase of added years
- group and individual transfers in

Unfunded pension benefits payable

12.9 Pension benefits payable to retired members, and group and individual transfers out, score only in the accounts via the balance sheet as it is simply a discharge of a provision. It represents the movement of cash and liabilities. As such it has no overall budgetary impact, as the discharge and use of provisions cancel each other out within the same budget boundary. However, to record the discharge of the provision correctly departments should record on OSCAR matching entries (a series 2 CoA with a negative and a 9 series CoA with a positive) within the AME budgeting boundary to ensure that the correct cash required can be calculated and that information required for the National Accounts is captured.

- 12.10 Bulk transfers to the private sector score as capital transactions in National Accounts and are treated as a cost in the resource budget offset by the release of provision.
- 12.11 Where payments are not covered by an existing provision (i.e. no account has been taken of the build-up of the pension liability), they score as charges in the resource AME budget.

Section B: Funded pension schemes: departments and ALBs who contribute to and run funded pension schemes

- 12.12 Some departments and ALBs run pension schemes with a real fund (as distinct from a notional fund used for unfunded schemes). Such departments and ALBs also have to comply with the accounting standard IAS 19.
- 12.13 IAS 19 covers the position where:
- there is a deficit in the pension fund (i.e. there is a shortfall in the value of the assets of the scheme over the present value of the scheme's liabilities)
 - the deficit is identifiable as belonging to the employer
 - the employer has a legal or constructive obligation to make good a deficit in the pension fund
- 12.14 In these circumstances, the employer should recognise that deficit in the fund as a liability on their balance sheet.
- 12.15 The cost in the departmental budget is the same as that shown in the accounts of the department or ALB under IAS 9. Specifically, the movement in the pension scheme liability as recorded in the SoCNE scores as a cost in the resource budget. Any actual contributions to the scheme that serve to reduce the liability score in the cash subsection of the Resource budget offset by a negative amount. However, note that these effects will not net-off within AME and DEL budgets. An example is given below.

Department or ALB Accounts	Resource budget		Total
	AME	DEL	
Increase in scheme liabilities			
Cr pensions liability	(110)		
Dr Statement of Comprehensive Net Expenditure/ I&E	110	110	110
Contribute cash to scheme			
Dr liability	100	(100)	(100)
Cr cash	(100)		100
		10	100
		100	110

- 12.16 The example assumes that the contributing department pays 100 cash to the scheme but that the accruing cost of the pension liability is 110.
- 12.17 The accruing liability would normally fall to departmental resource AME, whilst the cash costs would fall to DEL. This is more analogous to the costs borne by those departments who contribute to unfunded schemes, and reduces the scope for volatility in departmental resource DELs. Where there is a serious or structural deficit the scheme actuary will ultimately suggest higher contributions or a one-off payment to rectify affairs. This would score against DEL like normal contributions.
- 12.18 Where there is a surplus in the scheme, the department or ALB should recognise that surplus as an asset if the conditions in paragraph 37 and onwards of IAS 19 are satisfied (i.e. to the extent that employers can recover that surplus either through reduced contributions in future or through refunds from the scheme). This will be a benefit to the resource budget in AME. Movements in the value of the surplus then impact on the SoCNE and resource budget.

Section C: Unfunded by-analogy arrangements; departments and ALBs who run their own unfunded, by-analogy pension schemes

- 12.19 "By-analogy" means schemes run by-analogy to the multi-employer pension schemes. The budgets of departments or their ALBs that run unfunded by-analogy pension schemes should recognise the accruing cost of their existing staff's pension liability that will need to be met in future periods. Such schemes should be accounted for on an IAS 19 basis as adapted for the unfunded schemes in the central government sector.
- 12.20 The department or body that employs the staff recognises a provision on the balance sheet in respect of the accruing liability to pay pensions in the future, and a cost in their budget based on the change in that liability.
- 12.21 To ensure parity between those bodies who pay into multi-employer schemes and those bodies that run their own unfunded by-analogy schemes the costs borne by the by-analogy schemes in resource DEL are equivalent to those paid by departments who pay into the multi-employer schemes. Accordingly, the following transactions score in the resource budget DEL:

Expenditure:

- increases in provisions due to current service cost
- increases in provisions due to past service costs
- increases in provisions due to any bulk/individual transfers in
- increases in provisions due to purchases of added years

Income:

- income from bulk/individual transfers in (funds the increase in the provision due to transfers in)
- income from employees – normal contributions (goes part way to fund the increase in the provision due to the current service cost)

- income from employees - added years (funding increase in the provision due to added years)

12.22 This treatment is broadly analogous to the costs borne by a department that contributes a multi-employer scheme because the current service cost borne by the department is broadly equivalent to the ASLC that would be paid to multi-employer pension scheme administrators.

Charges to Departmental AME

12.23 To ensure parity in the DEL treatment between those departments who pay into the multi-employer schemes and those that run their own unfunded by-analogy schemes certain transactions score in departmental AME:

- pensions benefits paid, offset by the release of a provision from the balance sheet (in this case there will be a credit to RAME to represent the discharge of the liability and a net charge to departmental AME to reflect the payment)
- pensions benefits paid, if they are not charged to a provision on the balance sheet
- the accounts - and therefore budgets - score the increase in the liability due to the unwinding of the discount rate. This increase is sometimes termed the interest on the scheme liability. The discount rate is based on AA corporate bond rates, and a CPI inflation assumption derived from market data, and is advised annually

Unfunded board members

12.24 Unfunded broadly by-analogy arrangements for chairs, vice-chairs, board members and other holders of public appointments are also subject to IAS 19 as adapted for unfunded schemes in the central government sector and should be included in any measure of a body's unfunded liabilities.

Bulk transfers of unfunded schemes joining multi-employer public sector unfunded pension scheme

12.25 Where an unfunded scheme joins the multi-employer unfunded scheme it will be required to make a cash payment equivalent to the value of the liability that is being transferred. For the transferring body that has previously recognised a liability in its balance sheet in respect of its unfunded pensions liability, this will be a balance sheet transaction – a movement in cash and liabilities – with no impact on the SoCNE (the SoCNE does not include the discharge of provisions, which is what this effectively is). It follows that there is no overall impact on budgets.

12.26 However, to record the discharge of the provision correctly, departments should record on OSCAR matching entries within AME budgeting boundary to ensure that the correct cash required can be calculated and that information required for the National Accounts is correctly captured. In addition, any amount of cash that is *required above or below the liability previously recognised* on the transferring body's balance sheet will be a cost/benefit to the SoCNE.

- 12.27 Budgetary cover for this debit or credit will be provided for as an AME item. The cash required for the transfer will be provided in the appropriate manner - either through supply or grant-in-aid to the body transferring the liability with no further impact on budgets.
- 12.28 For an unfunded scheme joining an unfunded multi-employer scheme that has not previously recognised a provision on its balance sheet it follows that any payment it makes will be a cost in its SoCNE. Budgetary cover for this cost will be provided for in AME.

Section D: bulk transfers to funded schemes

- 12.29 Where a public-sector body makes a bulk transfer into a funded scheme this cash payment increases TME. Where departments are considering such payments they must contact HMT to obtain consent for the transfer. This is the case whether the transferring body has previously provided for the liability or not, or whether they have been making contributions to a public sector multi-employer scheme or not.
- 12.30 Departments should contact the Treasury early in the process of considering such transfers.

Chapter 13

PPP and similar arrangements

13.1 The chapter sets out:

- The purpose of Public Private Partnerships (PPP) and similar arrangements. The Private Finance Initiative (PFI) and Private Finance 2 (PF2) are types of Public Private Partnership.
- the recording of PPPs and similar arrangements
- the budgeting for PPPs and similar arrangements separately for departments and ALBs and PCs; and separately for on- and off-balance-sheet projects
- barter deals
- reversionary interest
- termination payments
- the treatment of refinancing gains

13.2 This chapter applies to leasing and similar arrangements including service concession arrangements, as identified under IFRS accounting standards. The term “PPP” is used throughout as a shorthand for these and similar transactions, but the substance of this chapter will still apply where leases or service concessions are not classed as PPPs.

PPP – purpose

13.3 A PPP is a means of procuring services with significant asset content. The choice of means of procurement should be driven entirely by **value for money** considerations. So:

- A PPP should be used where – and only where - it offers better value for money than other means of procurement

13.4 Departments must follow the principles and methodology laid out in the Green Book (see link in Annex E) when determining whether a prospective PPP project would be value for money. At Budget 2018 the Chancellor of the Exchequer announced that PF2 would not be used for new government projects

Recording of PPPs or similar arrangements

13.5 The UK public sector moved to IFRS accounting standards in 2008-09; under IFRS there are three important standards for the recording of PPPs and other leases

- IFRIC 12 provides an interpretation of how to apply IFRS standards to service concession transactions for the private sector. This standard is interpreted in Chapter 6 of the FReM under the heading “Accounting for PPP arrangements including PFI contracts under IFRS”. However, the standard is not applied when determining the budgetary treatment of a project – see below for details
 - IFRIC 4 provides an interpretation for identifying when a transaction may contain a lease
 - IAS 17 covers the classification of leases between operating and finance leases, as well as details of the correct accounting policies to apply in each case
- 13.6 DAs should be completed according to the IFRS compliant standards set out in the FReM.
- 13.7 The recording in budgets is intended to match the fiscal impacts of a PPP transaction. The last two bullets above (relating to IFRIC 4 and IAS 17) are broadly in line with National Accounts standards; as such the budgeting will follow departments’ accounting treatment (except in exceptional cases).
- 13.8 IFRIC 12 (as interpreted in the FReM) is very different to the equivalent standard in National Accounts. Since National Accounts is used to measure the fiscal position, budgets follow the National Accounting standards rather than IFRS. Recording in Estimates follows this treatment
- 13.9 For accounting purposes, service concession arrangements should be assessed under IFRS-based FReM. However, the department should further consider the treatment of these arrangements under National Accounts standards. These transactions are covered in Part VI of the ESA10 Manual on General Government Deficit and Debt – see Annex E for link.
- 13.10 Budgeting and accounting standards fit together as follows:

On / off balance sheet for National Accounts purposes

- 13.11 If a project is either a finance lease or in substance borrowing then it is held to be on balance sheet. On-balance-sheet projects are in effect capital expenditure by the purchasing authority that has been financed by borrowing from the contractor. Off-balance-sheet projects are purchases of services by the purchasing authority from the contractor who has created an asset in order to deliver the services. Departments should be aware that public sector controls on the individual entities involved in the procurement arrangement could affect the classification of those entities and the project as a whole. These issues are covered in Part VI of the ESA10 Manual on General Government Deficit and Debt and in the supporting guidance on the statistical treatment of PPPs – see Annex E for link.
- 13.12 It is the department’s responsibility to come to a view on the expected classification of a project, where possible with the agreement of its auditor. The department is at risk in cases where the eventual classification by the auditor or by the Office for National Statistics does not match the department’s expectations. The ONS will not consider the classification of

most projects, but can consider any classification they wish as part of the National Accounts process.

- 13.13 Additionally, HMT may choose to scrutinise any PPP project regardless of the recording under the different standards. In the first instance departments and procuring authorities should consult their Treasury spending team while preparing the project's Outline Business Case to determine if it requires Treasury approval.
- 13.14 In the fiscal framework, on-balance-sheet projects:
- score in Public Sector Net Investment and Public Sector Net Borrowing
 - score in Public Sector Net Debt
 - score in the Maastricht general government measure of the deficit and stock of debt
- 13.15 The budgeting system reflects the distinction between on and off balance sheet projects, with technical differences in the way that the distinction impacts on departments and ALBs versus PCs.

Budgeting – departments and ALBs

Projects on balance sheet for National Accounts purposes

- 13.16 Projects on balance sheet for National Accounts purposes score in capital budgets like capital expenditure undertaken directly by the department / ALB. The value of the capital expenditure and the timing of recognition should follow the accounting set out above.
- 13.17 Annual repayments under the PPP contract, i.e. the unitary charge, will be treated in the resource budget as a mix of:
- service charges (RDEL)
 - repayment of the imputed loan to the private sector (outside budgets) and
 - the full amount of interest charged on the loan (RDEL)
 - depreciation of the asset (RDEL)

Projects off balance sheet for National Accounts purposes

- 13.18 Where the project is off balance sheet for National Accounts purposes, the budgeting impact is as if the department is purchasing services. Any associated capital expenditure is an investment by the private sector and does not appear on the procuring authority's budget. The only entries in the budget of the department or ALB are the payments under the unitary charge, which are payments for services and score in the resource budget.

Budgeting – Public Corporations

Projects on balance sheet for National Accounts purposes

PCs scored on the external finance basis.

- 13.19 For most public corporations the budgeting system scores their external finance. External finance includes Public Corporations' Market and Overseas Borrowing (PCMOB). A PPP that is on balance sheet for National Accounts purposes is a form of PCMOB and is treated in the same way:
- the borrowing implied by on-balance-sheet capital expenditure of public corporations scores in the capital budget
 - as the debt is reduced the capital budget of the sponsor department is credited back and
 - the profit that public corporations make should be calculated after the payment of the interest and service elements of service charge on the finance lease and after the deduction of depreciation on the PPP financed asset

Projects off balance sheet for National Accounts purposes

- 13.20 Projects that are off balance sheet for National Accounts purposes do not score in capital budgets (except to the extent there is a reversionary interest to be accrued over the length of the contract). The public corporation's payments of the unitary charge are a cost of doing business in the calculation of profits like any other purchase of services.

Barter deals

Definition of barter

- 13.21 A barter transaction is one in which party A disposes of an asset, good or service to party B; party A then receives an asset, good or service in return from party B. Money is not used as the medium of exchange, or is used for only a proportion of the transaction. Barter deals can involve the creation of financial assets and liabilities such as loans, if the goods and services are exchanged at different times.

Example of a barter deal

- 13.22 Sale and lease-back deals may include an element of barter. In this scenario a department disposes of buildings to a private sector company at no charge, or at a price below the normal market value. In return the company provides the department with serviced office accommodation at below market price for a number of years. The reduction in the cash charge for service payments is a way for the department to obtain value from its asset, instead of getting the full market value in cash.
- 13.23 In effect part of the value of the building is bartered for future serviced office space. The reduction in the selling price is in effect a pre-payment of rentals. You can view this as a loan to the private sector company financed from the receipt from the disposal of the building.

13.24 However, this is only one example, and these general principles apply equally to barter deals that do not involve property or PPPs.

Principles of recording barter deals

- 13.25 Barter deals should be recorded as if the exchanges had taken place in cash at current market prices. This recording applies to accounts, budgets and in the National Accounts.
- 13.26 National Accounts aim to score transactions at the Open Market Value (OMV). Scoring barter transactions at zero or another price would not reflect the economic substance of the transactions and misstate the balance of expenditure between sectors of the economy.
- 13.27 The real economic value of the asset disposed of is the OMV not nil or just the cash sum received; the annual running costs should also be measured at the OMV cost of accommodation and not just the cash sum paid.
- 13.28 If the delivery of bartered assets, goods and services occur at different times it might be necessary to record a financial transaction. For example, if a department sells a building at below OMV in return for reduced future rents, there is in substance a loan from the department to the company. The reduction in the selling price is a prepayment of rents, and represented as such in the Departmental Accounts.
- 13.29 For a barter transaction to be a viable proposition, the reduction in sale price would have to be at least equal to the net present value of the future rent reductions – using a discount rate reflecting the cost of capital of the government. So, the imputed future rents have to be recorded as being equal to the cash actually paid, plus the amount being financed by the prepayment, plus an extra amount (representing a finance charge on the prepayment).

Open Market Value

- 13.30 OMV is the price of the asset, good or service that would be paid in an open market transaction without any element of barter. When assets, goods or services are bartered it is necessary to determine their OMV so that accounts can be recorded properly (i.e. using OMVs) and also for investment appraisal to ensure that the barter deal is good value for money.
- 13.31 It is for departments to determine and record OMVs.
- 13.32 Broad information for establishing OMVs should be available from information in the investment appraisal undertaken before the department decided to structure the deal in a particular way, in the supplier's bid documentation, and in the contract documentation and supporting papers.
- 13.33 For accounts, it should be assumed that the goods bartered have equal value. This means that once the OMV has been determined for the assets, goods or services supplied, the value of the assets, goods or services received in exchange will be known. For example, consider the case of a building being sold at below OMV in return for being able to pay reduced rents (i.e. at below OMV) in the future. The OMV of the building could be estimated as the cash price paid plus the net present value of the future rent reductions

(using 3.5 per cent discount rate); or the rent reductions could be estimated from the difference between the cash received and OMV of the building sold; or if both components can be estimated reliably the residual would be the implied discount rate for the financing charge. The method used should be agreed with Treasury.

- 13.34 Note that the OMV of an asset for this purpose may differ from the amount recorded in the department's balance sheet if that has not been updated recently. In such cases the difference between the balance sheet figure and OMV would be recorded in Departmental Accounts and budgets as a loss/gain on sale. The difference between the OMV and the cash amount actually received as a result of the barter deal (i.e. that part of the value of the building that is bartered) would not be recorded as a loss on sale, in our example this would be shown as a prepayment.
- 13.35 For investment appraisal it is of course necessary to measure as directly as possible the OMV of all components - to identify which option is best value for money.

Budgeting for a sale and lease back deal comprising of a bartered element – off balance sheet

- 13.36 This section of the budgeting guidance assumes that accounting tests have determined that the new rental contract is not a finance lease. If the department continues to bear most of the risks and rewards associated with ownership, then this suggests that the new rental contract is in fact a finance lease and the provisions of this section of the guidance do not apply (see separate section).

Treatment in Departmental Accounts and budgets

- 13.37 Barter deals should be scored in Departmental Accounts and budgets as though they were separate transactions made at the OMV.
- 13.38 In the example above departments should record:
- the sale of the assets at their open market value comprising
 - actual cash received plus
 - the difference between cash received and the open market value (this creates a debtor on the Statement of Financial Position - a pre-payment of rentals)
 - the full annual costs for accommodation this has three parts
 - actual cash paid
 - the amount financed by the pre-payment
 - a capital charge on the outstanding pre-payment asset
- 13.39 The profile through time of the unwinding of the pre-payment will depend on the discount rate assumed and the desired profile of the imputed additions to the service charges (could be flat or perhaps increase with inflation). In the rest of the example a 3.5 per cent discount rate is used, and

the imputed additions to the service charges are constant. In other words, the sum of the loan repayment and the capital charge on the amount outstanding is constant.

- 13.40 Capital DEL scores the book value as a benefit on disposal. Resource DEL scores profit/loss on disposal as a benefit/cost respectively.
- 13.41 The resource budget includes the full cost as reflected in the SoCNE comprising.
- actual cash paid
 - the amount financed by the pre-payment
 - a capital charge on the outstanding pre-payment asset
- 13.42 The balance sheet will show an asset (pre-payment) for the difference between the cash received and the OMV of the asset as determined by the barter deal.
- 13.43 So in the example given above suppose:
- the open market value of the building was £300 million
 - the net book value of the building was also £300 million
 - the department sold it for a cash receipt of £200 million
 - the market value of the service element of the deal was £64 million per year. The department took the benefit of the remaining £100 million of the value of the building by agreeing to reduce this charge by £20 million per year. The remainder of the service charge was to be included in the rental
 - the sale took place and the receipt came in year 0 and occupation began
 - And rent became payable, from year 1 to 5

Capital DEL	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Disposal of asset at OMV	-300.00					
Prepayment	100.00					
<i>Repayment of prepayment</i>		-20.00	-20.00	-20.00	-20.00	-20.00
<i>Calculated as</i>						
<i>Debtor (prepayment) – end year</i>	100.00	80.00	60.00	40.00	20.00	0.00
Total CDEL	-200.00	-20.00	-20.00	-20.00	-20.00	-20.00
Resource DEL						
OMV of rental		64.00	64.00	64.00	64.00	64.00
<i>financed by cash paid</i>		40.85	41.55	42.25	42.95	43.65

<i>reduction in value of prepayment</i>		20.00	20.00	20.00	20.00	20.00
<i>notional interest on prepayment</i>		3.15	2.45	1.75	0.05	0.35
Total RDEL		64.00	64.00	64.00	64.00	64.00
Accruals to Cash Adjustment						
Net Resource Requirement		64.00	64.00	64.00	64.00	64.00
Capital	-200.00	-20.00	-20.00	-20.00	-20.00	-20.00
Notional interest on prepayment		-3.15	-2.45	-1.75	-1.05	-0.35
Net Cash Requirement	-200.00	40.85	41.55	42.25	42.95	43.65

Budgeting for a sale and lease back deal including a bartered element – on balance sheet

13.44 Appendix 1 to this chapter shows a worked example of the accounting and budgeting for a sale and lease-back deal that includes a bartered element, where the deal is on balance sheet.

Budgeting for reversionary interest

13.45 Some deals involve the legal transfer of the asset to the public sector at the end of the deal period. In some cases the asset will not be expected to have a value and in other cases it will. Where the asset is expected to have a value the department is said to have a reversionary interest (RI).

13.46 In many cases the existence of a reversionary interest will point to the public sector having the whole of the asset on its balance sheet for the life of the deal, as the public sector is taking residual value risk. In that case the reversionary interest rules are irrelevant.

13.47 However, in some cases the deal may be judged to be off balance sheet and the department is taking residual value risk, departments are required to score against CDEL the reversionary interest that would have applied under UKGAAP – note this only applies to projects signed before April 2009.

13.48 Under UKGAAP, where a department had an RI it would build up an RI asset on its Statement of Financial Position over the life of the contract. At the end of the contract the asset would revert to the department who would debit non-current (infrastructure) assets and credit the RI asset. In other words, the RI asset built up over the life of the contract will finance the acquisition of the infrastructure asset at the end of the period. In order to build up the RI over the life of the contract part of the unitary payment would have been capitalised. This would have resulted in a lower SoCNE-cost scoring in the departmental accounts and an increase in the RI asset on the balance sheet.

Budgeting transactions

13.49 Where schemes are off balance sheet for budgets, but there would have been a RI charge under UKGAAP, the budgets will not follow the accounts but will show.

capital DEL shows the following

- movement in the RI on the balance sheet over the life of the contract and
- the acquisition of the asset at the end of the period

resource DEL shows the following

- The resource budget simply shows the costs that are in the SoCNE, i.e. the unitary payment less the amount that is capitalised as the RI

Termination payments

13.50 Termination payments may be payable if a PPP contract is ended early.

13.51 In the case of on balance sheet PPPs, termination payments could represent just the extinguishment of the liability, and so not be shown in budgets, or in addition to the repayment of debt there could be a cost in budgets. That difference in treatment would depend upon the level of the balance sheet liability compared with the termination payment and what, if any, other assets come on the balance sheet.

13.52 Where the amount of cash paid is different to the outstanding liability, and the department is not gaining any other assets, then the National Accounts treat this element of the payment (difference between liability on the balance sheet and cash paid) as a capital grant to the contractor. This is a cost (or potentially a benefit) in the departmental capital budget (DEL).

13.53 Where the department is receiving additional assets as part of the termination deal then it may be appropriate to capitalise the cash payment above the value of the liability. In effect the department is purchasing the additional assets from the contractor, and the price paid is the value of the cash payment above the liability that is being extinguished. Departmental budgets treat this in the same way as any other capital addition, i.e. in capital budgets (DEL).

13.54 Termination payments paid under off-balance-sheet deals lead to a cost in the SoCNE and a charge to the Resource budget (assuming no asset arrives in return).

13.55 Any department facing a termination payment should contact your normal Treasury spending team to seek advice.

Refinancing gains

13.56 This section of the guidance briefly sets the background and the policy of sharing refinancing gains on PPP deals, and details the treatment of the associated transactions in the National Accounts, Departmental Accounts and budgets. The guidance deals with the scenario where the PPP contractor goes to the private sector debt markets to refinance their debt.

Background

- 13.57 When a private sector contractor enters into a PPP deal they will borrow from the market to finance the capital expenditure they are undertaking. The market will charge the contractor a certain interest rate on that borrowing; this will be based on many things including the amount of risk perceived by the lender. The contractor will take this rate of interest into account when setting the unitary charge that is charged to the public sector for the use of the infrastructure created under the PPP contract.
- 13.58 It is common practice for the PPP contractor to refinance or restructure their debt once the project is up and running. The contractor will, at this point, be able to negotiate a lower interest rate, as they can demonstrate that the amount of risk has reduced.
- 13.59 Guidance on how procuring authorities with PPP contracts should be able to access these gains and split the benefit with the private sector partner can be found in the HM Treasury publication "Refinancing of Early PFI transactions" and in Eurostat's publication "A Guide to the Statistical Treatment of PPPs".

Refinancing

- 13.60 When refinancing occurs the contractor's cost of providing the service drops thanks to the restructured debt profile. This is shared with their customers (the public sector) via a reduced price to buy the service, an increased level of service to buy the service, or as a one-off payment.
- 13.61 Where the gain is shared via a cheaper service cost this is simply less current expenditure in the National Accounts, departmental accounts and departmental budget over the remaining life of the contract.
- 13.62 Where the gain is shared via a one-off windfall payment to the public sector we risk distorting measures of GDP in the economy if we record this as less consumption by the public sector in one year. It is more correct to view the lump sum as a portion of the on-going savings to the contractor, which has been rolled up and then split between the parties. The view in such a situation is that the private sector has lent the public-sector cash up front and has an asset on their balance sheet, each month this would unwind to finance the reduction in the unitary charge. In effect the contractor is pre-paying a reduction in the service charge.
- 13.63 This means that the refinancing gain is recorded as a benefit to the public sector matched to the time frame in which it is viewed to have accrued. A simple example ignoring any discounting is given below.
- public sector receives lump sum of £15million in respect of a refinancing gain, to be accounted for over 15 years, the remaining life of the contract
 - suppose that the public sector continues to pay a unitary charge of £10million per annum for 15 years
 - the cash lump sum should be recorded as a financial transaction – in effect borrowing from the private sector. The department would show cash of £15million and a matching liability. Each year the public sector

continues to pay the contractor a £10million cash unitary charge for the year

Accounts and Budgets

13.64 On receiving the cash the department shows an increase in liabilities (creditors).

Then annually:

- the SoCNE score £9million unitary payment and
- cash out the door would be £10million and the liability would reduce by £1million

13.65 The budgets follow the accounts. In other words, the upfront receipt of the cash does not benefit the Resource budget, but the lower annual service charge does.

Appendix 1 to chapter 13: Sale and leaseback

13.66 This appendix sets out the accounting and budgeting treatment for a sale and lease-back deal including a bartered element where the deal is on balance sheet. This does not relate to service concession arrangements.

Background

13.67 Department Yellow enters into a PPP deal for a new headquarters building with the Reader Sinclair Consortium. The consortium will design and build and then operate the HQ for a period of 30 years from the date of occupation. In addition, the consortium will provide the IT systems for seven years, after which that part of the contract will terminate. The building will revert to Department Yellow at no cost at the end of the contract period. This is determined to be an on-balance-sheet PPP deal.

13.68 The cost to Department Yellow comprises two elements: annual Unitary Payments (UP) and the transfer of properties (Barter Deal). The transfer of properties under Barter Deal results, over time, in lower service payments. Annual UPs cover capital, a finance charge, and a service payment. The Barter Deal comprises the transfer of five properties at various stages throughout the project, including two prior to occupation of the new HQ. The final transfer can be deferred by five years. If Department Yellow opts for deferral, the department will pay compensation to the Consortium in the form of an upfront cash payment equal to the value of the property under the contract at the original transfer date. Upon vacation of the property, the Consortium will repay to Department Yellow the value of the property at that date.

13.69 The contract takes effect from 1 April YEAR 0. The new HQ will be occupied from 1 April YEAR 3. The schedule of Barter Deal transfers is:

Plot 1	1 April YEAR 0	Land only
Plot 2	1 April YEAR 1	Land only
Plot 3	1 April YEAR 2	Land only
Plot 4	1 April YEAR 4	Land and Buildings
Plot 5	1 April YEAR 10 (with possible deferral to 1 April YEAR 15)	Land and Buildings

13.70 The total value of the new HQ and IT is £250 million. It is estimated that £229 million is in respect of the new HQ and £21 million relates to the IT element. In addition, the UP includes total interest of £320 million and total service costs of £15 million. (Total value of UP over 30 years is £560 million). The values of the five plots included in the Barter Deal are shown below. The year YEAR-1 is the year prior to the contract coming into effect.

	Book values		Barter Deal Values							
	1 April	YEAR	1 April	YEAR	1 April	YEAR	1 April	YEAR	1 April	YEAR
	-1		0		1		2		4	10
Plot 1	4.5 million		4 million							
Plot 2	2.5 million				3 million					
Plot 3	4 million						4 million			
Plot 4	1.5 million								1 million	
Plot 5	13 million									13 million

13.71 The schedule of UPs is as follows, starting in year beginning 1 April YEAR 3.

1 April	31 March	£million	
YEAR 3 -	YEAR 4	23.5	1 year at 23.5 = 23.5
YEAR 4 -	YEAR 10	23.25	6 years at 23.25 = 139.5
YEAR 10 -	X029	17.25	23 years at 17.25 = 396.75
		0.25	Balancing payment
		560	Total

Accounting for the Barter Deal – asset valuations

13.72 The value of the plots in Department Yellow's accounts needs to be adjusted for 1 April YEAR 0 to reflect the Barter Deal value at the future date of transfer, taking account of projected movements in value in the intervening period, during which the plots continue to be recognised as fixed assets by the department. (Note: this assumes that the values have been agreed at the time the contract is signed.)

At 31 March YEAR 0 (the end of YEAR -1)		Budget impact	Departmental accounts
Plot 1	The value is written down by £0.5 million.	resource AME cost with write down in value	Dr Revaluation reserve or SoCNE (FRoM 5.2.34) Cr Fixed assets
Plot 2	Upwards revaluation to £3 million.	None	Dr Fixed assets Cr Revaluation Reserve
Plot 3	No change	None	None

Plot 4	The split between land and buildings is £0.75 million land and £0.75 million buildings. Without the PPP deal, the buildings had a remaining economic useful life of 10 years, with residual value of £0.3 million. It is assumed that the value of the plot at 1 April YEAR 4 will comprise land at £0.75 million and buildings at £0.25 million. Department Yellow has four years' use of the property. The value of Plot 4 is written down to £1.20 million, comprising land at £0.75 million and buildings at £0.45 million. Over the four years ending March YEAR 1, YEAR 2, YEAR 3 and YEAR 4, depreciation of £0.05 million will be charged annually.	resource AME cost with write down of £0.3 million. Routine depreciation is reflected in RDEL	Dr Revaluation reserve or SoCNE (FReM 5.2.34) Cr Fixed assets, Routine accounting entries
Plot 5	The split between land and buildings is £10 million land and £3 million buildings. Because the transfers are not due to take place until YEAR 10, the value at YEAR -1 is agreed as proxy for the value at YEAR 10, taking into account increases in land values offset by changes in the value of the buildings on the site.	None	None

Accounting for the Barter Deal – transfers of property prior to occupation

13.73 Department Yellow accounts for the plots as they are transferred to the Consortium prior to the occupation of the new accommodation as follows

	Date of transfer	Value	Budget impact	Departmental Accounts
Plot 1	1 April YEAR 0	£4 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets
Plot 2	1 April YEAR 1	£3 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets
Plot 3	1 April YEAR 2	£4 million	Negative CDEL for the NBV of the transfer	Dr Prepayments Cr Fixed assets

Accounting for the occupation of the new building

13.74 When Department Yellow occupies the new accommodation, the property is valued at £250 million (see background section) and is brought on balance sheet.

13.75 The accounting entries are:

- Dr Fixed assets
- Cr Long-term lease creditor of £250 million

13.76 The £250 million is a capital DEL hit.

Accounting for the transfer of Plot 4

13.77 Department Yellow accounts for the transfer of Plot 4 after the occupation of the new building as follows:

	Date of transfer	Value	Budget impact	Departmental Accounts
Plot 4	1 April YEAR 4	£1 million	Negative CDEL for the NBV of the transfer	Dr Prepayments (if prepayment against service / interest charged) Cr Fixed asset

Subsequent accounting

13.78 Each year until the end of the lease, there will be a cash requirement in respect of the UP. There will be a resource DEL hit equal to the imputed interest rate. As the building is on balance sheet, depreciation also scores in both the SoCNE and resource DEL. The capital repayment, i.e. the movement in the long-term creditor is outside of budgets.

13.79 The accounting entries are:

- Dr Long-term lease creditor for capital element of UP
- Dr SoCNE for service and interest elements of UP
- Cr Cash

13.80 (In addition to the service and interest elements, depreciation also passes through the SoCNE.)

13.81 In addition, Department Yellow can now start to release the pre-payment. Because it represents the lower service payment, it should be released over the period of the reduced service payment (in this example, considered to be the life of the contract).

13.82 The accounting entries are:

- Dr SoCNE
- Cr Prepayment

13.83 The release of the pre-payment has no budgetary impact – as noted it is the full SoCNE costs that are reflected in the budget.

Department Yellow defers the final stage of the Barter Deal

13.84 In X008, Department Yellow determines that it needs to retain Plot 5 beyond YEAR 10. Under the contract, therefore, the department will have a cash requirement of £13 million to pay to the Consortium.

13.85 The accounting entries are:

- Dr Long-term lease creditor
- Cr Cash

13.86 Since the value of the Plot 5 is included in the overall valuation of the new accommodation, there is no DEL hit involved in the deferral, as the cash is

used to repay the creditor. (Note: the accounting entries do not deal with Supply in respect of the net cash requirement.)

13.87 During the five years of the deferral, the department will continue to revalue and depreciate Plot 5 in the normal manner.

Final deal

13.88 Under the terms of the contract, Department Yellow has to vacate the property in X015, and the Consortium pays to the department the value of the property at that date.

13.89 The accounting entries are:

- Dr Cash
- Cr Fixed Assets

13.90 There is a negative capital DEL impact in respect of the disposal of the asset.

Annex A

Difference between budgets and accounts

- A.1** As a result of the implementation of the Treasury’s Alignment project in 2011-12 most differences between Departmental Accounts and budgets have now been removed. The majority of transactions should therefore be recorded in budgets at the same value and with the same timing as in accounts. There are however some outstanding misalignments, these are set out in the tables below. Treasury will continue to try and minimise the differences between budgets and accounts consistent with the principles of alignment.
- A.2** Table A.1 below shows the main differences between the SoCNE in Departmental Accounts and the resource budget.
- Table A.2 shows the main differences between capital budgets and additions to fixed assets and investments in DA’s.

Table A.1: The main differences between the Statement of Comprehensive Net Expenditure (SoCNE) and Resource budgets

Departments’ own spending	The SoCNE includes capital grants; these score in capital budgets.
	The SoCNE includes R&D costs that meet the ESA10 definition; these score in capital budgets.
	The SoCNE score the creation of provisions. The release and payment are both movements on the Statement of Financial Position. In budgets, the creation and release score to AME whereas the payment scores to DEL.
Departments’ income	Equity withdrawals from PCs may score in the SoCNE if they are treated as special dividends and would in all cases score in capital budgets.
	Income that is classified as a capital grant, such as a donation that is to be used to finance acquisition of a capital asset, scores in the capital budget.
Support for local authorities	Capital grants to LAs score in the SoCNE and in capital budgets.
Public Corporations	Capital grants to PCs score in the SoCNE and in capital budgets for PCs on the external finance basis.
	Equity withdrawals from PCs may score in the SoCNE as special dividends and will in all cases score in capital budgets for PCs on the external finance basis.

PPP	PPP contracts recorded as service concessions in accounts will be recorded in budgets on the basis National Accounts (ESA10) standards, which may lead to a different balance sheet treatment of the asset. See chapter 12 for full details.
Research and Development	Research and development expenditure that meets the criteria under the National Accounts are recorded as capital in budgets (See Annex C for details). This may differ to the treatment in departmental accounts where research expenditure is usually expensed in the SoCNE and development expenditure is capitalised in accordance with IAS 38 <i>Intangible Assets</i> as adapted by the FReM

Table A.2: The main differences between the capital budget and the Departmental Account entries for total net additions to fixed assets and investments

Departments' own spending	Capital budgets include capital grants; these score in the DA SoCNE
	Capital budgets include R&D costs that meet the ESA10 definition of R&D; these score in the DA SoCNE
	In a limited range of cases, purchase and disposal of stocks scores in capital budget, but are not transactions in fixed assets in the DA, which treats the transaction as dealing in current assets.
Departments' income	Income that counts as capital transfers in the national accounts, such as a donation to finance construction of an asset, passes through capital budgets.
	There are limits on the quantum of income from the sale of assets that departments may keep in their budgets.
Support for Local Authorities	Capital grants to LAs score in the SoCNE and in capital budgets
	Capital budgets include Supported Capital Expenditure (Revenue) which does not feature in DAs
Public Corporations	Capital grants to PCs score in the SoCNE and in capital budgets
	Budgets for PCs include PCMOB which is not included in DAs (see Public Corporations Chapter)
	If a trading fund that is a department in its own right borrows from the National Loans Fund the "parent" department for budgeting purposes will show no accounting entry. However, its budget will show borrowing net of repayments
	Equity withdrawals from PCs may score in the SoCNE as special dividends and will always score in capital budgets for PCs on the external finance basis.
Service Concessions	Service concession arrangements which are subject to IFRIC 12 in accounts, are measured according to ESA95 standards set out in the Manual on Government Deficit and Debt
Research and Development	Research and development expenditure that meets the criteria under the National Accounts are recorded as capital in budgets (See Annex C for details). This may differ to the treatment in departmental accounts where research expenditure is usually expensed in the SoCNE and development expenditure is capitalised in accordance with IAS 38 <i>Intangible Assets</i> as adapted by the FReM

Annex B

Debt Management Guidance

- B.1** Good debt management is a key part of achieving the government's objectives for fiscal policy. These objectives are set out in the Charter for Budget Responsibility (section 3.1) and in the Consolidated Budgeting Guidance (section 1.3).
- B.2** Overdue debt owed to central government at 31 March 2018 was estimated at £23.5billion.

Debt management

- B.3** Government has a duty to manage its debtors effectively as part of good financial management in order to maximise value for the taxpayer. Government debt includes overdue tax liabilities, benefit overpayments, tax credit overpayments, loans, outstanding fines, penalties and court confiscation orders.
- B.4** Departments and their arms' length bodies (ALBs) must work together with HM Treasury and the Cabinet Office to reduce fraud, error and debt.
- B.5** Government has developed a Cross Government Debt Management Strategy which outlines the government's aim to create a more consistent strategic approach to debt management. Departments and their ALB's must work with Cabinet Office and HM Treasury to deliver this strategy through the following specific activities
- embed the Debt Standard, assessing organisational maturity and identifying opportunities to further improve efficiency, effectiveness and performance
 - explore the scope to improve capability through an HMG debt management training and/or accreditation scheme
 - contribute to a cross government/ sector view of fairness and customer treatment, working in partnership with non-fee debt advice services
 - effectively monitor and consistently report debt data to the centre, and use this information internally to inform collections strategies
 - seek additional capacity and capability through the Debt Market Integrator, in line with the NAO report on Managing Debt Owed to Central Government – see Annex E for link
 - consider if there are opportunities to help identify and reduce fraud and debt owed to the public sector by sharing data through the Digital Economy Act 2017

B.6 Departments and their ALBs must have their own debt management strategies, agreed with their Senior Management Teams, which should be reviewed annually. These strategies must be in line with Managing Public Money, the Consolidated Budgeting Guidance rules and the **Balance Sheet Review's debt performance measures**. These strategies must also align to the principles set out below;

- 1 minimise the creation of debt, including building and deploying good data analytics effectively to prevent fraud and error
- 2 prevent the creation of overdue debt, tackle aged debt and reduce the ageing of debt
- 3 consider the balance between collectability, allowing debt to age and applying write-off or hardship policies
- 4 consider the impact of new policies on both debt creation and on the management of existing debt
- 5 identify and tackle policy barriers preventing effective debt management
- 6 include clear governance and reporting arrangements agreed with the Treasury for debt remissions and write-offs
- 7 ensure relevant debt KPIs are presented in Board reports and discussed regularly at Board level

Balance sheet review debt management principles

B.7 Following the government's Balance Sheet Review, and in line with the government's commitments announced in the 2018 Budget, departments and their ALBs should also:

- 8 report on key performance measures in their debt management strategies through the Consolidated Date Returns (CDRs) and annual review
- 9 apply the risk management framework on debt developed by Cabinet Office, capturing current and future risks, and report on risk management
- 10 apply the performance management measures set out below to improve the management of overdue debt owed to government
 - base debt collection measures from 2018 – 19 on financial year-end forecasts at Q1 for overdue debt, write-offs and remissions
 - additional debt metrics on overdue debt in departmental CDRs (as detailed in CDR guidance) to help tackle the challenges on overdue debt and track all overdue debt

Managing Public Money and Consolidated Budgeting Guidance

B.8 The management of debt must be in accordance with Managing Public Money and Consolidated Budgeting Guidance:

- the budgetary framework ensures that departments and other central government bodies have good incentives to manage their business well,

to prioritise across programmes, and to obtain value for money – this should include robust debt management. The budgeting policies and purpose of control totals apply all to areas of a department’s budget including debt owed to government. Sections in the Consolidated Budgeting Guidance that specifically address debt are 3.26 - 3.36 Impairments, 3.37 - 3.43 Write offs, 3.62 - 3.66 Debtors, 3.86 - 3.89 Tax credits, 4.14 - 4.15 Income (including treatment of tax), 4.27 – 4.31 Taxes, licences (treated as tax in the National Accounts) and levies and Chapter 8 Financial transactions (including student loans)

- B.9** Managing Public Money sets out how to handle public funds with probity and in the public interest. All aspects of the guidance should be considered however in addition to the main chapters, the key areas from a debt management perspective are Box 3.1 Standards expected of the accounting officer’s organisation, Box 4.5 Essential features of systems for collecting sums due, Box 4.8 Factors to consider when planning policies or projects, Annex 2.2 Delegated authorities, Annex 4.9 Fraud, Annex 4.10 Losses and write offs and Annex 4.11 Overpayments Annex B, B.5, Consolidated Budgeting Guidance

Annex C

Guidance on Research and Development under ESA10

Introduction

- C.1 This note provides further guidance for Chief Scientific Advisers and Finance Officers to help decide whether expenditure meets the ESA10 definition of Research and Development (R&D). Appendix 1 provides a decision tree on capitalising R&D costs that is provided for departmental accounting purposes. Appendix 2 provides details of activities that are to be included or excluded as R&D.
- C.2 Expenditure that is currently capitalised under IFRS (International Financial Reporting Standards) for in-year accounting will continue to be capitalised and depreciated in these accounts. Expenditure that does not meet the criteria for capitalisation under IFRS but fits with the ESA10 definition of R&D will be treated as an expense in departmental accounts, so no depreciation will arise.
- C.3 Under ESA10 R&D is defined as:
- “Creative work undertaken on a systematic basis to increase the stock of knowledge, and use of this stock of knowledge for discovering or developing new products, including improved versions or qualities of existing products, or discovering or developing new or more efficient processes of production”¹
- C.4 This definition of R&D is based upon and viewed as equivalent to the definition of R&D in the OECD Frascati Manual² Clarifications include:
- ‘creative work undertaken on a systematic basis to increase the stock of knowledge, and use of this stock of knowledge....’ should be interpreted to mean ‘and/or’. That is, all R&D should be included that meets either or both of the conditions in this definition
 - in addition, the term ‘product’ in this definition should be widely interpreted to include a good or a service; all R&D that underpins policy development, design and implementation should be included under this definition
 - the term R&D covers three types of activity: (a) Basic research (b) Applied research (c) Experimental development

¹ European System of Accounts 2010, section 3.82 (see Annex E for link to the document)

² Frascati Manual 2015, Chapter 2 (see Annex E for link to the document)

- C.5 It may be helpful to note that there are five criteria to help identify R&D. The activity must have elements of all of these:
- 1 aimed at new findings (**novel**). This includes acquiring new knowledge directed primarily towards a specific aim or objective. It also encompasses experimental development projects, aimed at creating knowledge in support of the development of new concepts and ideas related to the design of new products or processes
 - 2 based on new concepts or ideas with the objective of improving on existing knowledge (**creative**). This includes R&D to improve methods or ways of doing things
 - 3 uncertain about its final outcome (**uncertain**)
 - 4 systematically performed. R&D is conducted in a planned way, with the process and outcomes documented (**systematic**) and
 - 5 lead to results that have the potential to be reproduced (transferable and/or reproducible). All R&D that serves the purposes of a department's objectives should be included in R&D capital

Staff

- C.6 The cost of staff who conduct or manage R&D should be included within R&D expenditure. Programme management offices that solely (or mostly) provide support for running R&D programmes should also be included.

Data collection

- C.7 Data collection and surveys solely or primarily conducted as part of the R&D process are to be included as R&D. However, data collected for other or general purposes for example, the collection of unemployment statistics, the collection and reporting of management information for annual reporting are to be excluded.

Scientific and technical information

- C.8 Scientific and technical information services maintained predominantly for the dissemination and publication of R&D are to be included. However, the activities of central communications, Press Office etc. should be excluded.

Testing

- C.9 Activities to devise new or improved methods of testing are to be included. However, organisations and laboratories whose main purpose is to test products and verify standards are met should be excluded.

Experimental development

- C.10 The ESA10 definition of R&D includes experimental development. If work relating to the development of new products or processes fits the definition and criteria to be classified as R&D (as defined in this document), then it should be included as R&D expenditure.

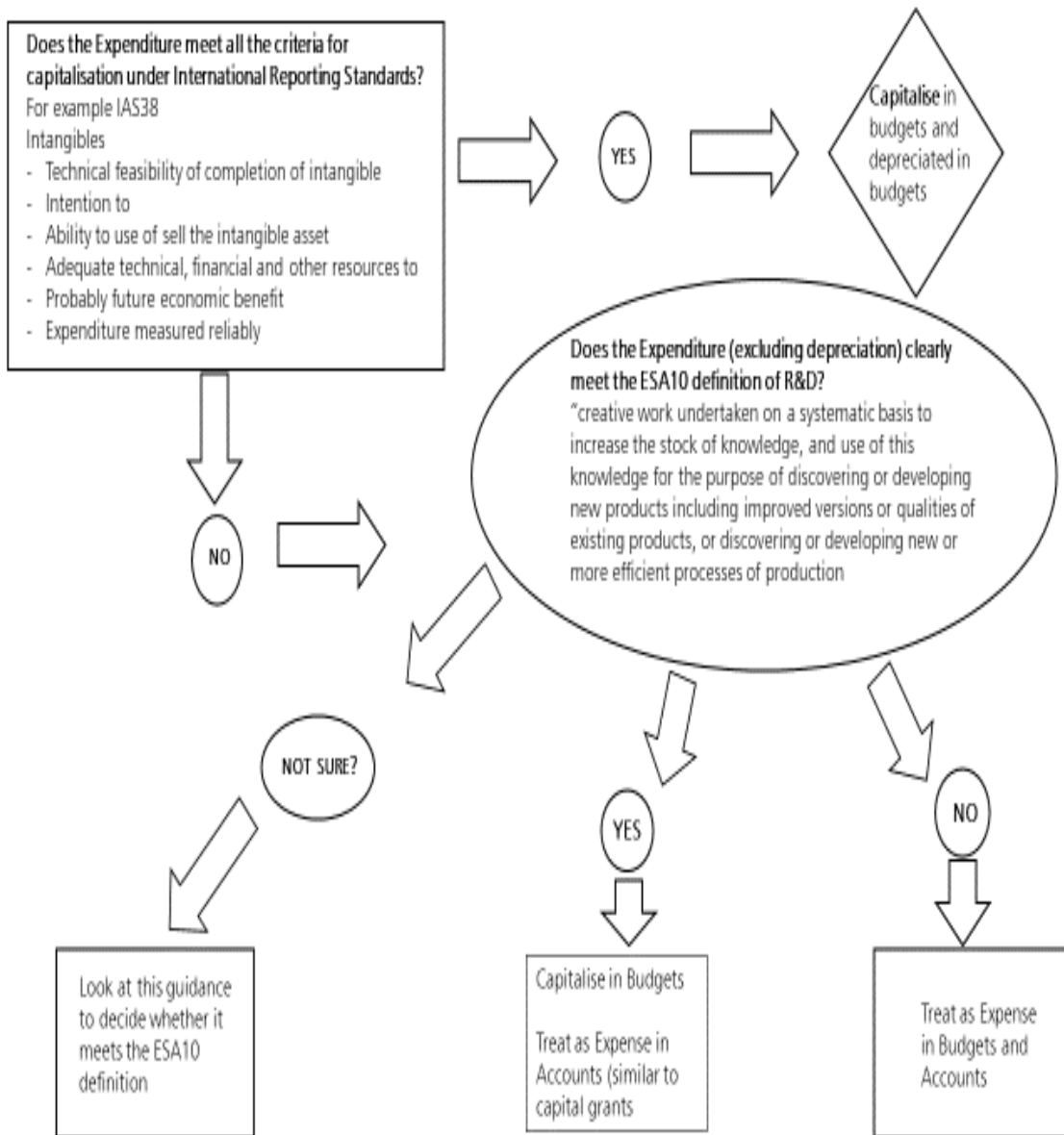
Small Business Research Initiative (SBRI)

- C.11 If work on projects commissioned through the SBRI fits the definition and criteria to be classified as R&D (as outlined in this document), then it should be included as R&D expenditure.

Apportioning costs for partner organisations and internal units

- C.12 Where a considerable proportion (materially all) of a partner organisation's or in-house unit's activities are R&D related, the full budget of the organisation or unit should be included. In other cases, these activities should be distinguished, and costs apportioned where it is administratively sensible to do so. Departments should take a pragmatic approach when apportioning costs.

Appendix 1 to Annex C: Decision tree for capitalising research and development costs in budgets



C.13 If after having followed the decision tree departments are still unclear as to whether or not expenditure meets the ESA 10 definition of R&D, they should consult their HM Treasury spending team.

C.14 In all instances the treatment in Estimates is the same as the treatment in budgets. Depreciation is only recognised in budgets on assets recognised in Accounts.

Appendix 2 to Annex C: Activities to be included or excluded in R&D Capital

Activities to be included as R&D

Research performed in-house, including by in house research units (intramural R&D)
Research commissioned from an external organisation (extramural R&D)
Resources needed to deliver and manage research, as appropriate, including;
- People who conduct or manage R&D
- Programme management offices that solely (or mostly) procure and manage R&D contracts
Policy (or programmatic) evaluations that employ experimental or quasi-experimental methods. Evaluations conducted by skilled professionals using a rigorous methodology meet the criteria for inclusion³
Data collection and surveys solely or primarily conducted as part of the R&D process
Scientific and technical information services predominantly for the dissemination and publication of R&D
Feasibility studies on research projects as part of R&D⁴

Activities to be excluded as R&D

Routine data collection and surveys
Routine monitoring and surveillance
Scientific and technical information services
Feasibility studies (for example an investigation of a proposed engineering project using existing techniques to provide additional information before deciding on implementation, is not R&D)⁴
Policy related activities, generally carried out by policy professionals, for example, provision of policy advice, relations with the media etc. should be excluded. (However, research activities aimed at providing decision makers with a thorough knowledge about social, economic or natural phenomena should be included in R&D)⁵
Purely R&D financing activities, for example, central procurement and commercial units, albeit they may help procure some R&D projects
Indirect supporting activities which support R&D but are not undertaken exclusively for R&D, such as payroll, HR departments, canteen services etc.

³ Frascati Manual 2015 Section 2.119 – See Annex E for link

⁴ Frascati Manual 2015 Section 2.114

⁵ Frascati Manual 2015 Section 2.116 – 2.118

Costs to be included

- C.15** All costs, other than depreciation, within the scope of the ESA10 definition that are directly attributable to R&D activities and can be reliably measured. Grant funding to private sector bodies to undertake R&D activities can be classified as R&D expenditure.

Annex D

Treasury and other contacts

D.1 This annex gives details of Treasury and other officials who may be contacted for further advice

Issue	Contact	Team	Telephone / E-mail
Initial contact for any aspect of the public spending control system	Your normal Treasury Spending team contact		
Resource & Capital budgeting			
Resource budgeting Policies, Administration Budgets, Capital budgeting Policies	Andrew Evans	GFR	020 7270 4623 Andrew.Evans@hmtreasury.gov.uk
	Jennifer Rowland	GEP	020 7270 4418 Jennifer.Rowland@hmtreasury.gov.uk
Budget Exchange	Jennifer Rowland	GEP	020 7270 4418 Jennifer.Rowland@hmtreasury.gov.uk
Classification of Bodies and Transactions			
National Accounts classification of flows	Andrew Evans	GFR	020 7270 4623 Andrew.Evans@hmtreasury.gov.uk
Sector Classification	Lesley Neill	GFR	020 7270 5338 Lesley.Neill@hmtreasury.gov.uk
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Treatment of receipts and income in the National Accounts and in budgets			Lesley.Neill@hmtreasury.gov.uk
Technical Accounting Advisor	Sarah Geisman	GFR	020 7270 5273 Sarah.Geisman@hmtreasury.gov.uk
Designation as an NDPB	Alastair Davies	Cabinet Office	020 7276 0387 alastair.davies@cabinetoffice.gov.uk
Resource Estimates			
Resource Estimates for: CO, DExEU, MOD, DWP, DFT, ORR, DCMS, HMT, NS&I, Civil Superannuation, Armed Forces pensions, Royal Mail pensions, IPSA pensions, SIA pensions, DFID pensions	Gary Hansman	GFR	020 7270 5533 Gary.Hansman@hmtreasury.gov.uk
Resource Estimate for: BEIS, DfE, DHSC, ECGD, OFQUAL, OFSTED, OFGEM, FSA, DIT, UKAEA Pensions, Teachers pensions, NHS pensions	Orietta Barbari	GFR	020 7270 6304 Orietta.Barbari@hmtreasury.gov.uk
Resource Estimate for: HO, NCA, MHCLG, DEFRA, WSRA, HoC (Members), HoC (admin), HoL, PHSO, FCO, Charity Commission, Crown Estate Office	Malcolm Pellett	GFR	020 7270 4812 Malcolm.Pellett@hmtreasury.gov.uk
Resource Estimate for: LGBCE, NAO	Steven Melbourne	GFR	020 7270 1154 Steven.Melbourne@hmtreasury.gov.uk
Resource Estimate for: MOJ, JPS, HMRC, Statistics Board, GAD, DFID	Matthew Carter	GFR	020 7270 5899 Matthew.Carter@hmtreasury.gov.uk
Resource Estimate for: SFO, CPS, TSOL, UKSC, TNA, CMA, EC, NIO, SO, WO	Mohammad Huq	GFR	020 7270 6170 Mohammad.Huq@hmtreasury.gov.uk

Public Corporations and Trading Funds			
Public Corporations Policy	David Sandford	CFI	020 7270 5351 David.Sanford@hmtreasury.gov.uk
Local Authorities			
New Burdens Rules	Ravi Badat	LG Ministry of Housing, Communities and Local government	020 7270 2445 Ravi.Badat@hmtreasury.gov.uk newburdens@communities.gsi.gov.uk
Accounts			
Accounting	Departmental Finance Teams		
Whole of Government Accounts	Kevin Pertaub	GFR	07393005403
Recording			
Recording Resource budgets on OSCAR	Andrew Evans	GFR	020 7270 4623 Andrew.Evans@hmtreasury.gov.uk
	Lesley Neill	GFR	020 7270 5338 Lesley.Neill@hmtreasury.gov.uk
OSCAR Database; New Segments, database maintenance, database operations & data updates	Fenn Brown	OSM	020 7270 5873
PES Papers			
PES Papers	Gary Hansman	GFR	020 7270 5533 Gary.Hansman@hmtreasury.gov.uk

Annex E

Useful links

- The Treasury's public website gives access to the Charter for Budget Responsibility (which provides details of the Fiscal Mandate)
<https://www.gov.uk/government/publications/charter-for-budget-responsibility-autumn-2016-update>
- ONS publish a **Sector Classification Guide** which lists many bodies and sets out what sector of the economy they are in
[Public Sector Classification Guide and Forward Work Plan - Office for National Statistics](#)
- The Cabinet Office publishes a range of material about **Arm's Length Bodies**
<https://www.gov.uk/government/publications/public-bodies-information-and-guidance>
- The Treasury publishes a range of classification guidance notes that cover **National Accounts treatments**
<https://www.gov.uk/government/publications/introduction-to-classification>
- Guidance on **Supply Estimates** is available at the HM Treasury public website
[Supply Estimates guidance manual - Publications - GOV.UK](#)
- **Public Expenditure Statistical Analyses** gives information on public spending analysed by reference to the budgetary control framework, sectors of the economy, government functions (irrespective of which organisation is spending the money), and the country or region of the UK, which has benefited from public spending. Appendices describe the control framework. One of the appendices is a **glossary of public expenditure terms**
<https://www.gov.uk/government/collections/public-expenditure-statistical-analyses-pesa>
- **Managing Public Money** offers guidance on how to handle public funds of all kinds
[Managing public money - Publications - GOV.UK](#)

- The **Government Financial Reporting Manual (FReM)** contains the technical accounting guidance used for public funds. It is available on its dedicated website

[Guidance on annual reports and accounts - GOV.UK](#)

- **Dear Accounting Officer** letters give guidance on a range of subjects

[HMT Dear Accounting Officer \(DAO\) letters - GOV.UK](#)

- Information on **Whole of Government Accounts** is at:

<https://www.gov.uk/government/collections/whole-of-government-accounts>

- **PPP/** are of the Treasury's website gives access to the main policy document on PPP – Meeting the Investment Challenge, the value for money guidance and guidance on refinancing

<https://www.gov.uk/government/publications/pfipp-ppp-finance-guidance>

- The Cabinet Office's website for **pensions** is at:

<http://www.civilservice.gov.uk/pensions>

- The **European System of Accounts (ESA10)** is used by the Office for National Statistics in assembling the National Accounts

[European system of accounts - ESA 2010 - Product - Eurostat](#)

- The **ESA10 Manual on Government Deficit and Debt** provides detailed guidance on the application of ESA10 to General Government. Part VI includes guidance relating to the recording of service concessions

[Manual on Government Deficit and Debt - Implementation of ESA 2010 - 2016 edition - Product - Eurostat](#)

- The **PPP Policy Note: Early termination of contracts** set out the budgeting, accounting and fiscal implications of a voluntary termination of a PPP contract by an Authority, as well as the review and approval process that should be followed.

[PPP Policy Note: Early termination of contracts](#)

- A **Guide to the Statistical Treatment of PPPs** provides further clarity and understanding of how the MGDD 2016 rules should be applied to PPPs.

[A Guide to the Statistical Treatment of PPPs](#)

- The **Control Framework for levy-funded spending** is at:

[\[ARCHIVED CONTENT\] Control framework for DECC levy-funded spending - HM Treasury](#)

- The Department for Communities and Local Government's **new burdens guidance** is at:

<https://www.gov.uk/government/publications/new-burdens-doctrine-guidance-for-government-departments>

- The **Frascati Manual** is the Internationally recognised methodology for collecting and using R&D statistics published by the OECD
[Frascati Manual 2015 | OECD READ edition](#)
- **Contingent Liabilities Approval Framework** is at
<https://www.gov.uk/government/publications/contingent-liability-approval-framework>
- The guidance on the **CRC Energy Efficiency Scheme** (CRC) guidance is at
[CRC Energy Efficiency Scheme - GOV.UK](#)
- The National Audit Office report **Managing Debt Owed to Central Government** is at
[Managing debt owed to central government - National Audit Office \(NAO\) Report](#)

Annex F

List of abbreviations

F.1 A glossary of public expenditure terms is published as an appendix in Public Expenditure Statistical Analyses – see Annex E for link

ALB	Arms Length Bodies
AME	Annually Managed Expenditure
BEIS	Department for Business, Energy & Industrial Strategy
CAME	Capital Annually Managed Expenditure
CDEL	Capital Departmental Expenditure Limits
CFER	Consolidated Fund Extra Receipts
CoA	Chart of Account code
DA	Departmental Accounts
DEL	Departmental Expenditure Limits
DfID	Department for International Development
DIS	Departmental Investment Strategy
DH	Department of Health
DUP	Departmental Unallocated Provision
DWP	Department for Work and Pensions
EU	European Union
ESA10	European System of Accounts (2010 version)
FReM	Financial Reporting Manual
IFRS	International Financial Reporting Standards
MOD	Ministry of Defence

NAO	National Audit Office
NCR	Net Cash Requirement (in Estimates)
NDPB	Non-Departmental Public Body
NLF	National Loans Fund
OMV	Open Market Value
ONS	Office for National Statistics
OSCAR	Online System for Central Accounting and reporting
PCMOB	Public Corporations' Market and Overseas Borrowing
PCs	Public Corporations
PPP	Private Finance Initiative
PPA	Prior Period Adjustment
PSCE	Public Sector Current Expenditure
PSCR	Public Sector Current Receipts
PSNB	Public Sector Net Borrowing
PSND	Public Sector Net Debt
R&D	Research and Development
RAME	Resource Annually Managed Expenditure
RCV	Regulatory Capital Value
RDEL	Resource Departmental Expenditure Limits
RI	Reversionary Interest
SCE(R)	Supported Capital Expenditure (Revenue)
SoCNE	Statement of Comprehensive Net Expenditure
SFPC	Self-Financing Public Corporation
SR	Spending Review
TME	Total Managed Expenditure
WACC	Weighted Average Cost of Capital

Annex G

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